This book is provided in digital form with the permission of the rightsholder as part of a Google project to make the world's books discoverable online.

The rightsholder has graciously given you the freedom to download all pages of this book. No additional commercial or other uses have been granted.

Please note that all copyrights remain reserved.

About Google Books

Google's mission is to organize the world's information and to make it universally accessible and useful. Google Books helps readers discover the world's books while helping authors and publishers reach new audiences. You can search through the full text of this book on the web at http://books.google.com/

The Canada Income Tax Act: Enforcement, Collection, Prosecution A Case Compilation, 6th Ed.

A Collection of 220+ Cases and 10 CRA Operations Manuals Regarding the Enforcement, Collection and Prosecution Issues of The Canada Income Tax Act

By: Lyndon Maither, CFE, B.Comm.

Digitized by Google

How to Use This Internet Book

I'm very happy that companies like Googlebooks allow me to publish this which allows me to deliver my compilations to anyone who wants to improve their knowledge. You are encouraged to use Google Chrome or Firefox to view this since with Internet Explorer the pages may not render properly.

Also, you're encouraged to use the hypertext embedded Table of Contents *immediately following rather than* Google's generated Table since it is far more accurate.

Publishing on-line also allows easy use of the product since you're able to much more quickly jump back and forth through the product with your browser buttons. You are also able to search within with the lower left hand search field. And, with Googlebooks, you can always enlarge the print with the magnify button, which may make reading easier than if you had a hard-copy. And lastly, it's always there – you don't even have to go to the proverbial other room to haul a hard-copy off the shelf.

Disclaimer

This compilation is published with the understanding that the author is not responsible for the results of any actions taken on the basis of information in this work nor errors or omissions and that the author is not engaged in the business of rendering legal, accounting or other services. The author expressly disclaims any and all liability to any person whether a purchaser of this work or not in respect of anything and of the consequences of anything done or omitted to be done by any person in reliance, whether in whole or in part, on the whole or part of the content of this publication. If legal advice or other expert assistance is required the services of a competent professional person should be sought.

This source is available as a free download with the above right-hand sprocket button and I can only hope that since this is made available for free that you can contribute, any amount, towards a valid cause pursued by the below organizations this compiler highly values:

Federation CJA (Montreal)
United Way
Covenant House (Toronto-Vancouver)
Centraide (Montreal)
Kids HelpPhone
Breakfast Club of Canada
Sierra Club of Canada
SPCA (Montreal-Toronto-Vancouver).
Mona Parsons Commemoration Project
or, give some money to a university law library (U. of Western Ontario's good...)

If you're from the USA: Shamayim V'Aretz

Digitized by Google

For Kimberley Edith who worked for and earned New York and Washington DC and set this cog-in-history in motion in 1987 with her conclusively high dignity, professionalism, honesty and hard work (once a star, always a star)...

"Larry" ,"the Institution", of Concordia U. who spoke of the best databases in Canada and that the fact that even 'rock stars' don't have much music to perform, if CRA has seized their equipment on-stage for tax non-payment...

...and for Provincial Crowns who can only properly convict unfortunately oh so few tax evaders (and Federal Crowns for other tax-realization methods) and under-manned CRA officials who amass cases against them.

Digitized by Google

[1]

Table of Contents

Foreword **12**

The Voluntary Disclosures Program (VDP) **22**

Aashish M. Karia v. Minister Of National Revenue, 2005 FC 639, "Was Found Out" **22**

334156 ALBERTA LTD. v. MNR, 2006 FC 1133, "Showed Up on Radar" **28**

334156 ALBERTA LTD. v. Minister Of National Revenue, 2008 FCA 228, Proverbial Telephone Call to Taxpayer "CRA inquiring?" Exempts VDP **32**

Graham Worsfold, Stoneridge Managmeent Services Inc., Lyn Worsfold, Jonathan Coles As Trustees For Gr And Ls Worsfold Life Interest Settlement Trust v. MNR, 2012 FC 644, Corporate Audit Pops up Non- Filed Principals resulting in No VDP **33**

Edward Palonek v. The Minister of National Revenue, 2007 FCA 281, VDP means Complete Disclosure while CRA is Not Responsible for Advising/Stating Results in Advance **53**

Peter Livaditis v. Canada Revenue Agency, 2012 FCA 55, Appeal of Judicial Review of Refusal of VDP Acceptance **60**

Voluntary Disclosures Program **62**

IC00-1R2 ..... **62**

Fairness Applications **71**

Waiver of penalty or interest - S. 220(3.1) **71**

A Discretionary Decision Only, The Law Otherwise Applies **72**

[1] "Flower Flow of Colour", 2012, Patricia Vertes, Howick, Quebec

Digitized by Google

Inability to Pay or Financial Hardship 73
Necessities of Life and Financial Hardship 74
Célyne Laflamme v. Minister of National Revenue, 2008 FC 1403, An Instance Where the Taxpayer Did Suffer a Catastrophe 75
Verna Hauser v. Canada Revenue Agency, 2007 FC 113, A Case of Mental Illness and Corresponding Financial Hardship, Not Enough 80
Julie Deborah Surtherland v. Canada Customs & Revenue Agency, 2006 FC 154, Bi-polar Disorder and Uncontrolled Financial Responsibility 83
Financial Restructuring though No New Equity 88
Segregation of 1st and 2nd Fairness Reviews Important. 90
Latent Establishment of Interest/Penalty and Discoverability 92
Reliance on Erroneous 3rd Party Advice Not "Extra-Ordinary Circumstances" 102
Taxpayer's Right to Review Decision Before It is Made and Demands for Specific Foundation(s) of Decision 103
Stemijon Investments Ltd. v. The Attorney General of Canada, 2011 FCA 299, Too Narrowly Following the Information Circular Criteria Than the Act, Though with Examination, Same Result 105
Ronnie Louis Bozzer v. Her Majesty the Queen in Right of Canada, 2011 FCA 186, When Does the Clock Start for Possible Leniency: Where Does Prescription Kick-in and the Issue Falls off the Table 114
Lloyd D. Hillier v. Attorney General Of Canada, 2001 FCA 197, Lengthy Audit/Objection Results in Lowered Amount Owing 121
Wilfrid Comeau v. Canada Customs And Revenue Agency, 2005 FCA 271, While Filing the Objection the Interest Does Accrue and You take Your Chances at Losing Ability – And the Appropriate Measure of Review 128
Denis Lanno v. Canada Customs And Revenue Agency, 2006 FCA 220, Fairness can Extend Time to File Notice of Objection 132
Canada Revenue Agency v. M. Dianne Telfer, 2009 FCA 23, Reasonableness of Decision in Light of Objection in Abeyance, as Interest Continued to Accrue – Again, Take Your Chances if Not Paid subject to Later Refund 135
Canada Revenue Agency v. Slau Limited, 2009 FCA 270, Settlement Not Processed Properly Per Taxpayer, Can't Compel Minister to Achieve a Very Particular Result if Discretion 142
Taxpayer Relief Provisions 149
IC07-1 149
CRA Internal Operations Manuals - Fairness Provisions 168

Limitations Period and Prescription 170
Definitions - S. 222. 170
Markevich v. Canada, 2003 SCC 9, [2003] 1 S.C.R. 94, The Case that Changed The Act 172
The Queen v. Gibson, 2005 FCA 180, Acknowledgment of Tax Debt Through Loss

Digitized by Google

Carry-back as The Trigger 189
Richard Collins v. CCRA, 2005 FC 1431, An Interpretation of The New Prescription Statute 193
Hugh Doig v. Her Majesty The Queen, 2011 FC 371, a 25 Yr-Old Debt 197
Glenn Alexander Ross v. The Queen, 2002 FCT 401, Latent Issue of Requirement to Pay 205
Norman John Raymond MacKinnon v. The Queen, 2003 FCA 158, Limitation Period Starts When Tax is Due, Not Income that Produces it, while Tax Debt Certification Does Renew the Limitation Period 211

The Certification of Tax Debt and Realization 214
Definition of "amount payable" - S. 223(1) 214
Any Type of Property Can Be Certified 227
Was Ownership Properly Certified? 242
Certification with Ancillary Proceedings of Actual Tax Determination 246
No Argument for Over-Certification 250
Layer-Piercing for Other Assets 252
Certification the First Step, No Need for Writ to Seize, Second. 256
Seizure Causes Fair Market Value Dispositions in Debtor's Hands, and Her Accompanying Tax Consequences 261
Damages on Pushed to Bankruptcy 262
Seizure of goods, chattels or movable property - S. 225 266
CRA Internal Operations Manual - Certificates 266

The Primary Garnishment Provisions and the Requirement to Pay Process 268
Garnishment - S. 224(1) 269
Rank in The Face of Provincial Liens and Claims 271
Is Underlying Debt Prescribed? 277
No Need for Assessment or Certificate to be Issued 280
Harold Coombs And Joan Coombs v. Canada Revenue Agency, 2012 FC 1499, DAS Collection through RTP Without Notice still Valid 285
Failure to Respond to RTP and Intercept – Payor Becomes Liable 288
In re the *Income Tax Act, against* A Corporation Steckmar/Steckmar Corporation (Judgment debtor) and Steckmar National Realty And Investment Corporation (Garnishee), 2004 FC 1568, Unspecified "Term" loans and Issues of Payability to be Decided by Court 296
In the Arena of Bankruptcy 304
Norman A. Mintzer v. Her Majesty the Queen, A-68-95, Seizure of CPP Proceeds as Set-off 311
Bertrand Bouchard and Attorney General of Canada, 2009 FCA 321, Rank of

Digitized by Google

Provincial Set-off and Compensation Laws in Federal Environment When Not Referred To 324
Writs of Seizure 333
The Primary Collection Mechanics 335
Collection restrictions - S. 225.1(1) 335
Collections Policies 337
IC 98-1R3 337
The 90 Day Pause to Collection When Objection 352
Appeals Prevent Collection Acts to Start 352
James Walker v. Her Majesty the Queen, 2005 FCA 393, "I Didn't Receive the Assessment and The Collectors Started Calling": Whether s. 18.5 of the *Federal Court Rules* can Stop Collection Activity when the Underlying Process Hasn't Been Properly Pursued 352
Test Case Abeyances 354
Abeyance not Relevant When Clear Decision On A "Same Or Substantially The Same" Issue 355
Charles Webster v. The Minister Of National Revenue et al., 2003 FCA 442, Agreement on Ancillary Test Case does not Prompt Statutory Collection Delay Protections if Test Case Not Favourable 355
CRA Internal Operations Manual - Garnishment 359

Jeopardy Orders 362
Definition of "judge" - S. 225.2 363
In The Matter Of Brent Robarts, 2010 FC 875, a Review of a Jeopardy Order 365
Hearing *in camera* – 225.2(10) 376
Doreen Tennina et al v. Minister of National Revenue, 2010 FCA 25 376
CRA Internal Operations Manual - Jeopardy 378

Withholding Taxes and Liability to Withhold 380
Withholding taxes - S. 227 380
First Vancouver Finance v. M.N.R., [2002] 2 S.C.R. 720, 2002 SCC 49 382
Century Services Inc. v. Canada (Attorney General), 2010 SCC 60, [2010] 3 S.C.R. 379 – Company's Creditors Arrangement Act Considerations 393
Royal Bank of Canada *v.* Sparrow Electric Corp., [1997] 1 S.C.R. 411, Crown's Rank vs-a-vs Bank's Security on Corporate Assets 434
Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny, 2009 SCC 49, [2009] 3 S.C.R. 286 – Bankruptcy and Insolvency Act Considerations on ETA Deemed Trusts ceasing to apply 477
Caisse populaire Desjardins de l'Est de Drummond v. Canada, 2009 SCC 29, [2009] 2 S.C.R. 94 – Bankruptcy and Insolvency Act and "Security Interests" 491

Digitized by Google

Her Majesty the Queen in Right of Canada as represented by the Minister of National Revenue v. HSBC Bank of Canada, 2004 FC 467, Tracing the Interest in The Proceeds of The Trust Into a Subordinate Creditor's Hands 549

CRA Internal Operations Manual - Deemed Trusts 555

Directors Liability 557

Liability of directors for failure to deduct - S. 227.1 557

Soper v. Canada, [1998] 1 FC(A) 124, 1997 CanLII 6352 (FCA); 149 DLR (4th) 297; 51 DTC 5407; [1997] 3 CTC 242, The Federal Appeal That Set Out The Present Environment and its Criteria 558

Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] 3 S.C.R. 461, 2004 SCC 68, A Recent SCC on Identical Director Responsibility (a slight Divergence?) 579

Her Majesty the Queen v. Kevin Richard Buckingham, 2011 FCA 142, A Recent case on the New Purely Objective Test of Diligence and Care based on People's 603

The Attorney General Of Canada v. Lynda Mckinnon et al, A-421-98, Continuing Business in Face of Lack of Liquidity and Inside Directors' Diligence 617

Normand Cadrin v. Her Majesty The Queen, A-112-97, Inside vs Outside Directors and Their Differing Actions 629

Alexander Bruce Cameron v. Her Majesty The Queen, A-763-99, A Properly Complying Outside Director with Adverse Management 631

Thomas Gerald Liddle v. Her Majesty the Queen, 2011 FCA 159, The Possibility of another Dominant Director Seemingly Interfering Not Enough To Absolve Duty of Care 633

Gordon E. Smith v. Her Majesty The Queen, 2001 FCA 84, a case of Outside Turning to Inside Director and Failing Financial Resources 635

Jean Ruffo v. The Minister Of National Revenue, A-429-97, A Clear Case of Improper Shifting of Financial Priorities with the Proper Result 639

Jane Hanson v. Her Majesty The Queen, A-792-96, Ignorance of the Law Not Equal to Proper Conduct: The Need to Remedy the Ignorance 641

Her Majesty The Queen v. Gary J. Corsano, A-752-97, De facto Directors 643

Bruno Hartrell v. Her Majesty The Queen, 2008 FCA 59, A Clear Case of *de facto* Director Liability and People's Interpreted 650

Dupont Roofing & Sheet Metal Inc. v. The Minister of National Revenue, 2011 FC 160, No Need for Notice of Assessment of DAS Liability Before Tax Debt Certification 653

Giovanni Zen v. MNR, 2010 FCA 180, The Minister Does Not have to Issue Additional Assessments to realize the Interest Accruing 658

Directors' Liability Section 227.1 of the *Income Tax Act,* Section 323 of the *Excise Tax Act,* Section 81 of the *Air Travellers Security Charge Act,* and subsection 295(1) of the *Excise Act, 2001* 668

IC 89-2R2 668

Agathe Létourneau v. The Queen, 2011 FCA 354, A Resigned Director "Pulled Back In" with Falsified Minutes that was Exonerated 675

Digitized by Google

CRA Internal Operations Manual - Director's Liability 683

Records and books - S. 230 685
Books and Records Retention/Destruction 687
IC78-10R4 687
Books, Records and Other Requirements for Taxpayers Having Foreign Affiliates 694
IC 77-9R 694
The Tax Audit 697
IC 71-14R3 697

Requests for Information 703
Definitions - S. 231 703
Inspections - S. 231.1 704
Requirement to provide documents or information - S. 231.2 705
Search warrant - S. 231.3 705
AGT Limited v. The Attorney General Of Canada, A-514-96/[1997] 2 F.C. 878, The Balancing of State Interest in a Regulatory Environment, and the Taxpayer's Right to Privacy 706
Bankruptcy Proceedings 713
Deloitte & Touche Inc., The Trustee of the Estate of Vancouver Trade Mart Inc., a bankrupt v. Attorney General Of Canada representing the Minister Of National Revenue, T-1071-96, Trustee Papers under a s. 231.2 Request 722
Charter Implications 733
Jarvis/Ling and the Charter's Effect on RFI's use By SI Investigators 737
R. v. Jarvis, [2002] 3 S.C.R. 757, 2002 SCC 73, The Case That 'Changed The World' on Self- Incrimination, Delineation between Auditor and SI Investigator and Evidence Collection 737
Mere Potential for Situation Leading to Special Investigations Not Enough to Prevent Response 781
Jean Breau v. The Minister Of National Revenue, 2013 FCA 215, Appeal Court Disagreeing to Interfere with RFI Due to PURPORTED CRIMINAL Investigation 837
Supporting Documents to Arrive at Stated Amounts 838
Accountant's Files While No Accountant-Client Privilege 843
143471 Canada Inc. v. Quebec (Attorney General); Tabah v. Quebec (Attorney General), [1994] 2 S.C.R. 339, Impounding Seized Documents under a Provincial Tax Act 857
Obtain Information On Unnamed Taxpayers From Third Parties 883
The Historic SCC on Unnamed Persons – Tempered Now 883
Discretion of Judge to Withhold Authorization 889
The Inter-play of the Process 892
Ascertainable Class Size Not a Limit 895

Digitized by Google

Related to 3rd Party and Whether Access Through Other Route Relevant 903
Minister of National Revenue v. RBC Life Insurance Company, 2011 FC 1249, A Case of Incomplete Disclosure on ex parte Application that Does Not Necessarily Cause Order to be Set Aside, But Ulterior Motive to Proper Tax Enforcement and Analysis of the Nature of the Court's Process 907
The Minister Of National Revenue v. Cormark Securities Inc., 2011 FC 1472, Purported Vagueness of Class of Identities, Purported Ability to Realize Info. from Other CRA Source, All Not Conclusive 920
Inquiries by CRA/Justice 927
Inquiry - S. 231.4 927
Del Zotto v. Canada, [1997] 3 FC 40, A-55-97 928
Del Zotto *v.* Canada, [1999] 1 S.C.R. 3 951
Spencer v. The Queen, [1985] 2 S.C.R. 278, Compellable Witness Notwithstanding Conflict with International Disclosure Laws 953
Copies - S. 231.5 956
Foreign Based Information and Treaty Interaction 957
Definition of "foreign-based information or document" - S. 231.6 957
SOFT-MOC INC. v. MNR/AG of Canada, 2013 FC 291, Judicial Review of S. 231.6 Foreign Information Request 978
Compliance order – 231.7(1) 1009
Compliance Orders and Contempt of RFIs 1010
Minister Of National Revenue v. The Money Stop Ltd And Tel Sutherland, 2013FC133, An Example of a S. 231.7 Contempt Proceeding 1026
Issues in Solicitor Client Privilege 1033
Definitions - S. 232 1033
Solicitor-client privilege defence - S. 232(2) 1033
Seizure of certain documents where privilege claimed - S. 232(3) 1034
Examination of certain documents where privilege claimed - S. 232(3.1) 1034
Minister of National Revenue v. Welton Parent Inc., 2006 FC 67, a *Tax Lawyer's* files, though Substance Acutely Measured… 1036
In the case of MNR v. Bruce Kitsch, Leslie Tower, Robert Tower and BDO Dunwoody LLP, 2003 FCA 307, Ability of Minister to Elicit Information From *Tax Accountants* of Information of "Non-Document" Nature (Questions) And Documentary Evidence 1057
Opinion Provided to Lawyers From Sub-contractors (Accountants) 1066
Common Interest Privilege 1077
The Minister Of National Revenue v. Grant Thornton et al., 2012 FC 1313, A Recent SCP: Documents realized *Through Auditor* Which Prompted Extension of Privilege to Cover as well as Concerns Over Common Interest 1082
Material Released Pursuant to Another Statutory Requirement 1096
Privilege Doesn't Apply to Supporting Financial Transactions of Lawyer 1101

Digitized by Google

MNR v. Joseph R. Jakabfy, 2013 FC 706, An Example of SCP Not Applying to a Lawyer's Financial Records 1119
MNR v. Singh Lyn Ragonetti Bindal, 2005 FC 1538, A Clear Instance of Lawyer's Financial Records Not Being Subject to SCP 1123
Duncan Thompson v. The Minister Of National Revenue, 2013 FCA 197, SCP of a Lawyer Subject to Enforcement Action 1133
CRA Internal Operations Manual - Requests for Information 1147

OFFENCES AND PUNISHMENT 1149
Offences and punishment - S. 238(1) 1149
Filing is a Strict Obligation, Absent of Frame of Mind 1150
Various Excuses Not Enough to Not Comply 1152
The Proverbial Mouldy/Damaged Papers 1152
"I Had No Taxes Payable, Thus No Need to File, and I ignored the Demand to File" 1154
"It's Against My Religion – and My Charter" 1157
An Expanded Defence 1164
The Principal Evasion Charge, Sec 239(1) 1170
Other offences and punishment - S. 239(1) 1170
The Proper Forum as a Criminal Offence 1177
Need of Existence of Mens Rea 1177
Beyond a Reasonable Doubt 1191
Knowingly Non-Payment Enough 895
Poor Record Keeping Not a Defence 895
Honest Mistake as Defence 898
Natural Person and "Right to Enjoy Property" as Defence 905
R. v. Porisky & Gould, 2012 BCSC 67 (CanLII), Another Person Trying to Argue the Natural Person Argument – It's Amazing in Canada What Some will Try and Develop Argument Not to Pay Tax 907
Net Worth Evidenced Evasion 927
Régent Lacroix v. Her Majesty The Queen, 2008 FCA 241, Net Worth Assessments with 'Civil' Penalties for Incredible Assertions – Not Statute Barred for Reassessment When No Evidenced Support 953
Michel Guibord v. Her Majesty The Queen, 2011 FCA 344, Net Worth Argument and an Issue of Credibility 961
The Charter, Special Investigations and Disclosures/RFIs and Warrants 966
R. v. Alberta Hot Oil Services Ltd., 2007 ABQB 155, Small Owner-Operations and Close-Knit Environments that Give Rise to Tax Evasion on Personal Expenses (it just doesn't happen with NYC hotel magnates) 967
ITA Sec. 231.2 Requirement or C.C. Sec. 487.01 Warrant to Obtain Evidence? 977

Digitized by Google

R. v. Ling, [2002] 3 S.C.R. 814, 2002 SCC 74, The *Jarvis* Principles Applied on Audit realized Evidence Before, and After, Interrogation and Advice of Rights to Counsel ... 996

R. v. Caul, 2008 ONCJ 353, A Proper Audit that Caused Proper Auditor Disengagement, that Promptly Caused SI to Act ... 1004

Her Majesty The Queen v. Ostrowski, Ontario Superior Court Of Justice, CR-06-0309, 2008 CanLII 35698 (ON SC), Another Clear Cut Between Auditor and Investigator with *Jarvis* Interpreted ... 1008

Ciglen v. R., [1970] S.C.R. 804, The Recognition of what Income has to be evaded (characterization) and other Issues on Errors in Law ... 1015

R. v. Alberta Hot Oil Services Ltd., 2009 ABQB 11 (CanLII), 2009-01-22, [2009] 4 CTC 38, Sentencing Issues on Straight-Forward Evasion ... 1032

R. v. Leo-Mensah, 2010 ONCA 139 (CanLII), 2010-02-24, Too Light a Sentence for Considerable Tax Evasion Appealed and Granted ... 1038

Her Majesty The Queen v. Norman Jurchison et al, 2001 FCA 126, Discoverability on Charter-Excluded Evidence for Civil Penalties ... 1040

George Alexander Madraga v. Her Majesty The Queen In Right Of Canada, 2001 SKQB 53, Non-Payment of Fine Leads to Committal with Consideration ... 1043

Her Majesty The Queen v. Yu Wu, Court Of Appeal For Ontario C35987, 2001 12 12, Imprisonment on Inability to Pay Fine (Excise Act) – Certain Considerations ... 1049

R. v. Wu, [2003] 3 S.C.R. 530, 2003 SCC 73, Supreme Court Conditional Sentencing Issues Pronouncement when Fines Not Paid ... 1059

Her Majesty The Queen v. Pierre Bourque, Court Of Appeal For Ontario, Docket: C40814, Date: 2005 02 18, Application of C.C. Sentencing Retroactively ... 1081

Prosecution on indictment – 239(2) ... 1083

Indictment or Summary Proceedings ... 1085

Providing incorrect tax shelter identification number – 239(2.1) ... 1098

Provision of information - S. 241 ... 1105

R v. Wilder, 2000 BCCA 29 (CanLII), 2000-01-14, 142 CCC (3d) 418; 70 CRR (2d) 259, Confidentiality Provision not Bar to Admissibility of Evidence on Alternative Criminal Code Charge in face of Charter Self- Incrimination ... 1122

Slattery (Trustee of) v. Slattery, [1993] 3 S.C.R. 430, Realizing Information for Bankruptcy Proceedings and the Extent of "the Act" ... 1136

Glover v. Minister of National Revenue[1], Ontario Court of Appeal, CANLII.org, Piercing s. 241 for Civil Purposes Not Allowed ... 1152

Glover v. Minister of National Revenue, [1981] 2 S.C.R. 561, The Ontario Case Appealed ... 1157

Her Majesty The Queen and The Minister of National Revenue v. George William Harris (et al), A-25-99, Mister Harris and his Purportedly Favoured Trusts ... 1158

Her Majesty The Queen and The Minister Of National Revenue v. George William Harris, 2001 FCA 74, The Final Resolution ... 1172

Maxine Collins v. Her Majesty The Queen, 2011 FCA 140, A CRA Employee with a s. 241

Digitized by Google

Breach, on Her Own Information 1177
Circumstances involving danger – 241(3.1) 1185

Non Arm's Length Transfers to Shield Assets from Tax Payment 1198
Tax liability re property transferred not at arm's length - S. 160 1198
Vicarious Liability for Another's Tax Debt on Non-FMV Transfer 1201
The Classic Case of Livingston 1202
Applies to Cover Subsequent Interest and Penalties 1221
Transferee Cannot Be Absolved with Due Diligence, but held to Strict Liability and Intent to Evade Irrelevant 1230
Possible to Contest Transferor's Tax Liability as a Latent Party 1235
Prescription on Tax Debt and When Minister May Make Assessment 1238
Mortgage Payments – A Classic Transfer 1242
Consideration for Shared Living Expenses 1248
Resulting and Constructive Trust Extinguishment 1272
Eleanor Martin v. Her Majesty The Queen, 2013 TCC 38, An Argument for Constructive Trust on S. 160 Transfer 1280
Matrimonial Property Transfers 1295
"Family Support Obligations" – Statutorily Recognized? 1308
Corporate Distributions – Dividends, Taxable and Otherwise 1312
CRA Internal Operations Manual - Non-Arm's Length Transfers 1321

Digitized by Google

The Canada Income Tax Act Enforcement, Collection, Prosecution
A Case Compilation, 6th Ed.

Foreword

"What have the Romans ever done for Us!!?" isn't much of a parody of the actual sentiment that perhaps too many real people have towards their government's care for them.[2] Mr. J. Cleese asking it as a principal rebellious character in the classic movie "The Life of Brian" quickly understands that he chose the wrong question to ask. In my opinion, the more relevant, safer question should be "What did the Romans *not* do for Us!!?"[3]

This may be my last research on income tax law. And I caution you, it's the sixth edition. In some ways it was my first. It is about satisfying your inherent financial obligations to, in this case, the Canadian State, as a result of you being allowed to experience the 4 pillars of its laws that allow you to exist here, flawed as you think they may be sometimes. And rather than delve into the application of what some see as a complex all-encompassing Act (though surprisingly rudimentary if you actually look at it) to the infinitesimally complex world of "Canada", this commentary speaks only of how it is enforced and, how ITA tax is collected in the face of adverse remitters and instances prosecuted and sentenced in the cases of purer contempt of our ITA regarding evasion.

This compilation of existing case law is broken down by principal applications of the ITA:

- Voluntary disclosure practice and fairness application,
- Requests for information,
- Enforcement functions such as collection mechanics including, requirements to pay, jeopardy orders, garnishments, certificates and writs of seizure,
- Section 160 targeted transfers of wealth in effort to evade collection attempts,
- Directors liability and trust imposition on deduction at source and other monies to be withheld/collected for the government,
- Pure evasion under section 238/239,
- Confidentiality mechanics and access to CRA "taxpayer information" for non-Act purposes.

This also reproduces 10 Canada Revenue Agency Internal Operations Manuals on Particular aspects of the ITA, which can be viewed in any TSO Public Reading Room. I've included them as image pages that are non-searchable. (I have also included them for completeness, to be off value to anyone interested in entering the employ of CRA who would like to understand exactly how things are done.) The 10 I chose relate to:

- Fairness (3)
- Section 160 Transfers
- Certificates
- Jeopardy Collections
- Requirements to Pay
- Requests for Information
- Deemed Trusts
- Directors Liability

---

[2] And "Yes" you are and look that silly when you behave like that…

[3] And with respect to a participatory democracy like Canada, "the Romans" are actually ourselves

Digitized by Google

and they are current circa July 2012. (You are certainly encouraged to visit a TSO Reading Room if you have issues of timeliness.)

The ITA is, in my opinion, the best example of how those supposed "inept politicians up there in Ottawa, living on the taxpayers' dime" prove that they don't, since what started out as the IWTA (the McGill CDH/Nahum Gelber Library faithfully has maintained copies all the way to its beginning) evolved extensively. But surprisingly, as recently as 2003, because its adaptors did not conclusively monitor all collection aspects of public debt our Supreme Court had to attend to *Markevich* concerning simple statutory prescription that led to immediate amendment. Mistakes happen, you can't cover all the possible angles as other statute / jurisprudence evolves, and, for that one case, the Act is strengthened. But don't ever forget that every one of those other syllables in it resulted from more "behind the scenes" concern than the route that SCC case took to decide (and many like it). In the instance of penal attributes *Jarvis*, another case at the SCC (and subsequent lower courts on extent of improperly obtained evidence), has given us detailed dicta on when a mere audit can lead to incarceration in light of Charter principles which allows taxpayers to understand the balance of their Charter rights vs. state prerogative. On the issue of Crown discretion to proceed by way of summary or indictment proceedings in evasion cases we also have *Smythe*, another SCC case in the face of equality under the Bill of Rights (and effectively under the Charter). And for the amount of case involved, the issues are surprisingly broad and this is an area of law that is very refined.

And, in these cases, and it's not done lightly, the least you can do is respect its objective. As was said by Judge Sexton in Her Majesty The Queen v. Jean Livingston[4]

> The power to tax means little without the power to collect. As a result, the Income Tax Act R.S.C. 1985, c. 1 (5th Supp.) (the "Act") provides for a myriad of powers to collect taxes owed that would otherwise not be obtainable when taxpayers attempt to evade their creditors. These powers must be interpreted in light of their intended purpose and within the contexts of the factual situations to which they are applied.

While in MNR v. Sung Young Park[5] it was provided by our Federal Court that:

> Based on the disclosure of one's income and its sources which does not constitute a self-imposed affliction but constitutes a legal imperative, the paying of taxes, thereby, does not arise of choice, but derives from a legal obligation.

As an educated mere bookkeeper, a mere Accountancy B. Comm who worked his way through, with an unadulterated love for the poetry of case and statute law – where a simple World "makes sense" - as some who know me, I choose not to further any public accounting practice since I have simply seen too too many not want to pay income tax using "sleigh-of-hand" bizarre interpretations of what they think they can pester a poor TCJ or senior to accept, if it leads there, let alone, simply falsifying the data. The standard phrase I often hear that sets my alarm off is *"I have paid my share."* to which I immediately think, as the individual is justifying her version of her law when in reality it is the country's version of our law, "Have you actually read the ITA, let alone, all the cases about it and understood them?". But, is not the payment of income tax a personal debt prescribed by only a law, part of the very fabric of your society, that creates it all around you, to your society that is not in any way related to what the entirety of the rest of it do? If "that other guy doesn't pay" does that thus increase "your share"? The ITA "applies to all" – with all its intricate peculiarities, and it applies "equally", with the entire history of literally generations of legal and practical public-conscience minds behind its evolution so we should be ever so

[4] 2008 FCA 89
[5] 2011 FC 263

Digitized by Google

sensitive to those who qualify the payment of an arbitrarily determined amount of tax to being "their share", when they don't know how much tax has to be collected out of the population, how much actually is, nor, how it is calculated to begin with. They're a few syllables that reveal something enormous since the phrase should be "I paid my income taxes [or recognized them]", not "I paid my share."

Because this is where it can lead. In our case, all 35,000,000+ Canadians are due the benefit, individually, of 1 35,000,000th of ***every dollar*** the law, your and their law, obliges you to pay. So both practically and theoretically, when you've clandestinely refused to recognize a simply calculated financial obligation (let alone take advantage of a flaw unforeseen in the minds of the legislators) you yourself have "ripped off" literally every other citizen in Canada. And sadly, far too many have no problem being unethical, or, law- breakers, (that is what you call yourself when you break a law) of that magnitude. And it's extremely dangerous because if you're willing to unethically or illegally disenfranchise *only 35,000,000*, just imagine what you can and may do to just one, if you get that ball rolling. But, those who value "their share" will forever blame it on those fat-cat politicians. But then again, according to Ben Franklin, "Democracy will never work without an educated population."[6] If you "chip away at an institution", you might end up as well taking it all down. And then what do you have in its place? In an instance where a bankrupt further didn't bother to pay his taxes we should all take Bice (Re), 2007 ABQB 708 where it was opined:

> [1] This is the bankrupt's third bankruptcy. *All bankruptcies have been tax driven leaving large amounts owing for taxes.* The bankrupt also admits to drug and alcohol abuse.
>
> [2] *An especially aggravating factor in this bankruptcy is the conviction of the bankrupt for tax evasion on January 24, 2000. The personal bankrupt failed to pay tax on reported income of $350,720.05 and remit GST in the amount of $72,212.36. The bankrupt was fined almost $100,000.00 and is paying back those amounts at $300.00/month.*
>
> [3] *The second bankruptcy and this bankruptcy were filed subsequent to the tax evasion charges and each involved substantial tax liabilities.*
>
> [4] Tax debts which are sought to be eliminated through the bankruptcy process should reflect the court's moral indignation.
>
> [5] Registrar Funduk expressed that moral indignation in *Re Trueman* 25 CBR (4th) p. 124:
>
> > The bankrupt enjoys the considerable benefits of being a Canadian citizen and an Alberta resident. *Those benefits are not cost free.* Taxpayers who do not pay their proper amount of tax are pickpockets. *They pick the pockets of those taxpayers who do pay their taxes*. What is so special about the bankrupt that paying taxpayers must bear a greater tax burden so he does not have to pay his proper tax liability? Canada has a substantial accumulated debt and each year pays substantial interest on that debt. Why should the bankrupt have a free ride, not once but twice. The trustee says that the bankrupt is slotted for a heart transplant. *Will the bankrupt pay for that, or will the cost be borne by health care which is funded from public funds, which includes income tax? Why should paying taxpayers pay for the bankrupt's heart transplant when he has twice now picked their pockets?*

while, further, with respect to pure evasion, it was opined in R. v. Kresanowski[7],

> … The effect of false returns is visited upon all taxpayers in Canada. To put it bluntly, a person who is instrumental in reducing the income tax of one person is simply not only being unfair to his fellow Canadians, because he is not acting honestly, but he is making those

---

[6] See "Attitudes, Incentives, and Tax Compliance" Viswanath Umashanker Trivedi, Mohamed Shehata, and Stuart Mestelman in the Canadian Tax Journal, (2005) vol. 53, no 1 Pg. 29 for general issues on present attitudes and data released

[7] 1982), 83 D.T.C. 5393 at p. 5398

Digitized by Google

other Canadians, perhaps his neighbours and friends, pay more than their fair share. Certainly tax evasion is to be punished to an extent that it will deter others from acting likewise.

It is in my view almost a certainty that tax evasion will be visited by a term of prison. Perhaps the only matter that is really to be decided is how long that prison term will be.

Further, on the issue of mere economics, without regard to the law, nor the ethics of the legality of the law, and I`m reminded of a favourite late friend of Vancouver, John Turner, one of the favourite phrases of whom was "All of this: And Heaven Too!": you get a pretty good "bang for the buck" when you "send Caesar" part of your earnings don`t you? I mean, all of "this", that completely engulfs you[8]. Wouldn`t youwant to pay a bit more for such "a deal"…? **You hardly miss it, and look where it goes**. Instead, unfortunately in Canada there is a small percentage of people who look at their government as alien to them and not in their own interest to deal honestly with. We have the stereotypical 'hard-nosed CRA tax collector' who is to be looked upon with unfounded deep-rooted contempt since she stands for something that will take away only a sliver of wealth from her party, even if, legally compelled to do so and the author is ever-so thankful for the role they play and the fact that they can carry-on doing it since an exception to the rule of law, if allowed to continue, will result in more exceptions and thereby lower public funding of government expenditure which only works for us all.[9]

And really, our "government" is us and we do elect people to ensure that our money is applied effectively.

And, "do you need it all"? For those who like our bumpy roads that do get us there, our overwhelmed doctors who do find the time, our overworked police when no one is standing at our door with a firearm, our overloaded justice system where we do assert our grievances, our lengthy check-in process at airports where planes don't blow up, et cetera, and all of our municipal/provincial/federal law that works to *our benefit* in all its aspects, are you *so unappreciative* of that which allowed you to realize on it financially: "*do you need it all*"? Again, such a "bang", for "the buck": best deal in the country actually. Everyone else above does their job: is there a reason why you don't do yours?[10]

What **exactly** would you do with that squandered chance in the form of a legally compelled payment to the country, where they could focus it, learnedly, that would make *you*, permanently, a better person?[10][11]]

As a family member would sometimes advise me: "What did they ever do to you that would cause you to [rip off as a tax cheat everyone else]?" When you're buying your Chicken Salad Sandwich

---

[8] "The Romans have it covered": try and think of an instance where ITA-raised funding *does not* benefit you.

[9] Again, care to pay for the spousal surgery, or your infant's birth, yourself? *Would you know how to manage your own money enough to know how?* In old Quebec during the reign of 'the seigniors' they used to have to shovel the snow off their section of the road in the winter to make it passable: can you see yourself doing that? That's how and why we evolved out of the 'dark ages', by paying income and other taxes. If you'd like to inform yourself with the studies and studies and studies done on income tax enforcement/collection/evasion you're encouraged to log into the **SSRN database.**

[10] There are thousands of people who work just so that that is what is accomplished, and that's why they call it, "in the public service".

[11] To tell you the truth, for some of the cases I've seen and/or read about, there are more sociopaths in society than anyone can guess. Sadly, only less than 300 cases are referred by CRA Special Investigations to Crown for prosecution per year, out of a population of 35,000,000. (They seem to have the same limitations as the SEC in the US if these numbers are reflective of resources.)

Digitized by Google

at Tim Hortons on the corner, were ALL of the other people ahead of you ALWAYS obnoxious to you? Did everyone who you met, in the entirety of your life, irritate you exhaustively? What did a whole country called "Canada" do to you that prompted you to falsify some info. to get back a few/many farthings/thousands of dollars that you were not entitled to, when they should have went to someone else or their benefit? [Thankfully not everyone leads such a miserable life, carrying on private wars, as you if such is the case...

With respect to the seemingly comic overtones in the above opening paragraph, for those church / synagogue / mosque attendees, would you hypocritically disenfranchise your fellow of, actually, the mechanics of their faith, when that's exactly what you're doing equivalently under the ITA when you purposefully do same?

And a simple story about a Quebec car accident. In 1999 I was working for a reputable firm with Judy, Craig, Gerald, Mr. I. and Mr. S., Sue, Cheryl, Mary, Anita and yes Ann and a radio news-spot came on that a day- care worker had hoped to take her charges out for a trip. The problem was that while she had no culpability in how she drove, she hit an icy patch on the Quebec highway and the van ended up in a field and 4-5 toddlers were killed. Probably happens all the time since unless you look into accident statistics you wouldn't know what 'the government' 'sees'. But, the accident happened since there was no salt/sand on that stretch of the road. How much does road salt/sand cost, pennies? So if it's so cheap, where was it? Well, it seems that municipalities have to work within their budgets for road protection and while they do receive revenue from various sources, the province can only give so much, since that's what the province has 'in the budget' for that municipality. The province, of course, has various streams of revenue coming in, in Quebec, pursuant to its own Taxation Act, but also the Federal government for transfer payments. But, that government too has 'its budget' with revenue coming from various sources as well. The long of the short of it is, we elect people to ensure that 'our money' is best applied and while exceptions do pop- up, generally it is but when people **even begin** to think that they don't have to contribute to, what is, their World around them then we should be ever-so-thankful for the information-collection, tax debt certification/realization, trust collection, jeopardy enforcement, s. 160 wealth-shifting mechanics and especially prosecution mechanics since even though the above happened, (and Sue McG was distraught wanting desperately to have someone charged, as one bookkeeper was thinking "ya, the tax-cheat"), day- care workers continue rightfully to make outings in winter.

As a consequence, even if I were an LLB or LLM, I'd find it unethical to advise a client on the enclosed aspects, at "$250/hour", without reflecting on "the Canadian academic system" that allowed me to excel to the point where my advice would be of assistance to a tax-cheat. I'd probably be thinking, as the client laments: "You enjoyed all the *privileges experiencing the aspects of and in amassing your wealth in the Canadian State, and not paying tax on it*, now pay your bill." But that's just me. And, as was said by the blonde to the back-country reptile-expert in the movie "Crocodile Dundee", with respect to those New York hot-dogs (charging those "$250/hr"), "Well, you can eat [money], but it tastes like ..."

Consequently this volume does not speak of "strategies" to either defer or enhance collection or acquit or convict offences: it is indifferent, but merely attempts to state the existing statutory provisions and some of the authoritative cases that have dealt with them. I would certainly not want to assist in instances of the former and there are far more competent persons than I who can attend to the latter. This is an introductory to the issues and better reflection will probably occur on the individual level via your differing investigation of case and other material.You "get out of it what you put into it": I have sometimes only briefly touched on some of the issues and you are

Digitized by Google

encouraged to look up further case if you're desirous. I have also extensively reproduced case for two reasons: firstly, Judges say it best without regurgitation by an author (you can read what she said yourself and I have tried to underline/highlight particularly important aspects of the case), secondly, if you are sincerely interested in this sport, you had better learn how to consume case[12], or forever take someone else's word for it (and reading the provisions in the Act are merely part of it: cases describe how it is to apply).

Some would say it's a very narrow field to be spending so much time on, given that in this country, it seems not to have been done before for internet consumption. I say that it is the most important of all the scheme of the Act since once an arbitrary specifically defined amount has been determined (no matter how it is derived), of the infinite number of possibilities the Act creates the end objective is its realization into the General Revenue Fund through the Receiver General. And, that's, how, Horton, hears, a, Who..., to pay for, amongst other things, the hospital laundry detergent that your Mom used so many years ago in her episode with, *you*, the ambulance that took you there, on a road, to a physician whose expertise was academically developed in a university, whose professional ethics were forged in a court-house, as administrators of various sorts advised the whole affair to best accommodate. As another "Dr.", who knew of "a Horton", would probably say, "All for you, before you were two."

The author has to make an equal comment about so-called "philanthropists" who purportedly "give back to their community". In some instances, they are of this sentiment: they have conducted themselves legally, making their earnings within the norms of law (and good taste) and realize on their legitimately developed and properly cultivated potential. They're "the saints". Others, on the exact other hand, suffer from the internal cold-hearted taint that compels them as thugs and disguised barbarians to always give "their spin" on their purported benevolent dealings. They're the "robber-barons". The difference is that one has no problem recognizing and paying their taxes, amongst other things, while the latter is forever reveling in "the game" of not doing so, bragging that they don't have to. One takes from the environment, only, the other truly desperately does "give back". True "philanthropists" honour the dealings of their government in all their aspects as allowing them the environment to thrive: the false ones are forever looking for other governments who will turn a blind-eye to what they are actually about. True philanthropy, not that generated by false hype nor their ego nor megalomania, is almost always anonymous – they don't "sell sizzle" but "give away steak" - without need for public gratification or especially financial reward. Some run 'cons', some don't. Some link their own wealth, indirectly but hideously direct enough, to how much they can harness popular general sentiment "doing it for the children": the other, legitimate, don't make a dime from it and don't have multiple 'flashy' web-sites for example. And finally, true philanthropy operates on the individual level: not surrounded by those 'conned' to ignorantly, without knowing who they are exactly dealing with or what they are endorsing, as they are used to further 'the cause'. That's why our ITA does recognize proper charities, screened, while there are hordes of the 'unclean' out there. And true philanthropists can take it to the point of donating to their government, at their own expense, what their government needs[18], which includes cutting a cheque to them, yes, believe it or not, thus ensuring that properly qualified, educated, warm hearted and low-salaried people focus the money, where '*only the population'* has decided, through their studied representation, it will best be used, without profit-taking on the side and as primary motive, nor ego, nor walls of the "best picture-capture" in the world. The 'robber- barons' are frauds, in some instances a multitude of times, speaking legally too: the

[12] You're encouraged to use CANLII.org as your research database since it captures everything, though if you're trying to write your own book *don't save the files in pdf format*: they seem not to be able to be key-word searched by Windows after that – greatly hindering your work

Digitized by Google

others do have a proven ground history and record. Care to be your own "philanthropist": let some token interest accrue on your nominal tax debt and let them make money on the spread, 'bank' your income tax refund by not filing for 3 years allowing the cash-flow in the government's hands[13], send a money order to CRA as a gift without trace, pay for a legal publisher's sale to them, etc. and laugh at and financially starve those that try and pass themselves off as such? Recognizing a **true definition** anyone can be one and you can be one yourself don't you know? (...and you don't have to sell the World's unsuspecting destitute health problems such as rampant flatulence, literally, 'putting the spins in place', to try to qualify, because there are people who will try to pass themselves off as such, and you should try and make up for it!).

This is posted on Google Books with the objective of providing as much condensed compilation as possible to educate and perhaps lead towards less tax collection litigation. It's a start on the subject: legal environments are always more complex but you'll get a sense from this. As a book by David Franklin Ad. B.C.L., "International Commercial Debt Collection" starts, "so acquaint yourself with the law, and conduct yourself lawfully". That way, a judge may just sometime simply start a trend and say to a party: "This is on the internet, and pay costs for wasting our time." It will be updated frequently.

And as we already meander through what I consider the secular "promised land", becoming professionals at everything under the sun and being "Doctors of Suesses", "looking on the bright side of life", we should always reflect very favourably on what "the Romans actually do for us."

For all those unsung people who, desperately, want to handle simple cases of people not wanting to pay taxes as best described in Jules Fafard v. Her Majesty the Queen[14].

Hope you like.
LM

---

[13] D*o you even remember what your tax refund was from 3 years ago, let alone what you spent it on? How much enjoyment does it give you, now?* **Wouldn't** you like to get a '**hellova**' cheque, on year three, at 3 times the amount, so you can zip down to NYC and blow it at Saks on Fifth in some shin-dig that will turn heads at the office and smile knowing that **you've**, even still, helped out the best '**debtor**' in the country, in this case the country, with its cash-flow, for example? You could get yourself 1-2-3 Versaces '**n** a whole bunch of them-there **Armani's** to boot! *Again, do you remember what that refund was, 3 years ago, if you're rewardingly engaged in the economy?"* Let it ride": **you'll** get back the proverbial 3 times as much, later, (**it's** "**ten** weeks away on **filing**"). Would you like to go crazy: elect for additional withholdings on salary, say $25/wk. and get an extra **$1,300** back at year end? *Will you miss it in the meantime*: Tim **Horton's** has ridiculously cheap coffee after all and **you'll** learn to work around it? Holy smoke, you could "**buy** yourself **rich**"! ($150/mth generates $1,800/yr. if **you'd** like to know, when the interest on that principal, in your hands, may not even be able to take the family out for **dinner**... Disney Land? Or Giza? *Or, a neww carrrrrr!!*) **You'll** learn to love the road, whatever condition **it's in**...

[14] A-870-97

Digitized by Google

Digitized by Google

PART XV

ADMINISTRATION AND ENFORCEMENT

Minister's duty – 220(1)
220. (1) The Minister shall administer and enforce this Act and the Commissioner of Revenue may exercise all the powers and perform the duties of the Minister under this Act.
Officers, clerks and employees – 220(2)
Such officers, clerks and employees as are necessary to administer and enforce this Act hall be appointed or employed in the manner authorized by law.
Delegation – 220(2.01)
(2.01) The Minister may authorize an officer or a class of officers to exercise powers or perform duties of the Minister under this Act.
Waiver of filing of documents – 220(2.1)
(2.1) Where any provision of this Act or a regulation requires a person to file a prescribed form, receipt or other document, or to provide prescribed information, the Minister may waive the requirement, but the person shall provide the document or information at the Minister's request.[28]
Extensions for returns – 220(3)
The Minister may at any time extend the time for making a return under this Act.

Digitized by Google

28 See Bul River Mineral Corporation et Al v. Minister Of National Revenue, T-1062-05 for an example of the issue.

Digitized by Google

15

The Voluntary Disclosures Program (VDP)

CRA offers the VDP to allow taxpayers to satisfy their tax filing obligations as fully as possible by allowing them to find out anonymously if they should file more complete information. It allows taxpayers to come forward in an effort to satisfy their obligations, voluntarily, so as to possibly avoid penalties/fines if they are eventually found out.

Aashish M. Karia v. Minister Of National Revenue, 2005 FC 639, "Was Found Out"

BETWEEN:

AASHISH M. KARIA

Applicant

and

MINISTER OF NATIONAL REVENUE

Respondent

AND BETWEEN:

[15] "Flower Masks", 2012, Patricia Vertes, Howick, Quebec

Digitized by Google

M. KARIA LTD.

Applicant

and

MINISTER OF NATIONAL REVENUE

Respondent

REASONS FOR ORDER

STRAYER D.J.

INTRODUCTION

[1] These two applications brought by an individual and his wholly-owned corporation involve the same facts and were argued together. They seek judicial review to set aside a decision contained in a letter of August 19, 2004 from the Canada Customs and Revenue Agency (CCRA) **on behalf of the respondent Minister in which the CCRA confirmed that the applicants did not qualify for the Voluntary Disclosures Program (VDP). That letter was simply confirming the decision already conveyed to the applicants in a letter of February 18, 2004.**

[2] Subsection 220(3.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th sup.) authorizes the Minister to waive or cancel all or any portions of a penalty or of interest otherwise payable under that Act. Section 281.1 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 makes similar provision for the waiving of penalties and interest with respect to the Goods and Services Tax. **This discretionary power is exercised in part by a Voluntary Disclosures Program which was described, at the time in question, by Information Circular 00-1R dated September, 2002. It states the purpose of the program to be to promote voluntary compliance with reporting and payment of taxes and "encourages clients to come forward and correct deficiencies to comply with their legal obligations".** The Information Circular in question deals with clients who have deliberately omitted to report and pay. (There are other programs for those who have inadvertently omitted reporting or who have been unable to comply due to circumstances beyond their control). The incentive for making voluntary disclosures of past omissions under this program is that if full disclosure is made to the satisfaction of the CCRA then the discretion of the Minister may be exercised so as to waive all or part of the penalties that otherwise could be imposed.

[3] The conditions for a valid disclosure are set out in paragraph 6 of the Information Circular. Subparagraph (a) states as follows:

The disclosure must be voluntary. The client has to initiate the voluntary disclosure. A disclosure may not qualify as a voluntary disclosure under the above policy if it is found to have been made with the knowledge of an audit, investigation, or other enforcement action that has been initiated by the CCRA, or other authorities or administrations with which the CCRA has information exchange agreements.

Subparagraph (b) requires that the disclosure be complete. Subparagraph (c) requires that the disclosure must involve at least one penalty in order to qualify for this program and subparagraph (d) requires that the information disclosed must be either at least one year past due or not initiated simply to avoid late filing or instalment penalties. It is subparagraph (a) which is the most pertinent to this case. It is common ground that the Information Circular is made available to the public and that the applicants and their legal representative proceeded in their disclosures on the basis of the information provided in this circular.

Digitized by Google

FACTS

[4] **On September 17, 2003 the Peel Regional Police executed search warrants on the residence and business of the applicants in connection with a fraud investigation. On the same day the Investigations Division of CCRA had requested the tax returns of these applicants for study. On September 18, 2003 the Peel Regional Police referred certain information from their search to the Investigations Division of CCRA. On October 14, 2003 the applicants' counsel had a telephone conversation with an officer of CCRA concerning the VDP and pursuant to that conversation he wrote to CCRA on October 17, 2003 on a "no-name basis". He advised that according to his information his clients had received credit card payments and deposited them in bank accounts without reporting them as income. He noted that it was possible that some of these amounts had been received on account of Goods and Service Tax that had not been remitted. He also reported his understanding that the individual client had earned some interest income in respect of funds deposited offshore which had not been reported. He advised that his unnamed individual client had been charged by an unnamed police force "with a minor fraud" and that an investigating officer had mentioned to his client that the police might notify CCRA that he had failed to report income tax. The police officer had not made it clear whether such notification would actually occur or when, and to the best of the knowledge of the client and his counsel it had not yet occurred. He stated that because the police were holding his client's records they were not in a position to ascertain the *quantum* of unreported income. He concluded his letter with this paragraph:**

Based on our telephone discussion, I understand that under the circumstances described above the CCRA will view the disclosure to be made by our clients as voluntary, for the purposes of the Voluntary Disclosure Program. Please confirm that understanding by signing below and returning to my attention a copy of this letter.

CCRA did not confirm this "understanding" by signing the letter. However on October 21 CCRA sent a letter to the applicants' counsel which included this paragraph:

Based on the circumstances described we consider that the disclosure would be valid as presented. However our determination has been made based on the facts as presented and could change if any new details come to light during the handling of the actual full disclosure. Therefore, a full determination of whether we can accept the voluntary disclosure as valid cannot be confirmed until after the names of your clients are given and all facts are verified. In this regard at the time of the full disclosure the information provided should meet the following four conditions to be valid. . . .

There then followed the quotation of the four conditions set out in the Information Circular, in subparagraphs 6(a), (b), (c) and (d) as referred to above. As a result the applicants' counsel sent a letter to CCRA on January 19, 2004 disclosing the names of the individual client and his company, together with the individual's address and social insurance number and other identifying information in respect of the company. This was the only new information disclosed but the letter noted that "we are preparing the necessary details of their voluntary disclosure and will send them to you in due course". CCRA replied by writing a letter to the individual taxpayer on February 18, 2004 to advise him "of our decision concerning your request for the waiver of penalties under the Voluntary Disclosure Program. . . ." It went on to say:

The circumstances of your case have been carefully considered and I regret to

Digitized by Google

inform you that your request cannot be granted. Four conditions must be satisfied to qualify for the benefits of the VDP. Unfortunately, the disclosure was not considered to be voluntary since it was initiated based on the knowledge of current enforcement activities.

[5] The individual taxpayer through his counsel sought an administrative review of this decision. He was advised by CCRA in a letter of August 19, 2004 that a review had taken place and the decision would not be changed. In seeking judicial review of the August 19, 2004 decision the applicants are really seeking a review of the decision conveyed to them on February 18, 2004 which was simply confirmed in the later letter.

[6] It will be noted that in the letter of February 18, 2004 the reason for finding the applicants disqualified for the VDP was that "**the disclosure was not considered to be voluntary since it was initiated based on the knowledge of current enforcement activities". The CCRA takes the position that this is based on subparagraph 6(a) of the Information Circular which says that a disclosure is not voluntary if it is made by a taxpayer with the knowledge of an audit, investigation, etc. already initiated by the CCRA or other authorities "with which the CCRA has information exchange agreements".** In his initial contact with CCRA counsel for the applicants raised the question as to whether, due to the fact that the police officer had said they might report information to the CCRA, would CCRA still consider a disclosure to be voluntary. According to the notes made by the CCRA Officer who spoke with counsel, he

[e]xplained that we may as it sound [sic] like the client was not aware of any compliance action by CCRA but would need to have the details in writing before we could formally make that type of decision.

There is nothing in the record to indicate that the applicants had knowledge that the Peel Regional Police constituted an authority "with which the CCRA has information exchange agreements" as required in subparagraph 6(a) of the Information Circular. Further there is no documentary evidence of any such agreement existing. Internal discussions within CCRA, as described in their records, indicate that some officers believed there to be such an agreement. However when counsel for the applicants, in preparation for the hearing of this matter, quite properly requested a copy of such agreement from the Department of Justice representing the respondent, he received a letter of November 29, 2004 which stated in part as follows:

I have been advised that there is no written agreement. It is merely an informal relationship that exists between the CCRA office in Toronto West, the Investigation Division and Fraud Bureau of the Peel Regional Police.

This information was not provided on a "Without Prejudice" basis and I regard it as an admission properly made by counsel.

ANALYSIS

[7] It is common ground that the Information Circular and the Guidelines concerning the VDP are not delegated legislation and have no force of law as such.

[8] The applicants contend, however, that the terms of the Information Circular, particularly paragraph 6 thereof, create procedural entitlements and constraints which prevent the Minister's discretion being exercised as it was in the letters of February 18 and August 19, 2004. **They argue that either the respondent acted without jurisdiction because it had already determined by the letter of October 21, 2003 that the applicants' disclosure would be considered voluntary; or that the applicants had a legitimate expectation that the respondent's later**

Digitized by Google

disclosure would not be considered involuntary because of the commitment made in the letter of October 21; or that the respondent is estopped from denying that the disclosure is voluntary having led the applicants to believe by the letter of October 21, 2003 that it would be treated as voluntary; or that the respondent's decision of February 18, 2004, as confirmed by the letter of August 19, 2004 was patently unreasonable.

[9] I believe the matter can be determined on the basis of the last two submissions combined. First, I believe that the requirements of promissory estoppel exist here. Those requirements are that there must be a promise that the promisor will conduct himself in a certain way in certain circumstances. There must be reliance on that promise by the promisee, and to the detriment of the promisee. In such circumstances the promisor will not be allowed to exercise his discretion in a manner inconsistent with the promise, if he otherwise has lawful authority to fulfill that promise. See e.g. *Aurchem Exploration Ltd. v. The Queen* (1992), 91 D.L.R.(4th) 710 (F.C.T.D.); *W & R Plumbing and Heating Ltd. v. The Queen*, [1986] 2 F.C. 195 (F.C.T.D.). Here the promise exists in the form of the Information Circular which says in effect, in subparagraph 6(a) that a disclosure will be treated as voluntary if the client initiates it, subject to it being considered involuntary if the client initiates the disclosure with the knowledge of an audit, investigation, etc. by the CCRA or "authorities or administrations with which the CCRA has information exchange agreements". After counsel for the applicants had specifically advised CCRA that they had been the target of a police search by an unidentified police force and that a police officer had said his force might report information to the CCRA, CCRA wrote the letter of October 21, 2003 to counsel saying that "based on the circumstances described we consider that the disclosure would be valid as presented". There was of course the usual warning that this would have to be confirmed after full disclosure was made "and all facts are verified". Read together with the Information Circular, this was an invitation to proceed with disclosure on the basis of the facts as disclosed so far, and the applicants were entitled to assume that unless there were undisclosed facts which were pertinent to the question of whether they had knowledge of an investigation already under way they could assume that further disclosures would be regarded as voluntary. They acted to their detriment. In the letter from their counsel of January 19, 2004 they revealed their identity. While the bare fact of giving their identity may not of itself have been to their detriment, when combined with the information which their counsel had already provided on a "No-name" basis in the letter of October 17, 2003 they had disclosed to CCRA that they had received undisclosed monies which they owed for income tax and GST. Further the individual client by the combination of these letters had disclosed that he had earned interest on income from funds deposited offshore.

[10] I am therefore of the view that the respondent was estopped from deciding this matter on a basis other than as specified in subparagraph 6(a) of the Information Circular. The applicants were entitled to rely on that as the manner in which their disclosure would be dealt with. In determining whether the respondent complied with the language of the Information Circular, I believe the appropriate standard of review is that of reasonableness *simpliciter*. It involves in part the interpretation of the language of the Information Circular which in my view is the governing instrument, and its application to these facts. I believe the Court has as much expertise as the Officers of CCRA in

Digitized by Google

interpreting this language. The matter is therefore analogous to a mixed question of law and fact and I believe the appropriate standard is reasonableness. I might add however that if I am wrong in this, and greater deference is owed, I would still consider that the decision of the respondent was patently unreasonable.

[11] It is clear to me that the respondent never addressed the question of whether the applicants had made their disclosure *with the knowledge* of an audit or investigation by an authority or administration with which the CCRA had an information exchange agreement as required in subparagraph 6(a) of the Information Circular. It is clear from an internal document of CCRA that they accepted that the applicants were not aware of the CCRA investigation which had been initiated in September, 2003:(see applicants' record volume 1, page 69). Internal records of CCRA which show what information the CCRA had before it in making its decision that disclosure was involuntary, indicate that officers only focussed on whether the Peel Regional Police had an exchange of information agreement with CCRA but not whether the applicants had knowledge of it. CCRA did not know the identity of the police force in question until after the applicants made their disclosures by counsel of January 19, 2004 providing their names. As a result CCRA was able to trace through their names the fact that a CCRA investigation of the applicants was already under way and that the Peel Regional Police Force was the force involved with these parties, having already provided information to CCRA in September, 2003 (see applicants' record volume 1, page 70). Once CCRA officers learned, or believed that they had learned, that there was an "agreement with" the Peel Regional Police, that was apparently considered determinative of the matter. But there is nothing to indicate, and clearly CCRA did not concern itself about the matter, that these applicants would have had knowledge that the Peel Regional Police Force had an agreement with the CCRA. Counsel for the respondent seemed to argue that it was sufficient if the applicants ought to have known of such an agreement or ought to have found out if there was such an agreement: in other words knowledge in paragraph 6(a) includes constructive knowledge. I am unable to interpret the language of the Information Circular in that way. If CCRA wishes to administer a program on that basis it should modify the Information Circular accordingly. If it does so, however, it should also provide some anonymous means for taxpayers learning with which agencies or authorities it has such agreements, perhaps through a website or publication in the *Canada Gazette*.

[12] Although this disposes of the matter I would also add that I have great difficulty in accepting that the CCRA had proper information before it as to the existence of an "information exchange agreement" between the CCRA and the Peel Regional Police Force. While the internal report made by the relevant appeals officer states that such an agreement existed, when their counsel was asked for a copy of it he advised that there was **no "written agreement" but only an "informal relationship". An "informal relationship" does not meet the requirement of "an information exchange agreement" in the Information Circular, nor I suggest does it meet basic requirements of transparency to allow a taxpayer to know in advance whether some agency investigating his affairs has an agreement with CCRA. Among other things, we have no idea when this "arrangement" came into effect nor whether the information here was within the scope of that agreement. It is surprising that when CCRA was informed on October 17 by the**

Digitized by Google

"No-name" disclosure of the fact of a search by an unnamed police force and of the conversation between a police officer and the taxpayer suggesting that the police might report information to CCRA, the CCRA in its letter of October 21 to counsel made no mention of the possible difficulty if the unnamed police force turned out to have an agreement with CCRA. Instead they advised that "based on the circumstances described we consider that the disclosure would be valid as presented", subject of course to "any new details" which might come to light and which could change this determination. By not warning the applicants of this problem whose parameters were knowable by CCRA at that time, and by taking the position later that once such an "agreement" had been found the disclosure would be considered involuntary without need for proof of the taxpayer's knowledge of the existence of that agreement, the CCRA left the applicants with a false sense of security.

[13] I will therefore set aside the decision of August 19, 2004 (confirming the decision of February 18, 2004) on the basis that it is unreasonable, and I will refer the matter back to the respondent with the direction that the disclosures of the applicants be treated as voluntary and assessed in the Voluntary Disclosures Program on that basis.

(s) "Barry L. Strayer"
Deputy Judge

334156 ALBERTA LTD. v. MNR, 2006 FC 1133, "Showed Up on Radar"

T-2182-05
Citation: 2006 FC 1133
Ottawa, Ontario, September 26, 2006
PRESENT: The Honourable Madam Justice Dawson

BETWEEN:
334156 ALBERTA LTD.
Applicant
and
MINISTER OF NATIONAL REVENUE
Respondent
REASONS FOR JUDGMENT AND JUDGMENT

[1] Subsection 220(3.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (Act) is one of the "fairness provisions" of the Act that vests discretion in the respondent Minister to waive or cancel some or all of a penalty or interest otherwise payable under the Act. Encompassed within that discretion is the Voluntary Disclosure Program (VDP). Information Circular 00-1R (Information Circular) describes the VDP in the following terms:

> The VDP encourages clients to come forward and correct deficiencies to comply with their legal obligations. It is a fairness program that is aimed at providing clients with an opportunity to correct past omissions, thus rendering themselves compliant. By offering this opportunity for clients to self-correct, the program provides a greater level

Digitized by Google

of fairness to all clients and stakeholders.

[2] The Information Circular also explains that a valid voluntary disclosure is defined by four conditions, only one of which is relevant to this proceeding. That condition is that the Canada Revenue Agency (CRA) must determine the disclosure to be voluntary. In the words of the Information Circular:

> The disclosure must be voluntary. The client has to initiate the voluntary disclosure. A disclosure may not qualify as a voluntary disclosure under the above policy if it is found to have been made with the knowledge of an audit, investigation, or other enforcement action that has been initiated by the [CRA], or other authorities or administrations with which the [CRA] has information exchange agreements.
> [underlining added]

[3] In the present case, the applicant failed to file on a timely basis tax returns required under the Act for the taxation years from 1998 to, and including, 2003. On February 2, 2004, the applicant filed tax returns for the outstanding years and penalties for late filing applied. The applicant's accountant submitted that the returns for the 2000, 2001, and 2002 taxation years were voluntarily disclosed and the applicant sought relief from penalties under the VDP.

[4] This request was denied on the ground that the disclosure was not voluntary because "information available to the Agency indicates that enforcement actions were taken on the account for these years prior to the disclosure". The applicant's request that the Minister reconsider his decision was treated as a second level request. A Voluntary Disclosure Officer (officer) prepared a report that recommended that the CRA not accept that the disclosure had been voluntary because enforcement actions by the Non-Filer Unit of the CRA were ongoing right up to the date of disclosure. The Chief of Appeals at the Calgary Tax Services office reviewed the file and the officer's recommendation and decided to deny the second level request. He wrote:

> **The circumstances of your case have been carefully considered and I regret to inform you that your request cannot be granted. Under the VDP Policy, a disclosure must be considered voluntary in order to be considered as a valid voluntary disclosure. A disclosure is considered voluntary if a client has wholly initiated the disclosure in order to ensure his or her tax records are complete. Information available to the Agency indicates that enforcement was taken on the account prior to the disclosure.**

[5] This is an application for judicial review of that negative decision.

STANDARD OF REVIEW

[6] The parties agree that the standard of review to be applied to that discretionary decision is reasonableness *simpliciter*. In my view that is correct, as reflected in the pragmatic and functional analysis of the Federal Court of Appeal in *Lanno v. Canada (Customs and Revenue Agency)*, 2005 FCA 153.

[7] Review on this standard requires the Court to ask after a "somewhat probing examination" whether the reasons given for the decision, when taken as a whole, support the decision. The reviewing court is not to ask what the correct decision would have been. Rather, "[a]pplying the standard of

Digitized by Google

reasonableness gives effect to the legislative intention that a specialized body will have the primary responsibility of deciding the issue according to its own process and for its own reasons. The standard of reasonableness does not imply that a decision-maker is merely afforded a margin of error around what the court believes is the correct result". See: *Law Society of New Brunswick v. Ryan*, [2003] 1 S.C.R. 247 at paragraphs 47 and 50.

APPLICATION OF THE STANDARD OF REVIEW TO THE DECISION

[8] The applicant admits that at the time of the voluntary disclosure there was audit, investigative or other enforcement action initiated by the CRA in respect of the 1998 and 1999 taxation years. It is argued, however, that knowledge of enforcement activity must necessarily be considered in respect of specific taxation years. It is said that there is no evidence of any inquiry concerning the 2000-2002 tax returns so the ongoing inquiries concerning 1998 and 1999 should not prevent the returns for the 2000, 2001 and 2002 taxation years from being considered to be voluntary for the purposes of the VDP policy.

[9] In my view, it is not correct for the applicant to argue that there was no evidence before the decision-maker of any inquiries being made by the CRA concerning the taxation years from 2000 through 2002. The report prepared by the officer as a result of the second level request referenced entries in the SUDS diary. The SUDS diary is the computer diary system used by the Non-Filer Unit of the CRA. Employees working in that unit are required to record in the SUDS diary system their conversations with taxpayers and their representatives. Pertinent entries contained in the SUDS diary system related to the applicant's account and relied upon by the officer were:

> 1. An entry dated February 11, 2003 which stated:
> Spoke to director Arthur Wenngatz @ [...] regarding o/s T2's for yrs 98-2001. States he thought they had been done, but asked me to call his accountant Diane Olsen @ [...] re o/s returns & to call him back if I needed to. LM for Diane Olsen @ [...] @ 3:50 p.m.
> 2. An entry dated April 14, 2003 which stated:
> Spoke to accountant Diane Olsen. States she has most of the information for the 98 to 2001 years & expects to have them done by the end of April 03. Advised her where they have to come to & to call me if there is a problem with getting them in by then.

[10] This is evidence of inquiry with respect to the 2000 and 2001 tax years.

[11] On this application for judicial review the applicant relies upon the affidavits of Mr. Arthur Wenngatz and Ms. Diane Olsen where, respectively, they swear that "I have never communicated with representatives of the Respondent about the Applicant's tax matters. Furthermore, I am not even authorized to discuss the Applicant's tax matters with the Respondent" and "[w]hile on February 17, 2003 a representative of the Respondent contacted me about the outstanding 1998 and 1999 tax returns of the Applicant, at no time during this communication did we discuss the Applicant's outstanding 2000 and 2001 tax returns". These affidavits were not before the decision-maker and therefore cannot be relied upon on this application for judicial review. Parenthetically, I do note that Mr. Wenngatz' position that he did not have any conversation with a CRA employee with regard to the late filed returns and Ms. Olsen's position that her records only reflected CRA enforcement activity with respect to the 1998 and 1999 taxation years were before the officer. As discussed

Digitized by Google

below, the officer dealt with those assertions.

[12] The decision-maker swears that:

> I specifically considered the Applicant's submission that Mr. Wenngatz maintained that he did not have a conversation with a CRA employee with regard to the Applicant and that Applicant's accountant stated that her records indicated that CRA had only initiated enforcement on the 1998 and 1999 tax returns, but not on any subsequent tax years. However, based on my review, I concluded that various employees from the CRA Non-Filer Unit had issued a TX14 to the Applicant on May 18, 1999 for the Applicant's 1998 taxation year and a TX14 on January 27, 2000 for the Applicant's 1999 taxation year. The TX14 is a computer-generated letter from the CRA which requests that a taxpayer file its tax returns, and I considered that the mailing of the TX14s were enforcement actions by the CRA. I also noted that, after the TX14s were sent, the Non-Filer Unit had contacted, by telephone, both Arthur Wenngatz and the Applicant's accountant as far back as 2000 requesting the Applicant's late returns. The Non-Filer Unit continued to make numerous and ongoing verbal requests for the Applicant's unfiled returns, as they came due, from May of 2000 until the time of disclosure.

[13] The officer referred to relevant SUDS diary entries to conclude that they provided "evidence of continued contact by the non-filer section right up to the date of the disclosure". This was a reasonable conclusion to be drawn from the entries. The officer's decision that the disclosure was not voluntary because of the ongoing activities of the Non-Filer Unit was tenable for the reasons given and it withstands a somewhat probing analysis.

[14] With respect to the February 11, 2003 and April 14, 2003 SUDS diary entries that record communications between the CRA and Arthur Wenngatz and Diane Olsen, the applicant argues that even if such communications did occur, neither Arthur Wenngatz and Diane Olsen was a director, officer or authorized representative of the applicant. <u>As such, it is submitted, their knowledge cannot be imputed to the applicant because such communication was unauthorized and contrary to the Act.</u>

[15] In my respectful view, this argument cannot succeed for the following important reason.

[16] This argument was not put before the decision-maker on either the initial or the second level request. The jurisprudence of the Court is well-established that on judicial review a decision cannot be impugned on the basis of an issue not raised before the decision-maker, unless the new issue is a jurisdictional issue (which, in the present case, it is not). See, for example, *Toussaint v. Canada (Labor Relations Board)*, [1993] F.C.J. No. 616 (C.A.) at paragraph 5; *Chen v. Canada (Minister of Citizenship and Immigration)*, [2000] F.C.J. No. 1954 (T.D.) at paragraphs 9 through 12; *Nametco Holdings Ltd. v. Canada (Minister of National Revenue-M.N.R.)*, 2002 FCA 149 at paragraph 2; and *Armstrong v. Canada (Attorney General)*, 2006 F.C. 505 (F.C.) at paragraph 26.

<u>CONCLUSION</u>

Digitized by Google

[17] To conclude, the impugned decision that the applicant's disclosure was not voluntary because enforcement was taken on the account prior to the disclosure was supported by evidence before the decision-maker and the reasons given for the decision withstand a somewhat probing examination.

[18] The applicant cannot raise for the first time on judicial review the new issue of an alleged absence of authority for CRA representatives to speak to Arthur Wenngatz or Diane Olsen. The Court cannot, in the circumstances now before it, decide an issue not raised before the decision-maker.

COSTS

[19] I see no reason why costs should not follow the event.

[20] The Minister seeks costs fixed in the amount of $2000.00. In my view, those costs are reasonable and in oral argument the applicant did not make any submission that the amount was unreasonable. The applicant shall, therefore, forthwith pay to the Minister costs fixed in the amount of $2000.00.

JUDGMENT

THIS COURT ORDERS AND ADJUDGES THAT:

1. The application for judicial review is dismissed.
2. The applicant shall forthwith pay to the respondent costs, fixed in the amount of $2000.00, inclusive of disbursements.

"Eleanor R. Dawson
Judge

334156 ALBERTA LTD. v. Minister Of National Revenue, 2008 FCA 228, Proverbial Telephone Call to Taxpayer "CRA inquiring?" Exempts VDP

REASONS FOR JUDGMENT OF THE COURT
(Delivered from the Bench at Calgary, Alberta, on June 25, 2008)
EVANS J.A.

[1] This is an appeal by 334156 Alberta Ltd. from a decision of the Federal Court (2006 FC 1133), in which Justice Dawson dismissed the appellant's application for judicial review of a decision by the Chief of Appeals at the Calgary Tax Services denying the appellant's application to be relieved of penalties payable for the late filing of its tax returns for the taxation years 1998-2002.

[2] Upholding a decision made at the first level review, the Chief of Appeals concluded that the appellant was not eligible for relief from penalties under the Voluntary Disclosure Program ("VDP"). The appellant's disclosure was not voluntary for the purpose of the VDP because it had "been made with the knowledge of an audit, investigation, or other enforcement action" initiated by the Canada Revenue Agency ("CFRA"). The Chief of Appeals reached this conclusion by relying on a contemporaneous computer diary system entry by a CRA official of telephone conversations. The first was on February 11, 2003, with Mr Arthur Wenngatz, a 50% shareholder in the appellant. The second was on April 14, 2003, with Diane Olsen, the appellant's accountant. The Non-Filer Unit of the CRA used the computer diary system, "SUDS", in which these entries were made

[3] The entry of the first call stated that the officer spoke to "director Arthur Wenngatz … regarding o/s T2s for yrs. 98-2001", who referred him, "re o/s returns", to "his accountant, Diane Olsen". The entry of the call to Ms Olsen stated that she had told him that she had "most of the information for the 98 to 2001 years" and expected to file the returns at the end of April.

Digitized by Google

[4] The appellant challenged the Chief of Appeals' decision on the basis of statements by Mr Wenngatz and Ms Olsen which were before the Chief of Appeals when he made his decision. Mr Wenngatz denied speaking to a CRA officer about the late filed returns, while Ms Olsen stated that her records only indicated enforcement activity with respect to the years 1998 and 1999. Accordingly, the appellant argued, there was no evidence on which the Chief of Appeals could have based his negative decision. It was conceded that there was knowledge of enforcement activity respecting the years 1998 and 1999; only 2000 and 2001 were in dispute.

[5] After conducting a pragmatic and functional analysis, Justice Dawson held that unreasonableness *simpliciter* was the standard of review applicable to the Chief of Appeals' discretionary decision to deny the appellant "fairness relief" under the VDP, promulgated pursuant to subsection 220(3.1) of the *Income Tax Act*. Applying this standard, she concluded that the Chief of Appeals had drawn a reasonable inference from the computer entries about ongoing enforcement for the years 2000 and 2001 prior to the disclosure in February 2004, when the appellant filed the late returns.

[6] The appellant also argued that, even if the conversations with Mr Wenngatz and Ms Olsen occurred as the Chief Officer found, their knowledge of enforcement activity could not be attributed to the appellant because only Irene Wenngatz, a 50% shareholder and sole director and officer of the appellant, was authorized to speak to the CRA about its tax affairs. Justice Dawson refused to consider this argument because it was being advanced by the appellant for the first time on judicial review, and had not been put to the Chief of Appeals.

[7] Substantially for the reasons given by Justice Dawson, we see no reviewable error in the Chief of Appeals' decision. In view of the considerable deference given to administrative fact-finding, it cannot be said to have been unreasonable for the Chief of Appeals to have preferred the evidence provided by the computer entries to the subsequent statements of Mr Wenngatz and Ms Olsen.

[8] It was not necessary on the simple facts of this informal proceeding for the Chief of Appeals to have stated expressly that he had considered the statements of Mr Wenngatz and Ms Olsen and to have explained why he preferred the evidence provided by the SUDS' entries.

[9] We would only add this. It is now no longer appropriate for a court to review an administrative decision on a standard of unreasonableness *simpliciter*. However, to the extent that there is a difference between unreasonableness *simpliciter* and the standard of reasonableness articulated in *Dunsmuir v, New Brunswick*, 2008 SCC 9, it is not material on the facts of this case.

[10] For these reasons, the appeal will be dismissed with costs.

"John M. Evans"
J.A.

Graham Worsfold, Stoneridge Managmeent Services Inc., Lyn Worsfold, Jonathan Coles As Trustees For Gr And Ls Worsfold Life Interest Settlement Trust v. MNR, 2012 FC 644, Corporate Audit Pops up Non- Filed Principals resulting in No VDP

REASONS FOR JUDGMENT AND JUDGMENT

[1] This is a consolidated application under subsection 18.1(1) of the *Federal Courts Act*,

Digitized by Google

RSC 1985, c F-7 for judicial review of the second level review decisions by an assistant director of enforcement of the Minister of National Revenue (the officer), made between October 22, 2010 and November 17, 2010, refusing to waive the penalties and interest owed by the applicants as a result of the late filing of their tax returns. **The decisions not to exercise the discretion under subsection 220(3.1) of the *Income Tax Act*, RSC 1985, c 1 (5th Supp) to reduce the penalties and interest were based on the officer's finding that the applicants' disclosures were not voluntary as they were prompted by enforcement action against a related company.**

[2] The applicants request that the decisions be set aside and sent back for reconsideration with directions that this Court deems appropriate.

Introduction to Voluntary Disclosure Program

Taxpayer Relief Provision

[3] Taxpayers that file late tax returns generally incur penalties and interest on the payments. However, subsection 220(3.1) of the *Income Tax Act* grants the Minister the discretion to cancel or waive all or any portion of any penalty or interest otherwise payable under the Act. This taxpayer relief provision was introduced in 1991 as part of what was called a fairness package (see *Bozzer v Canada (Minister of National Revenue)*, 2011 FCA 186, [2011] FCJ No 842 at paragraph 22). The purpose of this provision was articulated by Mr. Justice Paul Rouleau in *Kaiser v Canada (Minister of National Revenue)*, 93 FTR 66, [1995] FCJ No 349 (at paragraph 8):

The purpose of this legislative provision is to allow Revenue Canada, Taxation, to administer the tax system more fairly, by allowing for the application of common sense in dealing with taxpayers who, because of personal misfortune or circumstances beyond their control, are unable to meet deadlines or comply with rules under the tax system [...]

[4] Granting of relief under this provision is discretionary. It is not available as of right (see *Lanno v Canada (Customs and Revenue Agency)*, 2005 FCA 153, [2005] FCJ No 714 at paragraph 6).

Voluntary Disclosure Program

[5] The exercise of the discretion under subsection 220(3.1) of the *Income Tax Act* is integral to the Canada Revenue Agency (CRA)'s voluntary disclosure program (VDP). The VDP allows taxpayers to make disclosures to correct inaccurate or incomplete information, or to disclose information not previously reported. This program is intended to promote voluntary compliance. Therefore, when a valid disclosure has been made, the Minister may exercise its discretion under subsection 220(3.1) to cancel or waive associated penalties and interest.

Applicable CRA Policies

[6] The CRA has published policy documents to assist the Minister and its delegates with the exercise of its discretion under subsection 220(3.1) of the *Income Tax Act*. At the time of the applicants' disclosures in 2005, the following documents pertinent to this exercise of discretion and the VDP were in effect:

CRA Information Circular IC00-1R, effective from September 30, 2002 to October 21, 2007 (the IC00-1R); and

VDP Processing Guidelines (the Guidelines).

[7] The Guidelines are an internal CRA document intended to assist VDP officers in exercising their functions.

Conditions for Valid VDP Disclosures

[8] IC00-1R outlines four conditions for a disclosure to be deemed valid (at paragraph 6) –it must:

Be voluntary – meaning it must be initiated by the taxpayer and must not "have been made

Digitized by Google

with the knowledge of an audit, investigation, or other enforcement action that has been initiated by the [CRA], or other authorities or administrations with which the [CRA] has information exchange agreements";
Be complete – meaning it must include "full and accurate reporting of all previously inaccurate, incomplete, or unreported information";
Involve a penalty –meaning if no penalties apply to the information being disclosed, the taxpayer does not need to seek penalty relief under the VDP; and
Meet timing conditions –meaning it must:
include information that is at least one year past due; or
if the information is not one year past due, the disclosure must not be initiated simply to avoid late filing or installment penalties.

Determining Voluntariness

[9] Guidance for a VDP officer's determination of whether a disclosure is voluntary is provided under section
8.3 of the Guidelines. Subsection 8.3.1 states in part:
A disclosure is considered voluntary if a [taxpayer] has wholly initiated the disclosure in order to ensure his or her tax records are completed. A disclosure must meet this definition of voluntary in order to be considered as a valid voluntary disclosure. The following suggestions for research are guidelines only. […]
[10] The relevant date to the question of voluntary disclosure is the "effective date of disclosure". This is the "date the taxpayer identifies himself or the date the taxpayer or his representative signs the client agreement form, whichever of the two is earliest" (see *Brown v Canada (Customs and Revenue Agency)*, 2005 FC 1639, [2005] FCJ No 2087 at paragraph 16; affirmed in 2007 FCA 26, [2007] FCJ No 141).

Enforcement Action Questions

[11] When a VDP officer discovers that enforcement actions have commenced, section 8.3.5 of the Guidelines recommends that the officer answer the following set of questions (the enforcement action questions):
Was any direct contact made with the [taxpayer] or is the [taxpayer] likely to have been aware of the enforcement action?
Is it likely that the CRA would have uncovered the information disclosed based on the enforcement action? [12] In assessing these questions, the Guidelines explicitly state that taxpayers should be given the benefit of the doubt (section 8.3.5).

Background

[13] Graham Worsfold is the principal applicant and a computer science engineer. In 2001, he moved to Canada from the United Kingdom (UK) under a temporary work permit. After renewing this permit on at least one occasion, the principal applicant and his family were granted permanent residency status in January 2005.
[14] The additional applicants in this case are: Lyn Worsfold – the principal applicant's wife; Stoneridge Management Services Inc. (Stoneridge Management)– a company incorporated on December 16, 2003 in the British Virgin Islands that provides management consulting services on international computer development. The principal applicant is the sole director and shareholder, and has been employed by the company since 2004; and The GR and LS Worsfold Life Interest Settlement Trust (Worsfold Trust) – a personal family trust located in the UK and established in 1997 by the principal applicant. The trustees are the principal applicant, his wife and Jonathan Coles (a UK based lawyer).

Digitized by Google

[15] As of October 3, 2005, the applicants had not filed tax returns in Canada.
[16] This application also concerns Stoneridge Inc. (Stoneridge). Stoneridge is a real estate development company that was incorporated on August 1, 2002. The principal applicant does not receive employment income from Stoneridge. However, as of October 3, 2005, the principal applicant was a director, held all of the preferred shares of Stoneridge and held one third of the common shares of GLD Holdings Inc. which owns all the common shares of Stoneridge. Larry Burton and David Turk held equal parts of the remaining common shares of GLD Holdings Inc.

Timeline of Events

[17] On September 6, 2005, the principal applicant completed a tax amnesty form on the DioGuardi and Company LLP (DioGuardi) website. This entailed the provision of personal and financial information on the principal applicant's worldwide income and immigration status. By completing this form, a request was also made for an assessment and legal opinion on his need and eligibility for a voluntary disclosure (tax amnesty).
[18] On September 21, 2005, DioGuardi sent the principal applicant an email stating they believed he needed to file tax returns and was eligible for a voluntary disclosure. The principal applicant was asked to contact their office.
[19] On September 23, 2005, the principal applicant called DioGuardi's office. During this call, it became evident that an in-depth meeting was required. As the principal applicant was out of the country during the week of September 25 to 29, the meeting was scheduled for Wednesday, October 5, 2005.
[20] At 7:30 a.m. on Monday, October 3, 2005, CRA auditor Joanne Adey (the auditor) from the East Central Ontario (Peterborough) tax service office called Larry Burton, Stoneridge's secretary and listed contact, to inform him that the CRA was planning to audit Stoneridge's 2003 and 2004 tax returns. The purpose of the audit was to review property transactions, conduct a general review and review associated T2 corporation tax returns. The Stoneridge audit had been assigned to the auditor in the preceding week. Prior to speaking with Larry Burton, the auditor had left two voice messages to Larry Burton's attention with her name and contact information. She had also spoken to his wife, with whom she also left her name and contact information.
[21] During the call on October 3, 2005, Larry Burton informed the auditor that the other two shareholders, the principal applicant and David Turk, ran Stoneridge. Larry Burton and the principal applicant work in the same building. Later the same morning, at 10:07 a.m., the principal applicant made a short call to DioGuardi. The principal applicant states that this call was to confirm the October 5th meeting. Conversely, the respondent suggests that this call was to schedule a meeting with DioGuardi in response to being informed by Larry Burton of the pending Stoneridge audit.
[22] On October 5, 2005, the principal applicant met with Paul DioGuardi at DioGuardi'sOttawa office. Paul DioGuardi indicated that at this meeting, they discussed the tax implications of the principal applicant's immigration status and his sources of income. From this discussion, Paul DioGuardi determined that a voluntary disclosure was necessary for the 2001 tax year onwards. The Stoneridge audit was allegedly not discussed at this meeting and the principal applicant maintains that at that time he still had no knowledge of the planned audit.
[23] In the same afternoon, at 3:25 p.m., the auditor faxed the initial audit letter to Brad Huggins, the corporate accountant for Stoneridge, requesting that specific books and records be ready for her to review at the beginning of the audit, scheduled for October 27, 2005. The end of this letter stated:
Please be advised that as the audit progresses, we may request additional records

Digitized by Google

related to the associated companies and all respective shareholders. [emphasis added]

[24] Later the same day, at 4:25 p.m., Paul DioGuardi sent a fax to the CRA initiating a no-name voluntary disclosure for the 2001 to 2004 taxation years. This disclosure stated that it was on behalf of a male taxpayer, born in 1956 and resident of Canada since 2001. The disclosure was for unreported income and capital gains for the taxation years 2001 to 2004, and possibly GST.

[25] On November 17, 2005, Brad Huggins told the auditor that the principal applicant"was being investigated by Ottawa on international issues". This investigation pertained to a letter from CRA London requesting information on a clearance certificate request for DigiPos shares disposed of by the principal applicant. As no information was submitted, this request was denied.

[26] On November 30, 2005, DioGuardi informed the CRA that the principal applicant was the individual behind the no-name disclosure made on October 5, 2005. DioGuardi also provided CRA with a memorandum from its accounting firm detailing additional research and returns to be filed for the principal applicant's spouse, overseas trusts and various companies potentially deemed resident of Canada based on the principal applicant's residency status.

[27] On August 31, 2006, after several extensions of time, the principal applicant's tax returns and foreign information forms, along with tax returns for the other applicants, were filed with the CRA.

[28] On September 19, 2006, the applicants' files were referred to the auditor for review to determine if the information was accurate and met the complete criterion under the VDP.

[29] In a memorandum dated April 26, 2007, the auditor recommended to Mark Loftus, VDP officer in Ottawa, that adjustments be made to the principal applicant's income for the 2002 and 2003 taxation years. The auditor also found that the principal applicant had appropriated $315,451 from Stoneridge in 2004. The documents that the auditor used to support these adjustments were provided to her during her audit of Stoneridge.

First Level Review Decisions

[30] In letters dated September 25, 2007, the applicants were informed that all their VDP applications had been denied (the first level review decisions). The following issues were raised with their disclosures: Principal applicant:

Not voluntary – CRA had initiated enforcement actions against a related taxpayer prior to the date of voluntary disclosure;

Not complete – material amounts of taxable income had not been properly included in the T1 returns; and Timing– included information that was not one year past due.

Principal applicant's wife:

Not voluntary – CRA had initiated enforcement actions against a related taxpayer prior to the date of voluntary disclosure; and

No penalty – included a year that did not involve a penalty. Stoneridge Management:

Not voluntary – CRA had initiated enforcement actions against a related taxpayer prior to the date of voluntary disclosure;

No penalty – did not involve a penalty for some years; and Timing– included information that was not one year past due. Worsfold Trust:

Not voluntary – CRA had initiated enforcement actions against a related taxpayer prior to the date of voluntary disclosure; and

No penalty – did not involve a penalty for some of the years.

[31] Between April 25 and 28, 2008, all the applicants filed separate requests for second level reviews. The principal applicant's request included a receipt dated September 6,

Digitized by Google

2005 from DioGuardi acknowledging a payment of $45 to cover an assessment and legal opinion fee.

Additional Submissions

[32] In letters dated October 5, 2009, July 30, 2010 and September 9, 2010, applicants'counsel made additional submissions in support of their voluntary disclosures.

[33] The first letter (October 5, 2009) provided clarification on alleged inaccuracies, namely that:

The disclosure was not made as a reaction to the audit;

The principal applicant fully intended to make the disclosure;

The disclosure was materially complete; and

The audit did not sufficiently constitute an enforcement action on which to deem the disclosure involuntary. [34] In the letter dated July 30, 2010, applicants' counsel reviewed provisions in the Guidelines and applied them to the facts of this case. The voluntary aspect of disclosure, the completeness of the disclosure and the exercise of discretion were discussed. The following points were also included in this submission:

Email dated September 21, 2005 and apparently from Philippe DioGuardi to the principal applicant stating that "our opinion of your current tax situation" is that "you are eligible for a tax amnesty";

Letter dated September 29, 2008 to the principal applicant from Dean McIntosh, investigator of the Enforcement Division of CRA. The letter proposes an adjustment of $132,606 to the principal applicant's 2004 T1 general income tax and benefit return. The letter also states that penalties will be applied to this adjustment and sets out the basis for which the CRA proposed that charges be laid against the principal applicant under section 239 of the *Income Tax Act*; and

Notice of Reassessment from CRA dated November 12, 2008.

[35] Finally, the following documents were included in the letter dated September 9, 2010: 1. Letter from Brad Huggins, the corporate accountant for Stoneridge, to Dean McIntosh (dated August 5, 2008) with attachments:

CRA question sheet indicated that Brad Huggins likely had a call regarding the audit with Larry Burton on October 3, 2005, and had a conversation with the principal applicant on either October 3 or 4, 2005; and

Brad Huggins'timesheet (for October 4 and 5, 2005) indicating that Brad Huggins had a call with Dave Turk on October 4, 2005: "Two hours, audit prep, call Dave T.";

Bell print-outs of the principal applicant's personal communications showing that he placed calls on September 23, 2005 and October 3, 2005 to DioGuardi Tax Law; and

Information to obtain production order which included:

References to the principal applicant's journal in which an entry labeled "Brad" (from Stoneridge's accounting firm) precedes an entry for DioGuardi (allegedly suggesting that the principal applicant communicated with Stoneridge's accountant before touching base with DioGuardi).

Statement that Paul DioGuardi provided an affidavit claiming that he met with the principal applicant at 1:30 p.m. on October 5, 2005, at which time the principal applicant signed an agreement. No information was provided as to when the date of this meeting was set or whether it was arranged through the internet or a phone conversation.

Officer's Decisions

[36] In response to the applicants' requests for second level reviews, their files were transferred to a separate CRA office in St. Catharines. The officer tasked with these

Digitized by Google

reviews stated that the IC00-1R were applied and the Guidelines were considered. To maintain independence and impartiality, the officer also stated that this review was kept separate from the first level review.

[37] Separate decisions were issued for each applicant. Each decision consisted of a letter and a report with more detailed explanations of the underlying reasons. All the decisions included: a summary of the sequence of events leading up to the principal applicant's disclosure and the audit of Stoneridge; a description of the share structures for Stoneridge and its associated companies (GLD Holdings Inc., Burton Custom Homes Inc. and Lighthouse Developments Inc.) with an acknowledgment that all of these companies were mentioned in the initial audit letter; and an observation that the principal applicant owned shares in Stoneridge and one or more of the associated companies.

[38] The following details were included in the individual decisions. Principal Applicant (Graham Worsfold)

[39] In a letter dated October 22, 2010, the officer denied the principal applicant's second level review request on his personal T1 tax returns. The officer observed that the effective date of disclosure was October 5, 2005, at which time CRA had already commenced an enforcement action against Stoneridge, a related party. Based on the timeline of events, the officer deemed it reasonable to expect that on being made aware of CRA's intention to audit Stoneridge, Larry Burton and Brad Huggins would have been in immediate contact with all of the corporation's directors and/or shareholders. Therefore, the officer concluded that the principal applicant's disclosure was made with knowledge of an enforcement action against Stoneridge.

[40] In the report dated November 9, 2010, the officer noted that the principal applicant's communications with DioGuardi in September 2005 had occurred before both the audit notification and the subsequent disclosure. This, coupled with the fact that the principal applicant had not filed any tax returns or reported income to the CRA since coming to Canada, rendered it reasonable that the CRA would have uncovered the income disclosed by the principal applicant. As the disclosure was deemed non-voluntary, the officer did not consider the remaining three conditions outlined in the IC00-1R.

[41] In a letter dated November 10, 2010, the officer also denied the principal applicant's second level review request on his foreign information returns. Similar reasons were provided as those set out above for his personal T1 tax returns.

Lyn Worsfold

[42] In the decision letter dated November 17, 2010, the officer observed that Lyn Worsfold and the principal applicant are the settlors and trustees of the Worsfold Trust. In addition, the officer noted that the second level review had determined that title to a property being reviewed in the Stoneridge audit had been registered in Lyn Worsfold's name. Therefore, although the audit had not been commenced against Lyn Worsfold, the officer concluded that it was reasonable to believe that the information disclosed by Lyn Worsfold would have been uncovered during the course of the audit. On this basis, the officer found that the disclosure by applicant Lyn Worsfold was not voluntary and her second level review request was denied.

[43] In the report dated November 12, 2010, the officer again noted that Lyn Worsfold and her husband (the principal applicant) were settlors, trustees and primary beneficiaries of the Worsfold Trust. The officer stated that the timeline of events made it reasonable to expect that the principal applicant would have informed his wife that the audit was underway. The officer also acknowledged that the effective date of the initial disclosure was October 5, 2005, although the request to include Lyn Worsfold's 2001 T1 personal tax return and T1135 foreign income verification statement for 2001 to 2005 was not made until August 31, 2006. Based on the review of the documentation on file, the officer

Digitized by Google

believed that there was sufficient information to conclude that CRA would have uncovered the information disclosed by the principal applicant's spouse by way of the Stoneridge audit.

Stoneridge Management

[44] In a letter dated November 10, 2010, the officer concluded that Stoneridge Management's disclosure was not voluntary because it was prompted by the principal applicant's disclosure. The officer found that through the Stoneridge audit, it was reasonable to believe that CRA would have uncovered the income disclosed by the principal applicant, including the T4 earnings from Stoneridge Management. It was also reasonable to believe that the unfilled T4 supplementaries and summaries, T2 returns and T1135 foreign income information returns for Stoneridge Management would have been addressed through the audit process. As Stoneridge Management did not meet the voluntary requirement, the officer did not consider the other three factors and Stoneridge Management's second level review request was denied.

[45] In the report dated November 9, 2010, the officer noted that the principal applicant, the sole shareholder of Stoneridge Management, received a T4 slip from Stoneridge Management in 2004 and in future years. The years 2003 and 2004 were initially slated for review in the Stoneridge audit. The officer acknowledged that the effective date of the initial disclosure by Stoneridge Management was August 2006, when its returns were first filed. However, for the sake of consistency, the VDP officer (for the first level review) accepted October 5, 2005 as the effective date of disclosure. Based on the circumstances, the officer found that through the Stoneridge audit, it was reasonable to believe that the CRA would have uncovered the income being disclosed by the principal applicant, a shareholder of one or more of the associated companies. This discovery would have led to the discovery of Stoneridge Management's unfiled returns.

Worsfold Trust

[46] In a letter dated November 17, 2010, the officer found that Worsfold Trust's disclosure was not voluntary and its second level review request was therefore denied.

[47] In the report dated November 10, 2010, the officer acknowledged that the principal applicant and his wife were settlors, trustees and primary beneficiaries of the Worsfold Trust. The officer noted that although the effective date of disclosure was October 5, 2005, a request to include information on the trust in the disclosure was not received until August 30, 2006. Nevertheless, whether the effective date of disclosure was in fact October 5, 2005 or August 30, 2006, the officer found that the auditor had made direct contact with Stoneridge prior to both of these dates.

[48] The officer highlighted that the principal applicant, his wife and the Worsfold Trust had not filed any tax returns since their arrival in Canada in 2001 The officer noted that the principal applicant's no-name disclosure was filed on the same day as Stoneridge's accountant received the audit letter for Stoneridge, a related party. Therefore, based on the officer's review of the documentation on file, the officer believed that there was sufficient information to conclude that CRA would have uncovered the unfiled returns and unreported income of the Worsfold Trust from the Stoneridge audit. As the Worsfold Trust's application was deemed non-voluntary, the officer did not evaluate the remaining three requirements and the second level review request was denied.

Penalties

[49] Based on the above decisions, late filing penalties were issued to all the applicants as follows: Principal applicant:

T1 tax returns $175,000

Foreign information returns $ 47,500 Lyn Worsfold: $ 12,500

Digitized by Google

Stoneridge Management: $ 8,000 Worsfold Trust: $ 14,000
The total late filing penalty for all the applicants was $257,000.
[50] In response to these decisions, the applicants filed five separate notices of application. By order of this Court dated February 11, 2011, these applications were consolidated into the present application.

Issues
[51] The applicants submit the following points at issue:
Did the respondent err in law in its interpretation of subsection 220(3.1) of the *Income Tax Act*and the IC00-1R and Guidelines regarding the voluntary criteria?
Were the respondent's decisions based on reasonable findings of fact rationally supported by the material before it?
Did the respondent observe the principles of natural justice and procedural fairness in making the decisions?
Did the respondent act in bad faith in the decision making process? [52] I would rephrase the issues as follows:
What is the appropriate standard of review?
Did the officer err in the finding that the applicants' disclosures were prompted by the audit of Stoneridge?
Did the officer base the decisions on any findings of fact that were made in a perverse or capricious manner or without regard to the material on the record?
Did the officer breach principles of natural justice or procedural fairness?

Applicants' Written Submissions
Standard of Review
[53] The applicants submit that the appropriate standard of review for decisions involving the exercise of discretion under subsection 220(3.1) of the *Income Tax Act* is reasonableness. Similarly, a reasonableness standard should be applied to the findings of fact made in these decisions. Questions of procedural fairness are reviewable on a standard of correctness.

Relation of Enforcement Action to the Applicants
[54] The applicants refer to subsection 6(a) of IC00-1R which states in part:
A disclosure may not qualify as a voluntary disclosure under the above policy if it is found to have been made with the knowledge of an audit, investigation, or other enforcement action that has been initiated by the [CRA], or other authorities or administrations with which the [CRA] has information exchange agreements. [emphasis added]
[55] The applicants submit that in *L'Heureux v Canada (Attorney General)*, 2006 FC 1180, [2006] FCJ No 1479, this Court held that the words "audit, investigation, or other enforcement action" in the above provision should not be interpreted as being limited to activities initiated against the individual making the disclosure (at paragraph 24). The applicants submit that in this case there were no enforcement actions initiated against any of the them. Rather, the relevant enforcement action pertained to the audit of Stoneridge, a third party. [56] The applicants highlight the CRA policy on enforcement actions against third parties, as provided in section 8.3.3 of the Guidelines:
In some cases, it may also be appropriate to determine whether or not there has been enforcement activity on related program lines, partners of the client or corporations related to the client. In all cases, discretion should be applied in determining whether these activities should invalidate a disclosure based on how closely those activities relate to the

Digitized by Google

disclosure.
[57] Turning to the enforcement action questions outlined in section 8.3.5 of the Guidelines, the applicants submit that they provide that not all enforcement actions invalidate a disclosure. Further, it is a reviewable error for the second of the two questions not to be expressly considered in the reasons for a VDP decision (see *Poon v Canada*, 2009 FC 432, [2009] FCJ No 1713 at paragraph 26). This second question focuses on finding a link between the enforcement action and the information being disclosed; not a link between any particular parties. The applicants submit that support for this position is provided in both *L'Heureux* above and *Amour International Mines d'Or Ltée v Canada (Attorney General)*, 2010 FC 1070, [2010] FCJ No 1325. [58] The applicants submit that in the decisions, the officer erred by only focusing on whether they were related to Stoneridge and not whether the information they disclosed was related to the scope of the corporate audit. The applicants highlight the officer's acknowledgement that although the principal applicant's returns were not reviewed to determine the source of income, the officer was aware that none of the applicants reported income from Stoneridge. In addition, the officer did not review Stoneridge's T2 returns to consider whether there was a link between the information on the corporate tax returns and the information disclosed by each of the applicants.
[59] The applicants submit that by limiting the review to the relationships between the entities involved and not examining what was disclosed and audited, the officer blatantly disregarded the enforcement action questions. In so doing, the officer erred in law. The decisions should therefore be quashed and referred back for redetermination.
Findings of Fact
[60] The applicants also submit that the officer's findings that the disclosures were not voluntary were based on two unreasonable findings of fact that were not rationally supported by the material:
The principal applicant had knowledge of the audit of Stoneridge, which triggered the disclosure for all the applicants; and
Each applicant was related to Stoneridge and the audit of Stoneridge would have uncovered the information disclosed by each applicant.
[61] On the first finding of fact, the applicants submit that the decisions infer that they all had knowledge of the audit from either Larry Burton or Brad Huggins prior to the October 5, 2005 disclosure; knowledge which prompted their disclosures. However, the applicants submit that suspicion of such prior knowledge cannot alone form the basis of a reasonable decision. The decision must be based on a full objective evaluation of the facts.
[62] The applicants submit that there is independent evidence of another reason that explains the timing of their disclosure. This reason was described by both the principal applicant and Paul DioGuardi in their provision of details on the events preceding the filing of the principal applicant's formal disclosure. Records (receipts, emails and phone logs) were filed to substantiate these claims. This evidence must be considered when weighing whether the disclosures were made as a result of knowledge of a pending audit. In addition, in preferring one version of events over the other, the officer erred in not providing an explanation for the preference chosen.
[63] Theapplicants also submit that the officer's testimony on cross-examination indicates that the officer ignored the correspondence and actions prior to the date that the auditor first attempted to contact Larry Burton. However, this information was relevant as it supported the alternative explanation of the timing of the applicants' disclosure. Had it been considered, any suspicions that the principal applicant only came forward in response to knowledge of the audit would have been eliminated. The applicants submit that this refusal

Digitized by Google

to consider relevant evidence is a breach of procedural fairness and also renders the decisions unreasonable. [64] The applicants highlight the officer's failure to contact any of the parties to evaluate the credibility of their statements. Rather, the officer made the decisions purely on the basis of a paper exercise and little deference is therefore owed. By failing to articulate a rationale for the officer's suspicions and by failing to ask further questions of the parties, the decisions are unsupported and the applicants are deprived of the right to know or respond to the allegations.

[65] Further, the applicants submit that the officer's conclusion that the principal applicant actively ran Stoneridge was based on a misapprehension of the facts and was not supported by the evidence. In support, the applicants note Larry Burton's: signature on the Stoneridge tax returns; repeated involvement in the audits; and position as the listed contact for Stoneridge. In addition, the applicants highlight the principal applicant's: constant absence from Canada due to overseas travel for business; external employment and significant income from his computer development business; lack of income from Stoneridge; statement to the auditor that Larry Burton and David Turk were responsible for day to day operations as he was too busy with his other companies; and statement to the auditor that the only time the principal applicant got involved pertained to a loss of right-of-way that affected two of the properties purchased by Stoneridge.

[66] Similarly, the officer's finding that an authorized contact of a company would immediately inform all directors and shareholders of an audit was purely speculative without any evidentiary basis.

[67] The applicants also highlight the officer's limited analysis in the decisions as to how the applicants (other than the principal applicant) would have been made aware of the Stoneridge audit.

[68] For these reasons, the applicants submit that they were not properly accorded the benefit of doubt required in evaluations of the voluntariness of disclosures under section 8.3.5 of the Guidelines. The officer did not establish a reasonable basis in the evidence that supported a causal link between the notification of a third party of the planned audit and the applicants'disclosures. The applicants submit that this rendered the officer's decisions unreasonable.

[69] On the second finding of fact, the applicants submit that the officer erred in the shareholding analysis to determine whether the applicants were related to Stoneridge as defined under section 251 of the *Income Tax Act*. Nevertheless, none of the applicants could be considered related to Stoneridge as the principal applicant only had a non-controlling one third indirect interest in the company and none of the other applicants owned any shares in it. In addition, submissions were provided throughout the second review that outlined the lack of relationship between the applicants and Stoneridge. It did not appear that the officer considered these submissions.

[70] The applicants further submit that the decision for the principal applicant did not include a statement that the officer believed the audit of Stoneridge would have uncovered the income that the principal applicant disclosed. As such, the officer did not address the second of the two enforcement action questions. As per *Poon*above, the decision should therefore be overturned.

[71] The applicants also criticize the officer's speculative domino effects approach to the Stoneridge audit. According to the officer's affidavit, the Stoneridge audit would have uncovered the fact that the applicants had not filed tax returns. However, the applicants submit that this approach disregards the CRA policies that expressly focus on the relationship between the information being audited and that being disclosed. In addition, the applicants submit that the officer's belief that more information would be uncovered was purely speculative and not supported by the evidence. In fact, the narrow

Digitized by Google

scope of the Stoneridge audit would not have uncovered the actual information disclosed by the applicants in their voluntary disclosures.

[72] Finally, the applicants submit that the statement in the October 5, 2005 letter that "as the audit progresses, we may request additional records related to the associated companies and all respective shareholders" is a standard sentence used in audit notifications. Drawing similarities to the facts in *Amour Mines* above, the applicants submit that the mere possibility that an auditor could have asked for additional records was insufficient to demonstrate that the enforcement action would have triggered an in-depth audit and uncovered the information filed by them. There was also nothing in the screener's comments, auditor's notes or audit plan to suggest that CRA intended to pursue or did pursue any audit of the applicants.

Principles of Natural Justice and Procedural Fairness

[73] The applicants submit that the officer did not observe the principles of natural justice and procedural fairness in making the decisions. The applicants submit that when exercising its discretion, the CRA is both required and expected to operate reasonably and by its own guidelines (see *Montréal (City) v Montreal Port Authority*, 2010 SCC 14, [2010] 1 SCR 427 at paragraph 33).

[74] As discussed above, the applicants submit that there were several procedural errors in the officer's decision, specifically:

Failure to follow the criteria set out in the Guidelines;
Failure to give the applicants the benefit of doubt;
Failure to provide adequate reasons;
Reliance on conjecture and speculation to support the findings of fact;
Considerations of irrelevant evidence of the relationship between parties; and
Ignoring relevant submissions and evidence.

[75] The applicants criticize the officer's failure to obtain the full audit and investigation file for the second level reviews. Rather, the officer relied on incomplete evidence and the opinion and summaries of others, which perpetuated the prejudices and errors identified at the first level reviews.

[76] The applicants further submit that the length of time that it took to process the second reviews, over two and a half years, was unacceptable and invalidated the subsequent decision.

[77] As such, the decisions were not made in accordance with the principles of natural justice and they lacked procedural fairness.

[78] In summary, the applicants submit that the decisions were not made in accordance with the Guidelines and inadequate and unsupportable reasons were provided. These were based on conjecture and cannot withstand probing examination. The decisions should therefore be set aside and the applicants' VDP requests reconsidered.

Respondent's Written Submissions

Standard of Review

[79] The respondent submits that the question of whether the officer failed to observe a principal of natural justice or procedural fairness is reviewable on a correctness standard. Conversely, the question of whether the officer based the decisions on erroneous findings of fact made in a perverse or capricious manner or without regard to the material is reviewable on a reasonableness standard. Even if this Court finds the answer to these questions is in the affirmative, the respondent submits that this Court must consider the outcome of the officer's exercise of discretion in making the final decision.

[80] The respondent also submits that the standard of review of decisions made under the VDP is reasonableness. The respondent highlights the unstructured nature of the

Digitized by Google

Minister's extraordinary statutory discretion and submits that this militates against a Court subjecting the decision process to close scrutiny.

Relation of Enforcement Action to the Applicants

[81] The respondent refers to the conditions for a valid VDP, as provided in IC00-1R. It submits that the application before this Court pertains to the first of these conditions; namely, that the VDP must be voluntary to be valid. The respondent submits that the enforcement action does not need to be against the taxpayer who made the disclosure (see *L'Heureux* above, at paragraph 24). To come to a determination on this issue, all relevant facts must be considered. If the officer finds that the disclosure was prompted by knowledge of an enforcement action, the respondent submits that this is a sufficient ground on which to deny the disclosure as it evidences that the taxpayer did not come forward voluntarily.

[82] With regards to the Guidelines, the respondent submits that it does not articulate strict tests that must be followed in determining whether a VDP application is valid.

[83] Although a direct link between the enforcement action and information disclosed can serve as proof that the disclosure was not voluntary, the respondent submits that an officer is not limited to relying on a direct link. An officer can also examine indirect links or other factors. This includes a finding that the taxpayer would not have come forward were it not for an enforcement action against a related party or the disclosure by a related party that was prompted by an enforcement action.

[84] The respondent submits that *Amour Mines* above, is not applicable to this case. The respondent distinguishes *Amour Mines* above, as pertaining to an enforcement action against an indirect shareholder. Conversely, in this case, the enforcement action is against an operating corporation. The respondent further notes that there was a clear sense that the disclosure was not prompted by an enforcement action by the CRA in *Amour Mines* above.

[85] The respondent also submits that the definition of the word "related" as used in the Guidelines, is not restricted to the definition set out in section 251 of the *Income Tax Act*. It is notable that the Guidelines do not refer to this provision of the *Income Tax Act* and the VDP itself is not limited to the *Income Tax Act* but applies to many legislative schemes. Therefore, rather than being used in a technical sense, the respondent submits that the term "related" refers to a relationship between two or more persons of a somewhat close nature.

Findings of Fact

[86] The respondent submits that the officer's findings of fact were reasonable and justified based on the evidence. In support, the respondent provides submissions on the following:

Voluntariness of principal applicant's disclosure;
Voluntariness of principal applicant's wife's disclosure;
Voluntariness of Stoneridge Management's disclosure;
Voluntariness of Worsfold Trust's disclosure;
Officer's obligation to gather additional information; and
Deference owed to the officer's findings of fact.

[87] On the first point, the respondent submits that the officer's finding that the principal applicant's disclosure was prompted by the enforcement action against Stoneridge was reasonable and justified. The respondent highlights:

Ties to Stoneridge: The principal applicant was a director and major shareholder of Stoneridge.

Property transactions: The principal applicant was involved in property transactions with

Digitized by Google

Stoneridge that were reported in the company's books and records.
Chain of events: The chain of events, particularly the notification of the audit and the subsequent filing of the disclosures that occurred between October 3 and 5, 2005.
Scope of audit: The scope of the Stoneridge audit (including property transactions and T2 returns of associated corporations) rendered it a reasonable finding that the principal applicant would have known that the audit would lead to him.
Jennings property: The involvement of Larry Burton and the principal applicant in the Jennings property scheme rendered it likely that Larry Burton would have informed the principal applicant about the audit.
Lack of evidence: The lack of concrete evidence submitted by the applicants to show that the principal applicant's disclosure was not prompted by the enforcement action – particularly the lack of documentary evidence on the substance or purpose of the communications between the principal applicant and DioGuardi.
[88] The respondent also highlights the applicants' previous requests that the officer not communicate with those involved in the principal applicant's audit and investigation, followed by their subsequent critique of the officer abiding to these requests. Further, although some information was inaccurate in the VDP file, the respondent submits that while the applicants had the opportunity to do so, they did not address these errors or show that they would have made a difference in the officer's decisions.
[89] The respondent distinguishes this case from *Livaditis v Canada (Revenue Agency)*, 2010 FC 950, [2010] FCJ No 1184. Rather than preferring the account of a fellow CRA officer over that of a taxpayer, the officer in this case put more weight on the concrete evidence than on the principal applicant's allegations. It was within the officer's purview to weigh the evidence in this manner.
[90] In addition, the respondent submits that the officer did not limit the review to the relationship between the parties, but considered all the evidence as well as the relationship between the information at issue. Based on this review, the officer reasonably concluded that the audit of Stoneridge, a closely-held company, would have led to the principal applicant.
[91] Finally, the respondent submits that neither the principal applicant's reasons for making the disclosure or the fact that he consulted with DioGuardi automatically renders his disclosure voluntary. Considering the idea of disclosure is not sufficient and a taxpayer that delays in coming forward does so at his own risk. Concrete action must be taken.
[92] The respondent submits that the officer's decision on the disclosure of the principal applicant's wife was also reasonable. An auditor reviewing the principal applicant's case would also have reasonably considered that of his wife. Further, the principal applicant's wife was not only related to Stoneridge through her husband, but also through her previous property transaction with the company.
[93] The respondent submits that the officer's decision on Stoneridge Management's disclosure was also reasonable. This company was closely associated with the principal applicant, who was its sole director and shareholder and who received substantial income therefrom.
[94] The Worsfold Trust is closely related to both the principal applicant and his wife. The couple act as trustees of the trust and it was set up for their benefit and that of their children. Further, as the principal applicant reported income from a trust, this would have led to an inquiry on whether there were other trusts from which he received an income. Finally, the couple would also have been required to submit foreign income verification statements with their tax returns.
[95] The respondent submits that the officer was not obliged to gather more information. In this case, the applicants made submissions and the officer considered them. The

Digitized by Google

officer's decision to disagree with the applicants' submissions was well within the officer's discretionary power.

[96] Finally, the respondent submits that the applicants' submissions are, in essence, objections to the officer's weighing of the evidence. Weighing of the evidence lies at the heart of the officer's exercise of discretion and it is not the reviewing court's role to consider alternative assessments of the evidence. The Court must instead consider whether the officer's interpretation was reasonable.

Principles of Natural Justice and Procedural Fairness

[97] The respondent submits that the officer did not breach any principles of natural justice or procedural fairness.

[98] First, the respondent submits that the officer acted impartially in the second level review of the applicants' disclosures. The officer's consideration of whether the disclosures were voluntary revolved around the facts that took place in 2005 and were not impacted by subsequent events. In addition to preserve independence, the officer avoided discussing the case with the individuals previously involved with it.

[99] Second, the respondent submits that while IC00-1R is the governing instrument on VDP requirements and policy, the Guidelines are merely an internal document that is intended to assist VDP officers in the exercise of their function. The Guidelines do not grant legal rights to applicants. There are no tests outlined in the Guidelines for determining the validity of disclosures, nor are there legitimate expectations that the CRA will strictly follow them or be bound by them. Further, the respondent submits that the Guidelines are not meant to provide an exhaustive list of factors that a VDP officer needs to follow, nor constrain the respondent's exercise of discretion in any way. In fact, an officer's strict application of the Guidelines, without exercising its own judgment in considering the merits of a particular case, would be a fettering of its discretion.

[100] The respondent also submits that the doctrine of legitimate expectation only creates procedural rights, not substantive rights. Therefore, to allege that the Guidelines must be strictly followed would incorrectly elevate them from an internal document to the status of law.

[101] The respondent submits that *Poon* above, is not applicable to this case. It is incompatible with the VDP officer's discretion that a test suggested in internal guidelines be mandatory in reviewing a file.

[102] Finally, the respondent submits that the officer's reasons were adequate to support the decisions. The respondent highlights the officer's reasons addressing the circumstances pertaining to the principal applicant's decision to come forward. In addition, the respondent submits that the officer did address the connection between the enforcement action against Stoneridge and the information disclosed by the applicants.

Analysis and Decision

[103] **Issue 1**

What is the appropriate standard of review?

Where previous jurisprudence has determined the standard of review applicable to a particular issue before the court, the reviewing court may adopt that standard (see *Dunsmuir v New Brunswick*, 2008 SCC 9, [2008] 1 SCR 190 at paragraph 57).

[104] The jurisprudence has clearly established that the appropriate standard of review for discretionary decisions made in relation to the VDP is reasonableness (see *Charky v Canada (Attorney General)*, 2010 FC 1327, [2010] FCJ No 1641 at paragraphs 20 and 21; *L'Heureux* above, at paragraph 15; and *Palonek v*
Canada (Minister of National Revenue), 2006 FC 494, [2006] FCJ No 619 at paragraphs 72 and 73). This standard of review requires the Court to consider whether the decision-

Digitized by Google

making process is transparent and intelligible and whether the decision is rationally justified. Both the ultimate result and the manner in which the result is achieved must fall within a "range of possible, acceptable outcomes" (see *Dunsmuir* above, at paragraph 47; and *Livaditis* above, at paragraph 25).

[105] Findings of fact made by the officer in making the decisions are also afforded a considerable degree of deference (see *Spence v Canada (Revenue Agency)*, 2010 FC 52, [2010] FCJ No 51 at paragraph 18).

[106] Conversely, issues of procedural fairness and natural justice are reviewable on a standard of correctness.Decision-makers are not entitled to any deference by the Court on these issues (see *Canada (Attorney General) v Sketchley*, 2005 FCA 404, [2006] 3 FCR 392 at paragraphs 52 to 54; and *Poon* above,
at paragraph 17).

[107] **Issue 2**

Did the officer err in the finding that the applicants' disclosures were prompted by the audit of Stoneridge?

In this case, the officer's decisions ultimately rest on the finding that the applicants' disclosures were prompted by the audit of Stoneridge; thereby rendering their disclosures non-voluntary.

[108] To determine whether the officer's findings in relation to the voluntariness of the disclosure were reasonable, the underlying facts must be carefully considered. As a starting point, it is not in dispute that the principal applicant first made contact with Paul DioGuardi, a tax amnesty lawyer, on or about September 6, 2006. On September 21, 2009, Philippe DioGuardi, Paul DioGuardi's son, sent the following email to the principal applicant:

Taxamnesty.ca Communication Backup From: support@taxamnesty.ca
Sent: September 21, 2005 6:37:25 PM To: GWORSFOLD61@HOTMAIL.COM
Here is our opinion of your current tax situation:
Based on the information you have provided, you are eligible for a tax amnesty. Given the total of undeclared income and/or gain and subject to considering your residency status, you may be committing criminal tax evasion under section 239 of the Income Tax Act. Prosecution could result in a prison sentence as well as criminal and civil penalties and fines that could be as much as %250 of the amount of the tax owing. A tax amnesty will resolve your situation.
Here are your next steps:
Contact me during the course of this week to represent you in this matter. I can be reached by telephone at 613-237-2222, 416-657-4408 or 1-866-758- 9030. When we speak I will explain to you our services. In pursuing a tax amnesty for you, I will endeavor to negotiate a settlement with the authorities on the following terms:
No charges for tax evasion.
Complete waiver of all penalties.
A limit to the interest owing or a limit on the number of years on which you must pay tax.
At all times your identity will be protected by the confidentiality of lawyer- client privilege. Your name will only be revealed after a settlement has been agreed by you.
It is extremely important that you file for a tax amnesty before the Canada Revenue Agency becomes aware of your tax evasion. I urge you to retain our services to begin your tax amnesty immediately.
I look forward to speaking with you by telephone ASAP. Yours sincerely,
Philippe DioGuardi 613-237-2222
416-657-4408

Digitized by Google

1-866-758-9030
[109] The principal applicant's phone records show that he made a telephone call to the DioGuardi law office on September 21, 2009 at which time a meeting between the DioGuardi law firm and the principal applicant was set up. The meeting was subsequently held and it was determined that a voluntary disclosure should be made. There was no evidence that the Stoneridge audit was discussed at the meeting.
[110] On October 3, 2005, the CRA auditor first spoke with Larry Burton, a director of Stoneridge, to inform him of the audit. Two days later, in the afternoon of October 5, 2005, the auditor faxed the initial audit letter to Brad Huggins, the corporate accountant of Stoneridge. Mr. Huggins was not the principal applicant's accountant and there was no clear evidence of contact between Mr. Huggins and the principal applicant. The principal applicant's disclosure was filed an hour after the auditor faxed the initial audit letter to Mr. Huggins. [111] In the report on the second level request, the officer made frequent use of the word "alleged" to describe certain factual statements made by the principal applicant and his tax advisors. The officer ultimately found that the facts indicated that the applicants' disclosures were not voluntary.
[112] The requirement that a disclosure be voluntary is set out in the first condition for a valid disclosure in IC00-1R, as follows:
Conditions for a valid disclosure
A valid voluntary disclosure is defined by the following four conditions:
(a) The CCRA determines that the disclosure is **voluntary**.
The disclosure must be voluntary. The client has to initiate the voluntary disclosure. A disclosure may not qualify as a voluntary disclosure under the above policy if it is found to have been made with the knowledge of an audit, investigation, or other enforcement action that has been initiated by the CCRA, or other authorities or administrations with which the CCRA has information exchange agreements.
This is the only condition for a valid disclosure that is at issue in this case.
[113] The effective date of the disclosure is the date on which CRA receives the disclosure; in this case that date was October 5, 2005.
[114] It is my view that there is no evidence before me that would lead to the conclusion that any of the applicants knew of the existence of an audit of Stoneridge by CRA. In fact, the evidence points the opposite way. The respondent has accepted that there is no clear evidence that Stoneridge's accountant, Mr. Huggins, spoke with any of the applicants. The letters from DioGuardi to the CRA made no mention of an audit of Stoneridge.
[115] In addition, the facts of the case establish that the principal applicant took the first step in a process that ultimately led to the voluntary disclosures on October 5, 2005. Although the voluntary disclosure is not effective until the date received by CRA, the chain of events shows that the voluntary disclosure process which was initiated by the principal applicant on September 6, 2005 was not triggered by the audit of Stoneridge.
[116] The respondent simply relies on the inference that after the call with the auditor on October 3, 2005, the director Larry Burton would have been in immediate contact with all of the directors and shareholders, including the principal applicant who was also a director. The respondent submits that this alleged contact then caused the principal applicant to file the voluntary disclosure. I do not accept this conclusion as there is insufficient factual basis for this conclusion. It is mere conjecture.
[117] I would also note that the officer did not deal with the facts submitted by Mr. DioGuardi and the principal applicant. The reason for the officer's preference of conjecture over the other facts is not clear from the officer's decisions. Concurrently, it is important to consider the closing words of section 8.3.5 of the Guidelines:

Digitized by Google

If the answer to either of these question is "NO", the disclosure may be considered voluntary. Clients should be given the benefit of the doubt.[emphasis added]

In light of the lack of evidence in this case, it would appear that none of the applicants were granted the "benefit of the doubt".

[118] I conclude that the applicants had no knowledge of the audit when they filed their disclosures.

[119] In further support, I also note section 8.3.5 of the Guidelines which outlines the two enforcement action questions:

8.3.5 Impact of Enforcement Activity on Determination

Not all enforcement action is automatic cause to invalidate a disclosure. If any of the above research suggests that the CCRA or a related administration has taken enforcement action against a disclosing client, partner, or related corporation, the VDP officer will need to consider whether the disclosure can still be considered voluntary. For example:

a source deduction audit may have no relation at all to a GST disclosure that is being made; the CCRA may have established an audit protocol with a large file client and the client may have disclosed a matter unrelated to the audit.

Therefore, when a VDP officer discovers that enforcement actions have begun against a client, the following judgments should be made:

Was any direct contact made with the client or is the client likely to have been aware of the enforcement action?

Is it likely that the CCRA would have uncovered the information being disclosed based on this enforcement action?

If the answer to either of these questions is "NO", the disclosure may be considered voluntary. Clients should be given the benefit of the doubt.

[120] To begin, it is important to note that no audit was being done on any of the applicants. The audit or enforcement action was being done on Stoneridge; an unrelated company. The only connection seems to be that the principal applicant was a director of Stoneridge.

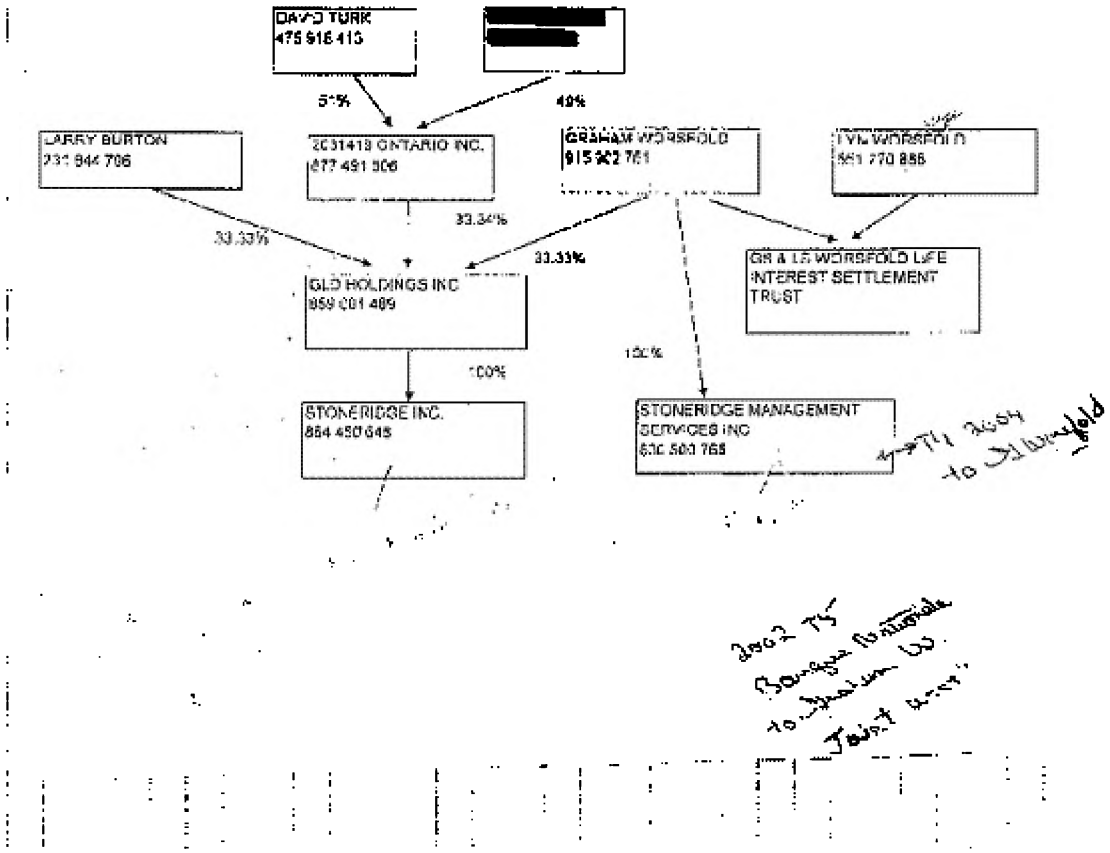
Was any direct contact made with the client or is the client likely to have been aware of the enforcement action?

[121] I have already dealt with the facts as they relate to the principal applicant under this first question. As I concluded that there was insufficient evidence that the principal applicant had knowledge of the audit of Stoneridge when he made his voluntary disclosure on October 5, 2005, this first question must be answered in the negative. The same is also true for the other applicants as there is no evidence that any of them were contacted or were aware of the enforcement action relating to Stoneridge.

Is it likely that the CRA would have uncovered the information being disclosed based on the enforcement action?

[122] It may be helpful at this point to look at a chart prepared by an official at CRA which shows the various entities involved.

Digitized by Google



[123] With respect to the principal applicant, the officer must decide whether it was likely that the audit of Stoneridge would have uncovered the information contained in his voluntary disclosure. I have reviewed the decision of the officer and I am of the view that this question was not addressed by the officer. The most that could be said is that the officer looked at the relationship between some of the parties.

[124] There is no doubt that the officers were aware that this question should have been answered as the following e-mail was sent to George Deszpoth, the first level review officer by Harold Howard C.G.A.:

From: Howard, Harold [Harold.Howard@cra-arc.gc.ca] Sent: Thursday, March 22, 2007 4:11 PM

To: Deszpoth, George

Subject: VDP Case for your info Follow Up Flag: Follow up

Flag Status: Flagged

Attachments: L'Heureux v AGC, 2006 FC 1180.doc

George sorry I missed your call. But I thought it best to answer by email as I wanted to send the court case.

with respect to your 3 points

. . .

Digitized by Google

Third issue – related party enforcement action. Review the attached case – it may shed some light on the situation.
Questions to ask – Is the income on the T1 related to the corp. audit? If so there is a link.
. . .
Harold Howard, CGA Senior Officer, VDP /
Enforcement & Disclosures Directorate / Direction de l'exécution et des divulgations
Compliance Programs Branch
Tel. 613-946-5136 / Fax. 613-948-8792
[125] In the applicants' oral submissions, Mr. Howard is referred to as the CRA's expert on voluntary disclosure matters. As of the time of the audit, the principal applicant had not shown any income from Stoneridge. Consequently, the disclosed T1 income has no connection or link with the audit.
[126] In addition, had the officer assessed the submissions made by Paul DioGuardi with respect to this question, the officer may well have found that the CRA would not, as a result of the audit of Stoneridge, have uncovered the information being disclosed by the principal applicant. There was simply no connection between the T1 income from Stoneridge Management and any audit findings from enforcement action against Stoneridge. The same can be said for the other applicants.
[127] In *Poon* above, Madam Justice Sandra Simpson of this Court stated at paragraphs 21 to 26: 21 The question is whether, having indicated in the Decision that he was applying the Guidelines, the Director was required to address section 8.3.5 thereof. It indicates that "Not all enforcement action is automatic cause to invalidate a disclosure".
As stated above, the Guidelines suggest, in part, that:
[...] when a VDP officer discovers thatenforcement actions have begin against a client, the following judgments should be made:
[Question 1] Was any direct contact made with the client or is the client likely to have been aware of the enforcement action?

[Question 2] It is likely that the CRA would have uncovered the information being disclosed based on this enforcement action?
If the answer to either of these questions is "NO", the disclosure may be considered voluntary. Clients should be given the benefit of the doubt.
The Decision refers to the Guidelines and provides fairly detailed reasons for explaining, in answer to the first question, why the Director concluded that the Applicant was aware of CRA's enforcement action against APS.
What is missing is any mention in the Decision of the Director's reasoning and conclusion about the second question.
The Applicant said, with regard to the second question, that any enforcement action CRA took against APS would not have revealed all the personal sources of income described in the Personal Disclosure. In particular, he referred to investment income, rental income and income from employers other than APS.
The Director's failure to deal with the second question in the Decision means that he has not adequately explained why he exercised his discretion to reject the Applicant's Personal Disclosure.
[128] In my view, the same situation arises in the present case. The second question that the officer must pass judgment on was simply not addressed. A review of the material in the record does not assist in this respect. The officer's decision is therefore unreasonable and must be set aside on that basis.
[129] Also, with respect to the knowledge of the applicants in relation to the enforcement

Digitized by Google

action against Stoneridge, the officer's treatment of the evidence provided by the principal applicant, and his lawyer Paul DioGuardi was unreasonable. Why was it not accepted? No analysis or reason was provided. It was simply referred to as being "alleged".
[130] In my view, the same reasoning applies to all of the other applicants and the decisions with respect to them are therefore also unreasonable.
[131] Because of my finding on this issue, I need not deal with the remaining issues.
[132] The application for judicial review is allowed and the applicants' request for penalty and interest relief under the VDP are to be reconsidered by the Minister.
[133] The applicants shall have their costs of the application.
[134] A copy of these reasons for judgment and judgment are to be placed on files T-2049-10, T-2050-10, T- 2077-10 and T-2078-10.

JUDGMENT
THIS COURT'S JUDGMENT is that:
The application for judicial review is allowed and the applicants' request for penalty and interest relief under the voluntary disclosures program are to be reconsidered by the Minister.
The applicants shall have their costs of the application.

"John A. O'Keefe"
Judge

Edward Palonek v. The Minister of National Revenue, 2007 FCA 281, VDP means Complete Disclosure while CRA is Not Responsible for Advising/Stating Results in Advance

REASONS FOR JUDGMENT LÉTOURNEAU J.A.
[1] This is an appeal from a decision of Mactavish J. of the Federal Court of Canada (judge) rendered on April 18, 2006. She dismissed Mr. Palonek's (the appellant's) application for judicial review of the decision made by the Minister of National Revenue's delegate to deny the appellant access to the Voluntary
Disclosures Program (VDP). The VDP finds its source in subsection 220(3.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) and section 281.1 of the *Excise Tax Act*, R.S.C. 1985, c. E-15.
[2] This appeal cannot succeed. There is no need to relate all the facts in details. The following summary will be sufficient to understand the issues at play before this Court and this Court's brief reasons for dismissing the appellant's allegations. I hasten to add that counsel on appeal had to struggle gallantly with a record created by the appellant in the Federal Court where he elected to be self-represented.

FACTS
[3] The appellant, who lives in the Republic of Panama, did not file Canadian income tax and Goods and Services tax returns for the 1993-2001 taxation years. In June 2002, his counsel contacted Canada Revenue Agency (CRA), which at the time was the Canadian Customs and Revenue Agency, in order to make a voluntary disclosure under the VDP. The VDP is a program which allows the CRA to provide relief from penalties, interests and possible prosecution to individuals who make a disclosure to correct inaccurate or incomplete information or to disclose information

Digitized by Google

not previously reported. Neither the appellant nor his counsel were presented with or asked to sign a "Client Agreement Form" before disclosing any relevant information.

[4] At the request of the appellant's counsel, a CRA's agent asserted a few days later that the appellant was not under CRA's investigation by saying that "everything was fine" and asked the appellant to prepare documentation for submission. The appellant then produced his T-1 income tax and GST returns for the years in question.

[5] During the process, CRA's audit department advised the CRA's agent in charge of the appellant's file that the appellant was potentially involved with two or three companies, as well as with a "T3 Trust". CRA's audit department had located a website which indicated that the appellant had been very successful in a business venture known as "Found Money". Found Money Inc. and Found Money International were noted as associated companies.

[6] After being advised and asked to provide additional information concerning these entities and his source of income, the appellant asked for extensions of time due to his responsibilities outside Canada. He later declined to present further submissions other than the fact that he had disposed of his Found Money Inc. shares five or six years ago. According to the respondent, no capital gain or loss had been declared on any of the appellant's tax returns filed under the VDP.

[7] CRA's agents conducted three level of administrative review regarding the appellant's admissibility to the VDP. The last review confirmed the two earlier decisions which denied the appellant access to the VDP because of an incomplete disclosure by him. The third-level decision was rendered on November 15, 2004. This is the decision that was challenged by way of judicial review before the Federal Court.

THE ISSUES ON APPEAL

The respondent's failure to warn the appellant of the consequences of an incomplete disclosure

[8] First, the appellant complains that the Minister of National Revenue (Minister) failed to inform him of the possible consequences of making a disclosure under the VDP. That failure also consisted in not requesting the appellant to sign a "client agreement form". These failures, according to the appellant, constituted a violation of administrative law obligations of fairness as well as an infringement of his rights under sections 7 and 8 of the *Charter of Rights and Freedoms*.

[9] The short answer to this contention is, as the judge found, that the appellant was represented by knowledgeable counsel in the field of taxation, who, on behalf of his client, initiated the process of voluntary disclosure. In his initial contact with CRA, counsel for the appellant made a specific reference to the Information Circular describing the VDP in a way, as the judge found, that indicated "a familiarity with the VDP process": see reasons for judgment, at paragraphs 101 and 102 and counsel's letter at pages 312 and 313 of Appeal Book, volume 2.

[10] **I agree with the learned judge that "in these circumstances, it was entirely reasonable for the Agency to presume that the appellant would have had the benefit of legal advice regarding the parameters of the program":** see reasons for judgment at paragraph 101. There is no evidence at all on the record that appellant's counsel was incompetent.

[11] The appellant contends that the respondent had a specific duty to inform him individually of the consequences of an incomplete disclosure. This duty, he submitted, exists despite the fact that he was represented by counsel. **Apart from the fact that it**

Digitized by Google

would have been unethical for the respondent or respondent's counsel to contact the appellant directly, the duty that the appellant faced here is not different from the duty that any taxpayer has with respect to income tax returns, i.e. full disclosure of all income from all sources.

[12] Nor are the consequences of a failure to disclose different for the appellant, as he contends, from those that a taxpayer would suffer if he failed to disclose income. Both would be subject to interests, penalties and a possible prosecution.

[13] The appellant submits that his situation is different because he is making voluntary disclosure. I do not agree. A taxpayer is in the same situation as the appellant when, at the end of the fiscal year, he files an income tax return: he voluntarily discloses his income. The only difference here is that the appellant has hidden his income for nine years when he should have declared it annually. Surely, he cannot be put in a better position than another taxpayer would be if he fails to make a complete and truthful disclosure.

The alleged unfair treatment by the judge in the judicial review proceedings

[14] As previously mentioned, the appellant elected to represent himself in the judicial review proceedings. On appeal, he was represented by two experienced counsel. He now complains that the judge should have counselled and helped him throughout the process. The fact is that she did to the extent permissible. The appellant's complaint is not supported by the record as a whole.

[15] The appellant is a sophisticated businessman. He sought to obtain in his favour a summary judgment on his application for judicial review which certainly showed some knowledge of the procedure.

[16] Counsel for the appellant drew our attention to selected excerpts of this Court's decision in *Wagg v. Canada*, 2003 FCA 303, page 206 where Pelletier J.A., properly so, reasserted the need to maintain fairness in the proceedings when a person is self-represented. However, he also sounded the following warning at paragraphs 23, 24 and 25 of his reasons for judgment:

[23] Litigants represent themselves for a variety of reasons. If they come to realize before the commencement of trial that they have underestimated the complexity of the task before them, it is in their interest and the Court's to allow them to obtain representation. But once a trial is underway, I do not think it unfair to hold appellants to their choice to represent themselves, and to be guided by their own judgment.

[24] The decision to represent oneself is not irrevocable, nor is it trivial. Persons who undertake to represent themselves in matters of the complexity of the *Income Tax Act* [R.S.C., 1985 (5th Supp.), c. 1] or the *Excise Tax Act* must assume the responsibility of being ready to proceed when their appeal is called. If they embark upon the hearing of their appeal, they are representing to the Court that they understand the subject matter sufficiently to be able to proceed. …

[25] Putting the matter another way, litigants who choose to represent themselves must accept the consequences of their choice (*Lieb v. Smith et al.* (1994), 120 Nfld. & P.E.I.R. 201 (S.C.T.D.), at paragraph 16):

Thus, while the court will take into account the lack of experience and training of the litigant, that litigant must also realize that, implicit in the decision to act as his or her own counsel is the willingness to accept the consequences that may flow from such lack of experience or training.

[Emphasis added]

This is also true in judicial review proceedings challenging decisions made under or in relation to the *Income Tax Act or the Excise Tax Act*. The rationale in paragraphs 23 to 25

Digitized by Google

of the *Wagg* decision has also been applied in a number of decisions of this Court: see *Canada (Minister of Human Resources Development) v. Hogervorst*, 2007 FCA 41; *Bérubé v. Canada*, 2006 FCA 166; and *Dionne v. Canada*, 2003 FCA 451.

Whether the decision made by the third level of review was fatally flawed

[17] The appellant argues that the decision made by the third level of review was fatally flawed because the person who undertook the review did not have before her the tax returns filed by the appellant on August 12, 2002 for the taxation years 1993 to 2001.

[18] It should be recalled that this third review was a review of the appellant's file pursuant to the first and second level decisions made respectively on October 21, 2003 and August 19, 2004 which concluded that the appellant had not fully disclosed his income in his August 12, 2002 disclosure made in his tax returns. The date at which completeness of disclosure is to be assessed is August 12, 2002.

[19] The evidence on the record shows that, after August 12, 2002 the appellant was informed by CRA agents that they had discovered new sources of income and additional income. He was given ample opportunity to explain his position in this respect. He sought, and was granted over a 7-month period, numerous extensions of time to make submissions or provide explanations. He acknowledged that he had sold his shares in Found Money Inc., but he never provided additional information nor did he make further representations: see Appeal Book, volume 2, pages 337-338.

[20] The appellant also admitted, after having filed his tax returns, that he received income from Found Money International Ltd. as far back at least as year 2000 and possibly before.

[21] The decision makers at the first and second level of review examined the 2002 tax returns filed by the appellant. They found that no capital disposition of the shares were reported in these tax returns. Nor was the income from Found Money International Inc. declared.

[22] **I should add that they found that the accuracy of some of the information disclosed by the appellant in his tax returns was dubious.** According to the separation agreement signed with his wife, the maximum annual amount that he had to pay was $30,000. Yet he claimed payments of $70,769, $126,053,
$116,810, $85,454, $100,536 and $88,484 for the years 1996 to 2001: see Appeal Book, volume 2, page 342.

[23] This now brings me to a consideration of the material upon which the third review decision was made. [24] Mrs. Charlton was the Director of the Hamilton Tax Services Office. She is the person who made the decision at the third review level.

[25] In his argument, counsel for the respondent conceded that the appellant's 2002 tax returns were not before Mrs. Charlton when she conducted the review: see Appeal Book, volume 3, at page 618. However, she consulted the record of events and information prepared by CRA agents with respect to the appellant's voluntary disclosure, especially a substantial and detailed Voluntary Disclosure Report, dated July 28, 2004 prepared for the second level review: see Appeal Book, volume 2, pages 336 to 344. The Report is signed by three experienced officials: an Appeals Officer, the Team Leader, Appeals Division and the Chief of Appeals. No evidence was adduced by the appellant that the information regarding the appellant's 2002 tax returns was not properly summarized in that report considered by Mrs. Charlton. Nor is there any evidence filed with the CRA or the Federal Court on the judicial review proceedings which casts doubts on the accuracy of the information and on the facts set out in the report regarding these tax returns.

[26] In her decision, Mrs. Charlton informed the appellant that she based her decision on the "evaluation of the information provided by you during the Voluntary Disclosure review".

Digitized by Google

At page 178 of the Appeal Book, volume 2, she provided the following as an example of incomplete disclosure:

However, no evidence has been provided by you to establish the type of income i.e. management fees or capital dispositions arising from your involvement to be reported for tax purposes. Nor has any detailed breakdown been provided to confirm that the total of all source(s) of income have been included in your disclosure.

[27] **Furthermore, in her decision and her affidavit, she referred to the appellant's omission to disclose his ownership of 30,000 shares in Rothwell Corporation and to provide appropriate information regarding child support and alimony payments.** At pages 179 and 303 of the Appeal Book, volume 2, she wrote:

I would also like to address the concern in your September 14, 2004 letter regarding documentation related to your child support and alimony payments having been either lost or misplaced by the Agency. Our records indicate that at no time were the requested receipts, cancelled cheques, bank transfers or other documentation provided by you to substantiate the deductions claimed. Your lawyer (Mr. Pister) indicated in December 2002 that he never received instructions from you in the making of further representations concerning this issue. Furthermore, the September 1993 separation agreement makes reference to ownership of 30,000 shares in Rothwell Corporation. Our records indicate that during the course of the voluntary disclosure process neither ownership nor involvement in this corporation by you was communicated. This omission confirms the incompleteness of the information provided by you.

In the Third-Level Decision, I noted that a September 1993 separation agreement between the Applicant and his former spouse makes reference to his owning 30,000 shares in Rothwell Corporation and that CRA records indicated that during the course of the VDP process neither ownership nor involvement in this corporation was communicated by the Applicant. Attached hereto as Exhibit "Q" is a copy of the separation agreement.

[Emphasis added]

[28] Finally, the record in the proceedings before the Federal Court and this Court indicates that the appellant made substantial amendments to his 2002 income tax and GST returns, some in relation to sources of income that he had not originally declared in 2002, but that he acknowledged after being confronted with the fact.

[29] The following is a summary of the amendments brought on February 7, 2005:

DATE	DOCUMENT	AMENDMENT

Digitized by Google

February 7, 2005	Exhibit 35 – Appeal Book (Volume 2) p.225	1994 Income Tax Return : Sale of 12,125 Rothwell Corporation Class A Common Shares for 30 cents a share or $3,628.00, with an adjusted cost base of 60 cents a share or $7,275.00, resulting in a – **Capital loss totaling $3,637.00** Reduction of professional income from $133,103.00 to $126,253.00 Increase employment income from Found Money Inc. to $6,850.00 1995 Income Tax Return: Sale of beneficial interest in the trust that owns Found Money Inc. – **Capital gain of $449,700.00** Reduce professional income from $147,106.00 to $125,454.00 Increase employment income from Found Money Inc. to $21,652.00 1996 to 2001 Income Tax Returns: Reduce professional income from $144,991.00 to $48,030.00 Increase employment income from Found Money Inc 1994 to 2001GST Returns: Reduce previously filed taxable revenue $641,009.17 to $Nil - Reduce legal fees from $451,334.58 to $Nil
February 7, 2005	Exhibit 36 – Appeal Book (Volume 2) p.243	1994 to 2001 GST Returns: Reduce previously filed taxable revenue Reduce GST payable
February 7, 2005	Exhibit 39 – Appeal Book (Volume 2) p.256	1993 Income Tax Return: - Sale of 1,000 Rothwell Corporation Class A Common Shares for 55 cents a share or $550.00, with an adjusted cost base of 60 cents or $600.00, resulting in a **capital loss totaling**

[30] At paragraphs 29 and 30 of her affidavit, Appeal Book, volume 2, pages 304 and 305, Mrs. Charlton stated the following with respect to some of these amendments:

I have reviewed the affidavit sworn by the Applicant on March 14, 2005 and filed in the within proceeding (the "Affidavit"). I note that Exhibit "35" to the Affidavit consists of "Notices of Amendment" dated February 7, 2005 sent by the Applicant to the Chief of Appeals of the CRA's International TSO in Ottawa in respect of his 1994 through 2001 taxation years. In each Notice of Amendment, the Applicant requests that the CRA reduce his previously filed gross professional income and increase employment income received from Found Money Inc. By my calculation, the Applicant now claims he received a total of $866,415 in employment income from Found Money Inc. In the T1 returns filed on August 12, 2002, as described in paragraph 5 above, the Applicant claimed no employment income from

Digitized by Google

Found Money Inc. or from any other source.
In the Notice of Amendment dated February 7, 2005 for the 1994 taxation year found at Exhibit "35" to the Affidavit, the Applicant acknowledges the sale of 12,125 shares of Rothwell Corporation Class A common stock, where no such sale had been acknowledged in his T1 return filed for 1994 on August 12, 2002. In the Notice of Amendment dated February 7, 2005 for the 1995 taxation year found at Exhibit "35" to the Affidavit, the Applicant acknowledges the sale of his beneficial interest in the Trust that owns Found Money Inc. resulting in a capital gain of $449,700 for that year, where no such sale or gain had been acknowledged in his T1 return filed for 1995 on August 12, 2002.
[Emphasis added]
[31] In assessing the reasonableness of the third level decision, the judge did not consider the amendments brought by the appellant because they occurred after the third level decision and, therefore, were not part of the CRA's record at that time. I think she made the right decision in this respect.
[32] However, I am now referring to them for two reasons. First, to show the amount of undeclared income received by the appellant from Found Money Inc. and the Trust that owned Found Money Inc. and to show how material these omissions to declare were. Second, to point out that, even if we were to accept the appellant's argument that the third level decision is flawed and order a new revision on the completeness of the appellant's disclosure in his 2002 income tax and GST returns, this new decision would be the same as those rendered by the three levels of review. To use professor Wade's words in *Administrative Law* (6th ed. 1988) at page 535, "the demerits of the claim are such that it would in any case be hopeless" if the matter were returned for a new review: see for example *Mobil Oil Canada Ltd. v. Newfoundland Offshore Petroleum Board*, [1994] 1 S.C.R. 202, at page 228; *Vezina v. Attorney General of Canada*, 2003 FCA 67, at paragraph 7; *Uniboard Surfaces Inc. v. Kronotex Fussboden GmbH*, 2006 FCA 398; *Canada (Minister of Human Resources Development v. Hogervorst*, *supra*; *Yassine v. Canada (Minister of Employment and Immigration*), [1994] F.C.J. No. 949 (FCA), at paragraph 9; and *Cartier v. Procureur general du Canada (Ministre du Revenu national)*, 2003 FCA 67, at paragraph 7.
[33] The issue of the extent of the appellant's actual disclosure involved a question of fact. The judge found that the third level decision was not only reasonable, but was also correct on the record before the decision maker: see reasons for judgment, at paragraphs 122 and 130. I see no overriding and palpable error in the judge's finding.
[34] Finally, on more than one occasion, the judge found the appellant not credible and inconsistent in his assertions regarding the extent of his disclosure in his 2002 income tax and GST returns: see for example paragraphs 83, 84, 85, 127 and 128. In these last two paragraphs she wrote:
[127] During the hearing, Mr. Palonek was insistent that all of his sources of income were fully disclosed to the Agency in the tax returns that he filed in August of 2002. According to Mr. Palonek, the only debate was as to whether he should be claiming as an employee or as an independent contractor.
[128] First of all, the evidence before this Court does not support Mr. Palonek's submissions in this regard. In addition, it is difficult to understand how Mr. Palonek can assert that all income was properly disclosed to the Agency in August of 2002, given his equally emphatic insistence that he had not prepared the tax returns in question, never signed them, and had no knowledge as to their contents.
[Emphasis added]
She had the benefit of seeing and hearing the appellant. She made a credibility assessment

Digitized by Google

that this Court is not in a position to second guess.

CONCLUSION
[35] For these reasons, I would dismiss the appeal with costs.

"Gilles Létourneau" J.A.
" I agree
A.M. Linden" J.A.
"I agree
Johanne Trudel" J.A.

Peter Livaditis v. Canada Revenue Agency, 2012 FCA 55, Appeal of Judicial Review of Refusal of VDP Acceptance

REASONS FOR JUDGMENT OF THE COURT
(Delivered from the Bench at Calgary, Alberta, on February 15, 2012)

TRUDEL J.A.

[1] Mr. Livaditis (the appellant) unsuccessfully applied to the Minister of National Revenue (or the Minister's Delegate) for relief under the Voluntary Disclosures Program (VDP) seeking relief from penalty and interest with respect to a previously undisclosed capital gain for the 2006 taxation year. His request was denied at the second level by the Minister's Delegate because "enforcement was taken on the account prior to the disclosure" (decision of the Minister's Delegate, appeal book at page 107).

[2] The appellant's ensuing application for judicial review was dismissed by the Federal Court (2010 FC 950).

[3] In his reasons, the Federal Court Judge (the Applications Judge) reviewed the impugned administrative decision in light of the two following questions addressed by the Minister's Delegate (VDP Second Review Report, appeal book at page 153) :

> 1) Was any direct contact by a CRA employee, other authority or administration, for any reason relating to non-compliance (e.g. unfiled returns, audit, collection issues) made with the taxpayer or is the taxpayer likely to have been aware of the enforcement action?
>
> 2) Was any enforcement action initiated against a person associated with, or related to, the taxpayer or a third party, where the enforcement action is sufficiently related to the present disclosure and is likely to have uncovered the information being disclosed?

[4] These questions stem from Circular IC00-1R2 with respect to the VDP and the VDP Guidelines 2008-06, June 2008, which lists the four conditions to be met for a disclosure to be qualified as valid, the first one being that it must be voluntary in the sense that both questions above must be answered in the negative. Whether the disclosure was voluntary is the sole issue surrounding the disclosure made by the appellant.

[5] To dispose of this appeal, few facts are needed. Suffice to know that the appellant was the President of LaCaille Fifth Avenue Inc. (LaCaille), a company whose business included a new residential condominium project (Five West). In 2003, before construction began, the appellant and four of his family members personally acquired condominium units in the Five West project. In 2006, prior to the completion of the project, they resold these units for a gain. The appellant realized a capital gain that went unreported.

Digitized by Google

[6] On August 26, 2008, the Minister of National Revenue sought from the Federal Court an Order *ex parte* in order to impose on LaCaille a Requirement to Provide Information and Documents (the Requirement) pursuant to subsection 231.2(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) and subsection 289(1) of the *Excise Tax Act*, R.S.C. 1985, c. E-15 relating to a group of unnamed persons. The purpose of this Requirement was to verify tax compliance by purchasers of units in the Five West project.

[7] The Order sought was issued by the Federal Court on September 4, 2008 (docket T-1330-08, appeal book at page 76) but was not served until November 2008.

[8] Meanwhile, on October 28, 2008, the appellant received a phone call from a representative of the Canada Revenue Agency (CRA). As the appellant recollects it, the conversation was "very brief and general" and served to inform him that the CRA sought a meeting to gather "information pertaining to purchasers who may have acquired condominium units in the Five West project" (appellant's affidavit, appeal book at page 28). The respondent's recollection of the same conversation is said to be somewhat inconsistent but could reasonably be considered only to be more detailed (see VDP Second Review Report, appeal book at pages 150 and f.).

[9] In an event, the telephone conversation between the CRA's representative and the appellant was followed on October 31 by a no-name disclosure for income tax purposes for the 2006 taxation year wherein the unnamed person, later identified as being the appellant, stated that he was "not aware of any audit or enforcement measure being conducted on matters specifically involving the disposition at the time of this letter". Therefore, the appellant asserted that the disclosure was voluntary.

[10] As already stated, the Minister's Delegate disagreed. So did the Applications Judge who partially agreed with the Minister's Delegate.

[11] The Minister's Delegate answered favourably both questions mentioned above. On the first one, he concluded that as a result of the October 28, 2008 telephone conversation, the appellant was fully aware of the information sought by the CRA and how "it would uncover that [the appellant] and members of his family did not report any income resulting from the sales of condos in [the Five West project]" (VDP Second Level Report, appeal book at page 153).

[12] The Applications Judge held that this finding was unreasonable because the Minister's Delegate had failed to provide a rationale for accepting the CRA representative's account of the telephone conversation rather than that of the appellant (Applications Judge's reasons at paragraphs 29 and 32). We respectfully disagree with the Applications Judge for reasons given later.

[13] On the second question, the Applications Judge found that it was reasonable for the Minister's Delegate to have found that the Requirement constituted an enforcement action as this second ground for finding the disclosure not voluntary did not require that the appellant be aware of the existence of an enforcement action. The appellant strongly opposes this conclusion. However, we need not comment on this statement to dispose of this appeal and decline to do so.

[14] We are all of the view that the evidence on record supported the conclusion of the Minister's Delegate as to the appellant's awareness on October 28 of an enforcement action set to be conducted by the CRA with respect to the information being disclosed. There existed a reasonable basis upon which the Minister's Delegate could have decided as he did and this Court will not interfere (*Alberta (Information and Privacy Commissioner) v. Alberta Teachers' Association*, 2011 SCC 61).

[15] In conclusion, we agree with the judgment under appeal. Therefore, the appeal will be dismissed with costs.

"Johanne Trudel"

Digitized by Google

J.A.

Voluntary Disclosures Program
IC00-1R2
DATE: October 2007
SUBJECT: Voluntary Disclosures Program

Contents

Application (¶s1-3)
Introduction(¶s 4-7)
Principles of the VDP(¶s 8-9)
Legislation (¶ 10)
Relief Provided Under the VDP(¶s 11-17)
Penalty Relief(¶ 11)
Interest Relief (¶ 12)
Limitation Period on Discretion for Relief of Penalties and Interest(¶s 13-17)
Circumstances Under Which VDP Relief May be Granted(¶ 18)
Circumstances Under Which VDP Relief Will Not be Considered(¶s 19-21)
Disclosure Methods(¶s 22-30)
"Named" Disclosure Method(¶ 25)
"No-Name" Disclosure Method(¶s 26-30)
Conditions of a Valid Disclosure(¶s 31-42)
i) Voluntary(¶s 32-34)
ii) Complete(¶s 35-37)
iii) Penalty(¶38)
iv) One Year Past Due (¶s 39-42)
Making a Disclosure – Information/Documentation Required(¶s 43-45)
A Second Disclosure by the Same Taxpayer(¶ 46)
Authorization of a Taxpayer's Representative(¶s 47-49)
The Effective Date of a Disclosure (EDD)(¶s 50-54)
Where to Make a Disclosure (¶ 55)
Denial of a Disclosure Submission(¶ 56)
Right of Redress for the Taxpayer(¶s 57-63)
Second Administrative Review(¶s 57-58)
Judicial Review(¶s 59-62)
Notice of Objection (¶ 63)
Need More Information(¶ 64)
Comments(¶ 65)

Application

¶ 1. This information circular cancels and replaces Information Circular 00-1R, *Voluntary Disclosures Program*, dated September 30, 2002.

¶ 2. In this information circular, the term "taxpayer" includes an individual, an employer, a corporation, a partnership, a trust, a Goods and Services Tax/Harmonized Sales Tax (GST/HST) registrant/claimant or a registered exporter of softwood lumber products.

¶ 3. Unless otherwise specified, all legislative references in this information circular refer to the *Income Tax Act* (ITA), the *Excise Tax Act* (ETA), the *Excise Act, 2001* (EA, 2001), the *Air Travellers Security Charge Act* (ATSCA), or the *Softwood Lumber Products Export Charge Act, 2006* (SLPECA), and any other acts administered by the Canada Revenue Agency (CRA).

Digitized by Google

Introduction

¶ 4. The purpose of this information circular is to provide information about the CRA's *Voluntary Disclosures Program* (VDP). Taxpayers can make disclosures to correct inaccurate or incomplete information, or to disclose information not previously reported. For example, taxpayers may not have met their tax obligations if they claimed ineligible expenses, failed to remit source deductions or the GST/HST, or did not file an information return.

¶ 5. This information circular provides information on the discretionary authority of the *Minister of National Revenue* (Minister) under the ITA, the ETA, the EA, 2001, as well as the ATSCA and the SLPECA to grant relief to taxpayers in accordance with specific legislative provisions. It also explains how a taxpayer may make a disclosure, including the proper information and documentation needed to support such a disclosure. In addition, it outlines the administrative guidelines the CRA will follow in making a decision whether to accept the disclosure as valid.

¶ 6. The VDP applies to disclosures for income tax, excise tax, excise duties under the EA, 2001, source deductions, GST/HST, as well as charges under the ATSCA and SLPECA.

¶ 7. The information provided on the VDP process is only a guideline, is not intended to be exhaustive, and is not meant to restrict the spirit or intent of the legislation.

Principles of the VDP

¶ 8. The VDP promotes compliance with Canada's tax laws by encouraging taxpayers to voluntarily come forward and correct previous omissions in their dealings with the CRA. Taxpayers who make a valid disclosure will have to pay the taxes or charges plus interest, without penalty or prosecution that the taxpayer would otherwise be subject to under the acts noted above.

¶ 9. The VDP is not intended to serve as a vehicle for taxpayers to intentionally avoid their legal obligations under the acts administered by the CRA.

Legislation

¶ 10. The CRA has the legislative authority to provide relief for valid disclosures in accordance with the following legislative provisions:

subsection 220(3.1) of the ITA,
section 88 and section 281.1 of the ETA,
section 173 and section 255.1 of the EA, 2001,
section 30 and section 55 of the ATSCA, and
section 37 of the SLPECA.

Relief Provided Under the VDP

Penalty Relief

¶ 11. If the CRA accepts a disclosure as having met the conditions set out in this policy, it will be considered a valid disclosure and the taxpayer will not be charged penalties or prosecuted with respect to the disclosure.

Interest Relief

¶ 12. In addition to penalty relief, if a disclosure is accepted as valid by the CRA, the Minister may grant partial relief in the application of interest against a taxpayer in respect of assessments for years or reporting periods preceding the three most recent years of returns required to be filed.

Limitation Period on Discretion for Relief of Penalties and Interest

¶ 13. For income tax submissions made on or after January 1, 2005, the Minister's ability to grant relief is limited to any taxation year (or fiscal period in the case of a partnership) that ended within the previous 10 years before the calendar year in which the submission is filed. For example: in an income tax submission made on May 1, 2007, the limitation would apply so that relief would only be available for the 1997 and subsequent taxation years.

¶ 14. Unless a submission was filed before the 10-year limitation rule coming into effect on January 1, 2005, submissions filed for the 1985 to 1994 tax years will not be accepted.

¶ 15. For GST/HST, excise tax and the SLPECA, the limitation pertains to submissions made on or after April 1, 2007 and is for reporting periods that ended within the previous 10-year period.

Digitized by Google

Similarly, for duties under the EA, 2001, the limitation applies to submissions made on or after April 1, 2007 and is for fiscal months that ended within the previous 10-year period.

¶ 16. For submissions under the ATSCA, the Minister may, on or before the day that is ten calendar years after the end of the fiscal month of a person, waive or reduce interest, or waive or cancel penalties, payable by the person.

¶ 17. The Minister does not have to grant relief under the VDP provisions. Each request will be reviewed and decided on it's own merit. If relief is denied or partly granted, the CRA will provide the taxpayer with an explanation of the reasons and factors for the decision.

Circumstances Under Which VDP Relief May be Granted

¶ 18. Relief from penalty and prosecution, as provided for under the VDP, may be considered if a taxpayer:

failed to fulfill their obligations under the applicable act,

failed to report any taxable income they received,

claimed ineligible expenses on a tax return,

failed to remit source deductions of their employees,

failed to report an amount of GST/HST, (which may include undisclosed liabilities or improperly claimed refunds or rebates, unpaid tax or net tax from a previous reporting period),

failed to file information returns, and

failed to report foreign sourced income that is taxable in Canada.

Circumstances Under Which VDP Relief Will Not be Considered

¶ 19. The following, lists examples of circumstances that would not be considered under the VDP policy:

income tax returns with *no taxes owing* or with *refunds expected*; these would be handled using normal processing procedures.

"*elections*"; there are provisions within the various acts administered by the CRA which entitle taxpayers to choose or "elect" specific treatment of certain tax transactions, e.g. section 216 returns under the ITA.

"*advance pricing arrangement*"; this is an agreement between the Minister of National Revenue and a taxpayer that covers certain tax transactions between the taxpayer and a non-resident entity. The agreement confirms an appropriate transfer pricing methodology, in advance, and its application to specific transactions for a specified time frame using certain terms and conditions. See IC 94-4, *International Transfer Pricing: Advance Pricing Arrangements (APAs)* for further information.

"*rollover provisions*"; as election provisions, these allow a taxpayer to defer income amounts that would otherwise arise on the transfer of property to a taxable Canadian corporation. See IC 76-19, *Transfer of Property to a Corporation Under Section 85* for further information.

"*bankruptcy returns*"; these returns are required to be filed by the taxpayer in the year of bankruptcy.

post-assessment requests for penalty and interest relief: these requests will be considered as retroactive tax planning.

¶ 20. If the VDP is not applicable to a taxpayer's particular tax situation, relief may be requested in accordance with the taxpayer relief provisions as described in *IC 07-1, Taxpayer Relief Provisions*.

¶ 21. For information on requesting relief from penalty and interest with respect to GST/HST see GST/HST Memorandum G500-3-2-1, *Cancellation or Waiver of Penalties and Interest*. Each of the above-referenced documents is available from any Tax Services Office (TSO) and from the CRA website at www.cra-arc.gc.ca.

Disclosure Methods

¶ 22. Disclosures may be submitted to a TSO using either of the two methods described below (Named or No-Name). Each method includes the same consideration and review of all relevant information, however it is the timing of the identification of the taxpayer that differs in these two methods.

Digitized by Google

¶ 23. A submission must be made in writing, and may be mailed or faxed to the TSO that has jurisdiction over the area where the taxpayer resides. For businesses, this would be based on their operating address. Information as described in paragraphs ¶ 43 to ¶ 45 must be included in the submission. See also "Where to Make a Disclosure".

¶ 24. There may be circumstances where the taxpayer cannot immediately submit all of the information or documentation for the disclosure. In these circumstances the CRA may allow the taxpayer a period of time to submit such information in order to complete the disclosure submission. Normally this period of time is no more than 90 days from the effective date of disclosure (EDD) (paragraphs ¶ 50 to ¶ 54).

"Named" Disclosure Method

¶ 25. A "named" disclosure is a disclosure in which the identification of the taxpayer is stated on the initial disclosure submission.

"No-Name" Disclosure Method

¶ 26. Taxpayers who are unsure they want to proceed with a disclosure are given an opportunity to participate in preliminary discussions about their situation on a *"no-name"* basis. These discussions with a VDP officer are informal, non-binding, and general in nature and are done before the identity of the taxpayer is revealed. They are for the benefit of the taxpayer and are intended to provide insight into the VDP process, a better understanding of the risks involved in remaining non-compliant, and the relief available under the VDP.

¶ 27. Based on the preliminary information provided by the taxpayer as described in paragraph ¶ 44, the VDP officer may confirm that there is nothing set out in the information provided that may immediately disqualify the taxpayer from further consideration under the VDP. If all the required information for a complete disclosure, except for the identity of the taxpayer, has been submitted, the CRA can also review, upon request, this preliminary information and advise, without prejudice, on the possible tax implications of the disclosure. This advice is based on the facts as submitted on a no-name basis. If there is any discrepancy between the information that is provided and the information that is verified once the taxpayer is identified, this preliminary advice may be invalidated.

¶ 28. The CRA can undertake to provide a final and determinative decision on a no-name disclosure only after the identity of the taxpayer is known and all facts of the disclosure, in respect to the four validity conditions (paragraphs ¶ 31to ¶ 42), have been verified. In these circumstances, the identity of the taxpayer must be provided within 90 days of the EDD (paragraphs ¶ 50 to 54). There will be no extensions to the timeframe for providing the identity of the taxpayer.

¶ 29. In the event a taxpayer had previously put forward a no-name disclosure, a subsequent no-name disclosure for the same information and taxpayer, will not be considered. In order for the taxpayer to then make use of the VDP, they must identify themselves.

¶ 30. The taxpayer may decide not to proceed with the no-name disclosure. They would then, however, remain at risk of the CRA finding the omission and assessing the applicable tax or charge, penalty and interest, in addition to possible criminal investigation and prosecution.

Conditions of a Valid Disclosure

¶ 31. A disclosure must meet the following four conditions in order to qualify as a valid disclosure:

i) Voluntary

¶ 32. A disclosure will not qualify as a valid disclosure, subject to the exceptions in paragraph 34, under the "voluntary" condition if the CRA determines:

the taxpayer was aware of, or had knowledge of an audit, investigation or other enforcement action set to be conducted by the CRA or any other authority or administration, with respect to the information being disclosed to the CRA, or

enforcement action relating to the disclosure was initiated by the CRA or any other authority or administration on the taxpayer, or on a person associated with, or related to the taxpayer (this includes, but is not restricted to, corporations, shareholders, spouses and partners), or on a third

Digitized by Google

party, where the purpose and impact of the enforcement action against the third party is sufficiently related to the present disclosure, and
the enforcement action is likely to have uncovered the information being disclosed.
¶ 33. For purposes of the VDP, an “enforcement action” may include, but is not limited to:
requests, demands or requirements issued by the CRA, relating to unfiled returns, unremitted taxes/ instalments, deductions required at source or non-registrants; (although the aforementioned actions may only pertain to one specific year or reporting period, the procedure will be considered to be an enforcement action, for purposes of the VDP, for all taxation years or reporting periods).
For example: a taxpayer has not complied with their filing requirement for the 2002 through 2005 taxation years. Upon determining that the taxpayer was required to file tax returns, the CRA issued a “request-to-file” (Form TX11). The CRA request, requiring the taxpayer to file the 2003 tax return, is mailed to the taxpayer on July 20, 2006. On August 15, 2006, the taxpayer makes a disclosure and submits all of the tax returns (2002-2005), correctly prepared with all supporting documentation, etc. The CRA request-to-file is an enforcement action relating to all unfiled returns for that taxpayer. Although the request-to-file was for the 2003 taxation year, the disclosure would be denied because the taxpayer did not voluntarily come forward to file the other returns before the CRA undertook enforcement action;
requests, demands or requirements which have been issued with reference to other tax accounts of the taxpayer, partners of the taxpayer or corporations associated with or related to the taxpayer;
direct contact by a CRA employee for any reason relating to non-compliance (e.g. unfiled returns, audit, collection issues); and/or
an audit, investigation or other enforcement action by another authority or administration, such as, but not limited to, a police force, securities commission or provincial authority.
¶ 34. Not all CRA initiated enforcement action may be cause for a disclosure to be denied by the CRA. Examples of this include:
a recent audit of a taxpayer was related to a source deductions (payroll) issue. The same taxpayer is submitting a disclosure for an amount of GST/HST, which was collected but not remitted to the CRA as required. There may be no correlation between these two taxation issues and as such, the enforcement action on the payroll account may not be cause to deny the GST/HST disclosure, or
a large corporation may be under CRA audit but the information being disclosed is not part of the audit protocol.

ii) Complete

¶ 35. The taxpayer must provide full and accurate facts and documentation for all taxation years or reporting periods where there was previously inaccurate, incomplete or unreported information relating to any and all tax accounts with which the taxpayer is associated. While the disclosure is being evaluated by the CRA, the VDP officer may request additional specific documentation in order to verify certain details such as revenue amounts being disclosed, tax credits being applied for, or expenses being claimed. The taxpayer must comply with such requests within the stipulated timeframes (see paragraphs ¶ 50 to ¶ 54), and provide sufficient detail to allow all of the facts of the case to be verified. Additional information on requirements for maintaining books and records can be found in the current version of IC 78-10, *Books and Records Retention/ Destruction*, for Income Tax, and for GST/HST, in GST/HST Memorandum 15-1, *General Requirements for Books and Records* (Revised June 2005), for Excise Duties, in Excise Duties Memorandum 9.1.1, *General Requirements for Books and Records*, and for Excise Taxes, in Excise Taxes and Special Levies Memorandum X6-1 - *Books and Records*.
¶ 36. Due to the nature of a particular disclosure, referrals to other programs within the CRA may be considered necessary in order to fully analyze the disclosure.
¶ 37. While the information provided in a disclosure must be complete, the disclosure may not be disqualified simply because it contains minor errors or omissions. Each submission will be reviewed on it's own merits.

Digitized by Google

iii) Penalty

¶ 38. A disclosure must involve the application, or potential application of a penalty. The penalty type may be a late filing penalty, a failure to remit penalty, an instalment penalty, or a discretionary penalty, such as an omission penalty or a gross negligence penalty. In the event a penalty does not apply, the taxpayer cannot seek relief through the VDP. However, the disclosed information should still be submitted and it will be handled through the CRA's normal processing procedures.

iv) One Year Past Due

¶ 39. The disclosure must include information that is:

(i) at least one year past due, or

(ii) less than one year past due where the disclosure is to correct a previously filed return or where the disclosure contains information that also meets the condition of subparagraph (i) above.

¶ 40. For example, a taxpayer had not filed tax returns for the years 2000 to 2004. On November 10, 2005, the taxpayer submitted all of the tax returns requesting they be considered under the VDP. Although the 2004 tax return is less than one year past due (filing deadline of April 30, 2005) the CRA will consider the 2004 return as part of this disclosure, provided that all other conditions have been met.

¶ 41. In contrast, the 2004 tax return would not be considered for VDP treatment if it were the only return being filed. In that case, the 2004 return would be handled through the CRA's normal processing procedures.

¶ 42. The intent of sub-paragraph 39(ii) noted above, is to allow the timely correction of previously filed returns and to allow the inclusion of unfiled returns (less than one year past due) only when they are part of a disclosure submission that includes information or unfiled returns that meet the condition in sub-paragraph ¶ 39(i).

Making a Disclosure – Information/Documentation Required

¶ 43. Taxpayers must send in a written submission to make a disclosure. Form RC199, *Taxpayer Agreement* should be used to initiate the disclosure. A copy of this form is available on the CRA's website at: www.cra-arc.gc.ca. Failure to use Form RC199 or to provide similar information as per Form RC199, may delay the review of the disclosure.

¶ 44. In order to support a disclosure submission, the following information pertaining to the taxpayer's situation must be submitted:

the name, address, telephone number, social insurance number, partnership number, trust account number, business number, license number, GST/HST registration number or any other identification tax number assigned by the CRA to the taxpayer,

if a no-name disclosure, this information would not be required;

the taxpayer's postal code,

if a no-name disclosure, only include the first three characters of the taxpayer's postal code (used to determine the TSO that will be responsible for the file);

the address of the taxpayer's authorized representative, including telephone and fax numbers (if applicable);

gender and age (if an individual and involves a no-name disclosure);

the taxation year(s), reporting period(s) or fiscal period(s) involved in the disclosure;

amount of the disclosure (where applicable);

type of return(s) involved: personal T1, GST/HST, corporate T2, trust T3, etc.;

type of information return(s) and/or slip(s) involved (e.g. T3, T4, T1134, T1135) (if applicable);

type of omission (business income, unremitted GST/HST, investment income, pension income, capital gain, etc.);

reason for the omission;

primary business activity, and

an explanation of how the taxpayer considers that each of the four validity conditions (paragraphs ¶ 31 to ¶ 42) have been met.

Digitized by Google

¶ 45. Each disclosure submission must include enough detail to allow for verification of the facts. Taxpayers and/or their authorized representatives are expected to make all documents, records, and books of account, as well as any other required information, available upon request.

A Second Disclosure by the Same Taxpayer

¶ 46. Taxpayers are expected to remain compliant after using the VDP. Under normal circumstances, a taxpayer is entitled to utilize the benefits of the VDP only one time. A second disclosure for the same taxpayer may be considered by the CRA if the circumstances surrounding the second disclosure are beyond the taxpayer's control. At the time of making a second disclosure, a taxpayer must provide their name and specify that they had previously made a disclosure. If it is discovered during the course of the disclosure review that the taxpayer had previously made a disclosure and the taxpayer has not disclosed this fact, the CRA may deem the disclosure to be invalid for VDP purposes. If the second disclosure is for the same issue that was previously denied as incomplete due to information not being received by the stipulated date, then the second disclosure will be denied.

Authorization of a Taxpayer's Representative

¶ 47. The taxpayer's authorized representative can make the disclosure. The taxpayer must grant proper authorization to the representative by submitting a signed copy of the appropriate authorization form.

For individuals (income tax matters), submit form T1013, *Authorizing or Cancelling a Representative.*

For all business entities (all busines program accounts), submit form RC59, *Business Consent Form*.

For matters pertaining to Canada Pension Plan or Employment Insurance disclosures, submit form CPT139, *CPP/EI - Authorizing or Cancelling a Representative*.

¶ 48. The CRA cannot discuss any confidential information with a representative prior to receiving the appropriate authorization.

¶ 49. When a taxpayer's authorized representative makes a disclosure, the written authorization should be attached to that submission. In the case of a no-name disclosure, the authorization should be presented at the same time the identification of the taxpayer is provided.

The Effective Date of a Disclosure (EDD)

¶ 50. The EDD is the earlier of:

the date the CRA receives a completed and signed form RC199, *Taxpayer Agreement*, or

the date a letter, signed by the taxpayer or the taxpayer's authorized representative and containing similar information (see paragraphs ¶ 43 to ¶ 45) to Form RC199, is received by the CRA.

¶ 51. From this date, provided that the disclosure meets the four validity conditions, the taxpayer is granted protection against penalties and possible prosecution, regarding the amounts included in the disclosure.

¶ 52. If necessary, the taxpayer may have up to 90 days from the EDD for the submission of additional relevant information and/or documentation that may be required to complete the disclosure.

¶ 53. If this time frame is not sufficient due to the complexity of the disclosure or other extraordinary circumstances, the Assistant Director, Enforcement Division of the TSO, may authorize an extension of this period, upon receipt of a written request from the taxpayer. The additional information must be provided within the stipulated time frame. However, an extension will not be granted to the 90-day time frame to provide the taxpayer's identity under the no-name disclosure method.

¶ 54. If the additional information and/or documentation is not received within the stipulated time frame:

in the case of a named disclosure, the CRA may commence enforcement action wherein penalties and interest are applicable and prosecution may be initiated, or

Digitized by Google

in the case of a no-name disclosure, the file will be closed. The taxpayer could then be subject to full penalties, interest and possible prosecution.

Where to Make a Disclosure

¶ 55. The detailed disclosure submission should be forwarded to the Assistant Director, Enforcement Division of the TSO that has jurisdiction over the area where the taxpayer resides. For businesses, this would be based on their operating address. To locate your TSO, please click on the following link, TSO, or consult the CRA website at: www.cra-arc.gc.ca. Under limited circumstances, a taxpayer may request to transfer a disclosure to another TSO. This type of request must be adequately justified in writing, and the decision on where the disclosure is reviewed will be at the discretion of the CRA.

Denial of a Disclosure Submission

¶ 56. If it is determined, after the VDP officer has completed evaluating the disclosure submission, that any of the four validity conditions have not been met; the taxpayer would then be advised in writing that:

the disclosure is being denied,
the disclosed information may be referred to another CRA program area,
the disclosed information may result in an assessment or reassessment,
penalties and interest may be levied, and
in certain circumstances, an investigation and prosecution may be initiated.

Right of Redress for the Taxpayer

Second Administrative Review

¶ 57. There is no right of objection under the Acts mentioned in paragraph 3 of this information circular, for a taxpayer to dispute a discretionary decision that denied relief, or allowed only partial relief. However, if the taxpayer believes that the Minister has not exercised discretion in a fair and reasonable manner, the taxpayer may request in writing, that the Director of the TSO where the original decision was issued, review and reconsider the original decision. The taxpayer has the opportunity at that time to make additional representations for the CRA to consider. The CRA will not consider a request for a second review if a disclosure was denied because the information was not previously submitted within the stipulated time frame.

¶ 58. The Director may designate a delegated authority, not involved in the previous review and decision, to carry out the second administrative review on their behalf.

Judicial Review

¶ 59. Where a taxpayer does not believe the Minister exercised discretion in a fair and reasonable manner, the taxpayer may make an application to the Federal Court for a judicial review of the Minister's discretionary decision, pursuant to section 18.1 of the *Federal Courts Act,* within 30 days from the date the notification of the decision was communicated to the taxpayer.

¶ 60. To request a judicial review, the taxpayer must send a completed Form 301, *Notice of Application*, with the appropriate filing fee, to the registrar of the Federal Court. For more information on how to file an application for judicial review or other general enquiries, contact the Courts Administration Service at 613-992-4238, or access their website at www.cas-satj.gc.ca.

¶ 61. If the Federal Court is of the view that the Minister's discretion was not properly exercised, the Court will generally not substitute the Minister's decision but rather, will refer the request back to the CRA for reconsideration.

¶ 62. As a general rule, taxpayers should request a second administrative review from the CRA before filing an application for a judicial review with the Federal Court.

Notice of Objection

¶ 63. In the event the taxpayer's disclosure resulted in an assessment or reassessment to which the taxpayer disagrees, the taxpayer is entitled to file a Notice of Objection to the assessment or reassessment. The Notice should be addressed to the Chief of Appeals in the taxpayer's TSO.

Need More Information

Digitized by Google

¶ 64. For more information on the *Voluntary Disclosures Program,* or for contacting the TSOs, please click on the links, or consult the CRA website at: www.cra-arc.gc.ca.

Comments

¶ 65. If you have any comments about this information circular, please write to us at:

Enforcement and Disclosures Directorate
Canada Revenue Agency
Ottawa ON K1A 0L5

Digitized by Google

Fairness Applications

If you fail to perform your obligations under the ITA that result in a penalty or interest charged on any balance you owe you may be entitled to request a Fairness Application whereby CRA officials will evaluate your circumstances to see if they can grant you relief. The Act requires application of the penalties/interest, **statutorily**, there is no discretion, but, equally, within finely described circumstances, our fiscal legislators do recognize that not everyone can actually abide by the ITA and thus the introduction and use of the fairness provisions therein. It should be noted that Sec. 220(2) applies **only to interest and penalties and NOT the underlying tax that is payable.**

The basic criteria in order for the provisions to apply must include at least one of the following:

- natural or man-made disasters such as, flood or fire;
- civil disturbances or disruptions in services, such as a postal strike;
- a serious illness or accident; or
- serious emotional or mental distress, such as death in the immediate family,
- actions of the CRA
- inability to pay or financial hardship**.**

The Minister's representative can only make a valid determination on whether a taxpayer's file requires a favourable exercise if there has been sufficient evidence placed before them to make it. In other words, one would definitely want to make sure that all of the facts are properly evidenced and submitted to the relevant CRA party along with form *RC4288, Request for Taxpayer Relief* find following at the time of request. There have been numerous cases where the Fed. Ct. on a review held that there was insufficiency of evidence in the Minister's hands that warranted them coming to conclusion that they did.

Waiver of penalty or interest - S. 220(3.1)

(3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

Late, amended or revoked elections

(3.2) The Minister may extend the time for making an election or grant permission to amend or revoke an election if

> **(*a*) the election was otherwise required to be made by a taxpayer or by a partnership, under a prescribed provision, on or before a day in a taxation year of the taxpayer (or in the case of a partnership, a fiscal period of the partnership); and**
>
> **(*b*) the taxpayer or the partnership applies, on or before the day that is ten calendar years after the end of the taxation year or the fiscal period, to the Minister for that extension or permission.**

Date of late election, amended election or revocation

(3.3) Where, under subsection 220(3.2), the Minister has extended the time for making an election or granted permission to amend or revoke an election,

> **(*a*) the election or the amended election, as the case may be, shall be deemed to have been made on the day on or before which the election was otherwise required to be**

Digitized by Google

made and in the manner in which the election was otherwise required to be made, and, in the case of an amendment to an election, that election shall be deemed, otherwise than for the purposes of this section, never to have been made; and
(*b*) the election that was revoked shall be deemed, otherwise than for the purposes of this section, never to have been made.

The below Information Circular details CRA's position on how they apply the rules.

Unfortunately, taxpayers can sometimes think that they are entitled to their version of the Act and there has been substantial litigation, via Federal Court Rule 18.1 review of an administrative decision, of when they were disenfranchised from relief. I have broken them down by basis by which they were contested and I observe that there was a small chance of success in the Court's eyes, in all cases so far.

A Discretionary Decision Only, The Law Otherwise Applies

The Fairness Decision is only discretionary, it allows the Minister to all "an out" in very extra-ordinary circumstances listed in the Information Circular below. In all cases, the rest of the Act in its entirty applies to arbitrarily determine the results. This was fully pronounced In Sandeep Kapil V Canada Revenue Agency And Attorney General Of Canada[16] where the Trial Ct. held:

> *Analysis*
>
> [20] As a matter of law, this Court does not have the jurisdiction to order the Minister to waive taxes, penalties, and arrears interest. The jurisdiction of the Court is limited to ordering the Minister to substantively reconsider his decisions not to waive the taxes and related interest and penalties. The applicant must understand, therefore, that even if this Court had found in his favour, he would not automatically be entitled to a waiver and refund of his money. This Court's review is confined to an analysis of whether the Minister's exercise of discretion in refusing the waiver requests was lawful, not to substitute its decision for that of the Minister: *Canada (Citizenship and Immigration) v Khosa*, 2009 SCC 12, [2009] 1 SCR 339.
>
> [21] In order succeed in this application for judicial review it is necessary for the applicant to demonstrate that the Minister, when exercising his discretion, committed a reviewable error when he refused the applicant's application for a waiver of (a) tax; and (b) late-filing penalties and arrears interest. The applicant advances three arguments in support of setting aside the decisions; first, that he made reasonable errors; second, he acted with due diligence and took steps to remove the excess contributions; and third, that he relied on CRA advice.
>
> …
>
> [32] The scope of the discretion accorded the Minister was considered in *Jenkins v Canada (Revenue)*, 2007 FC 295, Justice Pierre Blais held at para 13:
>
> …it is important to keep in mind that the power of the Minister, as set out in subsection 220(3.1) of the Act, is a discretionary power and as such, there is no obligation on the part of the Minister to reach any given conclusion. Furthermore, the liability of a taxpayer to pay penalties and interests for the late filing of income tax returns results from the application of the Act itself, not from any discretionary decision of the Minister to impose such penalties and interests. Therefore, the discretionary power of the Minister is limited to providing exceptional relief from the operation of the Act, where the Minister believes such relief to be warranted.

[16] 2011 FC 1373

Digitized by Google

[33] The penalty and arrears interest were imposed as a matter of law, by operation of the *ITA*. Moreover, the nature of the relief itself is limited to exceptional situations in which the Minister believes is warranted." Thus, even though the Manual states that a reasonable error may be the product of incorrect information provided to the taxpayer; *Gagné*, the Minister is not obligated to make such a finding. In any event, I have not found a reasonable error to have been made.

Inability to Pay or Financial Hardship

In Sam Goldmaker v. MNR[17], on a review, the Federal Trial Court held:

[5] In *Kaiser v. The Minister of National Revenue* (1995), 95 D.T.C. 5187 (F.C.T.D.), Mr. Justice Rouleau of this Court commented on the purpose of section 220(3.1) at page 5188 as follows:

The purpose of this legislative provision is to allow Revenue Canada, Taxation, to administer the tax system more fairly, by allowing for the application of common sense in dealing with taxpayers who, because of personal misfortune or circumstances beyond their control, are unable to meet deadlines or comply with rules under the tax system. **The language used in the section bestows a wide discretion on the Minister to waive or cancel interest at any time. To assist in the exercise of that discretion, policy guidelines have been formulated and are set out Information Circular 92-2.**

[8] The scope of judicial review in relation to a Ministerial decision, made in the exercise of discretion, is limited to reviewing whether the Minister has properly exercised his discretion, with regard for relevant considerations and without regard to extraneous factors. The standard of review of discretionary decisions in the context of section 220(3.1) of the *Income Tax Act* was addressed by Mr. Justice Rouleau in *Kaiser v. Minister of National Revenue, supra*, as follows:

The jurisprudence has established the standard to be employed by the courts when called upon to review the exercise of a discretionary power such as the one in question here. In *Re Maple Lodge Farms Ltd. and Government of Canada et al* (1982), 137 D.L.R. (3d) 558 (S.C.C.), McIntyre, J. stated at p. 562:

In construing statutes such as those under consideration in this appeal, which provide for far-reaching and frequently complicated administrative schemes, the judicial approach should be to endeavour within the scope of the legislation to give effect to its provisions so that the administrative agencies created may function effectively, as the legislation intended. **In my view, in dealing with legislation of this nature, the courts should, wherever possible, avoid a narrow, technical construction, and endeavour to make effective the legislative intent as applied to the administrative scheme involved*. It is, as well, a clearly-established rule that courts should not interfere with the exercise of a discretion by a statutory authority merely because the court might have exercised the discretion in a different manner had it been charged with that responsibility. Where the statutory discretion has been exercised in good faith and, where required, in*accordance with the principles of natural justice, and where reliance has not been placed upon considerations irrelevant or extraneous to the statutory purpose, the courts should not interfere.

[9] I am unable to conclude, based on the facts presented, that the Minister improperly exercised his discretion in the present case. **The applicant"s contention that he was not given an opportunity to present his case is not substantiated on the evidence. On the contrary, the record shows that the applicant was given full opportunity to present evidence concerning his present financial situation, including his income,**

[17] T-1245-98

Digitized by Google

expenses, assets and liabilities. The applicant was given the opportunity to make representations as to why the interest should be waived and he argued before both the Minister and this court that he did not have the money to pay the interest. As an explanation for his inability to pay, Mr. Goldmaker offered a history of some unfortunate professional difficulties and problems in collecting accounts receivable. This history is set out in the affidavit filed as part of the applicant"s record.

…

[11] In the course of his submissions, the applicant submitted that he had understated his expenses**. I note that upon a hearing in a judicial review proceeding, it is not open to an applicant to introduce unsworn evidence. In any event, the submissions of the applicant in this case do not change my view that the Minister had given consideration to relevant matters, that is, the information presented by the applicant upon his initial request to the Minister for waiver of the outstanding interest**. In my opinion, there was sufficient information before the Minister to justify the conclusion which was reached.

[12] I refer again to the decision of Mr. Justice Rouleau in *Kaiser v. Minister of National Revenue, supra*, where he says:

Absent bad faith on the part of the Minister, a breach of the principles of natural justice or consideration of extraneous or irrelevant factors, there is nothing to warrant the Court"s interference with the exercise of his discretion.

Necessities of Life and Financial Hardship

In Don And Linda Getson v. Attorney General Of Canada[18] the Fed. Ct. gave credence to a norm in evaluating whether a taxpayer was suffering from financial hardship to the extent of being deprived of basic necessities of life with a reference to the Minister's response:

Undue hardship for an individual person means causing the person unnecessary or oppressive suffering or privation, that is, not being able to meet basic family needs. It is apparent from the information that you provided, that you could rearrange your financial obligations in order to liquidate the debt in full.

The Ct. then went on to note, on $6,519.06 in taxes and $3,365.61 in arrears interest that:

[10] In *Her Majesty the Queen v. Barbara L. Barron et al.* (1997), 97 D.T.C. 5121 (F.C.A.), Pratte J.A. stated the applicable principles governing the review of the exercise of discretionary powers when he was dealing with an analogous provision of the Act concerned with the reopening of statute-barred taxation years; I consider these principles as applicable to the exercise of ministerial power under subsection 220(3.1) of the Act. Justice Pratte said this at page 5122:

. . . it may be useful to recall that subsection 152(4.2) of the *Income Tax Act* confers a discretion on the Minister and that, when an application for judicial review is directed against a decision made in the exercise of a discretion, the reviewing court is not called upon to exercise the discretion conferred on the person who made the decision. The court may intervene and set aside the discretionary decision under review only if that decision was made in bad faith, if its author clearly ignored some relevant facts or took into consideration irrelevant facts or if the decision is contrary to law. [*emphasis mine*]

[11] In this case, the decision-maker examined Mr. & Mrs. Getson's average family income between 1995 and 1999 stating it to be $51,578 recognizing, however, that for them, 1998 was a poor year with total family income of $23,469. The decision-maker noted Mr. Getson, in 1999, received a Workers' Compensation Board payment of some $30,000 which was not taxable bringing his total net income for that year to $41,537. The applicants explained to me that this W.C.B. payment was a lump sum payment of a non-recurring nature. The decision-maker also

[18] 2001 FCT 550

Digitized by Google

noted Mrs. Getson's contributions to an R.R.S.P. between 1995 through 1999 including a contribution of $5,516 in 1999.
See also Charles Desjarins v. MNR[19] for a clear case of abuse under the Fairness application provision
when the taxpayer had allowed a very large balance to accrue, never took concrete steps to pay it down while continuing to enjoy a higher income and was flatly denied a rewarding judicial review.

Célyne Laflamme v. Minister of National Revenue, 2008 FC 1403, An Instance Where the Taxpayer Did Suffer a Catastrophe

BETWEEN:
CÉLYNE LAFLAMME
Applicant
and
MINISTER OF NATIONAL REVENUE
Respondent

REASONS FOR JUDGMENT AND JUDGMENT

[1] This application for judicial review was filed by the applicant against a decision made on January 28, 2008 by Lucie Bergevin, Director of the Ottawa Tax Services Office of the Canada Revenue Agency. By that decision, the respondent refused to cancel the penalties and interest assessed against the applicant as a result of the late filing of the applicant's income tax returns for the years 2003, 2004 and 2005.

Factual Context

[2] The applicant was a nurse and was married with children. She lived with her husband in St. Albert, Ontario.

[3] At the time, by agreement between the spouses, the applicant looked after the house and children while her husband worked outside the home and handled household business, banking and tax returns.

[4] In 2002, a series of catastrophic events occurred. First, the applicant's husband died suddenly; her mother and father-in-law died the same year. The couple's youngest son became depressed and suicidal. The accountant who had handled their previous tax returns fell ill and died of cancer in 2005.

[5] In 2003, the basement of the couple's house was flooded and infested with rodents that made their way in. After 2002, with no income to live on, the applicant had to find a job, and had to change jobs three times between 2002 and 2005. All of those events and misfortunes caused the applicant to fall into a deep depression, and since 2002 she has been under the care of a psychiatrist and needs to take medication.

[6] The applicant's depression and inability to make the necessary decisions, and the loss of her accountant, prevented her from filing her 2003, 2004 and 2005 tax returns. In addition, she believed that because she had not earned taxable income she was not required to file tax returns.

[7] After the death of her husband, at the urging of the executor of her husband's estate, and with his assistance, she was able to have the tax returns for the years 1999 to 2002 prepared.

[8] It was not until 2007, when her sister France Laflamme came to help her, that she was able to collect the necessary documents and, with the help of a new

[19] 2011 FC 1490

Digitized by Google

accountant, was able to file the tax returns for the years 2003 to 2006 and pay the amounts owing, which came to $33,000 at that time. She then received an assessment totalling $13,005.02 in penalties and interest on arrears.

[9] Since November 2007 she has been collecting employment insurance benefits for illness, given her psychological condition and inability to work outside the home.

[10] She applied for relief from that assessment based on these extraordinary circumstances and her deeply depressed condition. In support of her application for relief from the assessment, she cited the Canada Revenue Agency's "Taxpayer Relief Provisions". In brief, that circular provides that if a taxpayer falls victim to exceptional circumstances that prevent the taxpayer from satisfying his or her tax obligations, the Minister may grant relief. In spite of the applicant's letters explaining her health problems and requesting relief, Lucie Bergevin, acting on behalf of the Minister, denied the application, in her decision dated January 28, 2008, which reads as follows:

> [TRANSLATION] ... I have reviewed your application and I have determined that you failed to act quickly to remedy the delay and failed to meet your tax obligations in the past. As well, there was no error or delay on our part, nor were there circumstances beyond your control that might have prevented you from doing your accounting on time and as required. The penalty for late filing and interest on arrears are therefore upheld.

[11] The applicant is challenging that decision.

Standard of Review

[12] Ministerial discretion under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act), in relation to penalties and interest on arrears, is subject to the reasonableness standard when the issue is a question of fact or of mixed law and fact (see, *inter alia*, *Lanno v. Canada Customs and Revenue Agency*, 2005 FCA 153, 334 N.R. 348; *Kreklewich v. Canada Revenue Agency*, 2007 FC 892, [2007] 5 C.T.C. 145; *Dunsmuir v. New Brunswick*, [2008] 1 S.C.R. 190).

Applicable Legislation

[13] Subsection 220(3.1) of the Act reads as follows:

220. (3.1) The Minister may at any time waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by a taxpayer or partnership and, notwithstanding subsections 152(4) to 152(5), such assessment of the interest and penalties payable by the taxpayer or partnership shall be made as is necessary to take into account the cancellation of the penalty or interest.	**220.** (3.1) Le ministre peut, à tout moment, renoncer à tout ou partie de quelque pénalité ou intérêt payable par ailleurs par un contribuable ou une société de personne en application de la présente loi ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

[14] The Canada Revenue Agency has adopted and published an information circular entitled "Taxpayer Relief Provisions", No. IC07-1, dated May 31, 2007. Sections 23 to 34 of that circular set out the circumstances in which an application may be made and the factors used in making a decision. The relevant sections are as follows:

> ¶23. The Minister may grant relief from the application of penalty and interest where the following types of situations exist and justify a taxpayer's inability to satisfy a tax obligation or

Digitized by Google

requirement at issue:
(a) extraordinary circumstances;
(b) actions of the CRA;
(c) inability to pay or financial hardship.
¶24. The Minister may also grant relief if a taxpayer's circumstances do not fall within the situations stated in ¶ 23.
¶25. Penalties and interest may be waived or cancelled in whole or in part where they result from circumstances beyond a taxpayer's control. Extraordinary circumstances that may have prevented a taxpayer from making a payment when due, filing a return on time, or otherwise complying with an obligation under the Act include, but are not limited to, the following examples:
(a) natural or man-made disasters such as, flood or fire;
(b) civil disturbances or disruptions in services, such as a postal strike;
(c) a serious illness or accident; or
(d) serious emotional or mental distress, such as death in the immediate family.
. . .
¶34. When an extraordinary event (e.g., natural disaster) has prevented a large number of taxpayers from meeting their tax obligations, the Minister may issue a news release to announce that special consideration will be given to providing relief, such as a waiver or cancellation of penalty and interest charges on late tax remittances or late filing of a return. In such cases, taxpayers need to make a request to get relief. CRA news releases on extraordinary events that qualify for relief can be found at **www.cra-arc.gc.ca/newsroom/releases/menu-e.html**.

[15] Section 23 provides that exceptional circumstances are the basis on which the Minister must exercise his discretion. Section 25 lists the situations that are considered to be exceptional circumstances, such as natural disasters (a flood), serious illness and serious emotional or mental distress (such as a death in the immediate family). Section 34 elaborates on the concept of an extraordinary event (for example, a natural disaster).

Analysis

[**16**] **The facts established by the applicant were not disputed. They were also corroborated in the letter from Dr. Francine Pagé, psychiatrist, dated September 19, 2007, under whose care the applicant has been since 2002. She says that the applicant has experienced exceptional circumstances, both family-related and other, since 2002, that were beyond her control: the loss of people very close to her and the major stressful events that were added to that between 2002 and 2007.**

[17] The directives set out in the circular are not part of the Act and are not necessarily binding on the Department (*Lee v. Minister of Citizenship and Immigration*, 2005 FC 413). However, they are published by the Department to guide the Minister or his delegates. They were developed by the Department to guide it in the exercise of its discretion and enable it to manage the tax system more fairly, by allowing room for common sense to benefit taxpayers who have been victims of misfortune or circumstances beyond their control. **Taxpayers in that situation are entitled to the benefit of those directives (*Kaiser v. Minister of National Revenue* (1995), 93 F.T.R. 66; *Jim's Pizza (1980) Ltd. v. Canada Revenue Agency*, 2007 FC 782, [2007] 5 C.T.C. 43; *Construction & Rénovation M. Dubeau Inc. v.***

Digitized by Google

***Canada Customs and Revenue Agency*, 2001 FCT 1139, 213 F.T.R. 94 [*Dubeau*]).**

[18] The applicant submits that she is entitled to the benefit of the tax relief provisions quoted *supra* under both the Act and the principles of fairness, and the rights set out in the Charter of Taxpayer Rights. She argues that she was not in a normal psychological state, capable of making appropriate and timely decisions, having regard to the major depression she suffered as a result of a series of exceptional circumstances. Those multiple circumstances include three deaths of close family members, the depression and suicidal tendencies of her son, income problems and the damage to her house caused by flooding.

[19] The respondent argues that his decision was sound and reasonable because:

- **the applicant failed to act quickly to remedy any delay;**
- **the applicant failed to meet all her tax obligations in the past;**
- **there were no circumstances beyond the applicant's control that might have prevented her from doing her accounting in a timely manner.**

[20] The applicant replies:

- in the past, it was her husband who looked after filing tax returns;
- she could not have done anything before she had assistance from her sister, having regard to her deep depression;
- the circumstances explained earlier, which were not disputed, constitute exceptional circumstances under the Department's own directives, and she should have been given the benefit of those directives.

[21] The fundamental question to be answered here is whether the decision made is reasonable in the circumstances of this case. Does it fall within the range of decisions that could reasonably be justified by the factual evidence (see *Dunsmuir*, *supra*)?

[22] To solve this dilemma, I believe it is useful to adopt the reasoning followed by Pinard J. in a case that raised the same kind of problems: *Dubeau*, *supra*. At paragraph 14 of that decision, Pinard J. wrote that in interpreting sections 220 and 227 of the Act, departmental directives or policies regarding cancellation of penalties and interest had to be considered, along with the following factors:

(a) Relationship of parties involved.
(b) Date of death.
(c) Date(s) and nature of illness or accident.
(d) Explanation as to how the event prevented compliance.
(e) Explanation as to whether other business obligations were impaired.

[23] Also in that paragraph, Pinard J. added, with respect to departmental policy,

> . . . examples of cases where the cancellation of penalties and interest could be justified are provided, including "a serious emotional or mental distress such as, death in the immediate family."
>
> (Emphasis added.)

[24] In *Dubeau*, *supra*, the taxpayer cited lengthy absences from work because of his illness and the subsequent death of his son and illness of his own wife. Pinard J. dismissed the application for judicial review because, under the standard of review that applied at that time (i.e. in 2001), which was the patent unreasonableness standard, he could not have intervened. He wrote:

> **[21] In all of this context, despite all of the sympathy aroused by the misfortunes of Marc Dubeau and his family, the strict standard of judicial review that was confirmed in**

Digitized by Google

***Baker v. Canada (M.C.I.)*, [1999] 2 R.C.S. 817, prevents me from intervening. . . .**

[25] I am inclined to think, even speculate, that if the reasonableness standard that has applied since *Dunsmuir* had been the standard to be applied, the decision might not have been the same.

[26] In *Case v. Attorney General*, 2004 FC 825, [2004] 4 C.T.C. 71, the application for judicial review of a negative decision by the Minister regarding interest and penalties was dismissed because the applicant had not discharged her burden of proof in that she had been unable to show, in medical terms, that she could not have filed her tax return in a timely manner.

[27] An application for judicial review was dismissed in *Grundy v. Canada Customs and Revenue Agency*, 2005 FC 1312, [2005] D.T.C. 5574, because the failure to file the tax return in question did not result from an event beyond the applicant's control.

[28] In *PPSC Entreprises Ltd. v. Minister of National Revenue*, 2007 FC 784, [2007] 5 C.T.C. 79, the judge dismissed the application for judicial review because the error by the applicant did not result from circumstances beyond its control.

[29] In *Laframboise v. Canada Revenue Agency*, 2008 FC 196, [2008] D.T.C. 6178, Judith Snider J. allowed the application for judicial review of a negative departmental decision because the delay in filing a tax return had been caused by the destruction of the taxpayer's home by a fire, in which all of the necessary documents had been destroyed.

[30] In *Nixon v. Minister of National Revenue*, 2008 FC 917, [2008] F.C.J. No. 1146 (T.D..) (QL), Douglas R. Campbell J. allowed the application for judicial review because the decision-maker had failed to have regard to the fact that the failures to report additional income had been involuntary.

[31] In this case, the uncontradicted evidence is that the applicant was the victim of numerous distressing events between 2002 and 2007: her husband died suddenly in 2002, and her mother and father-in-law died the same year. The applicant's son was depressed to the point that he attempted suicide. The applicant's home was flooded. The accountant who had looked after her affairs and earlier tax returns died of cancer.

[32] All of these catastrophic events left the applicant in a state of deep depression, accentuated by the fact that she was obliged to seek paid employment and that she then had to change jobs three times. According to the applicant and her psychiatrist, she still suffers the effects of that depression today. **The consequence was that the applicant was unable to manage her affairs properly and to make the necessary decisions in relation to her tax obligations in a timely manner.**

[33] In my opinion, the combination of these events and circumstances, and the applicant's psychological condition, amply constitute the exceptional circumstances to which the guidelines refer and justify the delay that prevented her from filing her annual tax returns between 2002 and 2005.

[34] This situation falls squarely within the exceptional circumstances beyond the applicant's control referred to in sections 23, 24 and 25 of the provisions quoted *supra*.

[35] Section 25 lists some such exceptional circumstances, although it is not exhaustive:

> (a) natural or man-made disasters such as, flood or fire;
> (b) civil disturbances or disruptions in services, such as a postal strike;
> (c) a serious illness or accident; or;
> (d) serious emotional or mental distress, such as death in the immediate family.
>
> (Emphasis added.)

Digitized by Google

[36] Section 34 adds special consideration because of exceptional events.

[37] In my opinion, the applicant's situation fits precisely within all those considerations. The only negative factor cited by the decision-maker is that she had previously filed necessary returns late and that she had managed to file them only to settle her husband's estate. That situation was highly exceptional in that it was the executor of the estate who urged or required the applicant to do those returns and who motivated the applicant even though she was still in a state of deep depression. I find that this should not have been relied on against the applicant.

[38] With deference to the person who made the decision of January 28, 2008, that decision is unreasonable in the exceptional circumstances that occurred and having regard to the applicant's psychological condition.

[39] An analysis of the case law cited *supra* shows that if ever there was a situation that merited tax relief, it is the applicant's in this case, in accordance with the very criteria formulated by the Department of National Revenue.

[40] I must therefore find that the applicant's application is well founded in fact and in law. The application for judicial review will therefore be allowed.

JUDGMENT

The application for judicial review is allowed and the decision made by Lucie Bergevin on January 28, 2008, is set aside.

The application is referred back to another authorized representative of the Minister of National Revenue for consideration in accordance with the reasons set out in this judgment.

The parties will bear their own costs.

"Orville Frenette"
Deputy Judge

Verna Hauser v. Canada Revenue Agency, 2007 FC 113, A Case of Mental Illness and Corresponding Financial Hardship, Not Enough

BETWEEN:
VERNA HAUSER
Applicant
and
CANADA REVENUE AGENCY
Respondent

REASONS FOR ORDER AND ORDER

[1] The Applicant failed to pay her income taxes on the time for the taxation years 1995, 1996, 1998, and 1999, resulting in interest accrual.

[2] In 2003, the Applicant applied to the Minister of Finance (the Minister) pursuant to subsection 220(3.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act), **for waiver of interest and penalties with respect to the period from January 1, 1995 to December 31, 2002, on the following three grounds: (i) waiver of penalties; (ii) waiver of interest on grounds of extraordinary circumstances; and (iii) waiver of interest on grounds of financial hardship. The Applicant's request was particularly based on emotional health issues and ongoing financial hardship.**

[3] Each of the above-noted three grounds of the Applicant's initial request for waiver of interest and penalties (Fairness Request) was considered by a separate officer of the Canada Revenue Agency (CRA).

Digitized by Google

[4] On October 7, 2003, the Minister decided to waive the late filing penalties for both the 1998 and 1999 taxation years.

[5] A CRA officer reviewed the Applicant's request for the waiver of interest on grounds of extraordinary circumstances. **He found there were no circumstances to warrant a waiver of interest and that, in spite of the Applicant's claims of stress in her personal life, she was able to maintain both regular and business income during the time in question and should have been able to meet her tax obligations.**

[6] Another CRA officer reviewed the request for the waiver of interest on grounds of financial circumstances. He reported that he found no financial hardship to warrant the waiver of interest.

[7] On June 21, 2004, the Minister notified the Applicant of his decision to deny the waiver of interest on the grounds of either (i) extraordinary circumstances or (ii) financial hardship for the 1995, 1996, 1998 and 1999 taxation years. **In response to that decision, the Applicant provided additional information for the Minister to review. The Minister treated this additional information as a new first level Fairness Request for the waiver of interest on the grounds of extraordinary circumstances and financial hardship.**

[8] Another CRA officer reviewed this second first level Fairness Request and recommended, after considering the additional information, that there were no grounds to warrant the waiver of interest. This decision was confirmed by a CRA team leader and was communicated to the Applicant on April 12, 2005.

[9] On December 27, 2005, the Applicant sent the Minister a letter requesting further consideration, which the Minister treated as a request for second-level review. The Applicant provided a letter from her psychiatrist stating that the Applicant was being treated, since May 31, 2005, for chronic anxiety and has developed a specific phobia related to financial transactions.

[10] The second-level review was conducted by a CRA officer who reviewed this new information. The officer reviewed all of the information on the file, conducted further research into the Applicant's financial circumstances and considered the Applicant's health issues. The officer found that the psychiatrist's letter was not relevant for the period in issue for the fairness relief and recommended that the request be denied. The officer's recommendation was reviewed by a CRA manager and the Assistant Director of Revenue Collections and they decided to deny the Applicant's Fairness Request. **In his February 28, 2006 letter informing the Applicant of the negative decision, the Assistant Director, Revenue Collections, wrote the following:**

> **We have examined all the submitted evidence related to your ongoing anxiety issues and surgery to remove a chest tumour. Although we can empathise [*sic*] the difficulties you no doubt encountered in dealing with and recovering from these experiences, we cannot agree that there is evidence that the circumstances were so extraordinary as to prevent you from paying your taxes on time. It is apparent from our review that you were able to maintain your employment and earn additional income from business activities during this time, which enabled you to keep your commitments to other creditors over that of your tax obligations.**

[11] On April 5, 2006, the Applicant filed the within application for judicial review of the Minister's decision.

I. Issue

[12] Did the Minister discharge his duty to act fairly in exercising his discretion under subsection 220(3.1) of the Act to deny fairness relief to the Applicant?

Digitized by Google

II. Standard of Review

[13] The applicable standard of review of a fairness decision of the Minister has been settled by the Federal Court of Appeal in *Lanno v. Canada (Customs & Revenue Agency)*, 2005 FCA 153, at paragraphs 6-7. In that case, the Court conducted a pragmatic and functional analysis and determined the applicable standard to be reasonableness *simpliciter*. I will apply the reasonableness standard in reviewing the Minister's decision in this case.

III. Analysis

[14] Did the Minister discharge his duty to act fairly in exercising his discretion under subsection 220(3.1) of the Act to deny fairness relief to the Applicant?

[15] The Applicant argues that her health condition was not considered in the decision by the Minister. She states that, in the decision, the CRA focuses on finances and does not adequately address physical and emotional health. She contends that her letters clearly stated that she was unable to function as a bookkeeper for her husband's business, and therefore she was unable to file income tax returns in a timely fashion.

[16] She further contends that she does not believe the officers who reviewed the file had taken into account the emotional distress she and her family were under. **The Applicant submits that the CRA officers are not qualified to produce opinions about physical and emotional health and are consequently not qualified to conclude reasonably with respect to her inability to pay her taxes. The Applicant argues that the Minister should have consulted a health care professional about her case. She contends that a medical professional would have been able to explain, contrary to the CRA's determination, how it is possible for someone to be able to meet certain obligations while not maintaining others in a time of stress.**

[17] On this point, I agree with the Respondent. There is no obligation on the Minister to consult with a health care professional in making a fairness decision. It was reasonable for the Minister to determine that the impugned December 27, 2005 letter from the Applicant's psychiatrist was not relevant to the period in issue. In the circumstances, the Minister acted fairly and in accordance with the rules of procedural fairness as developed in administrative law.

[18] The Applicant cites three decisions in support of her claim: *Ross v. Canada (CCRA)*, 2006 FC 294; *Dick v. Canada (CCRA)*, 2005 FC 560; and *Bilida v. Revenue Canada*, 51 D.T.C. 5041, 124 F.T.R. 172. In all three cases, the Minister's decision to deny a waiver of penalties and interest was set aside by the Federal Court. I have reviewed these cases and find that they can be distinguished.

[19] In *Ross*, the Minister significantly overstated the annual surplus of the taxpayer' income, and therefore the Court found the Minister's conclusions regarding the ability to pay back the tax to be unreasonable. In *Dick*, the Minister failed to take into consideration that the taxpayer was a 72-year-old chronic alcoholic, and given his retirement income, unable to ever repay the amounts owed. Further, the taxpayer's liabilities were equal to his assets and the penalties and interest assessed against him far exceeded the taxes owing. In *Bilida*, the taxpayer was a 76-year-old widow living on an old age pension who was unable to pay the tax owed. The Court held that Revenue Canada's delay in assessing the taxpayer's returns contributed to the arrears and penalties.

[20] The circumstances of the taxpayers in the above cited cases are certainly not those of the Applicant. **The Applicant was able to maintain employment and to earn additional income from her business activities, enabling her to meet her commitments to other creditors. It was not unreasonable for the Minister to conclude, in these circumstances, that the Applicant was simply showing preference to other creditors**

Digitized by Google

over the CRA. Further, the evidence indicates that the Applicant's net worth shared with her spouse is estimated at $500,000.00, an amount she does not dispute. Relative to her net worth, the outstanding interest owing in the amount of $12, 632.63 is relatively small.

[21] On the record before me, I am satisfied that the Minister exercised his statutory discretion in good faith and in accordance with the principles of natural justice. I am satisfied that Minister properly considered the evidence before him and that the decision was not based on considerations irrelevant or extraneous to the statutory purpose. (*Maple Lodge Farms v. Government of Canada*, [1982] 2 S.C.R. 2, at page 8.)

[22] For the above reasons, the application for judicial review of the Minister's February 28 2006, fairness decision will be dismissed.

ORDER

THIS COURT ORDERS that the application for judicial review of the Minister's February 28, 2006, fairness decision is dismissed.

Julie Deborah Surtherland v. Canada Customs & Revenue Agency, 2006 FC 154, Bi-polar Disorder and Uncontrolled Financial Responsibility

BETWEEN:
JULIE DEBORAH SURTHERLAND
Applicant
- and -
CANADA CUSTOMS & REVENUE AGENCY
Respondent

REASONS FOR ORDER

PINARD J.:

[1] This is an application for judicial review of the July 30, 2004 second level Fairness decision, made by Roger A. Ouellette, on behalf of the Minister of National Revenue, denying the applicant relief from interest and penalties with respect to the 1994 to 2001 taxation years.

* * * * * * * *

[2] Julie Deborah Sutherland (the "applicant") had been assessed by Canada Revenue Agency ("CRA") interest and penalties related to her income tax returns for the years 1994 to 2001 arising from her late payment of income taxes on her disability pension from 1994 to 2000, as well as her late filing of returns for 1999 and 2000.

[3] In April 2002, the applicant paid her outstanding debt to the CRA.

[4] In 2003, the applicant applied to the Minister pursuant to subsection 220(3.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th supp.) (the "Act") for waiver of interest and penalties ("Fairness") with respect to the 1994 to 2001 taxation years. The basis of the applicant's Fairness request was that she suffers from bipolar affective disorder as well as a number of other health problems.

[5] On October 27, 2003, the Minister notified the applicant of his decision to waive only the applicant's late filing penalty for the 2000 taxation year because the applicant was in the hospital at the time that her 2000 tax return was due. The Minister found no other extraordinary circumstances nor sufficient financial hardship to warrant the waiver of interest or penalties.

[6] On January 28, 2004, the Minister received a letter from the applicant that the Minister treated as a request for a second level of Fairness review. In that letter, the

Digitized by Google

applicant emphasized the effects of her bipolar affective disorder on her ability to manage her tax affairs.

[7] The Fairness committee found that the applicant knew that no tax was being deducted from her pension income for at least six years before she took steps to rectify the situation by arranging for source deductions in 2000. The committee also recognized that the applicant had severe medical problems but it was of the opinion that the applicant should have been able to take action to prevent the accrual of interest before six years had elapsed.

[8] The Fairness committee concluded that the applicant should be denied relief from interest and penalties. The committee prepared a memorandum with its findings and recommendation to Roger Ouellette, the Assistant Director of the Revenue Collections Division, who reviewed the material and approved the committee's recommendation.

[9] On July 30, 2004, the Minister's second level Fairness decision to deny relief was sent to the applicant. In this letter, Mr. Ouellette noted that the applicant had been reminded annually since 1994 to arrange for source deductions from her disability pension, yet did not do so until September 2000. He also reiterated the Fairness committee's point that the applicant's disability should not have prevented her from making those arrangements.

[10] Like counsel for the respondent, it is my understanding that this last decision does not affect the previous relief granted in the first level Fairness decision, waiving the late filing penalty for the year 2000, in the amount of $712, as the applicant was in the hospital at the time the return was due.

* * * * * * * *

[11] The relevant provisions of the Act are as follows:

220. . . .

(2.01) The Minister may authorize an officer or a class of officers to exercise powers or perform duties of the Minister under this Act.

[. . .]

(3.1) The Minister may at any time waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by a taxpayer or partnership and, notwithstanding subsections 152(4) to 152(5), such assessment of the interest and penalties payable by the taxpayer or partnership shall be made as is necessary to take into account the cancellation of the penalty or interest.

220. . . .

(2.01) Le ministre peut autoriser un fonctionnaire ou une catégorie de fonctionnaires à exercer les pouvoirs et fonctions qui lui sont conférés en vertu de la présente loi.

[. . .]

(3.1) Le ministre peut, à tout moment, renoncer à tout ou partie de quelque pénalité ou intérêt payable par ailleurs par un contribuable ou une société de personnes en application de la présente loi, ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

* * * * * * * *

[12] The applicant submits that the Fairness committee erred in finding her ineligible for waiver of interest and penalties, as there was adequate information before the committee to find her eligible for cancellation and waiver of interest and penalties for the years 1994 through 2001.

Digitized by Google

[13] The applicant submits that she suffers from an acute form of bipolar affective disorder. Her children also suffer from psychiatric disorder, while her mentally ill brother had recently committed suicide at the time of her first level request. This information was before the Fairness committee.

[14] Additionally, the applicant submits that the Fairness committee made the following errors:

- adjudicated her first level request on financial hardship grounds rather than on medical grounds;

- made an incorrect assumption when it concluded that she and her spouse purchased a home from monies saved during their cohabitation, when her RRSPs were instead accumulated in the year 2000 only and were quickly eradicated due to the loss of judgment attributable to her mental illness; and

- ignored section 12 of the *Interpretation Act*, R.S.C. 1985, c. I-21, which states that "[e]very enactment shall be construed as being remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects."

[15] Subsection 220(3.1) of the Act allows the Minister to waive interest and penalties otherwise payable in respect of 1985 and subsequent taxation years. Subsection 220(2.01) of the Act permits the Minister to delegate the discretion granted under subsection 220(3.1).

[16] The Minister's discretion is broad in the context of Fairness decisions. The Act and its regulations are silent as to what criteria are to be used by the Minister in exercising his discretion. In these circumstances, the Minister may use any criteria he chooses, as long as he abides by a general duty to act fairly in accordance with the rules of procedural fairness as developed in administrative law (*The Estate of the Late Henry H. Floyd v. The Minister of National Revenue* (1993), 93 D.T.C. 5499 at 5501 (F.C.T.D.) and *Kaiser v. The Minister of National Revenue* (1995), 95 D.T.C. 5187 at 5188 (F.C.T.D.)).

[17] To facilitate the exercise of his discretion, the Minister has created guidelines in the form of Information Circular 92-2. However, although the Minister can formulate these general policy guidelines, he cannot fetter his discretion by treating the guidelines as binding and excluding all other relevant reasons for exercising his discretion (*Maple Lodge Farms Limited v. Government of Canada*, [1982] 2 S.C.R. 2 at pages 6 and 7).

[18] In *Lanno v. Canada Customs and Revenue Agency*, 2005 D.T.C. 5245, the Federal Court of Appeal determined that the standard of review applicable to discretionary Fairness decisions made by the Minister is reasonableness *simpliciter*.

[19] The grounds upon which the decision of the Minister may be reviewed are set out in section 18.1 of the *Federal Courts Act*, R.S.C. 1985, c. F-7, which reads:

18.1 (1) An application for judicial review may be made by the Attorney General of Canada or by anyone directly affected by the matter in respect of which relief is sought.

(2) An application for judicial review in respect of a decision or an order of a federal board, commission or other tribunal shall be made within 30 days after the time the decision or order was first communicated by the federal board, commission or other tribunal to the office of the Deputy Attorney General of Canada or to the party directly affected by it, or within any further time that a

18.1 (1) Une demande de contrôle judiciaire peut être présentée par le procureur général du Canada ou par quiconque est directement touché par l'objet de la demande.

(2) Les demandes de contrôle judiciaire sont à présenter dans les trente jours qui suivent la première communication, par l'office fédéral, de sa décision ou de son ordonnance au bureau du sous-procureur général du Canada ou à la partie concernée, ou dans le délai

Digitized by Google

supplémentaire qu'un juge de la Cour fédérale peut,
judge of the Federal Court may fix or allow before or after the end of those 30 days.

(3) On an application for judicial review, the Federal Court may

(*a*) order a federal board, commission or other tribunal to do any act or thing it has unlawfully failed or refused to do or has unreasonably delayed in doing; or

(*b*) declare invalid or unlawful, or quash, set aside or set aside and refer back for determination in accordance with such directions as it considers to be appropriate, prohibit or restrain, a decision, order, act or proceeding of a federal board, commission or other tribunal.

(4) The Federal Court may grant relief under subsection (3) if it is satisfied that the federal board, commission or other tribunal

(*a*) acted without jurisdiction, acted beyond its jurisdiction or refused to exercise its jurisdiction;

(*b*) failed to observe a principle of natural justice, procedural fairness or other procedure that it was required by law to observe;

(*c*) erred in law in making a decision or an order, whether or not the error appears on the face of the record;

(*d*) based its decision or order on an erroneous finding of fact that it made in a perverse or capricious manner or without regard for the material before it;

(*e*) acted, or failed to act, by reason of fraud or perjured evidence; or

(*f*) acted in any other way that was contrary to law.

(5) If the sole ground for relief established on an application for judicial review is a defect in form or a technical irregularity, the Federal Court may

(*a*) refuse the relief if it finds that no substantial wrong or miscarriage of justice has occurred; and

(*b*) in the case of a defect in form or a technical irregularity in a decision or an order, make an order validating the decision or order, to have effect from any time and on any terms that it considers appropriate.

avant ou après l'expiration de ces trente jours, fixer ou accorder.

(3) Sur présentation d'une demande de contrôle judiciaire, la Cour fédérale peut :

a) ordonner à l'office fédéral en cause d'accomplir tout acte qu'il a illégalement omis ou refusé d'accomplir ou dont il a retardé l'exécution de manière déraisonnable;

b) déclarer nul ou illégal, ou annuler, ou infirmer et renvoyer pour jugement conformément aux instructions qu'elle estime appropriées, ou prohiber ou encore restreindre toute décision, ordonnance, procédure ou tout autre acte de l'office fédéral.

(4) Les mesures prévues au paragraphe (3) sont prises si la Cour fédérale est convaincue que l'office fédéral, selon le cas :

a) a agi sans compétence, outrepassé celle-ci ou refusé de l'exercer;

b) n'a pas observé un principe de justice naturelle ou d'équité procédurale ou toute autre procédure qu'il était légalement tenu de respecter;

c) a rendu une décision ou une ordonnance entachée d'une erreur de droit, que celle-ci soit manifeste ou non au vu du dossier;

d) a rendu une décision ou une ordonnance fondée sur une conclusion de fait erronée, tirée de façon abusive ou arbitraire ou sans tenir compte des éléments dont il dispose;

e) a agi ou omis d'agir en raison d'une fraude ou de faux témoignages;

f) a agi de toute autre façon contraire à la loi.

(5) La Cour fédérale peut rejeter toute demande de contrôle judiciaire fondée uniquement sur un vice de forme si elle estime qu'en l'occurrence le vice n'entraîne aucun dommage important ni déni de justice et, le cas échéant, valider la décision ou l'ordonnance entachée

Digitized by Google

du vice et donner effet à celle-ci selon les modalités de temps et autres qu'elle estime indiquées.

[20] This Court is not called upon to exercise the discretion conferred on the Minister or to substitute its own decision for that of the Minister. This Court should not conclude that the Minister is wrong merely because the Court would have exercised the discretion differently. The review is instead limited to the manner in which the Minister exercised his discretion (*Maple Lodge Farms Limited*, *supra*).

[21] It is my opinion that, in the present case, it was reasonable for the Minister to conclude that despite the applicant's documented medical problems, she had allowed an extraordinary period of time to elapse before taking steps to rectify her tax situation and that she should therefore not qualify for Fairness relief.

[22] For the period under review, the applicant was able to file her returns on time in all years except 1999 and 2000, which were each filed approximately six months late. It was only the taxes associated with those returns which were not paid until 2002.

[23] Additionally, the applicant had been reminded annually since 1994 that she should arrange for source deductions to be taken from her disability pension. It is not unreasonable for the Minister to conclude that the fact that she did not take action until September 2000 was a delay which cannot reasonably be explained by the applicant's circumstances.

[24] Before the commencement of the annual reminders from the Minister to arrange for source deductions, the applicant was also lectured about fiscal responsibility by the Master in chambers at the discharge hearing in her second bankruptcy in 1993. In my opinion, it was reasonable for the Minister to conclude that Fairness relief is not appropriate in these circumstances.

[25] In response to the applicant's submission that the Minister erred in referencing her income, RRSPs and ability to purchase a home, I disagree. On my reading of the paragraph, contrary to the applicant's submission, there is no assumption made that the applicant's home was purchased with RRSP monies. These facts, whether right or wrong, were put forth as evidence of the applicant's financial position. Regardless, the Minister's July 30, 2004 decision letter clearly shows that the applicant's inordinate delay was the reason for the Minister's refusal to grant Fairness relief at the second level.

[26] Regarding the applicant's submission that the first level request was adjudicated on the basis of financial hardship rather than on medical grounds, I do not think this issue is determinative, as the second level Fairness information (the same information as was submitted with the first level request) clearly referenced her medical issues, and therefore cured any deficiency (had there been any) in the process to that point-in-time.

* * * * * * * *

[27] I am unable to conclude, based on the facts before me, that the Minister improperly exercised his discretion in the present case. The applicant was afforded the opportunity to make representations as to why the interest should be waived and the Minister had before him all the relevant facts necessary on which to base a reasoned and objective decision. Absent bad faith on the part of the Minister, a breach of the principles of natural justice or consideration of extraneous or irrelevant factors, there is nothing to warrant the Court's interference with the exercise of his discretion. I am not satisfied that any of these exist in the present case.

[28] As it is my opinion that the Minister discharged his duty to act fairly in exercising his discretion under subsection 220(3.1) of the Act to deny Fairness relief to the applicant and as I find that the decision is reasonable, this application for judicial review is dismissed, without

Digitized by Google

costs.

JUDGE
OTTAWA, ONTARIO
February 14, 2006

Financial Restructuring though No New Equity

In Frank G. Robertson v. MNR[20] the taxpayer had merely consolidated his credit-card balances into a bank loan to reduce interest and while being late on filing some years the Director of the Tax Office had denied fairness. When reviewed by the Trial Court it held:

> The issue is whether the Minister has properly exercised his discretion with regard to relevant considerations and without regard to erroneous factors. See: GoldMaker v.Canada,(Minister of National Revenue) (2000), 2 C.T.C. 149 (F.C.T.D.) The standard of review is patent unreasonableness: Chan v. Her Majesty The Queen (2001), D.T.C. 5575 (F.C.A.)and Sharma v. Minister of National Revenue(2001)D.T.C. 5360 (F.C.T.D.)
>
> As stated earlier, the letter of refusal provides reasons for the refusal. The Director, in his affidavit sworn September 20th, 2001, deposes at paragraph 7 that he considered the following factors: (a) the request made by the applicant and the reasons therefore; (b) the fact that the applicant did not indicate he was prevented from filing his income tax returns on time; (c) the applicant has accumulated additional consumer debt in December, 2000; (d) the financial hardship was not such that warranted the cancellation of penalties and interest, and (e) the guidelines established in Information Circular 92-2 and Internal Directive ARD 9201 dated April 16th, 1992 were not met in these circumstances.
>
> Regarding paragraph(b),the use of the word "prevented", at first blush, would appear to mean circumstances outside the applicant's control. However, when viewed in conjunction with the Director's report dated June 12th, 2001, the meaning to be attributed to "prevented" is not so clear. In the second paragraph of his report the Director states:
>
> "The client filed both his 1998 and 1999 returns on May 18th, 2000. No reasons have been given for filing late." The applicant, in fact, provided detailed reasons for the failure to file his returns in his correspondence to CCRA dated October 29th, 2000. It may well be that the Director did not consider these reasons to be sufficient. However, in the face of his statement that no reasons were given, I cannot say that the reasons were considered, let alone found to be insufficient.
>
> With respect to paragraph(c), additional consumer debt, the refusal letter specifically states:
>
> "In addition, our records indicate that you had accumulated additional consumer debt in December, 2000. In such situations, the cancellation of interest charges is not usually granted."
>
> This finding of fact is erroneous. The record clearly indicates that there was not additional debt, but a debt consolidation. The applicant provided all of the supporting documentation regarding the loan consolidation in correspondence to CCRA dated February 20th, 2001. Indeed, the Director in his report dated June 12th, 2001, refers specifically to the payouts made by the applicant. The comments contained in the Director's report fly in the face of his affidavit and the reason delineated in his refusal letter and are contradictory.
>
> There is an additional statement in the Director's report indicating a reported expense of $100.00 for recreation on the applicant's income and expense statement. Although nothing turns on this, it, too, is an erroneous finding because the applicant allocated $50.00 per month for recreation, not $100.00.

[20] 2003 FCT 16

Digitized by Google

Attached to the Director's affidavit are the notations of CCRA officers containing recommendations not to apply discretion in favour of the applicant. One such notation on June 5th states:

"Interest is not the reason for the hardship. Taxpayer made decisions not to borrow and pay tax arrears, paying other creditors while ignoring tax obligations."

The evidence indicates that the applicant did attempt to borrow the money to pay the tax arrears. A second notation on June 5th, 2001 contains the following statement:

"Agree with above comments, large unsecured credit balances, Visa, etc. are the cause of any hardship."

In fact, the applicant had consolidated his loans in December, 2000. There were no unsecured credit balances as of the date of the notation. There was merely the one consolidated loan with Canada Trust that has been referred to previously.

With respect to the Director's finding that financial hardship was not such that warranted the cancellation of penalties and interest, the applicant argues that the CCRA erred in its finding that he had $1,100.00 surplus monthly income. The Director found that the applicant was not suffering financial hardship and that he had a surplus of monthly income. In his report, he states:

"The client repeatedly mentions in his correspondence that his net monthly income for a family of six is below the poverty line. However, based on the client's income for 2000 on DD.3 and his expenses, the client has a monthly surplus of $800.00 after his monthly payment of $300.00 to CCRA."

The applicant calculates his surplus at $80.96 per month. The document relied upon by the Director is contained in the record but there is nothing to indicate how the calculations were completed. The Director was not, on cross-examination, able to enlighten the applicant in this regard, nor could counsel provide assistance at the hearing. In my view, the applicant is entitled to know where the calculations came from or how they were arrived at.

I am mindful of the comments of my colleague, Rouleau,J. in Kaiser v. The Minister of National Revenue, (1995), 93 F.T.R. 66 and I quote those comments for the benefit of the Director in this case:

"The purpose of this legislative provision is to allow Revenue Canada Taxation to administer the tax system more fairly by allowing for the application of common sense in dealing with taxpayers who, because of personal misfortune or circumstances beyond their control, are unable to meet deadlines or comply with rules under the tax system.

The language used in the section bestows a wide discretion on the Minister to waive or cancel interest at any time. To assist in the exercise of that discretion, policy guidelines have been formulated and are set out in Information Circular 92-2."

I refer to that primarily because, and I don't mean to imply that the Director has acted in bad faith or anything of that nature, but I do refer to paragraph 7(e) of his affidavit, and it would appear to me that, certainly on its face, it appears that the Director has attempted to place the applicant into pigeon-holed criteria cited in the guidelines and the directive, notwithstanding that it is specifically stated that they are not intended to be exhaustive. The comments of Justice Rouleau are enlightening in that regard. In any event, and not withstanding those comments, I am also mindful that the Court is not to substitute its findings or its opinion for those of the ministerial delegate and, while that is so, neither is it the Court's function to speculate on what the Director's ultimate decision might have been but for the erroneous findings of fact.

Here, the Director made erroneous findings of fact that, in my view, taint the decision. The reasons, particularly those that relate to the late filing of the returns, do not adequately

Digitized by Google

explain the Director's position. In the circumstances, this decision is patently unreasonable.

Segregation of 1st and 2nd Fairness Reviews Important.

One of the tenets of the Fairness Procedure that CRA has set up is that the applicant will be allowed an appeal to a second level of decision making which must be independent of the first. The independence of the 2 levels maintains and fosters a fuller environment for the fairness request. In John Herbert Rocke Robertson v. MNR[21] at issue, amongst other incidentals in a simple Fairness judicial review, was whether the taxpayer had obtained that *independent* 2nd appeal from the 1st decision. The Trial court pointed out:

> **ISSUE**
> [10] Did the respondent discharge his duty to act fairly in declining to exercise his discretion under subsection 220(3.1) of the Act?
>
> **THE FAIRNESS PROCESS**
> [11] The affidavit submitted with the respondent's record outlines the decision-making process with respect to a Fairness Request. The relevant passages of the affidavit are as follows:
> After receiving the CCRA's decision, the taxpayer may make a written "second level" Fairness request if he or she disagrees with the CCRA's decision at the first level.
> The file is then assigned to a Collections Officer who was not involved at the "first level", whose role it to conduct a complete review of the file to date, including the taxpayer's request for Fairness relief. This officer prepares a further summary of the file, accompanied by his or her recommendation as to whether or not to approve or deny the taxpayer's Fairness request. The file and summary with recommendation are forwarded to a Fairness Committee comprised of a Collections Manager who was not involved at the "first level" and the Assistant Director, Revenue Collections, for a decision. [*emphasis mine*]
> [12] It is acknowledged by the respondent that at the first level Mr. Robertson's waiver application was reviewed by a Collections Officer whose recommendation was concurred in by a Fairness Committee consisting of two Collections Managers: Diane Readman and Stan Thompson.
> [13] At the second level, the summary and recommendations were forwarded to a Fairness Committee comprised of Mr. Vondette who was a Collections Manager and Stan Thompson who was Acting Assistant Director, Revenue Collections, both of whom concurred with the recommendation that the second level appeal should be denied.
>
> **LEGISLATION**
> [14] The relevant legislative provision is as follows:
> (3.1) Waiver of penalty or interest
> The Minister may at any time waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by a taxpayer or partnership and, notwithstanding subsections 152(4) to (5), such assessment of the interest and penalties payable by the taxpayer or partnership shall be made as is necessary to take into account the cancellation of the penalty or interest.
> **DISCUSSION**
> [15] In *Getson v. Canada (Attorney General),* 2001 F.C.T. 550, I found the principles governing the exercise of ministerial power under subsection 220(3.1) of the *Act* were

[21] 2001 FCT 876

Digitized by Google

articulated by Pratte J.A. in *Her Majesty the Queen v. Barbara L. Barron et al.* (1997), 97 D.T.C. 5121 (F.C.A.) as follows:

... it may be useful to recall that subsection 152 (4.2) of the Income Tax Act confers a discretion on the Minister and that, when an application for judicial review is directed against a decision made in the exercise of a discretion, reviewing court is not called upon to exercise the discretion conferred on the person who made the decision. The court may intervene and set aside the discretionary decision under review only if that decision was made in bad faith, if its author clearly ignored some relevant facts or took into consideration irrelevant facts or if the decision is contrary to law.

[16] Accordingly, this Court cannot interfere with the Minister's decision unless a reviewable error was committed.

[17] It is my view, however, that the respondent breached the duty of fairness when it broke its own internal rules as to the composition of the second level appeal panel.

[18] The respondent contends that although Mr. Thompson was by circumstance in the position of acting Assistant Director, Revenue Collections, by the "second level" review, the independence of the review process was not nullified given that the request was considered by two Collections Officers and two other Managers in the course of the ordinary fairness review process.

[19] This argument cannot withstand scrutiny. The respondent has established specific procedures for assessing a Fairness Request. It is apparent that this procedure was designed to ensure that the same decision maker is not involved at both the first and the second level reviews. Notwithstanding this procedure, the respondent allowed Mr. Thompson to participate not only at the first level but also at the second level. Though Mr. Thompson held the position of "Acting" Assistant Director, rather than his substantive position of Collections Manager, I am satisfied that the respondent has not respected its own procedure. In *Baker v. Canada (Minister of Citizenship and Immigration,* [1999] 2 S.C.R. 817, Madam Justice L'Heureux-Dubé, in her analysis of criteria that enable a Court to determine whether procedures followed respected the duty of fairness, stated:

[T]he analysis of what procedures the duty of fairness requires should also take into account and respect the choices of procedure made by the agency itself, particularly when the statute leaves to the decision-maker the ability to choose its own procedures, or when the agency has an expertise in determining what procedures are appropriate in the circumstances: Brown and Evans, supra, at pp. 7-66 to 7-70. While this, of course, is not determinative, important weight must be given to the choice of procedures made by the agency itself and its institutional constraints: IWA v. Consolidated-Bathurst Packaging Ltd., [1990] 1 S.C.R. 282, per Gonthier J.

[20] In deciding whether to allow this judicial review application on this limited ground, I was influenced by the apparent purpose of the internal rule and the values which that rule was designed to convey to the public.

[21] The internal rule that was breached sought to assure the taxpayer that the appeal process was genuine and effective in that a person who had decided the waiver application at the first level could not sit on appeal from his/her decision.

[22] In addition, by setting up this procedure, while not quite meeting the requirements for the application of the doctrine of legitimate expectations, the respondent intended it be followed in order to promote its fairness policy.

[23] In terms of the relief sought, the applicant requested that if I allowed the judicial review application, I should direct the respondent to cancel penalties and interest or that I keep jurisdiction by requiring the respondent to report back to the Court after reconsideration was completed. I agree with the respondent that I do not have the ability to give the applicant

Digitized by Google

this kind of relief.

Latent Establishment of Interest/Penalty and Discoverability

What happens when a taxpayer is purportedly unaware of his tax liability and due to CRA's latent establishment of interest and penalties a Fairness application is filed? Are there grounds to state that a waiver should occur when there are disputes as to amounts and timing? This was the case in Pavage St- Eustache Ltée v. Attorney General Of Canada[22].

REASONS FOR JUDGMENT AND JUDGMENT

Overview

[1] This is an application for judicial review filed by the applicant Pavage St-Eustache Ltée (Pavage), a member of the Mathers Group, of the decision rendered on February 2, 2010, by the Canada Revenue Agency, Montréal Tax Services Office (the Agency) dismissing a request for relief dated September 3, 2009, from Pavage under subsection 220(3.1) of the *Income Tax Act* (the Act).

[22] 2011 FC 1014

Digitized by Google

[2] Section 220(3.1) of the Act provides:

Waiver of penalty or interest

Renonciation aux pénalités et aux intérêts

Digitized by Google

(3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

[Emphasis added.]

(3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l'année d'imposition d'un contribuable ou de l'exercice d'une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d'un montant de pénalité ou d'intérêts payable par ailleurs par le contribuable ou la société de personnes en application de la présente loi pour cette année d'imposition ou cet exercice, ou l'annuler en tout ou en partie.

Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

[Notre

Digitized by Google

soulignement]

[3] The reassessment issued by the Agency on May 26, 2004, for Pavage's fiscal year ending December 31, 1996, is the central issue between the parties. This reassessment formally disallowed the deduction of $1,128,454 for a farm loss (the farm loss) claimed by Pavage for the 1996 taxation year that the Agency had provisionally allowed.

[4] The reassessment of May 26, 2004, increased Pavage's payable taxes by $341,805 on its business income for 1996 plus interest on arrears of $299,565 and interest on a reimbursement of
$10,080.77 for a total of $651,450.77.

[5] The issuance of this reassessment was provided under the terms of a civil and penal settlement agreement (the agreement) entered into on November 25, 2002, between the Mathers Group companies and the Agency following an investigation by the Agency begun in 1998. Article 8 of the agreement covers Pavage. It confirms the Agency's reassessment of February 14, 2002, which, for the first time, disallowed the farm loss claimed by Pavage.

The request for relief dated September 3, 2009

[6] This request for relief is part of a proposal made by Mr. Paci, counsel for Pavage, in his letter of September 3, 2009, to Claudine Vinette of the Agency's Montréal office. He stated the following: [TRANSLATION]

Following our recent discussions relating to the matter of ending this imbroglio, please note that we have received instructions to propose to you a full and final settlement that would consist in paying the total assessment amount of May 26, 2004, or of $341,805 without penality or interest, less the amounts withheld by the CRA.

[Emphasis added.]

[7] Mr. Paci pointed out that [TRANSLATION] "this statement is made in the context of a fairness request justified by the extraordinary circumstances surrounding this file, in particular:

The death of the lawyer representing the company originally, Bruno J. Pateras, Q.C., on April 13, 2002;

The prolonged absence of the investigator in charge of the file, Marcel Kessiby, due to health problems;

The issuance of a notice of assessment May 26, 2004, 18 months after the date of the original settlement;

The fact that the said notice of assessment was never delivered to our client, Pavage St-Eustache Ltd, or to our office, or to the investigator in charge of the file, Marcel Kessiby, who was supposed to be aware of any notice of reassessment in the Mathers Group file;

In addition, the table summarizing all notices of assessment issued since December 31, 1996, to December 31, 2006, which was attached to the CRA's letter of September 25, 2007 (see tab 5), making no reference to the notice of reassessment issued in May 2004. The above-noted table had been previously sent by the Shawinigan Collections Branch and it had been received at the Enforcement Division in Laval on September 13, 2007, all at the request of Mr. Kessiby;

Given the circumstances, our client could not have guessed that such a notice of reassessment, which had not even been recorded in CRA's receivables, existed;

The receipt of a reconciliation from Mr. Kessiby dated September 25, 2007, and the immediate payment of final amounts due by our client according to this document, are evidence that the said notice of reassessment of May 26, 2004, did not exist at that

Digitized by Google

moment for neither for our client nor for Mr. Kessiby;
The many undue delays caused by CRA in tracking down a copy of the notice of reassessment dated May 2004, locating the missing explanatory document and informing the undersigned that these documents existed, caused our client serious prejudice;
Furthermore, if the CRA taken due care in issuing the notice of reassessment, there would not have been any undue delays, therefore no interest nor penalties to add to the reassessment;
The lack of co-operation of certain individuals from CRA identified to replace Marcel Kessiby during his illness, specifically Réal Barbeau."

The Agency's decision

[8] On February 2, 2010, Francine Laporte, Team Leader, Revenue Collections, in Montréal, rejected Pavage's proposal of September 3, 2009, on three grounds stated in its letter addressed to counsel for Pavage:
Pavage's request for relief is time-barred. Ms. Laporte writes: [TRANSLATION]
Under the proposed amendments, announced in the March 2004 Federal Budget and legislated on May 13, 2005, the Minister's discretionary power in a request for relief only applies to the applications filed for a taxation year ending during the previous ten calendar years. For example, as of January 1, 2010, a request filed in 2010 would be accepted only for taxation years 2000 and following. However, your application concerns the 1996 taxation year.

Pavage knew that the reassessment of May 26, 2004, had been issued. Her view is the following
[TRANSLATION]
Furthermore, the review of the file confirms that several statements of account subsequent to the notice of assessment of May 26, 2004, were sent to your client, such as the statement of interest assessed on May 26, 2004, and a statement of arrears on September 30, 2004, that showed the total arrears claimed for the fiscal year ended December 31, 1996. In this regard, no mail was returned.

According to the provisions of the agreement of November 25, 2002, Pavage had waived a fairness claim. She stated the following:
[TRANSLATION]
Finally, we draw your attention to point 18 of the *civil and penal settlement proposal* dated November 25, 2002, which states that withdrawal of a right of appeal and the waiver of a fairness claim should accompany it.
[9] Considering its importance, I reproduce article 18 of the November 25, 2002, agreement: [TRANSLATION]
18. A waiver of the right of appeal and a waiver of a fairness claim must accompany the final proposed settlement. The withdrawal of the right of appeal and waiver of fairness should be applied in its entirety to all "CCRA" Tax Services offices, without reservation. In the event of failure to comply with the withdrawal of right of appeal and waiver of fairness by the natural or legal persons involved in the final proposed settlement, the reassessments will be cancelled and renewed according to the notices of assessment issued between March 2000 and February 2002, all in compliance with the results of the "CCRA".
[Emphasis added.]

The impact of *Bozzer v. Her Majesty et al*.

Digitized by Google

[10] *Bozzer v. Her Majesty The Queen in Right of Canada, Canada Revenue Agency and The Attorney General of Canada*, 2011 FCA 186 (Bozzer), was rendered by the Federal Court of Appeal on June 2, 2011, during my deliberation.

[11] Counsel for the Agency thinks that *Bozzer* [TRANSLATION] "has the effect of changing the state of the law as to the issue of presumption." He is of the view that **[TRANSLATION]**

Indeed, the Court of Appeal found that an applicant may apply for relief for a period of 10 years prior to filing the application, regardless of the tax year in question. Thus, the right of an applicant to file such an application, for all practical purposes, cannot be time-barred.
However, as the decision of the Minister of National Revenue was not based solely on the limitation period, but also on Pavage's waiver from requesting relief, it is our view that a determination can still be rendered in our case. [Emphasis added.]

[12] The following day, counsel for Pavage advised this Court as follows: [TRANSLATION]
Further to the letter of July 4, 2011, from our colleague, Louis Sébastien, this is to share with the Honourable Mr. Justice Lemieux
that the respondent cannot invoke the "waiver" contained in the parties' agreement since he has not himself complied with the *exceptio non adimpleti contractus*. [Emphasis added.]

[13] In *Bozzer*, the issue was how the 10-year limitation in section 220(3.1) of the Act must be calculated. The Federal Court of Appeal's reasons were written by Justice Stratas and at this the time are only available in English.

[14] On December 6, 2005, Mr. Bozzer filed a request for relief of interest accrued on unpaid taxes for the 1989 and 1990 taxation years. The Agency had denied the request because it had been filed late, that is, more than 10 years after his 1989 and 1990 taxation years. According to the Agency, under section 220(3.1), the Minister, in such circumstances, had no discretion to cancel or waive interest.

[15] Ms. Laporte dismissed Pavage's application for the same reasons.

[16] The application for judicial review in Bozzer was dismissed by a Federal Court judge for the reason that the 10 year period is calculated after the relevant taxation year, i.e. the assessment year (in our case, 1996). Justice Stratas was of the view that "the ten year period in subsection 220(3.1) does not start in the year of assessment". According to Justice Stratas, subsection 220(3.1) permits the Minister to exercise his discretion to waive interest accrued in any taxation year ending within 10 years before the taxpayer's request for relief, regardless of when the underlying tax debt arose.

[17] In this case, Justice Stratas' interpretation means that the Agency had the discretion to waive the interest accrued between January 1, 1999, and December 31, 2009, after the tax debt arose for Pavage's 1996 taxation year by the May 26, 2004, reassessment.

[18] In the circumstances, I find that counsel for the Agency was right to conclude that *Bozzer* meant that the manner in which the Agency applied the limitation period for Pavage's application was wrong. The discretion given to the Agency to grant tax relief to Pavage had not expired.

[19] Consequently, I find it unnecessary to address the debate on limitation as described by the parties in their arguments. The sole issue to be discussed is whether the Agency could rely on the waiver in paragraph 18 of the agreement.

Digitized by Google

However, I find the issue of whether and when Pavage was unaware that the May 26, 2004, reassessment existed is still relevant if my finding on waiver is not correct because this issue is attached to the discoverability principle or the impossibility of acting principle (see *Novak v. Bond*, [1999] 1 S.C.R. 808; and *Location Robert Ltée v. Canada* 2010 FCA 31). In other words, the discoverability principle could possibly push the relief request date from September 13, 2009, to a later date.

The parties' arguments

Pavage

Pavage's awareness of the existence of the May 26, 2004, notice of assessment

[20] Pavage claims that there is no evidence in the file demonstrating that Pavage or its representatives had received this notice of assessment. Pavage stated that the investigator in charge of the file, Marcel Kessiby, was not aware of its existence and processed the files without taking into account this notice of reassessment, which is confirmed by the fact that no enforcement measures were taken before December 31, 2006.

[21] Pavage called the Agency's reasoning erroneous for having refused relief based on the fact that the applicant had allegedly received account statements subsequent to the notice of assessment of May 26, 2004, since it neglected to mention that none of the statements of account received by Pavage referred to this notice of assessment and that there was no way for Pavage to know since it had never received the notice of May 26, 2004.

[22] In addition, Pavage had advised Marcel Kessiby of the existence of statements of account and he should have informed Pavage that the necessary adjustments would be corrected in compliance with the agreement.

The agreement

[23] Pavage also qualified the Agency's reasoning as erroneous for because it refused Pavage's relief request based on article 18 of the agreement.

[24] According to Pavage, this reasoning is faulty because its claim (the request for relief) is based on the fact that the Agency did not comply with the terms of the agreement (amended on November 28, 2002) since article 8 of the agreement was subject to paragraphs 10(*a*), 23 and 24 of the agreement and its amendment of November 28, 2002.

[25] Furthermore, according to Pavage;

the notice of assessment of May 26, 2004, is not justified because the taxes claimed by this notice were to be calculated in the total amount mentioned in paragraph 11(*a*) of the agreement and that the remedies mentioned in paragraph 8 are already part of the agreement of November 25, 2002, modified on November 28, 2002;

Paragraph 23 of the agreement mentions that there is no interest on the companies mentioned, including Pavage, and, consequently, the notice of May 26, 2004, could not charge interest; and

Paragraph 24 of the agreement assigns any discrepancies arising from the reassessments to the Agency

[26] To support its judicial review, Pavage filed affidavits by Mr. Paci and Marcel Kessiby. They were cross-examined.

[27] In his affidavit, Mr. Paci stated that

On September 25, 2007, he received from Marcel Kessiby a summary reconciliation of Pavage's accounts, indicating that the final amount due from Pavage on September 12, 2007, was $21,502 and that on October 2, 2007, Pavage paid the amount claimed;

On February 14, 2008, he wrote to the Assistant Director of the Agency's Enforcement Division in which he mentioned the payment of $21,502 but that despite that,

Digitized by Google

[TRANSLATION] “our client continued to receive monthly statements of arrears”;
Following this correspondence, Ms. Vinette was reassigned to the file and [TRANSLATION] “after several months of exhaustive searching in the file” Ms. Vinette [TRANSLATION] “finally traced the origin of the aforementioned statement of arrears” and that, on November 14, 2008, she sent him a copy of the notice of assessment of May 26, 2004, which was incomplete because the additional explanations were not included in the notice; he received them on December 19, 2008; and
Since April 30, 2007, the Agency deducted, as compensation from amounts due to Pavage, the amount of $650,233.
[28] In his affidavit, Marcel Kessiby swore to (1) the start of his employment at the Agency in 1981 and his retirement on September 28, 2007; and (2) his responsibility as investigator in the family’s and the Mathers Group’s concerns.
[29] He filed the agreement of November 25, 2002, amended on November 28, 2002, and on March 30, 2003 (applicant’s record, pages 24 and 26).
[30] In paragraph 15 of his affidavit, Marcel Kessiby acknowledged that article 8 of the agreement upholding a decision previously made by the Agency rejecting the farm loss of $1,128,454 and at the following paragraph states that [TRANSLATION] “ in accordance with this article [article 8] of the agreement, a notice of reassessment was issued by the Agency dated May 26, 2004.” However, he states that he was unaware of the existence of this notice of reassessment (paragraph 17) and [TRANSLATION] “therefore, I continued to process the file without taking into account this new notice of assessment” (paragraph 18).
[31] Marcel Kessiby concluded his affidavit stating that the notice of assessment of May 26, 2004, did not meet the terms of the agreement. At paragraph 43 of his affidavit, he supported Mr. Paci’s conclusions, reproduced in paragraph 25 of these reasons.

The Agency
Awareness of the notice of assessment of May 26, 2004

[32] The Agency relies on the provisions of subsections 244(14) and (15) of the Act that, according to it, set out presumptions that the notice of May 26, 2004, was sent on that day to Pavage. The provisions read as follows:
Mailing or sending date
For the purposes of this Act, where ... any notice of assessment or determination is mailed, ... it shall be presumed to be mailed or sent, as the case may be, on the date of that notice or notification.

Date when assessment made
Where any notice of assessment or determination has been sent by the Minister as required by this Act, the assessment or determination is deemed to have been made on the day of mailing of the notice of the assessment or determination. [Emphasis added.]
[33] The Agency argued that the discoverability or impossibility of acting principles were not established by Pavage since the predominant evidence in the record is that Pavage was aware of the notice of reassessment of May 24, 2004, and in any case, Pavage was aware that the Agency would have to reject the farm loss.
[34] The Agency added that the purpose of the agreement is the final penal and civil settlement of the Agency’s numerous assessments as part of its investigation into the Mathers Group’s actions, including the issue of farm loss claimed by Pavage for its 1996 taxation year.

Compliance with the agreement

Digitized by Google

[35] On the issue raised by Pavage that the reassessment of May 24, 2004, did not comply with the agreement, the Agency argued the opposite and added that, in any event, this has no relevance in determining the two issues, i.e. limitation and waiver of filing a fairness application within this agreement. The Agency also claims that Mr. Kessiby acknowledged in his affidavit that the assessment was issued in compliance with the agreement.

[36] To support its claims, the Agency filed the affidavit by Guy Léonard, the investigator and acting team leader at the Agency, on which he was not cross-examined. He stated that he consulted documents regarding the companies in the Mathers Group from approximately 77 boxes at the Agency. I will summarize the essential points of his affidavit.

[37] The Agency also filed an affidavit by Francine Laporte on May 4, 2010, which she was also not cross-examined upon.

[38] Guy Léonard listed and explained that all the notices of reassessment issued by the Agency against Pavage for the 1996 taxation year, and in particular:

The notice of February 14, 2002, which disallowed for the first time, among other things, the farm loss claimed by Pavage; and

The notice of February 19, 2003, which cancels that of February 14, 2002. According to Guy Léonard:

[TRANSLATION]

The purpose of this was to re-establish the adjustments as assessed by the March 7, 2001, assessment, i.e. at the time when the farm loss had not been disallowed, contrary to what paragraph 8 of the agreement of November 25, 2002, as it appears from the agreement in Exhibit A of the affidavit by Marcel Kessiby dated March 18, 2010. [Emphasis added.]

The notice of May 26, 2004, in which [TRANSLATION] "the Agency disallowed again the farm loss as it appears in report T99A prepared by Paul-André Drolet, the auditor who issued the assessment of May 26, 2004.

[39] As to the participation of Marcel Kessiby in the issuance of the notice of reassessment of May 26, 2004, Guy Léonard wrote:

[TRANSLATION]

As of December 2003, Marcel Kessiby was working on issuing a reassessment for the 1996 taxation year, a notice of reassessment that was eventually issued on May 26, 2004, since he prepared, on January 14, 2004, an audit report (called T-20) for this purpose. This report states that the farm loss would be disallowed in compliance with the agreement of November 25, 2002, as it appears in the report I attached as Exhibit "7" of my affidavit. [Emphasis added.]

[40] In paragraph 6 of his affidavit, Guy Léonard stated that the notice of reassessment of May 26, 2004, complied with the November 25, 2002, agreement in that (1) the parties have always agreed that the farm loss would be rejected; (2) the amount of $2,502,324 established at the end of the agreement of November 25, 2002, did not include the adjustment of the future assessment of May 26, 2004, according to a chart prepared by Marcel Kessiby on or around March 17, 2003 (see his Exhibit 11); (3) from November 25, 2002, to March 10, 2003, the Agency did not charge interest on Pavage's debt in compliance with the agreement of November 25, 2002, and a first amendment of November 28, 2002. However, On March 11, 2003, the Agency chose to assess the interests of Pavage and the other companies in the Mathers Group on the unpaid balance in accordance with a new amendment of March 20, 2003, since Pavage had not yet paid the amounts required.

[41] Guy Léonard ended his affidavit by noting that the conciliation of September 12, 2007, to which Marcel Kessiby refers at paragraph 31 of his affidavit of March 28, 2010, was incomplete because it only constituted the last two pages of the 13-page e-mail sent

Digitized by Google

by André Ruoette of the Shawinigan Tax Centre and who, on page two of his e-mail referred specifically to the assessment issued on May 26, 2004 (see Exhibit 13 of Guy Léonard's affidavit).

Analysis

Standard of review

[42] Relying on the Federal Court of Appeal in *Lanno v. Canada* (*Customs and Revenue Agency*), 2005 FCA 153, Pavage argued that the standard of review on the discretionary decisions rendered under the Act's fairness provisions is that of reasonableness and that, in the circumstances of this case, the February 2, 2010, decision was not reasonable for the following reasons:

The decision-maker did not consider all the circumstances beyond Pavage's control, resulting in it not being aware of the May 26, 2004, notice of assessment before the limitation period.

The decision-maker did not consider that the Agency had not exercised a reasonable amount of care in the circumstances and, specifically, that it was because of the Agency that Pavage believed that it had fulfilled all his obligations following the November 2002 agreement.

The decision-maker did not apply the applicable guidelines citing *Cole v. Canada* (*Auditor General*), 2005 FC 1445.

[43] The Agency submits that that the applicable standard of review is correctness because the issue of review centres on a question of law, that is, the interpretation of the Act. The Agency recognizes that, normally, exercising discretion is reviewed on a reasonableness standard, except if it is an issue of legislative interpretation.

[44] The Supreme Court of Canada in *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] 1 S.C.R. 190, changed the law with respect to the standard of judicial review. I find that this decision established the following principles:

Pure questions of law are reviewable on a correctness standard.

The issue of whether a court exercised its discretion appropriately in law is reviewable on a standard of reasonableness.

A decision based on a question of fact is reviewable on the standard of reasonableness with the qualification made by the Supreme Court of Canada decision in *Canada* (*Citizenship and Immigration*) *v. Khosa*, 2009 SCC 12, [2009] 1 S.C.R. 339 on the significance of section 18.1(4)(*d*) of the *Federal Courts Act*.

[45] In this case, I find that:

The issue of limitation is moot because of *Bozzer*.

The issue of whether the Agency complied with the agreement is a mixed question of fact and law reviewable on the standard of reasonableness.

The issue of whether the discoverability principle is applicable is a question of fact reviewable on the standard of reasonableness.

Findings

[46] I have two issues to determine: (1) Did the Agency comply with the agreement, and; (2) was the discoverability principle established?

[47] I think that the first issue is relevant to Pavage's request for relief and I find that the evidence filed by the Agency clearly demonstrates that the notice of assessment of May 26, 2004, complies with the agreement. I list this evidence:

The purpose of the notice of assessment of May 26, 2004, was to disallow the farm loss. The agreement is clear on this point.

Marcel Kessiby acknowledges that the reassessment of May 24, 2004, had to be

Digitized by Google

issued and that the effect of it was to create a debt of $341,805 payable by Pavage and also that interests could be payable (see his cross-examination cited by the Agency in the respondent's record, at paragraph 28(*e*), page 243).
The Agency did not charge interest to Pavage's debt in compliance with the agreement of November 25, 2002, and its first amendment, but nevertheless, on March 11, 2003, it chose to assess the interest of Pavage and the other companies of the Mathers Group on the unpaid balance in compliance with the amendment of March 20, 2003 (affidavit of Guy Léonard, at paragraph 6).
The amount of $2,502,324 established for the purposes of the November 25, 2002, agreement on the Mathers Group debt did not include the future assessment of May 26, 2004, as appears in a chart prepared by Marcel Kessiby on or around March 17, 2003 (affidavit of Guy Léonard, respondents' record, page 26, at paragraph e).
[48] As to whether the discoverability principle could benefit Pavage, I agree with the counsel for the Agency that Pavage was sufficiently aware that the notice of reassessment of May 26, 2004, had been issued to enable it to act by requesting relief subject to the issue of the waiver. This awareness results from the numerous documents that the Agency sent to Pavage, always at the same address at 400 Hector Lanthier Street, St. Eustache, Quebec. Pavage did not deny that the documents were received.
[49] In his memorandum of fact and law, counsel for the Agency listed this documentation at paragraph 11, page 233 to 236. In my view, the most relevant documents are found in the following of Francine Laporte's exhibits: (1) Exhibit B, page 11 dated December 30, 2004, (2) Exhibit C, page 16, and; (3) Exhibit D, page 22 of the respondent's record and Exhibit 10 of Guy Léonard's affidavit, on page 85.
[50] For these reasons, the judicial review must be dismissed.

JUDGMENT
THIS COURT ORDERS AND ADJUDGES that the application for judicial review is dismissed with costs
"François Lemieux"
Judge

Reliance on Erroneous 3rd Party Advice Not "Extra-Ordinary Circumstances"
When a taxpayer obtains an opinion from either a lawyer or an accountant on her tax affairs, and it turns out to be wrong, what happens on a Fairness Application when interest and penalties are applied on assessment? This was the case in Toastmaster Inc. v The Minister Of National Revenue As Represented By The Attorney General Of Canada[23] where a taxpayer had a permanent residence in Canada but was advised by its first tax accountants that it did not have one thus no need to file T2s. When subsequent proper advice proved otherwise considerable interest and penalties were applied and the Trial Ct. had to consider whether the 1st tax advice qualified as extra-ordinary circumstances beyond the taxpayer's control. It held:

> [17] The Minister's delegate prepared a "Taxpayer Relief Fact Sheet" summarizing the circumstances:
>
> An outstanding balance had been allowed to exist and accrue interest, because tax became payable in June 2001 but was not remitted to the CRA until March 2008;

[23] 2011 FC 1309

Digitized by Google

Toastmaster had not exercised reasonable care, nor had it acted quickly to remedy any delays or omissions, given that:
The requirement to file a T2 return for a corporation is not dependent on having a PE in Canada, pursuant to s 150 of the ITA;
Toastmaster did not demonstrate that it had exercised a reasonable amount of care under the self-assessment system; and
- There was no demonstration of extenuating circumstances to justify waiving the arrears interest assessed, because taxpayers are generally liable for errors made by third parties.

…

[21] Toastmaster submits that the wording of s 220(3.1) discloses no requirement to demonstrate "extraordinary circumstances beyond the taxpayer's control", contrary to paragraph 25(*a*) of the Guidelines. Toastmaster relies on *Nixon v Minister of National Revenue*, 2008 FC 917 at para 5, [*Nixon*], where the Court noted that s 220(3.1) gives the Minister broad, open-ended discretion, and that the Guidelines themselves are non-binding. Toastmaster also notes that the jurisprudence has held that the Guidelines "are not intended to be exhaustive or to restrict the spirit or intent of the legislation": *Lalonde c Canada (Agence du revenu)*, 2008 CF 183 at para 9; *Nixon*, above at para 6; *Spence v Canada (Revenue Agency)*, 2010 FC 52 at paras 25-26, [*Spence*]. Toastmaster notes that in *Spence*, above at paras 30-31, Justice John O'Keefe determined that it is for the Minister to look beyond the Guidelines and apply the broad discretion he is afforded by the ITA. Toastmaster says that the Minister's delegates failed to consider its particular circumstances, failed to apply the broad discretion given under s 220(3.1), and allowed reliance on the Guidelines to impede the exercise of that discretion.

…

[26] First, Toastmaster submits that the Minister's delegates failed to take into account the errors made by third parties acting on behalf of the taxpayer. While third party errors are generally not grounds for relief, the Minister's Guidelines at para 35 refer to the possibility of taking these errors into account in "exceptional situations".

[27] Second, Toastmaster says that the Minister's delegate failed to take into account the fact that it acted quickly to remedy its situation, and voluntarily brought the matter to the attention of the CRA by making submissions under the VDP.

…

[32] The Minister's delegates were well aware of Toastmaster's submissions with respect to the third party errors they claim were made by Deloitte & Touche. However, in an exercise of their discretion afforded to them under the ITA, they concluded that Toastmaster had not adequately explained why its T2 returns had never been filed. Information that was publicly available at the time indicated that even if a corporation did not have a PE, it would still be required to file T2 returns. This failure indicated that reasonable care had not been exercised, especially in the absence of any obviously extenuating circumstances.

[33] It is true that Toastmaster voluntarily brought its situation to the CRA's attention through the VDP. However, it is arguable whether it did so "quickly". In one sense, it acted quickly once it discovered its problems, sometime between 2004 and 2006. On the other hand, with reasonable care, the problem would have been discovered many years earlier.

Taxpayer's Right to Review Decision Before It is Made and Demands for Specific Foundation(s) of Decision

Whether or not a taxpayer is allowed the discretion of a waiver depends on the details of the request by which the Minister's official evaluates and HOW they are evaluated in granting it. It is in the taxpayer's interest to provide as much evidence as possible that authenticates the

Digitized by Google

reasons why she feels she is entitled to a waiver. When full disclosure is provided and the taxpayer still disagrees is she entitled to have her interpretation of the details rank and gain an understanding, through disclosure, of how the CRA arrived at theirs? This was the case in Dolores Sherry v The Minister of National Revenue[24] where the court considered whether a financial hardship based request and there was disagreement on its denial. It held:

> **THE ISSUES**
>
> [8] The Applicant has raised the following issues:
>
> 1. Are the reasons adequate?
> 2. Should she have been given an opportunity to comment on CRA's conclusions before the Decision was made?
> 3. Is CRA entitled to rely on the affidavit of James McNamara sworn on September 2, 2010 [the Affidavit] to supplement its reasons and is the material it exhibits unintelligible?
> 4. Did the Minister err in the exercise of his discretion?
>
> **THE STANDARD OF REVIEW**
>
> [9] In my view, the first three issues involve questions of procedural fairness. "Correctness" is the standard of review for such issues. The correctness standard was applied (i) to review the adequacy of reasons rendered under subsection 220(3.1) of the Act, see *Hi-Tech Seals Inc. v Canada (Minister of National Revenue)*, 2009 FC 901, at para. 13, (ii) to determine whether claimaints should have the opportunity to comment on CRA's conclusions, see *Costabile v Canada (Revenue Agency)*, 2008 FC 943, at para. 25 and (iii) to review CRA's attempt to supplement its reasons with affidavit material, see *Adams v Canada (Revenue Agency)*, 2009 DTC 5174, at paras. 2 and 11-12.
>
> [10] The last issue is to be reviewed using the reasonableness standard. The Federal Court of Appeal has confirmed that reasonableness is the appropriate standard of review to apply to a discretionary decision of the Minister under subsection 220(3.1) of the Act, see *Telfer v Canada (Revenue Agency)*, 2009 FCA 23, at para. 24-27 and *Slau Ltd. v Canada (Revenue Agency)*, 2009 FCA 270, at para. 27.
>
> **1. The Adequacy of the Reasons**
>
> [11] The Applicant submits that the Decision fails to provide adequate reasons because she has not been told what facts CRA relied on, what methods it used in its calculations and what assumptions it made.
>
> [12] The Respondent acknowledges that CRA's *Taxpayer Bill of Rights* promises reasons but its position is that comprehensive detailed reasons are not required. The Respondent says that, because the Decision is highly discretionary, there is a low threshold for the adequacy of reasons which is met by the Decision in this case. The Decision shows that, because of positive cash flow in eight of eleven years and because of significant equity in real estate properties, CRA found no financial hardship.
>
> [13] In my view, the real question is whether the Applicant needs further information to make the reasons intelligible. The Respondent suggests that because the Decision is largely based on information supplied by the Applicant, she has no need of further material.
>
> [14] However, I am not persuaded by this submission. While it is true that the Applicant provided her income and expenses in 2001, CRA extrapolated those figures to generate a cash flow summary for the years 1989 to 2005. As well, when it considered whether she had equity in her real estate holdings, CRA relied, in part, on its own appraised values of the Applicant's properties.
>
> [15] I have concluded that the Decision does not provide adequate reasons. However,

[24] 2011 FC 1208

Digitized by Google

a twelve page document entitled Taxpayer Relief Report signed on October 29 and 30, 2009 and informally called a "Fairness Report" gives the Applicant the information she needs. It was filed as part of the Applicant's record on November 22, 2010 and counsel for CRA has advised the Court that there is no reason why it could not have accompanied the Decision. Had it done so, the reasons would have been sufficient.

2. A Right to Comment

[16] The Applicant also submits that she should have had an opportunity to comment on CRA's conclusions before the Decision was made.

[17] In *Costabile v Canada (Revenue Agency)*, above at para. 9, the applicant took issue with the fact that he was afforded no opportunity to discuss the review or the outcome of his request for reassessment under subsection 152(4.2) of the Act. Mr. Justice Russell noted at para. 37 that, while the CRA must exercise its discretion under both subsections 152(4.2) and 220(3.1) fairly, no specific rules of procedural fairness governing that discretion are set out in the Act. The applicant in *Costabile* was given an opportunity to submit relevant information and documents when he submitted his request for review to CRA. The Court therefore rejected his argument that CRA was required to seek further information, documents or submissions prior to exercising its discretion to deny his request.

[18] I draw the same conclusion here. The Applicant was afforded ample opportunity to provide all necessary information to CRA when she submitted her request for review. The rules of procedural fairness did not entitle her to further comment before the Decision was made.

3. CRA'S Affidavit

[19] I have determined that the Affidavit was not filed to supplement the Reasons as the Applicant alleges. The Decision alone has been considered on the issue of the adequacy of the reasons and has been found wanting.

[20] In my view, the Affidavit was properly filed to respond to the Applicant's allegation that the Decision is unreasonable. Further, I should observe that I do not agree with the suggestion in the Applicant's Supplementary Memorandum that the exhibits to the Affidavit are unintelligible and I note that no oral submissions were made to that effect.

4. Reasonableness

[21] The Applicant challenged the reasonableness of the Decision and asked for an order that it be reconsidered. However, no written or oral submissions were made to demonstrate that the Decision was unreasonable. No evidence was adduced about the state of the real estate market which might have suggested that CRA's finding that the Applicant had equity in her properties was unreasonable. It appears that the Applicant's apparent inability to sell her properties was caused by her decision to set very high listing prices.

[22] Further, with regard to the cash flow statements, no material was filed by the Applicant to suggest that CRA's conclusions were unjustified.

[23] In these circumstances, I cannot conclude that the Decision was unreasonable.

Stemijon Investments Ltd. v. The Attorney General of Canada, 2011 FCA 299, Too Narrowly Following the Information Circular Criteria Than the Act, Though with Examination, Same Result

REASONS FOR JUDGMENT

STRATAS J.A.

Introduction

[1] Before this Court are six appeals from six judgments of the Federal Court (*per* Justice Mandamin): 2010 FC 892, 2010 FC 893, 2010 FC 894, 2010 FC 895, 2010 FC 897, 2010 FC 898. In each, the Federal

Digitized by Google

Court dismissed an application for judicial review brought by the taxpayer concerning a decision by the Minister of National Revenue. In each, for identical reasons, the Minister refused the taxpayer relief from penalties and interest under subsection 220(3.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.).

[2] Since the facts and the law are substantially the same in each matter, this Court consolidated the appeals, the appeal in file A-376-10 being designated as the lead appeal. A copy of these reasons for judgment will be filed in each of files A-374-10, A-375-10, A-376-10, A-377-10, A-378-10 and A-382-10, and shall serve as this Court's reasons for judgment in each appeal. Given the identical nature of the appellant's submissions, the Minister's decision for each appellant, and the Federal Court's decision, these reasons will speak of one decision, one decision letter and one Federal Court decision.

[3] In my view, for the reasons set out below, the Minister's decision falls outside the range of defensibility and acceptability and, thus, is unreasonable. However, the relief is discretionary. In these particular circumstances, no practical end would be accomplished by setting aside the Minister's decision and returning the matter back to him for redetermination: the Minister could not reasonably grant relief on these facts. Therefore, I would dismiss the appeals.

The basic facts

Background information

[4] The Act requires persons to file certain forms in certain circumstances. These forms convey information to the Canada Revenue Agency. The Canada Revenue Agency uses this information to discharge its responsibilities under the Act.

[5] Form T1135 is one such form. This form must be filed by taxpayers who own specified foreign property, the total cost amount of which is over $100,000: subsection 233.3(3) of the Act.

[6] The appellants were obligated to file this form for each of the 2000 to 2003 taxation years. They did so, but were late. Due to their lateness, the Minister assessed penalties and interest against the appellants.

[7] The appellants sought relief from the penalties and interest from the Minister. The Minister can grant such relief under subsection 220(3.1) of the Act. Broadly speaking, the appellants alleged that they had made an innocent mistake and that it would be unfair to levy penalties and interest in the amounts assessed.

How the late filings happened

[8] The appellants employed a common financial representative to make all tax filings on their behalf.

[9] For the 1998 and 1999 taxation years, the appellants' representative filed the appellants' Forms T1135 on time. **However, for the 2000 to 2003 taxation years, the appellants' representative formed the view, contrary to the wording of subsection 233.3(3) of the Act, that it was unnecessary to file the forms. The appellants' representative felt that the Canada Revenue Agency was getting all the information it needed from other filings made by the appellants' Canadian investment managers.**

[10] Specifically, the appellants' representative believed that Form T1135 did not need to be filed where a foreign investment portfolio was managed by a Canadian investment manager subject to Canadian tax reporting requirements. In his view, that was the case with each of the appellants. However, as the appellants' representative conceded in a letter dated June 2, 2005, that logic did not apply to the appellant Canwest Communications Corporation, which had U.S. investments administered by U.S. fund managers.

[11] Somewhat later, the Canada Revenue Agency alerted the appellants to the fact

Digitized by Google

that they had not filed their forms for some time. The appellants complied, filing their forms late and explaining their misunderstanding.

The appellants' request for relief from interest and penalties and the first level administrative decision

[12] The appellants' financial representative wrote on behalf of the appellants to the Fairness Committee of the Canada Revenue Agency, requesting relief under subsection 220(3.1) of the Act against the penalties and interest assessed against the appellants for their late filings of the forms. **The representative conceded that the delay in filing was "a conscious decision" but was done in the mistaken belief, described above, that the forms did not need to be filed. The representative explained that it was guilty of "administrative oversight."**

[13] In its first level administrative decision, the Canada Revenue Agency denied the appellants' request for relief. It found that the appellants did not fall within one of the three specific scenarios set out in Information Circular (IC) 07-01 ("Taxpayer Relief Provisions"), a policy statement issued by the Minister. **These three specific scenarios are extraordinary circumstances beyond the taxpayer's control, actions of the Canada Revenue Agency, and inability to pay. The Canada Revenue Agency also denied the appellants' request for relief under a "one chance policy" that existed at the time. The appellants failed to qualify under that policy because they filed the forms only as a result of an inquiry made by the Canada Revenue Agency.**

The appellants' further request for relief from interest and penalties and the Minister's decision

[14] Dissatisfied, the appellants made a second level request for relief to a delegate of the Minister (hereafter, the "Minister"). They explained that their representative had engaged in an "administrative oversight." They enclosed their previous correspondence that explained that the representative believed that the forms did not need to be filed because the Canada Revenue Agency was getting information about the appellants' foreign holdings from other filings. They suggested that the delay of the Canada Revenue Agency should result in some relaxation in the interest charges. Finally, they also argued that there was an "error of omission common to all entities" and so the penalty, levied for each of the six appellants, should be substantially reduced.

[15] The Minister set out his reasons in a decision letter. In his decision letter, the Minister partly granted the appellants' request for relief. He was prepared to reduce the interest charged during six months due to the Canada Revenue Agency's delay in replying to the appellants. The Minister denied the remainder of the appellants' request for relief.

The applications to the Federal Court for judicial review

[16] The appellants applied to the Federal Court for judicial review of the Minister's denial of relief.

[17] In the Federal Court, and also in this Court, the appellants focused on the reasons set out in the Minister's decision letter. They submitted that the Minister improperly narrowed the scope of discretion permitted to him under subsection 220(3.1) of the Act. In their view, the Minister had regard only to the three scenarios of relief specifically set out in the Information Circular rather than the general concept of fairness under subsection 220(3.1) of the Act. In other words, the Minister improperly fettered his discretion.

[18] The appellants also submitted that the Minister's refusals of relief on the facts of this case could not be sustained under the standard of review of reasonableness.

The Federal Court's decision

Digitized by Google

[19] The Federal Court rejected the appellants' submissions. It found that the Minister had not fettered his discretion. Instead, he was aware of the full extent of his discretion and decided against granting relief. The Federal Court based this conclusion on the fact that the Minister had before him an array of material that went beyond the three scenarios set out in the Information Circular, such as the submissions of the appellant and a wide-ranging Taxpayer Relief Report. The Federal Court also found that the Minister fully addressed the appellants' requests for relief and reached a conclusion that passed muster under the standard of review of reasonableness.

Analysis

The standard of review to be applied

[20] The Federal Court held that the standard of review of the Minister's decision is reasonableness. In this Court, the parties accept this. This Court can interfere only if the Minister reached an outcome that is indefensible and unacceptable on the facts and the law: *Canada Revenue Agency v. Telfer*, 2009 FCA 23 at paragraphs 24-28; *Canada Revenue Agency v. Slau Ltd.*, 2009 FCA 270 at paragraph 27; *Dunsmuir v. New Brunswick*, 2008 SCC 9 at paragraph 47, [2008] 1 S.C.R. 190.

[21] The appellants' submissions, while based on reasonableness, seem to articulate "fettering of discretion" outside of the *Dunsmuir* reasonableness analysis. They seem to suggest that "fettering of discretion" is an automatic ground for setting aside administrative decisions and we need not engage in a *Dunsmuir*-type reasonableness review.

[22] On this, there is authority on the appellants' side. For many decades now, "fettering of discretion" has been an automatic or nominate ground for setting aside administrative decision-making: see, for example, *Maple Lodge Farms Ltd. v. Government of Canada*, [1982] 2 S.C.R. 2 at page 6. **The reasoning goes like this. Decision-makers must follow the law. If the law gives them discretion of a certain scope, they** cannot, in a binding way, cut down that scope. To allow that is to allow them to rewrite the law. Only Parliament or its validly authorized delegates can write or rewrite law.

[23] This sits uncomfortably with *Dunsmuir*, in which the Supreme Court's stated aim was to simplify judicial review of the substance of decision-making by encouraging courts to conduct one, single methodology of review using only two standards of review, correctness and reasonableness. In *Dunsmuir*, the Supreme Court did not discuss how automatic or nominate grounds for setting aside the substance of decision-making, such as "fettering of discretion," fit into the scheme of things. Might the automatic or nominate grounds now be subsumed within the rubric of reasonableness review? On this question, this Court recently had a difference of opinion: *Kane v. Canada (Attorney General)*, 2011 FCA 19. But, in my view, this debate is of no moment where we are dealing with decisions that are the product of "fettered discretions." The result is the same.

[24] *Dunsmuir* reaffirms a longstanding, cardinal principle: "all exercises of public authority must find their source in law" (paragraphs 27-28). Any decision that draws upon something other than the law – for example a decision based solely upon an informal policy statement without regard or cognizance of law, cannot fall within the range of what is acceptable and defensible and, thus, be reasonable as that is defined in *Dunsmuir* at paragraph 47. **A decision that is the product of a fettered discretion must *per se* be unreasonable. [25] In the circumstances of this case, if the Minister did not draw upon the law that was the source of his authority, namely subsection 220(3.1) of the Act, and instead**

Digitized by Google

fettered his discretion by having regard only to the three specific scenarios set out in the Information Circular, his decisions cannot be regarded as reasonable under *Dunsmuir*.

Subsection 220(3.1) of the Act

[26] Subsection 220(3.1) of the Act provides that if an application for relief is made in time, the Minister has discretion to grant relief against penalties and interest. Subsection 220(3.1) reads as follows:

220. (3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

220. (3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l'année d'imposition d'un contribuable ou de l'exercice d'une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d'un montant de pénalité ou d'intérêts payable par ailleurs par le contribuable ou la société de personnes en application de la présente loi pour cette année d'imposition ou cet exercice, ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

[27] The scope of the Minister's discretion under this subsection is determined, like any other matters of statutory interpretation, by examining the statutory words setting out the discretion (here unqualified), the other sections of the Act which may provide context, and the purposes underlying the section and the Act itself. **When that examination is conducted, it is fair to say that the scope of the Minister's discretion is broader than the three specific scenarios set out in the Information Circular.**

Does the Minister's decision pass muster under the standard of review of reasonableness?

[28] In my view, the Minister fettered his discretion, and thereby made an unreasonable decision. He did not draw upon subsection 220(3.1) of the Act to guide his discretion. He looked exclusively to the Information Circular. This is seen from the Minister's reasons for decision.

The Minister's reasons for decision, as evidenced by his decision letter

[29] In his decision letter, the Minister sets out reasons for his decision. At the beginning of the decision letter, the Minister mentions that his decision falls under "Taxpayer Relief Legislation." He explains that this legislation "gives the Minister the discretion to waive or cancel all or part of any penalty or interest payable." At this point, he says nothing about the scope of his discretion under this legislation. He never does.

[30] In the next sentence in his decision letter, the Minister defines the scope of his discretion, limiting it somewhat. He does this by reference to the Information Circular, not subsection 220(3.1). Specifically, he states that his discretion is to be guided by "whether the penalty or interest resulted from extraordinary circumstances, is due mainly to actions of the Canada Revenue Agency (CRA), or…[is due to an] inability to pay." **As we have**

Digitized by Google

seen in paragraph 13 above, these are the three specific scenarios set out in the Information Circular for the granting of relief. These words show that the Minister was limiting his consideration to the three circumstances set out in the Information Circular, and was not considering the broad terms of subsection 220(3.1) of the Act.

[31] Alone, reference to a policy statement, such as the Information Circular, is not necessarily a cause for concern. Often administrative decision-makers use policy statements to guide their decision-making. As I mention at the end of these reasons, such use is acceptable and helpful, within limits. But many administrative decision-makers are careful to note those limits – policy statements can only be a guide, and, in the end, it is the governing law that must be interpreted and applied. In his decision letter, however, the Minister did not note any limits on his use of the Information Circular.

[32] In the next portion of his decision letter, the Minister stated that the appellants sought relief on the basis of "administrative oversight." This was incomplete: as mentioned in paragraph 14, above, the appellants offered other explanations and justifications. The Minister never addressed these in his decision letter. The Minister responded to the appellants' explanation of "administrative oversight" by reminding them about their responsibility to determine and follow the deadlines set out in the Act.

[33] Next, the Minister turned to the appellants' request for interest relief due to the Canada Revenue Agency's delay. Here, as mentioned in paragraph 15 above, he granted limited relief. In granting that relief, the Minister did not refer to the Information Circular. However, delay by the Canada Revenue Agency does fit within the second scenario set out in the Information Circular for the granting of relief, namely conduct by the Agency.

[34] At the end of his decision letter, the Minister refused the rest of the relief sought by the appellants. In support of this, he offered the following explanation:

While I can sympathize with your position, the Taxpayer Relief Provisions do not allow for cancellation of penalties and interest when a Taxpayer, or their representative, lacks knowledge or fails to meet filing deadlines. I trust this explains the Agency's position in this matter.

[35] This passage offers further evidence that the Minister was restricting his consideration to the three scenarios set out in the Information Circular and was not drawing upon subsection 220(3.1) of the Act as the source of his decision-making power. This is seen from the Minister's reference to the

"Taxpayer Relief Provisions" – the title of the Information Circular – as the source of his decision-making power, not subsection 220(3.1) of the Act. On a fair reading of this passage, the Minister denied the appellants relief because their claims for relief did not fit within the scenarios set out in the Information Circular.

Does the record before the Minister shed any further light on the Minister's decision?

[36] The respondent urges us to go beyond the stated reasons in the Minister's decision letter. It points to the record that was placed before the Minister, and an affidavit filed with the Federal Court. The respondent submits that these materials demonstrate that the Minister drew upon more than the Information Circular as the source of his authority.

[37] I agree that the reasons in a decision letter should not be examined in isolation. Reasons can sometimes be understood by appreciating the record that was placed before the administrative decision-maker: *Vancouver International Airport Authority v. Public Service Alliance of Canada*, 2010 FCA 158 at paragraph 17.

[38] But sometimes the record is of no assistance. That is the case here. While the Minister had a broad record before him, his decision letter shows no awareness that he could go beyond the Information Circular. To the contrary, his decision letter shows an

Digitized by Google

understanding – faulty – that he was governed exclusively by the Information Circular. Further, as explained in paragraph 32, above, the Minister did not seem to have full and accurate regard to key portions of the record before him, namely the explanations and justifications in letters sent by the appellants. In such circumstances, resort to the record to explain why the Minister decided in the way that he did is not possible.

[39] **The Federal Court was willing to assume that the Minister considered the record before him. In my view, that assumption was not open to it given the reasons in the preceding paragraph.**

Does an affidavit filed in the Federal Court shed any further light on the Minister's decision?

[40] During argument of this appeal, the respondent referred us to an affidavit that was filed with the Federal Court. The affidavit is from the delegate of the Minister who made the decision that is the subject of judicial review in these proceedings. In that affidavit, and also in cross-examination on that affidavit, the delegate testified that he relied on other matters when he made his decision, including "the relevant sections of the *Income Tax Act*." The respondent points to this affidavit as evidence that the Minister had regard to the full extent of his discretion under subsection 220(3.1) of the Act and drew upon that section as the source of his authority.

[41] The Federal Court appears to have placed no weight on this evidence. I also place no weight on it. This sort of evidence is not admissible on judicial review: *Keeprite Workers' Independent Workers Union et al. and Keeprite Products Ltd.* (1980), 114 D.L.R. (3d) 162 (Ont. C.A.). The decision-maker had made his decision and he was *functus*: *Chandler v. Alberta Association of Architects*, [1989] 2 S.C.R. 848. After that time, he had no right, especially after a judicial review challenging his decision had been brought, to file an affidavit that supplements the bases for decision set out in the decision letter. His affidavit smacks of an after-the-fact attempt to bootstrap his decision, something that is not permitted: *United Brotherhood of Carpenters and Joiners of America v. Bransen Construction Ltd.*, 2002 NBCA 27 at paragraph 33. As a matter of common sense, any new reasons offered by a decision-maker after a challenge to a decision has been launched must be viewed with deep suspicion: *R. v. Teskey*, 2007 SCC 25, [2007] 2 S.C.R. 267.

[42] In this case, the Minister was obligated to disclose the full and true bases for his decision at the time of decision. The decision letter, viewed alongside the proper record of the case, is where the bases for decision must be found. In this case, the proper record sheds no light on the bases for the Minister's decision, and so the bases set out in the Minister's decision letter must speak for themselves.

Conclusion: the Minister's decision was unreasonable

[43] I conclude that in making his decision the Minister did not draw upon the law that was the source of his authority, namely subsection 220(3.1) of the Act. Instead, he drew upon the Information Circular, and nothing else. His decision thereby became unreasonable.

Should the decision be set aside and the matter returned to the Minister for redetermination?

[44] **Just because a decision is unreasonable does not mean that it must automatically be set aside and returned to the decision-maker for redetermination. Relief on an application for judicial review is discretionary.**

[45] In particular, this Court may decline to grant relief for an unreasonable decision where, for example, there is no substantial miscarriage of justice or the granting of relief would serve no practical end: *MiningWatch Canada v. Canada (Fisheries and Oceans)*, 2010 SCC 2, [2010] 1 S.C.R. 6; *Community Panel of the Adams Lake Indian Band v. Adams*

Digitized by Google

Lake Band, 2011 FCA 37.

[46] In this case, there would be no practical end served in setting aside the Minister's decision and returning the matter to him for redetermination. The excuses and justifications offered by the appellants for the delay in filing and the grounds offered in support of relief have no merit. The Minister could not reasonably accept them and grant relief under subsection 230(3.1) of the Act. Returning the matter back to the Minister would be an exercise in futility.

[47] **The appellants say that their financial representative had a reasonable but mistaken belief that filing the form was not obligatory. This is belied by the fact that it did file the forms for the 1998 and 1999 taxation years. It knew that the Act required that the forms be filed and filed them.**

[48] After the 1999 taxation year, the appellants' representative consciously chose not to comply with the Act. It did so on the basis that the Canada Revenue Agency was getting information from other sources, such as the appellants' Canadian money managers. As it turned out, this basis did not apply to the appellant Canwest Communications Corporation.

[49] Even if the Canada Revenue Agency was getting the information from other sources, this cannot be an acceptable excuse or mitigating factor for non-compliance in the circumstances of this case, especially where we are dealing with the appellants' representative, a professional firm that deals with tax matters. It is notorious that in various provisions of the Act, the Canada Revenue Agency is allowed to obtain the same type of information from different sources. This allows it to verify compliance with the Act. For example, an employer is obligated to file T-4 slips reporting the income it has paid to its employees. At the same time, the employees disclose their income from employment. The employers' and employees' figures should match. What if the employer, after filing T-4 forms for a period of years, consciously declined to file the T-4 slips and then argued that it should avoid penalties because the Canada Revenue Agency would get information about the **employees' income from the employees? In those circumstances, would there be any case for relief? Of course not.**

[50] In this case, compliance was fully within the appellants' control. Compliance happened in the 1998 and 1999 taxation years and there were no new extenuating circumstances that might explain the later non- compliance. These facts fall outside of what this Court has identified as being a focus of subsection 220(3.1), namely the granting of relief where there are extenuating circumstances beyond the control of the person seeking relief: *Bozzer v. Canada*, 2011 FCA 186 at paragraph 22.

[51] The appellants also argued that it is unfair for the Minister to levy six separate, sizeable penalties against the six appellants when there was really only one mistake made by their one common representative. **The appellants contended that the penalties should be substantially reduced for that reason. This argument, smacking of a plea for a "volume discount," has no merit. Each of the appellants is a separate legal entity and a separate taxpayer, potentially subject to penalties and interest for its own non-compliance. Each is capable of independent decision-making concerning the forms that are to be filed. Each, accepting the risk, chose instead to have a representative look after the filings. That risk materialized: their representative made a conscious decision not to file the forms, a decision made without reasonable excuse or justification, as explained above. Granting relief under subsection 220(3.1) on the basis of this argument would be an unreasonable exercise of discretion.**

[52] I accept that the normal remedy for an unreasonable decision is to set it aside and return the matter back to the decision-maker for redetermination. I also accept that this

Digitized by Google

Court should be reluctant to wade into the merits of administrative decision-making. But there are cases, perhaps rare, where no practical end would be served by returning the matter back to the decision-maker. This is just such a case.

[53] **In these circumstances, the appellants' explanations and justifications are entirely without merit. The appellants could not succeed on them if we returned the matter to the Minister for redetermination. Similar to what happened in *MiningWatch Canada*, *supra*, the Minister made an unreasonable decision but no practical end would be served in returning the matter back to him for redetermination. Therefore, in this case, I would decline to do so.**

Postscript

[54] So that these reasons provide proper guidance and are not misunderstood and misapplied in future cases, I wish to make three brief observations.

I

[55] Portions of the language used in the decision letter in this case are identical to that used in other decision letters: see, for example, *Spence v. Canada Revenue Agency*, 2010 FC 52. In itself, there is nothing wrong with using form letters or stock language taken from other decision letters. The reasons offered in one case can be appropriate for other cases, and the repeat use of those reasons is efficient**. However, as this case shows, a blind use of form letters or stock language can sometimes lead to trouble.**

[56] Whether the reasons are cut and pasted from a previous letter, are slightly modified from a previous letter or have to be drafted from scratch, the final product issued to the applicant for relief under subsection 220(3.1) of the Act should show an awareness of the scope of the available discretion under the Act, offer brief reasons why relief could or could not be given in the particular circumstances, and meaningfully address the arguments made that have a chance of success. If the reasons do not deal with one or more of these matters – something that can happen through careless or unthinking use of a form letter or stock language – the decision may not pass muster under the standard of review of reasonableness.

II -

[57] The foregoing comment and these reasons should not be taken to impose onerous new reasons- giving requirements upon the Minister. In this case, all that was required was perhaps a few additional lines in a letter that was just 33 lines long: *Vancouver International Airport Authority*, *supra* at paragraphs 16 and 17.

III -

[58] Finally, these reasons should not be taken to cast any doubt on the ability of administrative decision-makers, such as the Minister, to use policy statements, such as the Information Circular in this case, as an aid or guide to their decision-making.

[59] **Policy statements play a useful and important role in administration: *Thamotharem v. Canada (Minister of Citizenship and Immigration)*, 2007 FCA 198, [2008] 1 F.C.R. 385. For example, by encouraging the application of consistent principle in decisions, policy statements allow those subject to administrative decision-making to understand how discretions are likely to be exercised. With that understanding, they can better plan their affairs.**

[60] **However, as explained in paragraphs 20-25 above, decision-makers who have a broad discretion under a law cannot fetter the exercise of their discretion by relying exclusively on an administrative policy:** *Thamotharem*, *supra* at paragraph 59; *Maple Lodge Farms*, *supra* at page 6; *Dunsmuir*, *supra* (as explained in paragraph 24 above). **An**

Digitized by Google

administrative policy is not law. It cannot cut down the discretion that the law gives to a decision-maker. It cannot amend the legislator's law. A policy can aid or guide the exercise of discretion under a law, but it cannot dictate in a binding way how that discretion is to be exercised.

[61] In this case, the Minister ran afoul of these principles. Fortunately for him, however, he reached the only reasonable outcome on these facts.

Proposed disposition

[62] For the foregoing reasons, I would dismiss the appeals. However, in light of the unreasonableness of the Minister's decisions, I would not award the respondent in each appeal its costs of the appeal.

"David Stratas" J.A.
"I agree
Marc Noël J.A." "I agree
Johanne Trudel J.A."

Ronnie Louis Bozzer v. Her Majesty the Queen in Right of Canada, 2011 FCA 186, When Does the Clock Start for Possible Leniency: Where Does Prescription Kick-in and the Issue Falls off the Table

Date: 20110602

Docket: A-97-10 Citation: 2011 FCA 186 CORAM: SHARLOW J.A. TRUDEL J.A. STRATAS J.A. BETWEEN:
RONNIE LOUIS BOZZER
Appellant and
HER MAJESTY THE QUEEN IN RIGHT OF CANADA
(as represented by the Minister of National Revenue in his capacity as Minister responsible for the *Income Tax Act*), CANADA REVENUE AGENCY and THE ATTORNEY GENERAL OF CANADA
Respondents

REASONS FOR JUDGMENT STRATAS J.A.

[1] Subsection 220(3.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) allows the Minister to waive or cancel any portion of interest or penalties owing under the Act. It prescribes a ten year limitation period. But how is that ten year period to be determined? The answer to that question, a question of statutory interpretation, will determine the outcome of this appeal.

[2] The Federal Court judge agreed with the Minister's view of how the ten year period is to be determined under subsection 220(3.1) of the Act: 2010 FC 139 (CanLII), 2010 FC 139. The appellant, Mr. Bozzer, disagrees and, in this Court, proposes an interpretation that is more generous to taxpayers.

[3] As this is a legal issue concerning the proper interpretation of subsection 220(3.1) of the Act, the standard of review of the decision of the Federal Court judge is correctness: *Redeemer Foundation v. M.N.R.*, 2006 FCA 325 (CanLII), 2006 FCA 325 at paragraph 24 (affirmed, without comment on this point, at 2008 SCC 46 (CanLII), [2008] 2 S.C.R. 643, 2008 SCC 46).

[4] For the reasons below, I am of the view that Mr. Bozzer's interpretation ofsubsection 220(3.1) is the correct one.

Digitized by Google

Subsection 220(3.1) of the Act

[5] Subsection 220(3.1) provides as follows:

220. (3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or *interest* otherwise *payable* under this Act by the taxpayer or partnership *in respect of that taxation year or fiscal period*, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest. [emphasis added]

The basic facts

[6] On December 6, 2005, at a time when Mr. Bozzer had tax debts that arose in his 1989 and 1990 taxation years, Mr. Bozzer applied to the Minister under subsection 220(3.1) of the Act for a waiver of interest accrued on the tax debt.

[7] The Minister denied the application for the following reasons:

As of January 1, 2005, the Agency's policy with regards to fairness requests was amended to exclude debts over 10 years of age from the date of submission. The ten years expired on December 31, 1999 for the 1989 taxation year and December 31, 2000 for the 1990 taxation year. For this reason we are unable to consider your request for departmental delay or error and have concluded it would not be appropriate to cancel or waive the interest.

[8] Mr. Bozzer applied to the Minister for a second-level review. The Minister denied that application as well, for the following reasons:

The above legislation [subsection 220(3.1)] is applicable because you applied for interest cancellation on December 6, 2005. Therefore the Minister has no discretion under subsection 220(3.1) to waive or cancel any interest otherwise payable under the Act in respect of your 1989 and 1990 taxation years. This is because it has been more than ten calendar years since the ends of your 1989 and 1990 taxation years. In addition, you applied after 2004, which is more than ten calendar years after the ends of your 1989 and 1990 taxation years.

[9] Mr. Bozzer applied to the Federal Court for judicial review of the Minister's decision. The Federal Court judge dismissed the application, finding (at paragraph 51 of his reasons for judgment) that "the time limit in subsection 220(3.1) of the ITA is for the ten calendar years after the relevant taxation year, namely the year of assessment." In my view, this interpretation cannot stand, as the ten year period in subsection 220(3.1) of the Act does not start in the year of assessment. Nowhere does subsection 220(3.1) mention the year of assessment as a relevant consideration.

The parties' competing interpretations of subsection 220(3.1) of the Act and how they apply to the facts of this case

[10] Before this Court, the parties presented competing interpretations of subsection 220(3.1) of the Act. These competing interpretations result in drastically different results on the facts of this case.

[11] The parties' competing interpretations of subsection 220(3.1) concern only a portion of it and relate particularly to the phrase "interest payable in respect of [a] taxation year" (« d'intérêts payable pour [une] année d'miposition »):

220. (3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer…waive or cancel all or any portion of any …*interest*…*payable*…by the taxpayer…*in respect of that taxation year*…. [emphasis added]

Mr. Bozzer's interpretation

Digitized by Google

[12] Mr. Bozzer submits that "interest…payable…in respect of [a] taxation year" means any interest accrued in that taxation year on a tax debt. On his view of the matter, subsection 220(3.1) permits the Minister to exercise his discretion to cancel interest accrued in any taxation year ending within ten years before the taxpayer's application for relief, regardless of when the underlying tax debt arose.
[13] Under this interpretation, Mr. Bozzer analyzes the facts of this case as follows. He had tax debts that arose in the 1989 and 1990 taxation years. Interest accrued on those debts in every subsequent taxation year. On December 6, 2005, he applied to the Minister for a cancellation of interest. On his view of the matter, subsection 220(3.1) permits the Minister to cancel any interest that accrued in the ten taxation years preceding his application, that is, from January 1, 1995 to December 31, 2004. On this analysis, the fact that the tax debt arose in 1989 and 1990 is irrelevant.

The Minister's interpretation
[14] The Minister disagrees. The Minister submits that"interest…payable…in respect of [a] taxation year" means any interest accrued on a tax debt that arose in that taxation year. Therefore, the Minister may exercise his discretion to waive interest otherwise payable under the Act only if a taxpayer applies within ten calendar years of the end of the taxation year in which the underlying tax debt arose.
[15] In Mr. Bozzer's case, the underlying tax debt arose in 1989 and 1990. On the Minister's view of the matter, Mr. Bozzer had to apply for a waiver of interest on his 1989 tax debt by December 31, 1999 and his 1990 tax debt by December 31, 2000.
[16] Therefore, the Minister says that he has no statutory authority to consider Mr. Bozzer's application for a waiver of interest in this case. Mr. Bozzer's application was on December 6, 2005. On the Minister's view of the matter, that was nearly five years too late.

The proper approach to interpreting provisions in taxation legislation
[17] In*Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54 (CanLII), [2005] 2 S.C.R. 601, 2005 SCC 54 at paragraph 10, the Supreme Court of Canada set out the proper approach for interpreting taxation statutes:
The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words plays a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.
The Supreme Court went on to observe (at paragraph 13) that the Act "remains an instrument dominated by explicit provisions dictating specific consequences, inviting a largely textual interpretation." But where the text is equivocal, "greater recourse to the context and purpose of the Act may be necessary": *Placer Dome Canada Ltd.*
v. Ontario (Minister of Finance),2006 SCC 20 (CanLII), [2006] 1 S.C.R. 715 at paragraph 22.

The interpretation of the text of subsection 220(3.1)
[18] The parties' submissions on how the text of subsection 220(3.1) should be interpreted, summarized above, persuade me that the text is ambiguous. The words "interest…payable…in respect of a taxation year," examined in isolation, are conceivably capable of bearing either of the meanings suggested by the parties.
[19] As part of its submissions on how the text of subsection 220(3.1) should be interpreted, the Minister submits that an earlier decision of this Court is directly on point: *Montgomery v.*

Digitized by Google

M.N.R., 95 D.T.C. 5032; reflex, [1995] 1
C.T.C. 196.
[20] In my view, *Montgomery* is distinguishable. In *Montgomery*, this Court did not interpret the text of subsection 220(3.1) that is in issue in this appeal. Rather, this Court interpreted a transitional provision concerningsubsection 220(3.1): S.C. 1993, c. 24, subsection 127(5). That transitional provision limited the application of subsection 220(3.1) to the "1985 and subsequent taxation years." This Court simply held (at paragraph 11) that the Minister's discretion was limited to the waiving of interest otherwise payable under the Act for a taxation year that is either the 1985 taxation year or any later taxation year. *Montgomery* offers no guidance on the interpretation issue before us in this appeal.
[21] Since the text in this case is equivocal, in accordance with *Placer Dome*, *supra* at paragraph 22, it will be necessary for us to have"greater recourse" to the purpose of subsection 220(3.1) and the context surrounding it.

The purpose of subsection 220(3.1)
What is the purpose?
[22] Subsection 220(3.1) is one of several taxpayer relief provisions in the Act. It was introduced in 1991 as part of what was called a "fairness package." The Minister has explained the purpose behind these provisions as follows:
The legislation gives the CRA the ability to administer the income tax system fairly and reasonably by helping taxpayers to resolve issues that arise through no fault of their own, and to allow for a common- sense approach in dealing with taxpayers who, because of personal misfortune or circumstances beyond their control, could not comply with a statutory requirement for income tax purposes.
See *Information Circular* 07-1,"Taxpayer Relief Provisions," May 31, 2007, at paragraph 8.
[23] In law, the Information Circulars of the Canada Revenue Agency are nothing more than administrative policy statements. They are not finally determinative of the meaning of a provision of the Act.
[24] However, in this case, the plain words of subsection 220(3.1)support the description of purpose in the above passage, and there is nothing in the history behind subsection 220(3.1) or in related sections that would cast doubt on it. Indeed, in 2004 the Department of Finance confirmed it. It stated that subsection 220(3.1) permits the Minister to waive or cancel interest or penalties "in situations where factors beyond the taxpayer's control, such as illness or a natural disaster, prevented a tax return from being filed on time": Canada, Department of Finance, 2004 Budget, Budget Plan, March 23, 2004, annex 9, at page 347.
[25] Therefore, I am prepared to accept the description of purpose in the above passage as the purpose that subsection 220(3.1) is meant to further.

Testing the parties' competing interpretations against the purpose of subsection 220(3.1)
[26] One method of testing the parties' competing interpretations is to imagine factual scenarios in which subsection 220(3.1) might be applied, applysubsection 220(3.1) to those scenarios, examine the results, and then compare those results with the purpose that subsection 220(3.1) is meant to further.
[27] For this purpose, I shall examine two scenarios.
Scenario A
[28] Suppose that a taxpayer is obliged to remit income tax instalments during taxation year X but fails to do so. He files his income tax return for taxation year X on time, but fails to pay the resulting tax debt.
[29] At some point in year X+1, the Minister assesses the tax payable for taxation year X, with accrued interest, including interest on the unpaid instalments for taxation year X. Later, the

Digitized by Google

taxpayer decides to apply for a cancellation of the interest accrued on the unpaid instalments for taxation year X.

[30] In this scenario, both the Minister's interpretation of subsection 220(3.1) and Mr. Bozzer's interpretation of subsection 220(3.1) will lead to the conclusion that the taxpayer must submit his application within ten years of the end of taxation year X.

Scenario B

[31] Suppose that this same taxpayer is about to file his income tax return for taxation year X on time. As in scenario A, the taxpayer was obliged to remit tax instalments during taxation year X but did not do so.

[32] However, in January of taxation year X+1, just before preparing the income tax return for taxation year X, the taxpayer is seriously injured in a car accident. In taxation year X+11 – after going through a coma, enduring many operations, recovering slowly, dealing with physical and mental challenges, and going through years of rehabilitation and retraining – the taxpayer finally gets around to filing his tax return for taxation year X.

[33] In taxation year X+12, the Minister assesses the tax payable for taxation year X, with accrued interest, including interest on the unpaid instalments for taxation year X. Again, the taxpayer decides to apply for a cancellation of the interest accrued on the unpaid instalments for taxation year X.

[34] On the Minister's interpretation of subsection 220(3.1), the taxpayer would be barred from asking for any waiver of interest. The tax debt on which interest accrued was eleven years ago, past the ten year limitation period.

[35] On Mr. Bozzer's interpretation of subsection 220(3.1), the taxpayer could apply for a waiver of interest that accrued during the ten taxation years preceding his application.

Assessment of the scenarios

[36] Scenario B shows that the Minister's interpretation of subsection 220(3.1) leads to a harsh result that is contrary to the purpose of subsection 220(3.1): to allow taxpayers to ask for relief against penalties and interest and to allow the Minister to grant such relief where, in his view of the overall fairness of the situation, it is appropriate to do so. In the words of the *Information Circular*, subsection 220(3.1) is one of several that are supposed to give the Minister an ability "to administer the income tax system fairly and reasonably" by "helping taxpayers to resolve issues that arise through no fault of their own." In particular, according to the *Information Circular*, this subsection is one of several designed "to allow for a common-sense approach in dealing with taxpayers who, because of personal misfortune or circumstances beyond their control, could not comply with a statutory requirement for income tax purposes."

[37] Admittedly, scenario B will not be a commonly-occurring circumstance. But it does show that the Minister's interpretation can prevent him from addressing, in a fair and reasonable way, taxpayers' problems that were caused by personal misfortune or circumstances during the statutory ten year period that were beyond the taxpayers' control, contrary to the purpose ofsubsection 220(3.1).

[38] As scenario B demonstrates, Mr. Bozzer's interpretation is fairer and, thus, more consistent with the purpose of subsection 220(3.1). Mr. Bozzer's interpretation gives the Minister a greater ability to address a taxpayer's misfortune or circumstances within the statutory ten year period that were beyond the taxpayer's control.

Subsection 220(3.1), viewed contextually

The legislative history of subsection 220(3.1)

[39] Before 2004, there was no ten year limitation period in subsection 220(3.1). At any time, a taxpayer could ask the Minister to waive interest that accrued since 1985. The pre-2004 version of subsection 220(3.1) is as follows:

Digitized by Google

220. (3.1) The Minister may at any time waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership and, notwithstanding subsections 152(4) to (5), such assessment of the interest and penalties payable by the taxpayer or partnership shall be made as is necessary to take into account the cancellation of the penalty or interest.

[40] In 2004, subsection 220(3.1) was amended to include a ten year limitation period:S.C. 2005, c. 19, subsections 48(1) and (2). This resulted in the version ofsubsection 220(3.1) in issue in this case, which is reproduced here with the amendment emphasized:

220. (3.1) The Minister may, *on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day*, waive or cancel all or any portion of any penalty or *interest* otherwise *payable* under this Act by the taxpayer or partnership *in respect of that taxation year or fiscal period*, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest. [emphasis added]

[41] The 2004 amendment represents a restriction of a right previously enjoyed by the taxpayer. In my view, in this particular situation, it was incumbent on Parliament to be clear in its language imposing the restriction and any doubt should be resolved in favour of the taxpayer. I note the following passage from the judgment of Estey J. in *Morguard Properties Ltd. v. City of Winnipeg*,1983 CanLII 33 (SCC), [1983] 2 S.C.R. 493 at page 509:

…[T]he courts require that, in order to adversely affect a citizen's right, whether as a taxpayer or otherwise, the legislature must do so expressly. Truncation of such rights may be legislatively unintended or even accidental, but the courts must look for express language in the statute before concluding that these rights have been reduced.

[42] The words chosen by Parliament are ambiguous. In my view, in this particular situation, this ambiguity should be resolved in favour of the taxpayer.

The Minister's Technical Notes

[43] The Minister submitted that certain Technical Notes published at the time of the 2004 amendment to subsection 220(3.1) are relevant to the interpretation of the subsection. The Minister submitted that the Technical Notes reveal that the ten year limitation period was introduced in 2004 because of a concern that"administrative problems would arise if the Minister were required to verify claims going back as far as 1985" (Minister's memorandum of fact and law, paragraph 44).

[44] The Minister says that if Mr. Bozzer's interpretation is adopted, the Minister might have to verify details relevant to any past taxation year, even years before 1985, as long as the interest in question had accrued within the past ten years.

[45] I do not accept this as a plausible explanation for the ten year limitation period in the case of subsection 220(3.1).

[46] It might be an explanation for other provisions that were amended to include a ten year limitation period. For example, a taxpayer might try to use subsection 152(4.2) to claim a deduction for a business expense incurred 15 years ago. In that context, the addition of a ten year limitation period to that subsection does eliminate "administrative problems." Similarly, a taxpayer might try to use subsection 220(3.2) to file an election that he or she should have filed 15 years ago. The election goes back so many years that one might anticipate"administrative problems" for the Minister.

[47] But the ten year limitation period in subsection 220(3.1) is not needed to eliminate

Digitized by Google

"administrative problems." Under subsection 220(3.1), both before and after 2004, the Minister, in considering whether to grant relief, would only have to know the amount of the original tax debt upon which interest accrued, and what payments have been made and when. From there, the interest is determined by a mathematical calculation. There is no evidence that this poses an "administrative problem," and the record discloses no basis upon which the existence of any such problem can be inferred.

[48] I would also note that, based on *Montgomery*, *supra* the Minister can never be obliged to look to years prior to 1985 when considering an application under subsection 220(3.1).

The Minister's Voluntary Disclosures Program

[49] Mr. Bozzer pointed to the Minister's Voluntary Disclosures Program as another reason why its interpretation should be accepted by this Court.

[50] The Voluntary Disclosures Program is a policy (*Information Circular* IC00-1R2) of the Canada Revenue Agency, not law. Under this policy, taxpayers can make disclosures to correct inaccurate or incomplete information, or to disclose information not previously reported. If the Canada Revenue Agency accepts a taxpayer's disclosure as having met the terms of the policy, it will not charge the taxpayer penalties or prosecute the taxpayer regarding the matters disclosed.

[51] Mr. Bozzer submits that the Minister's statutory authority to relieve the taxpayer of penalties in such a case is found in subsection 220(3.1) of the Act, and nowhere else. Then he points to paragraph 13 of the policy, which describes exactly what penalties can be waived under this policy:

[13] For income tax submissions made on or after January 1, 2005, the Minister's ability to grant relief is limited to any taxation year in which the submission is filed. For example: in an income tax submission made on May 1, 2007, the limitation would apply so that relief would only be available for the 1997 and subsequent taxation years.

Mr. Bozzer notes that this is consistent with his interpretation and not the Minister's interpretation of subsection 220(3.1).

[52] But policy statements are not determinative of what statutory provisions mean in law. I do not consider Mr. Bozzer's submissions on the Voluntary DisclosuresProgram to be helpful on the legal issue of how subsection 220(3.1) of the Act is properly interpreted.

Parliament's ability to draft sections in the Act that achieve the effects it wants

[53] The Minister would like subsection 220(3.1) to have a forward looking effect, so that the ten year period runs forward from the year in which the tax debt occurred.

[54] As I have stated above, subsection 220(3.1) does not use language that clearly suggests that it should have a forward looking effect.

[55] But Parliament certainly knows how to draft sections that have a forward looking effect. For example, Parliament has drafted another subsection in section 220, namely subsection 220(3.201), using language that clearly causes a "forward looking effect":

220. (3.201) On application by a taxpayer, the Minister may extend the time for making an election, or grant permission to amend or revoke an election, under section 60.03 if

the application is made on or before the day that is three calendar years after the taxpayer's filing- due date for the taxation year to which the election applies; and

the taxpayer is resident in Canada

if the taxpayer is deceased at the time of the application, at the time that is immediately before the taxpayer's death, or

in any other case, at the time of the application.

[56] If Parliament meant subsection 220(3.1) to have a forward looking effect, it certainly knew how to draft it. It did not do so. This is another consideration in support of Mr. Bozzer's

Digitized by Google

interpretation of the subsection.

Effects on other sections of the Act or the administration of the Act
[57] If this Court were to adopt Mr. Bozzer's interpretation of subsection 220(3.1), would there be an unintended or unwelcome effect on other sections in the Act or in the administration of the Act? If there were, that might be a clue as to Parliament's intentions concerning subsection 220(3.1). However, in his written or oral submissions, the Minister did not identify any such effects.

Conclusion
[58] For the foregoing reasons, I agree with Mr. Bozzer's interpretation of subsection 220(3.1) of the Act.
[59] Accordingly, the Minister has the statutory authority to cancel interest on Mr. Bozzer's 1989 and 1990 tax debts, to the extent that it accrued during the ten taxation years preceding his application to the Minister for interest relief under subsection 220(3.1) of the Act. Mr. Bozzer's application was made on December 6, 2005. [60] Therefore, on the facts of this case, the interest that is the subject of Mr. Bozzer's application is the interest accrued under the Act from January 1, 1995 to December 31, 2004.
Proposed disposition
[61] Therefore, I would allow the appeal, set aside the judgment of the Federal Court, allow Mr. Bozzer's application for judicial review, and refer his application for interest relief back to the Minister for reconsideration in accordance with these reasons, all with costs to Mr. Bozzer both in this Court and in the Federal Court.

"David Stratas" J.A.
"I agree
Sharlow J.A." "I agree
Johanne Trudel J.A."

Lloyd D. Hillier v. Attorney General Of Canada, 2001 FCA 197, Lengthy Audit/Objection Results in Lowered Amount Owing

Digitized by Google

SEXTON J.A.

Digitized by Google

REASONS FOR JUDGMENT

SEXTON J.A.

[1] This is an appeal from an order of the Trial Division dismissing the appellant's application for judicial review of a decision of an officer of Revenue Canada to not cancel or waive interest and penalties assessed against him. **The appellant had alleged undue delay upon the part of the Minister of National Revenue in finally reassessing him.**

Facts

[2] In the fall of 1993 Revenue Canada commenced an audit of the appellant's income tax returns for the years 1989 to 1992. The audit turned up evidence of previously unreported income. As a result, reassessments for those taxation years were issued on April 28, 1995. The appellant was also assessed penalties and interest in respect of each of the audited years. On June 29, 1995, the appellant filed notices of objection with respect to the reassessments. The matter was assigned to the Appeals Division of Revenue Canada in St. John's, Newfoundland. On October 31, 1995, the appellant forwarded certain requested information to Revenue Canada. As a result of staff changes and reassignments, however, it was January 23, 1998, almost 31 months after the notices were filed, before a thorough review of the objections was commenced. The review was completed on July 31, 1998.

[3] On August 27, 1998, notices of reassessment for the 1990, 1991, 1992 taxation years were issued. The amount of total income that had been assessed as a result of the 1993-1995 audit was reduced, although not to the point of eliminating the appellant's additional tax liability. The 1995 reassessment with respect to the 1989 taxation year was confirmed.

[4] On November 23, 1998, the appellant requested, pursuant to subs. 220(3.1) of the *Income Tax Act,* that the Minister waive or cancel the penalties and interest assessed against him for the 1989 through 1992 taxation years. The appellant alleged that Revenue Canada had extended the process of dealing with his notices of objection "for an unreasonable and excessive period of time."

[5] By letter dated June 4, 1999, the Chief of Appeals, Newfoundland and Labrador Tax Services Office, denied the appellant's request. The letter stated, in part:

...

A detailed review of the audit process indicates that there were no undue delays during the audit as there were ongoing discussions between your representatives and the Audit Division officials throughout this period.

At the time you received your Notices of Reassessment, you became aware of the balance outstanding. You chose not to pay the amount owing and exercised your right under the Income Tax Act and filed a Notice of Objection. While this action was in progress arrears interest continued to accrue on the outstanding balance. Although the Department did not enforce payment of this balance, because of the Notice of Objection you filed, the option remained to pay the tax balance outstanding, pending the outcome of the Notice of Objection, to avoid further accumulation of interest.

It should be noted that the amount of the penalties assessed each year was not affected by the period of time it took to process the Notice of Objection. Accordingly, cancelling or waiving of the penalties would not be appropriate in the circumstances.

[6] As a result of Ministerial inquiry, a second review of the request was undertaken by the Director, Newfoundland and Labrador Tax Services office. He too denied the request, informing the appellant by letter dated July 16, 1999:

...

We have reviewed the facts of this case and considered the issues raised by your Representative's letter of November 23, 1998. As there is no indication that such circumstances existed in your case, I must confirm that the interest and penalties charged to

Digitized by Google

you were properly assessed. Our review indicated that there were no undue delays which occurred during the audit process. With respect to the period of time this case was outstanding at the Objection stage, the Department's position is that once a Notice of Reassessment has been issued, an individual becomes aware of any balances outstanding and has the option, after a Notice of [O]bjection has been filed, to pay the outstanding balances and avoid any further accumulation of interest. At this point, payments of these balances is within the control of the individual.

[7] On judicial review of the Director's decision, the Motions Judge held that the time taken to complete the audit and initial reassessment (from the fall of 1993 to the spring of 1995) was not unreasonable.

[8] The Motions Judge went on to review the Director's denial of the appellant's request for waiver or cancellation of penalties and interest, a request made on the basis of undue delay in dealing with the notices of objection. He pointed out that the appellant had been aware in May, 1995 of the amount of taxes and interest that were payable, subject to any adjustment resulting from the notices of objection and could, in his view, have paid the taxes and interest at that time. The Motions Judge reviewed the process and factors considered by the Director in making his decision. He concluded that the decision was a reasonable one, that there was no indication of bad faith on the part of the Minister or his delegate, the Director, that there was no breach of natural justice and that there was no reliance placed on considerations extraneous to the statutory provisions.

Issues

[9] The parties agreed before us that because the penalties assessed against the appellant were related to unreported income amounts that were not altered by the 1998 reassessment, there was no need for the Court to consider whether they should be waived or cancelled. As a result, the remainder of these reasons will focus only the decision to not waive or cancel interest amounts owed by the appellant. I propose to consider the following issues:

1. Did the Minster and his delegates act "with all due dispatch" in considering the appellant' tax liability for the years 1989-1992?
2. Does the fairness provision contained in subs. 220(3.1) apply to interest accrued as a result of delays in dealing with the appellant's notices of objection?
3. Did the Minister's delegate take into account all relevant considerations in deciding whether to apply the provisions of the fairness provisions of the *Income Tax Act*?

Relevant Legislation

[10] *Income Tax Act*

152. (1) The Minister shall, with all due dispatch, examine a taxpayer's return of income for a taxation year, assess the tax, for the year, the interest and penalties, if any, payable and determine (a) the amount of refund, if any, to which the taxpayer may be entitled by virtue of section 129, 131, 132 or 133 for the year; or (b) the amount of tax, if any, deemed by subsection 120(2), 122.5(3), 122.51(2), 125.4(3), 125.5(3), 127.1(1), 127.41(3) or 210.2(3) or 210.2(4) to be paid on account of the taxpayer's tax payable under this Part for the year.	152. (1) Le ministre, avec diligence, examine la déclaration de revenu d'un contribuable pour une année d'imposition, fixe l'impôt pour l'année, ainsi que les intérêts et les pénalités éventuels payables et détermine: a) le montant du remboursement éventuel auquel il a droit en vertu des articles 129, 131, 132 ou 133, pour l'année; b) le montant d'impôt qui est réputé par les paragraphes 120(2), 122.5(3), 122.51(2), 125.4(3), 125.5(3), 127.1(1), 127.41(3) ou 210.2(3) ou (4) avoir été payé au titre de l'impôt payable par le contribuable en vertu de la présente partie pour l'année.

Digitized by Google

165. (3) On receipt of a notice of objection under this section, the Minister shall, with all due dispatch, reconsider the assessment and vacate, confirm or vary the assessment or reassess, and shall thereupon notify the taxpayer in writing of the Minister's action.	165. (3) Sur réception de l'avis d'opposition, le ministre, avec diligence, examine de nouveau la cotisation et l'annule, la ratifie ou la modifie ou établit une nouvelle cotisation. Dès lors, il avise le contribuable de sa décision par écrit.
220. (3.1) The Minister may at any time waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by a taxpayer or partnership and, notwithstanding subsections 152(4) to 152(5), such assessment of the interest and penalties payable by the taxpayer or partnership shall be made as is necessary to take into account the cancellation of the penalty or interest.	220. (3.1) Le ministre peut, à tout moment, renoncer à tout ou partie de quelque pénalité ou intérêt payable par ailleurs par un contribuable ou une société de personnes en application de la présente loi, ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

Analysis

Did the Minister and his Delegates Act "With All Due Dispatch"

[11] The appellant's original request for waiver or cancellation of interest was based only upon an allegation of delay in dealing with his notices of objection. Nevertheless, the Motions Judge considered the time taken to conduct the audit and initial reassessment. Given all of the circumstances, I agree with him that there was no undue delay on the part of the respondent during that period of time.

[12] I turn, therefore, to the period between the time of filing of the notice of objection and the final reassessment. Subsection 165(3) of the *Income Tax Act* requires the Minister to act "with all due dispatch" upon receipt of a notice of objection.

[13] The meaning of the phrase "with all due dispatch" has been considered by both the Tax Court of Canada and this Court. In *J. Stollar Construction Ltd.* v. *The Minister of National Revenue*, 89 D.T.C 134, Bonner, J.T.C.C. held, at 136, that the purpose of the requirement that the Minster act "with all due dispatch" is "primarily to protect the individual taxpayer by bringing certainty to his financial affairs at the earliest reasonably possible time." With respect to what constituted a reasonable period of time, the learned judge had this to say:

The words "with all due dispatch" and the words "avec toute la diligence possible" express a clear intention on the part of the legislature to require the Minister to act within a reasonable period, the length of which will vary in accordance with the circumstances of each case. The statutory language does not permit the formulation of a rigid time limit.

In the circumstances of the case before him (a six year delay in processing a tax return), he found it significant that the Minister had failed to adduce evidence to explain a delay which, on its face, was inordinate. He concluded:

It is neither desirable nor possible to identify the last day of the period reasonably required to assess in the circumstances of this case. It is sufficient to say that if the words "with all due dispatch" are not to be deprived of all meaning, the period allowed by those words must be found to have expired long before the assessment under appeal was made.

[14] A similar approach was adopted by Christie A.C.J.T.C.C. in *Ginsberg* v. *The Queen*, 94 D.T.C. 1430 at 1437:

I believe that if there is a delay that *prima facie* indicates a failure to examine and assess a return with all due dispatch as required under subsection 152(1) of the Act there is an onus

Digitized by Google

on the respondent to establish by evidence pertaining to the manner in which that return was dealt with that the delay was not unreasonable. ...
In the case at hand the lapse of time between the receipt of the returns and the assessments was one and one-half years. It strikes me that on the face of it this is a failure to meet the requirements of subsection 152(1) that returns of income shall be examined and assessed with all due dispatch. If there were evidence of some special circumstance relating to the appellant's returns which established that a delay of 18 months was reasonable then the requirements of the law would have been met. But there is no such evidence before the Court on this appeal.
This Court, while allowing an appeal with respect to the effect of the Minister's failure to act with all due dispatch, nonetheless agreed with the Tax Court Judge's approach to determining whether the Minister had so acted. See *R.* v.*Ginsberg*, 96 D.T.C. 6372 at para. 7.

[15] While the above quoted cases related to the use of the phrase "with all due dispatch" in section 152, I am of the view that the Court's reasoning applies equally to the use of the same phrase in subs. 165(3).

[16] Turning to the case at bar, then, I am of the view that once the review of the appellant's file was commenced in the January, 1998, it was completed in a reasonable period of time. Thus, the focus of my inquiry is upon the 31 month delay before the commencement of any complete review of the appellant's file. For 27 of those months, there was no contact between Revenue Canada and the appellant.

[17] In my opinion, this amount of delay is, on its face, inordinate, particularly in light of the fact that once a review of the objections was commenced, it was completed in little more than 6 months. The Minister's only explanation for the delay is that there were staff changes in his office. In my opinion, this is insufficient to meet the onus upon him to show that the delay was not unreasonable. Therefore, I conclude that the Minister, by allowing an unreasonable length of time to elapse prior to reassessing the appellant and informing him of the results, failed to act with the dispatch required by the Act.

[18] The Minister's delay caused the accrual of significant additional interest charges against the appellant. I turn now to the appropriateness of the remedy that he sought.

Does Subsection 220 (3.1) Allow the Minister to Waive or Cancel Interest Accrued While Dealing With the Appellant's Notices of Objection

[19] During oral argument, the respondent submitted that the fairness provisions of section 220 only apply to remedy unfairnesses encountered during the period up to the time the taxpayer is first assessed under section 152 of the *Act*. It was argued that if the taxpayer is unhappy with that assessment and does not want to pay, his remedy is an appeal to the Tax Court.

[20] In my opinion, this cannot be so. To begin with, there is no express indication that Parliament intended subs. 220 (3.1) to apply only to actions taken under s. 152. Although the fairness provision does make reference to two subsections of s. 152, this is done in the context of explicitly applying the provision notwithstanding those subsections. More importantly, to accept the respondent's position would be to deprive the taxpayer of any remedy in the event that his notice of objection is not considered in a reasonable time. The objection procedure is, in effect, a mechanism to settle disputes between the taxpayer and Revenue Canada. In my view, this Court must be reluctant to deprive taxpayers of the benefits of this settlement process, which is the result if subs. 220 (3.1) is held to be inapplicable during the objection stage.

[21] I turn, finally, to the question of whether the Director's decision to deny the appellant a remedy was reasonable.

Did the Minister's Delegate Take into Account All Relevant Considerations

Digitized by Google

[22] The Motions Judge recited the factors taken into account by the decision-maker in his decision:

The decision maker, ... considered the following in making his decision:

a) the request made by the applicant and the reasons therefor;

b) the applicant is a major shareholder in Hillier's Trades Limited and Northern Home Products Limited;

c) in filing his income tax return for the 1989 taxation year, the applicant did not include income in the amount of $37,836 in his computation of total income;

d)in filing his income tax return for the 1990 taxation year, the applicant did not include income in the amount of $34,632 in his computation of total income;

e) in filing his income tax return for the 1991 taxation year, the applicant did not include income in the amount of $40,386 in his computation of total income;

f) in filing his income tax return for the 1992 taxation year, the applicant did not include income in the amount of $17,615 in his computation of total income;

g) the applicant does not dispute his liability;

h) the "self-assessing" system of taxation puts the onus on the taxpayer to properly report income;

i)the guidelines established in Information Circular No. 92-2 and Internal Directive ARD-92-01 dated April 16, 1992 were not met in these circumstances.

[23] In my opinion, this list demonstrates that the Minister's delegate, in making his decision considered irrelevant factors while failing to consider at least one very important and relevant factor. Items (c) through (f) on the list relate to the appellant's failure to report all of his income in each of the taxation years. However, these amounts were discovered in the course of the initial audit and reassessment and penalties and interest were assessed at that time. They cannot have any relevance to the unfairness that was alleged by the appellant - delay in considering his notices of objection.

[24] Item (g) states that "the Applicant does not dispute his liability". In fact, the appellant, by filing notices of objection, *did* dispute the amount of his liability. Thus, from the time of his notices in June, 1995 until the final reassessment in August, 1998, the appellant did not know what his actual liability was. In the end, his total liability was significantly reduced.

[25] The central error made by the decision-maker, however, was the failure to consider the processing delays which, as I have held above, resulted in the taxpayer not being informed, within a reasonable time, the amount of tax he owed. Revenue Canada itself recognizes that such delays are relevant to the question of waiver or cancellation of interest. Information Circular 92-2, *Guidelines for the Cancellation and Waiver of Interest and Penalties*, provides guidance to decision-makers dealing with requests for waiver or cancellation of interest amounts. Paragraph 6 provides, in part:

6. Cancelling or waiving interest or penalties may also be appropriate if the interest or penalty arose primarily because of actions of the Department, such as:	6. L'annulation des intérêts ou des pénalités ou la renonciation à ceux-ci peuvent également être justifiées si ces intérêts ou pénalités découlent principalement d'actions attribuables au Ministère comme dans les cas suivants :
(a) processing delays which result in the taxpayer not being informed, within a reasonable time, that an amount was owing; ...	a) des retards de traitement, ce qui a eu pour effet que le contribuable n'a pas été informé, dans un délai raisonnable, de l'existence d'une somme en souffrance; ...

[26] While the Director, in his letter to the appellant, mentioned Departmental delays

Digitized by Google

as a possible reason for waiving interest, there is no indication in the letter that he actually considered whether or not such a delay had occurred. Indeed, in the affidavit he swore for the purposes of the proceeding below, which was quoted by the Motions Judge and at paragraph 22 above, he does not list delay as a factor that he considered. His failure to take into account the delay in making his decision was unreasonable.

Conclusion

[27] I would allow the appeal with costs. The matter is remitted to the Minister of National Revenue for reconsideration of the appellant's request that he waive or cancel interest in light of these reasons.

"J. Edgar Sexton"

J.A.

"I agree
J. Richard C.J."

"I agree
Marshall Rothstein J.A."

Wilfrid Comeau v. Canada Customs And Revenue Agency, 2005 FCA 271, While Filing the Objection the Interest Does Accrue and You take Your Chances at Losing Ability – And the Appropriate Measure of Review

REASONS FOR JUDGMENT

PELLETIER J.A.

[1] The question raised by this appeal is whether there were unjustified delays in processing a notice of objection which would justify the cancellation of interest accumulated on arrears.

Facts

[2] In 1992, Mr. Comeau invested $50,000 in a tax shelter, namely flow-through shares in a mining exploration venture, Exploration Acabit. According to the advice he received at the time, this investment entitled him to a tax deduction of $45,000 and a rebate of $18,000. The tax deduction represented a proportion of the exploration expenses contracted by Exploration Acabit. In his tax return for the 1992 taxation year, Mr. Comeau claimed the $45,000 tax deduction.

[3] **In 1996**, the Canada Customs and Revenue Agency (the Agency) undertook an audit of Exploration Acabit and came to the conclusion that the exploration expenses it was claiming were not such expenses and that accordingly investors were not entitled to the tax deductions they had claimed. In 1997, a reassessment was issued, significantly reducing the tax deduction claimed by Mr. Comeau. He filed a notice of objection against this reassessment. **On September 18, 1998**, the Agency offered to settle the objection according to the following terms: he would not be entitled to any tax deduction but would be granted a capital loss of $32,000.

[4] The Agency clearly indicated in the letter containing the settlement offer that the case would be put on hold if the settlement offer were not accepted. Mr. Comeau rejected the offer because the Agency made a waiver of the right of objection and right of appeal a term of the settlement. Rightly or wrongly, he believed this would require him to give up the right to rely on equity provisions as to interest. Following the rejection of the settlement offer, the objection file was put on hold. **It was not until September 11, 2000, when all the**

Digitized by Google

criminal proceedings had been concluded, that the Agency issued a reassessment following the terms of the settlement offered by the Agency in 1998, namely the complete cancellation of the tax deduction and the granting of a $32,000 capital loss.
[5] Mr. Comeau complied with this decision and rendered unto Caesar what was Caesar's. At the same time, he objected to the accrued interest which significantly increased his tax debt. He said he acted at all times in good faith and with the intention of carrying out his obligations. It was not until September 2000 that he finally learned the amount of his tax debt, and he immediately paid it.

Proceedings
[6] Mr. Comeau then exercised the right conferred on him by subsection 220(3.1) of the *Income Tax Act*
(the Act) to file an application to cancel the interest accrued on his tax debt. The Act gives the Minister the power to cancel interest, but the Minister has delegated it to the Agency. The latter rejected the application. At Mr. Comeau's request, the decision was reviewed by another decision-maker in the Agency, who confirmed it. **The Agency said it found nothing in the file showing that the interest had accumulated for reasons independent of Mr. Comeau's will.**
[7] Mr. Comeau sought judicial review of the Agency's decision (the first decision). Martineau J. of the Federal Court ruled in his favour and referred the matter back to the Agency for a new decision, that was to take [TRANSLATION] "into account the applicant's submissions, the guidelines [of the Agency on interest and penalties], the spirit and intent of subsection 220(3.1) of the Act, the content of this order and any other relevant factors". **The order contained certain findings by Martineau J., including the following:**

. . . a significant part of the interest paid by the applicant resulted from a situation beyond his control and was primarily due to the actions of the Minister or his representatives;

. . . in the circumstances, the seven-year delay between the original assessment in 1993 and the final assessment in 2000 seems unreasonable;

. . . the result of the processing delays and errors attributable to the Minister or the respondent was that the applicant was not informed of the existence of the tax debt actually due within a reasonable time;

. . . the unfavourable decision of November 15, 2001 [the decision approving the first decision which dismissed his application to cancel interest] for which the applicant sought review and the unfavourable decision of October 2, 2001 [the first decision dismissing his application] referred to in the latter decision are patently unreasonable;

. . . the Minister's designated representatives did not exercise the Minister's discretionary power reasonably and fairly and arbitrarily rejected the grounds set out in the applicant's application to reduce interest.

[8] The matter was referred back to the Agency, where a new review was conducted. The Agency divided the period which had elapsed since Mr. Comeau filed his tax return for the 1992 taxation year into three segments:
from the filing of Mr. Comeau's tax return on May 12, 1993 to the commencement of the Exploration Acabit audit on November 24, 1995;

Digitized by Google

from the commencement of the Exploration Acabit audit to June 9, 1997, the date of the assessments; and

from June 9, 1997 to the date of payment in October 2000.

[9] The Agency concluded that there was no delay in the processing of Mr. Comeau's file in the first segment. On the other hand, it found that the second segment exceeded the six-month norm which it considered reasonable for carrying out an audit. If the norm had been followed, Mr. Comeau's audit would have been completed on May 24, 1996, instead of June 9, 1997, as it turned out, a discrepancy of 12.5 months.

[10] As to the third segment, the Agency found that Mr. Comeau had been notified of the outstanding amount in his reassessment of 1997 and could have paid it and thus avoided the accumulation of interest. [11] On behalf of the Agency, Mr. St. Denis notified Mr. Comeau of its decision to cancel interest on arrears for the segment from May 24, 1996 to June 9, 1997. Far from being satisfied with this result, Mr. Comeau filed a new application for judicial review alleging that the Agency had taken no account of the judgment of Martineau J.. **This new application was examined by Beaudry J., who held that the standard of review was that of the patently unreasonable decision. He then examined each of the three segments analyzed and, for each of them, found nothing patently unreasonable in the reasons and findings of the Agency, except for one point which I will consider below.**

[12] The judge reviewed Mr. Comeau's allegation that the Agency's decision was vitiated by bad faith. He noted that the Agency had considered Mr. Comeau's supplementary submissions, as required by the order of Martineau J., and had also considered the spirit and intent of subsection 220(3.1) of the Act. The judge could not find that the Agency had acted in bad faith.

[13] However, in the judge's opinion, there was one point on which his intervention was warranted. He felt that the Agency erred in setting the date for the commencement of the audit as of November 24, 1995 (the date on which the auditor arrived on the scene), instead of November 1, 1995 (the date on which the form T979 authorizing the audit was issued), with the result that the proper date for the termination of the audit would have been May 1, 1996, rather than May 24, 1996. The judge allowed the application for judicial review to give Mr. Comeau these 23 additional days of respite.

Parties' arguments

[14] Before this Court, Mr. Comeau has maintained his claim that the Agency's decision did not in any way comply with the spirit and terms of the order rendered by Martineau J.. He asked how the findings of Martineau J. could be reconciled with the second decision by the Agency granting him a cancellation of interest for barely 13 months, when the period for processing his return extended over 8 years. The Agency, for its part, filed a cross-appeal in which it denied that the judge had jurisdiction to alter the interest cancellation period in any way whatever.

Analysis

Standard of review

[15] In *Dr. Q v. College of Physicians and Surgeons of British Columbia*, [2003] 1 S.C.R. 226, 2003 SCC 19, the Supreme Court of Canada defined the role of an appellate court called on to rule on the judgment of a superior court sitting in review of a decision by an administrative tribunal:

Digitized by Google

[43] . . . The role of the Court of Appeal was to determine whether the reviewing judge had chosen and applied the correct standard of review, and in the event she had not, to assess the administrative body's decision in light of the correct standard of review, reasonableness. At this stage in the analysis, the Court of Appeal is dealing with appellate review of a subordinate court, not judicial review of an administrative decision. As such, the normal rules of appellate review of lower courts as articulated in *Housen, supra*, apply. The question of the right standard to select and apply is one of law and, therefore, must be answered correctly by a reviewing judge. The Court of Appeal erred by affording deference where none was due.

[16] Therefore, this Court must first determine whether the trial judge applied the standard of review that was appropriate. According to the judge, it was the standard of the patently unreasonable decision which applied. To arrive at this conclusion, he relied on *Barron v. Canada (Minister of National Revenue (M.N.R.))* (1997), 209 N.R. 392 (F.C.A.), *Cheng v. Canada,* 2001 FCTD 1114 (*Cheng*) and *Laviolette v. Canada (Customs and Revenue Agency)*, [2004] F.C.J. No. 229, 2004 FC 176. Although such was the state of the law at the date of the hearing before the judge, this had changed by the time of this hearing, before this Court: it was held in *Lanno v. Canada (Customs and Revenue Agency),* 2005 FCA 153, that it is the standard of the reasonable decision which applies to discretionary decisions pertaining to the equity provisions in the Act. When it so held, this Court disapproved *Cheng*, on which the judge had relied.

[17] As the trial judge erred on the standard of review, this Court must apply the standard which should have been applied, namely that of the reasonable decision.

Application of standard of review to facts

[18] As to the first segment ending at the beginning of the audit of November 24, 1995, it does not exceed the ordinary duration of the reassessment process, which as the Agency noted [TRANSLATION] "makes it possible to verify, check and maintain this system [of self-assessment]". It is thus not unreasonable to find that there is no basis for cancelling the interest accumulated during this period.

[19] As to the second segment, that of the audit itself, the decision of the Agency to cancel interest for the audit period exceeding the six-month standard cannot be qualified as unreasonable.

[20] As to the third segment, from the assessment of June 1997 to the reassessment of September 11, 2000, the Agency justified its refusal to cancel the interest by the fact that, on June 26, 1997, Mr. Comeau was aware that there was an outstanding amount and that this amount remained unpaid throughout this third segment. Mr. Comeau could have paid the outstanding amount, which would have terminated the accumulation of interest, subject to being reimbursed if his objection succeeded. In other words, a taxpayer may benefit from the suspension of collection proceedings while his objection is being processed and wager on the outcome of his objection by not paying the amounts claimed by the Agency, so that interest accumulates, but if he loses his wager (when his **objection is dismissed), he cannot complain that the rules of the game put him at a disadvantage.**

There is nothing unreasonable in the Agency's decision.

[21] Finally, Mr. Comeau claimed that the Agency had acted in bad faith by not implementing the judgment of Martineau J., which concluded that the first decision was patently unreasonable. However, if one looks carefully at the judgment of Martineau J., it is apparent that it imposes no findings on the new decision-maker. The only directive given to the latter by Martineau J. is to make a decision [TRANSLATION] "taking into account the applicant's submissions, the guidelines [of the Agency on interest and penalties],

Digitized by Google

the spirit and intent of subsection 220(3.1) of the Act, the content of this order and any other relevant factors". The minutes of the deliberations of the Agency committee indicate that the order by Martineau J. was in fact considered (Appeal Book, at page 99). In view of the Agency's procedure, its reasoning and the cancellation of interest which resulted, it cannot be said that the content of the judgment was not taken into account in arriving at the second decision.

[22] For these reasons, I would dismiss the appeal with costs.

Cross-appeal

[23] As to the cross-appeal, when it was objected that Beaudry J. had exceeded his jurisdiction by extending the interest cancellation period by 23 days, I think it should be allowed. In the judge's view, the audit period began when the form T979 was issued. The Agency explained that its calculation for the ordinary six-month period began as of the date the auditor arrived on the scene. By intervening as he did, the judge in effect applied the standard of the correct decision instead of that of the reasonable decision. There is nothing unreasonable in the Agency's original decision that would warrant this Court's intervention. The cross-appeal should be allowed without costs and the part of the judge's order regarding the interest cancellation period reversed.

"J.D. Denis Pelletier"
J.A.

I concur.
Robert Décary
J.A.

I concur.
Gilles Létourneau
J.A.

Denis Lanno v. Canada Customs And Revenue Agency, 2006 FCA 220, Fairness can Extend Time to File Notice of Objection

REASONS FOR ORDER

SHARLOW J.A.

[1] On May 2, 2005, in the decision of *Lanno v. Canada (Customs and Revnue Agency)*, 2005 FCA 153, this Court allowed Mr. Lanno's appeal from a decision of the Federal Court (2004 FC 932) which denied relief from a negative decision of the Minister of National Revenue under subsection 152(4.2) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), in relation to interest.

[2] This Court found that the denial of Mr. Lanno's application for relief was not reasonable in light of the various reasons given by the Minister in letters dated May 29, 2003, July 30, 2003 and November 4, 2003. This Court found three reasons why Mr. Lanno's appeal should be allowed.

[3] First, contrary to the Minister's assertion, the fairness provisions can be used to extend the time limits for the filing of an objection. Information Circular 75-7R3, "Reassessment of a Return of Income" states that a reassessment "ordinarily" will be made at a taxpayer's request, even if the taxpayer has not filed a notice of objection within the prescribed time. Paragraph 4 of Information Circular 75-7R3

Digitized by Google

provides (my emphasis):

A reassessment to create a refund ordinarily will be made upon receipt of a written request by the taxpayer, even if a notice of objection has not been filed within the prescribed time, provided that

(a) the taxpayer has, within the four-year filling period required by subsection 164(1), filed the return of income;

(b) the department is satisfied that the previous assessment or reassessment was wrong;

(c) the reassessment can be made within the four-year period or the seven year-year period, as the case may be, as referred to in paragraph 1 above or, if that is not possible, the taxpayer has filed a waiver in prescribed form;

(d) the requested decrease in taxable income assessed is not based solely on an increased claim for capital cost allowances or other permissive deductions, where the taxpayer originally claimed less than the maximum allowable; and

(e) the application for refund is not based solely upon a successful appeal to the Courts by a taxpayer.

Sur réception d'une demande écrite du contribuable, le Ministère établit ordinairement une nouvelle cotisation pour donner un remboursement, même si un avis d'opposition a pas été produit dans le délai prescrit, pourvu:

a) que le contribuable ait produit la déclaration de revenu dans le délai de quatre ans mentionné au paragraphe 164(1)

b) que le Ministère soit convaincu que la cotisation ou nouvelle cotisation précédente était inexacte;

c) qu'il soit possible d'établir une nouvelle cotisation dans le délai de quatre ans ou de sept ans, selon le cas, dont il est fait mention au numéro 1 précédent ou, s'il n'est pas possible de remplir cette condition, que le contribuable ait produit une renonciation en la forme prescrite;

d) que la réduction du revenu imposable établi ne résulte pas uniquement d'une majoration des déduction pour amortissement ou d'autre déductions laissant une marge de manoeuvre au contribuable, lorsque ce dernier a demandé au départ une déduction inférieure au maximum déductible; et

e) que la demande de remboursement ne se fonde pas uniquement sur un appel devant les tribunaux d'un autre contribuable ayant eu gain de cause.

[4] Second, Mr. Lanno's application under the fairness package was based on the fact that a number of misunderstandings had resulted in a failure to file timely notices of objection. Contrary to the Minister's assertion, his application was not based solely upon the successful appeal of another taxpayer in the decision of *Stewart v. Canada* [2002] 2 S.C.R. 645.

Digitized by Google

[5] Finally, the Minister failed to consider the question as to whether or not there was any reason to treat Mr. Lanno differently from the three other individuals who had obtained relief.

[6] This Court set aside the Federal Court's decision and allowed Mr. Lanno's application for judicial review. The matter was referred back to the Minister for reconsideration by a different decision maker.

[7] The Minister, by a different decision maker, reconsidered the application for relief under the fairness provisions. In a letter dated March 24, 2006, the Minister again denied relief under subsection 152(4.2) for these reasons:

In arriving at our decision, we considered each of the three areas, which posed a concern for the Court.

[1] "It is manifestly incorrect to say that the fairness provisions cannot be used to extend the time limits for the filing of a notice of objection."

In making this comment, the Court looked at the preamble in paragraph 4 of IC75-7R3 and notes that "if the exception in paragraph 4(e) of Information Circular 75-7R3 was not applicable, he should have been entitled to the benefit of the opening words of paragraph 4." While this is true, the fact is that paragraph 4(e) exists and the preamble in paragraph 4 cannot be read in isolation. Clearly, the insertion of the word **"and"** after paragraph 4(d) means that the condition in paragraph 4(e) must be met. It is not discretionary. [...]

[2] "Second, the reference to the July 20, 2003 decision letter, and the statement that the decision in the letter remains unchanged, suggests that Mr. Scarcello may have concluded, as Mr. Coelho had done, that this was a case where relief should be precluded by the fact that Mr. Lanno's application for a refund was "based solely upon a successful appeal to the Courts by a taxpayer" (Stewart)."

[...] while a strong argument can be made that there was intent to file Notices of Objection, the fact remains that none were filed and that the request under [sic] for reassessment under subsection 152(4.2) was not made until after the favourable decision in Stewart.

It is our view that there were no extraordinary circumstances that prevented the client and/or representative from complying.

[3] "Third, Mr. Scarcello failed to address the question as to whether or not there was any reason to treat Mr. Lanno differently from the three other individuals who had obtained relief. It is not possible to determine whether he ignored that submission, whether he thought that there was some relevant distinction, or whether he thought it acceptable to afford different treatment to similarly situated individuals. I must conclude that Mr. Scarcello failed to take into account a relevant consideration."

Due to confidentiality it is not possible to go into detail when discussing the three other individuals referred to by the Court. Suffice to say that every case is decided on the basis of the facts of the case and the applicable laws. We, with respect, believe Mr. Lanno's case was decided corrected [sic] and without any inconsistency in the application of our policies.

[8] Mr. Lanno commenced an application for judicial review in the Federal Court. He also applied to this Court for an Order pursuant to Rule 431(a) of the *Federal Courts Rules* (SOR/98-106) to enforce this Court's May 2, 2005 judgment.

[9] The Minister submits that the process for enforcing an order is provided in Rule 423:

423. All matters relating to the enforcement of orders shall be brought before the Federal Court.	423. Toute question concernant l'exécution forcée d'une ordonnance relPve de la Cour fédérale.

[10] Mr. Lanno submits that this Court should dispense with compliance with that Rule and permit Mr. Lanno to seek relief based on Rule 55 which provides:

Digitized by Google

55. In special circumstances, in a proceeding, the Court may vary a rule or dispense with compliance with a rule.	55. Dans des circonstances spéciales, la Cour peut, dans une instance, modifier une règle ou exempter une partie ou une personne de son application.

[11] **I am not convinced that there are any special circumstances which would justify an order pursuant to Rule 55. If Mr. Lanno is of the view that the Minister has not complied with this Court's May 2, 2005 decision, his remedy should be pursued in the Federal Court.**

[12] I would dismiss this motion with costs.

"K. Sharlow"

J.A.

Canada Revenue Agency v. M. Dianne Telfer, 2009 FCA 23, Reasonableness of Decision in Light of Objection in Abeyance, as Interest Continued to Accrue – Again, Take Your Chances if Not Paid subject to Later Refund

REASONS FOR JUDGMENT

EVANS J.A.

A. INTRODUCTION

[1] This is an appeal by the Canada Revenue Agency ("CRA") from a decision of the Federal Court (2008 FC 218) in which Deputy Judge Frenette allowed an application for judicial review by Ms Dianne Telfer to set aside a decision of the Minister not to waive the interest owed by Ms Telfer on unpaid taxes. The Judge referred the matter back to the Minister for redetermination.

[2] It is common ground that unreasonableness is the standard of review applicable to the exercise of the Minister's discretion under subsection 220(3.1) of the *Income Tax Act*. In my view, the Minister's decision not to waive the interest on the facts of this case was not unreasonable, and the Deputy Judge was therefore wrong to have intervened. Accordingly, I would allow the appeal, set aside the Federal Court's order, and dismiss Ms Telfer's application for judicial review.

B. FACTUAL BACKGROUND

[3] The facts relevant to this appeal can be stated quite shortly. Ms Telfer was reassessed by the Minister for her taxation years 1993 to 1999 inclusive (except 1995) and was not allowed to deduct losses from her investment in a limited partnership. She objected to these assessments in Notices of Objection dated July 31, 2000 and May 19, 2001.

[4] The Minister acknowledged receipt of the Notices and advised Ms Telfer that interest would continue to accumulate on any amount of unpaid tax. The Minister added that Ms Telfer could avoid or reduce the interest by paying, in whole or in part, the tax liability that she was disputing.

[5] On January 15, 2002, the Minister wrote to Ms Telfer again, this time to say that she could agree in writing to have her Notices of Objection held in abeyance pending a decision in a test case, *Brown v. The Queen*, which raised issues directly relevant to Ms Telfer's tax liability. Somewhat curiously, the letter also stated that her objections were being held in abeyance (even though she had not indicated that she consented) pending the determination of *Brown*.

[6] Ms Telfer neither agreed in writing that her Notices should be held in abeyance,

Digitized by Google

nor expressed any disagreement with this course of action. Further, she did not exercise her right to pursue her appeal to the Tax Court 90 days after filing her Notices of Objection: paragraph 169(1)(*b*). Collection activity was suspended while the Notices were being held in abeyance.

[7] In the same letter, the Minister reiterated that interest would continue to accumulate if she did not pay the balance and noted that, if she paid, and her objections were ultimately successful, the Minister would repay any overpayments, with interest. The Minister set out and itemized the amounts of tax, and penalties and interest which Ms Telfer then owed.

[8] The *Brown* litigation was concluded in January 2004 when the Supreme Court of Canada denied the appellant leave to appeal: *Brown v. The Queen* (2001), D.T.C. 1094 (T.C.C.), aff'd. 2003 FCA 192, leave to appeal to the S.C.C. refused, 29843 (January 22, 2004). Soon after, the Minister made an offer to settle Ms Telfer's tax liability, which, after taking legal advice, she accepted in September 2004, more than three years after filing her Notices of Objection. In accordance with the terms of the settlement, the Minister, on March 21, 2005, confirmed the reassessments for the taxation years 1993 and 1994, and reassessed her for the years 1996 to 1999.

[9] In a letter dated September 22, 2006, Ms Telfer asked the Minister to give her "some relief" on the interest of $10,467 then owing on her unpaid tax debt, **because she had no income and it had taken a long time for the department to settle her liability**. Her request was refused in a letter dated February 19, 2007, on the ground that there was no evidence of departmental delay. The notes and recommendation on which the decision was based set out the relevant facts.

[10] In a letter dated March 26, 2007, Ms Telfer requested a second-level administrative review of the first decision**, relying again on her lack of income and the delay by the CRA in dealing with her Notices of Objection while waiting for the result of *Brown***. In a letter dated May 23, 2007, her request was denied. This is the decision under review in these proceedings.

[11] The decision letter stated that the basis of Ms Telfer's request was departmental delay in resolving the Notices of Objection and that, since there was no evidence of any delay on the part of the department and she had been kept fully informed of the situation, her request would be refused. In particular, it noted that she had been advised that the Notices were being held in abeyance pending the determination of the *Brown* litigation and that interest would continue to mount on the sum owing if she did not pay it. Ms Telfer was also reminded that, soon after the result of the *Brown* litigation was known, the Minister made an offer to settle, which she accepted.

[12] The letter also informed Ms Telfer that her request for interest relief on the ground of financial hardship had been transferred to the fairness committee of the CRA's Collections Department in a different office, which had an expertise in determining such matters. The financial hardship aspect of Ms Telfer's request for relief is not relevant for present purposes.

[13] The facts surrounding Ms Telfer's case were set out more fully in the summary prepared within the CRA, on which a recommendation to refuse her request was based. The recommendation explained the departmental view that, pursuant to its guidelines, discretion will normally only be exercised in favour of a taxpayer who has failed to pay a tax debt as a result of "extraordinary circumstances beyond their control". It concluded that this was not the case here. There had been no delay because Ms Telfer had agreed that her Notices of Objection should be held in abeyance and that she had been advised that, meanwhile, she was liable to pay the interest accumulating on her tax debt.

C. LEGISLATIVE FRAMEWORK

[14] The statutory provisions of immediate relevance to this appeal are as follows:

Digitized by Google

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)

161.(1) Where at any time after a taxpayer's balance-due day for a taxation year

(a) the total of the taxpayer's taxes payable under this Part and Parts I.3, VI and VI.1 for the year

exceeds

(b) the total of all amounts each of which is an amount paid at or before that time on account of the taxpayer's tax payable and applied as at that time by the Minister against the taxpayer's liability for an amount payable under this Part or Part I.3, VI or VI.1 for the years,

the taxpayer shall pay to the Receiver General interest at the prescribed rate on the excess, computed for the period during which that excess is outstanding.

165.(3) On receipt of a notice of objection under this section, the Minister shall, with all due dispatch, reconsider the assessment and vacate, confirm or vary the assessment or reassess, and shall thereupon notify the taxpayer in writing of the Minister's action.

220.(3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

161.(1) Dans le cas où le total visé à l'alinéa *a)* excède le total visé à l'alinéa *b)* à un moment postérieur à la date d'exigibilité du solde qui est applicable à un contribuable pour une année d'imposition, le contribuable est tenu de verser au receveur général des intérêts sur l'excédent, calculés au taux prescrit pour la période au cours de laquelle cet excédent est impayé :

a) le total des impôts payables par le contribuable pour l'année en vertu de la présente partie et des parties I.3, VI et VI.1;

b) le total des montants représentant chacun un montant payé au plus tard à ce moment au titre de l'impôt payable par le contribuable et imputé par le ministre, à compter de ce moment, sur le montant dont le contribuable est redevable pour l'année en vertu de la présente partie ou des parties I.3, VI ou VI.1.

165. (3) Sur réception de l'avis d'opposition, le ministre, avec diligence, examine de nouveau la cotisation et l'annule, la ratifie ou la modifie ou établit une nouvelle cotisation. Dès lors, il avise le contribuable de sa décision par écrit

220.(3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l'année d'imposition d'un contribuable ou de l'exercice d'une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d'un montant de pénalité ou d'intérêts payable par ailleurs par le contribuable ou la société de

Digitized by Google

personnes en application de la présente loi pour cette année d'imposition ou cet exercice, ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

D. ISSUES AND ANALYSIS

[15] While counsel for Ms Telfer raised several points in his memorandum, the oral argument focused primarily on the following question. **Was the Minister's refusal to exercise the discretion conferred by subsection 220(3.1) liable to be set aside on an application for judicial review on the ground of unreasonableness because the Minister had failed to take into account, or to give sufficient weight to, the fact that it was in the interests of both parties to hold Ms Telfer's Notices in abeyance pending the determination of the *Brown* litigation?**

(i) Federal Court's decision

[16] The Minister alleges that, while the Applications Judge properly identified unreasonableness as the standard of review, an examination of his reasoning indicates that he did not in fact apply this standard. Rather, counsel said, the Judge substituted his view for that of the Minister on the "fairness" of the decision to deny Ms Telfer interest relief. In other words, the Judge reviewed the Minister's decision on a standard of correctness, not reasonableness. Accordingly, counsel argued, this Court must determine for itself whether the Minister's decision was unreasonable.

[17] Counsel for the Minister may well be right in his analysis of the Judge's decision. It is difficult to extract from the Judge's reasons what error he thought the Minister had committed, other than that the result was unfair. However, in my opinion, it is not necessary for this Court to decide the potentially difficult question of whether the Judge failed to "apply" the appropriate standard of review or applied it incorrectly.

[18] Despite some earlier confusion, there is now ample authority for the proposition that, on an appeal from a decision disposing of an application for judicial review, the question for the appellate court to decide is simply whether the court below identified the appropriate standard of review and applied it correctly. The appellate court is not restricted to asking whether the first-level court committed a palpable and overriding error in its application of the appropriate standard.

[19] The law is stated clearly by Rothstein J.A. (as he then was) in *Prairie Acid Rain Coalition v. Canada (Minister of Fisheries and Oceans),* [2006] 3 F.C.R. 610, 2006 FCA 31.

> [13] In *Dr. Q v. College of Physicians and Surgeons of British Columbia*, [2003] 1 S.C.R. 226 at paragraph 43, the Supreme Court dealt with the role of a Court of Appeal reviewing a decision of a subordinate court which itself was conducting a judicial review of a decision of an administrative tribunal. The Supreme Court found that "the normal rules of appellate review of lower courts as articulated in *Housen, supra*, apply". The *Housen* approach (*Housen v. Nikolaisen*, [2002] 2 S.C.R. 235) provides that on a question of law the appellate court reviews the subordinate court decision on a standard of correctness (paragraph 8). On all other issues, the standard of review is

Digitized by Google

palpable and overriding error (paragraphs 10, 19 and 28).

[14] However, in more recent cases, the Supreme Court has adopted the view that the appellate court steps into the shoes of the subordinate court in reviewing a tribunal's decision. See for example *Zenner v. Prince Edward Island College of Optometrists*, [2005] 3 S.C.R. 645, 2005 SCC 77 at paragraphs 29-45 *per* Major J. See also *Alberta (Minister of Municipal Affairs) v. Telus Communications Inc.* (2002), 218 D.L.R. (4th) 61 at paragraphs 25-26 *per* Berger J.A. The appellate court determines the correct standard of review and then decides whether the standard of review was applied correctly: see *Zenner* at paragraphs 29-30. In practical terms, this means that the appellate court itself reviews the tribunal decision on the correct standard of review.

(ii) ground of review

[20] Counsel for the Minister argued that the Judge failed to identify a ground of review on which the Court was entitled to interfere with the Minister's exercise of discretion under subsection 220(3.1).

[21] At one time, courts regarded *ultra vires* as the only ground of review available at common law for the exercise of statutory discretion. Administrative action could be held to be *ultra vires* if the repository of discretion committed one of the errors from the familiar catalogue, such as taking into consideration the irrelevant or ignoring the relevant, exercising the power for an improper purpose, or unlawfully failing to exercise the power by, for example, fettering its exercise. In English law, the various errors for which a discretionary decision may be reviewed have sometimes been generalized as review on the ground of unreasonableness: *Associated Provincial Picture Houses Ltd. v. Wednesbury Corporation*, [1949] 1 K.B. 223 (Eng. C.A.).

[22] In Canada, the more descriptive "abuse of discretion" seems now to be the preferred formulation of the ground on which courts review the exercise of administrative discretion: see especially, *Mount Sinai Hospital Center v. Quebec (Minister of Health and Social Services),* [2001] 2 S.C.R 281, 2001 SCC 41, at paras. 52-54. While the various categories of *ultra vires* error remain relevant as means of establishing that an abuse of discretion has occurred, reviewing courts are also to take a more holistic approach to review. Thus, in order to reflect the deference due to the decision-maker to whom the legislature has delegated discretion, a court should not necessarily assume that it may substitute its view on, for example, issues of propriety of purpose and the relevance of the factors considered: see *Baker v. Canada (Minister of Citizenship and Immigration)*, [1999] 2 S.C.R. 817 at paras. 53 and 56; *Dr. Q v. British Columbia (College of Physicians and Surgeons)*, [2003] 1 S.C.R. 226, 2003 SCC 19, at paras. 24-25 ("*Dr. Q*").

[23] The *Federal Courts Act*, R.S.C. 1985, c. F-7, subsection 18.1(4), does not specifically identify the ground on which the Court may grant an application for the judicial review of the exercise of a statutory discretion by a federal board, commission or other tribunal, such as that conferred on the Minister by subsection 220(3.1). However, the grounds of review set out in subsection 18.1(4) are potentially applicable to discretionary administrative action, including error of law (paragraph 18.1(4)(*c*)) and the residual ground of review in paragraph 18.1(4)*(f)* ("acted in any other way that was contrary to law").

(iii) standard of review

[24] Unreasonableness is the standard of review normally applicable to the exercise of discretion: *Dunsmuir v. New Brunswick*, [2008] 1 S.C.R. 190, 2008 SCC 9, at para. 51 ("*Dunsmuir*"). Indeed, this Court had previously held in *Lanno v. Canada (Customs and Revenue Agency)*, 2005 DTC 5245, 2005 FCA 153, that unreasonableness *simpliciter* (one of the two deferential standards then applied by the courts) was the standard of review applicable to a decision made under subsection 220(3.1).

Digitized by Google

[25] When reviewing for unreasonableness, a court must examine the decision-making process (including the reasons given for the decision), in order to ensure that it contains a rational "justification" for the decision, and is transparent and intelligible. In addition, a reviewing court must determine whether the decision itself falls "within a range of possible, acceptable outcomes which are defensible in respect of the facts and the law": *Dunsmuir* at para. 47.

[26] In elaborating the concept of judicial deference connoted by the standard of unreasonableness, the Court also said in *Dunsmuir* (at para. 49):

> In short, deference requires respect for the legislative choices to leave some matters in the hands of administrative decision-makers, for the processes and determinations that draw on particular expertise and experience and for the different roles of the courts and administrative bodies within the Canadian constitutional system.

[27] In the present case, counsel conceded that, on the facts, it might be reasonably open to the Minister to deny Ms Telfer's request for interest relief. Rather, the complaint is that the Minister failed to consider, or to give sufficient weight to, relevant facts, particularly the delay resulting from the CRA's holding her Notices of Objection in abeyance pending a decision in the *Brown* litigation, a course of action that was the fault of neither party and benefited both as a result of the settlement of Ms Telfer's tax liability in light of the *Brown* decision.

[28] Nor is Ms Telfer's allegation that the Minister committed an error of law by misinterpreting subsection 220(3.1), as might have been the case if the Minister had stated that holding Notices of Objection in abeyance pending the decision in other litigation could never be the basis for granting relief. Rather, counsel's argument seems to be that, because the reasons for the CRA's decision did not deal expressly with the particular characteristics of the circumstances in which Ms Telfer's Notices were held in abeyance, they lacked the requisite degree of "justification, transparency and intelligibility" demanded by the standard of unreasonableness.

(iv) application of the unreasonableness standard

[29] While the formulation of the standard of unreasonableness as applied to the process for making discretionary decisions is invariable, its application is context-specific: compare *Mills v. Ontario (Workplace Safety and Insurance Appeals Tribunal),* 2008 ONCA 435 at paras. 21-22, where the Court "contextualized" the application of the unreasonableness standard to a tribunal's findings of fact. In determining whether the decision-making process in this case provided adequate justification, transparency, and intelligibility in order to render the decision reasonable, I have taken into account the following considerations.

[30] First, while referring to the fact that her Notices of Objection were held in abeyance pending the outcome of other litigation, Ms Telfer's request for a second-level administrative review of the initial refusal to grant relief characterized the basis for relief as departmental "delay". I note that Ms Telfer was legally represented in this appeal and had been assisted by different counsel in her dealings with the CRA in connection with her subsection 220(3.1) request. The allegation of departmental delay in Ms Telfer's request (with the implicit suggestion of fault on the part of the CRA) is significantly different from the basis of relief that, counsel alleged, the Minister had unlawfully failed to consider, namely that neither party was at fault and both benefited from the decision to hold the Notices in abeyance pending the result of the *Brown* case.

[31] When, as in the present case, a consideration is not squarely presented to a decision-maker, it will be difficult to establish on judicial review that a failure to deal with it in the reasons for decision so deprives the process of "justification, transparency and

Digitized by Google

intelligibility" as to render it unreasonable.

[32] Second, it is clear from the decision letter sent to Ms Telfer, and from the internal report and recommendation on which it was based, that the CRA had not overlooked the circumstances that resulted in the lapse of more than three years between the time that Ms Telfer filed her Notices of Objection and the settlement of her tax liability. The background facts are accurately summarized in the supporting documents, including the decision to hold the Notices in abeyance pending the determination of the related *Brown* litigation. The recommendation, but not the decision letter itself, stated that Ms Telfer had "agreed" that the Notices be held in abeyance. It would have been more accurate to have described Ms Telfer as having acquiesced, but nothing, in my view, turns on this nuance.

[33] In these circumstances, Ms Telfer can hardly say that the Minister overlooked any relevant facts. The most that can be said is that the Minister failed to give sufficient weight to the fact that her tax liability was not settled until *Brown* was decided. Since deciding what weight to accord to a particular fact is at the heart of exercising discretion, it will normally be difficult to persuade a court that an administrative decision-maker has acted unreasonably in this regard.

[34] Third, the nature of the discretion is another aspect of the context for determining whether an impugned decision is unreasonable. In this case, the refusal to grant relief against accumulated interest did not infringe any right or expectation of Ms Telfer's. On the contrary, she was invoking the Minister's extraordinary statutory discretion to grant her an exemption from a basic principle of the tax system, namely, that taxpayers are liable to pay taxes owing by April of the following year, failing which, they must pay interest, at the prescribed rate, on any amount owing.

[35] Those who, like Ms Telfer, knowingly fail to pay a tax debt pending a decision in a related case normally cannot complain that they should not have to pay interest. If they had promptly paid the sum claimed to be due, and were later found not liable to pay it, the Minister would have had to repay the overpayment, with interest: see *Comeau v. Canada (Customs and Revenue Agency),* 2005 FCA 271, 2005 D.T.C. 5489, at para. 20. The relatively high rate of interest charged to the taxpayer is no doubt intended, for the benefit of all taxpayers, to encourage the prompt payment of tax debts.

[36] *Information Circular IC07-1 – Taxpayer Relief Provisions*, dated May 31, 2007, makes available to the public the guidelines developed by the Minister, within which the statutory discretion under subsection 220(3.1) will normally be exercised. While the guidelines do not purport to be exhaustive of the situations in which relief may be granted, they indicate that discretion will be exercised in favour of the taxpayer "in exceptional circumstances beyond (the taxpayer's) control".

[37] In *Cole v. Canada (Attorney General)*, 2005 DTC 5667, 2005 FC 1445, it was said that delay caused by litigation may justify the grant of relief under subsection 220(3.1). However, unlike the situation in *Cole*, the Minister in the present case took into consideration the whole period of the delay, including the time taken awaiting the decision in *Brown*.

[38] Counsel argued that the Minister unlawfully fettered his discretion by refusing to exercise it in favour of Ms Telfer, because the facts did not fall within an existing guideline. I disagree. I see no evidence in either the terms of the guidelines or the decision letter to support this suggestion. After all, in basing her request on departmental delay, Ms Telfer was not asking the Minister to consider something not dealt with in the guidelines.

[39] Counsel also argued that it was unfair for the Minister to deal separately with Ms Telfer's allegation that she should be given relief on the ground of financial hardship. I do not agree. It seems to me quite appropriate that the CRA should refer this aspect of requests under subsection 220(3.1) to an office with expertise in considering claims of this kind.

(v) conclusion

Digitized by Google

[40] The above considerations, as well as the unstructured nature of the Minister's statutory power under subsection 220(3.1), militate against a court's subjecting the decision-making process to close scrutiny. Despite the Minister's statutory duty to consider a taxpayer's Notice of Objection "with all due dispatch" (subsection 165(3)), it will require circumstances more compelling than those in the present case to persuade a reviewing court that the Minister acted unreasonably in the course of deciding not to give to a taxpayer what would effectively be an interest-free loan.

[41] In short, I am not persuaded that the Minister's decision lacked the degree of "justification, transparency and intelligibility" required by the unreasonableness standard of review. The precise point relied on by counsel before this Court was not squarely put to the minister; instead, in her letter Ms Telfer simply alleged "delay". In any event, it is clear from both the Minister's letter, and the supporting documents, that he was well aware of all the relevant facts and cannot be said to have excluded them from his consideration.

[42] Finally, the Court in *Dunsmuir* (at para. 47) noted that, although the primary focus of judicial review for unreasonableness is the "justification, transparency and intelligibility" of the decision-making process, a reviewing court should also consider whether the outcome itself is unreasonable. In light of both the facts of the case and the applicable law, the Minister's decision "falls within a range of possible, acceptable outcomes defensible in respect of the facts and the law" and is thus not unreasonable.

E. CONCLUSIONS

[43] For all these reasons, I would allow the appeal with costs both here and below, set aside the order of the Federal Court, and dismiss the application for judicial review.

"John M. Evans"
J.A.
"I agree
J. Edgar Sexton J.A."
"I agree
C. Michael Ryer J.A."

Canada Revenue Agency v. Slau Limited, 2009 FCA 270, Settlement Not Processed Properly Per Taxpayer, Can't Compel Minister to Achieve a Very Particular Result if Discretion

REASONS FOR JUDGMENT RYER J.A.

[1] This is an appeal by the Canada Revenue Agency (the "CRA") from a decision of Kelen J. (the "Application Judge") of the Federal Court (2008 FC 1142) granting an application for judicial review brought by Slau Limited ("Slau") to set aside a decision of the Minister of National Revenue (the "Minister") refusing to cancel certain interest and penalties that were payable by Slau pursuant to the *Income Tax Act*, R.S.C.

1985, c. 1 (5th Supp.) (the "ITA"), in respect of its 1988 to 1990 taxation years.

[2] The application arose out of a request by Slau pursuant to subsection 220(3.1) of the ITA. Under that provision, which was introduced in 1991 as part of the so-called "Fairness Package", the Minister has the discretion to cancel penalties and interest payable by a taxpayer. It reads as follows:

Digitized by Google

220(3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

220(3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l'année d'imposition d'un contribuable ou de l'exercice d'une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d'un montant de pénalité ou d'intérêts payable par ailleurs par le contribuable ou la société de personnes en application de la présente loi pour cette année d'imposition ou cet exercice, ou l'annuler en tout ou
en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

BACKGROUND

[3] Slau was engaged in the restaurant business in Ottawa in its 1988 to 1990 taxation years. Its income tax returns for those years, which were filed late, indicated that it had no taxable income in any of those years.

[4] As a result of an audit undertaken in 1992, the CRA issued reassessments in which Slau was assessed income tax, interest and a late-filing penalty in respect of each of its 1988 to 1990 taxation years.

[5] Slau objected to the reassessments and in 1996, it reached a settlement with the CRA that led to the execution, on December 16, 1996, of an agreement entitled Disposition of Appeal on Consent (the "Settlement Agreement").

[6] In its income tax returns for its 1991 to 1993 taxation years, which were also late-filed, Slau claimed certain non-capital losses, within the meaning of subsection 111(8) of the ITA (the "Losses"), the validity of which is not in issue in this appeal.

[7] The Settlement Agreement did not deal with the Losses, although the matter of carrying the Losses back to the 1988 to 1990 taxation years may have been discussed in the negotiations that preceded the execution of the Settlement Agreement.

[8] In furtherance of the Settlement Agreement, Slau filed revised financial statements for its 1988 to 1990 taxation years. At that same time, Slau filed documents entitled "Adjustments to 1988 Income Statement", "Adjustments to 1989 Income Statement" and "Adjustments to 1990 Income Statement" in which carrybacks of certain amounts of the Losses (the "Loss Carrybacks") were specified.

[9] On February 12, 1997, the CRA issued notices of reassessment in accordance with the Settlement Agreement but did not implement the Loss Carrybacks. As a consequence, those notices of reassessment stipulated that Slau owed $134,462.44 on account of income tax, interest and **penalties in respect of its 1988 to 1990 taxation years. Tangentially, it is noted that the Province of Ontario accepted and implemented Slau's request for a carryback of the losses in the 1991 to 1993 taxation years for Ontario income tax purposes.**

[10] Subsequent to the issuance of the February 12, 1997 reassessments, Slau corresponded with the CRA with respect to the Loss Carrybacks and on March 20, 2003, submitted CRA Form T2A(E) requesting the Loss Carrybacks. In that correspondence, Slau

Digitized by Google

reiterated that it had requested the Loss Carrybacks at the time of the implementation of the Settlement Agreement.

[11] On June 6, 2003, the Minister corresponded with Slau, stating:

I am informed that Ms. Aline Landry, Director of the Ottawa Tax Services Office, has accepted your request for a non-capital loss carry-back for the 1991, 1992 and 1993 taxation years. As a result, non-capital losses will be applied to the taxation years 1988, 1989 and 1990. I understand that related penalties and interest will be cancelled from December 1996; therefore the tax debt of Slau Limited will be reduced accordingly.

[12] In the ensuing reassessments, issued January 20, 2004, the Minister implemented the Loss Carrybacks which eliminated any liability for income tax in Slau's 1988 to 1990 taxation years but left it with an unpaid balance comprised of interest and penalties relating to the amounts assessed in respect of those years pursuant to the Settlement Agreement.

[13] By correspondence to the Minister, dated March 3, 2004 and August 17, 2004, Slau requested a waiver of all interest and penalties that had been assessed against it in respect of its 1988 to 1990 taxation years pursuant to the January 20, 2004 reassessments. In that correspondence, Slau indicated that it had anticipated losses in its 1988 to 1990 taxation years, and therefore did not make instalment payments in those years. In addition, Slau argued that the Minister should have implemented the Loss Carrybacks when the Losses arose in its 1991 to 1993 taxation years, rather than in December of 1996.

[14] On October 7, 2004, the Minister denied the request for a complete waiver of all interest and penalties but decided that the amount owing by Slau was the amount owing on December 1, 1996 rather than December 16, 1996. In otherwise denying the request, the Minister stated that the Loss Carrybacks could not be implemented before there was a written request to do so from the taxpayer. In addition, the Minister stated that a waiver of interest and penalties pursuant to subsection 220(3.1) of the ITA could not be granted on the basis of an error or an incorrect assumption on the part of a taxpayer.

[15] By correspondence dated December 13, 2005, counsel for Slau made a second request for a waiver of the interest and penalties in respect of Slau's 1988 to 1990 taxation years. In that correspondence, counsel argued that because the Loss Carrybacks fully offset the amounts of income taxes owing for those years, it was illogical and unfair that Slau should have to pay any interest and penalties in respect of such income tax. In addition, counsel argued that when Slau filed its 1988 to 1990 tax returns as "nil returns", there was no tax owing because there was no taxable income.

[16] On July 6, 2006, the Minister confirmed the October 7, 2004 decision. The Minister determined that the amount owing on December 1, 1996 represented interest and penalties that had accrued prior to the implementation of the Loss Carrybacks as of that date and that any interest charged after that date was calculated on the amount owing on that date.

[17] An application for judicial review of the July 6, 2006 decision was allowed on consent. On February 7, 2007, Mactavish J. set aside that decision and ordered that the request for a waiver of penalty and interest charges relating to Slau's 1988 to 1990 taxation be referred back to the Minister for a new review by persons not previously involved in the matter.

[18] In compliance with this order and on behalf of the Minister, Ms. Lucie Bergevin, Director of the Ottawa Tax Services Office of the CRA reviewed all of the facts of the case, including an external taxpayer relief report, dated October 11, 2007 (the "New Second Level Review Report") prepared and reviewed by CRA officials, and the submissions made on behalf of Slau. In correspondence dated November 6, 2007, in which Slau's request was once again denied, Ms. Bergevin stated:

Digitized by Google

My review reveals no indication that an error or delay on the CRA's part, or circumstances beyond your control, would have caused additional amounts of interest arrears or penalties to be incurred with respect to the taxation years 1988, 1989 and 1990. Therefore, I have concluded that it would not be appropriate to cancel the penalty and interest charged on your client's account for those years.

. . .

Under 161(7)(*b*) of the *Income Tax Act*, for the purposes of interest calculation, losses carried back were correctly applied effective December 1, 1996. Any interest arrears that accumulated after December 1, 1996, were due to instalment interest and late filing penalties assessed for each year and interest on the Part I taxes that remained outstanding from the date they were due up to December 1, 1996.

[Emphasis Added]

[19] This decision (the "Decision") was challenged by Slau in an application for judicial review that was filed in the Federal Court on December 7, 2007.

THE DECISION OF THE FEDERAL COURT

[20] The Application Judge determined that the Decision was reviewable on the standard of reasonableness.

[21] The Application Judge rejected Slau's argument that the effect of the Loss Carrybacks was that no taxes were ever owing by it in its 1988 to 1990 taxation years. However, he accepted, at least in part, Slau's additional argument that delay on the part of the CRA in accepting Slau's request for the Loss Carrybacks led to the imposition of some of the interest that was payable by Slau.

[22] The Application Judge found that the record indicated that Slau had requested the Loss Carrybacks as early as December of 1996. He then referred to a portion of the Decision in which the Minister stated that there was no error or delay on the Minister's part that caused Slau to be subject to additional interest or penalties. He went on to find that the CRA did delay the implementation of the Loss Carrybacks, stating in paragraph 42 of his reasons:

> [42] However, the CRA did make the error of initially denying the application of the loss carry-back; or, at least, took six years before it decided that the loss carry-back did apply and this eliminated the applicant's tax liability for 1988-1990.

[23] The Application Judge was satisfied that the amount payable by Slau, as of December 1, 1996, was appropriate. However, he determined that if the request for the Loss Carrybacks had been granted when that request was first made in December of 1996, interest on the amount payable on that date might never have accrued.

[24] After commenting that certain CRA forms and correspondence were confusing and that Slau was not able to easily obtain clarification of the CRA's calculations, the Application Judge reached his conclusion in paragraph 47 of his reasons, which reads as follows:

[47] The Court must conclude that the only reasonable application of fairness and equity by the Fairness Committee in this case would be to apply the CRA rationale of cancelling penalties and interest on the taxes from December 1996 to all interest after this date. According to the information received from the parties following the hearing, this means that the applicant would owe interest and penalties totalling $71,195.44.

ISSUE

[25] The issue in this appeal is whether the Minister erred in denying Slau's request, pursuant to subsection 220(3.1) of the ITA, for cancellation of all or any portion of the interest and penalties that were payable by Slau as a consequence of the January 20, 2004

Digitized by Google

reassessments.

STANDARD OF REVIEW

[26] In appellate review of a decision of a subordinate court that was engaged in judicial review of a decision of a tribunal, the appellate court is required to determine whether the reviewing court selected the appropriate standard of review and applied it correctly. (See *Canada Revi*ew *Agency v. Telfer*, 2009 FCA 23 at paragraphs 18 and 19.) Thus, in the circumstances of this appeal, the Court will be free to substitute its judgment for that of the Application Judge where the Court determines either that the wrong standard of review was selected by the Application Judge or that the correct standard of review was incorrectly applied by him. In effect, the Court is required to conduct its own review of the Decision using the correct standard of review.

[27] In *Telfer*, this Court determined that the correct standard of review of a discretionary decision of the Minister under subsection 220(3.1) of the ITA is reasonableness. *Telfer* also provides guidance with respect to the approach to the application of the reasonableness standard. At paragraph 25 of that decision, Evans J.A. states:

[25] When reviewing for unreasonableness, a court must examine the decision-making process (including the reasons given for the decision), in order to ensure that it contains a rational "justification" for the decision, and is transparent and intelligible. In addition, a reviewing court must determine whether the decision itself falls "within a range of possible, acceptable outcomes which are defensible in respect of the facts and the law": *Dunsmuir* at para. 47.

ANALYSIS

Introduction

[28] The record indicates that Slau made payments on account of penalties and interest in respect of its 1988 to 1990 taxation years of approximately $159,974. In making the Decision, the Minister denied Slau's request for the cancellation of the entirety of that amount, which may be regarded as consisting of two components: approximately $71,195 of interest and penalties that were owing on December 1, 1996 (the "December 1, 1996 Liability") and approximately $88,779 of interest on that amount from December 1, 1996 to the date of payment (the "Post-December 1, 1996 Accrued Interest").

[29] While the Application Judge stated that he was setting aside the Decision as unreasonable, in effect, he partially upheld it by directing in his order that on redetermination, the Minister should cancel only the Post-December 1, 1996 Accrued Interest.

[30] In this appeal, the Crown contends that the Minister's refusal to cancel both the December 1, 1996 Liability and the Post-December 1, 1996 Accrued Interest was reasonable and should be reinstated. Slau, on the other hand, accepts the decision of the Application Judge, the effect of which would be that Slau is liable to pay the December 1, 1996 Liability but not the Post-December 1, 1996 Accrued Interest.

[31] For my part, I see no reason why the Decision cannot be regarded as a composite decision whereunder the Minister refused to cancel both the December 1, 1996 Liability and the Post-December 1, 1996 Accrued Interest. Under this approach, this appeal effectively resolves itself into a question of the reasonableness of the Minister's decision not to cancel the Post-December 1, 1996 Accrued Interest, since Slau takes no issue with respect to the reasonableness of the Minister's decision not to cancel the December 1, 1996 Liability.

Digitized by Google

Selection of the Standard of Review

[32] The Application Judge determined that the standard of review of the Decision is reasonableness. In my view, having regard to *Telfer*, that determination was correct.

Application of Unreasonableness Standard

[33] In the Decision, the Minister stated that no error or delay on the Minister's part caused Slau to become liable for any interest arrears or penalties with respect to its 1988 to 1990 taxation years. This statement can be taken, correctly in my view, to mean that where an error or delay on the part of the Minister results in a taxpayer becoming liable for interest or penalties, it is appropriate for the Minister to exercise the discretion provided for in subsection 220(3.1) of the ITA and to cancel or waive such interest or penalties to the extent that they are attributable to the Minister's error or delay.

[34] The determination of whether the Minister has made an error or caused a delay for these purposes is largely a factual matter. As previously noted, the Application Judge found that the request for the Loss Carrybacks was made in December of 1996 and the Minister made an error or caused a delay in failing to accept and implement that request at that time. The Crown contends that the Application Judge erred in making these factual findings. With respect, I cannot agree with that contention.

[35] On page 2 of the Decision, the Minister states that the Loss Carrybacks "were correctly applied December 1, 1996". I take that statement to mean that having regard to the materials reviewed as a consequence of the order of Mactavish J. in the first judicial review, the Minister determined that Slau had, in fact, requested the Loss Carrybacks on or before December 1, 1996. This conclusion is consistent with a statement made by a CRA official at page 9 (Appeal Book page 256) of the New Second Level Review Report, one of the documents reviewed by the Minister before the Decision was made, wherein it is stated:

There is no written request prior to Dec 1996 on record. The taxpayer's representative Mr. Au-Yeung acknowledges that the loss carry-back request was only made in Dec 1996 at the time of the settlement. The CRA had no record of such a request till Mar 2003. However, due to some indications in our records that such a request might have been made at the time of the settlement the Agency gave the benefit of the doubt to the taxpayer that a request had been made in Dec 1996 – Dec 1, 1996.

[Emphasis added]

[36] In my view, these statements constitute ample support for the factual findings of the Application Judge that the request for the Loss Carrybacks was made in December of 1996 and the Minister made an error or caused a delay by refusing to accept and implement that request when it was made. Moreover, these statements are inconsistent with the Crown's contention at the hearing that the selection of December 1, 1996 as the effective date for the implementation of the Loss Carrybacks was a consequence of the exercise of Ministerial discretion pursuant to subsection 220(3.1) of the ITA.

[37] The effect of the Minister's failure to implement Slau's 1996 request for the Loss Carrybacks is clear. That failure resulted in the Post-December 1, 1996 Interest Accrual. That interest would likely not have arisen, or at least it would likely not have arisen to an extent that was anywhere close to the actual amount that was paid by Slau, if the Loss Carryback request had been processed when it was originally made in 1996.

[38] What then is the effect of this failure upon the Minister's decision not to cancel the Post-December 1, 1996 Accrued Interest? In substance, the Application Judge found that the decision not to cancel the Post- December 1, 1996 Accrued Interest was unreasonable and therefore set that decision aside. In my view, that conclusion is supportable.

Digitized by Google

[39] In the Decision, the Minister stated that the CRA committed no error and made no delay that would have caused Slau to become liable for any Post-December 1, 1996 Accrued Interest. However, that factual premise, upon which the Decision is based, has been found by the Application Judge to be faulty and, in my view, no basis for interfering with that finding has been made out in this appeal. It is clear to me that a decision based upon such an important factual premise cannot be said to be "justifiable" or "intelligible", as contemplated by *Dunsmuir v. New Brunswick*, [2008] 1 S.C.R. 190, 2008 SCC 9, where that factual premise has been found to be false. Accordingly, I am of the view that the decision of the Minister to refuse to cancel the Post-December 1, 1996 Accrued Interest was unreasonable and to that extent, I agree with the Application Judge.

The Disposition of the Application Judge

[40] Having found that the Decision was unreasonable, the Application Judge determined that it had to be set aside. To that extent, I agree with his determination. However, the Application Judge, relying upon subsection 18.1(3) of the *Federal Courts Act*, R.S.C. 1985, c. F-7 (the "*Federal Courts Act"),* then proceeded to direct the Minister to exercise the discretion provided in subsection 220(3.1) of the ITA in a very specific manner, holding that there was only one reasonable way in which that discretion could be exercised by the Minister. It is at this point that I must, with respect, disagree with the Application Judge.

[41] In this appeal, the Crown argues that the Application Judge exceeded his jurisdiction under subsection 18.1(3) of the *Federal Courts Act* by ordering the Minister to do something that was not required to be done under subsection 220(3.1) of the ITA. The Crown contends, correctly in my view, that this provision of the ITA simply requires the Minister to exercise the discretion that is provided thereunder and does not require the Minister to bring about any particular result. Unlike the Application Judge, I am of the view that, in the factual context of this appeal, the exercise of the Minister's discretion under subsection 220(3.1) of the ITA could lead to outcomes other than the one that he stipulated. Accordingly, I conclude that the Application Judge erred by imposing a single mandated outcome upon the Minister in the redetermination of the Decision that he ordered.

Conclusion

[42] Having found that the Application Judge made no error in holding that the portion of the Decision that encompasses the refusal of the Minister to cancel the Post-December 1, 1996 Accrued Interest was unreasonable but that he did err in the resulting order that he made, I am of the opinion that it is sufficient for me to simply set aside that portion of the Decision and to refer that matter to the Minister for redetermination in accordance with these reasons.

DISPOSITION

[43] For the foregoing reasons, I would allow the appeal, set aside the order of the Application Judge and, making the order that the Application Judge should have made, I would allow the application for judicial review, set aside the decision of the Minister, dated November 6, 2007, and refer the matter to Minister for redetermination in accordance with these reasons. Since success in this appeal is essentially divided, I would make no order as to costs.

"C. Michael Ryer" J.A.
"I agree
J. Edgar Sexton J.A."
"I agree

Digitized by Google

Carolyn Layden-Stevenson”

Taxpayer Relief Provisions
IC07-1
DATE: **May 31, 2007**
SUBJECT: **Taxpayer Relief Provisions**

Notice to the reader:
This version is only available electronically.

Contents

Application (¶s 1-4)
Introduction (¶s 5-7)
Part I
Legislation (¶ 8)
Taxpayer Relief Provisions (¶s 9-11)
Limitation Period on Exercising Ministerial Discretion and Deadline to Apply for Relief (¶s 12-16)
Who Is Authorized to Make the Decision? (¶s 17-18)
Part II
Guidelines for the Cancellation or Waiver of Penalties and Interest (¶ 19)
General (¶s 20-22)
Circumstances Where Relief From Penalty and Interest May Be Warranted (¶s 23-24)
Extraordinary Circumstances (¶ 25)
Actions of the CRA (¶ 26)
Inability to Pay or Financial Hardship (¶s 27-28)
Making a Request (¶s 29-32)
Factors Used in Arriving at the Decision (¶ 33)
Special Consideration Due to Extraordinary Events (¶ 34)
Third-Party Actions (¶s 35-36)
Gross Negligence Penalties (¶s 37-38)
Accrual of Arrears Interest (¶ 39)
Administrative Charge on Dishonoured Payments (¶ 40)
Employment Insurance Premiums and Canada Pension Plan Contributions (¶ 41)
Voluntary Disclosures Program (¶s 42-43)
Goods and Services Tax/Harmonized Sales Tax (¶ 44)
Part III
Guidelines for Accepting Late, Amended, or Revoked Elections (¶ 45)
General (¶ 46)
Prescribed Elections (¶s 47-50)
Penalty for Late, Amended, or Revoked Elections (¶s 51-54)
Deemed Prescribed Elections (¶ 55)
Acceptance of a Late, Amended, or Revoked Election (¶ 56)
Denial of a Late, Amended, or Revoked Election (¶ 57)
Making a Request (¶s 58-63)
Part IV
Guidelines for Refunds or Reduction in Amounts Payable Beyond the Normal Three-Year Period (¶ 64)
General (¶ 65)
Refund Entitlement (¶ 66)

Digitized by Google

Discretion to Allow a Statute-Barred Refund (¶ 67)
Reassessment or Redetermination (¶ 68)
Discretion to Refund or Reduce Tax Payable for a Statute-Barred Return (¶s 69-70)
Acceptance of a Refund or Adjustment Request (¶s 71-74)
Making a Request (¶s 75-83)
Provincial Benefits or Credits (¶ 84)
Permissive Deductions (¶ 85)
Employment Insurance Premiums and Canada Pension Plan Contributions (¶ 86)
Requests Based on a Court Decision or Other Resolution (¶s 87-88)
Part V
Rules and Procedures When Relief is Granted or Denied (¶ 89)
Reductions in Refunds (¶s 90-92)
Refund Interest (¶s 93-97)
Application of Refund to Other Debts (¶ 98)
Refund Withheld Until Outstanding Returns Are Filed (¶ 99)
Right of Objection (¶s 100-102)
Redress – Second Administrative Review (¶s 103-104)
Redress – Judicial Review (¶s 105-108)
Requests Made While an Objection or Appeal Is in Progress (¶s 109-110)
Comments (¶ 111)
Appendix A – List of prescribed elections

Application

¶ 1. This information circular consolidates and cancels information circulars IC 92-1, *Guidelines for Accepting Late, Amended or Revoked Elections, IC 92-2, Guidelines for the Cancellation and Waiver of Interest and Penalties, and IC 92-3, Guidelines for Refunds Beyond the Normal Three Year Period*, all dated March 18, 1992.

¶ 2. In this information circular, the term **taxpayer** includes an individual, an employer or a payer, a corporation, a partnership, a trust, an estate, and an organization, all of which can request relief from the Minister of National Revenue (Minister) to mitigate the strict application of certain provisions as a result of not satisfying various rules and obligations required under the *Income Tax Act*.

¶ 3. Unless otherwise specified, all legislative references in this information circular refer to the *Income Tax Act* (Act).

¶ 4. In this information circular, the terms **fairness provisions** and **fairness legislation** commonly used on the Canada Revenue Agency (CRA) Web site and in CRA publications have been replaced with the term **taxpayer relief provisions**.

Introduction

¶ 5. This information circular provides information on the discretionary authority the Minister has under the Act to grant taxpayers relief in accordance with the legislative provisions described in ¶ 9. It also explains how a taxpayer makes a request for relief, including the proper information and documentation needed to support such a request, and outlines the administrative guidelines the CRA will follow in making a discretionary decision whether to grant or deny relief based on a taxpayer's situation.

¶ 6. These are only guidelines. They are not intended to be exhaustive, and are not meant to restrict the spirit or intent of the legislation.

¶ 7. This information circular is divided into five parts:

Part I Legislation

Part II Guidelines for the Cancellation or Waiver of Penalties and Interest

Part III Guidelines for Accepting Late, Amended, or Revoked Elections

Part IV Guidelines for Refunds or Reduction in Amounts Payable Beyond the Normal Three-Year

Digitized by Google

Period
Part V Rules and Procedures When Relief Is Granted or Denied

Part I
Legislation
¶ 8. The legislation gives the CRA the ability to administer the income tax system fairly and reasonably by helping taxpayers to resolve issues that arise through no fault of their own, and to allow for a common-sense approach in dealing with taxpayers who, because of personal misfortune or circumstances beyond their control, could not comply with a statutory requirement for income tax purposes.

Taxpayer Relief Provisions
¶ 9. A taxpayer can ask for relief in accordance with the provisions of the Act listed in this paragraph. After consideration of the relevant facts and circumstances, a delegated official of the CRA (see ¶ 17) will decide whether it is appropriate to:
(a) waive or cancel penalties and interest under subsection 220(3.1);
(b) extend the filing-due date for making certain elections or grant permission to amend or revoke certain elections under subsection 220(3.2);
(c) authorize a refund to an individual (other than a trust) or a testamentary trust under paragraph 164(1.5)(a), even though an income tax return is filed outside the normal three-year period; or
(d) authorize a reassessment or redetermination for an individual (other than a trust) or a testamentary trust beyond the three-year normal reassessment period under subsection 152(4.2), where the adjustment would result in a refund or a reduction in an amount payable.
¶ 10. While paragraph 164(1.5)(a) and subsection 152(4.2) apply only to individuals (other than a trust) and testamentary trusts, subsections 220(3.1) and (3.2) apply to all taxpayers.
¶ 11. The Minister does not have to grant relief under the taxpayer relief provisions. Each request will be reviewed and decided on its own merit. If relief is denied or partly granted, the CRA will provide the taxpayer with an explanation of the reasons and factors for the decision.

Limitation Period on Exercising Ministerial Discretion and Deadline to Apply for Relief
¶ 12. For requests or income tax returns filed on or after January 1, 2005, the Minister may grant relief for any tax year (or fiscal period in the case of a partnership) that ended within 10 years before the calendar year in which the taxpayer's request or income tax return is filed.
¶ 13. Due to this limitation, a taxpayer has 10 years from the end of the calendar year in which the tax year or fiscal period at issue ended to make a request to the CRA for relief. This limitation applies to each of the legislative provisions described in ¶ 9.
¶ 14. The 10-year limitation period rolls forward every January 1. For requests or income tax returns that are filed in the current calendar year, the Minister has no authority to:
waive or cancel penalties and interest;
accept a late, amended, or revoked income tax election; or
issue a refund or adjustment beyond the normal three-year period;
where the request is for a tax year or fiscal period of the taxpayer that ended more than 10 years before the calendar year in which the request was made.

Examples
An initial request or income tax return filed during the 2007 calendar year must deal with an issue related to a taxpayer's 1997 and later tax years (or fiscal periods) to be eligible for relief.
An initial request or income tax return filed on or after January 1, 2008, related to a taxpayer's 1997 and previous tax years (or fiscal periods) is not eligible for relief, since those tax years (or fiscal periods) are beyond the 10-year period. Only requests or returns filed for the 1998 and later tax

Digitized by Google

years (or fiscal periods) are eligible for relief as of this date.
The Minister has no authority to grant relief for the 1998 tax year (or fiscal period) unless the taxpayer has filed an initial request or income tax return for that year before January 1, 2009.
¶ 15. If an assessment or reassessment for a tax year is issued by the CRA in a later year, or if an objection or appeal filed by a taxpayer may take considerable time to resolve, the taxpayer should send in their request for any potential relief before the 10-year time limit for that tax year expires.
¶ 16. Unless an initial request or income tax return was filed before the 10-year limitation rule coming into effect on January 1, 2005, requests filed for the 1985 to 1994 tax years will not be accepted and refunds beyond the normal three-year period will not be issued. For any active requests made before January 1, 2005, the taxpayer relief provisions in ¶ 9 and the redress process described in ¶ 103 and ¶ 105 continue to apply for the taxpayer's 1985 to 1994 tax years.

Who Is Authorized to Make the Decision?
¶ 17. Subsection 220(2.01) authorizes the Minister to delegate his/her powers and duties conferred in various provisions of the Act to designated officials within the CRA. The officials delegated to exercise the Minister's discretionary authority under the taxpayer relief provisions described in ¶ 9 are authorized through administrative delegation instruments. These instruments are available at **www.cra-arc.gc.ca/tax/technical/delegationofpowers/menu-e.html**.
¶ 18. These officials are authorized to conduct a review of a taxpayer's request for relief and to make a decision whether to grant, partly grant, or deny, the request. It is a general administrative practice of the CRA for another CRA official, or a committee of CRA officials, to prepare a decision report for the delegated official's consideration, including a recommendation on whether or not granting relief is justified. The final decision and notification of the decision to the taxpayer rests with the delegated official.

Part II
Guidelines for the Cancellation or Waiver of Penalties and Interest
¶ 19. The information in Part II of this information circular deals with the Minister's discretion to allow relief from the application of the penalty and interest provisions of the Act. The Minister may also provide relief from interest amounts, and in some cases penalty amounts, if he or she is satisfied that a taxpayer has an inability to pay or suffers from financial hardship related to a debt owed to the CRA.

General
¶ 20. Subsection 220(3.1) gives the Minister the discretionary authority to waive or cancel all or part of any penalty and interest otherwise payable by a taxpayer under the Act. The request must be made within the 10-year time limit described in ¶ 13.
¶ 21. The ability of the CRA to waive or cancel penalties and interest is not to be used by taxpayers as a way to arbitrarily reduce or settle their tax debt.
¶ 22. A **waiver** refers to penalties and interest otherwise payable by a taxpayer for which relief is granted by the CRA before these amounts are assessed or charged to the taxpayer. A **cancellation** refers to penalties and interest amounts that were assessed or charged to the taxpayer for which relief is granted by the CRA.

Circumstances Where Relief From Penalty and Interest May Be Warranted
¶ 23. The Minister may grant relief from the application of penalty and interest where the following types of situations exist and justify a taxpayer's inability to satisfy a tax obligation or requirement at issue:
(a) extraordinary circumstances
(b) actions of the CRA

Digitized by Google

(c) inability to pay or financial hardship
¶ 24. The Minister may also grant relief if a taxpayer's circumstances do not fall within the situations stated in ¶ 23.

Extraordinary Circumstances
¶ 25. Penalties and interest may be waived or cancelled in whole or in part where they result from circumstances beyond a taxpayer's control. Extraordinary circumstances that may have prevented a taxpayer from making a payment when due, filing a return on time, or otherwise complying with an obligation under the Act include, but are not limited to, the following examples:
(a) natural or man-made disasters such as, flood or fire;
(b) civil disturbances or disruptions in services, such as a postal strike;
(c) a serious illness or accident; or
(d) serious emotional or mental distress, such as death in the immediate family.

Actions of the CRA
¶ 26. Penalties and interest may also be waived or cancelled if the penalty and interest arose primarily because of actions of the CRA, such as:
(a) processing delays that result in the taxpayer not being informed, within a reasonable time, that an amount was owing;
(b) errors in material available to the public, which led taxpayers to file returns or make payments based on incorrect information;
(c) incorrect information provided to a taxpayer, such as in the case where the CRA wrongly advises a taxpayer that no instalment payments will be required for the current year;
(d) errors in processing;
(e) delays in providing information, such as when a taxpayer could not make the appropriate instalment or arrears payments because the necessary information was not available; or
(f) undue delays in resolving an objection or an appeal, or in completing an audit.

Inability to Pay or Financial Hardship
¶ 27. It may be appropriate, in circumstances where there is a confirmed inability to pay all amounts owing, to consider waiving or cancelling interest in whole or in part to enable taxpayers to pay their account. For example:
(a) when collection had been suspended due to an inability to pay and substantial interest has accumulated or will accumulate;
(b) when a taxpayer's demonstrated ability to pay requires an extended payment arrangement, consideration may be given to waiving all or part of the interest for the period from when payments start until the amounts owing are paid, as long as the agreed payments are made on time and compliance with the Act is maintained; or
(c) when payment of the accumulated interest would cause a prolonged inability to provide basic necessities (financial hardship) such as food, medical help, transportation, or shelter, consideration may be given to cancelling all or part of the total accumulated interest.
¶ 28. Consideration would not generally be given to cancelling a penalty based on an inability to pay or financial hardship unless an extraordinary circumstance, as described in ¶ 25 has prevented compliance. However, there may be exceptional situations that may give rise to cancelling penalties, in whole or in part. For example, when a business is experiencing extreme financial difficulty, and enforcement of such penalties would jeopardize the continuity of its operations, the jobs of the employees, and the welfare of the community as a whole, consideration may be given to providing relief of the penalties.

Making a Request

Digitized by Google

¶ 29. Taxpayers or their authorized representatives can make their requests in writing and send them to the tax centre where they file their returns or to the tax services office serving their area. Alternatively, **Form RC4288, *Request for Taxpayer Relief***, can be used to make a request. A copy of this form is available from the CRA Web site at **www.cra-arc.gc.ca/formspubs/menu-e.html** or by telephone at 1-800-959-2221.
¶ 30. Taxpayer requests on the basis of inability to pay or financial hardship should be sent to the taxpayer's tax services office.
¶ 31. For addresses and telephone numbers of CRA offices, see the listings in the government section of telephone books and on the "**Contact us**" page of the CRA Web site at **www.cra-arc.gc.ca**.
¶ 32. Taxpayers should include all the circumstances (as listed in ¶ 23) that they intend to rely on in their initial request. It is important that taxpayers provide the CRA with a complete and accurate description of their circumstances to explain why their situation should merit relief. To support a request, taxpayers should provide all relevant information including the following, where applicable:
(a) the name, address, telephone number, social insurance number, account number, partnership number, trust account number, and business number or any other identification tax number assigned by the CRA to the taxpayer;
(b) the tax year(s) or fiscal period(s) involved;
(c) the facts and reasons supporting that the interest or penalties were either mainly caused by factors beyond the taxpayer's control, or were as a result of actions of the CRA;
(d) an explanation of how the circumstances affected the taxpayer's ability in meeting their tax obligation;
(e) the facts and reasons supporting the taxpayer's inability to pay the interest or penalties levied, or to be levied;
(f) any relevant documentation such as death certificates, doctor's statements, or insurance statements to support the facts and reasons;
(g) in cases involving financial hardship (inability to pay), a meaningful payment arrangement which covers at least the tax and the penalty part, if applicable, and full financial disclosure including a statement of income and expenses, as well as a statement of assets and liabilities;
(h) supporting details of incorrect information given by the CRA in the form of written answers, published information, or other objective evidence;
(i) where incorrect information given by the CRA is of a oral nature, the taxpayer should give all possible details they have documented, such as date, time, name of the CRA official spoken to, and details of the conversation; and
(j) a complete history of events including what measures were taken (e.g., payments and payment arrangements) and when they were taken to resolve the non-compliance.

Factors Used in Arriving at the Decision
¶ 33. Where circumstances beyond a taxpayer's control, actions of the CRA, or inability to pay or financial hardship has prevented the taxpayer from complying with the Act, the following factors will be considered when determining whether or not the CRA will cancel or waive penalties and interest:
(a) whether or not the taxpayer has a history of compliance with tax obligations;
(b) whether or not the taxpayer has knowingly allowed a balance to exist on which arrears interest has accrued;
(c) whether or not the taxpayer has exercised a reasonable amount of care and has not been negligent or careless in conducting their affairs under the self-assessment system; and
(d) whether or not the taxpayer has acted quickly to remedy any delay or omission.

Special Consideration Due to Extraordinary Events
¶ 34. When an extraordinary event (e.g., natural disaster) has prevented a large number of

Digitized by Google

taxpayers from meeting their tax obligations, the Minister may issue a news release to announce that special consideration will be given to providing relief, such as a waiver or cancellation of penalty and interest charges on late tax remittances or late filing of a return. In such cases, taxpayers need to make a request to get relief. CRA news releases on extraordinary events that qualify for relief can be found at **www.cra-arc.gc.ca/newsroom/releases/menu-e.html**.

Third-Party Actions

¶ 35. Taxpayers are generally considered to be responsible for errors made by third parties acting on their behalf for income tax matters. A third party who receives a fee and gives incorrect advice, or makes arithmetic or accounting errors, is usually regarded as being responsible to their client for any penalty and interest charges that the client has because of the party's action. However, there may be exceptional situations, where it may be appropriate to provide relief to taxpayers because of third-party errors or delays.

¶ 36. It may be appropriate to consider granting relief from penalties and interest, in whole or in part, where an extraordinary circumstance beyond the control of a taxpayer's representative or actions of the CRA (as described in ¶ 25 and ¶ 26) have prevented the taxpayer from complying with an obligation or requirement under the Act.

Gross Negligence Penalties

¶ 37. Relief from a gross negligence penalty assessed under the Act can be considered under subsection 220(3.1). However, since the levy of these penalties indicates a degree of negligence and absence of care and diligence on the part of the taxpayer in the conduct of their tax affairs, the cancellation of a gross negligence penalty may be appropriate only in exceptional circumstances.

¶ 38. Given the nature of a gross negligence penalty, it is more appropriate for a taxpayer to dispute the assessment of such a penalty by filing a notice of objection. For more information on a taxpayer's right of objection, see Pamphlet **P148, *Resolving Your Dispute: Objection and Appeal Rights Under the Income Tax Act*** on the CRA Web site.

Accrual of Arrears Interest

¶ 39. Arrears interest that has accumulated on an outstanding balance during a calendar year that is within the 10 preceding calendar years, but relates to a liability that arose for a tax year or fiscal period beyond the 10-year limit (described in ¶ 12), is not eligible for relief. For example, a request made in the 2007 calendar year for relief from arrears interest that accumulated over the 1997 to 2007 calendar years in regard to a tax amount owed for the 1996 tax year cannot be given consideration.

Administrative Charge on Dishonoured Payments

¶ 40. An administrative charge payable under the *Financial Administration Act* for a dishonoured payment made to the CRA before April 1, 2007 cannot be cancelled under subsection 220(3.1). However, this charge may be waived or reduced under the *Financial Administration Act* and *Interest and Administrative Charges Regulations* where circumstances beyond the taxpayer's control, including an error made by the financial institution resulted in the payment being dishonoured. Taxpayers or their authorized representatives can make their requests in writing and send them to the tax centre where they file their returns or to the tax services office serving their area.

Employment Insurance Premiums and Canada Pension Plan Contributions

¶ 41. The 10-year limit in ¶ 12 and the guidelines in this part also apply to penalties and interest provided for in the *Employment Insurance Act* and *Canada Pension Plan* regarding the collection and payment of premiums and contributions required to be made.

Digitized by Google

Voluntary Disclosures Program

¶ 42. The Voluntary Disclosures Program is a CRA initiative that gives taxpayers the opportunity to come forward and to correct inaccurate or incomplete information, or to disclose previously unreported information, without penalties or fear of prosecution. Taxpayers who are considered to have made a valid voluntary disclosure will have to pay the taxes owing and arrears interest, and the CRA will waive the penalties that would otherwise be imposed under the Act. Under this program, and on a case-by-case basis, the CRA may provide some relief on the amount of arrears interest outstanding, after it is determined that the taxpayer made a valid voluntary disclosure. For more details, see Information Circular 00-1R2, *Voluntary Disclosures Program*.

¶ 43. Arrears interest payable on a valid voluntary disclosure may be cancelled or waived under subsection 220(3.1). For more details, see Part II in this information circular called "Guidelines for the Cancellation or Waiver of Penalties and Interest."

Goods and Services Tax/Harmonized Sales Tax

¶ 44. Section 281.1 of the *Excise Tax Act* (ETA) gives the Minister the discretion to waive or cancel penalties and interest payable under section 280 of the ETA, and effective April 1, 2007, the failure-to-file penalty payable under section 280.1. For more details on requesting relief from penalties and interest regarding the goods and services tax/harmonized sales tax (GST/HST), see GST Memorandum **G500-3-2-1, *Cancellation or Waiver of Penalties and Interest***.

Part III

Guidelines for Accepting Late, Amended, or Revoked Elections

¶ 45. The Act and *Income Tax Regulations* contain many elections that give taxpayers the opportunity to decide on an alternative tax treatment in conducting their financial affairs for income tax purposes. Most elections do not have tax rules that permit a taxpayer to file an election once the prescribed time for making that election expires or that give the taxpayer the ability to modify or cancel an original election filed on time. The information in Part III of this information circular deals with the Minister's discretion to allow a taxpayer the benefit of certain elections even though they missed the due date, and to permit a taxpayer to modify or cancel certain elections already filed.

General

¶ 46. Subsection 220(3.2) gives the Minister the discretionary authority to extend the statutory time for filing certain elections or to permit certain elections to be amended or revoked. The request must be made within the 10-year time limit described in ¶ 13.

Prescribed Elections

¶ 47. A request by a taxpayer to have a late or amended election accepted or to revoke an election is limited to the elective provisions of the Act and Regulations listed in section 600 of the Regulations. For the list of prescribed elections, see Appendix A at the end of this information circular.

¶ 48. A late, amended, or revoked election must be correct in law based on the relevant legislation in place for the applicable tax year to which the election applies.

¶ 49. When accepted by the CRA, a late or amended election will be considered to have been made at the time it was required to be made. For amended and revoked elections, the earlier election will be cancelled. To give effect to acceptance of a late, amended, or revoked election, the CRA will reassess the affected returns for the tax years in question even if the years are beyond the taxpayer's normal reassessment period (i.e., statute-barred years).

¶ 50. Any assessments or reassessments resulting from the CRA's acceptance of the request is subject to the general provisions concerning arrears interest charged on the balance owing.

Digitized by Google

Penalty for Late, Amended, or Revoked Elections

¶ 51. A taxpayer is liable to a penalty if the CRA accepts a late, amended, or revoked election. The penalty, calculated under subsection 220(3.5), is whichever amount is less:

(a) $8,000; or

(b) $100 for each complete month from the election's original due date to the date the application was made in a form satisfactory to the CRA.

¶ 52. The date on which the request (application) was made in a satisfactory form to the CRA is when the CRA has been provided with complete and accurate information for the election under review. To minimize the amount of penalty, the taxpayer should satisfy the application procedures described in ¶s 58 through 63.

¶ 53. It is CRA policy not to accept late, amended, or revoked elections, or to process the necessary adjustments to give an election effect, unless the amount of the penalty described in ¶ 51 is paid. Taxpayers should remit the penalty amount with their request. The CRA will determine and assess any unpaid balance of the penalty, which the taxpayer must pay at once. Interest will be charged on the unpaid balance of the penalty from the date of the *Notice of Assessment* to the date of payment.

¶ 54. The penalty described in ¶ 51 is subject to the provisions of subsection 220(3.1). For details on the cancellation or waiver of this penalty, see Part II in this information circular called “Guidelines for the Cancellation or Waiver of Penalties and Interest.”

Deemed Prescribed Elections

¶ 55. The rules and guidelines under this part also apply to the following designations and allocations that are considered prescribed elections, under subsection 220(3.21):

(a) Paragraph 80(2)(i) of the Act allows a taxpayer to designate the order in which commercial debt obligations settled at the same time are to be applied for the purpose of the debt forgiveness rules.

(b) Subsections 80(5) to 80(11) allow a taxpayer who has designated a forgiven amount to apply any remaining part of the forgiven amount in certain circumstances.

(c) Subsection 80.03(7) allows a taxpayer to designate a capital gain that would otherwise arise under subsection 80.03(2) as a forgiven amount for the purpose of the debt forgiveness rules.

(d) Subsection 132.11(6) allows a mutual fund trust, as well as any electing trust with a December 15 year-end, to choose an amount designated by it for a tax year to be added in computing its income for the year.

Acceptance of a Late, Amended, or Revoked Election

¶ 56. A request may be accepted in the following situations:

(a) There have been tax consequences not intended by the taxpayer, and there is evidence that the taxpayer took reasonable steps to comply with the law. This could include, for example, the situation where the taxpayer obtained a bona fide valuation for a property, but after the CRA's review the valuation was found to be not correct.

(b) The request arises from circumstances that were beyond the taxpayer's control. Such extraordinary circumstances could include natural or man-made disasters such as flood or fire; civil disturbances or disruptions in services, such as a postal strike; a serious illness or accident; or serious emotional or mental distress, such as death in the immediate family.

(c) It is evident that the taxpayer acted on incorrect information given by the CRA. This could include incorrect written replies to queries and errors in CRA publications.

(d) The request results from what is a mechanical error. This could include using the net book value amount when obviously the taxpayer intended to use the undepreciated capital cost or using an incorrect cost.

(e) The later accounting of the transactions by all parties is as if the election had been made, or had been made in a particular manner.

Digitized by Google

(f) The taxpayer can demonstrate that they were not aware of the election provision, even though they took a reasonable amount of care to comply with the law, and took remedial action as quickly as possible.

Denial of a Late, Amended, or Revoked Election
¶ 57. A request will not be accepted in the following instances:
(a) It is reasonable to conclude that the taxpayer made the request for retroactive tax planning purposes. This could include taking advantage of changes to the law enacted after the due date of the election.
(b) Adequate records do not exist.
(c) It is reasonable to conclude that the taxpayer had to make the request because he or she was negligent or careless in complying with the law.

Making a Request
¶ 58. Taxpayers or their authorized representatives can make their requests in writing and send them to the tax centre where they file their returns or to the tax services office serving their area. Alternatively, **Form RC4288, *Request for Taxpayer Relief***, can be used to make a request. A copy of this form is available from the CRA Web site at **www.cra-arc.gc.ca/formspubs/menu-e.html** or by telephone at 1-800-959-2221. To find the addresses and telephone numbers of CRA offices, see ¶ 31.
¶ 59. To support a request, taxpayers should provide all relevant information including the following, where applicable:
(a) the name, address, telephone number, social insurance number, partnership number, trust account number, and business number or any other identification tax number assigned by the CRA to the taxpayer;
(b) the tax year(s) or fiscal period(s) involved;
(c) the dates and details of the transactions;
(d) the date and details of the original election, including an explanation of why the taxpayer is asking to have an election amended or revoked; and
(e) details of a late election, and an explanation of why it is late.
¶ 60. For a request to accept a late or amended election, the election needs to be made in the appropriate manner required by the specific provisions of the Act concerning that election (e.g., filing the election in prescribed form or in a prescribed manner).
¶ 61. The request should briefly describe the income tax implications of the acceptance or refusal of the request for all the parties involved.
¶ 62. If accepting the request involves changes to continuing tax account balances, taxpayers should submit appropriate revised schedules reflecting these changes. This could include, for example, capital cost allowance schedules, reserve account schedules, and Canadian exploration or development expense account schedules.
¶ 63. When the request involves more than one taxpayer, an agreement, signed by all parties, to the changes requested should be included with the request.

Part IV
Guidelines for Refunds or Reduction in Amounts Payable Beyond the Normal Three-Year Period
¶ 64. The Act sets a three-year limitation period from the end of the tax year of an individual (other than a trust) and testamentary trust to file an income tax return to claim a tax refund and a three-year limitation period from the date of the original *Notice of Assessment* to ask for an adjustment to an assessment issued for a previous tax year. The information in Part IV of this information circular deals with the Minister's discretion to relieve an individual (other than a trust) and a testamentary trust from the limitation period and, in certain circumstances, to accept late requests to give the

Digitized by Google

individual or testamentary trust a refund or reduction in tax.

General
¶ 65. The relief provided under paragraph 164(1.5)(a) and subsection 152(4.2) applies only to individuals (other than trusts) and testamentary trusts.

Refund Entitlement
¶ 66. Subsection 164(1) restricts the CRA from refunding an overpayment of tax unless:
(a) an income tax return was filed within three years from the end of the tax year; or
(b) the CRA received a request for a refund within three years from the date of the original *Notice of Assessment* and the related income tax return was filed within three years from the end of the tax year. This is referred to as the normal reassessment period.

Discretion to Allow a Statute-Barred Refund
¶ 67. However, paragraph 164(1.5)(a) gives the Minister the discretionary authority to refund to an individual or a testamentary trust all or any part of an overpayment of tax for a tax year even if the tax return was filed later than three years from the end of the tax year. The request must be made within the 10-year time limit described in ¶ 13.

Reassessment or Redetermination
¶ 68. Subsection 152(4) generally restricts the CRA from reassessing a return of income for a tax year that is beyond three years from the date of the original *Notice of Assessment* or of an original notification that no tax was payable for the year. When the normal three-year reassessment period for a tax year ends, the return is considered statute-barred.

Discretion to Refund or Reduce Tax Payable for a Statute-Barred Return
¶ 69. However, subsection 152(4.2) gives the Minister the discretionary authority to make a reassessment or a redetermination beyond the normal reassessment period for a statute-barred tax year, when requested by an individual or a testamentary trust in order to determine a refund or to reduce tax payable. The request must be made within the 10-year time limit described in ¶ 13.
¶ 70. An individual or testamentary trust, as the case may be, can ask the CRA to redetermine certain amounts that are considered either as payments on account of tax or overpayment of tax under the Act. Paragraph 152(4.2)(b) refers to the following amounts for which a redetermination could be issued:
(a) refundable Quebec abatement for income earned in Quebec by an individual resident of Quebec under subsection 120(2);
(b) refundable First Nations abatement for individuals who are subject to income tax legislation of certain First Nations under subsection 120(2.2);
(c) goods and services tax/harmonized sales tax (GST/HST) credit available to eligible individuals under subsection 122.5(3);
(d) refundable medical expense supplement available to eligible individuals under subsection 122.51(2);
(e) refundable investment tax credit available to taxpayers under subsection 127.1(1);
(f) the tax credit that a beneficiary of a mining reclamation trust can claim under subsection 127.41(3);
(g) the tax credit that certain beneficiaries can claim under subsection 210.2(3) for the Part XII.2 tax paid by a trust;
(h) the tax credit a Canadian partnership flows through to its partners for the Part XII.2 tax paid by a trust under subsection 210.2(4); and
(i) Canada Child Tax Benefit (CCTB) payments available to eligible individuals for qualified

Digitized by Google

dependants under subsection 122.61(1).

Acceptance of a Refund or Adjustment Request

¶ 71. The CRA may issue a refund or reduce the amount owed if it is satisfied that such a refund or reduction would have been made if the return or request had been filed or made on time, and provided that the necessary assessment is correct in law and has not been already allowed.

¶ 72. Individuals and testamentary trusts can make a request if they were not aware of, or missed, claiming a deduction or a non-refundable tax credit that was available for the year, such as child care expenses or the amount for an eligible dependant. Individuals can also ask for refunds or reductions of amounts owing for refundable tax credits such as provincial tax credits that have not been claimed. In addition, payroll deductions may have resulted in an overpayment of taxes for which a refund can be requested.

¶ 73. The purpose for requesting an adjustment under subsection 152(4.2) is not to dispute or disagree on the correctness or validity of a previous assessment. The ability of the CRA to allow an adjustment to amounts for a statute-barred tax year should not be used as a means to have issues reconsidered, such as an audit reassessment, where the individual or testamentary trust chose not to challenge the issues through the normal objection/appeals processes or where the issues were already dealt with under the objection/appeal. For more information on a taxpayer's right of objection, see Pamphlet **P148, *Resolving Your Dispute: Objection and Appeal Rights Under the Income Tax Act***, on the CRA Web site.

¶ 74. The CRA will generally not accept a request for an adjustment to a statute-barred tax year of an individual where the adjustment would result in the increase of taxes, interest, or penalties to the returns of other individuals that are statute-barred and cannot be reassessed by the CRA.

Making a Request

¶ 75. Individuals and testamentary trusts, or their authorized representatives, can apply for a refund from a statute-barred tax year by filing the income tax return(s) together with documentation or explanations to support their claim(s). If the returns were previously filed, they can make a written request.

¶ 76. To ask for a refund or a reduction of amounts owing under subsection 152(4.2), individuals and testamentary trusts can make their requests in writing and include the following information:

(a) the name, address, telephone number, social insurance number, and trust account number or any other identification tax number assigned by the CRA to the taxpayer;
(b) the tax year(s) involved;
(c) all relevant documents to support any claims being made; and
(d) an explanation for the adjustment they are requesting.

¶ 77. Individuals and testamentary trusts, or their authorized representatives, can send returns, written requests, and supporting documentation to the tax centre where they file their returns or to the tax services office serving their area. Alternatively, Form **RC4288, *Request for Taxpayer Relief***, can be used to make a request. A copy of this form is available from the CRA Web site at **www.cra-arc.gc.ca/formspubs/menu-e.html** or by telephone at 1-800-959-2221. To find the addresses and telephone numbers of CRA offices, see ¶ 31.

¶ 78. To support a return or a request for an adjustment, individuals and testamentary trusts should provide the following information, if relevant:

(a) official receipts or certified true copies of receipts (e.g., tuition, registered retirement savings plan, or charitable donation receipts);
(b) copies of information slips (e.g., T3, T4, T5);
(c) details or calculations of expenses or deductions being claimed; and
(d) proof of payment, such as cancelled cheques for rental payments or a letter from a landlord.

¶ 79. If T4 information slips are relevant but are not available, individuals should provide a letter

Digitized by Google

from their present or former employer(s), which states their income and deductions for the year. Otherwise, they should provide the full name and address of the present or former employer(s), as well as copies of pay stubs or cancelled cheques.
¶ 80. If other types of information slips are not available, an individual and testamentary trust should provide the name and address of the slip issuer and the amount on the slip.
¶ 81. If it is impossible to get the proper documentation, individuals and testamentary trusts should submit full details and a written explanation for consideration.
¶ 82. The CRA will try to reconstruct and validate the claim or claims by referring to CRA records.
¶ 83. If the CRA cannot validate a claim after referring to its records, a refund will not be issued.

Provincial Benefits or Credits
¶ 84. If there are time limitations to claim certain provincial benefits or credits (which are administered by the CRA for provinces) stipulated in a provincial act, subsection 152(4.2) and paragraph 164(1.5)(a) do not override provincial limitations, unless provincial law allows for it.

Permissive Deductions
¶ 85. The CRA will not process requests for adjustments if the requested decrease in tax is the result of an increased claim for capital cost allowance or other allowable deductions, where the taxpayer originally claimed less than the maximum amount allowed. For more information, see Information Circular **84-1, *Revision of Capital Cost Allowance Claims and Other Permissive Deductions***.

Employment Insurance Premiums and Canada Pension Plan Contributions
¶ 86. The relief described in ¶ 67 and ¶ 69 does not affect refunds for overpayments of Employment Insurance premiums and Canada Pension Plan contributions. The time limit for refunds remains at three and four years under the *Employment Insurance Act* and *Canada Pension Plan* respectively.

Requests Based on a Court Decision or Other Resolution
¶ 87. CRA policy does not allow for the reassessment of a statute-barred return if the request is made as a result of a court decision (for more information, see Information Circular **75-7R3, *Reassessment of a Return of Income***). Requests made to reassess a statute-barred return based only on the successful appeal by another taxpayer will not be granted under subsection 152(4.2).
¶ 88. Similarly, knowledge of another taxpayer's negotiated settlement to resolve an objection, or another taxpayer's consent to judgment on an appeal, will not be extended to permit a reassessment of a taxpayer's statute-barred return under subsection 152(4.2), if the taxpayer has chosen not to protect his or her right of objection or appeal.

Part V
Rules and Procedures When Relief is Granted or Denied
¶ 89. Part V of this information circular deals with rules and procedures for interest paid on overpayments, issuing refunds, and the right of objection to an assessment or reassessment issued as a result of a decision made by the CRA to grant relief to a taxpayer. Part V also explains the recourse taxpayers have to ask for a second administrative review from the CRA or to have the Minister's decision reviewed by the Federal Court, when taxpayers do not agree with the Minister's decision for denying relief or partly granting relief.

Reductions in Refunds
¶ 90. Paragraph 164(1.5)(b) gives the Minister the discretion to refund an overpayment of tax that results from a reassessment or redetermination relating to:
(a) an adjustment made beyond the normal reassessment period under subsection 152(4.2);

Digitized by Google

(b) the cancellation of penalties and interest under subsection 220(3.1); or
(c) the application of subsection 220(3.4) for the accepting of a late, amended, or revoked election under subsection 220(3.2).
¶ 91. Under certain circumstances, the CRA may reduce the amount of a refund to which an individual or testamentary trust might otherwise be entitled. For example, this may happen when a requested adjustment for a year beyond the normal reassessment period results in a refund for that particular year, but the adjustment would result in an increase of taxes, interest, or penalties for another year that is statute-barred. Under these circumstances, the CRA will usually grant a refund only if it is more than the taxes, interest, and penalties that would otherwise have been paid if the other year had not been statute-barred.
¶ 92. Similarly, if a redetermination of Canada Child Tax Benefit (CCTB) or goods and services tax/harmonized sales tax (GST/HST) credit requested by an individual results in a refund for the particular year, but would necessitate a redetermination to repay CCTB or GST/HST overpayments received for another year(s) which is statute-barred, the refund may be reduced accordingly.

Refund Interest
¶ 93. For requests received after June 30, 2003, subsection 164(3.2) provides for the payment of interest on a refund arising from a reassessment or redetermination that:
cancels all or part of any penalty and interest previously paid; or
reduces the amount of tax previously paid as a result of accepting an adjustment or a late, amended, or revoked election.
¶ 94. Compound daily interest at the prescribed rates will start to accumulate on the 31st day after a written request to waive or cancel penalty and interest, accept a late, amended, or revoked election, or to allow an adjustment beyond the normal three-year limit was received in a manner satisfactory to the CRA.
¶ 95. The date on which the request was received in a manner satisfactory to the CRA is the date when the CRA has been given complete and accurate information about the request under review. In certain circumstances, refund interest may begin later than the day stated in ¶ 94. For example, refund interest may begin on a later date if there was not enough documentation given to support the taxpayer's claim for an adjustment, or a new request is made for penalty and interest relief, which relies on different grounds than the previous request that was denied by the CRA. Taxpayers should satisfy the procedures described in this information circular in the section called “Making a Request.”
¶ 96. Under subsection 164(3) and for the filing of a tax return for a tax year of an individual or testamentary trust that ended after June 30, 2003, refund interest on an overpayment will start to accumulate on the 31st day after the date the return was filed. For tax years that ended on or before June 30, 2003, refund interest will start on the 46th day after the date the return was filed.
¶ 97. There is no interest paid on a refund or part of a refund for GST/HST or CCTB payments made to an individual.

Application of Refund to Other Debts
¶ 98. Under subsection 164(2), the amount of any refund (except for CCTB payments) may be applied against any amount the taxpayer owes or is about to owe.

Refund Withheld Until Outstanding Returns Are Filed
¶ 99. Effective April 1, 2007, under subsection 164(2.01), a refund will not be paid to a taxpayer, applied to other debts, or used to set off amounts under the Act until such time as all outstanding returns that are required to be filed by the taxpayer under the *Income Tax Act*, the *Air Travellers Security Charge Act*, the *Excise Act, 2001*, and the *Excise Tax Act* have been filed with the CRA.

Digitized by Google

Right of Objection

¶ 100. If the Minister has waived or cancelled in whole or in part any penalties and interest under subsection 220(3.1) or has issued a *Notice of Reassessment* beyond the normal reassessment period under subsection 152(4.2), a taxpayer is prohibited under subsection 165(1.2) from filing an objection to dispute the assessment or reassessment.

¶ 101. If the Minister has accepted a late, amended, or revoked election under subsection 220(3.2), a taxpayer can file an objection under subsection 165(1.1) to dispute the assessment or reassessment made under subsection 220(3.4). However, objections are limited to matters that give rise to the assessment.

¶ 102. The normal objection procedures under subsection 165(1) apply to an individual (other than a trust) or testamentary trust for an original *Notice of Assessment* made to allow a refund from filing an income tax return beyond the normal three-year period. For more information on a taxpayer's right of objection, see Pamphlet **P148, *Resolving Your Dispute: Objection and Appeal Rights Under the Income Tax Act***.

Redress – Second Administrative Review

¶ 103. If a request was denied or partly granted, there is no right of objection for a taxpayer to dispute a decision under the taxpayer relief provisions. However, if the taxpayer believes that the Minister's discretion has not been properly exercised, the taxpayer can write to ask that the director of the tax services office or the tax centre reconsider the original decision and review the situation again. During the second review, the taxpayer will have the opportunity to make more representations for the CRA's consideration. To find the addresses of CRA offices, see ¶ 31.

¶ 104. CRA officials not involved in the first administrative review and decision would carry out the second administrative review. They would prepare a decision report for the director or another delegated official for his or her consideration, including a recommendation on whether or not granting relief is justified. The final decision and notification of the decision to the taxpayer rests with the director or another delegated official, such as an assistant director.

Redress – Judicial Review

¶ 105. If a taxpayer believes that the Minister's discretion was not properly exercised, the taxpayer can apply for judicial review of that decision to the Federal Court under section 18.1 of the *Federal Courts Act*, within 30 days of the date the decision was first received by the taxpayer.

¶ 106. To ask for judicial review, the taxpayer must send a completed Form 301, *Notice of Application*, with the appropriate filing fee to the registrar of the Federal Court. For more information on how to file an application for judicial review or other general enquiries, contact the Courts Administration Service or see their Web site at **http://www.cas-satj.gc.ca**.

¶ 107. If it is determined that the Minister's discretion was not properly exercised, the Federal Court cannot substitute its decision for a decision of the CRA but can only refer the decision back to the CRA to be reconsidered by another delegated official.

¶ 108. As a general rule, taxpayers should ask for a second administrative review (described in ¶ 103) from the CRA before filing an application for judicial review with the Federal Court.

Requests Made While an Objection or Appeal Is in Progress

¶ 109. A request to cancel penalty and interest on the grounds of extraordinary circumstances or actions of the CRA for an assessment under objection or appeal may be reviewed and an informal decision may be communicated to the taxpayer. However, a final decision about the taxpayer's request for relief will be held until the objection or appeal is resolved or until all rights of appeal have expired.

¶ 110. A taxpayer's request to cancel penalty and interest on the grounds of inability to pay or financial hardship under subsection 220(3.1), for an adjustment under subsection 152(4.2), or to

Digitized by Google

accept a late, amended, or revoked election under subsection 220(3.2) that relates to an assessment that is under objection or appeal will generally be held in abeyance until the outcome of the objection or appeal process or until all rights of appeal have expired.

Comments

¶ 111. If you have any comments about this information circular, please write to:

Taxpayer Relief and Service Complaints Directorate
Canada Revenue Agency
Ottawa ON K1A 0L5

Appendix A – List of prescribed elections

Section 600 of the *Income Tax Regulations* lists the provisions of the *Income Tax Act* and *Income Tax Regulations* under which a taxpayer or a partnership can apply under subsection 220(3.2) of the Act to make a late or amended election, or to revoke an election.

The list of eligible elections reflects the amendments to section 600 that were registered in the *Canada Gazette*, Part II, on August 29, 2006, as SOR/2006-200.

Below is a list of the prescribed provisions, and a brief description of related elections:

Deferral on non-Canadian controlled private corporation employee options

Subsection 7(8) of the Act allows an employee to defer the taxing of an employment benefit realized from a qualifying acquisition of a particular security under an agreement with the employer (or a person not dealing at arm's length with the employer) until the year in which the employee disposes of the security, becomes a non-resident of Canada or dies, whichever occurs first, if the employee elects in accordance with subsection 7(10) to have subsection 7(8) apply.

Deemed outlay or expense

Paragraph 12(2.2)(b) of the Act allows a taxpayer to elect to reduce the amount of an outlay or expense (other than an outlay or expense which relates to the cost of the property) incurred in the year, the immediately following year or any preceding year, by all or part of any related government assistance received in the year which would otherwise be included in income by virtue of paragraph 12(1)(x).

Interest income accrual rules

Former subsection 12.2(4) of the Act allowed an individual or a trust with individuals as beneficiaries to elect to report accrued interest income annually for certain life insurance policies and annuity contracts last acquired before December 20, 1980, rather than tri-annually under former subsection 12.2(3). Subsection 12.2(4) was repealed, after the introduction of mandatory annual reporting of accrued income on life insurance policies last acquired or materially altered after 1989.

Available-for-use rules on long-term projects

Subsection 13(29) of the Act allows a taxpayer to elect to include an amount, within limits, as undepreciated capital cost for long-term project depreciable property under the available-for-use provisions of subsections 13(26) to 13(28), before the completion of the project.

Amounts paid for undertaking future obligations

Subsection 20(24) of the Act allows a taxpayer to deduct from income certain payments made to obtain another person's agreement to undertake certain future obligations for which an amount was included in the taxpayer's income under paragraph 12(1)(a), if the taxpayer and the recipient jointly elect under subsection 20(25).

Cost of borrowed money

Digitized by Google

The elections contained in section 21 of the Act allow a taxpayer to elect to capitalize, instead of deducting as a current expense, the cost of borrowed money used to acquire depreciable property (subsections 21(1) and 21(3)) or used for exploring, developing, or acquiring a resource property (subsections 21(2) and 21(4)).

Exchanges of property
Subsections 13(4), 14(6), 44(1), and (6) of the Act allow a taxpayer to elect to defer an income inclusion or the recognition of a capital gain when a replacement property is acquired for a property that was stolen, expropriated, or destroyed, or for a former business property that was sold.

Adjustments to cost base
Subsections 13(7.4) and 53(2.1) of the Act allow a taxpayer to elect to reduce the capital cost of depreciable property and the adjusted cost base of non-depreciable capital property, respectively, by the amount of any related inducement, refund, reimbursement, contribution, allowance, or other assistance that would otherwise be included in income under paragraph 12(1)(x).

Election where change of use
Subsection 45(2) of the Act allows a taxpayer to elect to designate a property as his principal residence although there has been a change in use to an income producing property.
Subsection 45(3) of the Act allows a taxpayer to elect to defer a capital gain on the change of use of a property from an income producing property to a principal residence.

Debts established to be bad debts and shares of bankrupt corporation
Subsection 50(1) of the Act applies to debts established to have become bad debts in a tax year and to certain shares, and allows a taxpayer to elect to have a deemed disposition at the end of the year and a reacquisition immediately thereafter at a cost of nil.

Successor rules for resource properties
Paragraphs 66.7(7)(c), (d), and (e), and (8)(c), (d), and (e) of the Act allow a predecessor corporation and a successor corporation to elect to transfer the unused pools of resource expenses from the predecessor to the successor corporation.

Transfers or distributions to a taxpayer's spouse, common-law partner, or spousal/partner trust on the death of the taxpayer
Subsection 70(6.2) of the Act allows a taxpayer's legal representative to elect to have the rollover rules under subsections 70(6) and 70(6.1) not to apply, thus causing the deemed disposition of assets at fair market value under subsection 70(5) and the deemed payment of amounts in NISA Fund No.2 under subsection 70(5.4).

Transfer of farm property, or family farm corporations and partnerships to a child
Subsection 70(9) of the Act allows a taxpayer's legal representative to elect an amount, within limits, as proceeds of disposition for farm property that is transferred to a child on the taxpayer's death.
Subsection 70(9.1) of the Act allows a spousal or common-law partner trust to elect an amount, within limits, as proceeds of disposition for farm property that is transferred from the trust to a child on the spouse or common-law partner's death.
Subsection 70(9.2) of the Act allows a taxpayer's legal representative to elect an amount, within limits, as proceeds of disposition for a share in a family farm corporation, or an interest in a family farm partnership that is transferred to a child on the taxpayer's death.
Subsection 70(9.3) of the Act allows a spousal or common-law partner trust to elect an amount,

Digitized by Google

within limits, as proceeds of disposition for a share in a family farm corporation, or an interest in a family farm partnership that is transferred from the trust to a child on the spouse or common-law partner's death.

Election by legal representative and transferee re reserves
Subsection 72(2) of the Act lets a legal representative of a deceased taxpayer elect to claim a deduction for certain reserves, as long as the amount so deducted is then included in the income of the taxpayer's spouse or common-law partner or a spousal or common-law partner trust.

Inter vivos transfer of property
Subsection 73(1) of the Act allows a taxpayer to elect to have the rollover provisions for an inter vivos transfer of assets to a spouse or common-law partner or certain trusts not to apply, thus causing the assets to be considered to be transferred at fair market value for tax purposes.

Deemed settlement on winding-up
Paragraph 80.01(4)(c) of the Act allows a parent corporation to elect to reduce the amount to which subsection 80(1) (debt forgiveness rules) might otherwise apply in cases where a debt owed between a parent corporation and its subsidiary is settled on the winding up of the subsidiary for less than both the principal amount and the cost amount of the debt.

Expropriation assets acquired as compensation for, or as consideration for sale of, foreign property taken by or sold to a foreign issuer
Subsection 80.1(1) of the Act applies to a Canadian resident taxpayer who has acquired expropriation assets issued or guaranteed by a foreign government as compensation for the expropriated or forced sale of shares of a foreign affiliate, or foreign property used to carry on business in a foreign country. The election establishes the deemed cost of the expropriation assets and the deemed proceeds of disposition of the property that was expropriated or sold.

Dividends received by taxpayer's spouse or common-law partner
Subsection 82(3) of the Act allows a taxpayer to elect to have a taxable dividend from a taxable Canadian corporation received by the taxpayer's spouse or common-law partner included in the taxpayer's income where such an inclusion increases the taxpayer's spouse or common-law partner credit under paragraph 118(1)(a).

Capital dividend
Subsection 83(2) of the Act allows a private corporation to elect to have the full amount of a dividend that is payable by it to be treated as a capital dividend, which effectively allows those dividends to be paid on a tax-free basis.

Eligible distributions of foreign spin-off shares
Paragraph 86.1(2)(f) of the Act allows a taxpayer to elect to defer the tax on eligible distributions of foreign spin-off shares.

Election to defer the 21-year deemed disposition date
Subsection 104(5.3) of the Act allowed certain family trusts to elect to defer the 21-year deemed disposition date. This provision was ended with the result that the deferred disposition date is no later than January 1, 1999.

Preferred beneficiary election
Subsection 104(14) of the Act allows a trust and its preferred beneficiaries to elect to have the

Digitized by Google

income of the trust included in the income of the preferred beneficiaries, instead of being taxed in the trust.

No rollover on election by trust
Subsection 107(2.001) of the Act allows a personal trust or prescribed trust resident in Canada at the time of the distribution to elect not to have the rollover in subsection 107(2) applied to a distribution of certain property to a beneficiary to satisfy the beneficiary's capital interest in the trust.

Deemed disposition on emigration
Paragraph 128.1(4)(d) of the Act allows an individual (other than a trust) to elect to treat certain properties that would otherwise be exempt from the deemed disposition that occurs when the individual ceases to be resident in Canada as having been disposed of.

Departure tax adjustment for a returning former resident
Paragraphs 128.1(6)(a) and 128.1(6)(c) of the Act apply to an individual (other than a trust) who ceases to be resident in Canada after October 1, 1996, and later returns to reside in Canada. The effect of the election is to unwind the deemed disposition under subsection 128.1(4) for certain properties still held on the individual's return to Canada.

Departure tax adjustment for a returning trust beneficiary
Paragraphs 128.1(7)(d) and 128.1(7)(g) of the Act apply to an individual trust beneficiary (other than a trust) who ceases to be resident in Canada after October 1, 1996, receives a distribution of property from the trust while a non-resident, and later returns to reside in Canada while still owning the property. These rules allow the beneficiary and the trust to jointly elect, on the beneficiary's return to Canada, to unwind the deemed disposition under subsection 107(2.1), which was triggered when the trust distributed the property to the non-resident beneficiary.

Post-emigration loss on disposition
Paragraph 128.1(8)(c) of the Act applies to an individual (other than a trust) who disposes of taxable Canadian property, after having ceased to be resident in Canada after October 1, 1996, for proceeds that are less than the deemed proceeds that arose on the deemed disposition on emigration under paragraph 128.1(4)(b) of the Act. The individual can elect to reduce the deemed proceeds of disposition that arose when the individual emigrated.

Allocation of income by communal organizations
Subsection 143(2) of the Act allows a communal organization to elect to have its taxable income, earned by the deemed trust under subsection 143(1), allocated to members of the organization.

Home Buyers' Plan
Subsection 146.01(7) of the Act allows a deceased taxpayer's legal representative and the surviving spouse or common-law partner to elect not to have the full outstanding balance of the Home Buyers' Plan included on the deceased taxpayer's final return. The practical effect of the election is to put the surviving spouse or common-law partner in the same position as the deceased taxpayer with respect to the balance outstanding.

Disposition of property by legal representative of deceased taxpayer
Subsection 164(6) of the Act allows a deceased taxpayer's legal representative to elect to treat certain capital losses or terminal losses of the taxpayer's estate for its first tax year as capital losses or terminal losses of the deceased taxpayer for the year of death.

Digitized by Google

Realization of deceased employees' options
Subsection 164(6.1) of the Act allows a deceased taxpayer's legal representative to elect to treat the amount of the loss realized on the exercise, disposition, or expiration of rights to acquire certain securities within the first tax year of the taxpayer's estate as a loss of the deceased taxpayer for the year of death.

Excess capital dividend
Subsection 184(3) of the Act allows a corporation to elect to have the amount of the elected capital dividend in excess of the balance in the corporation's capital dividend account treated as a separate, taxable dividend, thereby avoiding the tax otherwise payable under Part III.

Date of acquisition of control
Subsection 256(9) of the Act allows a corporation to elect not to have the acquisition of control deemed to occur at the start of the day on which the acquisition took place. If the corporation makes an election, the particular time of day that the acquisition of control took place will be recognized.

Elections to include properties in Class 1
Subsection 1103(1) of the Regulations allows a taxpayer to elect, for capital cost allowance purposes, to include in Class 1 all properties included in Classes 2 to 10 and Classes 11 and 12.

Elections to include properties in Class 2, 4, or 17
Subsection 1103(2) of the Regulations allows a taxpayer to elect, for capital cost allowance purposes, to include in Class 2, 4, or 17, a property acquired before May 26, 1976, that would otherwise be included in another class when the chief depreciable properties of the taxpayer are included in Class 2, 4, or 17.

Elections to make certain transfers
Subsection 1103(2d) of the Regulations allows a taxpayer to elect to defer a capital cost allowance recapture by transferring the property disposed of to a new class of which the taxpayer has property, when the property disposed of would have been a property of the new class if it had been acquired when the property of the new class was acquired.

Earnings of a foreign affiliate
Subsection 5907(2.1) of the Regulations allows that, in calculating the active business earnings of a foreign affiliate, a corporation can make an election for the cost of a foreign resource property or the cost of a capital property.

CRA Internal Operations Manuals - Fairness Provisions

(See image pages below)

Digitized by Google

Taxpayer Relief Reference Guide

February 2010

DISC
PURSU
THE A

Digitized by Google

Welcome to the Taxpayer Relief Reference Guide 5
1. Introduction 6
1.1. Purpose of this guide 6
1.2 How this guide is organized 6
1.3 Updates and revisions 7
1.4 Comments and questions 7
2. Legislation 8
2.1 Income Tax Act (ITA) 8
2.2 Excise Tax Act (ETA) 9
2.3 Excise Act, 2001 (EA, 2001) 10
2.4 Air Travellers Security Charge Act (ATSCA) 11
3. Roles and Responsibilities 13
3.1 Local level 13
3.2 Headquarters level 14
3.3 Regional program advisors 15
3.4 Taxpayer Relief Committee (TRC) 15
3.5 Taxpayer relief referrals 15
4. Taxpayer relief process 17
4.1 Validate and screen the request 17
4.2 Processing steps 19
5. Delegation Policies 22
5.1 Delegation of the minister's power and duties 22
5.2 Requests after second reviews 23
6. General policies and procedures 25
6.1 Purpose and intent of taxpayer relief provisions 25
6.2 Administrative reviews 25
6.3 Ministerial discretion 26
6.4 Consistency 28
6.5 Referrals to other areas 29
6.6 Supporting requests 30
6.7 Requests taken on behalf of taxpayers 30
6.8 Acknowledgement letter 31
6.9 What constitutes a first or second review 31
6.10 When more information is needed 32
6.11 Communicating decisions 33
6.12 Applying the taxpayer relief provisions actively 35
6.13 Keeping taxpayer relief records 36
6.14 Consent forms - Authorizing or cancelling a representative 37
7. Guidelines for cancelling or waiving penalties and/or interest 38
7.1 Difference between a cancellation and a waiver 38
7.2 Circumstances in which interest and penalties may be cancelled or waived 38
7.3 Extraordinary circumstances 39
7.4 Requests that arise due to actions of the CRA 41
7.5 Inability to pay or financial hardship 43
7.6 Other Circumstances 44

000104

Digitized by Google

7.8 Making a taxpayer relief request 45
7.9 Factors to consider in arriving at the decision 47
7.10 Assessing reasonable care 47
7.11 Assessing past compliance 48
7.12 Special consideration due to extraordinary events 48
7.13 Third parties 49
7.14 Ignorance of the law 49
7.15 Gross negligence penalties 50
7.16 Erroneous refunds 50
7.17 Amounts held in trust 50
7.18 Reinstating cancelled or waived penalties and/or interest 51
7.19 Taxpayer relief decision reports/fact sheets 51
8. Guidelines for refunds or reduction in amounts payable beyond the normal three-year period (income tax) 53
8.1 Refunds or reducing tax payable for a statute barred return 53
8.2 Accepting a refund or adjustment request 54
8.3 Limitations and restrictions 55
8.4 Making a taxpayer relief request 56
9. Guidelines for accepting late, amended, or revoked elections (income tax) 57
9.1 Elections covered by the taxpayer relief provisions 58
9.2 Penalty for late filed, amended or revoked elections 58
9.3 Deemed prescribed elections 58
9.4 Basis for accepting requests 59
9.5 Basis for denying requests 59
9.6 Making a taxpayer relief request 59
9.7 Taxpayer relief decision reports/fact sheets 61
10. Judicial review 61
10.1 Judicial Review Process Graph 62
10.2 Requests under Rule 317 64
11. Functional Guidelines 71
12. Taxpayer Relief Provisions Financial Reporting 77
13. Internal Order Number and Activity Types 79
13.1 Internal Order Number 79
13.2 Activity Types 80
Appendices 87
CRA contact lists 88
CRA contact lists 91
Federal Court contact list 92
Examples of taxpayer relief correspondence 97
Examples of taxpayer relief correspondence 102
List of elections covered under section 600 of the Income Tax Regulations 105
Deferral on non-CCPC employee options 105
Deemed outlay or expense 105
Interest income accrual rules 105
"Available for use" rules on long-term projects 105
Amounts paid for undertaking future obligations 105

000105

Digitized by Google

Cost of borrowed money 106
Exchanges of property 106
Adjustments to cost base 106
Election where change of use 106
Debts established to be bad debts and shares of bankrupt corporation 106
Successor rules for resource properties 106
Transfers or distributions to a taxpayer's spouse, common law partner or spousal/partner trust on the death of the taxpayer 106
Transfers of farm property, or family farm corporations and partnerships to child 107
Election by legal representative and transferee re reserves 107
Inter vivos transfers of property 107
Deemed settlement on winding-up 107
Expropriation assets acquired as compensation for, or as consideration for sale of, foreign property taken by or sold to foreign issuer 107
Dividends received by taxpayer's spouse or common-law partner 107
Capital dividend 108
Eligible distributions of foreign spin-off shares 108
Election to defer the 21-year deemed disposition date 108
Preferred beneficiary election 108
Deemed disposition on emigration 108
Departure tax adjustment for a returning former resident 108
Departure tax adjustment for a returning trust beneficiary 108
Post-emigration loss on disposition 108
Allocation of income by communal organization 109
Home buyers' plan 109
Disposition of property by legal representative of deceased taxpayer 109
Realization of deceased employees' options 109
Excess capital dividend 109
Date of acquisition of control 109
Elections to include properties in Class 1 109
Elections to include properties in Class 2, 4, or 17 109
Elections to make certain transfers 110
Earnings of a foreign affiliate 110
No rollover on election by trust 110
EXAMPLE of SCHEDULE "A" 111
SCHEDULE "A" 113

Digitized by Google

Welcome to the Taxpayer Relief Reference Guide

The Taxpayer Relief Reference Guide gives you complete and up-to-date guidelines on how to apply the taxpayer relief provisions. It is an easy-to-use reference that has information you need to process taxpayer requests.

DISC
PURSU
THE A

Digitized by Google

1. Introduction

The Canada Revenue Agency (CRA) has been emphasizing fairness and fair treatment of taxpayers for many years. The introduction of the taxpayer relief provisions in the early 1990's is a good example of the CRA's commitment to fairness. However, fairness is far broader than our taxpayer relief provisions. It is a concept built around service excellence, a positive way of thinking, and a culture with a taxpayer focus.

The CRA has further defined fairness through seven guiding principles, which are described in the document called *Our Fairness Pledge*. This pledge can be used by all of us as a guide to the way we interact with taxpayers and internal clients.

The CRA can grant relief to taxpayers through the taxpayer relief provisions contained in various acts it administers. This guide focuses on the taxpayer relief provisions. For information on the broader concept of fairness, visit the Fairness and Taxpayer Rights pages.

1.1. Purpose of this guide

This guide provides updated instructions and policies for CRA employees who apply the taxpayer relief provisions. It is designed to promote consistency and accuracy in decisions we make on taxpayer relief requests.

This guide has information employees need to process taxpayer relief requests. Its content applies to employees who work in tax services offices (TSOs), tax centres (TCs), Regional offices, and at Headquarters.

The guide gives policies and guidelines for processing taxpayer relief requests relating to:

- the cancellation or waiving of penalties and/or interest;
- issuing refunds or reducing amounts payable beyond the normal three-year period; and
- accepting late, amended, and revoked elections

1.2 How this guide is organized

This guide is divided into the following sections:

- Legislation applying to the taxpayer relief provisions
- CRA's roles and responsibilities
- Processing taxpayer relief requests
- Delegation policies concerning the taxpayer relief provisions
- General policies and procedures applying to taxpayer relief requests
- Guidelines for cancelling or waiving penalties and/or interest
- Guidelines for refunds or reduction in amounts payable beyond the normal three-year period

Digitized by Google

- Guidelines for accepting late, amended, or revoked elections
- Functional guidelines
- Taxpayer relief provisions financial reporting
- Appendices, consisting of technical publications, examples of letters, examples of reports, and contact lists.

1.3 Updates and revisions

The Taxpayer Relief and Service Complaints Directorate (TRSCD) in the Appeals Branch is responsible for updating and maintaining this reference guide.

The current version of the guide is available through the **Taxpayer Relief and Service Complaints Directorate** InfoZone site.

Updates and revisions to the reference guide are completed on a regular basis. These can be found on the guide's home page. A message will also be posted under TRSCD's **What's New**.

1.4 Comments and questions

If you have comments or questions regarding the Taxpayer Relief Reference Guide, please contact us by:

- sending an email to: Taxpayer Relief, Reference Guide/Allègements pour les contribuables, Guide de référence , or
- sending a fax to (613) 952-5825 (non-secure).

0010104

Digitized by Google

2. Legislation

This section provides the legislative references for the various Acts administered by the CRA that contain taxpayer relief provisions.

2.1 *Income Tax Act* (ITA)

Before 2005, taxpayer relief requests under the *Income Tax Act* (ITA) were considered for 1985 and later taxation years. Effective January 1, 2005, a 10-year rolling time limit is imposed due to amendments in the ITA. The 10-year limitation period rolls forward every January 1.

Requests made on or after January 1, 2005, are limited for consideration to any taxation year for individuals (or fiscal period in the case of a partnership) that ended ten years before the calendar year in which the request is made.

Requests made prior to January 1, 2005 are limited for consideration to the 1985 and subsequent taxation years.

2.1.1 Cancelling or waiving penalties and/or interest

For taxpayers (including employers), subsection 220(3.1) of the ITA permits us to cancel or waive penalties and/or interest payable under that Act.

Subsection 220(3.1) reads as follows:

The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

2.1.2 Refunds or reduction in amounts payable beyond the normal three-year period

Subsection 152(4.2) of the ITA permits us to process credit reassessments or redeterminations beyond the normal three-year period for individuals and testamentary trusts only.

Subsection 152(4.2) reads as follows:

Notwithstanding subsections (4), (4.1) and (5), for the purpose of determining, at any time after the end of the normal reassessment period of a taxpayer who is an individual (other than a trust) or a testamentary trust in respect of a taxation year, the amount of any refund to which the taxpayer is entitled at that time for the year, or a reduction of an amount payable under this Part by the taxpayer for the year, the Minister may, if the taxpayer makes an application for that determination on or before the day that is ten calendar years after the end of that taxation year,

a. reassess tax, interest or penalties payable under this Part by the taxpayer in respect of that year; and

Digitized by Google

b. redetermine the amount, if any, deemed by subsection 120(2) or (2.2), 122.5(3), 122.51(2), 127.1(1), 127.41(3) or 210.2(3) or (4) to be paid on account of the taxpayer's tax payable under this Part for the year or deemed by subsection 122.61(1) to be an overpayment on account of the taxpayer's liability under this Part for the year.

For individuals and testamentary trusts, paragraph 164(1.5)(a) of the ITA permits us to refund an overpayment beyond the normal three-year period.

Subsection 164(1.5) reads as follows:

Notwithstanding subsection 164(1), the Minister may, on or after mailing a notice of assessment for a taxation year, refund all or any portion of any overpayment of a taxpayer for the year

a. if the taxpayer is an individual (other than a trust) or is a testamentary trust and the taxpayer's return of income under this Part for the year was filed on or before the day that is ten calendar years after the end of the taxation year; or

b. where an assessment or a redetermination was made under subsection 152(4.2) or 220(3.1) or 220(3.4) in respect of the taxpayer.

2.1.3 Late, amended, or revoked elections

Subsection 220(3.2) of the ITA permits us extend the time for making an election or grant permission to amend or revoke an election. The elections to which the law applies are listed in Section 600 of the Income Tax Regulations, which can be found in the Appendices.

Subsection 220(3.2) reads as follows:

The Minister may extend the time for making an election or grant permission to amend or revoke an election if

a. the election was otherwise required to be made by a taxpayer or by a partnership, under a prescribed provision, on or before a day in a taxation year of the taxpayer (or in the case of a partnership, a fiscal period of the partnership); and

b. the taxpayer or the partnership applies, on or before the day that is ten calendar years after the end of the taxation year or the fiscal period, to the Minister for that extension or permission

2.2 Excise Tax Act (ETA)

Effective April 1, 2007, taxpayer relief requests made under the *Excise Tax Act* (ETA) are subject to a 10-year rolling time limit and the taxpayer relief provisions were extended to apply to the GST/HST failure to file penalty.

Requests made **prior to April 1, 2007**, to cancel or waive penalties and/or interest are limited for consideration to reporting periods that ended in 1991 and subsequent years.

Digitized by Google

Requests made on or after April 1, 2007, to cancel or waive penalties and/or interest are limited for consideration to any reporting period that ended within ten years before the calendar year in which the request is made.

2.2.1 Non GST/HST

Subsection 88(1) of the ETA permits us to cancel or waive penalties and/or interest payable under Parts I to VII (non GST/HST) of this Act.

Subsection 88(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or cancel any amount otherwise payable to the Receiver General under this Act that is interest or a penalty on an amount that is required to be paid by the person under this Act in respect of the reporting period.

2.2.2 GST/HST

Subsection 281.1(1) of the ETA permits us to cancel or waive interest payable under section 280 of this Act. Subsection 281.1(2) of the ETA permits us to cancel or waive late remitting penalty payable before April 1, 2007, under section 280; and the failure to file penalty payable as of April 1, 2007, under section 280.1 of this Act.

Subsection 281.1(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or cancel interest payable by the person under section 280 on an amount that is required to be remitted or paid by the person under this Part in respect of the reporting period.

Subsection 281.1(2) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or cancel all or any portion of any

a. penalty that became payable by the person under section 280 before April 1, 2007, in respect of the reporting period; and

b. penalty payable by the person under section 280.1 in respect of a return for the reporting period.

2.3 *Excise Act, 2001* (EA, 2001)

Section 173 of the *Excise Act, 2001* (EA,2001) permits us to cancel or waive interest payable under this Act.

Requests made **prior to April 1, 2007**, to cancel or waive interest payable under section 170 are limited for consideration to any fiscal month that ended on or after July 1, 2003.

000112

Digitized by Google

Requests made on or after April 1, 2007, for interest and/or penalties are limited for consideration to any fiscal month of a person that ended ten years before the calendar year in which the request is made.

Effective April 1, 2007, section 255.1 gives the Minister the authority to waive or reduce any penalty payable under section 251.1 (failure to file penalty) in respect of a return for any fiscal month before the day that is ten calendar years after the end of the fiscal month.

Section 173 reads as follows:

The Minister may, on or before the particular day that is 10 calendar years after the day an amount was required to be paid by a person under this Act, or on application by the person on or before the particular day, waive or reduce any interest on the amount payable by the person under section 170.

Section 255.1 reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a fiscal month of a person, or on application by the person on or before that day, waive or reduce any penalty payable by the person under section 251.1 in respect of a return for the fiscal month.

2.4 *Air Travellers Security Charge Act* (ATSCA)

Sections 30(1) and 55(1) of the *Air Travellers Security Charge Act* (ATSCA) permit us to cancel or waive penalties and/or interest payable under this Act.

Effective April 1, 2007, taxpayer relief requests made under the ATSCA are subject to a 10-year rolling time limit.

Requests made **prior to April 1, 2007**, to cancel or waive penalties and/or interest payable are limited for consideration to any fiscal month of a person that ended on or after April 1, 2002.

Requests made **on or after April 1, 2007**, to cancel or waive penalties and/or interest payable are limited for consideration to any fiscal month of a person that ended ten years before the calendar year in which the request is made.

Section 30(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a fiscal month of a person, or on application by the person on or before that day, waive or reduce any interest payable by the person under this Act on an amount that is required to be paid by the person under this Act in respect of the fiscal month.

Section 55(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a fiscal month of a person, or on application by the person on or before that day, waive or cancel any penalty payable by the person under section 53 in respect of the fiscal month.

2.5 *Softwood Lumber Products Export Charge Act, 2006*

000113

Digitized by Google

Subsection 37(1) of the *Softwood Lumber Products Export Charge, 2006* permits us to waive or cancel interest or a penalty payable under section 64 of this Act, effective October 12, 2006.

Subsection 37(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period, or on application by a person on or before that day, waive or cancel any amount otherwise payable to the Receiver General under this Act that is interest or a penalty payable under section 64 on an amount that is required to be paid by the person under this Act in respect of that reporting period.

Digitized by Google

3. Roles and Responsibilities

This section discusses the roles and responsibilities of those involved in the taxpayer relief provisions at the local, regional, and Headquarters functional levels. It concludes with a summary of the process to follow for taxpayer relief referrals.

3.1 Local level

3.1.1 Field office staff

Taxpayer relief provisions requests are handled in TSOs and TCs across Canada.

Field office staff are responsible for processing taxpayer relief requests in an impartial, just and consistent manner. They also are responsible for making sure taxpayer relief requests are accurately recorded on the Taxpayer Relief Registry (TRR). The TRR tracks taxpayer relief requests such as the number of penalties and/or interest waived and/or cancelled and refunds beyond the normal three year period. Late, amended or revoked elections are not recorded unless the taxpayer is also requesting CRA to waive/cancel the $100 per month late-filed penalty and/or any applicable interest.

3.1.2 Local taxpayer relief committees

Taxpayer relief committees within local offices can promote the uniform application of the taxpayer relief provisions. Local management determines the makeup and number of taxpayer relief committees, and whether a committee should be established. Not all sections or divisions in a local office will have a taxpayer relief committee.

Local taxpayer relief committees are responsible for reviewing requests and discussing local taxpayer relief-related issues and policies.

Examples of requests that a taxpayer relief committee might review include:

- requests that are complex, precedent-setting, or sensitive; and
- requests for a second review of items that were denied on a first review.

Taxpayer relief committees are involved in reviewing decisions made in their offices to ensure impartiality, accuracy, and consistency in the decision-making process. They can also give guidance to staff involved in taxpayer relief reviews.

See section Using taxpayer relief committees for more information on local committees and how they can promote overall consistency.

3.1.3. Directors of field offices

Digitized by Google

Directors of field offices have overall responsibility for applying the taxpayer relief provisions within their offices. They are responsible for ensuring that operational review processes are in place and are consistent with national taxpayer relief policies and guidelines, as well as functional guidelines.

See section Delegation policies for more information on the responsibilities of directors in the taxpayer relief review process as it relates to delegation issues.

3.2 Headquarters level

3.2.1 Taxpayer Relief and Service Complaints Directorate of Appeals Branch

The Taxpayer Relief and Service Complaints Directorate (TRSCD) is the Headquarters function that provides cross-functional leadership, policy development and program direction to the Taxpayer Services and Debt Management, Assessment and Benefit Services, Compliance Programs, Legislative Policy and Regulatory Affairs, and Appeals Branches, and to officers servicing taxpayers through TSOs and TCs. This includes functional, operational, system and policy support for taxpayer relief programs.

TRSCD is not responsible for either delivering or funding the taxpayer relief workload in the field.

For more information see the TRSCD's mandate.

How to contact us

If you have questions on the taxpayer relief provisions, please contact us by:

- sending an e-mail to Taxpayer Relief/Allégements pour les contribuables, General Enquiries/Demandes de renseignements généraux, or
- sending a fax to (613) 952-5825 (non-secure).

3.2.2 Other headquarters functions

Headquarters functions from Taxpayer Services and Debt Management, Assessment and Benefit Services, Compliance Programs, Legislative Policy and Regulatory Affairs, and Appeals Branches are responsible for answering **field enquiries regarding taxpayer relief provisions that specifically relate to their programs and for providing operational assistance.**

These headquarters functions, in conjunction with TRSCD are also responsible for monitoring taxpayer relief operations requests that relate to the program they administer.

As well, these headquarters functions, in conjunction with TRSCD, are responsible for gathering, verifying, validating, and approving amounts to be reported in the Public Accounts. Headquarters functions have identified one or more individuals as taxpayer relief functional contacts who will be available to act as contacts for taxpayer relief issues.

See CRA contact lists for a list of the headquarters taxpayer relief functional representatives.

Digitized by Google

Taxpayer Relief

Procedures Manual

April 30, 2012

000001

Digitized by Google

Table of Contents

1. Introduction 4
1.1 Program status 4
1.2 Purpose of this manual 5
1.3 How this manual is organized 5
1.4 Updates and revisions 5
1.5 Comments and questions 6

2. Legislation 7
2.1 Income Tax Act (ITA) 7
2.2 Excise Tax Act (ETA) 9
2.3 Excise Act, 2001 (EA, 2001) 10
2.4 Air Travellers Security Charge Act (ATSCA) 10
2.5 Softwood Lumber Products Export Charge Act, 2006 11

3. Roles and Responsibilities 12
3.1 Local and regional level 12
3.2 Headquarters level 13
3.3 Regional program advisors 14
3.4 Taxpayer Relief Committee (TRC) 14
3.5 Delegation of the Minister's power and duties 14
3.6 Referral process 16

4. Reporting 18
4.1 Financial reporting 18
4.2 Internal order numbers and activity types for ICs and CoEs 18

5. Intake and Screening 21
5.1 Taxpayer relief correspondence 21
5.2 Receiving the correspondence 22
5.3 Sort 1: all correspondence 23
5.4 Flow B: all taxpayer relief requests 27
5.5 Sort 2: begin screening sheet 28
5.6 Sort 3: additional documentation or a new request? 32
5.7 Flow D: taxpayer relief requests that are CoE responsibility 33
5.8 Flow H: determining completeness 37
5.9 Determining complexity 39
5.10 Work-ready taxpayer relief requests 39
5.11. File transfer guidelines 40

6. General policies and procedures 41
6.1 Purpose and intent of taxpayer relief provisions 42
6.2 Administrative reviews 43
6.3 Making a taxpayer relief request 44
6.4 Ministerial discretion 45
6.5 Receiving a taxpayer relief request 46
6.6 Supporting requests 47
6.7 Requests involving more than one area 48
6.8 Fact sheet 49
6.9 Obtain approval 49
6.10 Communicating decisions 50
6.11 Keeping taxpayer relief records 52
6.12 Consent forms - Authorizing or cancelling a representative 53
6.13 Undeliverable mail 54

000002

Digitized by Google

7. Cancelling or waiving penalties and/or interest **56**
7.1 Difference between a cancellation and a waiver 56
7.2 Circumstances in which interest and penalties may be cancelled or waived 57
7.3 Extraordinary circumstances 57
7.4 Requests that arise due to actions of the CRA 59
7.5 Other circumstances 60
7.6 Disputed assessment or amount charged 61
7.7 Third parties 61
7.8 Bank error 62
7.9 Ignorance of the law 62
7.10 Gross negligence penalties 62
7.11 Erroneous refunds 62
7.12 Amounts held in trust 63
7.13 Reinstating cancelled or waived penalties and/or interest 63
7.14 Inability to pay or financial hardship 63
7.15 Factors to consider in arriving at the decision 63
7.16 Completing a fact sheet 64

8. Inability to pay or financial hardship **66**
8.1 Definition of financial hardship 66
8.2 Determining the financial situation of an individual 67
8.3 Determining a corporation's financial situation 69
8.4 Penalty relief 71
8.5 Considerations for reviewing financial hardship 71
8.6 Additional submission requirements - unfiled returns 72
8.7 Write off 72
8.8 Requests regarding amounts in dispute 73
8.9 Financial adjustments 73
8.10 Application to directors' liability assessments (joint reviews with Revenue Collection Debt Management.) 73
8.11 Non-arm's length transfers (for information purpose only as it is ARD's responsibility) 74
8.12 Remission - Relief of tax (for information only) 75
8.13 Insolvency and taxpayer relief requests 75

9. Refunds or reduction in amounts payable beyond the normal three-year period **78**
9.1 Refunds or reducing tax payable for a statute barred return 78
9.2 Accepting a refund or adjustment request 79
9.3 Limitations and restrictions 80
9.4 Requests must be complete 80
9.5 Fact sheet 81

10. Accepting late, amended, or revoked elections **82**
10.1 Elections covered by the taxpayer relief provisions 82
10.2 Penalty for late filed, amended or revoked elections 82
10.3 Deemed prescribed elections 83
10.4 Basis for accepting requests 83
10.5 Basis for denying requests 83
10.6 Requests must be complete 84
10.7 Fact sheet 84

11. Judicial review **86**
11.1 Judicial Review Process Graph 86
11.2 Requests under Rule 317 87

12. Additional information **91**
12.1 CRA taxpayer relief forms and information 91
12.2 Headquarters functional taxpayer relief representatives 91
12.3 Regional program advisors 91
12.4 Federal Court contact list 91
12.5 List of elections covered under section 600 of the *Income Tax Regulations* 92

000003

Digitized by Google

13. Appendices 96
Appendix 5A Where to send taxpayer relief requests 97
Appendix 5B Expediting a request 104
Appendix 5C System Information 105
Appendix 5D Complexity Guidelines 106
Appendix 5E File Transfer Guidelines 109
Appendix 5F Income and Expense/Assets and Liabilities (IEAL) 112
Appendix 5G Screening Sheet 116
Appendix 6B Post-decision Financial Transactions - CoEs 118
Appendix 8A Roles and responsibilities of Appeals Branch and Debt Management staff 120
Example of Schedule "A" 122
Schedule "A" - Downloadable version .....

Digitized by Google

- **Welcome to the Taxpayer Relief Procedures Manual**
- **1. Introduction**
  - 1.1 Program status
  - 1.2 Purpose of this manual
  - 1.3 How this manual is organized
  - 1.4 Updates and revisions
  - 1.5 Comments and questions

Welcome to the Taxpayer Relief Procedures Manual

This manual gives you complete and up-to-date guidelines and procedures on how to apply the taxpayer relief provisions. It is an easy-to-use reference that has information you need to process relief requests.

1. Introduction

The Canada Revenue Agency (CRA) has been emphasizing fairness and fair treatment of taxpayers for many years. The introduction of the taxpayer relief provisions in the early 1990's is a good example of the CRA's commitment to fairness. However, fairness is far broader than our taxpayer relief provisions. It is a concept built around service excellence, a positive way of thinking, and a culture with a taxpayer focus.

The CRA has further defined fairness through seven guiding principles, which are described in the document called Our Fairness Pledge. This pledge can be used by all of us as a guide to the way we interact with taxpayers and internal clients.

The CRA can grant relief to taxpayers through the taxpayer relief provisions contained in various acts it administers. This manual focuses on the taxpayer relief provisions. For information on the broader concept of fairness, visit the Fairness and Taxpayer Rights pages.

1.1 Program status

On April 1, 2011, the CRA designated taxpayer relief as a program under the Appeals Branch. This change is part of the taxpayer relief business transformation in response to several external and internal reviews. Program status will improve consistency, reporting, and accountability for the taxpayer relief workload and enhance service to taxpayers.

The taxpayer relief business transformation involved the transfer of some of these workloads to the Appeals Branch using a phased-in approach. In addition, it involved the establishment of Taxpayer Relief Intake Centres (ICs) and Centres of Expertise (CoEs) in various regions across the country. See Contact List for location and contact information. For background information on the taxpayer relief business transformation, see Moving Toward the Taxpayer Relief Program. See also Chapter 3 Roles and Responsibilities for more information.

The scope of the program includes penalty and interest relief requests received from taxpayers. It excludes requests for a refund or reduction in amounts payable beyond the normal three-year period and requests to accept late, amended or revoked elections. In addition, certain specialized penalty and/or interest workloads, such as requests made by non-residents and requests associated with a voluntary disclosure, remain the responsibility of other sections of the Agency.

See Project Scope for more information on the excluded workloads and 5.4.1 Area of responsibility for details on where taxpayer relief requests are processed.

Digitized by Google

1.2 Purpose of this manual

This manual provides instructions and policies for CRA employees who apply the taxpayer relief provisions. It contains both general guidelines applicable to all relief requests as well as detailed procedures and links for specific workloads. It is designed to promote consistency and accuracy in decisions we make on these requests.

Its content applies to employees processing taxpayer relief requests in ICs, CoEs, tax services offices (TSOs), tax centres (TCs), regional offices, and at Headquarters.

The manual relates to the following requests:

- the cancellation or waiving of penalties and/or interest;
- the refund or reduction of amounts payable beyond the normal three-year period; and
- the acceptance of late, amended or revoked elections

Note: This manual is not intended for employees handling relief requests under the Voluntary Disclosures Program (VDP). These requests have their own unique set of conditions for relief and are the responsibility of the Enforcement and Disclosures Directorate, Compliance Programs Branch. For more information refer to Voluntary Disclosures Program Guidelines and see 5.4.1 Area of responsibility.

Use this manual in conjunction with the Taxpayer Relief Registry Guide (TRRG), the Taxpayer Relief Scanning Procedures and branch specific resources contained in Functional Guidelines.

This manual is available through the Taxpayer Relief and Service Complaints Directorate InfoZone site.

1.3 How this manual is organized

This manual is divided into the following chapters:

- Introduction
- Legislation
- Roles and Responsibilities
- Reporting
- Intake and Screening
- General policies and procedures
- Cancelling or waiving penalties and/or interest
- Inability to pay or financial hardship
- Refunds or reduction in amounts payable beyond the normal three-year period
- Accepting late, amended, or revoked elections
- Judicial review
- Additional information
- Appendices

This manual contains general guidelines applicable to all business lines, as well as more detailed information and links for specialized workloads. For example, employees at CoEs will refer to Chapter 8 Inability to pay or financial hardship whereas Chapter 10 Accepting late, amended, or revoked elections will be primarily of interest to staff in TCs and Audit who process election requests.

1.4 Updates and revisions

This manual replaces all former versions of the Taxpayer Relief Reference Guide. Significant changes include the addition of Chapter 5, Intake and Screening and Chapter 8, Inability to pay or financial hardship

The Taxpayer Relief and Service Complaints Directorate (TRSCD) in the Appeals Branch is responsible for updating and maintaining this manual.

Updates and revisions are completed on a regular basis and can be found on the manual's home page. A message will also be posted under TRSCD's What's New

Digitized by Google

1.5 Comments and questions

If you have comments or questions regarding this manual, please contact us by sending an email to:
AB-DGA HQ-AC Taxpayer Relief, General Enquiries/Allègements pour les contribuables, Demandes de renseignements généraux.

Digitized by Google

[redacted]

- 2. Legislation

- 2.1 *Income Tax Act* (ITA)
  - 2.1.1 Cancelling or waiving penalties and/or interest
  - 2.1.2 Refunds or reduction in amounts payable beyond the normal three-year period
  - 2.1.3 Late, amended, or revoked elections
- 2.2 *Excise Tax Act* (ETA)
  - 2.2.1 Non GST/HST
  - 2.2.2 GST/HST
- 2.3 *Excise Act, 2001* (EA, 2001)
- 2.4 *Air Travellers Security Charge Act* (ATSCA)
- 2.5 *Softwood Lumber Products Export Charge Act, 2006*

2. Legislation

This chapter provides the legislative references for the various Acts administered by the Canada Revenue Agency (CRA) that contain taxpayer relief provisions.

2.1 *Income Tax Act* (ITA)

Before 2005, taxpayer relief requests under the *Income Tax Act* (ITA) were considered for 1985 and later taxation years. Effective January 1, 2005, a 10-year rolling time limit is imposed due to amendments in the ITA. The 10-year limitation period rolls forward every January 1.

Requests made on or after January 1, 2005, are limited for consideration to any taxation year for individuals (or fiscal period in the case of a partnership) that ended ten years before the calendar year in which the request is made.

The Canada Revenue Agency (CRA) has made a policy change to the administration of the 10-year limitation period under subsection 220(3.1) of the *Income Tax Act* for requesting interest relief for a tax year that ended more than 10 years ago (see the CRA news release, Taxpayer relief deadline is December 31, 2011, dated November 21, 2011).

See also IC07-1 Taxpayer Relief Provisions and the revised ATR 2011-14.

2.1.1 Cancelling or waiving penalties and/or interest

For taxpayers (including employers), subsection 220(3.1) of the ITA permits the CRA to cancel or waive penalties and/or interest payable under that Act.

Subsection 220(3.1) reads as follows:

The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

Note: The 10-year period has been modified for interest relief requests. See "Revised 10-year limitation period for interest relief".

2.1.2 Refunds or reduction in amounts payable beyond the normal three-year period

Subsection 152(4.2) of the ITA permits the CRA to process credit reassessments or redeterminations beyond the normal three-year period for individuals and testamentary trusts only.

000009

Digitized by Google

Subsection 152(4.2) reads as follows:

Notwithstanding subsections (4), (4.1) and (5), for the purpose of determining, at any time after the end of the normal reassessment period of a taxpayer who is an individual (other than a trust) or a testamentary trust in respect of a taxation year, the amount of any refund to which the taxpayer is entitled at that time for the year, or a reduction of an amount payable under this Part by the taxpayer for the year, the Minister may, if the taxpayer makes an application for that determination on or before the day that is ten calendar years after the end of that taxation year,

a. reassess tax, interest or penalties payable under this Part by the taxpayer in respect of that year; and

b. redetermine the amount, if any, deemed by subsection 120(2) or (2.2), 122.5(3), 122.51(2), 127.1(1), 127.41(3) or 210.2(3) or (4) to be paid on account of the taxpayer's tax payable under this Part for the year or deemed by subsection 122.61(1) to be an overpayment on account of the taxpayer's liability under this Part for the year.

For individuals and testamentary trusts, paragraph 164(1.5)(a) of the ITA permits the CRA to refund an overpayment beyond the normal three-year period.

Subsection 164(1.5) reads as follows:

Notwithstanding subsection 164(1), the Minister may, on or after mailing a notice of assessment for a taxation year, refund all or any portion of any overpayment of a taxpayer for the year

a. if the taxpayer is an individual (other than a trust) or is a testamentary trust and the taxpayer's return of income under this Part for the year was filed on or before the day that is ten calendar years after the end of the taxation year;

b. where an assessment or a redetermination was made under subsection 152(4.2) or 220(3.1) or 220(3.4) in respect of the taxpayer; or

c. to the extent that the overpayment relates to an assessment of another taxpayer under subsection 227(10) or (10.1) (in this paragraph referred to as the "other assessment"), if the taxpayer's return of income under this Part for the taxation year is filed on or before the day that is two years after the date of the other assessment and if the other assessment relates to

    i. in the case of an amount assessed under subsection 227(10), a payment to the taxpayer of a fee, commission or other amount in respect of services rendered in Canada by a non-resident person or partnership, and

    ii. in the case of an amount assessed under subsection 227(10.1), an amount payable under subsection 116(5) or (5.3) in respect of a disposition of property by the taxpayer.

Note: Paragraph 164(1.5)(*c*) applies to overpayments in respect of applications for refunds made after March 4, 2019.

2.1.3 Late, amended, or revoked elections

Subsection 220(3.2) of the ITA permits the CRA to extend the time for making an election or grant permission to amend or revoke an election. The elections to which the law applies are listed in Section 600 of the *Income Tax Regulations*, which can be found in the section for Additional Information.

Subsection 220(3.2) reads as follows:

The Minister may extend the time for making an election or grant permission to amend or revoke an election if

a. the election was otherwise required to be made by a taxpayer or by a partnership, under a prescribed provision, on or before a day in a taxation year of the taxpayer (or in the case of a partnership, a fiscal period of the partnership); and

b. the taxpayer or the partnership applies, on or before the day that is ten calendar years after the end of the taxation year or the fiscal period, to the Minister for that extension or permission.

Digitized by Google

2.2 *Excise Tax Act* (ETA)

Effective April 1, 2007, taxpayer relief requests made under the ETA are subject to a 10-year rolling time limit and the taxpayer relief provisions were extended to apply to the GST/HST failure to file penalty.

Requests made prior to April 1, 2007, to cancel or waive penalties and/or interest are limited for consideration to reporting periods that ended in 1991 and subsequent years.

Requests made on or after April 1, 2007, to cancel or waive penalties and/or interest are limited for consideration to any reporting period that ended within ten years before the calendar year in which the request is made.

Pursuant to the ETA, "GST/HST registrants must file a return for each reporting period, even where no taxable supplies have been made during a reporting period". A National assessment is not a GST/HST return; it is an assignment of debt. Penalty and interest relief assessed on GST notional assessments cannot be granted.

Note: The 10-year period has been modified for interest relief requests. See "Taxpayer relief deadline is December 31, 2011".

2.2.1 Non GST/HST

Subsection 88(1) of the ETA permits the CRA to cancel or waive penalties and/or interest payable under Parts I to VII (non GST/HST) of this Act.

Subsection 88(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or cancel any amount otherwise payable to the Receiver General under this Act that is interest or a penalty on an amount that is required to be paid by the person under this Act in respect of the reporting period

2.2.2 GST/HST

Subsection 281.1(1) of the ETA permits the CRA to cancel or waive interest payable under section 280 of this Act. Subsection 281.1(2) of the ETA permits the CRA to cancel or waive late remitting penalty payable before April 1, 2007, under section 280; and the failure to file penalty payable as of April 1, 2007, under section 280.1 of this Act.

Subsection 281.1(2)(*b*) permits the CRA to cancel or waive a penalty for failure to file a return electronically charged under section 280.11, and the penalty for failure to report information on a return or misstate amounts on a return under section 284.01 of the ETA

Subsection 281.1(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or cancel interest payable by the person under section 280 on an amount that is required to be remitted or paid by the person under this Part in respect of the reporting period.

Subsection 281.1(2) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or cancel all or any portion of any

a. penalty that became payable by the person under section 280 before April 1, 2007, in respect of the reporting period; and

b penalty payable by the person under section 280.1, 280.11 or 284.01 in respect of a return for the reporting period.

Digitized by Google

2.3 *Excise Act, 2001* (EA, 2001)

Section 173 of the EA, 2001 permits the CRA to cancel or waive interest payable under this Act.

Requests made prior to April 1, 2007, to reduce or waive interest payable under section 170 are limited for consideration to any reporting period that ended on or after July 1, 2003.

Requests made on or after April 1, 2007, to reduce or waive interest and/or penalties are limited for consideration to any reporting period of a person that ended ten years before the calendar year in which the request is made.

Effective April 1, 2007, section 255.1 gives the Minister the authority to waive or reduce any penalty payable under section 251.1 (failure to file penalty) in respect of a return for any reporting period before the day that is ten calendar years after the end of the reporting period.

Section 173 reads as follows:

The Minister may, on or before the particular day that is 10 calendar years after the day an amount was required to be paid by a person under this Act, or on application by the person on or before the particular day, waive or reduce any interest on the amount payable by the person under section 170.

Section 255.1 reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or reduce any penalty payable by the person under section 251.1 in respect of a return for the reporting period.

Note: The 10-year period has been modified for interest relief requests. See 'Taxpayer relief deadline is December 31, 2011'.

2.4 *Air Travellers Security Charge Act* (ATSCA)

Subsection 30(1) of the ATSCA permits the CRA to reduce or waive interest payable under this Act while subsection 55(1) permits to cancel or waive penalties.

Effective April 1, 2007, taxpayer relief requests made under the ATSCA are subject to a 10-year rolling time limit.

Requests made prior to April 1, 2007, to cancel, reduce or waive penalties and/or interest payable are limited for consideration to any reporting period of a person that ended on or after April 1, 2002.

Requests made on or after April 1, 2007, to cancel, reduce or waive penalties and/or interest payable are limited for consideration to any reporting period of a person that ended ten years before the calendar year in which the request is made.

Subsection 30(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or reduce any interest payable by the person under this Act on an amount that is required to be paid by the person under this Act in respect of the reporting period.

Subsection 55(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period of a person, or on application by the person on or before that day, waive or cancel any penalty payable by the person under section 53 in respect of the reporting period.

Note: The 10-year period has been modified for interest relief requests. See 'Taxpayer relief deadline is December 31, 2011'.

Digitized by Google

2.5 *Softwood Lumber Products Export Charge Act, 2006*

Subsection 37(1) of the *Softwood Lumber Products Export Charge Act, 2006* permits the CRA to waive or cancel interest or a penalty payable under section 64 of this Act, effective October 12, 2006.

Subsection 37(1) reads as follows:

The Minister may, on or before the day that is 10 calendar years after the end of a reporting period, or on application by a person on or before that day, waive or cancel any amount otherwise payable to the Receiver General under this Act that is interest or a penalty payable under section 64 on an amount that is required to be paid by the person under this Act in respect of that reporting period.

Note: The 10-year period has been modified for interest relief requests. See "Taxpayer relief deadline is December 31, 2011".

Digitized by Google

[redacted]

- 3. Roles and Responsibilities
  - 3.1 Local and regional level
    - 3.1.1 Taxpayer Relief Intake Centres
    - 3.1.2 Taxpayer Relief Centres of Expertise
    - 3.1.3 Other field office staff
    - 3.1.4 Local taxpayer relief committees
    - 3.1.5. Chiefs of Appeals and directors of field offices
  - 3.2 Headquarters level
    - 3.2.1 Taxpayer Relief and Service Complaints Directorate
    - 3.2.2 Other headquarters functions
  - 3.3 Regional program advisors
  - 3.4 Taxpayer Relief Committee (TRC)
  - 3.5 Delegation of the Minister's power and duties
    - 3.5.1 First reviews
    - 3.5.2 Second reviews
    - 3.5.3 Requests after second reviews
  - 3.6 Referral process
    - 3.6.1 Tier 1 - Local resolution
    - 3.6.2 Tier 2 - TRSCD general enquiries mailbox
    - 3.6.3 Tier 3 – Referrals to HQ, TRSCD (IC/CoE workloads only)
    - 3.6.4 Mandatory notifications to HQ (IC/CoE workloads only)
    - 3.6.5 Mandatory notifications to HQ (Agency wide)

3. Roles and Responsibilities

As mentioned in the Introduction to this manual, taxpayer relief received program status effective April 1, 2011

This chapter provides the roles and responsibilities of those involved in the taxpayer relief provisions at the local, regional, and Headquarters functional levels. It concludes with a summary of the process to follow for taxpayer relief referrals

3.1 Local and regional level

All employees involved in processing taxpayer relief requests must do so in an impartial, just and consistent manner.

The majority of requests will be received and screened at taxpayer relief intake centres (IC), however, all staff are responsible for making sure valid requests are accurately recorded on the Taxpayer Relief Registry (TRR). The registry is used for requests on cancelling or waiving penalties and/or interest, refunds or reduction in amounts payable beyond the normal three-year period and accepting late, amended or revoked elections. Elections are not recorded unless the taxpayer is also requesting CRA to waive/cancel penalties and/or interest. See the Taxpayer Relief Registry (TRR) Guide for more information.

3.1.1 Taxpayer Relief Intake Centres

The primary purpose of intake centres (ICs) is to undertake front-end activities including the receipt of mail, date stamping, sorting and screening of taxpayer relief correspondence and related documentation. IC staff will also determine validity, create a registry entry, ensure completeness and identify complexity for taxpayer requests for penalty and interest relief before scanning and transferring the work-ready files to centres of expertise (CoEs).

Employees will create a registry entry, send acknowledgement letters and redirect mail for all relief requests received at an IC that are not the responsibility of a CoE.

Note that the IC will not determine validity for taxpayer relief requests redirected to another area.

The IC will send any correspondence that is not taxpayer relief request to the appropriate area, no acknowledgement letter will be sent.

Digitized by Google

Refer to Contact List for intake centre locations and contact information.

3.1.2 Taxpayer Relief Centres of Expertise

Employees at centres of expertise (CoE) are responsible for reviewing the taxpayer requests for relief of penalty and/or interest transferred from the IC. If expertise is needed from another program area, such as Appeals or Audit, it will be requested through consultation and where appropriate, a joint decision will be issued. See 6.7.1 Joint reviews.

Refer to Contact List for centre of expertise locations and contact information.

3.1.3 Other field office staff

Requests for refunds or reduction in amounts payable beyond the normal three-year period, requests to accept late, amended or revoked elections and proactive relief (initiated by CRA) are handled in TSOs and TCs.. See also 5.4.1 Area of responsibility for additional information, including other specialized workloads.

3.1.4 Local taxpayer relief committees

Local management determines the makeup and number of taxpayer relief committees, and whether a committee should be established.

3.1.5 Chiefs of Appeals and directors of field offices

Chiefs of Appeals of ICs and CoEs and directors of field offices have overall responsibility for applying the taxpayer relief provisions within their offices. They are responsible for ensuring that operational review processes are in place and are consistent with national taxpayer relief policies and guidelines, as well as functional guidelines.

See section 3.5 Delegation of the Minister's power and duties for more information.

3.2 Headquarters level

3.2.1 Taxpayer Relief and Service Complaints Directorate

The Taxpayer Relief and Service Complaints Directorate (TRSCD) is the Headquarters function that provides cross-functional leadership, policy development and program direction to the Assessment and Benefit Services, Compliance Programs, Legislative Policy and Regulatory Affairs, and Appeals Branches, and to officers servicing taxpayers through TSOs and TCs. This includes functional, operational, system and policy support for taxpayer relief programs.

For more information, see the TRSCD's mandate

How to contact us
If you have questions on the taxpayer relief provisions, please contact us by sending an e-mail to AB-DGA_HQ-AC Taxpayer Relief, General Enquiries/Allégements pour les contribuables, Demandes de renseignements généraux.

3.2.2 Other headquarters functions

Headquarters functions from Compliance Programs, Legislative Policy and Regulatory Affairs, and Appeals Branch (Tax & Charities Appeals Directorate) are responsible for answering field enquiries regarding taxpayer relief provisions that specifically relate to their programs and for providing operational assistance.

In conjunction with TRSCD, these functions are responsible for monitoring taxpayer relief operations that relate to the taxpayer relief requests they administer, and for gathering, verifying, validating, and approving amounts to be reported in the Public Accounts.

Headquarters functions have identified one or more individuals as taxpayer relief functional contacts who will be available to act as contacts for taxpayer relief issues.

See Chapter 12, Additional Information for a list of the Headquarters Taxpayer Relief Functional Representatives.

Digitized by Google

3.3 Regional program advisors

Regional program advisors monitor taxpayer relief operations within their region to ensure consistent application of the taxpayer relief provisions.

See Chapter 12, Additional information for a list of Regional Program Advisors

3.4 Taxpayer Relief Committee (TRC)

The TRC is a cross-functional committee, chaired by the Director General of TRSCD. It was established in December 2005 and meets on an *ad hoc* basis. It provides a forum where members can discuss new developments and progress in the administration of taxpayer relief

Members of the TRC include directors' general of applicable Headquarters Branches and directors of Regional Programs (alternatively a Regional Champion and/or Regional Program Advisor) as well as the Director General, the director and the managers of TRSCD.

For more information see the Taxpayer Relief Committee section of the TRSCD Intranet site.

3.5 Delegation of the Minister's power and duties

The Minister's powers and duties to exercise his discretion under the taxpayer relief legislation are administratively delegated as specified in the instruments of delegation signed by the Minister.

Positions and acting positions are delegated. People themselves are not delegated authority. The positions they occupy are delegated to perform certain duties.

Each time there is an amendment to a delegation instrument, a separate document is prepared for the approval of the Minister or Commissioner. These instruments are published on the CRA's external Website: Delegation of powers, duties, and functions and Authorization to Exercise Powers Duties of the Minister of National Revenue.

See also 6.2 Administrative reviews and 6.4 Ministerial discretion for more information.

3.5.1 First reviews

Requests for first review are authorized at the team leader level in all CoEs.

For other sections of the Agency, low-risk or routine first review requests are normally authorized at the first level of supervision.

- More sensitive or complex first review requests may, depending on local procedures, be reviewed and authorized by a more senior delegated person or by a taxpayer relief committee (reviewed by the committee and authorized by a member). These requests include complex requests of a sensitive or precedent-setting nature.

The delegated authority level for the first review request approval is usually the team leader/coordinator. An exception to this rule is when you are accepting a request for a refund or reduction in amounts payable beyond the normal three-year period. If you are approving the taxpayer's request in full, a notice of assessment or notice of reassessment will be issued. These notices are issued under the authority of the Commissioner of Revenue and will suffice as being reviewed by the appropriate delegated authority.

Partial or full denials for a request for refund or reduction in amounts payable beyond the normal three-year period require a decision letter signed by the appropriate delegated authority.

If information requested by CRA is submitted after the decision letter has been issued, the same persons who solicited the requested information and rendered the decision can be involved in the continuation of the first review.

Chiefs of Appeals, directors and managers should not personally review and make decisions for first review requests, since this could affect impartiality if the taxpayer subsequently requests a second review of the decision.

Digitized by Google

3.5.2 Second reviews

To preserve the impartiality of the review process, second review requests must be made by someone other than the original decision-maker. Requests for second review should be reviewed and authorized by someone who is more senior than the original decision-maker, such as a manager, or a taxpayer relief committee (reviewed by the committee and authorized by a member). Requests previously decided by a taxpayer relief committee should go to someone more senior than the chairing committee member, such as an assistant director.

Second review requests are authorized at the manager level in all CoEs.

If information requested by CRA is submitted after the decision letter has been issued, the same persons who solicited the requested information and rendered the decision can be involved in the continuation of the second review. If new information not requested by CRA is provided and the original decision-maker still feels that the request should not be granted, the request should automatically go for review to someone more senior, a taxpayer relief committee, or to a director.

If it is determined that a person or persons who participated in the first review also acted on the second review, that alone can suffice to have the request returned back to CRA by the Federal Court for a new review, as can be seen in the case of *Robertson v. Minister of National Revenue*.

3.5.3 Requests after second reviews

It is CRA policy that taxpayers are entitled to two administrative reviews within the CRA. Taxpayers also have recourse to judicial review. While CRA policy does not permit a third review, taxpayers sometimes come back to the CRA to ask for a review of a second decision; either before they ask for a judicial review, or because they have no intention to bring the matter to Court.

For requests that are the CoE responsibility:

For third/subsequent reviews not as a result of a judicial review decision, the CRA has discretion whether or not we will even conduct a third review. Normally, the case would only be reopened if the taxpayer is providing new relevant information. See 6.2.3 A third or subsequent review.

To preserve the impartiality of the review process, all third or subsequent review requests must be made by someone other than the previous decision-makers. Requests for third/subsequent review should, in most cases, be reviewed and authorized by someone who is of **equal title/position** or **higher** than the previous decision-makers.

If information requested by CRA is submitted after the second or subsequent decision letter has been issued, the same persons who solicited the requested information and rendered the decision can be involved in the continuation of the subsequent review (e.g.: in cases citing financial hardship where the taxpayer did not submit documents). If new information not requested by CRA is provided and the previous decision-maker still feels that the request should not be granted, the request should automatically go for review to someone else.

If the CRA does perform a third or subsequent review, taxpayers must be informed of their right to judicial review even if this right was previously communicated

For third/subsequent reviews as a result of a judicial review decision, the CRA must conduct a new review. Refer to Chapter 11 Judicial review for more information

For requests that are not CoE responsibility:

Requests addressed to the director or regional Assistant Commissioner

Requests for third or subsequent reviews that are outside the taxpayer relief program, but received at an IC, will be forwarded to the party that issued the second decision on a priority basis. See also Appendix 5B Expediting a Request.

For these requests, the director of the office responsible for the second review or the Assistant Commissioner of the region responsible for that office has full discretion over the necessary course of action. Normally, the case would only be reopened if the taxpayer is providing new relevant information.

Digitized by Google

Note: When a delegated official at any office reviews a request because new relevant information has been submitted and the request is denied or partially approved, taxpayers must be informed of their right to judicial review even if this right was previously communicated. This note also applies to sections Requests addressed to the Minister, Commissioner, or Deputy Commissioner and Requests addressed to headquarters functions or another office or region .

Requests addressed to the Minister, Commissioner, or Deputy Commissioner

Ministerial correspondence areas have full discretion over all requests addressed to the Minister, Commissioner, or Deputy Commissioner. Although they have the authority to change a director's decision, they will usually consult with the Chief of Appeals and/or director involved in the previous decision to determine the best course of action.

Requests addressed to headquarters functions or another office or region

Requests should be forwarded to the Chief of Appeals and/or director responsible for the second review, and taxpayers should be informed that their request is being forwarded for review to the office that conducted the second review. If the recipient of the request expresses concerns about the last decision, the matter can be brought informally to the attention of the director responsible for that decision. If necessary, the recipient's Assistant Commissioner can formally refer the matter to the Assistant Commissioner of the Director responsible for the case.

For third/subsequent reviews as a result of a judicial review decision, the CRA must conduct a new review. Refer to Chapter 11 Judicial review for more information

3.6 Referral process

Most taxpayer relief requests are resolved using the guidelines and procedures available to the field. However, some requests may not be easy to resolve because of their complexity, sensitivity, precedent-setting nature, or because they raise cross-functional or policy issues. In addition, there are some circumstances when a Headquarters (HQ) referral is mandatory.

The referral guidelines are as follows:

3.6.1 Tier 1 - Local resolution

All front-line staff needing procedural or technical assistance should contact a local resource officer, senior officer and/or team leader to resolve the question. Staff at an IC may consult with employees at the CoE when additional technical assistance is required, for example, when determining validity of an ambiguous request

3.6.2 Tier 2 - TRSCD general enquiries mailbox

If the resource officer, senior officer or team leader requires assistance with procedural or technical issues send an email to AB-DGA_HQ-AC Taxpayer Relief, General Enquiries/Allégements pour les contribuables, Demandes de renseignements généraux, or * contact your branch directly if your issue is branch specific.
* If the TRSCD requires technical assistance to answer a question, or if the issue is branch specific or of an operational nature that falls under another branches' responsibilities, the TRSCD will refer the enquiry to the applicable branch directly and the TRSCD will ask for a c.c. of the answer.

3.6.3 Tier 3 – Referrals to HQ, TRSCD (IC/CoE workloads only)

For all of the following HQ referrals, after consulting a team leader or manager, send an email to the to AB-DGA_HQ-AC Taxpayer Relief, General Enquiries/Allégements pour les contribuables, Demandes de renseignements généraux. In the subject of the email, indicate "Tier 3 - Referrals to HQ". You may be asked to forward the correspondence and/or supporting documentation to HQ at a later time. In rare circumstances HQ may make the decision that will be communicated by the field.

Digitized by Google

Situations meeting the following conditions may be referred for guidance or an opinion:

- where, in the opinion of the manager, HQ input would be desirable before a decision is made. These cases could include, but are not limited to situations involving a significant dollar amount, where a community may be impacted or if the media has or may become involved.
- must involve actual cases and not hypothetical situations

3.6.4 Mandatory notifications to HQ, TRSCD (IC/CoE workloads only)

HQ must be advised in the following situations:

- requests which may indicate a systemic[1] problem or issue
- requests where the amount of relief granted exceeds $500,000
- when a new review is required after a judicial review decision and/or when a judicial review application has been withdrawn on condition that a new review be conducted
- requests that are very sensitive in nature, such as cases where a community may be impacted

After having consulted a team leader or a manager, send an email to AB-DGA_HQ-AC Taxpayer Relief, General Enquiries/Allégements pour les contribuables, Demandes de renseignements généraux. In the subject of the email, indicated "Notification to HQ". Please also provide the taxpayer relief registry entry number.

[1] A systemic problem/issue has national or regional impact; affects a segment of the taxpayer population; or has the potential for substantial implications for Canada's self-assessment tax system, or the CRA's strategy or voluntary compliance.

3.6.5 Mandatory notifications to HQ, TRSCD (Agency-wide)

HQ must be advised in the following situation for reporting purposes.

- requests where the amount of relief granted exceeds $500,000

After having consulted a team leader or a manager, send an email to AB-DGA_HQ-AC Taxpayer Relief, General Enquiries/Allégements pour les contribuables, Demandes de renseignements généraux. In the subject of the email, indicated "Notification to HQ". Please also provide the taxpayer relief registry entry number.

Digitized by Google

- **4. Reporting**
    - 4.1 Financial reporting
    - 4.2 Internal order numbers and activity types for ICs and CoEs

4. Reporting

This chapter provides information on financial reporting in the Public Accounts and on internal order numbers and activity types used by intake centres and centres of expertise's staff. For other field office staff, refer to your Headquarters functions instructions.

4.1 Financial reporting

Section 24.2 of the *Financial Administration Act* requires that forgiveness of a debt or obligation under the Acts the CRA administers is to be reported in the Public Accounts. This legal requirement applies to penalties and interest cancelled and waived under the taxpayer relief legislation. The public can access the Public Accounts of Canada through the Public Works and Government Services Canada Web site.

The ReportNet/Cognos 8 tool produces workload summary reports including inventory reports, intake reports and production reports based on information taken from the taxpayer relief registry. Financial reports are also available with statistics taken from the financial systems that are used to process the taxpayer relief transactions and the automated waivers. Some of the amounts for waivers of penalties and interest will continue to be provided based on estimates provided by the functions.

Each Headquarters function is responsible for gathering, verifying, validating and approving amounts to be reported in the Public Accounts. The Taxpayer Relief and Service Complaints Directorate (TRSCD) is responsible for consolidating this information. The Finance and Administration Branch later incorporates the information provided by TRSCD into the overall CRA financial report that is forwarded to the Public Accounts.

4.2 Internal order numbers and activity types for ICs and CoEs

Internal order numbers

Number 71625
This number is to be used only for taxpayer relief requests received prior to April 1, 2011, and only for the Ontario backlog. To be used with activity codes 755, 772 and 776.

Number 716263
This number is to be used for ATIP and ministerial mail requests. To be used with activity codes 755, 772 and 776.

Number 716264
This number is to be used for judicial review requests. To be used with activity codes 755, 772 and 776.

Number 717498
This number is to be used for financial hardship requests. To be used with activity code 776.

Number 717499
This number is to be used for taxpayer relief requests. To be used with activity code 776

Number 717549
This number is to be used for taxpayer relief requests related to payroll service providers. To be used with activity code 776.

Digitized by Google

Activity types

755 – Taxpayer Relief Activities – Intake Centre

SSA Manager: Taxpayer Relief (SSA 35110)

Valid for: TSOs, TCs and Headquarters only

Time
Record the time spent screening and registering requests for the waiver or cancellation of penalty and/or interest.

Production
For Taxpayer Relief Intake Officers: record a unit of production for each completed request. (A request is a relief file, which may have multiple periods or tax years.)

---

772 – Taxpayer Relief Activities – Resource Duties

SSA Manager: Taxpayer Relief (SSA 35110)

Valid for: TSOs, TCs and Headquarters only

Time
Record the time spent on providing on-the-job coaching and in completing quality reviews to identify training needs.

Production
Do not record a unit of production for this activity.

---

776 – Taxpayer Relief Activities – Centre of Expertise

SSA Manager: Taxpayer Relief (SSA 35110)

Valid for: TSOs, TCs and Headquarters only.

Time
Record the time spent reviewing and analyzing requests for the waiver or cancellation of penalty and/or interest.

Production
For Taxpayer Relief Centre of Expertise: record a unit of production for each completed request. (A request is a relief file, which may have multiple periods or tax years.)

Digitized by Google

[redacted]

- **6. Intake and Screening**
  - 5.1 Taxpayer relief correspondence
    - 5.1.1 The screening process
    - 5.1.2 First in first out (FIFO)
  - 5.2 Receiving the correspondence
    - 5.2.1. Date stamp
    - 5.2.2 Receiving faxed correspondence
  - 5.3 Sort 1: all correspondence
    - 5.3.1 Misdirected mail - Flow A
      - 5.3.1.1 Accounting issues
      - 5.3.1.2 Waiver of tax payable (excess contributions)
        - 5.3.1.2.1 Tax-Free Savings Account (TFSA)
      - 5.3.1.3 Type 4 Housing rebates – Owner built
      - 5.3.1.4 Notice of objection
        - 5.3.1.4.1 Gross negligence penalties
        - 5.3.1.4.2 Due diligence
        - 5.3.1.4.3 Due diligence - Late Filing Penalties under the ETA
        - 5.3.1.4.4 Return filed on time/payment made on time
      - 5.3.1.5 Requests to extend the period for filing an application for the Canada Child Tax Benefit (CCTB)
      - 5.3.1.6 Other requests that are not taxpayer relief requests
      - 5.3.1.7 Penalty and/or interest not applicable and/or not assessed
        - 5.3.1.7.1 Goods and Services Tax Credit (GSTC) or Canada Child Tax Benefit (CCTB) overpayments
      - 5.3.1.8 Remission - Relief of tax
    - 5.3.2 Forwarding misdirected correspondence
    - 5.3.3 Accounting issues received with a taxpayer relief request
  - 5.4 Flow B: all taxpayer relief requests
    - 5.4.1 Area of responsibility
      - 5.4.1.1 CoEs, TRSCD, Appeals Branch
      - 5.4.1.2 Taxpayer relief requests handled outside a CoE
  - 5.5 Sort 2: begin screening sheet
    - 5.5.1 Verifying authorization
      - 5.5.1.1 No authorization
    - 5.5.2 Acknowledgement letters
      - 5.5.2.1 Acknowledgement letters: requests handled outside a CoE
      - 5.5.2.2 Acknowledgement letters: requests that are CoE responsibility
    - 5.5.3 Flow C: redirected mail
      - 5.5.3.1 Appeals/notice of objection
    - 5.5.4 Groups: bulk/projects/other
  - 5.6 Sort 3: additional documentation or a new request?
    - 5.6.1. Flow F: supporting documentation for an existing/open taxpayer relief request
    - 5.6.2 Delayed receipt of supporting documentation
  - 5.7 Flow D: taxpayer relief requests that are CoE responsibility
    - 5.7.1 Taxpayer Relief Registry
      - 5.7.1.1 Existing registry entry
      - 5.7.1.2 Second or subsequent review request
      - 5.7.1.3 Open registry entry exists
    - 5.7.2 Validating the taxpayer relief request
      - 5.7.2.1 Beyond legislated time limitation
      - 5.7.2.2 Requests for which there are no legislative provisions
      - 5.7.2.3. Third or subsequent review request
      - 5.7.2.4 Deceased taxpayer
  - 5.8 Flow H: determining completeness
    - 5.8.1 Incomplete request
    - 5.8.2 Incomplete request – information available internally
    - 5.8.3 Types of information or documentation that may be required
  - 5.9 Determining complexity

Digitized by Google

- 5.10 Work-ready taxpayer relief requests
  - 5.10.1 Original documentation
- 5.11 File transfer guidelines

5. Intake and Screening

This chapter of the manual is structured to follow the flow of a piece of correspondence from the time it comes into a taxpayer relief intake centre (IC), to the time the screening process is completed. While the majority of requests will be received at an IC, the information provided is also useful when requests are received by another section of the Agency. See Contact List for IC locations and contact information and 3.1 Local and regional level roles and responsibilities for more information.

5.1 Taxpayer relief correspondence

There are three types of taxpayer relief requests:

1. cancelling or waiving penalties and/or interest;
2. refunds or reduction in amounts payable beyond the normal three-year period (individuals and testamentary trusts only);
3. accepting late, amended, or revoked elections (income tax)

See Chapter 2, Legislation for details of the legislation referred to as the taxpayer relief provisions.

A taxpayer relief request should clearly indicate:

- the type of request;
- the years/periods involved;
- detailed reasons for the request.

Taxpayers may use form RC4288, Request for Taxpayer Relief. Although use of this form should be promoted, it is not mandatory. This form is available from the CRA Web site at www.cra-arc.gc.ca/formspubs/menu-e.html or by telephone at 1-800-959-2221.

A taxpayer is not required to use the word "taxpayer relief" or "relief". If the intent is clear, treat the correspondence as a request for relief. See 6.3.2. Unclear/ambiguous request for more information.

5.1.1 The screening process

When correspondence is received at an IC, the screener will determine if it is a new taxpayer relief request, a document to be matched with an existing request, or correspondence not intended for the Taxpayer Relief Program.

See Process Map of Intake and Screening for an overview of screening steps followed at an IC.

There are three main screening sorts with related tasks:

Sort 1 all correspondence

- receive and date stamp all correspondence;
- identify and separate misdirected mail (Flow A) from taxpayer relief requests (Flow B);
- forward misdirected mail.

Note: Do not create a registry entry and do not send an acknowledgement letter for misdirected mail.

Digitized by Google

Sort 2: taxpayer relief requests: partial screening for requests processed outside a CoE (redirected mail)

- identify and separate relief requests that are processed outside a CoE (Flow C) from relief requests which are CoE responsibility (Flow D);
- create a registry entry within 4 business days from receipt;
- acknowledge and forward taxpayer relief requests handled outside a CoE.

Note: Do not determine validity, determine completeness, or complexity for redirected requests. These tasks are the responsibility of the section that will conduct the review.

Sort 3: taxpayer relief requests: full screening for requests that are CoE responsibility

- validate and if applicable, send an invalid letter;
- create a registry entry within 4 business days from receipt;
- acknowledge, and request additional information, if required.
- assign complexity;
- scan the work-ready file: for files that are about 50 pages and over, put a note at the top of the screening sheet to indicate that (50+ pages request) and that the hard copy is being sent. Scan the screening sheet;
- transfer the registry entry to the CoE.

The screening process will result in five (5) main categories of mail:

- misdirected mail;
- redirected relief requests;
- supporting documentation to support an existing/open relief request;
- invalid relief requests;
- work-ready relief requests.

5.1.2 First in first out (FIFO)

Generally, correspondence is to be processed on a FIFO basis. However, prioritizing certain requests is appropriate. See Appendix 5B Expediting a request for additional information

5.2 Receiving the correspondence

Correspondence received at an IC may have been referred directly by the mailroom, or redirected from another section within the Agency.

Note: If you are *not* located at an IC or a CoE and you receive a taxpayer relief request that is the sole responsibility of your section (i.e. a request for a refund or reduction in amounts payable beyond the normal three-year period received at a tax centre) keep the request. Create a registry entry, determine the validity of the request and proceed with the review, recommendation and decision as usual.

5.2.1 Date stamp

The CRA mailroom will date stamp incoming correspondence and other documents with the CRA 'Received' stamp. Incoming mail is processed daily.

Date stamp all correspondence received at the IC whether it is received directly from the mailroom or redirected from another section within the Agency. There is no need to keep the envelopes.

Note: When creating the registry entry use the earliest date for "Date received in CRA". The "Date received in section" is to be completed by the section reviewing the request. See Part 3.1.1 of the Taxpayer Relief Registry Guide for more information.

Digitized by Google

5.2.2 Receiving faxed correspondence

Faxed correspondence is date stamped by the FAX machine with the time and date of receipt. This correspondence is treated in the same fashion as mailed correspondence.

5.3 Sort 1: all correspondence

Where easily identifiable, sort and separate correspondence that has been misdirected (Flow A) from correspondence that is a taxpayer relief request (Flow B).

At this stage, it may also be efficient to separate mail that is intended to support an existing/open relief request (Flow F). See 5.6 Sort 3: Additional documentation or a new request?

5.3.1 Misdirected mail - Flow A

The mailroom conducts a basic, cursory review of mail received by CRA. A correspondence may be identified as a taxpayer relief request because a taxpayer has used a word(s) such as "fairness", "relief", "penalty" or "interest".

Misdirected mail is correspondence that was received at an IC, but is not a taxpayer relief request.

Taxpayer relief workload is for correctly charged penalties and/or interest. If the penalty/interest was charged in error it should not be reviewed under the Taxpayer Relief Provisions, these requests should be sent to the applicable TC.

Sometimes it may be clear, without further research, that mail received in an IC belongs to another section of the Agency. Examples include a Form T2201, Disability Tax Credit Certificate, a request for relief of a bank-charge back or an adjustment request received within the normal three-year period.

Read and examine the correspondence, and if necessary, review system information to determine if the request is a taxpayer relief request. Refer to Appendix 5C System Information for common screens.

If, after reading the correspondence, and verifying system information, doubt about the taxpayer's intent remains, contact the taxpayer or authorized representative for clarification. See 6.3.2 Unclear/ambiguous request.

5.3.1.1 to 5.3.1.6 provide situations where correspondence is not a taxpayer relief request. This list is not exhaustive. If the situation is unclear, contact the taxpayer to clarify

5.3.1.1 Accounting issues

Sometimes a taxpayer writes to enquire about a lost cheque or other accounting issue such as:

- an amount of tax that was withheld at source,
- instalment payments are not credited to the appropriate taxation year;
- a payment that was made but not applied to an account;
- whether a statement of account reflects a proper debit or credit; and
- payments were not applied to the intended period, or taxation year, etc.

When a taxpayer describes one or more accounting problems or issues, forward the mail to the correspondence section (Individual Benefits Services Division and/or Business Returns) of the tax centre (TC) of record for action. If the enquiry was made using a RC4288, you don't have to send a letter to the taxpayer advising that the correspondence has been forwarded.

When a taxpayer describes an accounting problem *and* also requests relief of the penalty and/or interest, refer to 5.3.3 Accounting issues received with a taxpayer relief request (CoE responsibility only).

Digitized by Google

5.3.1.2 Waiver of tax payable (excess contributions)

Under Part X.1 of the ITA, a taxpayer may be liable for a 1% monthly tax based on over contributions to an RRSP (T1-OVP). The additional tax payable is designed to discourage taxpayers from making excess contributions in a year. The CRA has the authority to legislatively waive this tax pursuant to subsection 204.1(4) of the ITA.

Similar provisions exist for over contributions made to Registered Education Savings Plans (RESP) (Part X.5 and 204.91(2), Registered Disability Savings Plans (Part XI and 208.4) and additional taxes in respect to Tax-Free Savings Accounts (TFSA) (Part XI.1 and 207.06(1) and (2).

Providing relief of these additional taxes involves Ministerial discretion, however, the subsections are standalone provisions which are separate and apart from the taxpayer relief provisions. For details, see Chapter 2 Legislation.

Other than Tax-Free Savings Account (TFSA), (see below) these types of requests are handled in an Assessing Unit at a TC. However, if the taxpayer is specifically objecting to the assessment of the tax, consult with the Appeals Intake Centre servicing the taxpayer's region to determine the course of action. See 5.3.1.4 Notice of objection for more information.

Note: Generally, when relief of the 1% tax is granted the related penalty and interest are reversed. However, if relief of the 1% tax is denied or partially approved, a review under the taxpayer relief provisions may be required. This may occur when a taxpayer also requests relief based on circumstances including death/illness, financial hardship or inability to pay. The review for relief of the 1% tax (sometimes referred to as "administrative relief") should always be conducted prior to a review under the taxpayer relief provisions

5.3.1.2.1 Tax-Free Savings Account (TFSA)

A TFSA Processing Unit (TPU) has been established in Ottawa and is responsible for performing assessments and reassessments of TFSA tax returns, certain compliance related activities as well as administrative and taxpayer relief reviews

Forward all correspondence involving TFSA to:

TFSA Processing Unit
CR 1280, work section 746
PO Box 9768 Stn T
Ottawa ON K1G 3X9

5.3.1.3 Type 4 Housing rebates – Owner built

Forward all requests to extend a filing deadline for a New Housing Rebate to the Summerside Tax Centre, attention Detailed Enquiries and Complex Assessing (DECA).

5.3.1.4 Notice of objection

It is important to distinguish a taxpayer relief request from an objection because the taxpayer's subsequent recourse for a taxpayer relief decision differs from that of an objection.

Taxpayer relief request: Relief sought from correctly charged penalties and/or interest.

Notice of objection: Dispute the correctness of the assessment of penalties and/or interest.

Subsequent recourse

Taxpayer relief request: The taxpayer may request a second administrative review of the decision and if not satisfied may apply for a judicial review to the Federal Court. If the judicial review application is allowed, the Federal Court will not alter CRA's decision, but CRA is directed to conduct a fresh review. See Chapter 11 Judicial Review for more information.

Notice of objection: The taxpayer may appeal to the Tax Court and beyond.

It is not always easy to distinguish between a taxpayer relief request and an objection - judgment is required. When uncertainty remains, contact the taxpayer or consult a senior officer or team leader.

Digitized by Google

Note: A taxpayer or representative may also submit *both* a request for relief and a notice of objection. See 5.5.3.1 When there is a related notice of objection for information.

The following situations may result in a taxpayer relief request being treated as a notice of objection. See also the Tax & Charities Appeals Directorate (TCAD) Appeals Manual for more information.

5.3.1.4.1 Gross negligence penalties

A request to cancel a gross negligence penalty can be considered under subsection 220(3.1) of the ITA.

However, since these penalties indicate a degree of negligence and absence of care and diligence on the part of the taxpayer, the cancellation of a gross negligence penalty may be appropriate only in exceptional circumstances.

Taxpayers have the right to object to penalties assessed under the provisions of subsection 163(2) of the ITA and Section 285 of the ETA. Given the nature of a gross negligence penalty, it is more appropriate for a taxpayer to dispute the assessment of the penalty by filing a notice of objection. If a taxpayer requests relief of these penalties communicate with the Appeals Intake Centre and determine if the correspondence is actually a valid notice of objection.

Eastern Appeals IC (Sudbury)
E-mail: nor-sud.appeals@cra-arc.gc.ca
Long distance: 1-866-242-3161 (E), 1-866-276-0969 (F)
Local: 705-671-0238 (E), 705-677-7764 (F)

Western Appeals IC (Burnaby-Fraser)
E-mail: rc.pac-bfiao@cra-arc.gc.ca
Long distance: 1 800-959-5513 (B)
Local: 604-585-5180 (B)

If the taxpayer is requesting relief due to extraordinary circumstances or financial hardship, or if the time frame for filing an objection has expired, the request will be treated as a relief request.

Note: There are no legislative provisions to allow a taxpayer to request relief for penalties assessed under Section 285 of the ETA. See 5.7.2 Validating the taxpayer relief request for additional instructions for these types of requests.

5.3.1.4.2 Due diligence

A taxpayer may claim that he/she exercised the degree of care that a reasonably prudent person would have exercised in comparable circumstances. If a taxpayer presents a "due diligence" argument, the appropriate recourse mechanism is to file a notice of objection. If the taxpayer raises a due diligence defense, consult with a senior officer, team leader and/or Appeals Intake Centre to determine how to treat the correspondence.

5.3.1.4.3 Due diligence - Late Filing Penalties under the ETA

In situations where the CRA determines that a person has exercised due diligence, the penalty is not eligible and where it has already been charged it will be cancelled. The due diligence defense may apply to the 6% penalties (eliminated effective April 1, 2007) and to late filing penalties under 280.1 but it does not result in cancellation of interest payable under section 280. For additional information, refer to GST/HST Policy Statement P-237 The Acceptance of a Due Diligence Defense.

5.3.1.4.4 Return filed on time/payment made on time

A taxpayer may write stating that a return was filed on time or a payment was made on time.

Generally, if the taxpayer states he/she was not late, the request may be treated as a notice of objection because the taxpayer is in effect saying the penalty and/or interest was levied in error. If the correspondence is received on an RC4288 and/or the taxpayer is specifically requesting relief of penalty and/or interest see 5.3.3 Accounting issues received with a taxpayer relief request (CoE responsibility only). If the taxpayer is not objecting to the assessment and the primary question is whether a return or payment was given the correct received date, forward the correspondence to the applicable section at the TC (Individual Benefits Services Division and/or Business Returns) for verification. See the Taxpayer Relief Correspondence Binder (*under construction*) for a sample letter.

* The TC may have identified situations that warrant an adjustment on a proactive basis and/or as an individual taxpayer self-identifies. Examples include incidents of misplaced mail in a certain geographical area; unidentified returns destroyed in a flood; mechanical failure within CRA, etc.

Digitized by Google

Remember: If a taxpayer is stating that the return was filed on time and the penalty and/or interest was assessed incorrectly, the correspondence may also constitute a notice of objection. If there is doubt, contact the taxpayer or consult a senior officer or team leader.

5.3.1.5 Requests to extend the period for filing an application for the Canada Child Tax Benefit (CCTB)

The ITA limits CCTB eligibility to a maximum of 11 months prior to the filing of an application. However, subsection 122.62(2) gives the Minister the discretion to extend the period for filing an application beyond the normal 11-month period. Refer these requests to the Eligibility Section of the Benefit Programs in the appropriate tax centre.

5.3.1.6 Other requests that are not taxpayer relief requests

A request is not a taxpayer relief request when a taxpayer seeks to:

- receive an explanation of the penalties and/or interest charged;
- reimburse costs (such as phone charges, postage costs);
- cancel Canada Revenue Agency (CRA) administrative charges such as a bank charge back fees.

5.3.1.7 Penalty and/or interest not applicable and/or not assessed

A taxpayer may write requesting relief upon filing a tax return or with an adjustment request. When the relief request is received at the IC:

- If the return and/or the adjustment have not yet been processed, write to the taxpayer to inform him/her to submit a request when he/she will have received the notice of assessment/reassessment showing the charge of penalty and/or interest. Return the correspondence to the taxpayer. See Taxpayer Relief Correspondence Binder *(under construction)*

- If the return and/or the adjustment have been processed and no penalty nor interest have been charged, write to the taxpayer and attach the correspondence. See Taxpayer Relief Correspondence Binder *(under construction)*.

Note: If the taxpayer is requesting relief based on a voluntary disclosure, refer to Appendix 5A.

5.3.1.7.1 Goods and Services Tax Credit (GSTC) or Canada Child Tax Benefit (CCTB) overpayments

Interest is not applicable on GSTC and CCTB overpayments.

If a taxpayer submits a request for relief concerning these overpayments, write to the taxpayer to inform him/her that interest does not apply and to call the toll-free number 1-800-465-6933 for account resolution. Forward the request to the Thunder Bay TSO, responsible to collect these overpayments, at the following address:

Thunder Bay TSO
130, South Syndicate Avenue
Thunder Bay On P7E 1C7.

5.3.1.8 Remission - Relief of tax

The taxpayer relief provisions provide for relief of penalties and/or interest but not for the relief of tax. On occasion, a taxpayer or representative may write requesting relief and/or remission of tax. When the balance on the account includes penalties and/or interest, proceed with the screening as usual. If the taxpayer is specifically requesting remission, see 6.12 Remission - Relief of tax (for information only).

5.3.2 Forwarding misdirected correspondence

If the correspondence has been misdirected, attach a routing slip indicating the area of responsibility and forward accordingly. Do not create a registry entry.

0000027

Digitized by Google

5.3.3 Accounting issues received with a taxpayer relief request (CoE responsibility only)

When a taxpayer states that a delay was not his/her fault and provides reasons for late-filing/late payment, generally, the request will be treated as a taxpayer relief request because he/she admits being late but would like relief of the penalty and/or interest due to the extenuating circumstances.

If the correspondence deals with *both* an accounting issue and a taxpayer relief request, the accounting question should be resolved prior to a review of the relief request. In these situations:

- create a registry entry within 4 business days from receipt;
- send an acknowledgement letter (requesting additional information where applicable);
- attach a round trip memo and referring a copy of the correspondence to the appropriate area at the TC (Individual Benefits Services Division and/or Business Returns).

If after the TC examination is completed:

Penalty and/or interest are fully reversed

- delete the registry entry,
- add an ACSES diary note with details of TC actions, stating a review will not be required if the request was for financial hardship, otherwise put a note in the ELCS Notepad.

OR

Penalty and/or interest remain

- ensure details of the TC actions are documented in the file;
- screen the request as usual.

5.4 Flow B: all taxpayer relief requests

As mentioned in the Introduction, the taxpayer relief workload gained program status effective April 1, 2011. At that time, four centres of expertise (CoE) were established to review the majority of requests for penalty and/or interest relief. However, other sections of the Agency retain responsibility for conducting reviews for other specific taxpayer relief workloads.

Note: The CoE processes relief requests received at its IC, even if requests are not from provinces under the IC's responsibility.

5.4.1 Area of responsibility

Taxpayer relief requests are handled by different sections of the Agency. Certain types of requests are more common than others. Some specialized workloads receive very few requests for relief. The majority of situations are listed below. If you encounter an unusual request, not listed below, consult a senior officer or team leader. See 3.6 Referral process for more information.

5.4.1.1 CoEs, TRSCD, Appeals Branch

Employees at CoEs are responsible for handling:

- taxpayer-initiated requests for penalty and/or interest relief;

including

- all situations requiring a joint review with another section of the Agency. See 5.7.1 Joint reviews for more information.

excluding

- refer to the table in Appendix 5A.

Digitized by Google

5.4.1.2 Taxpayer relief requests handled outside a CoE

In order to know where to forward relief requests handled outside a CoE, refer to Appendix 5A.

When a taxpayer has received a proactive decision and subsequently writes to request additional relief, redirect the correspondence to the office that provided the proactive relief. If the taxpayer requests relief based on a reason that was not previously considered, the subsequent request may require a joint review. In both cases, the taxpayer's request is considered a first request for relief. See also 7.4.1 Proactive taxpayer relief and 8.7.1 Joint reviews.

5.5 Sort 2: begin screening sheet

A screening sheet has been developed to capture particular details of all taxpayer relief requests.

The amount of information recorded depends on whether the request will be processed outside a CoE or at a CoE.

Using the screening sheet will provide efficiencies when performing repetitive tasks such as creating registry entries, generating acknowledgement letters and creating scanned folders.

For requests with more than one period/year, verify that one of them is a valid relief request during screening, for each revenue type. The IC does not have to identify the invalid periods/years on the screening sheet, nor in the acknowledgement letter. The CoE will determine which periods/years are valid or not, modify the registry entry, if applicable, and advise the taxpayer in the decision letter.

See Appendix 5G, Screening Sheet.

5.5.1 Verifying authorization

IC staff will also verify authorization and send an acknowledgement letter for all taxpayer relief requests. Consent form; level 1 authorization allows only for the disclosure of information, while level 2 allows for both the disclosure of information and changes to a taxpayer's account. Therefore, for taxpayer relief requests, level 2 authorization is required.

Note: If the request involves more than one revenue type, you must verify the authorization for each account.

Read the correspondence to determine who has made the request.

- For a T1 account, if the taxpayer relief request is signed by a representative but not by the taxpayer, check the mainframe system. Refer to Appendix 5C to determine whether the representative is authorized to act on the taxpayer's behalf.
- For any other type of account, verify if the person that signed the relief request is an "authorized person". An authorized person, as indicated on the RC59 Business Consent form is: the owner, the partner of a partnership, a director of a corporation, an officer of a non-profit organization, or a trustee of an estate. If the request is signed by a "representative", refer to Appendix 5C to determine whether the representative is authorized to act on the behalf of the authorized person. A request from a contact, showing on RCON (Retrieve Contact (BN)), is acceptable.
- When a new consent form or letter of authority is received with the correspondence, keep a copy with the correspondence and forward the original to the applicable TC for input. (T1013 to the attention of T1 Specialty Services and RC59 to attention of Business Number Services)

Note: A taxpayer or an authorized person may provide consent using a T1013 (T1, T3) or an RC59 (Business Numbers) or a letter of authorization; however, a letter of authorization must include the same information that is provided when a T1013 or an RC59 is used. If the letter of authorization does not include all the required information, contact the taxpayer or an authorized person directly for the missing information and do not send it to the TC. See 5.5.1.1 No authorization below.

When the request is submitted by an authorized representative, send an acknowledgement letter to the representative and a copy to the taxpayer (for a T1 account). For a business, send a copy to the taxpayer/business if the authorized person is a third party (someone not within the business, for example an accountant or a lawyer).

000029

Digitized by Google

All authorizations on a taxpayer's file become null and void at the moment of death. When a date of death is updated, all representatives are deleted from the system in the overnight sweep. In order to be valid, an authorization has to be entered on the account after the date of death or should have "Executor", "Administrator" or other such title after their name on RAPID option M.1. For more information, see TOM 3968 for T1/T3 accounts.

For sole proprietors, all authorizations on a taxpayer's file become null and void at the moment of death. In order to be valid, an authorization has to be entered on the account after the date of death or should have "Executor", "Administrator" or other such title after their name on RAR (BN System). For more information, see the Reference Guide for Business Enquiries Agents for business accounts.

See also 6.12 Consent forms – Authorizing or cancelling a representative. For more information on confidentiality requirements, see Confidentiality for Taxpayer Services - Individual Programs for T1/T3 in TOM 3960, and, Consent Forms and Letters of Authorization for business accounts.

5.5.1.1 No authorization

If the representative is unauthorized, attempt to make contact by telephone:

- if you reach the representative, and authorization is not readily available, inform the representative that the request will be returned and may be resubmitted when authorized; or
- if you leave a message for the representative, the message should advise you require a return call within 2 business days, or the request will be returned and may be resubmitted when authorized.

See the Taxpayer Relief Correspondence Binder (*under construction*) for a sample letter when returning correspondence to an unauthorized representative.

5.5.2 Acknowledgement letters

All taxpayer relief requests must be acknowledged, including requests that are the responsibility of an area outside a CoE. However, the content of an acknowledgement letter will differ for a request that is redirected to another section of the Agency (partial screening) versus a request that is the responsibility of a CoE (full screening).

See the Taxpayer Relief Correspondence Binder (*under construction*) for acknowledgement letter templates.

5.5.2.1 Acknowledgement letters: requests handled outside a CoE

The acknowledgement letter will advise that CRA:

- has received the taxpayer's request for relief under the taxpayer relief provisions;
- the request has been forwarded to the applicable section of the Agency; and
- provide the 1-800 number for the applicable revenue type.

Note: In ELCS, under topic DF, use verse 85651.

5.5.2.2 Acknowledgement letters: requests that are CoE responsibility

For requests that are processed at a CoE, the acknowledgement letter will advise that CRA:

- has received the taxpayer's request for relief under the taxpayer relief provisions;
- charges daily compound interest on any outstanding balance;

And, if applicable:

- describe and request additional information required for the review;
- provide a contact name and phone number within the IC
- if an original document (e.g. death certificate, notice of (re)assessment) is included with an enquiry, it should be returned to the taxpayer. Discard funeral director's statement of death and copies of death certificates in classified waste. Scan or photocopy the document prior to returning it.

Digitized by Google

For requests with more than one period/year, verify that one of them is a valid relief request during screening, for each revenue type. The IC does not have to identify the invalid periods/years on the screening sheet, nor in the acknowledgement letter. The CoE will determine which periods/years are valid or not, modify the registry entry, if applicable, and advise the taxpayer in the decision letter.

And, for requests based on financial hardship and/or inability to pay when there is a balance;

Go to page 1 of ACSES and key an "x" beside ACSES info. You will be taken to the next page. Place an X over the ? under User to find the name of the collections officer, if applicable

- When the account is assigned, include the contact information and toll-free number in the acknowledgement letter;

OR

- If the account is unassigned, provide the 1-800-675-6183 toll-free number;

OR

- If the account balance is $2500.00 or less, provide the 1-800-959-2018 toll-free number.

5.5.3 Flow C: redirected mail

Generally, after verifying authorization and sending the acknowledgement letter, the next step is to create a registry entry within 4 business days from receipt. An entry is created for requests for the acceptance of late, amended or revoked elections only if the taxpayer has requested the cancellation or waiver of penalties and interest.

IC staff does not determine validity or send invalid letters for requests that are processed outside a CoE. Refer the request directly to the responsible section.

Note: Indicate in Section IV – Info/Delays/Transfer of the fact sheet where the request is being sent and the type of request. Ex.: Audit - Request sent to Ass. director of Compliance, Toronto-North TSO.

See 5.7.1 Taxpayer Relief Registry and 5.7.2 Validating the taxpayer relief request for more information.

5.5.3.1 Appeals/notice of objection

If the request relates to an assessment that is under objection or if the request is received with a notice of objection, follow the next steps:

- select CSAPP, Case Appeals, on SLP;
- enter the account number in the applicable section of the Search screen;
- check to see if there is an existing Case Appeals record.

If the SRCH does not provide a result, it is a new objection:

- verify the authorization;
- create a registry entry within 4 business days from receipt;
- set the entry as non-workable with code 01 Awaiting the outcome of an objection/court.
- send an acknowledgement letter;
- forward both the request and the notice of objection to the applicable appeals intake centre.
- put the registry entry number on the correspondence.

For taxpayers with a postal code starting with A to P and non-residents forward the correspondence to:

Eastern Intake Centre
Sudbury TSO/TC
1050 Notre-Dame Avenue
Sudbury ON P3A 5C1

Digitized by Google

For taxpayers with a postal code starting with R to Y forward the correspondence to the:

Western Intake Centre
Burnaby-Fraser TSO
9737 King George Highway
P.O. Box 9070, Station Main
Surrey BC V3T 5W6

If there is an existing Case Appeals record:

- and the activity code on the "Case Information" screen is 333 or 338, this is a CPP/EI objection. For CPP/EI, the status will always show "assigned" even if it's finalized. Press F11 to access the "Options Menu" screen, then choose option 1 VSUM. If the case has been finalized you will see the activity "AM/ES Record Decision".

If the Case Appeals record is open:

- verify the authorization;
- create a registry entry within 4 business days from receipt,
- set the entry as non-workable with code 01 Awaiting the outcome of an objection/court;
- send an acknowledgement letter;
- determine where the notice of objection has been assigned,
- record the Case Appeals Globus number and registry entry number on the correspondence;
- forward the correspondence to the applicable Appeals office.

Note: Appeals is responsible to answer the requests for which there is an open record. If the request relates to several years/periods and there is a notice of objection for one or some of the years/periods involved, the Appeals will review this or these specific years/periods. The other years/periods can be reviewed by the CoE. It's the same if the request relates to more than one revenue type. Appeals will review the request concerning the revenue type for which the record is open. In doubt, consult Appeals.

If the Case Appeals record is closed:

If the request relates to a tax year or period that was under objection, read the taxpayer's correspondence and determine if the taxpayer alleges delays at the objection or appeal stage. If so, the Appeals are responsible to review these requests even if the record is closed. Refer to the above steps. In some circumstances a joint review could be required. See 5.7.1 Joint reviews.

When there is a closed Case Appeals record and the taxpayer is not alleging delays at the objection or appeal stage, screen the request as usual.

See the Appeals Manual of the Tax & Charities Appeals Directorate (TCAD) for more information.

Note: The acknowledgement letter will differ depending on whether the notice of objection is open or closed. Refer to the Taxpayer Relief Correspondence Binder (*under construction*).

5.5.4 Groups: bulk/projects/other

Under Construction

See Appendix 5E, File Transfer Guidelines.

Digitized by Google

5.6 Sort 3: additional documentation or a new request?

Sometimes it may be clear that the correspondence is intended to support an existing/open taxpayer relief request. For example, documents such as banking statements may be addressed to the IC, received by fax at the IC or submitted with a copy of the IC's request for additional information.

5.6.1 Flow F: supporting documentation for an existing/open taxpayer relief request

- separate the correspondence;
- add a note to the ACSES diary for documents intended to support financial hardship;
- remove the non-workable status from the registry entry; and
- scan and/or add the documents to the file

5.6.2 Delayed receipt of supporting documentation

Occasionally, supporting or additional documentation will be received after the request has been redirected to another section of the Agency or the work-ready file has been transferred to a CoE

In either case:

1. add a note to the ACSES diary for documents intended to support financial hardship

   and

2. refer the documentation to the appropriate area by either:

   a. locating a contact and forwarding the correspondence

      OR

   b. scanning the documentation, emailing to the responsible contact or adding to the existing file, if the entry in the registry is still open

      OR

   c. if the entry is closed (might have been closed with the decision denied-incomplete), create a new registry entry with the same level of review as the closed entry, scan the documentation and also indicate the prior registry entry number on the screening sheet

Information available in the registry will also help determine if the request is a duplicate of a previously submitted request or additional information intended to support an existing or closed entry. If uncertainty remains, review details available in the ACSES diary and/or Notepad or BN notes.

Note: Matching additional documentation with an existing open file should be considered a priority because an officer may be in the process of denying a request based on insufficient information

See also Taxpayer Relief Scanning Procedures for more information.

Digitized by Google

5.7 Flow D: taxpayer relief requests that are CoE responsibility

In addition to the basic steps of verifying authorization and acknowledging the request, IC staff will also determine validity, create a registry entry within 4 business days from receipt, determine complexity and request additional information (if applicable), for requests that are the responsibility of a CoE.

Note: If the IC sent a request that is not CoE responsibility (eg. invalid request), the CoE will send the request back to the IC for their action: forward the request to the appropriate area or inform the taxpayer (letter).

5.7.1 Taxpayer Relief Registry

The Taxpayer Relief Registry is a central repository for all taxpayer relief requests. IC staff will create a registry entry, within 4 business days from receipt, for taxpayer relief requests. If the request involved more than one revenue type, a registry entry must be created for each revenue type. In addition, on the create screen, you should indicate the related account numbers and/or the related revenue types. Refer to the Taxpayer Relief Registry Guide and the Taxpayer Relief Scanning Procedures for detailed instructions.

Prior to creating a registry entry, it is important to ensure that the taxpayer's intent is clear. For example, a taxpayer may have been assessed both interest and penalties but appears to be requesting relief of penalties only. If there is doubt, contact the taxpayer for clarification. See also 6.3.2. Unclear/ambiguous requests.

When creating a registry entry, the TRR system will alert you if a request has already been entered for that account number.

Note: See 6.11.2 Keeping an audit trail

5.7.1.1 Existing registry entry

A taxpayer may request relief but not mention a previous request and/or decision for the same taxation year or period. Accessing the registry will help determine if the request is about a first, second or subsequent review request.

Compare the information provided in the correspondence against any existing entry(ies). When in doubt, verify other system information, including ELCS (for prior decisions), ELCS Notepad, ACSES diary entries and/or BN notes to determine the nature of the correspondence you are examining. If doubt remains, contact the person who closed entry for clarification.

5.7.1.2 Second or subsequent review request

A previously closed entry may indicate a taxpayer is making a second or subsequent review request. Read the correspondence and verify available system information.

If you determine it is a second review request and the first review request is not a scanned file, the IC will locate the first review file, contact the office to obtain the hard copy of the file and associate it with the second review request. Both requests should be scanned.

If you determine it is a third or subsequent review request, go to section 5.7.2.3.

See also 6.2 Administrative reviews for more information.

5.7.1.3 Open registry entry exists

If there is an open registry entry relating to the correspondence, it may indicate a review is underway

If the request/entry is assigned:

- contact and advise the officer
  and
- scan and add to the scanned folder or forward the document to include in the file.

Digitized by Google

If the request/entry is unassigned:

- scan and add the document to the scanned folder and/or file

In either case, do not assume that the correspondence is an exact duplicate. The officer who conducts the review will determine if the correspondence contains any new details or information

Note: Page 1 of ACSES diary will contain a flag TAXPAYER RELIEF O/S when a registry entry is open and the flag TAXPAYER RELIEF when a registry entry has been closed. In either case, view and compare details in the registry for this taxpayer against the correspondence you are screening.

5.7.2 Validating the taxpayer relief request

Although a taxpayer may be requesting relief of penalty and/or interest, in some cases, the request may be invalid. There are three main reasons that a request *may* be invalid:

1. The request was received outside the legislated time limitation. See 5.7.2.1
2. There are no provisions (legislation) to permit the Minister to consider the request. See 5.7.2.2
3. The taxpayer is requesting a third or subsequent review of a request for relief. See 5.7.2.3 and also 3.5.3 Requests after second reviews.

A request could also be considered as invalid if you don't have enough details to create the registry entry and you are not able to obtain them.

When you determine that a request is invalid, the request should be sent back to the taxpayer, representative or authorized person, with a letter signed by a delegated authority (team leader level). Note that no retention period is required since the request and the related documents are sent back.

Note: IC staff is not responsible for determining validity of requests that are processed outside a CoE. Refer the request directly to the responsible section of the Agency.

5.7.2.1 Beyond legislated time limitation

A taxpayer relief request will be considered invalid if it is a first review request* (*excluding* a continuation of a proactive or continuation of an incomplete request)for

- cancellation or waiver of interest for a taxation year/reporting period that ended more than 10 years before the calendar year in which the request is made. See the note below;
- cancellation or waiver of penalty** for a taxation year/reporting period that ended more than 10 years before the calendar year in which the request is made;
- refunds or reduction in amounts payable beyond the normal three-year period for a tax year ending outside of the 10 previous calendar years;
- accepting late, amended or revoked elections for a tax year ending outside of the 10 previous calendar years.

* CRA policy provides for two administrative reviews of a request for relief. Currently there are no legislated or policy time limitations on requesting a second review.

**Exception: the late remitting penalty for GST periods ending prior to April 2007 accrued the same way as interest. Therefore requests for these penalties should be considered as valid requests if they pertain to a reporting period that is more than ten years prior to the calendar year in which it was received.

Note: For interest relief requests made on or after June 2, 2011, the Minister has the discretion to cancel interest that accrued during the 10 calendar years preceding the year in which the request for relief is made, regardless of the tax year in which the tax debt arose. For more information, see "Revised 10-year limitation period for interest relief".

Digitized by Google

See Chapter 2 Legislation for more information on determining the effective date of the 10-year limitation period and Chapter 9 Refunds or reduction in amounts payable beyond the normal three-year period and Chapter 10 Accepting late, amended or revoked elections.

Evidence that a request has been received in time:
A review will not be conducted if the taxpayer's request is invalid. Therefore, before advising the taxpayer that the time limitation has expired, it is important to verify available information to ensure that the request is not:

- an initial first review request that was lost and/or missing but originally received on time;
  OR
- a second or subsequent review request.

Check the registry and review mainframe/system information, such as the ACSES diary, SUDS diary, ELCS letters, Notepad etc. to determine if either of the two circumstances above applies. For example, the ACSES diary may contain notes that detail the receipt of an original request, but a registry entry was not created.

Accept the request when there is evidence the request was made on time.

If the request was clearly received outside the legislated timeframe, send an invalid letter using Taxpayer Relief Correspondence Binder (*under construction*).

Note: Exercise judgment when examining the account history. For example, it may be appropriate to accept an application where there is evidence the taxpayer discussed the availability of relief with his/her Collections Officer, but the application was delayed while the parties were negotiating a payment arrangement.

Creating a registry entry
The registry will not allow a date that is beyond the 10 year limitation for first requests. When accepting a request based on evidence it was received on time, use the most recent date possible to create the registry entry.

In Section III of the registry fact sheet, record the following information using sub-section – Other elements of analysis:

- details that support accepting the request
  and
- the date of the correspondence.

If there is doubt as to whether the request was received on time, refer to the senior officer and/or team leader for verification. If discrepancy remains, the IC team leader should consult the CoE team leader who will determine if the request is valid or invalid. Once the CoE makes a determination of validity, proceed accordingly.

5.7.2.2 Requests for which there are no legislative provisions

The taxpayer relief provisions allow taxpayers to apply for relief of penalty and/or interest; request a refund or reduction in amounts payable beyond the normal three-year period (individuals and testamentary trusts only), or accept, amend, or revoke an election. For a request to be valid there must be a legislative provision that allows the request to be made.

See Chapter 2, Legislation for an overview of the relevant sections which do provide for relief.

Gross negligence penalties – GST/HST
The taxpayer relief provisions contained in the *Excise Tax Act* do not extend to penalties assessed under section 285. However, a taxpayer who is requesting relief of penalties assessed under section 285, False statements or omissions, may have a right to redress by filing a notice of objection. See the Taxpayer Relief Correspondence Binder (*under construction*)

Notional assessment - GST/HST
A Notional assessment is not a GST/HST return; it is an assignment of debt. Penalty and interest relief assessed on GST notional assessments cannot be granted, these relief requests are invalid.

Digitized by Google

To identify a notional assessment, access the ACSES Account Information screen, click on the field OVERDUE PERIOD details. "Yes" under the column NOTL ASSMT for the period is an indication that a notional has been raised for that period.

Late, amended or revoked elections not listed in Regulation 600 of the ITA
A taxpayer may request to file, amend or revoke an election that is not listed in Regulation 600 of the ITA. However, IC staff does not determine validity and do not send an invalid letter for these requests. Determining validity is the responsibility of the section that will handle the request.

Requesting a refund beyond the statute-barred period for a corporation and/or partnership
The provisions to allow for a refund beyond the normal three-year period apply to individuals and testamentary trusts only. A request received from a corporation and/or partnership is invalid. See the Taxpayer Relief Correspondence Binder (*under construction*).

Recaptured refund interest
Recaptured refund interest is a reduction in the amount of interest that had previously been paid to the taxpayer. When refund interest is reduced, as per 164(3.1) of the ITA, it becomes an amount payable by the taxpayer, in the same manner that tax is payable. A recaptured refund interest posting on RAPID option N means that the total amount of refund interest previously allowed has been reduced. This overpayment is not interest that can be cancelled under the taxpayer relief provisions. See the Taxpayer Relief Correspondence Binder (*under construction*)

Relief of tax
The taxpayer relief provisions provide for relief of penalty and/or interest, but not for relief of tax.

For requests that relate to over contributions such as a T1OVP or a TFSA, see 5.3.1 Misdirected mail - Flow A.

Occasionally, a taxpayer will specifically request relief of tax or may use the word "remission". If the taxpayer is also requesting relief of penalty and interest, screen the correspondence as usual. See 5.12 Remission - Relief of tax (for information only) for more information.

5.7.2.3 Third or subsequent review request

It is CRA policy that taxpayers are entitled to two administrative reviews within the CRA. Each time a second or subsequent decision is made, the taxpayer is advised, in writing, of the option to request a judicial review.

A third or subsequent review request may be:

- a request for a review of a second decision, either before the taxpayer asks for a judicial review or because they have no intention to bring the matter to Court;
- a request for a judicial review/or a judicial review application that has been misdirected to the IC; or
- a judicial review application that has been heard, allowed by the Federal Court and referred back to CRA for an additional review.

If you determine it is a third or subsequent review request:

- create a registry entry within 4 business days from receipt;
- do not determine validity;
- do not examine the file to determine if additional information is required;
- do not send an acknowledgement letter;
- forward the correspondence on a priority basis.

For requests that are not CoE responsibility: forward the request to the section that issued the last decision.

Digitized by Google

5.7.2.4 Deceased taxpayer

A relief request made by a taxpayer for their individual account, who passed away after the request was received at IC, is considered as:

- an invalid request if IC does not have all the necessary information to create the registry entry and that no authorization was entered to the taxpayer's file after the date of death, or that there is not the mention of "executor" or "administrator" after the name of the representative to M.1 option. Send an invalid letter to "the estate of the late" and provide the reasons for which the request is considered as invalid.

- a valid request if IC has the necessary information to create the registry entry or, if information is missing, it is possible to ask the information because an authorization was entered to the taxpayer's file after the date of death, or the mention of "executor" or "administrator" is after the name of the representative to M.1 option. If the request is complete (valid) and there is no authorization, send the acknowledgement letter to "the estate of the late" and forward the request as usual.

5.8 Flow H: determining completeness

IC employees are responsible for ensuring that information and supporting documentation required to complete a request is on hand when the review is conducted at a CoE. IC staff will determine completeness for requests that are the responsibility of a CoE only. Ask the taxpayer to provide the supporting documentation at the same time that the request is acknowledged. See 5.5.2 Acknowledgement letters for more information.

What is a complete request?

A taxpayer relief request should clearly indicate:

- the type of request;
- the tax years/periods involved; and
- details of reasons for the request.

Both the taxpayer and CRA staff are responsible for making sure that taxpayer relief requests are properly supported. Taxpayers should give details of any extenuating circumstances and the documentation needed to support and establish the validity of their request. Taxpayers also have to reply in a timely manner when we ask them for more information.

5.8.1 Incomplete request

If the information provided is incomplete or inappropriate, the taxpayer should be given the opportunity to provide more information before we conduct our review and make our decision.

More information can be requested either in writing or by telephone; however, the preferred method is in writing at the time the acknowledgement letter is issued. The letter will specify a time frame or a date for response and inform the taxpayer that after that date, the request will be processed on the basis of the available information.

A request is considered to be incomplete when there is an absence of essential information relevant to the decision-making process. Below are some situations of incomplete requests:

- a statement of income and expenses and/or assets and liabilities has not been provided, and/or returns are not filed in the case of a request for interest relief under financial hardship;

- details such as the dates and description of events are not provided in the case of a request for penalty and/or interest relief under extraordinary circumstances.

When additional information is requested, complete the non-workable field with reason 03 in Section IV-Info/Delays/Transfer. Be sure to remove the non-workable code when the documentation is received and/or after the period has expired, the time frame is 45 days, 30 days for the taxpayer and 15 days for the mailing time . See the Taxpayer Relief Registry Guide for more information.

000038

Digitized by Google

Note: You can allow an additional delay if the taxpayer specifies a date or period of time (eg. taxpayer will meet with his doctor in 3 weeks). Do not keep an entry open if the taxpayer cannot give a precise delay to submit the requested information or if you haven't heard from the taxpayer.

5.8.2 Incomplete request – information available internally

A taxpayer is responsible for providing facts and supporting documentation. However, there may be situations where the details described in the request can be readily verified with internal CRA information. See Appendix 5C, System Information for locations.

Common reasons/situations that may be verifiable internally:

- death of a taxpayer, a taxpayer's spouse or child,
- birth of a child;
- information slip was submitted with the return;
- ongoing disability (Disability Tax Credit on file).

5.8.3 Types of information or documentation that may be required

Determining which additional information or supporting documentation is needed requires judgment and tact. Taxpayers may request relief due to any one or a number of reasons and there may also be unique or unusual circumstances. When a relief request involve multiple revenue types it might be necessary to request additional information in two separate letters. See 6.10 Communicating decisions for more information about legal entities.

If after examining the request and/or talking to the taxpayer, doubt remains as to whether to request additional information or supporting documentation, seek the advice of a resource officer or team leader.

Situations where contact by telephone may be more appropriate
If, after reviewing the correspondence and available CRA information, the taxpayer's intent remains unclear, contact the taxpayer or representative for clarification. The nature and reasons for the request are required for the Taxpayer Relief Registry and therefore, in these types of situations, it may best to make contact by telephone, rather than by mail, to ensure the processing of the request is not delayed more than necessary.

Requests based only on financial hardship, inability to pay
The CRA requires current financial information to conduct a thorough review based on financial hardship or inability to pay. However, if the relief request is on a **deceased individual's account (T1 estate or T3)** or if the taxpayer died since the request was received by CRA, the financial information is not required.

When a taxpayer is requesting relief based only on financial hardship or inability to pay:

- check the ACSES diary to determine if the taxpayer has been communicating with a Collections officer;
- check TP1 and TP2 to determine if current income and expense information is available;

When:

- the account is unassigned,

and/or

- financial details do not exist;

and/or

- the financial information available is more than 3 months old.

In the acknowledgement letter, request the following documentation:

- 3 months worth of current banking statements (from all bank accounts/sources)

Digitized by Google

and

- an Income and Expense/Asset and Liability statement (IEAL) for individuals and partnerships*;
- a current financial statement (for corporations).

See Appendix 5F, Income and Expenses/Assets and Liabilities (IEAL) for the attachment, Taxpayer Relief Correspondence Binder (*under construction*) and 5.5.2, Acknowledgement letters for more information.

* If a request is received from a partnership, advise that we require a completed IEAL from each partner applying for relief. See Taxpayer Relief Correspondence Binder (*under construction*).

Note: When a taxpayer raises financial hardship as one reason for relief, and the request requires review by a section of the Agency outside a CoE, refer the request to the other section first. See 6.7.1 Joint reviews for additional information.

5.9 Determining complexity

IC staff will determine if a request is routine or complex for requests that are CoE responsibility. In certain situations, complexity may also be assigned or reassigned at the CoE. See Appendix 5B, Expediting a request.

The information found in this section and in Appendix 5D, Complexity Guidelines are applicable only to penalty and/or interest requests that are handled in a CoE. Requests handled in other sections of the Agency have their own complexity guidelines. For a general overview, see 3.5.1 First reviews.

Consider the following when assigning complexity:

- a routine request is any request that is not complex;
- each request should be handled at the lowest possible level;
- a request should not automatically be coded complex because one or more of the indicators are present. For example, although it may be appropriate to expedite a request due to the timeframes present with Ministerial correspondence, the facts of the relief request may be routine;
- apply the complexity guidelines in conjunction with Appendix 5B, Expediting a request;
- use your judgment – if a situation is unique and might be considered complex, discuss with your resource officer or team leader; and
- once assigned, if a case is found to be either more or less complex than originally thought, complexity should be re-coded to properly reflect the circumstances of the case.

Note: Level of complexity (routine or complex) is recorded manually on the screening sheet and electronically when the scanned file is created using the Taxpayer Relief Scanning System (TRSS). See Taxpayer Relief Scanning Procedures for more information.

5.10 Work-ready taxpayer relief requests

Other than expedited requests, a file is ready to forward to a CoE when the:

- request has been acknowledged;
- registry entry have been created;
- supporting documentation has been requested and either;
    - received and included in the scanned folder or file

      OR

    - the deadline* to submit the supporting documentation has expired.

* The deadline is 45 days, 30 days for the taxpayer and 15 days for the mailing time..

When the file is work-ready, scan the documents and create a scanned file. See Taxpayer Relief Scanning Procedures for instructions.

000040

Digitized by Google

6.10.1 Original documentation

Store the original documentation that was scanned at the IC until the decision has been issued. Refer to 6.11 Keeping taxpayer relief records and to the Taxpayer Relief Scanning Procedures for more information.

5.11 File transfer guidelines

There may be circumstances where a transfer of file is appropriate. See Appendix 5E File Transfer Guidelines for more information.

Digitized by Google

- **6. General policies and procedures**
  - 6.1 Purpose and intent of taxpayer relief provisions
    - 6.1.1 Applying the taxpayer relief provisions
    - 6.1.2 How to communicate and apply the taxpayer relief provisions
  - 6.2 Administrative reviews
    - 6.2.1 A first review
    - 6.2.2 A second review
    - 6.2.3 A third or subsequent review
  - 6.3 Making a taxpayer relief request
    - 6.3.1 Requests taken on behalf of taxpayers
    - 6.3.2 Unclear/ambiguous request
    - 6.3.3 Request for a deceased taxpayer
  - 6.4 Ministerial discretion
    - 6.4.1 Using discretion
    - 6.4.2 Making impartial decisions
  - 6.5 Receiving a taxpayer relief request
    - 6.5.1 Acknowledgement letter
  - 6.6 Supporting requests
    - 6.6.1 When more information is needed
    - 6.6.2 Requesting more information in writing
    - 6.6.3 Requesting more information over the telephone
    - 6.6.4 Additional information not received
  - 6.7 Requests involving more than one area
    - 6.7.1 Joint reviews
  - 6.8 Fact sheet
  - 6.9 Obtain approval
    - 6.9.1 Post-decision financial transactions
  - 6.10 Communicating decisions
    - 6.10.1 First review letters
    - 6.10.2 Second review letters
  - 6.11 Keeping taxpayer relief records
    - 6.11.1 Complete file
    - 6.11.2 Keeping an audit trail
  - 6.12 Consent forms - Authorizing or cancelling a representative
    - 6.12.1 Individual, trust and T5 accounts
    - 6.12.2 Business accounts
    - 6.12.3 *Canada Pension Plan* or *Employment Insurance Act*
  - 6.13 Undeliverable mail

6. General policies and procedures

This chapter provides general taxpayer relief policies and procedures that apply to all business lines and all types of taxpayer relief requests.

Use the general information in this chapter in conjunction with guidelines for specific types of relief requests. For example, see Chapter 10 for additional information on accepting late, amended or revoked elections. See Branch Specific Information, Functional Guidelines for additional resources and links.

Digitized by Google

6.1 Purpose and intent of taxpayer relief provisions

The taxpayer relief provisions permit the CRA to help taxpayers resolve problems that arise through no fault of their own. The provisions allow for a common-sense approach in dealing with those who, because of personal misfortune or other circumstances beyond their control, are unable to comply with a statutory requirement or have failed to pay or remit an amount when due. The taxpayer relief provisions allow the CRA to be flexible and responsive to a taxpayer's circumstances when it would be unreasonable or unfair to penalize the taxpayer.

The types of circumstances beyond a taxpayer's control may be summarized as follows:

- natural or human-made disasters such as flood, heavy storms, or fire;
- civil disturbances or disruptions in services such as strikes or demonstrations;
- serious illness or accident;
- serious emotional or mental distress caused by death, serious illness, or accident in the immediate family, marital separation, or loss of employment; or
- actions of the CRA, such as providing incorrect information, processing delays or errors, or delays in providing information

See 7.3 Extraordinary circumstances for more information and guidelines for evaluating them.

There may be other circumstances not listed above. See 7.5 Other circumstances for more information

Consideration is also given to situations where taxpayers suffer from an inability to pay or from financial hardship. See Chapter 8, Inability to pay or financial hardship for more information.

The taxpayer relief provisions were not intended and should not be used as a way to negotiate settlement of a taxpayer's account. In all circumstances, taxpayer relief requests should be reviewed independently.

6.1.1 Applying the taxpayer relief provisions

CRA employees are encouraged to be proactive in communicating and applying the taxpayer relief provisions. This is especially important for front-line employees, since they are the most frequent point of contact with the taxpayers. This section provides the benefits of communicating with taxpayers and how to apply the taxpayer relief provisions.

6.1.2 How to communicate and apply the taxpayer relief provisions

Front-line employees can give information on the taxpayer relief provisions proactively over the telephone or at the counter when a taxpayer's situation warrants. In these circumstances, the information given should be limited to the basic conditions taxpayers have to meet and how to make a request. Employees can also be proactive by identifying unclaimed credits and benefits, as well as overpayments, while performing audits, examining a complaint, or evaluating a taxpayer-requested adjustment.

When front-line employees inform taxpayers, they should refer them to the following documents:

- IC07-1, *Taxpayer Relief Provisions*
- Memorandum 16-3, *Cancellation or Waiver of Penalties and/or Interest*
- RC4288, *Request for Taxpayer Relief*

Employees should understand the relief provisions and how they are applied so they do not raise a taxpayer's hopes and generate unnecessary additional work for the CRA. For example, employees should avoid encouraging taxpayers to submit requests when it is determined that the year(s) for which relief is being sought is past the 10-year limitation.

Although a proactive approach may result in an increase in requests received, there are many benefits to being proactive in communicating and applying the taxpayer relief provisions. Active communication gives the taxpayers information they are entitled to and serves to enhance their confidence in the integrity and fairness of our self-assessment system.

Digitized by Google

6.2 Administrative reviews

Taxpayers can request two internal administrative reviews. Taxpayers are also entitled to a judicial review by the Federal Court

Taxpayers can ask for a second review if they are not satisfied with the outcome of a first review. Requests for second reviews should be addressed to the attention of the manager of the centre of expertise (CoE). First and second reviews are discretionary administrative reviews. As a result, there is no formal right of appeal. However, taxpayers can apply for a judicial review to the Federal Court if they feel that discretion was not properly exercised during a first or second review or if they are not satisfied with a CRA decision.

The scope of the Federal Court review is restricted to the exercise of discretion. The Federal Court will not overturn a CRA decision.

First review requests must be submitted within the 10-year limitation. Second review requests have no time restrictions.

6.2.1 A first review

A taxpayer request for relief will result in a first review if

- this is the first time the taxpayer has made the request;
- the taxpayer has submitted additional information to support a request for relief for which a decision has not yet been rendered;
- the requested information for a first review is submitted after the decision letter has been issued, the request will be considered as a continuation of the first review; or
- the taxpayer is denied relief under one legislative provision and a subsequent request is made under a different legislative provision. For example, when a taxpayer is denied relief under one legislative provision (i.e. 220(3.1) penalty and/or interest relief) and a subsequent request is made under a different legislative provision (i.e. 152(4.2) reassessments beyond the normal reassessment period), the request will be considered as a first review.

6.2.2 A second review

A taxpayer request for relief will result in a second review if:

- the taxpayer is asking CRA to reconsider its original decision and does not provide further information;
- the taxpayer is asking CRA to reconsider its original decision and provides information that was not included with the first request;
- the taxpayer is asking CRA to reconsider its original decision and cites a reason/motive (i.e. extraordinary circumstances to financial hardship) that was not raised at the time of the first request;
- the requested information for the second review is submitted after the decision letter has been issued, the request will be considered as a continuation of the second review. See 5.6.2, point 2 c).

A taxpayer's second request should include the following:

- the reasons why the taxpayer disagrees with our decision (e.g. not all information was considered);
- facts or details were misinterpreted or not considered in their proper context, the taxpayer simply disagrees; and
- any relevant new documents, new facts, or correspondence.

See 3.5 Delegation of the Minister's power and duties for more information.

6.2.3 A third or subsequent review

A relief request will result in a third/subsequent review if the taxpayer comes back to the CRA to ask for a review of a second decision; either before they ask for a judicial review, or because they have no intention to bring the matter to Court. Normally, the case would only be reopened if the taxpayer is providing new relevant information.

000044

Digitized by Google

The intake centre (IC) forwards these requests on a priority basis. The responsible section of the CRA, including centres of expertise (CoE), should also process them on a priority basis, that is to say:

- determine validity;
- determine whether or not a third review will be conducted.

If a third review is not conducted, the registry entry will be closed with decision "Denied-Incomplete". In this case, only the "Summary of recommendation" and "Decision" fields, in Section V, and Section VII of the fact sheet are mandatory. In Section V, indicate the reason for which we did not conducted the third review. A letter signed by a delegated authority will be sent to the taxpayer.

If a third review is conducted, the section of the Agency responsible for the review, including CoEs, will send the acknowledgement letter and will request additional information if required. The review of these requests can be made on a FIFO basis or on a priority basis.

If the CRA does perform a third or subsequent review, taxpayers must be informed of their right to judicial review even if this right was previously communicated.

Consult 3.5.3 Requests after second reviews for more information.

6.3 Making a taxpayer relief request

Taxpayers or their authorized representative normally have to ask for the cancellation or waiver of a penalty or interest in writing. In a request, taxpayers have to give the reasons why charges should be cancelled or waived, as well as to give enough relevant information and documents to support the validity of their claim

When informing taxpayers how to make a relief request, it should be stressed that it helps to expedite processing when a request is identified as a taxpayer relief request, and whether it is a first or second review request. This will save time screening and help avoid situations where requests are held in the wrong inventories for extended periods of time.

Taxpayers or their authorized representatives can make their requests by writing to their intake centre (IC). See Contact List for locations and contacts.

Form RC4288, *Request for Taxpayer Relief* can be used by taxpayers to request relief. Although this is not a prescribed form, employees should promote its use to taxpayers. The CRA will not deny a request simply because the taxpayer did not complete a RC4288. A copy of this form is available from the CRA Web site at www.cra-arc.gc.ca/formepubs/menu-e.html or by telephone at 1-800-959-2221.

6.3.1 Requests taken on behalf of taxpayers

As a general rule, CRA employees should not take requests over the telephone or at the counter on behalf of taxpayers for the following reasons.

- requests accepted over the telephone or in person would in all likelihood be incomplete, since they would not give all the information needed to efficiently resolve the request on the first attempt. More contact would be needed, which in turn would cause processing delays;
- taking requests over the phone or in person could jeopardize our impartiality since employees could inadvertently substitute themselves in the role of the taxpayer, which could modify or taint the taxpayer's information.

However, it could happen in cases where previously submitted requests are unactioned or where there is an inability to write or communicate in writing and the taxpayer has no one to help them. In these situations, care must be used to formulate requests on behalf of taxpayers in an impartial way and to try to gather as much detail and information as possible. Taxpayers should be told that more contact might be necessary. Under no circumstances should an opinion be given on whether requests will be approved or denied-this can only be determined after a thorough review.

Digitized by Google

6.3.2 Unclear/ambiguous request

There may be instances in which requests may be unclear or ambiguous. For example, a taxpayer that has been assessed both late filing penalties and/or omission penalties and interest charges may only seek interest relief. The general rule in such cases is not to make any assumptions and to resolve any unanswered questions prior to review, as taxpayers may not distinguish penalty from interest charges.

Taxpayer contact should be attempted to confirm the details of their request. This can be done easily by telephone. Details of taxpayer contact are to be noted in the file. Proceeding with an unclear/ambiguous request or not asking for more information when needed can create additional unnecessary workload and cause processing delays as well as result in poor taxpayer service.

For example, if a request is denied or partially approved based on lack of information or details, the taxpayer may ask for another review of their file. This situation could have been avoided from the start by gathering all the required information prior to file review. If a second review is requested, the task for the reviewing officer would be much more simplified.

See 6.6.1 When more information is needed.

6.3.3 Request for a deceased taxpayer

A relief request made by a taxpayer for their individual account, who passed away after the request was received at IC, will be reviewed as any other requests. If more information is needed, you must verify if an authorization was entered to the taxpayer's file after the date of death, or that there is the mention of "executor" or "administrator" after the name of the representative to M.1 option. If there is no authorization and that essential information relevant to the decision-making process is missing, the request will be closed with the decision "denied-incomplete". If there is no authorization, the decision letter will be sent to "the estate of the late".

Consult 5.5.1 Verifying authorization and 5.7.2.4 Deceased taxpayer for more information

6.4 Ministerial discretion

Discretion is defined as the freedom to make decisions. This section of the manual sets parameters for exercising proper discretion during taxpayer relief reviews. Topics covered are the use of discretion, impartiality, and how to properly analyze facts.

6.4.1 Using discretion

The taxpayer relief provisions give the Minister of National Revenue discretion to cancel or waive penalties and interest, issue income tax refunds or reduce amounts payable beyond the normal three-year period (income tax only), and accept certain late-filed, amended, or revoked elections (income tax only). The Minister's discretion is outlined in the phrase "the Minister may" that appears in each taxpayer relief provision.

Some CRA officials are delegated the authority to exercise the Minister's powers and duties to allow, partially allow or deny taxpayer relief requests. Positions are delegated, not individuals.

Delegated employees must carefully review the taxpayer's request and any supporting documentation, such as the taxpayer relief fact sheet. Most importantly, they are responsible for making a decision to allow, partially allow, or deny a taxpayer's request.

In using discretion, you must consider CRA policies and guidelines, the circumstances that gave rise to the request, submissions made by the taxpayer, and any other relevant information.

When deliberating on a request it is important that:

- all correspondence and notes of telephone conversations with the taxpayer concerning the request, along with the taxpayer's file or a summary of the facts relating to the request, be made available to and be reviewed by the person exercising the discretion;
- the delegated authority, in exercising their discretion, reads and considers the taxpayer's submission along with the recommendation and summary of the pertinent facts; and
- the officer who prepared the fact sheet be available to answer any questions that might arise concerning the appropriateness of the recommendation.

Digitized by Google

The way in which discretion has been exercised can be questioned during second reviews and judicial reviews.

See 3.5 Delegation of the Minister's power and duties for more information on delegation and who is authorized to exercise Ministerial discretion.

6.4.2 Making impartial decisions

To properly use discretion, it is essential that taxpayer relief employees involved in the review and decision-making process remain impartial. Evidence of non-impartiality could have adverse consequences in court. It could also undermine the CRA's reputation for fairness.

For example, we should not automatically refuse a request to cancel or waive penalties and interest because a taxpayer has a poor compliance history. The circumstances surrounding the situation may have been completely out of the taxpayer's control, which could then lead to a full or partial approval of the request.

Impartiality can best be defined as being just and fair or unprejudiced. The best way to remain impartial when performing a review is to avoid prejudging taxpayers or situations and to not be biased. Equal consideration and treatment must be given to all taxpayers.

Taxpayers deserve to be treated equally, regardless of their:

- age, gender, race, religion, or marital status;
- location (e.g., whether they are from a poor region or an affluent neighbourhood);
- background (e.g., their level of education or social status);
- sophistication (e.g., how well they speak);
- access to tax professionals;
- assertiveness or aggressiveness; or
- employer or business sizes.

The above list is not intended to be exhaustive since other extraneous factors exist.

6.5 Receiving a taxpayer relief request

When correspondence is received at an IC, the screener will determine if it is a new relief request, a document to be matched with an existing taxpayer relief request, or correspondence not intended for the Taxpayer Relief Program.

Staff will verify authorization, open a registry entry and send an acknowledgement letter for all taxpayer relief requests received at an IC.

IC staff will also determine validity, request additional information (when applicable), and assign complexity for requests that are CoE responsibility.

Staff at an IC will not determine validity, completeness or complexity for requests that are processed outside a CoE. These steps will be the responsibility of the section that handles the work. Requests for relief handled in other sections of the Agency will be forwarded by mail. See 6.4.1 Area of responsibility for more information.

Note: If you are not located in an IC or a CoE and you receive a taxpayer relief request that is the sole responsibility of your section (e.g. a request for a refund beyond the normal three-year period received at a tax centre), do not redirect the request to the IC. Create a registry entry, determine validity and proceed with the review, recommendation and decision as per usual.

See Chapter 5, Intake and Screening, for more information and Process Map of CoE for an overview of steps followed at a centre of expertise.

6.5.1 Acknowledgement letter

An acknowledgement letter will be sent for all taxpayer relief requests. If you are located in a CoE and receive a new request, forward it to the IC for screening and acknowledgement.

If you are located outside an IC or CoE and you receive a taxpayer relief request that is the sole responsibility of your section (e.g. a request for a refund beyond the normal three-year period received at a TC), issue the acknowledgement letter accordingly. Do not redirect the request to the IC. See Taxpayer Relief Correspondence Binder (*under development*).

000047

Digitized by Google

6.6 Supporting requests

Both the taxpayer and CRA employees are responsible for making sure taxpayer relief requests are properly supported. Taxpayers have to make sure they give details of any extenuating circumstances and the documentation needed to support and establish the validity of their request. Taxpayers also have to reply in a timely manner when we ask them for more information.

It is the CRA's responsibility to make sure taxpayers are made aware that their requests have to be complete. Officers evaluating and reviewing relief requests must determine whether taxpayers have provided enough information or if more information should be requested. If more information is needed, staff must try to contact taxpayers to obtain the information before reaching a decision.

Not asking for more information when it is needed can cause processing delays and result in poor taxpayer service.

See below for instructions on how to request more information and 6.8.2 Incomplete request - information available internally for steps taken at an IC.

6.6.1 When more information is needed

All the facts and questions relevant to a case must be gathered, reviewed, and answered. If the information given is incomplete, inappropriate or inconsistent, the taxpayer should be given the opportunity to provide more information or clarification/explanation before we make our decision

When conducting a review, if further information or clarification is required, follow the steps below:

6.6.2 Requesting more information in writing

Give 30 days to the taxpayer to submit the requested information and an additional 15 days for mailing time.

Written requests to the taxpayer should include the following elements or information:

- a precise description of the information requested (e.g., a doctor's letter that would provide the dates and details of an illness);
- a precise description of the receipts/information slips required to support the request for (re)assessment (e.g., child care receipt(s), rent receipt(s) or official donation receipt(s));
- a time frame or a date for the taxpayer to respond;
- an indication that if a reply is not received within the time frame, the request will be reviewed based on the information available and a decision will be made;
- the name of the employee and their direct phone number or extension the taxpayer can contact for more information or ask for an extension of time to reply; and
- an address for reply

If information is requested in writing, complete the non-workable field with reason 03 in Section IV-Info/Delays/Transfer of the TRR fact sheet. Depending on the file, a note could be entered in another system (ACSES diary, ELCS notepad)

See the Taxpayer Relief Correspondence Binder (*under development*)

6.6.3 Requesting more information over the telephone

Information can also be obtained by phone. Phone requests should include the same elements and information in 6.6.2 Requesting more information in writing. There are advantages to requesting information or clarification over the phone, since it can reduce the time in which the needed information is received. However, there is a chance the taxpayer could misinterpret what information is needed or could forget what information was requested.

Staff has to be prepared not to discuss the possible outcome of the case when talking to a taxpayer on the phone. No opinion should be given as to whether the request will be approved or denied - this can only be determined after a thorough review.

Digitized by Google

If information is requested by telephone, a note must be entered in Section IV - Info/Delays/Transfer of the TRR fact sheet (summary of the conversation, information requested, delay allowed), complete the non-workable field with reason 03. Depending on the file, a note could be entered in another system (ACSES diary, ELCS notepad).

6.6.4 Additional information not received

Where the taxpayer does not provide the requested information within the specified time frame, a taxpayer relief decision report is required to be prepared with a recommendation for the delegated authority's approval. The report (recommendation) should also indicate that the request has been denied due to insufficient information.

A decision letter signed by a delegated authority must be issued to the taxpayer in accordance with 6.10.1 First review letters.

The registry entry will be closed with the decision "Denied-Incomplete".

6.7 Requests involving more than one area

We will receive taxpayer relief requests that require involvement by more than one area. When more information is needed, a reasonable attempt should be made to minimize the number of times we contact the taxpayer.

6.7.1 Joint reviews

A joint review is a request for relief where more than one section or the Agency contributes to and/or has responsibility for the review with recommendation and a single decision is communicated.

It is important to consider the entirety of a taxpayer's circumstances, even when more than one area has contributed to the review. Moreover, the facts may not lead to the same recommendation depending on the requirements and obligations associated with a revenue type. See 6.10 Communicating decisions for more information.

For requests received at the Intake centre (IC):

When the IC determines that a joint review is required, the other area of the CRA will first review the request. The IC must:

- verify the authorization;
- create a registry entry within 4 business days from receipt;
- send the acknowledgement letter;
- forward the correspondence to the other responsible area with a RTM/Memorandum (see the note below);
- scan the request and the RTM/Memorandum (will indicate to the CoE that a response from another area is expected);
- create scanned documents in TRRS;
- indicate in Section IV – Info/Delays/Transfer of the fact sheet where the request has been forwarded;
- transfer the file to the CoE.

Upon receiving the response from the other area, the CoE will process the request as a priority. If a review from the CoE is no longer required, the CoE will ensure that the registry entry has been closed.

Since the relief request may be resolved in full by the other area, we recommend that if additional information is required, it will be requested by the CoE. Thus, we can prevent information from being unnecessarily requested from the taxpayer or that the information will be outdated.

Note: The RTM/Memorandum should indicate to the other area that a response should be sent to the CoE. Here is an example of what might be the RTM/Memorandum:

> The taxpayer relief intake centre has determined that the attached request requires a joint review according to section 6.7.1 Joint reviews of the Taxpayer Relief Procedures Manual
>
> When you have completed your portion of the exam, please close the registry entry if a joint review with the taxpayer relief centre of expertise (CoE) is no longer required.

000049

Digitized by Google

If a joint review with the CoE is required, please forward the request along with your recommendation to the CoE. The CoE will send the decision letter, including your recommendation.

Provide the CoE coordinates.

For requests received outside the IC:

- transfer the registry entry and the request for the other section to conduct their review first; or
- conduct their portion of the review first and then transfer the registry and file to the other section.

The decision as to which area conducts the first review is driven by efficiency. For example, if a taxpayer invokes extraordinary circumstances and financial hardship, we should review the facts related to extraordinary circumstances first.

A joint review will include, but is not limited to:

- A request where the taxpayer cites more than one reason and responsibility for these reasons rests with more than one section of the agency, for example, a request for a T3 account based on extraordinary circumstances and financial hardship.
- A request where a taxpayer cites more than one revenue type, for example, a T1 account and TFSA.

6.8 Fact sheet

Taxpayer relief fact sheet is mandatory. The fact sheet is used to enter facts and reasons cited by the taxpayer, to review the request; to record the analysis; to recommend a decision and to obtain approval from a delegated authority. See 4.2 Fact sheet in the Taxpayer Relief Registry guide for more information.

In addition, the fact sheet may be used in a second review or a judicial review by the Federal Court of Canada. Taxpayers can also ask for a copy of the fact sheet through *Access to Information Act*.

When writing a report, remember:

- be impartial, avoid making personal opinions and judgments;
- stick to the facts, leave out irrelevant considerations;
- do not use words that curtail your discretion;
- tone should be neutral – objective;
- motivate your decision - state the facts considered and explain the importance of each fact;
- be clear and concise, avoid jargon; and
- avoid putting words in quotations, in capitals, in bold or italics

Refer to the "Top five rules for good report and decision letter writing".

Note: If an internal report is used, other than the TRR fact sheet, it must contain the same elements.

6.9 Obtain approval

The fact sheet with the recommendation must be reviewed and approved by a team leader, manager or another delegated authority. If the delegated authority does not agree with the recommendation, and changes are required, the fact sheet is returned to the officer for revision.

To approve a decision, the delegated authority should enter his/her userid in Section VII, Delegated Authority, of the taxpayer relief registry fact sheet. Since this step serves as an electronic signature, it is not necessary to print and sign the fact sheet. See 4.2.7 Delegated Authority, of the TRR guide and 3.5 Delegation of the Minister's power and duties for more information.

Team leaders, managers and other delegated authorities, who routinely approve taxpayer relief requests, should ensure they have the proper delegation authority in ORG. To make a request, send the name and userid to Taxpayer Relief, General Enquiries.

Digitized by Google

6.9.1 Post-decision financial transactions

If a financial transaction is required in the taxpayer's account, consult Appendix 8B Post-decision Financial Transactions - CoEs for all requests that are CoE responsibility to find out how to request the processing of the transactions. For other workloads, see Functional Guidelines for more information.

6.10 Communicating decisions

All taxpayer relief decisions must be communicated in writing, except when a taxpayer wishes to withdraw the request. See the Note below.

For requests that are CoE responsibility: Decisions must be communicated by means of a decision letter.

For requests that are not CoE responsibility: Decisions are usually communicated by means of a decision letter. A notice of assessment/reassessment or notice of determination/redetermination can be acceptable in lieu of a decision letter for an approval in full. Note that these notices contain the signature of a delegated authority, the Commissioner.

Note: For decision "Withdrawn", only the "Summary of recommendation" and "Decision" fields, in Section V of the fact sheet, are mandatory.

Decisions letters should include the following:

- type of request;
- period/year involved;
- an indication that the decision was made after considering the request, the facts of the case, and the legislation involved;
- the factors which were considered in the decision;
- the basis or reasons for the partial approval or denial;
- the name, position, and telephone number of the officer who handled the case along with an invitation to contact the officer if the taxpayer wants to discuss the matter; and
- signature of the delegated authority.

Decision letters should not refer to "taxpayer relief committees" since this term is for internal use only. The terms "fairness provisions" and "fairness legislation" have been replaced with the term "taxpayer relief provisions". Letters should reflect this terminology.

Care should be taken to use proper writing style and a current mailing address. Letters should be written in plain language whenever possible. Plain language uses straightforward, familiar words and simple, logical sentences. Letters must have a neutral and objective tone. People reading a letter that is written in plain language should easily understand our decision. Address your reader directly, using the pronoun you. When you refer to the CRA, use we or us. Make your letter more personal by using I or me. Be consistent; otherwise, you will confuse your reader. Consider the document structure and flow and use your judgment. You can find guidelines for writing in plain language on the Public Affairs Branch site. Refer also to the "Top five rules for Good report and Decision Letter Writing".

The letter should clearly indicate why the CRA has decided to partially approve/deny the request. In cases where multiple issues/reasons are involved, for example, if the request involves both extraordinary circumstances and financial hardship, the letter must address those issues to the extent that the taxpayer can acknowledge that all of his arguments have been analyzed and covered. The more detail provided, the more unlikely it will be that a second review will be submitted. Moreover, the decision letter should not state that the request has been denied because the taxpayer relief provisions do not allow to cancel and/or waive penalties and/or interest in X situation. The taxpayer relief provisions, the published and/or internal CRA guidelines should assist officers when exercising discretion. In the past, the Court has criticized our decisions when it finds we have "fettered discretion" by limiting our review to circumstances outlined in our guidelines.

When a request is reviewed by more than one area, it is preferable to issue a single decision letter. Keep in mind that reporting requirements and obligations may be different depending on the revenue type. Consequently the facts may not result in the same recommendation for each area/business line. Clearly indicate the periods under consideration and ensure to provide detailed reasons for each decision. See also 6.7.1 Joint reviews. We want to issue one decision letter for all reasons and revenue types at onetime; this is to avoid having the taxpayer making several applications for judicial review in respect of the same relief request.

Digitized by Google

However, some requests could involve different legal entities. If it's the case, we must send one decision letter for each entity.

Legal entities can be defined as:

- Individual = T1 return (program account RI).
- Proprietorship (sole proprietor) = business owned by one person = PAYDAC (program account RP), GST/HST (program account RT)
- Partnership = business owned by more than one person, not a corporation, each partner is liable for any tax payable = PAYDAC (program account RP), GST/HST (program account RT).
- Corporation: an artificial person or legal entity created by or under the authority of the law. The corporation is liable for any tax payable. The owners (shareholders) are not personally liable. Directors may be held personally liable for the debts on trust accounts (if directors' liability assessments were raised) = T2 return (program account RC), PAYDAC (program account RP - trust account), GST/HST (program account RT - trust account).

If the request is for the individual (T1 return) and the corporation = 2 separate legal entities = 2 separate decision letters (one for the individual and one for the corporation).

If the request is for the individual (T1 return) and the partnership = 2 separate legal entities = 2 separate decision letters (one for the individual and one for the partnership).

If the request is for the individual and the proprietorship = 1 legal entity = one letter as we are dealing with the same individual.

A facsimile signature stamp should not be used under any circumstances for taxpayer relief decision letters, as there could be a perception that the delegated authority did not actually make the decision.
If the delegated authority is in an acting position, the signature field should be the name and acting position. Do not use "FOR" signatures.

See the Taxpayer Relief Correspondence Binder (*under development*).

Note: For a request that involve more than one legal entity, you can create a letter for one of them and use that letter as a base letter for another entity. To use a letter as a base letter, the status of that letter should be "complete" or "draft". So, if a request involves a T1 account (individual) and a T2 account (corporation), you can prepare the letter with the T1 account number, leave the letter as "complete" or "draft", and use it as a base letter for the T2 account. When you have finished, you can print the letters. See the ELCS manual for more information.

6.10.1 First review letters

When a relief request is allowed in full, a combined response, such as, informing the taxpayer of the decision over the phone, followed by a decision letter or notice, can be done

In cases of a partial approval or denial, letters have to inform taxpayers of their right to a second independent review. If taxpayers do not agree with the decision or feel that the CRA has not exercised its discretion in a fair and reasonable manner, they can ask in writing that the centre of expertise's Chief of Appeals or the director of their local tax services office or tax centre review their request again

Although taxpayers are entitled to apply for a judicial review after the first review, they will only be told of this recourse after a second review.

The delegated authority, who approved and signed the fact sheet, must sign the decision letter as well.

Digitized by Google

6.10.2 Second review letters

Such as a first review, when a second request is allowed in full, a combined response, such as, informing the taxpayer of the decision over the phone, followed by a decision letter or notice, can be done.

In cases of a partial approval or denial, letters have to inform taxpayers of their right to redress through a judicial review. Second review letters have to contain the following paragraph:

> If you feel that discretion was not properly exercised during our review of your request for relief, section 18.1(2) of the Federal Courts Act provides for a judicial review of any discretionary decision made by the federal government. You can apply to the Federal Court for a judicial review within thirty (30) days of the day you received this letter. For more information on the judicial review process and how to apply, phone the Registry of the Federal Court at (phone number). This information is also available at the Federal Court Web site.http://www.fct-cf.gc.ca.

NOTE: If a taxpayer contacts you (by phone or letter) because they have missed the 30-day time limit to apply for judicial review, refer to Chapter 11 Judicial review.

The delegated authority, who approved and signed the fact sheet, must sign the decision letter as well.

6.11 Keeping taxpayer relief records

The *Privacy Act* requires that documents be kept for a minimum of two years from the date they were last used for administrative purposes. Records can be destroyed after the two-year period has passed. However, local management may choose to extend the retention period, particularly for sensitive cases.

For requests that have been scanned, the original relief request documentation hard-copies must be kept and stored in a manner that it can easily be located until a decision has been made. The documents can then be destroyed as per regional office disposal procedures. It is suggested that the hard-copy of relief requests that have been scanned but the request was not approved in full be retained for a minimum of 3 months following the decision. For approved files, you do not have to retain the hard-copy documents. It is the responsibility of each intake centre (IC) to destroy hard-copies documents that they saved in TRSS. With Cognos, the IC can have reports showing the province of residence, the decision in the registry, etc.

For relief requests that have not been scanned, files that are 50+ pages (only the screening sheet is scanned with a note), a hard-copy must be kept for two (2) years after a decision has been made before disposal.

6.11.1 Complete file

A complete taxpayer relief file includes all:

- documents submitted by the taxpayer and/or representative;
- relevant internal documents and information that is not retained electronically* and/or not filed elsewhere in permanent records**

* Do not copy/scan documents or information that is retained electronically. This includes:

- TRR fact sheet;
- taxpayer relief decision letter;
- information found in CRA systems i.e. ACSES diary notes, DO.3 screens, etc

** Other internal documents such a tax return, or Appeals report may be examined during the course of a review. Relevant details and location of the source documents should be recorded in the TRR fact sheet. When there is likelihood that the source documents will be destroyed prior to the taxpayer relief two-year retention period, copy relevant sections of the source documents for inclusion in the taxpayer relief file.

Note: IC staff creates scanned files for work-ready cases to be reviewed at CoEs. Any additional documentation received or considered after a review has begun must be scanned and added to the folder to ensure the file is complete. See Taxpayer Relief Scanning Procedures for more information

Digitized by Google

See also Chapter 11 Judicial Review for details on preparing certified bundle of documents when a taxpayer makes a request for material under Rule 317 of the *Federal Courts Rules*.

6.11.2 Keeping an audit trail

All valid relief requests must be entered in the Taxpayer Relief Registry (TRR). The TRR provides information on the date of the request, its location (office/section), its status (open, non-workable or closed) and on the contact person. There is also all the information entered in the fact sheet. The information from the registry is useful in helping answer taxpayer enquiries or requests for which records were destroyed or cannot be located. See the Taxpayer Relief Registry Guide for more information.

In some cases, the registry entry may have been deleted because it was created in error (wrong account number, invalid request, etc.). Therefore, no audit trail is available in TRR.

If a registry entry is deleted at the intake centre (IC) before an acknowledgement letter is issued, it causes no problem; therefore no action is required. However, if the error is caught after the acknowledgement letter has been sent, there should be some type of audit trail why the registry entry was deleted. Create a brief note in ELCS Notepad indicating the registry entry number, why it was deleted, along with any action that has been requested on the account, if applicable. This is to ensure officers in CRA can respond to taxpayer's enquiries regarding their requests as well as to provide an audit trail.

In other cases, a closed entry can be deleted by HQ when requested by the responsible officer. Generally, the entry will be deleted and a new one will be created with the correct information. In these cases, it is a good practice to indicate, in the fact sheet (Other elements of analysis), that the new entry replaces the entry xxx because there was erroneous information in it.

6.12 Consent forms – Authorizing or cancelling a representative

6.12.1 Individual, trust and T5 accounts

For individuals (T1 accounts), trusts (T3s) and T5 information returns, form T1013 - Authorizing or Cancelling a Representative, has been revised to include two levels of authorization with expiry dates. Level 1 authorization allows only for the disclosure of information, while level 2 allows for both the disclosure of information and changes to a taxpayer's account.

Therefore, for taxpayer relief requests, level 2 authorization is required. Should you receive requests with either no authorization or level 1 authorization, return the request to the representative advising that you are unable to review the request without level 2 authorization provided on form T1013. A signed letter from the taxpayer, which clearly states that the representative has the authority to request changes to the taxpayer's account, is also acceptable. See 5.5.1 Verifying authorization for more information.

6.12.2 Business accounts

For business accounts (T2, GST/HST, PAYDAC, Import/Export, etc.) RC59 - Business Consent Form or equivalent information is required for authorizing or cancelling a representative. The form has also been revised to include two levels of authorization with expiry dates. Level 1 authorization allows only for the disclosure of information, while level 2 allows for both the disclosure of information and changes to the Business Number account(s). See 5.5.1 Verifying authorization for more information.

6.12.3 *Canada Pension Plan* or *Employment Insurance Act*

CPT139 - Authorization form is used to authorize representatives for matters relating to the *Canada Pension Plan* or *Employment Insurance Act*. There are no differing levels of consent. See 5.5.1 Verifying authorization for more information.

Digitized by Google

6.13 Undeliverable mail

Undeliverable mail is defined as mail returned to Canada Revenue Agency (CRA) because the taxpayer does not reside at, or no longer resides at the mailing address.

If a letter mailed to a taxpayer is returned by the Post Office, every effort must be made to redirect the correspondence. Search the CRA's systems for the most current address, and/or place a telephone call to the taxpayer in order to obtain the most current mailing address. Follow the procedures below depending on where the relief request will be reviewed.

For requests that are CoE responsibility

If no new address is available and the taxpayer cannot be located, change the status of the letter in ELCS to undeliverable.

For T1 accounts, set the returned mail flag using option L.6. RAPID Option L.6.8 On-Line Help (PF1) provides instructions on setting the returned mail flag.

For business accounts such as payroll, GST and corporations, forward the correspondence to the Business Number Services, of the tax centre of record, to have the returned mail flag updated.

For other accounts, set the returned mail flag following the applicable procedures according to the revenue type. If you don't have access to the required system, forward the letter to the appropriate section that could set the returned mail flag.

Then, perform the following actions.

- If the letter is a letter informing the taxpayer that their request has been forwarded to the applicable section of the CRA: enter a note in ELCS Notepad.
- If the letter is a first review decision letter: enter a note in ELCS Notepad, and in ACSES for financial hardship case.
- If the letter is a second review decision letter:
  - enter a note in ELCS Notepad, and in ACSES for financial hardship case;
  - scan the letter and the envelope that indicates "undeliverable" and attach it to the second request electronic file as proof*.

* Following a second review, it is important to keep proof/record of the returned mail since the taxpayer can apply for judicial review within 30 days of the date the decision letter was first received by the taxpayer. See Chapter 11 Judicial review for more information.

- If the letter is an acknowledgment letter: enter a note in ELCS Notepad, and in ACSES for financial hardship case.
- If the letter is an acknowledgment letter requesting additional information:
  - enter a note in ELCS Notepad, and in ACSES for financial hardship case;
  - remove the registry entry from non-workable in Section IV;
  - scan documentation and transfer the registry entry to the CoE.

When the CoE officer is ready to review the request.

- If the returned mail flag is no longer displayed in the account, the request will be processed as usual. If additional information was requested and is still required, the officer will send a letter to the taxpayer and will attach a duplicate of the returned letter to it.
- If the returned mail flag is still displayed in the account, the officer will do a new search to find the taxpayer's address. If the taxpayer cannot be located, the registry entry will be closed with decision "Denied-Incomplete". In this case, only "Summary of recommendation" and "Decision" fields, in Section V, and Section VII are mandatory. In Section V, indicate that we did not review the request as there is a returned mail flag on the account since xxxx (date).

Note: No decision letter should be issued when there is a returned mail flag on the account to avoid a security incident. For example, when an individual contacts the CRA to report the receipt of information belonging to another person, this is considered "misdirected mail". Misdirected mail is a security incident.

Digitized by Google

For requests that are not CoE responsibility

If no new address is available and the taxpayer cannot be located, change the status of the letter in ELCS to undeliverable and enter a note in ELCS Notepad. For the returned mail flag, follow the procedures indicated in your Taxation Operational Manual (TOM). If a system other than ELCS has been used for the letter, follow your procedures to put a note in the taxpayer file about the undeliverable mail.

- If the letter is a first review decision letter: destroy the ELCS letter (if you set the returned mail flag).
- If the letter is a second review decision letter: attach the letter and the envelope that shows "undeliverable" to the 2nd request file as proof*.
- If the letter is a letter requesting additional information: removed the registry entry from non-workable in Section IV, if applicable, and destroy the ELCS letter (if you set the returned mail flag).

* Following a second review, it is important to keep proof/record of the returned mail since the taxpayer can apply for judicial review within 30 days of the date the decision letter was first received by the taxpayer. See Chapter 11 Judicial review for more information.

When the officer is ready to review the request:

- If the returned mail flag is no longer displayed in the account, the request will be processed as usual. If additional information was requested and is still required, the officer will send a letter to the taxpayer and will attach a duplicate of the returned letter to it.
- If the returned mail flag is still displayed in the account, the officer will do a new search to find the taxpayer's address. If the taxpayer cannot be located, the registry entry will be closed with decision "Denied-Incomplete". In this case, only "Summary of recommendation" and "Decision" fields, in Section V, and Section VII are mandatory. In Section V, indicate that we did not review the request as there is a returned mail flag on the account since xxxx (date).

Note: No decision letter should be issued when there is a returned mail flag on the account to avoid a security incident. For example, when an individual contacts the CRA to report the receipt of information belonging to another person, this is considered "misdirected mail". Misdirected mail is a security incident.

Digitized by Google

[redacted]

- **7. Cancelling or waiving penalties and/or interest**
  - 7.1 Difference between a cancellation and a waiver
  - 7.2 Circumstances in which interest and penalties may be cancelled or waived
  - 7.3 Extraordinary circumstances
    - 7.3.1 Natural or human-made disasters
      - 7.3.1.1 Special consideration due to extraordinary events
    - 7.3.2 Civil disturbances or disruptions in services
    - 7.3.3 Serious illness or accident
    - 7.3.4 Serious emotional or mental distress
  - 7.4 Requests that arise due to actions of the CRA
    - 7.4.1 Proactive taxpayer relief
  - 7.5 Other circumstances
  - 7.6 Disputed assessment or amount charged
  - 7.7 Third parties
  - 7.8 Bank error
    - 7.8.1 Employer error
  - 7.9 Ignorance of the law
  - 7.10 Gross negligence penalties
  - 7.11 Erroneous refunds
  - 7.12 Amounts held in trust
  - 7.13 Reinstating cancelled or waived penalties and/or interest
  - 7.14 Inability to pay or financial hardship
  - 7.15 Factors to consider in arriving at the decision
    - 7.15.1 Assessing reasonable care
    - 7.15.2 Assessing past compliance
  - 7.16 Completing a fact sheet

7. Cancelling or waiving penalties and/or interest

This section provides guidelines that apply to all business lines to evaluate taxpayer relief requests for cancelling or waiving penalties and/or interest. These guidelines should be used in conjunction with the General policies and procedures located in Chapter 6 of this manual.

Most Headquarters functions have additional guidelines for their workflows. You can find references and links to these additional guidelines in Functional Guidelines.

The CRA may waive or cancel all or part of any penalty and interest otherwise payable under the taxpayer relief provisions. The ability to waive or cancel penalties and interest is not to be used as a way to arbitrarily reduce or settle tax debt.

See Chapter 2 Legislation for more information.

7.1 Difference between a cancellation and a waiver

The terms cancellation and waiver have two distinct meanings.

Cancellation: A cancellation refers to penalties and interest amounts that were assessed or charged to the taxpayer for which relief is granted by the CRA.

Waiver: A waiver refers to penalties and interest otherwise payable by a taxpayer for which relief is granted by CRA before these amounts are assessed or charged to the taxpayer.

Digitized by Google

7.2 Circumstances in which interest and penalties may be cancelled or waived

Interest and penalties may be cancelled and/or waived in the following types of situations:

- extraordinary circumstances;
- actions of the CRA;
- inability to pay or financial hardship.

The Minister may also grant relief if a taxpayer's circumstances do not fall within these situations. The request must be made within the 10-year time limit.

7.3 Extraordinary circumstances

This section provides examples of various extraordinary circumstances and guidelines for evaluating them.

The types of circumstances beyond a taxpayer's control that may have prevented a taxpayer from making a payment when due, filing a return on time, or otherwise complying may be summarized, but not limited to, the following examples:

- natural or human-made disasters such as flood, heavy storms, or fire,
- civil disturbances or disruptions in services such as strikes or demonstrations;
- serious illness or accident;
- serious emotional or mental distress caused by death, serious illness, or accident in the immediate family, marital separation, or loss of employment.

7.3.1 Natural or human-made disasters

Taxpayers can ask for relief due to natural or human-made disasters such as flood, heavy storms, or fire. Relief can be granted when the event destroyed books and records, or made them inaccessible, or for other obvious reasons compliance was delayed or prevented

Guidelines for evaluating such circumstances include, but are not limited to, the following:

- consider the dates and description of events, and whether they correspond to the period when an obligation or requirement was missed;
- review the taxpayer's explanation of how the event prevented compliance;
- review the taxpayer's explanation of what other means were explored to comply with requirements,
- review the taxpayer's supporting documentation such as a copy of the police, fire, or insurance report to determine whether the dates and description of damages correspond to the taxpayer's presentation of the facts.

7.3.1.1 Special consideration due to extraordinary events

The Minister may issue a news release to announce that special consideration will be given to providing relief due to an extraordinary event that has prevented a large number of taxpayers from meeting their tax obligations. Generally, taxpayers still need to make a written request to get relief

CRA news releases on extraordinary events that qualify for relief can be found at http://www.cra-arc.gc.ca/nwsrm/rlss/menu-eng.html.

See Communications for internal instructions issued to field office staff on TRSCD site.

Digitized by Google

7.3.2 Civil disturbances or disruptions in services

Disruptions in services such as a postal strike, a strike within the government, or civil disturbances may give cause to a request for relief.

Guidelines for determining if such circumstances prevented compliance include, but are not limited to, the following:

- review the dates and description of events, and verify that they correspond to the period when an obligation or requirement was missed;
- consider the taxpayer's explanation of how the event prevented or delayed compliance corresponds to the facts Consider how long the disruption had been ongoing before the date payments, remittances, income tax, GST/HST, or information returns were due;
- review the taxpayer's explanation of what other means were explored to comply with the requirement. Does the taxpayer have relatively easy access to a CRA office? Does he or she live in an area with reasonably close access to a tax services office or tax centre?;
- review the taxpayer's supporting documentation such as a newspaper clipping that supports the disruption.

7.3.3 Serious illness or accident

Taxpayers can ask for relief if they have suffered from a serious illness or an accident to such an extent that they could not meet an obligation or requirement.

Some guidelines for evaluating such requests include the following:

- review the date(s) and nature of the illness or accident, and how it corresponds to the period for which the relief is requested;
- review the taxpayer's explanation of how the event prevented compliance. Consider whether the taxpayer could have had someone else take care of his or her obligations.
- consider the taxpayer's explanations of whether other personal or business obligations were impaired;
- review any supporting documentation such as accident reports, insurance reports (accident or health), and medical or hospital reports to make sure they verify the taxpayer's description of events.

For a corporation, estate, or trust, ask if the circumstances involve an individual having sole authority to execute the return, make the deposit, pay the tax, or remit amounts owing to the CRA. If someone else was authorized to meet the obligation, consider the reasons that person did not meet the obligation when evaluating the request. For a business, if only one person was authorized, determine if this was in keeping with reasonable standards of care.

Although it is imperative that these requests be thoroughly verified, they also should be handled with consideration and tact.

7.3.4 Serious emotional or mental distress

Taxpayers can also be granted relief if compliance was delayed or prevented because they suffered serious emotional or mental distress because of a death, serious illness, or accident in the immediate family, marital separation, or loss of employment.

To resolve these types of cases in a consistent manner, consider the following factors.

- did the taxpayer work during the period in question or do any type of activity that would be similar in complexity to filing an income tax return?
- was the taxpayer hospitalized during the timeframe in question?
- was the taxpayer under medical care during the timeframe in question?
- is this (non-compliance, late filing, late payment, etc.) an isolated case?
- are the tax returns prepared by the taxpayer or a representative?

Digitized by Google

Guidelines to consider when evaluating such circumstances include those listed in serious illness or accident as well as these additional guidelines:

- consider the relationship of the parties involved;
- review the date of death of the family member, marital breakdown, loss of employment, or other traumatic event and how it relates to the period for which the relief is requested;
- review any supporting documentation to make sure it verifies the taxpayer's description of events.

These types of requests should be handled with consideration and tact.

7.4 Requests that arise due to actions of the CRA

Cancelling or waiving penalties or interest may be appropriate if the penalties or interest resulted mainly because of CRA actions and through no fault of the taxpayer, such as if:

- incorrect information given by the CRA in the form of written answers or published information, or provided in person or over the telephone, led the taxpayer to file returns or make payments or remittances based on incorrect information;
- processing delays resulted in the taxpayer not being informed within a reasonable time that an amount was owing;
- errors occurred in processing;
- delays occurred in providing information necessary to meet an obligation, such as if the taxpayer could not make the appropriate payments/remittances because the necessary publication or return was not available;
- undue delays in resolving an objection, appeal or completing an audit

In cases involving incorrect information provided by the CRA, the following should be assessed:

- determine whether the taxpayer provided the CRA with accurate and complete information. Missing or inaccurate details provided by taxpayer can lead to an incorrect response on the part of the CRA;
- assess the relationship between the taxpayer's situation, the information provided, and the penalty and interest assessed;
- assess the degree of completeness of the details given to support a claim of incorrect verbal information. The more detailed the facts presented, (such as date, time, person spoken to, and details of the conversation), the more it could aid in strengthening the case.

In cases where it is alleged that the CRA was responsible for the delay, a determination should be made whether it was so and the period of delay should be established.

The examples, which follow, should help in identifying what is and what is not a delay caused by the CRA.

Examples

CRA delay
When an income tax return is first assessed, a limited review is done to speed processing. However, to protect the integrity of the tax system, returns are also reviewed in more detail at a later date. Generally, any necessary adjustments will be made to a return within three years of the original date of assessment. Any reassessments within that 3 year window are not considered an undue delay.

Furthermore, if for one reason or another, the CRA took more time than normal to process/complete a file (employee is on sick leave for a long period of time and the files were not reassigned, new priority), we could consider cancelling or waiving a portion of the interest.

Taxpayer delay
Let's take a project where the CRA sends letters to several taxpayers requesting supporting documentation. Some taxpayers comply, provide the requested documentation and have their files reassessed. However, a portion of the taxpayers do not cooperate for unknown reasons, and do not produce the documentation. Six months later, the CRA sends a follow-up letter to obtain the documentation or decides to reassess based on the existing available information. In this type of situation, the CRA should not consider canceling or waving interest because the delays have been due to the taxpayer's lack of action or response

Whenever we review a request to cancel or waive interest and/or penalties, we must take into account the four factors used to arrive at a decision. See 7.15 Factors to consider in arriving at the decision.

Digitized by Google

7.4.1 Proactive taxpayer relief

Approving relief of interest and/or penalties due to the actions of the CRA without a taxpayer relief request is considered proactive taxpayer relief.

Some circumstances where proactive relief from interest and/or penalties may be warranted are undue delays in resolving an objection, an appeal, or in completing an audit.

The decision to recommend a waiver/cancellation of interest and/or penalties will be based on the judgment of the CRA officer/auditor and the delegated authority after considering the facts of the case and the guidelines outlined in IC07-1, *Taxpayer Relief Provisions* and GST Memorandum Series 16-3 *Cancellation or Waiver of Penalties and/or Interest*.

Documentation to support the waiver of interest and/or penalties should include one or more of the following:

- relevant audit or appeals working papers – the information necessary to determine the appropriateness of any waiver of interest and/or penalties;
- T2020 Memo to File (or similar working paper) – this should include a chronological account of the audit/objection/appeal as well as comments relating to the cause of any delays;
- taxpayer relief report.

An entry should be created in the taxpayer relief registry as soon as a proactive request is initiated. The received date must reflect the date a recommendation of proactive waiver and/or cancellation is considered.

In all cases, the officer or the auditor must complete a fact sheet and forward it for approval, with the decision letter, to the delegated authority or to the taxpayer relief committee. The registry entry is closed once the fact sheet and the decision letter have been approved by a delegated authority.

All taxpayer relief decisions must be communicated in writing. The letter should suit the particular case and is not intended to give the taxpayer a detailed explanation, only some insight as to what is being waived/cancelled. If the taxpayer requests clarification, the officer/auditor is instructed to advise the taxpayer as to how the portion of the interest waived/ cancelled was calculated and the reason(s). See 6.10 Communicating decisions for details.

The delegated authority, who approved and signed the fact sheet, must sign the decision letter as well.

The actual interest waived will be provided on the notice of assessment/reassessment (as applicable).

If the taxpayer disagrees with the interest and/or penalty relief that was proactively allowed by CRA and requests additional interest and/or penalty relief in respect of the same taxation year/audit period, we would consider this as a first request.

REMEMBER, be proactive! Waive interest and penalty if it is appropriate, e.g. if there has been undue delay in completing the review/audit.

7.5 Other circumstances

There may be other circumstances in which it may be appropriate to cancel or waive penalties and/or interest. For example, a taxpayer requests relief due to a specific situation that is not considered to be an "extraordinary" circumstance. In these situations, we must consider the request to be valid and review the request in the same manner as we would for any other request.

When preparing the fact sheet and the decision letter, it is important to indicate why the specific situation presented is denied or partially approved. We cannot base our decision on the fact alone that the circumstance(s) was not considered "extraordinary". Therefore, never indicate that the relief is not granted because the circumstance is not extraordinary.

In the court case, *Nixon v. Canada* (National Revenue), the judge set aside the decision to deny the request for taxpayer relief. The taxpayer asked for relief due to a specific situation that prevented him from complying with his tax obligations. At the second review process, both the report and the letter indicated that the request was denied because there were no "extraordinary" circumstances. The judge indicated that our own guidelines were not followed as we did not consider other circumstances as indicated in paragraph 24 of IC07-01. Paragraph 24 says that the Minister may also grant relief if a taxpayer's circumstances do not fall within situations stated in paragraph 23 (extraordinary circumstances, actions of the CRA or inability to pay or financial hardship). In this case, the taxpayer had a circumstance that was not considered extraordinary and the decision to deny should not have been based on that fact alone.

000061

Digitized by Google

7.6 Disputed assessment or amount charged

Relief should not be considered for a disputed assessment or amount charged. For example, you may have two categories of requests/situations for late filing penalties:

- Taxpayers' admit the return/document is filed late but would like the penalty to be waived/cancelled; or
- Taxpayers may dispute the correctness of the penalty (taxpayers indicate the return/document was filed on time).

The first bullet situations are clearly valid taxpayer relief requests, where you are dealing with correctly charged penalties.

The second bullet situations should not be considered a taxpayer relief request. Taxpayers may dispute the penalty informally by writing/contacting us; they may also formally dispute the penalty by filing a notice of objection.

It is the officer's responsibility to ensure, before recommending relief or referring the correspondence to taxpayer relief, that the law was applied correctly. In other words, the assessment must be valid or the taxpayer must have late-filed a return, otherwise taxpayer relief provisions do not apply.

See 5.3.1.4 Notice of objection and 5.3.1.4.4 Return filed on time/payment made on time.

7.7 Third parties

A third party can be defined as a representative acting on behalf of the taxpayer/employer

Taxpayers are responsible for meeting their obligations under the legislation we administer. As a result, taxpayers are generally considered to be responsible for errors made by third parties. Third parties who receive a fee and give incorrect advice, and make arithmetic or accounting errors should normally be regarded as being responsible to the taxpayer, if the taxpayer has suffered penalty or interest charges because of the party's actions.

In rare situations, relief could be granted to taxpayers because of third-party errors or delays. An extraordinary circumstance beyond the control of a taxpayer's representative, which prevented the taxpayer from complying, can be a reasonable basis for granting relief. For example, it would be proper to grant relief when a taxpayer's representative cannot file a return or an election on time because the representative was just hospitalized.

This is why it is important to review relief requests with care when third-party error is involved. Special care should be taken in granting taxpayer relief in cases of third-party errors so as not to undermine the principles of self-assessment

Following the Ian Spence adverse judicial review decision, the judge properly outlines CRA's guidelines that should be followed. Paragraph 24 of the IC07-1 *Taxpayer Relief Provisions* indicates that subsection 220(3.1) of the ITA gives the Minister (CRA delegate) broad discretion to waive or cancel any penalty and interest without setting any rigid rules in what situations relief is granted or not granted to a taxpayer. Therefore, a CRA delegate must consider other reason(s), including third party errors, as the taxpayer's circumstances are not limited to the conventional situations listed in paragraph 23 of the IC07-1 (i.e. extraordinary circumstances beyond the taxpayer's control, actions of the CRA and inability to pay or financial hardship).

A taxpayer relief request cannot be refused on the basis that the circumstances of the taxpayer fails to meet a specific criteria set out in the IC07-1

Paragraph 35 of the IC07-1 explains CRA's current taxpayer relief policy relevant to third party error:

> ¶ 35. Taxpayers are generally considered to be responsible for errors made by third parties acting on their behalf for income tax matters. A third party who receives a fee and gives incorrect advice, or makes arithmetic or accounting errors, is usually regarded as being responsible to their client for any penalty and interest charges that the client has because of the party's action. However, there may be exceptional situations, where it may be appropriate to provide relief to taxpayers because of third-party errors or delays.

Digitized by Google

7.8 Bank error

There may be exceptional situations where it may be appropriate to provide relief arising from a bank error or delay, if it has been established that the error occurred from a situation beyond the taxpayer's or employer's control. For example, if the employer makes his payment on time directly at his financial institution, but a delay occurs in the transfer of funds to CRA due to a computer breakdown, then it may be possible to consider cancelling the penalty and interest charges on the remittance, providing the bank can corroborate the situation. In this case, the bank is the third party and has admitted being at fault. This is clearly a situation beyond the employer's control. As a general rule, these types of requests should be approved if the financial institution can substantiate the circumstances.

7.8.1 Employer error

An employer error is different from a third party error as the employer commits the error.

In cases of employer error, officers need to look at each relief request on a case-by case basis. Where the CRA is satisfied that the employee had no knowledge or could not have been expected to know that the amounts on the T4 were incorrect because of an employer error, it would be reasonable to consider waiving or cancelling the interest and/or penalties.

7.9 Ignorance of the law

Generally, ignorance of the law or taxpayer error should not be accepted as a proper basis for granting relief under the taxpayer relief provisions. If the delay in compliance or in making a payment/remittance arose through neglect, carelessness, or lack of awareness on the part of the taxpayer, the penalties or interest should not normally be cancelled or waived, or the election should not normally be accepted. For example, the fact that a taxpayer was not aware of a filing requirement does not constitute by itself an acceptable reason for granting relief.

7.10 Gross negligence penalties

Relief request to cancel a gross negligence penalty can be considered under subsection 220(3.1).

However, since these penalties indicate a degree of negligence and absence of care and diligence on the part of the taxpayer, the cancellation of a gross negligence penalty may be appropriate only in exceptional circumstances.

Given the nature of a gross negligence penalty, it is more appropriate for a taxpayer to dispute the assessment of the penalty by filing a notice of objection.

Note: The taxpayer relief provisions contained in the *Excise Tax Act* do not extend to penalties assessed under section 285. See 5.3.1.4 Notice of objection and 5.7.2.2 Requests for which there are no legislative provisions for more information.

7.11 Erroneous refunds

Cancelling or waiving penalties and/or interest may be appropriate if the CRA made an error by issuing a cheque to a taxpayer for a greater amount than the taxpayer is entitled to without justification, foundation, or rationale. An example would be a refund cheque for $1,000 mistakenly issued for $10,000, due to a keystroke error.

The question of whether or not to waive or cancel penalties and/or interest that have accrued on a refund issued to a taxpayer in error would need to be decided based on the facts of each individual case.

The main considerations when reviewing such requests would be:

- whether the taxpayer acted in a timely manner to bring the matter to the CRA's attention: did the taxpayer contact the CRA within a reasonable time?
- whether the taxpayer has taken a reasonable amount of care in trying to resolve the situation: did the taxpayer contact the CRA to question the discrepancy?

Digitized by Google

- whether it would have been clear to the taxpayer that an error had been made and that he or she was not entitled to the funds; was there a discrepancy between the balance or refund calculated by the taxpayer and the amount of the refund received?

Although each case must be evaluated on its own merit, the taxpayer is normally expected to report the occurrence to the CRA within a reasonable time after becoming aware of the error, to qualify for total penalty and interest relief.

7.12 Amounts held in trust

If a taxpayer meets the criteria for taxpayer relief, it should be granted whether or not trust funds (e.g., payroll accounts or GST/HST accounts,) are involved. The fact that amounts are considered to be held in trust should not be the sole basis for denying a request under the taxpayer relief provisions. For example, a waiver or cancellation may be considered in cases of legitimate financial hardship where the continuity of business operations and the continued employment of the firm's employees are unnecessarily jeopardized because of circumstances beyond the control of the taxpayer.

7.13 Reinstating cancelled or waived penalties and/or interest

After penalties and/or interest have been cancelled or waived, they generally cannot be reinstated, since there is no basis in law to allow for reinstatement. Even if penalties or interest could be reinstated, in most cases it would not be fair, expedient, or cost effective to do so after the cancellation or waiver has been granted.

7.14 Inability to pay or financial hardship

A taxpayer may request relief of penalties and/or interest based on inability to pay or financial hardship. This workload is the responsibility of staff located in taxpayer relief centres of expertise (CoE). See exceptions in Appendix 5A for some non-residents accounts. If you are located outside a CoE, and are processing a request and the taxpayer has requested relief based in part on an inability to pay or financial hardship, a joint review may be required. See also 6.7.1 Joint Reviews and Chapter 8 for detailed procedures on requests based on financial hardship or inability to pay. See Contact List for CoE locations and contact information.

7.15 Factors to consider in arriving at the decision

Consider the following factors, refer to IC07-1 when determining whether it is appropriate to cancel or waive penalties and/or interest.

- past compliance;
- has the taxpayer knowingly allowed a balance to exist?;
- reasonable amount of care,
- has the taxpayer acted quickly to remedy any delay or omission?

7.15.1 Assessing reasonable care

The CRA will generally not make a decision in the taxpayer's favour unless the taxpayer took a reasonable amount of care to comply. In a normal situation, efforts should have been made to avoid, or at least minimize, delays in complying, paying, or remitting amounts due. A taxpayer should remedy any delay or omission within a reasonable time after he or she became aware of the delay or omission, or as soon as circumstances permitted.

Reasonable care is best described as whether the action or inaction of a taxpayer reflects what a person might reasonably be expected to do under comparable circumstances.

If the CRA can determine that a delay in payment or compliance arose through neglect or lack of awareness on the part of the taxpayer, relief under the taxpayer relief provisions should not be granted.

Digitized by Google

Here are some guidelines to use in determining whether reasonable care was exercised:

- examine the taxpayer's reasons for failing to comply to determine if the dates and explanations correspond with events on which the penalties or interest are based;
- examine the length of time between the event cited as a reason for the non-compliance and subsequent compliance, as this can indicate whether care was exercised. For example, if the taxpayer claims that he or she was unable to comply due to a fire, the reasonableness of the length of time between the fire and subsequent compliance may serve to support or refute all or part of the event's effect. This could be more difficult to assess if the reasons claimed are illness, accident, or serious emotional or mental distress. We would normally rely on medical or professional documents or proof submitted by taxpayers;
- review whether or not the taxpayer could have anticipated the event that caused the non-compliance and to what extent the non-compliance was within the taxpayer's control;
- determine if the taxpayer or the taxpayer's representative has knowledge that would help in knowing what the requirements or obligations would be and the repercussions in not meeting them.

7.15.2 Assessing past compliance

We should normally review a taxpayer's past compliance (e.g., penalty/interest history) to help determine if reasonable care was used. This is normally achieved by consulting mainframe applications or consulting a taxpayer's past records.

Evaluating a taxpayer's compliance history is particularly relevant in a situation where a taxpayer claims that he or she was not aware of, or informed of, an obligation such as the requirement to make an instalment payment or remittance, but has been assessed late instalment or remittance penalties in the recent past. If the same types of penalty or interest charges are assessed from year to year, this may indicate that a taxpayer is not exercising reasonable care in meeting his or her obligations. How far back we should assess a taxpayer's compliance history depends on the circumstances of each case.

It should be emphasized that a taxpayer's compliance history should not be the sole basis on which a decision is based. It is only one of the factors to consider. The purpose or intent of weighing the compliance history when deliberating on a relief request is to determine the credibility of the taxpayer's description of events and facts.

Assessing a taxpayer's past compliance would be less relevant if circumstances were out of the taxpayer's control and the non-compliance was reasonably remedied.

The fact that a taxpayer has a poor compliance record would not lead to refusing the taxpayer's request if the circumstances of the case show no evidence of negligence. For example, penalties and interest could be cancelled or waived if an electronic transaction or filing was overdue because of the failure of the CRA's systems, even if a taxpayer has a poor compliance history.

7.16 Completing a fact sheet

Taxpayer relief fact sheets are mandatory. For detailed information on what they should include and other essential elements, refer to 6.6 Fact sheet. See also 4.2 Fact sheet, in the Taxpayer Relief Registry guide.

Digitized by Google

- **8. Inability to pay or financial hardship**
  - 8.1 Definition of financial hardship
    - 8.1.1 Application to inability to pay/financial hardship situations
      - 8.1.1.1 Temporary inability to pay
      - 8.1.1.2 Marginal ability to pay
      - 8.1.1.3 Permanent inability to pay
  - 8.2 Determining the financial situation of an individual
    - 8.2.1 Identifying family income
    - 8.2.2 Identifying a household's net worth
    - 8.2.3 Conclusion
  - 8.3 Determining a corporation's financial situation
    - 8.3.1 Identifying corporate earnings
    - 8.3.2 Identifying corporate equity
    - 8.3.3 Conclusion
  - 8.4 Penalty relief
  - 8.5 Considerations for reviewing financial hardship
    - 8.5.1 Decision scenarios
  - 8.6 Additional submission requirements - unfiled returns
  - 8.7 Write off
    - 8.7.1 Potential write off process
    - 8.7.2 - Accounts already written off
  - 8.8 Requests regarding amounts in dispute
  - 8.9 Financial adjustments
  - 8.10 Application to directors' liability assessments (joint reviews with Revenue Collections/ Debt Management)
  - 8.11 Non-arm's length transfers (for information purpose only as it is ARD responsibility)
  - 8.12 Remission - Relief of tax (for information only)
  - 8.13 Insolvency and taxpayer relief requests

8. Inability to pay or financial hardship

This chapter provides guidelines and procedures for processing taxpayer relief requests based on an inability to pay and financial hardship. These guidelines and procedures should be used in conjunction with Chapter 6 General policies and procedures

Note: On April 1, 2011, the responsibility for taxpayer relief requests based on inability to pay or financial hardship was transferred from Accounts Receivable Directorate (ARD) of the Taxpayer Services and Debt Management Branch to the Taxpayer Relief and Service Complaints Directorate (TRSCD) of the Appeals Branch. See exceptions in Appendix 5A for some non-residents accounts. This chapter contains updated information on the respective roles and responsibilities of TRSCD and ARD. See Appendix 8A for more information.

Staff in the taxpayer relief intake centres (IC) and centres of expertise (CoE) will be responsible for the processing of correspondence from taxpayers requesting relief due to an inability to pay or financial hardship.

It may be appropriate, in circumstances where there is a confirmed inability to pay all amounts owing, to consider waiving or cancelling interest in whole or in part to enable taxpayers to pay their account. For example:

(a) when collection has been suspended due to an inability to pay and substantial interest has accumulated or will accumulate;

(b) when a taxpayer's demonstrated ability to pay requires an extended payment arrangement, consideration may be given to waiving all or part of the interest for the period from when payments start until the amounts owing are paid, as long as the agreed payments are made on time and compliance with the Act is maintained; or

(c) when payment of the accumulated interest would cause a prolonged inability to provide basic necessities (financial hardship) such as food, medical help, transportation, or shelter, consideration may be given to cancelling all or part of the total accumulated interest.

Digitized by Google

The taxpayer relief officer is not responsible for negotiating a payment arrangement but to determine if the taxpayer is eligible for relief of the penalties and/or interest charges due to an inability to pay or financial hardship. Accounts Receivable retains responsibility for all actions taken to collect the taxpayer's debt, both during and after the taxpayer relief review process. Collection Action should continue, when a valid taxpayer relief request has been received. Accounts Receivable will limit new enforcement action on principal amounts only while a taxpayer relief decision is pending. Both parties will promptly inform each other of any change in a taxpayer's financial circumstances while a taxpayer relief decision is pending.

Intake centres officers will scan work-ready files into electronic folders to be assigned to taxpayer relief officers at the CoEs. Any documentation received after a review has begun must also be scanned and added to the electronic file after the final decision has been made to ensure the file is complete. See Taxpayer Relief Scanning Procedures for more information.

To assist you in drafting letters to taxpayers, see the Taxpayer Relief Correspondence Binder. According to the situation, you will find a variety of verses to help you in writing letters.

8.1 Definition of financial hardship

For an individual taxpayer, financial hardship refers to financial suffering or lack of what is needed for basic living requirements such as food, clothing, shelter and reasonable nonessentials. For a business taxpayer, it refers to situations where the continuity of business operations and the continued employment of a firm's employees are jeopardized.

8.1.1 Application to inability to pay/financial hardship situations

Every case must be considered on its own merit; however, it is appropriate to consider the cancellation of interest and penalty charges based on the taxpayer's ability to pay. If there is some confusion after reviewing the documents provided by the taxpayer, a phone call or letter may be appropriate to obtain clarification. Along with the information provided by the taxpayer, review the information that might already be stored in CRA systems: For example ACSES, Rapid, SUDS, ELCS, SA, etc.

When considering a request for the cancellation of penalties and/or interest charges, it is essential that the Ability to Pay guidelines outlined in the "Payment Arrangements" chapter of the Collections Manual be followed, specifically follow the guidelines that relate to determining and confirming the ability to pay. In this regard, when considering a taxpayer relief request, conduct a full and comprehensive review of the taxpayer's current and foreseeable financial situation. This includes a review of all assets and liabilities, as well as current and projected cash inflows and outflows from all sources. In addition, it would be appropriate to consider spousal income, expenses, assets and liabilities when determining the ability to pay.

Taxpayers that are capable of acquiring sufficient funds to pay their arrears are expected to do so and would not be candidates for the waiver or cancellation of penalties and/or interest charges, based on an inability to pay.

Similarly, when the inability to pay is attributable to factors within the taxpayer's control, such as maintaining an opulent lifestyle without sufficient means, preferring other creditors to the detriment of the Agency, or unreasonable discretionary spending not required to maintain a family or a business, requests to cancel or waive penalties and or interest should not be granted. Lavish lifestyle choices do not support an inability to pay.

When considering a taxpayer's ability to pay, it is important that anticipated credits from prior, current and future year returns be taken into consideration; therefore, all outstanding returns should be filed. Note that the forgiveness of interest should not be considered where the interest relief sought can be accomplished through assessing or reassessing action, such as through the application of loss carry backs.

Other examples are claiming unused RRSP contributions and the Disability Tax Credit (if applicable).

Revenue Collections/Debt Management will share supporting documentation regarding a taxpayer's financial circumstances that are not readily available in the CRA systems. Where the information is contradictory and/or unclear, contact the taxpayer or representative for clarification.

Digitized by Google

8.1.1.1 Temporary inability to pay

A temporary inability to pay is when a taxpayer has experienced circumstances beyond their control, such as the unexpected loss of income or employment and the taxpayer is experiencing financial hardship.

This type of situation would typically involve cases where collection action has been or will be suspended or deferred due to a legitimate but temporary inability to pay. Consideration could be given to waiving interest charges, for the period during which temporary financial hardship is experienced. Once the taxpayer's financial situation improves, the cancellation of interest would cease and a payment arrangement to clear the balance owing could be concluded at that time with Revenue Collections/Debt Management.

8.1.1.2 Marginal ability to pay

A marginal ability to pay is when the charging of penalties and/or interest in the context of a long-term payment arrangement would make it difficult for the taxpayer to resolve his/her account over time without creating financial hardship.

8.1.1.3 Permanent inability to pay

There may also be isolated instances where consideration could be given to the cancellation or waiver of penalties and or interest charges where the inability to pay is of a permanent nature. An example would be that the account has been identified as or made uncollectible and there would be a material consequence to not granting relief. See 8.7 Potential write-off process for more information.

8.2 Determining the financial situation of an individual

To determine an individual's ability to pay or borrow, the following must be identified:

- family household income and expenses;
- household assets and liabilities.

8.2.1 Identifying family income

When screening and acknowledging a relief request for financial hardship or inability to pay, the intake centre (IC) will ask for supporting documentation. Along with the acknowledgement letter, the IC will attach the Income and Expense/Assets Liabilities (IEAL) document to be completed, if not already provided by the taxpayer. See Appendix 5F Income and Expenses/Assets and Liabilities (IEAL).

To identify a taxpayer's available disposable family income:

1. Have the taxpayer complete the Income and Expense/Assets and Liability (IEAL) statement;

2. Obtain details of all income sources and amounts, including:
   - employment income (e.g. salary, wages, commissions, self-employed earnings),
   - investment income (e.g. annuities, dividends, interest income);
   - other income (e.g. rental income, pension income, Canada Child Tax Benefit (CCTB), spousal income);
   - when a taxpayer is self-employed, (sole proprietorship or partnership);
   - when a taxpayer owns a corporation, assessing his company's ability to pay dividends or salary may be required.

3. Obtain details and amounts of essential expenses, including:
   - employment expense (e.g. withholding taxes, union or association due, registered pension plan deductions),
   - household expenses (e.g. accommodation, food, clothing, utilities);
   - other expenses (e.g. transportation, insurance, health insurance, property taxes, loan payments, alimony/child support).

Digitized by Google

In general, a taxpayer is expected to make full disclosure of their financial circumstances when requesting relief based on financial hardship. However, in some circumstances, if specific details are not available, there may be a need to estimate expenses by consulting the Canadian Expenditure Averages. Refer to Estimating Expenses Using the Canadian Expenditure Averages, from the Collections Manual Guide and Guide to Income and Expenditure Accounts, from the Statistics Canada website.

4. Obtain details and amounts used for discretionary expenses, including:

    - recreation,
    - registered retirement savings plan (RRSP) contributions;
    - pension contributions that are not mandatory;
    - loan/credit card payments;
    - savings plan contributions;
    - vacation fund;
    - donations,
    - tuition fees.

Note 1: Although the reason for the initial loan may not have been essential, if the loan has already been negotiated, the payment is an essential expense. The reason for the loan and the date it was negotiated should be taken into account to determine if the taxpayer made discretionary financial arrangements while he had a tax debt, i.e. preference to finance or refinance for purposes other than paying outstanding tax debts.

Note 2: Credit card repayment is allowed but only at the minimum monthly level of repayment.

5. Determine the reasonableness and necessity of expenses claimed using discretion and good judgement. Allowances may be made for expenses and costs, which are reasonable in light of the taxpayer's circumstances. Items that are not considered essential are not given priority over the payment of a tax debt.

6. Determine if there is an income deficit or surplus by subtracting the expenses from income. It should be very clear in the analysis, and in the decision letter to the taxpayer, which expenses were disallowed or adjusted and why.

7. Calculate the available disposable income by subtracting the essential expenses from the income. Income amounts in excess of essential expenses represent the amount available to pay the tax debt or external borrowing. This will determine if the taxpayer is in fact experiencing an inability to pay and therefore whether he is eligible for relief of the interest charges.

8.2.2 Identifying a household's net worth

The taxpayer's ability to borrow or liquidate assets should also be considered. To determine this possibility, the review of a net worth statement will be required. When identifying a family's financial situation, perform a credit bureau search.

Information on the credit bureau search plus information and/or documentation provided by the taxpayer could be sufficient to analyze the family's financial situation.

In exceptional circumstances, if a Property Search is warranted, you should contact the Collections Officer to validate the need.

To identify a family's financial situation:

1. The taxpayer should complete the Income and Expense/Assets and Liability (IEAL) statement. The taxpayer relief officer will:
    - obtain details of the assets, including:
        a. amount or current estimated market value;
        b. descriptions of the assets;
        c. estate, motor vehicles, Registered Retirement Savings Plan (RRSP), other receivables, valuable collectibles types of assets (e.g. cash, term deposits, stocks, real)
    - obtain details of the liabilities, including:
        a. amount of liabilities;
        b. descriptions and terms of encumbrances

Digitized by Google

2. Determine the equity by subtracting the liabilities from the value of the assets.

In addition to reviewing the household assets and liabilities, it will be necessary to consider the business activities of the taxpayer if they are operating a sole proprietorship or partnership. Business and personal expenses may overlap. It may be necessary to request a copy of the Statement of Business Activities to determine reasonable expenses and review the assets and liabilities of the Business.

8.2.3 Conclusion

Income amounts in excess of essential expenses and equity represent the amount available for the tax debt and/or external borrowing. This will determine if the taxpayer is in fact experiencing an inability to pay and whether he is a candidate for relief of the penalties and or interest charges.

Reminder: financial hardship must be considered along with the four factors indicated in IC07-1, paragraph 33.

Note: The criteria for the "Individual" also apply for the "Sole Proprietorship" and the "Partnership" financial situation.

8.3 Determining a corporation's financial situation

The primary difference when dealing with a corporation as opposed to an individual is that expenses or assets for necessities of life are not involved. Therefore, all income, expenses and assets are subject to scrutiny. Nevertheless, it is important to use a reasonable approach and good judgment when obtaining the necessary information in determining a corporation's ability to pay

To determine a corporation's ability to pay, or eligibility for relief, the taxpayer relief officer will identify:

- Corporate earnings,
- Corporate equity

8.3.1 Identifying corporate earnings

In order to identify corporate earnings and estimate cash flow when screening a relief request for financial hardship or inability to pay, the IC will ask for the following supporting documentation:

1. A statement of earnings from the corporation. If this information is not made available by the corporation, review the available financial information obtained from previous tax returns.

2. Details and amounts of income, including:
    - dividends;
    - gross sales;
    - interest;
    - rental income;
    - other income

3. Details and amounts of expenses, including:
    - cost of goods sold;
    - interest expense,
    - operating expenses;
    - other expenses.

The corporate earnings are calculated by subtracting the expenses from the income. The excess amount will be taken into consideration in the analysis to verify if the corporation is a candidate for relief of the penalties and/or interest charges.

Digitized by Google

8.3.2 Identifying corporate equity

When identifying corporate equity, perform the credit bureau search. The information found following the credit bureau search plus the information/documentation provided by the taxpayer should be sufficient to analyze the corporate equity. In the event that Property Searches might be warranted, you should contact the Collections Officer to validate the need.

To identify corporate equity:

1. Obtain a corporate balance sheet (if not already in the file) from the corporation;

2. Analyze details of the assets, including
   - amount or current estimated market value,
   - description and location of assets;
   - list of accounts receivable;
   - type of asset (e.g. cash, term deposits, stocks, real estate, motor vehicles, other receivable, inventory, investment in other entities, real property).

3. Analyze details of encumbrances, including
   - amount of liabilities (e.g. bank loans, line of credit, mortgages, leases);
   - terms of the contract,
   - shareholder loans and interrelated third party loans

4. Determine the equity by subtracting the encumbrances from the asset's value. The excess amount reflects the equity leverage available to the corporation's considered in the analysis to determine the corporation's ability to pay.

Other information to consider.

5. Dividends paid to shareholders;

6. Capital Cost Allowance (CCA) - This can provide valuable information regarding the ability of the business to purchase new equipment, machinery, vehicles, etc. CCA schedules also show the disposition of property and the funds received for that disposition.

7. Notes to the financial statements provide valuable information.

8.3.3 Conclusion

In the case of an employer remittance account, an analysis of ability to pay must take into consideration the taxpayer's capacity to pay the current remittances, arrears and other obligations necessary to continue operations, such as trade creditors.

Review the balance sheet to determine:

- whether the asset position could facilitate obtaining sufficient funds to pay the debt by borrowing from a financial institution;

- whether assets are available for liquidation without creating additional tax liabilities.

Corporate and business analysis is not simple. Answering the following questions will help to substantiate a decision:

1. Has the corporation incurred expenses to the detriment of its statutory obligations, such as travel expenses, advertising, bad debts, increases in wages and bonuses, capital expenditures?
2. Have dividends been paid out to shareholders, have the dividends resulted in a net loss?
3. Have other liabilities been paid?
4. Has the corporation made loans to other parties?

Reminder: financial hardship must be considered along with the four factors.

Digitized by Google

8.4 Penalty relief

Consideration would not generally be given to cancelling a penalty based on an inability to pay or financial hardship unless an extraordinary circumstance has prevented compliance. However, there may be exceptional situations that may give rise to cancelling penalties, in whole or in part.

For example, when a business is experiencing extreme financial difficulty, and enforcement of such penalties would jeopardize the continuity of its operations, the jobs of the employees, and the welfare of the community as a whole, consideration may be given to providing relief of the penalties.

8.5 Considerations for reviewing financial hardship

Financial hardship (FH) is considered when a taxpayer has made bona fide efforts to discharge arrears/balance over time but the interest/penalty charges absorb a significant portion of each payment; the interest/penalty arrears balance is so onerous in relation to the amount of payment that the taxpayer has the confirmed ability to pay, that it would be difficult, if not impossible, for the taxpayer to ever resolve their account.

8.5.1 Decision scenarios

Taxpayer relief officers are responsible for preparing a recommendation to grant full or partial relief or to deny relief all together while Revenue Collections/Debt Management is responsible for negotiating payment arrangements and collecting the account. When a decision is issued but a payment arrangement is not in place, inform Revenue Collections through the ACSES diary of the decision and Revenue Collections will negotiate a payment arrangement with the taxpayer. If a taxpayer makes a subsequent relief request, for the same situation, part of the analysis will consider if the taxpayer has taken all the necessary steps to address and resolve his situation, including negotiating a payment arrangement as directed in the previous relief request.

FH decision scenarios:

1. Decision: full or partial relief

- grant arrears interest to date of decision letter and/or other specific period based on financial circumstances;
- grant or deny penalty based on other circumstances that prevented compliance,
- arrange to have financial transaction(s) processed;
- for partial relief, include offer of second (2nd) review in decision letter.

If a balance remains:

- refer the taxpayer to Accounts Receivable to negotiate a payment arrangement;
- invite the taxpayer to reapply after a year if their circumstances have not changed.

A. Decision: denial of interest based on FH (with or without penalty relief for other circumstances).

- include offer of second (2nd) review in decision letter.

If a balance remains:

- refer the taxpayer to Accounts Receivable to negotiate a payment arrangement

Decisions will be based on a review of the four factors. Generally, when relief in part or full is granted, it is up to the date of the letter (for whichever period or years we decide is appropriate). The financial transaction will be sent for processing when the decision letter is issued. The decision letter will invite the taxpayer to apply for further relief if, after a year, their circumstances have not improved and they believe that they would continue to qualify for relief. This will reduce the need for follow-up actions. If after a year the taxpayer applies for further relief, the relief officer will examine what has transpired since the last decision. If the taxpayer's circumstances have changed, if they've made payments (for reasons of ability to pay), filed returns, etc.

Digitized by Google

8.6 Additional submission requirements – unfiled returns

Generally, all outstanding returns must be filed up-to-date, including those outstanding returns and remittances for related accounts, either prior to or as part of the taxpayer relief request.
When considering a relief request under financial hardship or inability to pay, the taxpayer should be up to date on all filing requirements. This will ensure the request for relief includes all the taxpayer's debts and that any available credits have been applied to the outstanding debts (full picture).

Exceptions:

1. The taxpayer was not required to file a particular tax year.

2. An arbitrary assessment was raised and there would be no benefit to filing an actual return. It is important to determine if filing the return would benefit the taxpayer in receiving credits that would reduce the debt.

You have to review all requests case by case. Exceptions do apply such as the example of Muriel Maaraman FC.

Here is a case where a return was not filed by the taxpayer but her request for relief was a valid request. The taxpayer, Muriel Maaraman, applied for relief on a tax year (1987) where CRA had raised an arbitrary assessment. She did not file an actual return. Losses from the 1988 tax year eliminated the tax owing on the 1987 tax year.

- The Judge could not conclude that Muriel Maaraman was aware of her tax liabilities and her requirement to file a return. She had never filed a return prior to 1990.
- CRA delay – 5 years from the time the request was made until a decision was made.
- Applicant alleges she never received a notice of assessment. Although CRA assured the court a NOA was sent, CRA no longer had a copy, therefore judge did not see it and it would be difficult at this point for the applicant to challenge a non-existent NOA.
- Judge believed the taxpayer was a victim of circumstances.
- Case sent back to CRA for a new decision based on these reasons.

When a request is denied due to unfiled returns, treat the request as an "incomplete" request. See 5.8.1 Incomplete request.

8.7 Write off

8.7.1 Potential write off process

While reviewing and analyzing the supporting documentation, taxpayer relief officers may identify a taxpayer who may be indigent and/or permanently unable to pay their debt.

When identifying a taxpayer who may have a permanent inability to pay, the taxpayer relief officer will deal with the relief request as any other relief request considering all factors including compliance history. Proceed with the analysis and recommendation to grant or deny relief. Following the issuance of the decision letter, the taxpayer relief officer will record the relief decision in the ACSES diary and indicate the type of hardship:

- Temporary
- Marginal
- Permanent

Revenue Collections/Debt Management will examine the situation and determine if the account should be made uncollectible.

8.7.2 Accounts already written off – recoverable write offs or accounts with Keep Code 4

Review the taxpayer's ability to resolve the entire debt. If the taxpayer is applying for relief on subsequent years and has incurred additional debt, the written off amounts should be included in the review.

Digitized by Google

8.8 Requests regarding amounts in dispute

Requests received for penalties and or interest relief based on an inability to pay, with respect to amounts and taxation years that are under objection or appeal should, in most cases, be held in abeyance pending the outcome of the appeal process. The taxpayer should be advised that we will consider the request with respect to the amount or tax year in dispute once a final determination of the amounts owing has been made, following the disposal of the objection or appeal by the Appeals Division or the Adjudications Division.

8.9 Financial adjustments

When a request for relief of penalty/interest has been approved in full or in part, the adjustments to the account are made through the applicable host system. How these host systems are informed varies with the system and the account to be adjusted. For example, requests for interest adjustments to a T1 account are processed through the Electronic Revenue Accounting (ERA) system, while interest adjustments to a GST account are done through Standardized Accounting (SA).

When financial transactions are being processed by the various host systems, the system will validate whether or not the registry entry is closed. If the entry has not been closed, a message, indicating that the registry entry is still open, is displayed. However, this will not occur with PAYDAC.

For more information, see 8.9.1 Post-decision financial transactions.

8.10 Application to directors' liability assessments (joint reviews with Revenue Collections/Debt Management)

The taxpayer relief provisions may also be applied to directors' liability assessments raised under section 227.1 and subsection 323(1) of the *Income Tax Act* (ITA) and *Excise Tax Act* (ETA) respectively.

Directors' liability assessment renders a director of a corporation jointly and severally liable together with the corporation to pay non-remitted source deductions, including any related interest or penalties. Directors' liability assessments are referred to as memorandum assessments because they are not posted anywhere and simply reflect the joint and several liabilities established. Accordingly, the component parts of an amount assessed against a director are the same as those for the corporation in respect of tax, penalties and interest.

A person assessed under the directors' liability provisions of the legislation we administer may qualify as an individual for post memo assessment interest only. The guidelines for considering a taxpayer relief request from a director based on financial hardship would be essentially the same as those for any other individual.

Where more than one director has been assessed pursuant to the directors' liability provisions of any of the legislation we administer, with respect to the same corporate indebtedness, each of these assessments stands independently. If circumstances apply, a director under the taxpayer relief provisions may have interest cancelled without affecting other memo assessments raised on the account.

Subsections 227.1(7) and 323(8) of the ITA and ETA respectively, provide that a director who has satisfied a claim under s. 227.1 or s. 323(1) is entitled to contribution from the other directors who were liable for the claim. In view of this, if we were to grant relief to one director under the condition of a payment arrangement, his/her right to contribution from the others could not exceed the amount he/she paid. Collections retain the ability to collect to the full amount of the corporate debt from the other directors. Note that their respective memo assessments often differ in amount based on the period(s) where they were actively involved with the corporation as a director.

For these types of relief, please consult with the Revenue Collections Officer on the best approach to be taken

Digitized by Google

8.11 Non-arm's length transfers (for information purpose only as it is ARD's responsibility)

Given the nature of such assessments, *bona fide* requests to waive or cancel interest with respect to the transferee's assessment should be rare.

Algoa Trust V Her Majesty the Queen
http://decision.tcc-cci.gc.ca/en/1998/1998tcc961186/1998tcc961186.html

In order for a taxpayer assessed under a S160, to be liable for any accrued interest, a new assessment must be made. It is important to recognize a potential S160 because if a taxpayer has engaged in this type of activity they are not likely a candidate for relief.

You may come across situations where assets (home, boat, motor vehicle, etc.) that could have been used to satisfy the tax liability have been transferred to a spouse in exchange for a token amount.

These transactions are common when people attempt to protect property from creditors, including the Crown. Some tax debtors believe that, once transferred to another person, their property can no longer be seized for payment of their tax debts.
There are legislative provisions to help resolve such situations. The purpose of sections 160 of the *Income Tax Act*, 325 of the *Excise Tax Act*, and 97.29 of the *Customs Act* is to prevent a taxpayer from avoiding his tax liability by simply transferring his assets.

The criteria for recognizing non-arm's length and arm's length transactions are as follows:

Non-arm's length

The parties:

- have mutual economic interests; and
- are related to each other.

Consideration is usually "given" or "paid" at less then the fair market value

Arm's length

The parties bargain:

- in good faith;
- in an objective manner; and
- completely independent of each other.

Consideration is usually fair market value or its equivalent.

If you think that the taxpayer or the corporation has engaged in non-arm's length transaction, consult with Accounts Receivable to determine if further investigation is warranted.

Examples:

1. While reviewing the financial statements for the last three years, you find that there was more than a million dollars in assets in the first year, approximately $500,000 in the second year and less than $100,000 in the third year without justification.

2. While examining a list of a taxpayer's property, you note that the house that was previously on the list is no longer there, indicating that there may have been a transfer.

Digitized by Google

8.12 Remission – Relief of tax (for information only)

A remission order is a very rare and extraordinary measure that allows the government to provide full or partial relief from a tax or penalty, or other debt, under certain circumstances, when such relief is not otherwise available under the existing laws. It is done through an act of parliament and is a lengthy process.

For information about Remission, refer to the CRA Remission Guide published by the Legislative Policy Directorate.

8.13 Insolvency and taxpayer relief requests

Taxpayer relief requests may be received from taxpayers that have undertaken a formal insolvency proceeding. It is important to note that CRA cannot refuse to consider a relief request based on the fact that the taxpayer has or may benefit from the provisions contained in the Bankruptcy and Insolvency Act (BIA), Farm Debt Mediation Act (FDMA) or Companies' Creditors Arrangement Act (CCAA). Systematically dismissing requests from taxpayers who have gone bankrupt, filed a proposal under the BIA, were placed in receivership or sought protection under the CCAA or FDMA is contrary to the Minister's legal obligation to exercise discretion.

If a relief request is received and prior to a decision being issued the taxpayer files for bankruptcy protection under the BIA, CCAA or FDMA, it may be appropriate to contact the taxpayer/trustee/receiver to determine if they still wish to proceed with the relief request

A relief request may not indicate that the taxpayer is insolvent. If the account currently has an insolvency status, the insolvency flag will be displayed on the first page of ACSES. More detailed information on current or past insolvency events can be viewed in RAPID at the following screens.

For T1 accounts select Option E in RAPID (Individual Identification Screen).

- An insolvency indicator will appear on the first page of Option E if insolvency information exists. Key an 'x' next to insolvency to get details.

For corporations insolvency information can be found in the BN system (RAPID Option FF).

- Select Client Registration Menu, Client and Program Account Menu, Retrieve Event.

Insolvency is defined as a financial state in which a person or corporation can no longer pay their bills and other obligations on time. It can also be defined as a person or corporation whose debts are greater than the value of their assets.

The terms insolvency and bankruptcy are commonly confused. Both insolvency and bankruptcy deal with liabilities exceeding assets, but...

- insolvency is a financial state; and
- bankruptcy is a legal standing.

A person can be insolvent but not legally bankrupt. Insolvency can lead to bankruptcy, but the condition may also be temporary and fixable without having to undertake a formal insolvency proceeding.
Insolvency may result in one or more of the following:

Proposal

A proposal is a contract between an insolvent taxpayer and his creditors. It can be a Division I (commercial) proposal or a Division II (consumer) proposal. The former would apply to corporations or individuals, whose debts, less amounts secured by their principal residence, exceed the sum of $250,000.00. The latter would apply to individuals only, if their total debts, less amounts secured by their principal residence, do not exceed the sum of $250,000.00.

The primary goal of a proposal is to allow the debtor an opportunity to offer a settlement to their creditors in an attempt to avoid filing an Assignment in Bankruptcy. If a proposal can be filed, the debtor normally retains most if not all of their assets.

Digitized by Google

Receivership

A receivership arises when a secured creditor enforces his security interest. Such would occur when the insolvent person is unable to meet their financial obligations as they become due or have stopped meeting current financial obligations as they are due, or not have enough value in their assets to satisfy their debts, if they were sold.

Bankruptcy

A bankruptcy arises when an insolvent person has made an assignment or when the court issues a bankruptcy order against him. The former is voluntary, while the latter is involuntary.

The goal of all bankrupt individuals is to receive their discharge from bankruptcy. Once a discharge is granted to an individual, they are no longer liable for a majority of the debts they owed as at the date of bankruptcy.

Generally, corporations that become bankrupt never receive a discharge. When a corporation becomes bankrupt, it is usually the death of the company and operations cease permanently. The CRA cannot refuse to consider a request for Taxpayer Relief based on the fact that the taxpayer has benefited from the provisions contained in the BIA, CCAA or FDMA.

In order to avoid the taxpayer receiving double relief, first by virtue of the ITA and second by virtue of the BIA, CCAA or FDMA, we will examine all relevant information including the four factors:

- whether or not the taxpayer has a history of compliance with tax obligations;
- whether or not the taxpayer has knowingly allowed a balance to remain unpaid on which interest has accrued;
- whether or not the taxpayer has exercised a reasonable amount of care and has not been negligent or careless in conducting their affairs under the self assessment system;
- whether or not the taxpayer has acted quickly to correct any delay or omission.

It is important to base decisions on the facts and take into consideration the arguments the taxpayer presented during the analysis

Generally, all years/periods prior to the insolvency event date are automatically covered by the insolvency event. Sometimes, the year of the proposal (T1 account) can also be included partially in the insolvency event. It should be noted that the taxpayer is not relieved of his debt under the BIA until he is discharged. He must honor certain obligations and conditions before he is discharged. Sometimes the trustee is discharged but the taxpayer is not. In that case, the debt becomes fully collectible again.

Things to note when reviewing a taxpayer relief request pertaining to an account that is in insolvency status include but are not limited to the following:

- the date of the insolvency event;
- has the trustee been discharged;
- has the taxpayer been discharged;
- does the request pertain to the same time period as the bankruptcy;
- was the request received prior to the taxpayer filing for bankruptcy;
- has the taxpayer complied with the conditions of the bankruptcy/proposal;
- it should not be assumed that the taxpayer relief request is based on financial hardship; there may be other reasons that require full consideration.

BIA

The *Bankruptcy and Insolvency Act* is the primary insolvency statute in Canada as it governs both bankruptcies and proposals.

Digitized by Google

CCAA

The *Companies Creditors Arrangement Act* provides corporations an opportunity to file a restructuring plan that is very similar to a proposal under the BIA.

The main differences between filing under the CCAA and a proposal are:

- only corporations may file a CCAA whereas both individuals and corporations can file a proposal under the BIA;
- only corporations with more than $5 million in liabilities are permitted to utilize the CCAA;
- the CCAA is more flexible than the BIA.

FDMA

The *Farm Debt Mediation Act* provides insolvent farmers and their creditors with mediation services to help them arrive at a mutually satisfactory arrangement for addressing the liabilities of a farmer.

For additional information see the Bankruptcy, Proposals in Bankruptcy and Insolvency and Receivership chapters of the Collections Manual.

Digitized by Google

[redacted]

- **9. Refunds or reduction in amounts payable beyond the normal three-year period**
  - 9.1 Refunds or reducing tax payable for a statute barred return
  - 9.2 Accepting a refund or adjustment request
  - 9.3 Limitations and restrictions
    - 9.3.1 Provincial benefits or credits
    - 9.3.2 Permissive deductions
    - 9.3.3 Employment Insurance Premiums and Canada Pension Plan
    - 9.3.4 Requests based in court decisions or other resolutions
  - 9.4 Requests must be complete
    - 9.4.1 Requesting additional information
  - 9.5 Fact sheet

9. Refunds or reduction in amounts payable beyond the normal three-year period

This section gives guidelines for considering taxpayer relief requests for refunds or reduction in amounts payable beyond the normal three-year period for individuals and testamentary trusts. These guidelines should be used in conjunction with General policies and procedures.

The Individual Returns Directorate of the Assessment and Benefit Services Branch has developed additional guidelines, which can be found in Functional Guidelines.

The CRA may issue a refund beyond the normal three-year period or reduce an amount owing if it is satisfied that such refund or reduction would have been made if a return or request had been filed or made on time, and as long as the assessment or reassessment is correct in law and has not been previously allowed. **This only applies to individuals and testamentary trusts.**

The request must be made within the 10-year time limit.

See also Chapter 2 Legislation and 5.7.2 Validating the taxpayer relief request for more information.

9.1 Refunds or reducing tax payable for a statute barred return

An individual or testamentary trust may ask the CRA for a refund or a reduction of tax payable for an income tax return that is beyond the normal three-year period. This may include:

a. a request for a refund of taxes for an income tax return not previously filed;

b. a request for a refund of taxes or a reduction of tax payable due to a deduction/non-refundable tax credit not previously claimed;

c. a request for a refund of taxes or a reduction of tax payable due to a decrease in taxable income; or

d. a request for a refund of taxes due to a refundable credit not previously claimed.

In any situation that a taxpayer or testamentary trust requests a refund beyond the normal three-year period, there may be a recalculation of certain refundable tax credits such as:

A. refundable Quebec abatement for income earned in Quebec by an individual resident of Quebec under subsection 120(2);

B. refundable First Nations abatement for individuals who are subject to income tax legislation of certain First Nations under subsection 120(2.2);

Digitized by Google

C. goods and services tax/harmonized sales tax (GST/HST) credit available to eligible individuals under subsection 122.5(3);

D. refundable medical expense supplement available to eligible individuals under subsection 122.51(2);

E. refundable investment tax credit available to taxpayers under subsection 127.1(1);

F the tax credit that a beneficiary of a mining reclamation trust can claim under subsection 127.41(3);

G. the tax credit that certain beneficiaries can claim under subsection 210.2(3) for the Part XII.2 tax paid by a trust;

H. the tax credit a Canadian partnership flows through to its partners for the Part XII.2 tax paid by a trust under subsection 210.2(4); and

I. Canada Child Tax Benefit (CCTB) payments available to eligible individuals for qualified dependents under subsection 122.61(1).

Whenever a request for a refund or reduction in amounts payable beyond the three-year period is accepted, paragraph 152(4.2)(b) allows for a redetermination of the above refundable credits.

9.2 Accepting a refund or adjustment request

The taxpayer relief provisions allow the CRA to issue a refund or reduce the amount of tax owed if it is satisfied that such a refund or reduction would have been made if the return or request had been filed or made on time.

Individuals and testamentary trusts can make a request if they were unaware of, or missed, claiming a deduction or a non-refundable tax credit that was available for the year. Individuals can also ask for refunds or reduction of amounts owing for refundable tax credits such as provincial tax credits or an overpayment of taxes.

The request may result in a calculation or recalculation of credits such as the Child Tax Benefit (CCTB) and/or the Goods and Services Tax Credit (GSTC).

There do not need to be circumstances beyond a taxpayer's control to allow these types of requests. The taxpayer needs to provide supporting documentation and the claim must be correct under law and not previously allowed.

Generally, CRA will not accept a request for an adjustment to a statute barred tax year of an individual where the adjustment would result in the increase of taxes, interest, or penalties to the returns of other individuals that are statute-barred and cannot be reassessed by the CRA.

Example 1

A taxpayer files a 2000 T1 income tax return on April 1, 2008. The taxpayer is requesting a refund of a portion of tax paid throughout the year. The return was filed more than three years from the end of the tax year but the request was made within the 10-year time limitation.

The request is accepted and the income tax return is processed. Paragraph 164(1.5)(a) of the *Income Tax Act* (ITA) allows us to refund the overpayment of tax.

Example 2

A taxpayer requests an adjustment to allow a deduction not previously claimed. The taxpayer has submitted an acceptable receipt to support the claim. The return was filed on time but the request was made outside the normal three-year reassessment period. The request was made within the 10-year time limitation. The adjustment will result in a refund of taxes and an increase in the amount of Goods and Services Tax Credit (GSTC) the individual is entitled to.

The request is accepted and the reassessment processed. Paragraph 152(4.2)(a) of the ITA allows us to reassess the return, paragraph 152(4.2)(b) of the ITA allows for the recalculation of the GSTC and paragraph 164(1.5)(b) us to refund the overpayment of tax.

Digitized by Google

9.3 Limitations and restrictions

This section provides information on limitations and restrictions regarding taxpayer's request for refunds or reduction in amounts payable beyond the normal three-year period.

9.3.1 Provincial benefits or credits

Time limitations to claim provincial benefits or credits that are administered by CRA for the provinces are stipulated in the applicable provincial act. Subsection 152(4.2) and paragraph 164(1.5)(*a*) of the ITA do not override provincial limitations, unless provincial law allows for it.

9.3.2 Permissive deductions

CRA will not process a reassessment if the requested credit is the result of an increased claim for capital cost allowance or other allowable deductions, where the taxpayer originally claimed less than the maximum amount allowable.

See IC84-1, *Revision of Capital Cost Allowance Claims and Other Permissive Deductions* for more information.

9.3.3 Employment Insurance Premiums and Canada Pension Plan

Taxpayer relief provisions to allow a refund beyond the normal three-year period do not affect refunds for overpayments of Employment Insurance premiums and Canada Pension Plan contributions.

The time limit for refunds is three years under the *Employment Insurance Act* and four years under the *Canada Pension Plan*.

Note: A legislative change to the *Canada Pension Plan* allows that individuals who are entitled to CPP disability benefits for prior years has 10 years from the end of the year to apply for a refund of excess CPP contributions. The legislation applies to disability pension decisions made on or after September 1, 2010.

9.3.4 Requests based on court decisions or other resolutions

Taxpayer relief requests to reassess a statute barred return will not be allowed if the request is based on another's successful appeal, negotiated settlement or consent to judgment on an appeal if the taxpayer has chosen not to protect their right of objection or appeal.

See IC75-7R3, *Reassessment of a Return of Income* for more information.

9.4 Requests must be complete

A taxpayer's request for a refund or a reduction of amounts owing should include:

- the taxpayer's name, address, and social insurance number, trust account number or other account number provided by CRA
- the tax year(s) involved;
- all supporting documents; and
- an explanation of the adjustment the taxpayer wants.

To support a request, taxpayers should give the following information:

- official receipts or certified "true" copies of receipts or documents (e.g., for tuition, RRSP contributions, charitable donations, and share certificates);
- copies of information slips (e.g., T3, T4, T5);
- details or calculations of specific expenses or deductions being claimed, such as previous and revised business or rental loss statements or investment income schedules; and
- proof of payment such as cancelled cheques for rental payments or notary contracts.

000081

See 8.2 Administrative reviews for information including determining if a request is a first or second request.

Digitized by Google

9.4.1 Requesting additional information

Taxpayers should be encouraged to make their requests as complete as possible. This allows CRA employees to exercise discretion and avoid processing delays. A proper review cannot be conducted if we do not have access to all relevant information.

Employees are encouraged to promote the requirement that taxpayer relief requests be complete when providing guidance or information to taxpayers on the taxpayer relief request process.

See 5.5 Supporting requests for more information.

9.5 Fact sheet

Taxpayer relief fact sheets are mandatory. For refunds or reduction in amounts payable beyond the normal three year period, there is no need to be circumstances beyond a taxpayer's control to allow these requests. The taxpayer needs to provide receipts, slips, etc., and the claim must be correct under law and not been previously allowed.

For detailed information on what they should include and other essential elements, refer to 6.8 Fact sheet. See also 4.2 Fact sheet, in the Taxpayer Relief Registry guide.

Digitized by Google

[redacted]

- **10. Accepting late, amended, or revoked elections**
  - 10.1 Elections covered by the taxpayer relief provisions
  - 10.2 Penalty for late filed, amended or revoked elections
  - 10.3 Deemed prescribed elections
  - 10.4 Basis for accepting requests
  - 10.5 Basis for denying requests
  - 10.6 Requests must be complete
  - 10.7 Fact sheet

10. Accepting late, amended, or revoked elections

This section gives guidelines for taxpayer relief requests to accept late, amended, or revoked elections. These guidelines should be used in conjunction with Chapter 6 General policies and procedures.

The CRA may extend the filing due date for making certain elections or grant permission to amend or revoke certain election. A late, amended, or revoked election must be correct in law based on the relevant legislation in place for the applicable tax year to which the election applies.

The request must be made within the 10-year time limit

See also Chapter 2 Legislation and 5.7.2 Validating the taxpayer relief request for more information

10.1 Elections covered by the taxpayer relief provisions

The elections for which a request can be made under the taxpayer relief provisions are found in section 600 of the *Income Tax Regulations*. See Chapter 12 Additional information for a complete list of these elections along with a brief description.

If the request to accept a late, amended or revoked election has been accepted, CRA will consider the late or amended election to have been made at the time it was required. Earlier elections will be cancelled for amended and revoked elections. CRA will reassess the affected returns for the tax years in question even if the years are beyond the taxpayer's normal reassessment period (i.e. statute-barred years).

10.2 Penalty for late filed, amended or revoked elections

Taxpayers that are allowed to late-file, amend, or revoke elections are liable, under subsection 220(3.5) of the *Income Tax Act*, to a penalty of $100 for each complete month from the due date of the election to the date the taxpayer made a complete application to CRA, to a maximum of $8,000.

The application date is when the taxpayer provided CRA with complete and accurate information for the election under review.

Taxpayers should remit the penalty amount with their request. It is CRA policy not to accept late, amended, or revoked elections, or to process the necessary adjustments unless the penalty is paid. The CRA will determine and assess any unpaid balance of the penalty. Interest will be charged on the unpaid balance of the penalty from the date of the notice of assessment to the date of payment.

This penalty is also subject to the taxpayer relief provisions. If the circumstances that allow for accepting a late-filed, amended, or revoked election are the same as the circumstances we would accept for cancelling or waiving penalties and interest, then we should strongly consider not levying this penalty (i.e. waiving it).

In these cases, a taxpayer relief registry entry must be created. See Chapter 7 Cancelling or waiving penalties and/or interest for more information.

Digitized by Google

10.3 Deemed prescribed elections

The rules and guidelines for accepting late, amended or revoked elections also apply to the following designations and allocations that are considered prescribed elections, under subsection 220(3.21):

- Paragraph 80(2)(*l*) of the Act allows a taxpayer to designate the order in which commercial debt obligations settled at the same time are to be applied for the purpose of the debt forgiveness rules.
- Subsections 80(5) to 80(11) allow a taxpayer who has designated a forgiven amount to apply any remaining part of the forgiven amount in certain circumstances.
- Subsection 80.03(7) allows a taxpayer to designate a capital gain that would otherwise arise under subsection 80.03(2) as a forgiven amount for the purpose of the debt forgiveness rules.
- Subsection 132.11(6) allows a mutual fund trust, as well as any electing trust with a December 15 year-end, to choose an amount designated by it for a tax year to be added in computing its income for the year.

10.4 Basis for accepting requests

A request may be accepted in the following situations:

- There have been tax consequences not intended by the taxpayer, and there is evidence that the taxpayer took reasonable steps to comply with the law. This could include, for example, a situation where the taxpayer obtained a *bona fide* valuation for a property, but after the CRA's review the valuation was found to be incorrect.
- The request arises from circumstances that were beyond the taxpayer's control. Such extraordinary circumstances could include natural or man-made disasters such as flood or fire; civil disturbances or disruptions in services, such as a postal strike; a serious illness or accident, or serious emotional or mental distress, such as death in the immediate family.
- The taxpayer acted on incorrect information given by the CRA. This could include incorrect written replies to queries and errors in CRA publications.
- The request results from what is clearly a mechanical error. This could include using the net book value amount (when obviously the taxpayer intended to use the undepreciated capital cost) or using an incorrect cost.
- The subsequent accounting of the transactions by all parties is as if the election had been made, or had been made in a certain way.
- The taxpayer can demonstrate that he or she was not aware of the election provision, even though the taxpayer took a reasonable amount of care to comply with the law, and undertook remedial action as quickly as possible.

10.5 Basis for denying requests

A request will not be accepted in the following instances:

1. It is reasonable to conclude that the taxpayer made the request for retroactive tax planning purposes. This could include taking advantage of changes to the law enacted after the due date of the election.
2. Adequate records do not exist to verify whether or not the request can be accepted.
3. It is reasonable to conclude that the taxpayer had to make the request because he or she was negligent or careless in complying with the law.

000084

Digitized by Google

10.6 Requests must be complete

Taxpayers should be encouraged to make their relief requests as complete as possible. This allows CRA employees to exercise discretion and avoid processing delays. A proper review cannot be conducted if we do not have access to all relevant information.

Note: Relief requests cannot be processed without a valid CRA account number.

A request to accept a late, amended or revoked election should contain the following elements:

- the names, addresses, social insurance numbers, partnership numbers, and corporation numbers of all the taxpayers involved;
- the dates and details of the transactions;
- the date and details of the original election including an explanation of why the taxpayer is asking to amend or revoke an election;
- details of a late-filed election, and an explanation why it is being filed late;
- the election needs to be made in the appropriate manner required by the specific provisions of the Act (e.g., filing the election in a prescribed form or in a prescribed manner);
- a brief description of the income tax implications of the acceptance or refusal of the request for all the parties involved; and
- appropriate revised schedules reflecting changes, should accepting the request involve changes to continuing tax account balances.

When the request involves more than one taxpayer, an agreement to the changes requested, signed by all parties, should be included with the request.

A request should also contain the following information:

- the type and nature of the extraordinary circumstances that prevented the taxpayer from complying,
- supporting documentation;
- supporting details of incorrect information given by the CRA in the form of written answers or errors in published information, or other objective evidence, and
- the name, address, and telephone number, where the taxpayer may be reached if more information or explanation is needed

See 6.2 Administrative reviews for information on making a taxpayer relief request and details on first and second reviews.

10.7 Taxpayer relief fact sheet

Taxpayer relief fact sheets are mandatory. For elections requests, taxpayers should provide supporting documentation and the claim must be correct under law.

For detailed information on what they should include and other essential elements, refer to 6.8 Fact sheet. See also 4.2 Fact sheet, in the Taxpayer Relief Registry guide.

Digitized by Google

- **11. Judicial review**
  - 11.1 Judicial Review Process Graph
  - 11.2 Requests under Rule 317
    - 11.2.1 Certified copy of material
    - 11.2.2 Time limit to produce certified copies (Rule 315)
    - 11.2.3 Rule 317 process
    - 11.2.4 Identify documents for certification
    - 11.2.5 Prepare certified copy of the material and certificate

11. Judicial review

A judicial review of any discretionary decision made by the federal government from which there is no right of appeal, may be applied for pursuant to Section 18.1 of the *Federal Courts Act*, within 30 days of the date notification of the discretionary decision is communicated.

In cases where taxpayers are not satisfied with the discretion the CRA exercised in its review of their requests, taxpayers can apply for a judicial review to the Federal Court by following certain steps. Our role is to advise the taxpayer of the option of pursuing the matter to Federal Court; we are not in a position to advise the taxpayer about Federal Court rules and procedures. Officers should be careful not to give the taxpayer an opinion about their chances of success in court. The Court will focus its review only on whether discretion was properly exercised.

NOTE: If a taxpayer contacts you (by phone or letter) because they have missed the 30-day time limit to apply for judicial review, advise the taxpayer, by phone, that they should contact the Registry of the Federal Court of Canada. You should put a note on the ELCS Notepad indicating that the applicant has been informed to contact the Federal Court to request an extension. The local Registry Office telephone numbers and addresses can be found in the Federal Court section of this manual. If the taxpayer cannot be reach by phone, send a letter. Here a suggestion for the verse

> As a courtesy, we have enclosed a copy of the taxpayer relief decision letter dated XXXXX denying (partially approving) your request under subsection 220(3.1) of the Income Tax Act (section 281.1 of the Excise Tax Act).
>
> If you feel that discretion was not properly exercised during our review of your request for relief, you can apply to the Federal Court for a judicial review. However, as the thirty (30) day time limit has passed, you must apply for an extension to the Federal Court. For more information on extensions under subsection 18.1(2), phone the Registry of the Federal Court of Canada at x-xxx-xxx-xxxx.

During its review, the Court has access to the taxpayer relief records (e.g., taxpayer's request, taxpayer relief report, and correspondence). As well, the officer who made the decision under review may be asked to give an affidavit to the Court.

There are three possible outcomes of a judicial review:

- withdrawn: the applicant decides not to continue to Court. In this case, the CRA will be advised that the application for judicial review has been withdrawn, meaning the case never makes it to the court hearing stage.
- dismissed: the Court finds that CRA acted in good faith and finds no reviewable error to warrant intervention of the Court.
- allowed: when the Federal Court finds concerns or flaws in our review process, the application for judicial review is allowed.

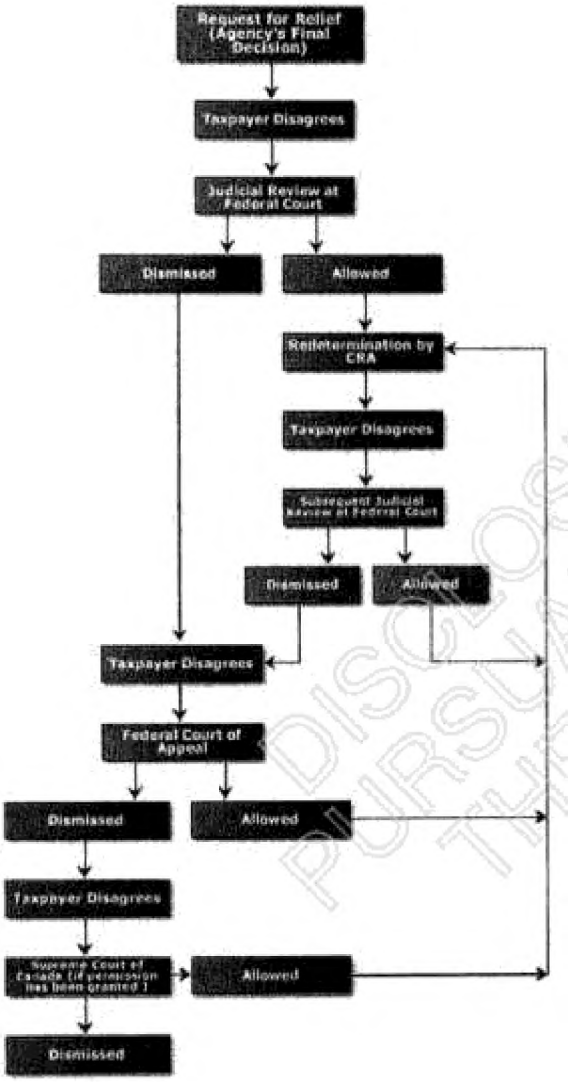
If the Court rules that discretion was not properly exercised, it will refer the matter back to the minister for reconsideration, as can be seen in Gandy v. Canada Customs and Revenue Agency. As with any subsequent review, cases referred back from the Federal Court must be handled by a person or persons not previously involved. Considerations, including the Court's direction, will determine if the case is referred back to the same office, or in some situations, to a different office, for a new review and decision.

Judicial review decisions are published on the Federal Court website. Search options include the Applicant's name and the year of decision. The site also allows the search for the Federal Court of Appeals decisions.

Digitized by Google

11.1 Judicial Review Process Graph

The following graph illustrates the judicial review process:



DISCLOSED PURSUANT TO THE

Digitized by Google

11.2 Requests under Rule 317

Some applicants (taxpayers) request copies of all materials from the Respondent (CRA) that were before the Minister's delegate who rendered the taxpayer relief decision, either in their Notice of Application or subsequently - Rule 317.

This section of the manual provides information on Rule 317 of the *Federal Courts Rules* and outlines the national standard process to be followed when the Canada Revenue Agency (the "respondent") is notified by the Department of Justice that the taxpayer (the "applicant") has made a Rule 317 request.

The CRA and the Tax Law Services Portfolio from the Department of Justice have come to an agreement about each of their respective roles and responsibilities to ensure requests made under Rule 317 are handled in a consistent, efficient, and timely manner.

11.2.1 Certified copy of material

Under Rule 317 of the *Federal Courts Rules*, an applicant is entitled to request a certified copy of material that is relevant to their Notice of Application for judicial review, and in possession of the CRA, but not in the possession of the applicant.

The request for certified documents may be included in the Notice of Application or made separately.

When a Rule 317 request is made, the office that conducted the taxpayer relief review and made the recommendation will:

1. Prepare the certified copy of material, and
2. Forward the taxpayer relief file, certificate (Schedule "A") and bundle of documents to the Department of Justice.

Where a separate Rule 317 request is made, and the relief file was sent to the Litigation Office at the time the Notice of Application was filed, the Litigation Office will forward the relief file to the officer, along with a copy of the judicial review application and the Rule 317 request to prepare the certified copy of material.

11.2.2 Time limit to produce certified copies (Rule 318)

Under Rule 318 of the *Federal Courts Rules*, the Department of Justice must transmit the certified copy of the requested material to the Federal Court and the applicant *within 20 calendar days* after the Rule 317 request was received by the Department of Justice. Where the Rule 317 request is made in the Notice of Application, use the Department of Justice received date stamp of service of the Notice of Application by the Federal Court or the Department of Justice received date stamp of service of the Rule 317 request, if it was made after the Notice of Application was filed.

Three certificates (Schedule "A") and three certified bundles of materials, along with the taxpayer relief file must be provided to the Department of Justice by courier or hand-delivered **at least 5 working days prior to the 20-day deadline**.

The **"20 calendar days"** excludes the day the request is received by the Department of Justice and includes the last day. If the last day falls on a weekend or a holiday, it is due the following business day.

Note: The "20 calendar days" does not include the court's Christmas recess from December 21 to January 7.
For example, a Rule 317 request served on the Department of Justice:

- September 10, 2009, the documentation must be transmitted on September 30.
- September 22, 2009, the documentation must be transmitted on October 13 (Thanksgiving is October 12, 2009).
- December 18, 2009, the documentation must be transmitted on January 26, 2010.

Digitized by Google

11.2.3 Rule 317 process

The following summarizes the process when a Rule 317 request is received.

1. The Department of Justice will advise the Litigation Office.

   Upon receipt of a request, the Department of Justice will advise the Litigation Office that a Rule 317 request has been made.

2. The Litigation Office will arrange for the certification of the material.

   Upon receipt, the Litigation Office will

   - Contact the officer involved with the decision and request that the certified documents be prepared, and
   - Provide the officer with a copy of the Notice of Application and request made under Rule 317 through secure transmission.

3. Certification of the material.

   Generally, the officer who conducted the review and prepared the recommendation for the authorized delegate's approval will prepare the certified copy of material.

   The officer will review the taxpayer relief file and identify all relevant documents, including screen prints to be certified. The Justice counsel assigned to the case will be available to advise the officer preparing the certified material and will make the final decision whether documents and/or specific information should be excluded from the certified bundle of material due to:

   - relevancy to the taxpayer relief decision under judicial review;
   - third party confidential information; or
   - solicitor-client privilege.

4. Prepare certificate and certified copy of the material.

   Prepare three original certificates (Schedule "A") and three certified bundles of documents. They must be forwarded along with the entire taxpayer relief file to the Department of Justice at least 5 working days prior to the 20-day deadline.

5. Update the Taxpayer Relief Registry

   Update Section IV – Info/Delays/Transfer of the Taxpayer Relief Registry to record the date of receipt of the Rule 317 request, confirm that the certification of the material has been completed and record the date the material was forwarded to the Department of Justice.

11.2.4 Identify documents for certification

A judicial review applicant making a request for documents under Rule 317 is required to "identify the material requested", but will often make a request for all documents in the CRA's possession that are not in the applicant's possession.

To identify documents for certification, read the Notice of Application and the request for documents to determine whether the applicant is asking for:

- specific documents; or
- all documents in the CRA's possession.

A document must be produced if it is:

- relevant to the judicial review application; and
- not already in the possession of the applicant.

Digitized by Google

The officer involved with the taxpayer relief decision will review the relief file and identify all the documents that must be certified. Consult with Justice Counsel if you are uncertain whether particular documents should be included.

Note: The Department of Justice will decide whether a document should be excluded.

Relevancy
Information reviewed by the officer and the delegated authority prior to the decision being issued is relevant. All documents prepared by them are also relevant. In addition, all supporting documents submitted to the CRA for review in relation to the taxpayer relief request, prior to the decision being issued, whether or not considered, are relevant.

Relevant information that was reviewed while considering the taxpayer's request for relief is detailed in the decision report/fact sheet. The fact sheet provides details of the taxpayer's request and the reasons why it was made, what steps were taken during the review, the officer's summary of recommendations, what decision was reached, and the reasons for the decision.

The following documents would generally fall within the scope of a Rule 317 request:

- first-review taxpayer relief report;
- second-review taxpayer relief report;
- all notes prepared by CRA officers that are contained in the taxpayer relief file; and
- all CRA system printouts of screens reviewed in assessing the relief request, such as ACSES Diary, ELCS Notepad, Notes for Businesses, GHRAPS, T2, BN and RAPID options.

While a document and/or screen print may be relevant to the judicial review application, only material not already in the possession of the applicant must be produced.

Material not already in the possession of the applicant
In situations where specific documents are listed on the request, certify the relevant documents (if not confidential or protected) regardless of whether they are in the applicant's possession. The request may include CRA internal procedures, such as a relevant section or part from a manual or guide. For these requests, sanitized versions available for certification can be obtained from CRA's public reading rooms where available

If the applicant requests that all documents in the possession of the CRA be produced, a determination must be made as to whether each document is already in the possession of the applicant. Only relevant documents that have not been submitted to the CRA by the applicant or authorized representative, or are not duplicate copies of documents issued by the CRA to the applicant, must be produced.

For example:
A letter issued to the taxpayer by the CRA considered during the review is relevant but does *not* need to be produced because the applicant already has the letter. While an Option C print-out may contain the same information as the notice of (re)assessment or notice of (re)determination issued to the applicant, it is not the same document and must therefore be produced

To determine if documents have been issued by the CRA, review the information in the taxpayer relief file and appropriate mainframe systems, such as RAPID, ELCS, BCCS, ACSES, CSAPP and applicable diary notes.

In some cases it may be difficult to determine whether a document is already in the possession of the applicant. If uncertain, provide a copy of the document unless it is confidential or protected

11.2.5 Prepare certified copy of the material and certificate

The certification of documents does not need to be completed by the authorized delegate who approved the taxpayer relief decision. Generally, the officer who conducted the review and prepared the recommendation for the authorized delegate's approval will prepare the certified copy of the material and certificate.

Once the relevant documents for certification have been identified, three copies of the original documents, printouts of documents retained in electronic form, and computer screen prints must be photocopied and/or printed. Note that **single-sided copies** of the certified documents are required

Digitized by Google

While the photocopying and screen prints can be completed by support employees, the relief officer must review each document to confirm that the photocopies and printouts are complete and accurate reproductions of the original documents.

Computer printouts
For guidelines on printing and sanitizing common individual screen printouts, see Table of available printouts - Documents requested by taxpayers or third parties in the *Individual Services Technical Help Guide*.

The Individual Enquiries Printout Request (IEPR) application provides sanitized printouts of taxpayer information. For example, the following information will not be printed from a RAPID, Option C screen:

- Information about others
- Internal CRA codes

Other RAPID Options available for print using IEPR are:

Income and Deductions	(Rapid Option C)
Information Slips	(Rapid Option DD.3)
Capital Gains and Losses & Multi Year Data	(Rapid Option C-MY)
Home Buyer's Plan	(Rapid Option HH.01)
RRSP Deduction Limit & Multiyear RRSP Contributions	(Rapid Option R.1) (Rapid Option R.7)
Instalment Reminders	(Rapid Option BB.1)
Discounter Clearance	(Rapid Option Q)
Tuition and Education Amounts	(Rapid Option C-MY)

For information about this application, refer to the Individual Enquiries Printout Request User Manual.

For screen prints, other than IEPR, do not forget to black out any information that is not to be disclosed, including any information that would reveal the identity of third parties (spouse's income or SIN, employer's account number, etc.) You must then photocopy the sanitized printout.

Complete Schedule "A"
Three originals of Schedule "A", *Certificate pursuant to a request made under Rule 317 of the* Federal Courts Rules must be completed and forwarded to the Department of Justice along with three certified bundle of documents and the taxpayer relief file.

The Court File Number located in the top right corner should be entered by the officer. If this number is not available from the information received, the officer should consult with Justice Counsel.

A description of each document included in the certified copy of material must be listed on Schedule "A". The physical document should appear as itemized on the certificate. See Chapter 13 Appendices for an example of descriptions included on Schedule "A".

The certificate must be signed and dated by the officer who compiled the material and who physically reviewed each photocopy and each printout.

Digitized by Google

[redacted]

- **12. Additional information**
  - 12.1 CRA taxpayer relief forms and information
  - 12.2 Headquarters functional taxpayer relief representatives
  - 12.3 Regional program advisors
  - 12.4 Federal Court contact list
  - 12.5 List of elections covered under section 600 of the *Income Tax Regulations*

12. Additional information

This section provides a variety of information that may be of assistance when reviewing a taxpayer relief request.

12.1 CRA taxpayer relief forms and information

IC07-1, *Taxpayer Relief Provisions*

GST/HST Memoranda Series 16-3, *Cancellation or Waiver of Penalties and/or Interest*

RC4288, *Request for Taxpayer Relief*

Web - Taxpayer Relief Provisions and Voluntary Disclosures Program

12.2 Headquarters functional taxpayer relief representatives

http://sh0zapdb0393:8500/WBA007/E_A/1500/1510/08_003.cfm

12.3 Regional program advisors

http://sh0zapdb0393:8500/WBA007/E_A/1500/1510/08_004.cfm

12.4 Federal Court contact list

http://sh0zapdb0393:8500/WBA007/E_A/1500/1510/08_005.cfm

Digitized by Google

12.5 List of elections covered under section 600 of the *Income Tax Regulations*

Section 600 of the *Income Tax Regulations* lists the provisions of the *Income Tax Act* and Regulations in respect of which a taxpayer or a partnership can apply under subsection 220(3.2) of the Act to make a late or amended election, or to revoke an election.

The list of eligible elections reflects the amendments to section 600 that were published in the Canada Gazette Part II on August 29, 2006, as SOR/2006-200.

The following is the list of the prescribed provisions and a brief description of the nature of the election:

Deferral on non-CCPC employee options
Subsection 7(8) of the Act allows an employee to defer the taxation of an employment benefit realized from a qualifying acquisition of a particular security under an agreement with the employer (or a person not dealing at arm's length with the employer) until the year in which the employee disposes of the security, becomes a non-resident of Canada or dies, whichever occurs first, if the employee elects in accordance with subsection 7(10) to have subsection 7(8) apply.

Deemed outlay or expense
Paragraph 12(2.2)(*b*) of the Act allows a taxpayer to elect to reduce the amount of an outlay or expense (other than an outlay or expense which relates to the cost of the property) incurred in the year, the immediately following year or any preceding year, by all or part of any related government assistance received in the year which would otherwise be included in income by virtue of paragraph 12(1)(x).

Interest income accrual rules
Former subsection 12.2(4) of the Act allowed an individual or a trust with individuals as beneficiaries to elect to report accrued interest income on an annual basis with respect to certain life insurance policies and annuity contracts last acquired before December 20, 1980, rather than on a tri-annual reporting basis under former subsection 12.2(3). Subsection 12.2(4) was repealed given the introduction of mandatory annual reporting of accrued income on life insurance policies last acquired after or materially altered after 1989.

Available for use rules on long-term projects
Subsection 13(29) of the Act allows a taxpayer to elect to include an amount, within limits, as undepreciated capital cost in respect of long-term project depreciable property under the "available for use" provisions of subsections 13(26) to 13(28) prior to the completion of the project.

Amounts paid for undertaking future obligations
Subsection 20(24) of the Act allows a taxpayer to deduct from income certain payments made to obtain another person's agreement to undertake certain future obligations for which an amount was included in the taxpayer's income under paragraph 12(1)(a), if the taxpayer and other person jointly elect in accordance with subsection 20(25).

Cost of borrowed money
The elections contained in section 21 of the Act allow a taxpayer to elect to capitalize, instead of deducting as a current expense, the cost of borrowed money used to acquire depreciable property (subsections 21(1) and 21(3)) or used for the exploration, development or the acquisition of a resource property (subsections 21(2) and 21(4)).

Exchanges of property
Subsections 13(4), 14(6), 44(1) and (6) of the Act allow a taxpayer to elect to defer an income inclusion or the recognition of a capital gain when a replacement property is acquired for a property that was stolen, expropriated or destroyed, or for a former business property that was sold.

Adjustments to cost base
Subsections 13(7.4) and 53(2.1) of the Act allow a taxpayer to elect to reduce the capital cost of depreciable property and the adjusted cost base of non-depreciable capital property, respectively, by the amount of any related inducement, refund, reimbursement, contribution, allowance, or other assistance which would otherwise be included in income by virtue of paragraph 12(1)(x).

Election where change of use
Subsection 45(2) of the Act allows a taxpayer to elect to designate a property as his principal residence although there has been a change in use to an income producing property.

Subsection 45(3) of the Act allows a taxpayer to elect to defer a capital gain on the change of use of a property from an income producing property to a principal residence.

000093

Digitized by Google

Debts established to be bad debts and shares of bankrupt corporation
Subsection 50(1) of the Act applies to debts established to have become bad debts in a taxation year and to certain shares and allows a taxpayer to elect to have a deemed disposition at the end of the year and a reacquisition immediately thereafter at a cost of nil

Successor rules for resource properties
Paragraphs 66.7(7)(*c*), (*d*) and (*e*) and (8)(*c*), (*d*), and (*e*) of the Act allow a predecessor corporation and a successor corporation to elect to transfer the unused pools of resource expenses from the predecessor to the successor corporation.

Transfers or distributions to a taxpayer's spouse, common law partner or spousal/partner trust on the death of the taxpayer
Subsection 70(6.2) of the Act allows a taxpayer's legal representative to elect to have the rollover rules under subsection 70(6) and 70(6.1) not apply, thus causing the deemed disposition of assets at fair market value under subsection 70(5) and the deemed payment of amounts in Net Income Stabilization Account (NISA) Fund No.2 under subsection 70(5.4).

Transfers of farm property, or family farm corporations and partnerships to child
Subsection 70(9) of the Act allows a taxpayer's legal representative to elect an amount, within limits, as proceeds of disposition for farm property that is transferred to a child on the taxpayer's death.

Subsection 70(9.1) of the Act allows a spousal or common-law partner trust to elect an amount, within limits, as proceeds of disposition for farm property that is transferred from the trust to a child on the spouse or common-law partner's death.

Subsection 70(9.2) of the Act allows a taxpayer's legal representative to elect an amount, within limits, as proceeds of disposition for a share in a family farm corporation, or an interest in a family farm partnership that is transferred to a child on the taxpayer's death.

Subsection 70(9.3) of the Act allows a spousal or common-law partner trust to elect an amount, within limits, as proceeds of disposition for a share in a family farm corporation, or an interest in a family farm partnership that is transferred from the trust to a child on the spouse or common-law partner's death.

Election by legal representative and transferee re reserves
Subsection 72(2) of the Act permits a legal representative of a deceased taxpayer to elect to claim a deduction for certain reserves, provided that the amount so deducted is subsequently included in the income of the taxpayer's spouse or common-law partner or a spousal or common-law partner trust.

Inter vivos transfers of property
Subsection 73(1) of the Act allows a taxpayer to elect to have the rollover provisions in respect of an inter-vivos transfer of assets to a spouse or common-law partner or certain trusts not apply, thus causing the assets to be considered to be transferred at fair market value for tax purposes.

Deemed settlement on winding-up
Paragraph 80.01(4)(*c*) of the Act allows a parent corporation to elect to reduce the amount to which subsection 80(1) (debt forgiveness rules) might otherwise apply in cases where a debt owed between a parent corporation and its subsidiary is settled on the winding up of the subsidiary for less than both the principal amount and the cost amount of the debt.

Expropriation assets acquired as compensation for, or as consideration for sale of, foreign property taken by or sold to foreign issuer
Subsection 80.1(1) of the Act applies to a Canadian resident taxpayer who has acquired "expropriation assets" issued or guaranteed by a foreign government as compensation for the expropriated or forced sale of shares of a foreign affiliate, or foreign property used to carry on business in a foreign country. The election establishes the deemed cost of the expropriation assets and the deemed proceeds of disposition of the property that was expropriated or sold.

Dividends received by taxpayer's spouse or common-law partner
Subsection 82(3) of the Act allows a taxpayer to elect to have a taxable dividend from a taxable Canadian corporation received by the taxpayer's spouse or common-law partner included in the taxpayer's income where such an inclusion increases the taxpayer's spouse or common-law partner amount under paragraph 118(1)(*a*).

Capital dividend
Subsection 83(2) of the Act allows a private corporation to elect to have the full amount of a dividend that is payable by it to be treated as a capital dividend

Digitized by Google

Eligible distributions of foreign spin-off shares
Paragraph 86.1(2)(*f*) of the Act allows a taxpayer to elect to defer the tax on eligible distributions of foreign spin-off shares.

Election to defer the 21-year deemed disposition date
Subsection 104(5.3) of the Act allowed certain family trusts to elect to defer the 21-year deemed disposition date. This provision was terminated with the result that the deferred disposition date was no later than January 1, 1999.

Preferred beneficiary election
Subsection 104(14) of the Act allows a trust and its preferred beneficiaries to elect to have the income of the trust included in the income of the preferred beneficiaries, instead of being taxed in the trust.

No rollover on election by trust
Subsection 107(2.001) of the Act allows a personal trust or prescribed trust resident in Canada at the time of the distribution to elect not to have subsection 107(2) applied to a distribution of certain property to a beneficiary in satisfaction of the beneficiary's capital interest in the trust.

Deemed disposition on emigration
Paragraph 128.1(4)(*d*) of the Act allows an individual (other than a trust) to elect to treat certain properties that would otherwise be exempt from the deemed disposition that occurs when the individual ceases to be resident in Canada as having been disposed of.

Departure tax adjustment for a returning former resident
Paragraphs 128.1(6)(*e*) and 128.1(6)(*c*) of the Act apply to an individual (other than a trust) who ceases to be resident in Canada after October 1, 1996, and subsequently returns to reside in Canada. The effect of the election is to "unwind" the deemed disposition rule of subsection 128.1(4) for certain properties still held upon the individual's return to Canada.

Departure tax adjustment for a returning trust beneficiary
Paragraph 128.1(7)(*d*) and 128.1(7)(*g*) of the Act apply to an individual trust beneficiary (other than a trust) who ceases to be resident in Canada after October 1, 1996, receives a distribution of property from the trust while a non-resident, and subsequently returns to reside in Canada while still owning the property. These rules allow the beneficiary and the trust to jointly elect, upon the beneficiary's return to Canada, to "unwind" the deemed disposition rule in subsection 107(2.1) that was triggered when the trust distributed the property to the non-resident beneficiary.

Post-emigration loss on disposition
Paragraph 128.1(6)(*c*) of the Act applies to an individual (other than a trust) who disposes of taxable Canadian property, after having ceased to be resident in Canada after October 1, 1996, for proceeds that are less than the deemed proceeds that arose on the deemed disposition on emigration. The individual may elect to reduce the deemed proceeds of disposition when the individual emigrated.

Allocation of income by communal organization
Subsection 143(2) of the Act allows a communal organization to elect to have its taxable income earned by the deemed trust under subsection 143(1) allocated to members of the organization.

Home buyers' plan
Subsection 146.01(7) of the Act allows a deceased taxpayer's legal representative and the surviving spouse or common-law partner to elect not to have the full outstanding balance of the Home Buyers' Plan included on the deceased taxpayer's final return. The practical effect of the election is to put the surviving spouse or common-law partner in the same position as the deceased taxpayer with respect to the balance outstanding.

Disposition of property by legal representative of deceased taxpayer
Subsection 164(6) of the Act allows a deceased taxpayer's legal representative to elect to treat certain capital losses or terminal losses of the taxpayer's estate for its first taxation year as capital losses or terminal losses of the deceased taxpayer for the year of death.

Realization of deceased employees' options
Subsection 164(6.1) of the Act allows a deceased taxpayer's legal representative to elect to treat the amount of the loss realized upon the exercise, disposition or expiration of rights to acquire certain securities within the first taxation year of the taxpayer's estate as a loss of the deceased taxpayer for the year of death.

Excess capital dividend
Subsection 184(3) of the Act allows a corporation to elect to have the amount of the elected capital dividend in excess of the balance in the corporation's capital dividend account treated as a separate taxable dividend, thereby avoiding the penalty tax otherwise payable.

000095

Digitized by Google

Date of acquisition of control
Subsection 256(9) of the Act allows a corporation to elect not to have the acquisition of control deemed to occur at the commencement of the day on which the acquisition took place. The particular time of day that the acquisition of control took place will be recognized if the corporation makes an election

Elections to include properties in Class 1
Subsection 1103(1) of the Regulations allows a taxpayer to elect, for capital cost allowance purposes, to include in Class 1 all properties included in Classes 2 to 10 and Classes 11 and 12.

Elections to include properties in Class 2, 4, or 17
Subsection 1103(2) of the Regulations allows a taxpayer to elect, for capital cost allowance purposes, to include in Class 2, 4, or 17, a property acquired before May 26, 1976, and included in another class when the chief depreciable properties of the taxpayer are included in Class 2, 4 or 17.

Elections to make certain transfers
Subsection 1103(2d) of the Regulations allows a taxpayer to elect to defer a capital cost allowance recapture by transferring the property disposed of to a new class of which the taxpayer has property, when the property disposed of would have been a property of the new class if it had been acquired when the property of the new class was acquired.

Earnings of a foreign affiliate
Subsection 5907(2.1) of the Regulations allows that, in calculating the active business earnings of a foreign affiliate, a corporation may make an election with respect to the cost of a foreign resource property or the cost of a capital property.

Digitized by Google

- **13. Appendices**

  - Appendix 5A Where to send taxpayer relief requests
  - Appendix 5B Expediting a Request
  - Appendix 5C System Information
  - Appendix 5D Complexity Guidelines
  - Appendix 5E File Transfer Guidelines
  - Appendix 5F Income and Expense/Assets and Liabilities (IEAL)
  - Appendix 5G Screening Sheet
  - Appendix 8B Post-decision Financial Transactions - CoEs
  - Appendix 8A Roles and responsibilities of Appeals Branch and Debt Management staff
  - Example of Schedule "A"
  - Schedule "A" - Downloadable version

Digitized by Google

Appendix 5A Where to send taxpayer relief requests

The majority of requests will be received and screened at the taxpayer relief intake centres (IC).

Centres of expertise (CoEs)

The CoEs are responsible for reviewing requests for relief of penalty and/or interest transferred from the ICs. It includes the following workloads:

- T1 - Individuals
- T1-OVP (RRSP) – T1-OVP (RESP) - **only requests due to financial hardship**
- T2 - Corporations
- **T3 - Trust returns - only requests due to financial hardship**
- GST/HST
- GST/HST rebates – centralized in the Atlantic CoE
- T4 - Payroll accounts, including:
  - payroll service providers – centralized in the Quebec CoE. See Note 3 and also the table under PAYDAC);
  - bank remitters accounts; and
  - Retirement Compensation Arrangements (RCA) - centralized in the Prairie CoE
- T5 - Information returns (return of investment income) - **only requests due to financial hardship**
- T5018 Information returns (contract payments)
- Native Leasing Services (NLS) – centralized in the Quebec CoE (native individuals with T4 slip issued by Roger Obonsawin). See Note 2.
- Non-residents. T1, T2 and T3 accounts – only requests based on financial hardship
- Nunavut requests - centralized in the Prairie CoE
- Other levies – **only requests due to extraordinary circumstances for excise duty (RD accounts) and excise tax (RE accounts)** – centralized in the Quebec CoE

Note 1: Consult the table below to verify the exceptions to the above workloads.

Note 2: Send hard document of relief requests for NLS to the Shawinigan TC (without scanning it), attention Christine Martel, Team Leader, Taxpayer Relief, Appeals Division. Once these cases are identified, staff from other ICs will only create a registry entry (group code 90100) indicating relief request re Native Leasing Services/Roger Obonsawin transferred to Quebec CoE. The Quebec CoE will send the acknowledgement letter.

Note 3: Payroll service providers are businesses who specialize in providing payroll services to a large number of clients (main business activity). We do not consider an accounting firm doing the bookkeeping for a business a payroll service provider. For the time being, only requests from Ceridian, TimePlus, ADP, Cognicase and Desjardins should be sent to the Quebec CoE.

Other offices/sections

Refer to the table to send requests processed outside the CoEs.

Appeals/notices of objection • request received with a new notice of objection • request related to an assessment that is under objection/appeal • request alleging delay during the objection/appeal stage	For a new notice of objection, for taxpayers with a postal code starting with A to P and non-residents forward the correspondence to: Eastern Intake Centre Sudbury TSO/TC 1050 Notre-Dame Avenue Sudbury ON P3A 5C1 For taxpayers with a postal code starting with R to Y forward the correspondence to the: Western Intake Centre Burnaby-Fraser TSO 9737 King George Highway P.O. box 9070, Station Main Surrey BC V3T 5W6

000098

Digitized by Google

	Concerning any other situations, forward the correspondence to the appropriate Appeals' office For more details, consult 5.3.1.4 and 5.5.3
Audit Request that alleges delays during the course of an audit	This type of request is the responsibility of the Compliance Programs Branch (CPB) Send the request to the attention of the assistant director of the office where the audit was conducted
Customs (RM accounts)	Send the request to the Revenue Collections Division of the following TSOs: **Atlantic** Nova Scotia TSO 1557 Hollis Street P.O. box 638 Halifax NS B3J 1V4 **Quebec** Montréal TSO 305, René-Lévesque Blvd. W Montréal QC H2Z 1A6 **Ontario** East Central Ontario – Kingston TSO 185 King Street West Peterborough ON K9J 8M3 **Prairie** Winnipeg TSO 325 Broadway Winnipeg MB R3C 4T4 **Pacific** Vancouver TSO 1166 West Pender Street Vancouver BC V6E 3H8
Elections – all elections with the exceptions below: 1. 83(2) and 184(3) 2. Elections listed in the table at the bottom of the page	These requests are the responsibility of Taxpayer Services and Debt Management or Compliance Programs Branch staff in either a TC or TSO environment. Send the request to Audit in the TSO of record 1. See T2054 in this table 2. Send the request to the Special Elections and Returns (SER) section in the TC of record
Filing extensions	**New Housing Rebates (NHR)**: Send a request to extend a filing deadline to the Detailed Enquiries and Complex Assessing (DECA) Unit at the Summerside Tax Centre **Canada Child Tax Benefit (CCTB)**: Send the request to extend the period for filing an application beyond the normal 11-month period to the Eligibility Section of the Benefit Programs in the TC of record Send other requests to the TC of record
GST/HST accounts	**Audit or Appeals (objections)**: Send the request to the TSO of record

DISCLOSED PURSUANT TO PRIVACY ACT

Digitized by Google

Non-residents: penalty and interest relief requests *(except for other levies and GST accounts)* **See the note at the bottom of the page.**	International Tax Services Office (ITSO) 2204 Walkley Road P.O. box 9769, Station T Ottawa ON K1A 1A8 For T1 accounts, send to Revenue Collections and Client Services Division (RCCSD), ITSO, except if the reason is financial hardship For T2 and T3 accounts, send to Returns Processing Division (RPD), ITSO, except if the reason is financial hardship For Part XIII accounts (those beginning with NRF, NRH, NRJ, NRX, etc.), send to Compliance & Non-Resident Withholding Division (CNRWD), ITSO **Other Levies (OL)**: See below **GST accounts and employer accounts (PAYDAC)**: Send the request to the Intake Centre assigned to the TSO of record
Other levies (OL) • Air Travellers Security Charge (ATSC) (RG accounts) • Softwood Lumber (e.g. 123456789 SL 0001) • Excise Duty (RD accounts) • Excise Tax (RE accounts) • Part 1 - Insurance Premiums other than marine (RN accounts)	**All accounts - Audit or Appeals (objections)**: Send the request to the TSO of record **RG accounts (ATSC)**: Send all requests to: Collections Division – Other Levies Calgary TSO Room 330 220, 4th Avenue SE Calgary AB T2G 0L1 Fax: (403) 691-6664 **SL accounts (Softwood Lumber)**: Send all requests to: Collections Division – Other Levies Burnaby-Fraser TSO 9737 King George Boulevard P.O. box 9070 Surrey BC V3T 5W6 Fax: (604) 587-2405 ========== **RD, RE and RN accounts: Financial hardship** **Atlantic** Collections Division – Other Levies Nova Scotia TSO 1557 Hollis Street P.O. box 638 Halifax NS B3J 1V4 Fax: (902) 426-9215 **Quebec** Collections Division – Other Levies Eastern Quebec TSO 165 Pointe-aux-Lièvres Street Quebec QC G1K 7L3 Fax: (418) 649-6808

DISCLOSED PURSUANT TO ATIA

Digitized by Google

	Ontario Collections Division – Other Levies Toronto West TSO 5800 Hurontario Street Mississauga ON L5R 4B4 Fax: (905) 277-6247 **Prairie** Collections Division – Other Levies Calgary TSO Room 330 220, 4th Avenue SE Calgary AB T2G 0L1 Fax: (403) 691-6664 **Pacific** Collections Division – Other Levies Burnaby-Fraser TSO 9737 King George Boulevard P.O. box 9070 Surrey BC V3T 5W6 Fax: (604) 587-2405 **RN accounts: Extraordinary circumstances** Charlottetown TSO 161 St. Peters Road Charlottetown PE C1A 5P7
PAYDAC (RP accounts)	If there is a note in ACSES indicating "**HQ TimePlus Project**" for the period involved in the request, send it to: Att.: Penny Kreamer Team Leader Taxpayer Services and Debt Management - Trust Section St. Catharines TSO 32 Church Street P.O. box 3038 St. Catharines ON L2R 3B9
Penalties charged on certain information returns including T100A, T100B, T100C, T106, T1044, T5001, T5003, T5013 and foreign reporting returns such as T1134A, T1134B, T1135, T1141, T1142 (*requests other than financial hardship*)	Other programs Ottawa Technology Centre Room 830 2215 Gladwin Cres. Ottawa ON K1A 1A2
Project Trident (*requests other than financial hardship*)	**Audit or Appeals (objections) delay(s)**: Send the request to the TSO of record
RC339 - Individual return for certain taxes for RRSPs or RRIFs for tax 2011 (*requests other than financial hardship*)	Send the request to the Individual and Benefit Services Division of the TC of record
RC4532 - Individual tax return for registered disability savings plan (RDSP) (*requests other than financial hardship*)	Send the request to the Individual and Benefit Services Division of the TC of record
Refunds or reduction in amounts payable beyond the normal three-year period (*T1 and testamentary trusts only*)	Send the request to the Individual and Benefit Services Division of the TC of record
Registered Charities (RR accounts)	*Note: this information is for internal purposes only* Att.: Susan Mott 7th Floor, Tower A Place de Ville 320 Queen Street Ottawa ON K1A 0L5

DISCLOSED TO PBO

000101

Digitized by Google

Registered Disability Savings Plan (RDSP)	Pension and Partnership Projects 3rd Floor, Tower C 25 McArthur Ottawa ON K1A 0L5
T1-OVP (RRSP) and T1-OVP (RESP) • Waiver of tax on excess RRSP and RESP contributions under subsections 204.1(4) and 204.91(2) of the ITA respectively • Relief of P&I for extraordinary circumstances	Send the request to the Individual Client Services and Benefits Division of the TC of record
T1161 – List of properties by an emigrant of Canada	Send the request to Client Services Directorate (CSD), ITSO
T2054 – or the taxpayer made reference to 83(2) or 184(3) elections **Note:** See also Elections in this table	Send the request to CDA/T2054 section of the applicable TSO or TC as follows: Atlantic Region – St. John's TC Ontario Region – Kitchener/Waterloo TSO Quebec Region – Jonquiere TC Pacific Region – Surrey TC Prairie Region – Regina TSO (for Regina, Calgary, Red Deer and Lethbridge TSOs) and Saskatoon TSO (for Saskatoon, Edmonton and Winnipeg TSOs)
T2062 – Information return *(requests other than financial hardship)*	Send the request to the Non-resident Audit of the TSO of record, which is the TSO that serves the area where the property is located (do not redirect to ITSO)
T2201 - Disability Tax Credit requests	Send the request to the Individual Client Services and Benefits Division of the TC of record
T244 - Information returns *(requests other than financial hardship)*	Employer Services Section Sudbury TC 1050 Notre Dame Avenue Sudbury ON P3A 5C1 Secure fax: (705) 669-2178 Non secure fax: (705) 670-6218
T3 *(requests other than financial hardship)*	T3 Estates and Trusts Ottawa Technology Centre 2215 Gladwin Cresc. Ottawa ON K1B 4K9
T5 - Information returns (RZ accounts – formerly HA accounts) –T5007, T5008 and RRSP *(requests other than financial hardship)*	Send the request to the Employer Services Section, Business Returns Division, of the TC of record
Tax-free savings account (TFSA)	TFSA Processing Unit RC 1280, work section 746 P.O. box 9768, Station T Ottawa, ON K1G 3X9 For internal purposes only, you can contact Rachel Tougas (613) 960-8236, or Francine Latulippe (613) 952-4171.

DISCLOSED TO PURSUANT TO

Digitized by Google

Voluntary disclosures Penalty and interest relief requests associated with a voluntary disclosure	**Atlantic** Voluntary Disclosures Program Saint John Tax Services Office 126 Prince William Street Saint John NB E2L 4H9 Fax: (506) 636-5316 **Quebec** Voluntary Disclosures Program Montréal Tax Services Office 305 René-Lévesque Boulevard W. Montréal QC H2Z 1A6 Fax: (514) 496-5809 **Ontario** Voluntary Disclosures Program St. Catharines Tax Services Office 32 Church Street P.O. box 3038 St. Catharines ON L2R 3B9 Fax: (905) 322-3133 **Prairie** Voluntary Disclosures Program Winnipeg Tax Centre 66 Stapon Road Winnipeg, Manitoba R3C 3M2 Fax: (204) 984-4141 **Pacific** For this region, there are offices in Vancouver, Burnaby-Fraser, Southern Interior and Vancouver Island. Therefore, on the following link, please use the address located under "To obtain more information on our Voluntary Disclosures Program or to make a voluntary disclosure" when redirecting requests. http://www.cra-arc.gc.ca/gncy/nvstgtns/cntcts/menu-eng.html

Note: ITSO handles T1, T2, T3 and Part XIII non-residents accounts. The relief request is to be sent to ITSO only if the taxpayer was non-resident for the taxation year/period involved and/or if the return has been processed by ITSO. For T1 accounts, page 2 of option I, Summary of T1 data, shows the year and return residence.

To identify a non-resident corporation (T2): the TC code in BN system is identified as "91", verify the line 200060 = 2 (non-resident), the country of residence at line 200061 and the type of corporation at line 200040 = 4 (corporation controlled by a public corporation) or 5 (other corporation).

The following is a list of identifying characteristics of returns processed and stored in ITSO:

A. A Social Insurance Number (SIN) beginning with a "9" and one of the following items:
   (a) an entry in Date of Entry or Departure; or
   (b) province of residence is 12, 13 or 15; or
   (c) an indication of "International Student" or "Foreign Student" on page 1 of the return.

B. A Temporary Tax Number (TTN) beginning with "091", "092", "093", or "094".

C. A Date of Departure.

D. A Province or Territory of Residence other than a Canadian province or territory (including CIDA).

E An address of:
   (a) P.O. box 500, Ottawa; or
   (b) a Canadian Forces post office (CFPO) box number.

F A black bar on the spine of the return.

Digitized by Google

G. An indication by the taxpayer that the return is filed under any of the following sections of the *Income Tax Act*:

(a) Section 114
(b) Section 115
(c) Section 116
(d) Section 122.3 (Overseas Employment Tax Credit)
(e) Section 216 (NR6)
(f) Section 217
(g) Section 250
(h) Paragraph 48(1)(c)

For all the elections listed in this table, send the request to the SER section in the TC of record:

T123	T913				
T1046	T1169	T2002	T2004	T2010	T2022
T2023	T2026	T2027	T2034	T2035	T2039
T2043	T2044	T2045	*T2046	T2047	T2049
T2053	T2056	T2057	T2058	T2059	T2060
T2065	T2076	T2079	T2096	T2098	T2099
T2101	T2107	T2140	T2141	T2142	T2143
T2147	T2148	T2149	T2150	T2152	T2152A
T2156	T2211	T2216	T2218	T3009	T3018

Digitized by Google

Appendix 5B Expediting a request

Generally, a request received at an intake centre (IC) should be expedited when the following circumstances are present:

- the continuation of a business is jeopardized and/or layoff of employees is imminent *;
- there is evidence that a prior relief request is missing or has been lost;
- requests received via the Service Complaints Program, Problem Resolution Program with an urgent tag, Minister's Office, Ministerial Correspondence and/or Ombudsman intervention,
- 3rd or subsequent requests**; or
- the correspondence relates to a judicial review application, such as:
    - a case was heard by the Federal Court and a new review has been allowed and/or
    - an application was withdrawn on condition that a new review would be conducted ***

When the above circumstances are present, determine the nature of the request, create a registry entry (if applicable), and either action or forward the correspondence to the responsible section on a priority basis.

When the correspondence is received at an IC, conduct a partial screening only. Do not determine validity and do not examine the file to determine if additional information is required - these steps will be completed by the section of the Agency, including centres of expertise (CoEs), responsible for the review and recommendation. In addition, do not request 1st review documents if the request is for a second review.

Examine the circumstances and customize the acknowledgement letter accordingly. Sending a standard acknowledgement letter may, in some situations, be confusing to the taxpayer and/or inappropriate if discussions with another Agency representative, such as a Service Complaints Officer, have taken place.

If it is unclear whether the case should be expedited, discuss with a resource officer or team leader.

When forwarding the correspondence, attach a memo describing the nature of the request and the reason it had been expedited. Update the registry with notes explaining the actions taken.

ICs must forward a hard copy to the CoE. It is also suggested that ICs staff deliver the hard copy of the request when both areas are located in the same building.

* This may include, but is not limited to, situations where the taxpayer has availed himself/herself of the *Bankruptcy and Insolvency Act* (BIA) and *Companies' Creditors Arrangement Act* (CCAA).

** Do not acknowledge 3rd or subsequent requests. The taxpayer will be contacted after it is determined if a new review will be conducted.

*** Judicial review applications will rarely be received outside Litigation, Appeals, however, should this occur, contact the Litigation section of the applicable Appeals office to arrange transfer. See 3.6.3 Tier 3 – Referrals to HQ, TRSCD if the request is CoE responsibility.

See also Appendix 5D, Complexity Guidelines.

Digitized by Google

Appendix 5C System Information

ACSES

The Automated Collection and Source Deductions Enforcement System (ACSES) displays detailed taxpayer information for all program lines. The following is a list of useful screens, instructions on how to locate the screens and highlights of the details provided. You will find ACSES located on the SLP menu under the acronym ACS.

Account Information (Page 1)	At "key Account Number" enter the social insurance number (SIN) or business number (BN) and the specific program identifier.	Name, address, phone number; DAC level; Disputed amount – indicates that a notice of objection has been filed; *Taxpayer Relief O/S* flag - a registry entry is open; *Taxpayer Relief* flag - a registry entry has been closed; Collections Officer Details: Key an "x" beside ACSES Info and press <Enter>; if available Key an "x" over the "?" under USER and press <Enter>. If assigned, the collector's name, location and phone number will be displayed.
ACSES Diary	from Account Information (page 1), press on PF18 (shift F6)	View diary entries on contacts with the taxpayer and/or actions taken.
ACSES Diary	from Account Information (page 1), press on PF19 (shift F7)	To add notes to the diary
ACSES Diary	from Account Information (page 1), press on PF21 and PF22 (shift F9 and F10)	Taxpayer Information (Part 1 and 2) about Income and Expenses/Assets and Liabilities (IEAL). (look for the last updated date)

CASE MANAGEMENT SYSTEM

The Case Management System (Case Appeals) is accessed by entering an "S" to the left of CSAPP on the SLP menu. Enter the account number in the applicable section of the Search screen; check to see if there is an existing Case Appeals record. View displays detailed taxpayer information for all program lines.

Case Appeals	CSAPP	When there is an unresolved notice of objection for the same taxation year/period relating to a taxpayer relief request.

Digitized by Google

RAPID

The RAPID system is a source of valuable information. Below is a snapshot of certain RAPID options. Consult the "Guide to Rapid" for more details.

A	T1 Charge-out menu	Charge-out, reserve or display: • T1 returns • EFILE attachments • Permanent documents
C	Income & Deductions	Displays a taxpayer's: • income • deductions • assessments and reassessments
D	Benefit Programs	Information on: • CCTB (provides child/children info) • GST/HST credits • CSA (Children's Special Allowances) • Related provincial/territorial programs
E	Individual Identification	Displays information such as: • name, date of birth, gender • marital info
G	Payment Inquiry	Details on payments made to the taxpayer such as: • T1 • GSTC • CCTB • provincial benefit payments
I	Summary of T1 data	Individual's filing information including: • taxpayer identification • account activity for the current year and previous seven years.
M	T.R.I.S.	Displays: • Authorization/Consent Forms (T1013) • Trustee in bankruptcy identification • Discounter information
N	T1 Accounting	Displays accounting details: • N.5 – full T1 account • N.4 – tax year financial transactions

DISCLOSED PURSUANT TO ATIP

000107

Digitized by Google

R	Pension Reform Enquiries	• Provides RRSP contribution and deduction
T	Individual Client Search	• Search for missing or invalid account number
Z	Correspondence	• View correspondence created in ELCS, OTCS and entries in Notepad.
AA	Subsidiary Ledger	• Display subsidiary ledger accounts
BB	Instalment System	• Provides information on instalment payments
DD	Infodec Display Menu	Displays: • T4, T4A, T4RSP, T4RIF, T4A-NR, T5, T5007, T4A(P) CPP, T3, T4A(P) QPP, T4E, T4(OAS), SAFER, NR4, T4F, T4A-RCA, T5008, T1204, and T5018. Summary and supplementary data filed on paper and magnetic media
FF	BN	Single Business Registration Number (SBRN) access Displays Authorization/Consent Forms (RC59) under option 4 Manage owner/ contact / representative of option 1 Client Registration menu
PP	PAYDAC Display Menu	Displays payroll deductions account information

Digitized by Google

Appendix 5D Complexity Guidelines

All requests are coded routine except where one or more of the following is applicable and the overall circumstances warrant review at a higher level:

- Judicial review applications and/or Federal Court decisions;
- Requests received via the Service Complaints Program, Minister's Office, Ministerial Correspondence and/or Ombudsman intervention;
- Second requests;
- Files under Special/Criminal Investigation;
- Requests based on financial hardship/inability to pay where the account is DAC 3 or higher;
- Files requiring extensive investigation, including multiple and/or related corporations, shareholders and transfers.
- Files whereby the taxpayer has availed himself/herself of the *Bankruptcy and Insolvency Act* (BIA) and *Companies' Creditors Arrangement Act* (CCAA).

A file may also be complex where there is evidence of the following:

- Detailed work which may include extensive research or review of various documents such as financial statements;
- Risk and/or danger* of tax loss;
- An issue, group and/or project which may also include a significant impact on the tax base;
- Sensitivity; consult 3.6.3 Tier 3 - Referrals to HQ, TRSCD
    - Risk of negative impact on the Agency;
    - Media attention

* Danger and risk are two separate concepts. "Danger", suggests intent on the part of the taxpayer (i.e. moving property out of the country, transferring assets etc). "Risk" suggests irresponsible behaviour or possible insolvency but does not have the same urgency or intent as Danger.

Note: Complexity is determined and coded at an intake centre (IC) for taxpayer relief requests which are centre of expertise (CoE) responsibility. With team leader approval, a file may be re-coded, if an indicator was not present, has changed, or was undetected at the IC level. Requests should be coded and worked at the lowest applicable level.

Digitized by Google

Appendix 5E File Transfer Guidelines

Other than the Ontario region, generally, a taxpayer relief request will be handled in the region where the request was received. However, there may be circumstances where a transfer may be warranted.

The purpose of these guidelines is to provide a working tool to assist in handling file transfers. Open and prompt communications between affected regions are essential to ensure the success of this policy.

File transfers may occur under the following circumstances:

1. a class or category of files is assigned to a particular office or region;
2. a taxpayer requested transfer;
3. the Agency identified need for a transfer;
4. direction from the Headquarters, Federal Court or Litigation.

See Taxpayer Relief Registry Guide (TRR) for information on transferring the registry entry.

1. Particular Class or Category of Files:

To maximize efficiencies and facilitate consistency, the responsibility of certain group files is assigned to a particular office or region. These situations may include, but are not limited to, a natural disaster, a bulk request and/or project files. This category does not include requests for where a notice of objection, Case Appeals record is open. See 5.5.3.1 When there is a related notice of objection for more information.

Where a request relates to a group request, and the workload has been assigned to a different region, create a registry entry and transfer the case to the office of responsibility

2. Taxpayer requested transfer:

Taxpayers will, from time to time, request that their file be handled in a different region. Requests for transfer will be reviewed on a case-by-case basis in light of the guidelines and factors described below

Note: A request received in a region other than the taxpayer's place of residence and/or books and records is *not* considered a request for a transfer.

Upon receipt of a taxpayer requested transfer, management in the receiving IC will:

- ask for the reasons, if not already provided;
- inform the other region affected and discuss the taxpayer's request for transfer of the file. Once the decision is made, the office responsible for handling the request will have ownership of the request.

If the two Team Leaders cannot agree on a common position, they will refer the file transfer request to their respective Chief of Appeals. In the unlikely event that a case cannot be resolved between the two regions, consult TRSCD, Headquarters (HQ) via the AB-DGA_HQ-AC Taxpayer Relief, General Enquiries/Allégements pour les contribuables, Demandes de renseignements généraux

3. Agency identified need for a transfer:

Where warranted, the Agency may initiate a file transfer at any point, from the time a request is received up to the point when the decision is rendered.

Employees who handle relief requests should apply the following general guidelines and factors to determine whether a file transfer is acceptable. This list is not exhaustive and other relevant factors may be considered when reaching a file transfer decision.

Digitized by Google

4. Direction from the Federal Court or Litigation:

In general, when a taxpayer's application for judicial review is allowed, the subsequent review is conducted in the same region by a person or persons who were not previously involved. However, on occasion, the Federal Court may recommend that the new review be conducted in a different office/region, or at the HQ level. Similarly, an application may be withdrawn after Litigation and/or the Department of Justice has determined that a new review is warranted and on occasion, they may also direct that the new review be conducted in a different office/region or at the HQ level. This type of recommendation is to be respected in all cases. See Chapter 11, Judicial review for more information.

General Guidelines

A request to transfer a file from one region to another in order to facilitate a meeting will be accepted.

The receiving office will ensure that all the relevant facts and any documents in their possession are shared with the office of responsibility.

Regional management should be informed of the impact on resources resulting from file transfers, including resource allocation and workload assignment prior to file transfer decisions

Factors

Note: A file will generally not be transferred from one region to another *after* the review has begun unless a factor(s) described below is applicable.

- **Additional Costs** - Any significant additional costs (additional field work, location of in-house experts, travel needs, etc) related to accepting or denying a transfer should also be considered in reaching a transfer decision.

- **Conflict of interest** - Impartiality is a key element of taxpayer relief reviews and should be considered not only in apparent conflict situations but also in situations where taxpayers may perceive the existence of conflict. For example, a file should be transferred when a delegated authority has been involved at the assessing/audit stage and there is no alternative delegated authority available. Another example of a potential conflict of interest situation is when staff members, their relatives or friends submit a relief request.

- **Consistency** - Certain files are processed together in a particular office or region to ensure the most efficient and consistent treatment of the files. This factor may also be applicable when determining whether to transfer a substantially similar, individual file.

- **Number of files involved** - From time to time, extraordinarily large volume of requests may necessitate sharing files with another region in order to process the relief requests within Agency standards for turnaround.

- **Privacy issues** - The sharing of private and confidential information with co-workers responsible for processing relief requests filed by staff members or their relatives may lead to delicate and embarrassing situations.

- **Representative's place of business** - Where a representative's place of business is in a different region of responsibility, the transfer request should generally be accepted.

- **Required expertise** - The office of responsibility that will process the file must have the necessary expertise to deal with the taxpayer relief issues.

- **Service Standards – Meeting service standards is one of the Branch's priorities. It is important to ensure that accepting or refusing a transfer request will not result in a significant delay in processing the relief request. This consideration however, must always be balanced with other considerations, including the necessity of an impartial review.

- **Taxpayer's choice of language** - The region that will handle the file must be in a position to offer the service in the official language of the taxpayer's choice. A transfer may also be warranted if the taxpayer requires assistance in a language other than the two official languages and the service is available in a different region

- **Taxpayer's residence** - A taxpayer's move outside the territory of the office of responsibility is an example of a situation where a request for transfer should generally be accepted.

Digitized by Google

Definitions:
Office of Responsibility:
The office(s) or region(s) assigned responsibility of a particular group of files.

Receiving Office:
The office or region where the relief request was received.

Digitized by Google

Appendix 5F Income and Expense/Assets and Liabilities (IEAL)

Word.doc

Taxpayer relief - Income and Expense/Assets and Liabilities Rev. May 2012

Please complete all sections on this form. Identify any sections which do not apply to your situation.

Name:		**Today's date:**	
Social Insurance Number (SIN):			
Home Address:			
Phone (home):	**Phone (cellular):**		
Employer name and address:			
CRA business numbers (BN)s:			
Spouse/common-law-spouse's name:			
Number/age of dependents:			

Employment net income		Alimony/child support payments	
Business/Farm net income		Rent	
Spouse's net income		Mortgage(principle & interest)	
Dependents' net income		Property taxes/strata fees	
Commissions		Repairs/maintenance	
Dividends and interest		Phone, including cellular	
Child Tax Benefits		Cable TV/Internet	
Universal Child Tax Benefit		Electric/water	
GST Credits		Heating	
Employment insurance		Insurance (vehicle(s) and home)	
Social assistance		Vehicle(s) payment	
Alimony and child support		Gas/oil (all vehicles)	
Workers comp. benefits		Maintenance (all vehicles)	
CPP benefits		Parking	

DISCLOSED PURSUANT TO

Digitized by Google

Old age security (OAS)		Public transportation	
Employment pension		Medical premiums	
Rental income (include room and board)		Net prescription/dental etc.	
Scholarships/bursaries		Day care/child care	
Bonuses		Groceries	
Other income (specify)		Dining out	
		Clothing/personal care	
TOTAL INCOME	$	Education - adults	
		Education - dependents	
		Memberships/club fees	
		Recreation/entertainment	
		Tobacco/liquor	
		Credit card payments	
		Bank loans	
		Other loans (ie. business, relatives)	
		Donations	
		Investments ie RRSP/RESP etc.	
		TOTAL EXPENSES	$

DISCLOSED TO PURSUANT

Digitized by Google

1.			
2.			
3.			
Primary residence			
Rental/investment property			
Recreation (cottage, etc.)			
Land/other			
RSP/RRSP			
Bonds		Maturity date:	
GIC's		Maturity date:	
Stocks		Publicly traded?: Y/N	
Other:			
Are you a director, shareholder or partner of any other business? Y/N		Details:	
1.			
2.			
3.			
		TOTAL ASSETS	$

DISCLOSED PURSUANT TO THE ATIP

Digitized by Google

1.		
2.		
3.		
1.		
2.		
1.		
2.		
1.		
2.		
1.		
2.		
1.		
2.		
3.		
1.		
2.		
	TOTAL LIABILITIES ASSETS	$

DISCLOSED PURSUANT TO

000116

Digitized by Google

Appendix 5G Screening Sheet

Printable version

Taxpayer Relief Intake Centre (IC) Screening Sheet

Registry number: _____ Account number: _____
(program identifier, eg. RT0001)

Taxpayer's name: _____

Related entries: _____ _____ _____ _____

Bulk request (indicate how many TP): _____ Group code: _____

Language: English French Multiple revenue types: English French

Large file (over 50 pages): Yes No Expedite: Yes No

Complex file: Yes No _____ Open Appeal/Objection: Yes No

Date received in CRA: _____ / _____ / _____
yyyy mm dd

Intake centre (IC): Atlantic Quebec Pacific Prairies

Date received in IC _____ / _____ / _____ Screened by: _____
yyyy mm dd Userid

Authorization: Level 1 Level 2 N/A Assigned CoE _____

Revenue Type:	Request Type:	Reason Type:
T1-RI (01)	Penalty / Interest (01)	CRA error (01)
T2-RC (02)		CRA delay (02)
T3 (03)	Refunds/reduction beyond 3 years (02)	Financial hardship/inability to pay (03)
PAYDAC-RP (04)		DAC Level: _____ (3↑ code Complex)
GST/HST-RT (05)		Natural or man-made disaster (04)
Misc (080	Elections (03)	Death/accident/serious illness... (05)
TFSA (12)		Civil disturbance (06)
Other: _____		Other circumstances (07)
		Voluntary disclosure (09)
		GST/HST-wash transactions (11)
		Financial hardship extension (12)

Year/Period: _____ _____ _____ _____
_____ _____ _____ _____

Review: First Second Third/subsequent
Additional info received after TRR no. _____closed

Acknowledgement letter: Date: _____ / _____ / _____

Redirect to: _____

Transfer/Assign information screen (TRR) updated: Transferred to _____

Digitized by Google

Invalid request/letter sent: ¯ Yes Reason: _____

Requested penalty amount: $_____ Requested interest amount: $_____ (if known)

Additional information required/letter sent: _ Yes ¯ No Date: _____ / _____ / _____
- ¯ Doctor's letter/certificate/duration of treatment
- ¯ Death certificate
- ¯ Police/Fire report
- _ Insurance statements
- Profit & Loss Statement and Balance Sheet (corporation)
- Income and expense/assets and liabilities form
- ¯ Monthly bills/Banking statements
- Other documentation: _____

Balance Owing: _ Yes; collector's contact information: _____
¯ Yes; unassigned, more than $2,500
_ Yes; unassigned, less than $2,500
No

Non-workable status: _ Set . Removed .. N/A

ACSES diary (financial hardship): . Updated N/A Credit Report requested

Comments: _____

Digitized by Google

Appendix 6B Post-decision Financial Transactions - CoEs

Taxpayer relief officers are responsible for reviewing the facts of a request and recommending a decision.

They will request to the appropriate business area at the TC of record to have the resulting adjustments completed.

ABSB/TC staff is responsible for processing the results (financial transactions) of the decision.

Use the following methods to refer the decision details to the TC:

- **T1 a) ERA:** Requests to cancel or reduce interest are referred to the TC with an ERA item, category 088, handled by T1 Accounts. Relief officers will provide the details of the decision (year, dates, and registry entry number) Calculations are done at the TC. Electronic Revenue Accounting (ERA) - Table of contents.

- **T1 b) RAP:** A reassessment is required for a cancellation or reduction of an omission penalty, for the cancellation or reduction (Tier 2 to Tier 1) of a late filing penalty and for instalment penalty. The CoEs will refer the requests for relief from penalties to the TCs by means of an RTM. Priority RAP requests should be rare. Information on the RTM will include:

  - Registry number;
  - Name and SIN of the taxpayer;
  - Year(s) involved;
  - Type of penalty to be adjusted;
  - Adjustment amount (if known);
  - Indication if a reply is required;
  - Indication that the RAP is to be processed on a priority basis and why;
  - Contact information for the taxpayer relief officer

Please note that if no response is requested, TPR assessors do not need to reply to the RTM.

- **GST:** Relief officer will refer details of the decision to the TC using SA Case.

- **T4 (PAYDAC):** Relief officer will refer details of the decision to the TC using SA Case.

- **T5:** The relief officer will send the details of the decision on an RTM to Employer Services of the TC of record for the taxpayer.

- **OL (RD and RE accounts):** A generic mailbox for each TC will be used to refer decisions.

- **One Taxpayer/Multiple Accounts:** Send each decision separately to the various sections (i.e. ERA, SA etc.).

T2 Corporate, GST & Source Deductions (PAYDAC) transactions

T2, GST and Source Deductions (PAYDAC) transactions requests will be forwarded via SA Case to the TC of record. The relief officer will create an SA Case for the account. Within the case, the officer will note all details of the request and then transfer to the TC of record.

This is being done using the existing Collections profile and slotting everyone into the Burnaby-Fraser TSO in ORG as a workaround for the centres of expertise that are housed in a TC.
Requirements to have users' set-up:

Please find attached a link to the SA Case Manual

Please find attached the SA CASE Quick user guide

SA Case Quick User Guide.doc

Digitized by Google

Please find attached the T2 Case Quick user guide

T2 case - Quick user guide.doc

OL transactions

The OL revenue type does not have the same system functionality in SA Case, therefore the referral method for these requests will differ.

A generic mailbox for each TC will be utilized for these requests.

The mailbox addresses are as follows:

ABSB/DGSCP = St John's TC - Business Accounting/ CF de St. John's - Programmes de la comptabilité des enterprises

ABSB/DGSCP - Summerside TC - Business Accounting/ CF de Summerside - Programmes de la comptabilité des enterprises

ABSB/DGSCP - Shawinigan TC - Business Accounting/ CF de Shawinigan - Programmes de la comptabilité des entreprisee

ABSB/DGSCP - Jonquiere TC - Business Accounting/CF de Jonquiere - Programmes de la comptabilité des entreprises

ABSB/DGSCP - Sudbury TC - Business Accounting/CF de Sudbury - Programmes de la comptabilité des enterprises

ABSB/DGSCP - Winnipeg TC - Business Accounting/ CF de Winnipeg - Programmes de la comptabilité des enterprises

ABSB/DGSCP – Surrey TC - Business Accounting/ CF de Surrey - Programmes de la comptabilité des entreprises

Digitized by Google

Appendix 8A Roles and responsibilities of Appeals Branch and Debt Management staff

The following are guiding principles and related business rules intended to ensure a common understanding of the roles and responsibilities of Appeals Branch and Debt Management staff (the parties) in situations where a taxpayer has requested relief based on financial hardship and/or the inability to pay.

1. Impartial Review
A review must be conducted in an impartial manner.

Business Rules
Each party will examine their capacity to be impartial and/or where the perception of bias may be present, self-identify and be excused from a review

Where a taxpayer indicates lack of confidence in the impartiality of one or more parties, every effort will be taken to excuse the party or parties and reassign.

Any party previously involved in a taxpayer relief decision will not be involved in a subsequent review

2. Relief of penalty and interest is not for debt settlement purposes
A decision to grant or deny relief relies on a taxpayer's unique set of facts and circumstances. Relief will not be used as a means to resolve a taxpayer's debt.

Business Rules
A taxpayer's full debt obligation, including tax, will be considered when determining if financial hardship and/or inability to pay are present.

A decision to grant relief of penalty and/or interest may be made independently of a taxpayer's ability to address the tax portion of the debt.

3. Debt Management Retains Collection Responsibility
Debt Management retains responsibility for all actions taken to collect the taxpayer's debt, both during and after the taxpayer relief review process.

Business Rules
Other than exceptional situations involving imminent threat of loss to the Crown, Debt Management will limit new enforcement action while a taxpayer relief decision is pending.

Both parties will promptly inform each other of any change in a taxpayer's financial circumstances while a taxpayer relief decision is pending.

Upon completion of a taxpayer relief review, if Appeals staff have determined that a taxpayer may have a permanent inability to pay, they will notify Debt Management staff that the account may warrant write-off consideration. Revenue Collections will examine the situation and determine if the account should be made uncollectible.

4 .Payment Arrangements
Debt Management staff will retain responsibility for negotiating payment arrangements.

Business Rules
Debt Management staff will not delay or deny referral of a taxpayer relief request to Appeals due to the absence of a payment arrangement.

A satisfactory arrangement may include a period of non-payment when a taxpayer is experiencing temporary inability to pay.

Each case must be considered on its own merit based on a taxpayer's ability to pay.

Digitized by Google

When a decision is issued but a payment arrangement is not in place, Appeals staff will inform Debt Management staff of the decision and Debt Management staff will negotiate a payment arrangement with the taxpayer.

6. Assessing Financial Hardship and Inability to Pay

When a request for relief is based, either in whole or in part on financial hardship and/or the inability to pay, Appeals staff will determine whether the taxpayer's circumstances satisfy these reasons, and whether relief is warranted.

Business Rules

Debt Management staff will share information regarding a taxpayer's financial circumstances that is not readily available in CRA systems.

Where information is contradictory and/or unclear, Debt Management staff will provide their input to assist in resolution of the request.

Digitized by Google

EXAMPLE of SCHEDULE "A"

CERTIFICATE PURSUANT TO A REQUEST MADE UNDER RULE 317 OF THE FEDERAL COURTS RULES

T-XXX-09

FEDERAL COURT

BETWEEN:

JOE TAXPAYER

Applicant

And

CANADA REVENUE AGENCY

Respondent

I, (name), (title) with the (Division), (Tax Services Office (TSO) or Tax Center (TC) of the Canada Revenue Agency (CRA), certify that the documents listed below and enclosed herewith are true copies of the material requested by the applicant which are relevant to the application and are in the possession of the CRA, and not in the possession of the applicant.

Tab	Documents
1	First-level decision in respect of Joe Taxpayer's request for taxpayer relief, dated May 25, 2008.
2	First-level taxpayer relief report for Joe Taxpayer dated May 22, 2008.
3	Second-level decision in respect of Joe Taxpayer's request for taxpayer relief, dated January 9, 2009.
4	Second-level taxpayer relief report for Joe Taxpayer, dated January 12, 2009
5	Memorandum from Jane Smith to John Doe, dated January 20, 2009.
7	Canada Revenue Agency computer print-out "Joe Taxpayer. 1989 Interest Charges Reviewed", dated March 21, 2007.
8	Canada Revenue Agency Objection Report - Diary, for the period from November 22, 2005 to March 22, 2006.
9	Canada Revenue Agency Taxpayer Relief Registry computer print-out dated May 7, 2008.
10	Canada Revenue Agency ACSES Diary computer print-out dated May 7, 2008.
11	Canada Revenue Agency Rapid Option C computer print-out dated May 15, 2008.

Dated at the City of _____, _____, this _____ day of _____.
(City) (Province) (Date) (Year)

_____
(Name)
Canada Revenue Agency

000123

122

Digitized by Google

3.3 Regional program advisors

Regional Program Advisors assist offices in their region to resolve taxpayer relief issues that arise. They also monitor taxpayer relief operations within their region to ensure consistent application of the taxpayer relief provisions.

See the Appendices for a list of Regional Program Advisors.

3.4 Taxpayer Relief Committee (TRC)

The TRC is a cross-functional committee, chaired by the Director General of TRSCD. It was established in December of 2005 and meets on an ad hoc basis. It provides a forum where members can discuss new developments and progress in the administration of taxpayer relief.

Members of the TRC include directors' general of applicable Headquarters Branches and directors of Regional Programs (alternatively a Regional Champion and/or Regional Program Advisor) as well as the Director General and the managers of TRSCD.

For more information see the Taxpayer Relief Committee site.

3.5 Taxpayer relief referrals

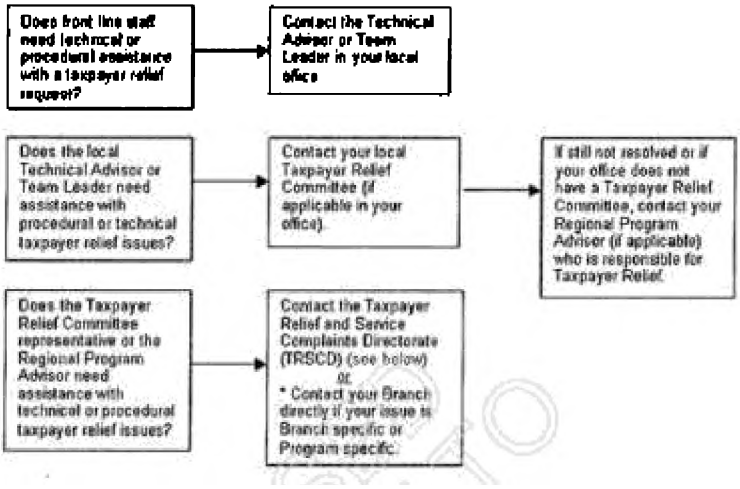
Field offices are able to resolve most taxpayer relief requests using the policies and guidelines available to them. However, some taxpayer requests may not be easy to resolve because of their complexity, sensitivity, precedent-setting nature, or because they raise cross-functional or policy issues.

The following chart summarizes the referral process that an internal taxpayer relief enquiry should follow.

DISCLOSED
PURSUANT TO
THE ATIP

000117

Digitized by Google



Referral Process [t]

Text version of chart

- Does front line staff need technical or procedural assistance with a taxpayer relief request? Contact the Technical Advisor or Team Leader in your local office.
- Does the local Technical Advisor or Team Leader need assistance with procedural or technical taxpayer relief issues? Contact your local taxpayer relief committee (if applicable in your office). If still not resolved or if your office does not have a taxpayer relief committee, contact your Regional Program Advisor (if applicable) who is responsible for taxpayer relief.
- Does the taxpayer relief committee representative or the Regional Program Advisor need assistance with technical or procedural taxpayer relief issues? Contact the Taxpayer Relief and Service Complaints Directorate (TRSCD) or * contact your Branch directly if your issue is Branch specific or Program specific.

* If the TRSCD requires technical assistance in order to answer a question received in the Common mailbox, or if the issue is Program specific or of an operational nature that falls under the other Branches responsibilities, the TRSCD will refer the enquiry to the applicable Branch directly and the TRSCD will ask for a c.c. of the answer.

Digitized by Google

4. Taxpayer relief process

This section provides a basic overview of screening and validation, processing steps and review process involved in a taxpayer relief request.

Process maps present a visual image of a business process and help demonstrate how activities are carried out. Process maps developed for taxpayer relief provide the basic steps in handling a taxpayer relief request and are applicable to all taxpayer relief officers.

The following four taxpayer relief process maps may be found on the Taxpayer Relief Process Mapping site:

- Taxpayer Relief Process
- Process of Screening Taxpayer Relief Requests
- Process to Review the Facts of the Case
- Approval Process

4.1 Validate and screen the request

There are three types of taxpayer relief requests:

1. requests to cancel or waive penalties and/or interest;
2. refunds beyond the normal three-year period (individuals and testamentary trusts only);
3. and late, amended, or revoked elections (income tax only)

The request should clearly indicate:

- the type of request (example: cancellation of penalty and/or interest, or a reassessment request);
- the time period in question;
- detailed reasons of the request.

Screening of taxpayer relief requests should be encouraged. Active screening can help expedite the overall processing by making sure requests are reviewed and processed by the right areas and employees and that request-related information is gathered (e.g., requesting returns before a file is ready to be worked on).

Section 4.2.4 of this guide provides instructions for transferring taxpayer relief files.

4.1.1 Unclear / ambiguous request

The taxpayer is not required to use the word "taxpayer relief" or "relief". Each time you receive a request, read the client's letter carefully. If the intent is clear - treat the correspondence as a request for relief.

Digitized by Google

Although requests should be complete, there are instances in which requests may be unclear or ambiguous.

For example, a taxpayer that has been assessed both late filing penalties and/or omission penalties and interest charges may only seek interest relief. The general rule in such cases is not to make any assumptions and resolve any unanswered questions prior to review, as taxpayers may not distinguish penalty from interest charges.

Taxpayer contact should be attempted to confirm the details of their request. This can be done easily by telephone.

See Supporting requests and When more information is needed for more information.

Proceeding with an unclear / ambiguous request or not asking for more information when needed can create additional unnecessary workload and cause processing delays as well as result in poor taxpayer service.

For example, if a request is denied or partially approved based on lack of information or details, the taxpayer may ask for a review of their file. This situation could have been avoided from the start by gathering all the required information prior to file review. If a second review is requested, the task for the reviewing officer would be much more simplified.

4.1.2 Misdirected requests / correspondence

All non-taxpayer relief related requests/correspondence should be redirected to the appropriate area for a response.

In some cases it will be clear that it is not a request for relief under the taxpayer relief provisions. For example, a request to cancel a late filing penalty because the return was filed on time is not a taxpayer relief request. Relief requests are only to be considered in situations where assessments or amounts are valid and correctly charged. Follow local procedures to have the return or amounts reviewed/corrected. No taxpayer relief review is required.

In other cases, consultation with a resource officer, team leader and/or another division may be required. If a decision cannot be made, refer the matter to headquarters, TRSCD at: Taxpayer Relief, General Enquiries/Allègements pour les contribuables, Demandes de renseignements généraux for resolution.

It is important to understand the taxpayer relief provisions legislation in order to review the request in an accurate and consistent manner.

4.1.3 Valid or invalid request

A request is considered **valid** when a taxpayer seeks to:

- cancel or waive penalties and/or interest relating to a taxation year/period ending in any of the 10 previous calendar years/periods;
- accept late-filed, amended, or revoked income tax elections (income tax only);

Digitized by Google

- issue income tax refunds beyond the normal three-year period (individuals and testamentary trusts only);
- consider situations where the taxpayer suffers from an inability to pay or from financial hardship.

A request is considered **invalid** when a taxpayer seeks to:

- cancel or waive tax;
- cancel or waive penalties and/or interest under the ITA for tax years prior to 1985, for requests made on or before December 31, 2004;
- cancel or waive penalty and/or interest under the ITA; ETA; EA, 2001; ATSCA or *Softwood Lumber Products Export Charge Act, 2006* for a tax year ending outside of the 10 previous calendar years**;
- issue tax refunds or reduce amounts payable beyond the normal three-year period under the ITA for a tax year ending outside of the 10 previous calendar years;
- accept late, amended or revoked elections under the ITA for a tax year ending outside of the 10 previous calendar years;
- cancel or waive GST/HST gross negligence penalty charged under section 285 of the ETA;
- accept late, amended or revoked elections that are not listed in Regulation 600 of the ITA;
- increase refund interest;
- issue tax refunds beyond the normal three-year period on corporate (T2) returns;
- provide an explanation of the penalties and/or interest charged;
- reimburse costs (such as phone charges, postage costs);
- cancel CRA administrative charges such as a bank charge back fees.

** Refer to Section 2 to determine the effective date of the 10-year limitation period.

4.2 Processing steps

The following summarizes the processing steps when a taxpayer relief request is received.

1) Screen and validate request

The request is screened and validated to identify which area or office should be completing the review. Identify the type of relief request and issue an acknowledgement letter, depending upon local TSO/TC procedures. If the file belongs to another area or office, the originating area/office will transfer the file.

2) Create taxpayer relief registry item

An item is opened on the Taxpayer Relief Registry. For better efficiency, taxpayer service and to maintain service standards, we recommend that, the office that initially receives the taxpayer relief request - "point

000121

Digitized by Google

of entry" should open the item. If the request is to only accept a late filed, amended or revoked election, an item is not opened on the Taxpayer Relief Registry. For information regarding "date received" go to Date Received in The Taxpayer Relief Registry Guide.

3) Taxpayer relief registry scratch pad

The Scratch Pad no longer exists in the new registry system launched in April 2009. Information concerning transfers, contact with the taxpayer and delays in processing the relief request is to be updated in Section IV- Info/Delays/Transfer of the on-line fact sheet.

4) Transferring files

For transfers, Section IV- Info/Delays/Transfer of the fact sheet must be completed with information such as originating office, office where the file is being transferred to, date file is transferred, and a brief description of the type of taxpayer relief request. To provide a proper audit trail, the receiving office must modify the Taxpayer Relief Registry when the file is received so that the receiving officer's contact name, telephone number and office responsibility centre and work section, as contained in the Organization System (ORG), are updated.

For more information, see http://sh13y393/WBA007/e_a/1500/1512/08_028.cfm?hdng=4#a424 in the *Taxpayer Relief Registry Guide*.

5) Determine if more information is needed

Ensure that you have all the relevant information needed to review to request. More information can be requested either in writing, by phone, or in person.

See When more information is needed for more information.

6) Gather and analyze facts

Gather and analyze all relevant information. You can find this information in supporting documents and in CRA systems. When analyzing the facts, remain impartial and consider factors contained in this guide and IC07-1.

7) Complete registry fact sheet and make recommendation

An internal report is prepared and a recommendation is made on the fact sheet in the Taxpayer Relief Registry. For further guidelines, see Part 4 in the *Taxpayer Relief Registry Guide* at: http://sh13y393/WBA007/e_a/1500/1512/08_022.cfm?hdng=4

8) Obtain approval

You must have your recommendation reviewed and approved. Either a delegated authority, and/or a committee, depending on local procedures, will carefully consider the report and recommendation.

See section Delegation policies for information on CRA delegation policies for staff who review and approve taxpayer relief requests.

9) Communicating the decision

000122

Digitized by Google

A delegated authority who considered the report, must sign the decision letter unless you are accepting a request for a refund beyond the normal three-year period. All taxpayer relief decisions must be communicated in writing by means of a decision letter or a notice of assessment / reassessment or notice of determination/redetermination.

See Communicating decisions for more information.

10) Update the taxpayer relief registry

All the mandatory fields in the Taxpayer Relief Registry are required to be updated for each completed request before closing the registry item. Close the registry item(s).

11) Process account transactions

Ensure that all taxpayer account transactions are processed.

12) Retaining information

The *Access to Information Act* requires that documents, such as reports and correspondence, be kept for a minimum of two years in the area that made the review.

Digitized by Google

5. Delegation Policies

This section sets out the CRA delegation policies for staff who review and approve taxpayer relief requests. It discusses delegation of the minister's power and duties, as well as the first, second, and judicial review processes. This section also provides policies on how to handle requests that are made after a second review, which are not judicial-review requests.

5.1 Delegation of the minister's power and duties

The Minister's powers and duties to exercise his discretion under the taxpayer relief legislation are administratively delegated as specified in the instruments of delegation signed by the Minister.

Positions and acting positions are delegated. People themselves are not delegated authority. The positions they occupy are delegated to perform certain duties.

Each time there is an amendment to a delegation instrument, a separate document is prepared for the approval of the Minister or Commissioner. These instruments are published on the CRA's external Website: Delegation of Ministerial powers, duties, and functions.

5.1.1 First reviews

Low-risk or routine first requests are normally authorized at the first level of supervision. Examples of low-risk or routine requests include:

- requests where the facts of the case are straightforward and the dollar amounts are not significant;
- requests of a non-complex nature that pose little or no risk of setting a precedent, attracting media attention, or bringing the CRA into criticism; and
- requests based on an inability to pay involving less than in penalty and interest, which are otherwise considered to be of a non-complex nature.

More sensitive or complex first requests may, depending on local procedures, be reviewed and authorized by a more senior delegated officer or by a taxpayer relief committee (reviewed by the committee and authorized by a member). These requests include:

- complex requests of a sensitive or precedent-setting nature;
- requests that involve more than one area within a local office or that are cross-functional;
- high-dollar items;
- requests where the media are involved or likely to become involved; and
- cases that may be detrimental to a community or group of taxpayers if an unfavourable decision is made (e.g., a group of employees affected by a large employer audit).

The delegated authority level for the first review approval is usually the Team Leader/Coordinator. An exception to this rule is when you are accepting a request for a refund beyond the normal three-year

Digitized by Google

period. If you are approving the taxpayer's request in full, a Notice of Assessment or Notice of Reassessment will be issued.

These notices are issued under the authority of the Commissioner of Revenue and will suffice as being reviewed by the appropriate delegated authority.

Partial or full denials for a request for refund beyond the normal three year period require a decision letter signed by the appropriate delegated authority.

If CRA requested information is submitted after the first level decision letter has been issued, the **same** persons who solicited the requested information and rendered the decision can be involved in the continuation of the first level review.

Directors **should not** personally review and make decisions for first requests, since this could affect impartiality if the taxpayer subsequently requests a second review of the decision.

5.1.2 Second reviews

To preserve the impartiality of the review process, second reviews should be made by someone other than the original decision-maker. The director of the tax services office or tax centre (income tax and GST/HST) decides who should conduct second reviews. However, requests for second reviews should be reviewed and authorized by an officer who is more senior than the original decision-maker, a taxpayer relief committee (reviewed by the committee and authorized by a member), or the director. Requests previously decided by a taxpayer relief committee should go to a more senior officer than the chairing committee member, or to a director.

Second requests that were denied because of missing CRA requested information can be reviewed and decided by the same persons who were involved in the original second level decision. If new information not requested by CRA is provided and the original decision-maker still feels that the request should not be granted, the request should automatically go for review to a more senior officer, a taxpayer relief committee, or to a director.

If it is determined that a person or persons who participated in the first review also acted on the second review, that alone can suffice to have the request returned back to CRA for a new review, as can be seen in the case of Robertson v. Minister of National Revenue.

5.2 Requests after second reviews

It is CRA policy that taxpayers are entitled to two administrative reviews within the CRA. Taxpayers also have recourse to judicial review. While CRA policy does not permit a third review, taxpayers sometimes come back to the CRA to ask for a review of a second decision; either before they ask for a judicial review, or because they have no intention to bring the matter to Court.

Here are the policies to follow when such requests are received:

5.2.1 Requests addressed to the taxpayer's director or regional assistant commissioner

Digitized by Google

The director of the office responsible for the second review or the assistant commissioner of the region responsible for that office has full discretion over the necessary course of action. Normally, the case would only be reopened if the taxpayer is providing new relevant information.

Note: When a delegated official at any office reviews a request because new relevant information has been submitted and the request is denied or partially approved, taxpayers must be informed of their right to judicial review even if this right was previously communicated. This note also applies to sections Requests addressed to the minister and Requests addressed to headquarters. See Section Second review denial/partial approval letters for guidelines on writing second review denial and partial approved letters.

5.2.2 Requests addressed to the minister, commissioner, or deputy commissioner

The ministerial correspondence areas have full discretion over all requests addressed to the minister, commissioner, or deputy commissioner. Although they have the authority to change a director's decision, they will normally consult with the director involved in the previous decision to determine the best course of action.

5.2.3 Requests addressed to headquarters functions or another office or region

Requests should be forwarded to the director responsible for the second review, and taxpayers should be informed that their request is being forwarded for review to the office that conducted the second review. If the recipient of the request expresses concerns about the last decision, the matter can be brought informally to the attention of the director responsible for that decision. If necessary, the recipient's assistant commissioner can formally refer the matter to the assistant commissioner of the director responsible for the case.

Digitized by Google

6. General policies and procedures

This section provides general taxpayer relief review policies and procedures that apply to all business lines and all types of taxpayer relief requests.

6.1 Purpose and intent of taxpayer relief provisions

The taxpayer relief provisions permit the CRA to help taxpayers resolve problems that arise through no fault of their own. The provisions allow for a common-sense approach in dealing with those who, because of personal misfortune or other circumstances beyond their control, are unable to comply with a statutory requirement or have failed to pay or remit an amount when due. The taxpayer relief provisions allow the CRA to be more flexible and responsive to a taxpayer's circumstances when it would be unreasonable or unfair to penalize the taxpayer.

The types of circumstances beyond a taxpayer's control may be summarized as follows:

- natural or human-made disasters such as flood, heavy storms, or fire;
- civil disturbances or disruptions in services such as strikes or demonstrations;
- serious illness or accident;
- serious emotional or mental distress caused by death, serious illness, or accident in the immediate family, marital separation, or loss of employment; or
- actions of the CRA, such as providing incorrect information, processing delays or errors, or delays in providing information.

See extraordinary circumstances for more information and guidelines for evaluating them.

Consideration is also given to situations where taxpayers suffer from an inability to pay or from financial hardship. See Inability to pay or financial hardship requests for more information.

The taxpayer relief provisions were not intended and should not be used as a way to negotiate settlement of a taxpayer's account. In all circumstances, taxpayer relief requests should be reviewed independently.

6.2 Administrative reviews

Taxpayers are entitled to two internal administrative reviews, which are generally the responsibility of the taxpayer's local office. Taxpayers are also entitled to a judicial review by the Federal Court.

First review decisions should be made at the first level of supervision. Taxpayers can ask for a second review if they are not satisfied with the outcome of a first review. Requests for second reviews are addressed to the attention of the director of the taxpayer's local office, and the director or a senior official or taxpayer relief committee authorized by the director reviews the decision.

First and second reviews are discretionary administrative reviews. As a result, there is no formal right of appeal. However, taxpayers can apply for a judicial review to the Federal Court, if they feel that discretion was not properly exercised during a first or second review. Taxpayers may apply for a judicial review if

Digitized by Google

they are not satisfied with a CRA decision; however, the scope of the Federal Court review is restricted to the exercise of discretion. The Federal Court will not overturn a CRA decision.

The first review requests must be submitted within the 10 year time limitation. For second review requests, there is no time restriction.

6.3 Ministerial discretion

Discretion is defined as the freedom to make decisions. This section of the guide sets parameters for exercising proper discretion during taxpayer relief reviews. Topics covered are the use of discretion, impartiality, and how to properly analyze facts.

6.3.1 Using discretion

The taxpayer relief provisions give the Minister of National Revenue discretion to cancel or waive penalties and interest, issue income tax refunds or reduce amounts payable beyond the normal three-year period (income tax only), and accept certain late-filed, amended, or revoked elections (income tax only). The minister's discretion is outlined in the phrase "the Minister may." that appears in each taxpayer relief provision.

Some CRA officials are delegated the authority to exercise the minister's powers and duties to allow, partially allow or deny taxpayer relief requests. Positions and acting positions are delegated, not individuals.

Delegated employees must carefully review the taxpayer's request and any documentation relevant to it, such as the taxpayer relief decision report. Most importantly, they are responsible for making a decision to allow, partially allow, or deny a taxpayer's request.

In using discretion, you must consider CRA policies and guidelines, the circumstances that gave rise to the request, submissions made by the taxpayer in dealing with the request, and any other relevant information.

When deliberating on a request it is important that:

- all correspondence and notes of telephone conversations with the taxpayer concerning the request, together with the taxpayer 's file or a summary of the facts relating to the request, be made available to and be reviewed by the person exercising the discretion;
- the person exercising the discretion read and consider the submissions of the taxpayer together with the recommendation and summary of the pertinent facts from the preparer of the recommendation; and
- the preparer of the recommendation be available to the person exercising the discretion to answer any questions that might arise concerning the appropriateness of the recommendation.

The way in which discretion has been exercised can be questioned during second reviews and judicial reviews.

See Delegation policies for more information on delegation and who is authorized to exercise Ministerial discretion.

000128

Digitized by Google

6.3.2 Making impartial decisions

To properly use discretion, it is essential that taxpayer relief staff involved in review and decision-making remain impartial. Evidence of non-impartiality could have adverse consequences in court. It could also undermine the CRA's reputation for fairness.

For example, we should not automatically refuse a request to cancel or waive penalties and interest because a taxpayer has a poor history of compliance. The circumstances of a request may have been completely out of the taxpayer's control, and this may allow us to grant the request.

Impartiality can best be defined as being just and fair or unprejudiced. The best way to remain impartial when performing a review is to avoid prejudging taxpayers or situations and to not be biased. Equal consideration and treatment must be given to all taxpayers.

Taxpayers deserve to be treated equally, regardless of their:

- age, gender, race, religion, or marital status;
- location (e.g., whether they are from a poor region or an affluent neighborhood);
- background (e.g., their level of education or social status);
- sophistication (e.g., how well they speak);
- access to tax professionals;
- assertiveness or aggressiveness; or
- employer or business sizes.

The above list is not intended to be exhaustive since other extraneous factors exist.

6.3.3 Properly analyzing the facts

Each request should be carefully analyzed. All the relevant facts have to be considered. A reasonable attempt must be made to gather all necessary information to make an informed decision. Unanswered questions during review may indicate that important information is missing, in which case a reasonable attempt should be made to get answers to our questions.

Each request to have the taxpayer relief provisions applied must be evaluated on its own merits. Do not make assumptions-they can jeopardize impartiality. Determine the merit of each case based on the events or parties involved.

When reviewing a request, stick to its facts. If a fact is not relevant to the case, it should not be considered. This also helps to maintain impartiality.

000129

Digitized by Google

6.4 Consistency

Consistency is equal treatment of taxpayers in the same or similar situations. This section outlines why consistency is important and how it can be achieved through the use of taxpayer relief committees, streamlined policies and guidelines, and enhanced communication.

6.4.1 Why consistency is important

Taxpayers have told us that they want us to apply the taxpayer relief provisions more consistently. The benefits of consistency are numerous and include:

- a fairer system;
- good taxpayer service; and
- improved public perception.

For example, if we allowed some requests because the amounts requested fall under a certain dollar value (e.g., penalties and interest under $10), this would lead to a huge inconsistency in the way the taxpayer relief provisions are applied. Taxpayers in the same situation would be treated differently based on the amount they owe.

This type of practice could also lead some taxpayers or their representatives to shop around for the best deal. This would also not be fair for taxpayers as a whole.

6.4.2 Using taxpayer relief committees

To improve consistency, field offices are encouraged to use taxpayer relief committees in situations where they are appropriate and manageable.

Since the inception of the taxpayer relief provisions, taxpayer relief committees have enhanced consistency by creating common approaches to processes and decision-making within work units and increasing knowledge on the part of staff.

Taxpayer relief committees are normally set at the local level within a division or are inter-divisional. They meet to make decisions on more difficult, sensitive, or precedent-setting cases and to discuss issues such as procedures and common requests. Membership may be fixed or open to any staff who work on taxpayer relief requests as directed by local management.

Some continuity in the makeup of these committees is needed. Continual, heavy turnover in staff would create a situation where a committee would be constantly starting over. However, some turnover can be good, as different employees will bring different viewpoints and experience to the table.

6.4.3 Developing streamlined policies and guidelines

Consistency can also be achieved through streamlined policies and guidelines that are updated in a timely fashion. This ensures that the same information is available to all staff, which leads to consistent and better decisions.

6.4.4 Enhancing communication

000130

Digitized by Google

Meetings or discussion groups for taxpayer relief staff of all levels can be constructive tools to enhance consistency, since this encourages dialogue and helps to ensure that everyone is "on the same page" in applying the taxpayer relief provisions. These meetings can be held within teams, divisions, local offices, or regions to discuss operational issues or problems, as well as update staff on any changes to or any new policies or guidelines.

6.5 Referrals to other areas

This section provides guidelines on when requests should be referred to other areas such as Collections, Appeals, or Audit.

6.5.1 Inability to pay and financial hardship requests

Collections areas within a tax services office are responsible for handling inability to pay and financial hardship requests. These types of requests, if received in other areas, have to be forwarded to Collections. Inability to pay or financial hardship may not be the only reason for the request.

Inability to pay requests related to an objection or appeal also have to be forwarded to Collections. These requests will be held in abeyance by Collections pending the outcome of the appeal process and the final determination of amounts owing. Collections staff should inform taxpayers that their requests will be reviewed after all appeal periods have expired.

6.5.2 Requests where a notice of objection or appeal is outstanding

Except for inability to pay requests, Appeals divisions in a tax services office or a tax centre are only responsible for handling taxpayer relief requests related to an assessment that is or was under objection or appeal.

Assessments that are or were under objection or appeal are recorded in CSAPP (Case Appeals), formerly GLOBUS.

Requests for penalty and/or interest relief related to an objection or appeal will be held in abeyance pending the outcome of the appeal process and the final determination of amounts owing. Appeals staff should notify taxpayers that their requests will be considered after all appeal periods have expired.

6.5.3 Certain Information Returns

Except for reasons due to inability to pay, all taxpayer relief requests received for penalties relief charged on certain information returns must be sent to the Ottawa Technology Centre, Other Programs Unit, 875 Heron Road, Ottawa ON K1A 1A2.

Penalty relief for the following information returns are processed only at the Ottawa Technology Centre (OTC):

- T100A, T100B and T100C, flow -through shares (FTS) information returns
- T106, Information Return of Non-Arm's Length Transactions with Non-Residents
- T1044, Non-Profit Organization (NPO) Information Return
- T5001, T5003, tax shelter information returns

0001131

Digitized by Google

- T5013, Information Return of Partnership Income
- T1134A, Information Return Relating to Foreign Affiliates That are not Controlled Foreign Affiliates
- T1134B, Information Return Relating to Controlled Foreign Affiliates
- Form T1135, Foreign Income Verification Statement
- T1141, Information Return in Respect of Transfers or Loans to a Non-Resident Trust
- T1142, Information Return in Respect of Distributions From and Indebtedness to a Non-Resident Trust

6.5.4 Other requests

Local management is responsible for determining which division/section will handle other types of requests. For example, an office may direct that taxpayer relief requests as a result of an enforcement action (audit) or gross negligence penalties be handled by Audit only.

6.6 Supporting requests

Both the taxpayer and CRA staff are responsible for making sure taxpayer relief requests are properly supported. Taxpayers have to make sure they give details of any extenuating circumstances and the documentation needed to support and establish the validity of their request. Taxpayers also have to reply in a timely manner when we ask them for more information.

It is the CRA's responsibility to make sure taxpayers are made aware that their requests have to be complete. Staff evaluating and reviewing taxpayer relief requests must determine whether taxpayers have provided enough information or if more information should be requested. If more information is needed, staff must try to contact taxpayers to obtain the information before reaching a decision.

Not asking for more information when it is needed can cause processing delays and result in poor taxpayer service and unnecessary additional requests.

See When more information is needed for instructions on how to request more information from taxpayers.

6.7 Requests taken on behalf of taxpayers

As a general rule, CRA employees should not take requests over the telephone or at the counter on behalf of taxpayers for the following reasons:

- Requests accepted over the telephone or in person would in all likelihood be incomplete, since they would not give all the information needed to efficiently resolve the request on the first attempt. More contact would be needed, which in turn would cause processing delays.
- Taking requests over the phone or in person could jeopardize our impartiality since employees could inadvertently substitute themselves in the role of the taxpayer, which could modify or taint the taxpayer's information.

000132

Digitized by Google

Exceptions can be made to these guidelines in cases where previously submitted requests are unactioned or where there is an inability to write or communicate in writing and the taxpayer has no one to help them. In these situations, care must be used to formulate requests on behalf of taxpayers in an impartial way and to try to gather as much detail and information as possible. Taxpayers should be told that more contact might be necessary. Under no circumstances should an opinion be given on whether requests will be approved or denied-this can only be determined after a thorough review.

6.8 Acknowledgement letter

It is advised that an acknowledgement letter be sent for all taxpayer relief requests.

Acknowledgement letters can be created using the Business Client Communication System (BCCS), Electronic Letter Creation System (ELCS), or a personal computer. Verification of the mailing address must be made.

You can find Electronic Letter Creation System (ELCS) information at http://sh13y393/wba007/e_a/1500/1501/08_001.cfm or click on Taxpayer Relief Letters on the Taxpayer Relief Provisions site. ELCS taxpayer relief verses for acknowledgement letters are in the ELCS Topical Index section.

See Appendices for an example of a taxpayer relief acknowledgement letter.

6.9 What constitutes a first or second review

6.9.1 What constitutes a first review

A taxpayer request for relief will result in a first level review if:

- this is the first time the taxpayer has made the request;
- the taxpayer has submitted additional information to support a request for relief for which a decision has not yet been rendered;
- the requested information for a first review is submitted after the decision letter has been issued, the request will be considered as a continuation of the first level review; or
- the taxpayer is denied relief under one legislative provision and a subsequent request is made under a different legislative provision. For example, when a client is denied relief under one legislative provision (i.e. 220(3.1) penalty and/or interest relief) and a subsequent request is made under a different legislative provision (i.e. 152(4.2) reassessments beyond the normal reassessment period), the request will be considered as a first request.

6.9.2 What constitutes a second review

A taxpayer request for relief will result in a second level review if:

- the taxpayer is asking CRA to reconsider its original decision and does not provide further information;

000133

Digitized by Google

- the taxpayer is asking CRA to reconsider its original decision and provides information that was not included with the first request or requested as part of the first request;
- the taxpayer is asking CRA to reconsider its original decision and cites a reason/motive (i.e. extraordinary circumstances to financial hardship) that was not raised at the time of the first request.
- the requested information for the second review is submitted after the decision letter has been issued, the request will be considered as a continuation of the second level review

6.10 When more information is needed

Discretion is best exercised when all the facts and all questions relevant to a case are gathered, reviewed, and answered. If the information given is incomplete or inappropriate, the taxpayer should be given the opportunity to provide more information before we make our decision. More information can be requested either in writing, by phone, or in person.

6.10.1 Requesting more information in writing

Letters asking for more information can be created using the Business Client Communication System (BCCS), Electronic Letter Creation System (ELCS), or a personal computer. Verification of the mailing address must be made. Taxpayers should be given a reasonable time frame (normally 30 days) to submit the requested information with an additional 10 days allowed for postal delays.

Written requests to the taxpayer should include the following elements or information:

- a precise description of the information requested (e.g., a doctor's letter that would provide the dates and details of an illness);
- a precise description of the receipts / information slips required to support the request for (re)assessment (e.g., child care receipt(s), rent receipt(s) or official donation receipt(s));
- a time frame for the taxpayer to respond (normally 30 days);
- an indication that if a reply is not received within the time frame, the request will be reviewed based on the information available and a decision will be made;
- the name of the employee and their direct phone number or extension the taxpayer can contact for more information or ask for an extension of time to reply; and
- an address for reply.

For more information, please see Communication 2008-13, Incomplete Taxpayer Relief Requests.

You can find Electronic Letter Creation System (ELCS) information at http://sh13y393/WBA007/e_a/1500/1501/08_001.cfm or click on Taxpayer Relief Letters on the Taxpayer Relief Provisions site.

See Appendices for an example of a letter requesting more information.

6.10.2 Requesting more information over the telephone

000134

Digitized by Google

Information can also be obtained by phone. Phone requests should include the same elements and information as listed in Requesting more information in writing. There are advantages to requesting information over the phone, since it can reduce the time in which the needed information is received. However, there is a chance the taxpayer could misinterpret what information is needed or could forget what information was requested.

Staff have to be prepared not to discuss the possible outcome of the case when talking to a taxpayer on the phone. No opinion should be given as to whether the request will be approved or denied-this can only be determined after a thorough review.

If information is requested by telephone, a record of the conversation (i.e., Form T2020) should be placed in the file showing the date of the call, the name of the officer, the name of the person with whom the conversation took place, what information was requested, and the period allowed to give the information.

In addition, place an electronic note recording the same information on the applicable system. For example, an electronic note should be recorded in Section IV- Info/Delays/Transfer of the Taxpayer Relief Registry fact sheet, EI.CS notepad, ACSES diary, GST/HST Notes or other applicable system, depending on the line of business.

6.10.3 Requests involving more than one area

We often receive taxpayer relief requests that involve review by more than one area. When more information is needed, a reasonable attempt should be made to minimize the number of times we contact the taxpayer.

6.11 Communicating decisions

This section gives guidelines on communicating decisions to taxpayer, including their recourse to a second review and judicial review. When more than one area reviews a request, a combined response should generally be sent.

In cases where multiple issues are involved, officers should exercise care and make sure they take into account all the motives in the request before rendering a decision, and cover all aspects in the decision letter. The letter should clearly indicate why the CRA has decided to approve/deny the request. For example, if the request involves both extraordinary circumstances and financial difficulties, the letter must address those issues to the extent that the taxpayer/employer can acknowledge that all of his arguments have been analyzed and covered. The more detail provided, the more unlikely it will be that a second review will be submitted.

A facsimile signature stamp should not be used under any circumstances for taxpayer relief decision letters, as there could be a perception that the delegated official did not actually make the decision.

If the delegated authority is in an acting position, the signature field should be the name and acting position. Do not use "FOR" signatures.

Decision letters to taxpayers should not refer to "taxpayer relief committees" since this term is for internal use only. It may also be confusing to taxpayers. The terms "fairness provisions" and "fairness legislation"

000135

Digitized by Google

have been replaced with the term "taxpayer relief provisions". Based on this change, all taxpayer relief letters and verses should be referencing to this terminology.

Care should be taken to use proper writing style and a current mailing address. Letters should be written in plain language whenever possible. Plain language uses straightforward, familiar words and simple, logical sentences. People reading a letter that is written in plain language should easily understand our decision. Address your reader directly. Try to use pronouns like you, we, us, our, and your, to make your letter more personal (you for the reader, we or us for the CRA). But be consistent; otherwise, you will confuse your reader. Consider the document structure and flow and use your judgment. You can find guidelines for writing in plain language on the Public Affairs Branch site. A list of best practices for writing taxpayer relief decision letters may be found at http://sh13y393/WBA007/e_a/1500/1501/08_001.cfm#pract. The web site also provides an ELCS topical index in order to make the search for taxpayer relief verses easier and faster.

6.11.1 Approval letters

See Appendices for examples of approval letters.

Taxpayer relief requests that are allowed in full cannot be closed over the phone. These decisions must be communicated in writing by means of a decision letter, notice of assessment/reassessment or notice of determination/redetermination. A combined response, such as, informing the taxpayer of the decision over the phone, followed by a decision letter or notice, can be done. The notice of assessment/reassessment and notice of determination/redetermination contains the signature of the Commissioner and is acceptable in lieu of a decision letter for an approval in full.

6.11.2 First review denial/partial approval letters

After a taxpayer relief request has been reviewed and a decision has been made, taxpayers must be advised in writing. Letters can be created using the Business Client Communication System (BCCS), Electronic Letter Creation System (ELCS), or a personal computer.

When communicating decisions, letters should include the following:

- an indication that the decision was made after considering the request, the facts of the case, and the legislation involved;
- a brief summary of the factors which were considered in the decision to deny the request in whole or in part;
- the basis or reasons for the denial or partial approval; and
- the name, position, and telephone number of the officer who handled the case along with an invitation to contact the officer if the taxpayer wants to discuss the matter.

It is very important that the taxpayer has a clear understanding of our decision and the reasoning for the denial in whole or in part. The taxpayer should be informed of what factors were considered in the decision. All comments, facts, and explanations provided by the requestor in writing or verbally need to be addressed by CRA. This is especially the case for a second review denial. The Federal Court may assume facts were overlooked if it is not shown that they have been considered.

Digitized by Google

Most importantly, letters have to inform taxpayers of their right to a second independent review of a denial or partial approval on the first review. Taxpayers should be informed that, if they are not satisfied with the decision or feel that the CRA has not exercised its discretion in a fair and reasonable manner, they can ask in writing that the director of their local tax services office or tax centre review their request again.

Although taxpayers are entitled to apply for a judicial review after the first review, they will only be told of this recourse after a second review.

The delegated official who made the decision to deny or partially approve the taxpayer's request by signing the taxpayer relief decision report, must sign the letter as well.

See Appendices for an example of a first review denial letter.

6.11.3 Second review denial/partial approval letters

After an unfavourable decision or partial approval from a second review, the written reply should inform taxpayers of their right to redress to a judicial review. Second review denial or partial approval letters have to contain the following paragraph:

"If you feel that discretion was not properly exercised during our review of your request for relief, you can apply to the Federal Court for a judicial review within thirty (30) days of the day you received this letter. For more information on the judicial review process and how to apply, phone the Registry of the Federal Court at (*phone #*). This information is also available at the Federal Court web site: http://www.fct-cf.gc.ca/index_e.shtml."

See Federal Court contact list for telephone numbers and addresses.

The senior officer who authorized the decision to deny or partially approve the taxpayer's request must sign the letter as well.

See Appendices for an example of a second review denial letter.

6.12 Applying the taxpayer relief provisions actively

CRA employees are encouraged to be proactive in communicating and applying the taxpayer relief provisions. This is especially important for front-line employees, since they are the most frequent and important point of contact with the taxpayers. This section discusses how to be proactive and the benefits of being proactive.

6.12.1 How to be proactive

Front-line staff can give information on the taxpayer relief provisions proactively over the telephone or at the counter when a taxpayer's situation warrants. In these circumstances, the information given should be limited to the basic conditions taxpayers have to meet to be eligible for relief under the taxpayer relief provisions and how to make a request. Staff can also be proactive by identifying unclaimed credits and

000137

Digitized by Google

benefits, as well as overpayments, while performing audits, examining a complaint, or evaluating a taxpayer-requested adjustment.

When the situation warrants, front-line employees should inform taxpayers of the taxpayer relief provisions and refer them to the following documents:

- IC07-1, Taxpayer relief Provisions
- Memorandum 16-3, Cancellation or Waiver of Penalties and/or Interest
- RC4288, Request for Taxpayer Relief

Employees should understand the taxpayer relief provisions and how they are applied so they do not raise a taxpayer's hopes unnecessarily and generate unnecessary additional work for the CRA. For example, employees should avoid encouraging taxpayers to submit requests when it is determined that the year(s) for which relief is being sought is past the 10-year limitation.

6.12.2 Benefits of being proactive

Although a proactive approach may result in an increase in taxpayer relief requests received, there are many benefits to being proactive in communicating and applying the taxpayer relief provisions. Active communication helps make sure taxpayers receive the information they are entitled to and enhances the taxpayers' confidence in the integrity of our self-assessment system by making sure they pay their proper share of duties and taxes.

6.13 Keeping taxpayer relief records

Taxpayer relief requests and all related information such as reports and correspondence must be kept and stored in the area that made the review for a period of two years. In situations where there has been more than one taxpayer relief request regarding the same matter, the documentation has to be combined and kept for two years from the date of the latest request. The Access to Information Act requires that documents be kept for a minimum of two years from the date they were last used for administrative purposes.

Records can be destroyed after the two-year period has passed. However, local management may choose to extend the retention period, particularly for sensitive cases.

6.13.1 Keeping an audit trail

When a local office receives a taxpayer relief request, an entry is made on the Taxpayer Relief Registry. For each completed request, the Taxpayer Relief Registry item has to be accessed to enter the rationale for the decision and the location of the documentation pertaining to the request. This information is useful in helping answer subsequent taxpayer enquiries or requests for which records were destroyed or cannot be located.

Any other useful information in the form of a narrative can also be added into the Taxpayer Relief Fact Sheet.

000138

Digitized by Google

6.14 Consent forms - Authorizing or cancelling a representative

6.14.1 Individual, trust and T5 accounts

For individuals (T1 accounts), trusts (T3s) and T5 information returns, form T1013 - Authorizing or Cancelling a Representative, has been revised to include two levels of authorization with expiry dates. Level 1 authorization allows only for the disclosure of information, while level 2 allows for both the disclosure of information and changes to a taxpayer's account.

Therefore, for taxpayer relief requests, level 2 authorization is required. Should you receive requests with either no authorization or level 1 authorization, return the request to the representative advising that you are unable to review the request without level 2 authorization provided on form T1013. A signed letter from the taxpayer, which clearly states the representative has the authority to request changes to the taxpayer's account, is also acceptable.

6.14.2 Business accounts

For business accounts (T2, GST/HST, PAYDAC, Import/Export, etc.) RC59 - Business Consent Form or equivalent information is required for authorizing or cancelling a representative. The form has also been revised to include two levels of authorization with expiry dates. Level 1 authorization allows only for the disclosure of information, while level 2 allows for both the disclosure of information and changes to the Business Number account(s).

6.14.3 Canada Pension Plan or Employment Insurance Act

CPT139 - Authorization form is used to authorize representatives for matters relating to the Canada Pension Plan or Employment Insurance Act. There are no differing levels of consent.

DISCLOSED PURSUANT TO THE A.I.A

Digitized by Google

7. Guidelines for cancelling or waiving penalties and/or interest

This section provides guidelines that apply to all business lines to evaluate taxpayer relief requests for cancelling or waiving penalties and/or interest. These guidelines should be used in conjunction with General policies and procedures.

Most Headquarters functions have additional guidelines for their workflows. You can find references to these additional guidelines in Functional guidelines.

The CRA may waive or cancel all or part of any penalty and interest otherwise payable under the taxpayer relief provisions. The ability to waive or cancel penalties and interest is not to be used as a way to arbitrarily reduce or settle tax debt.

Effective April 1, 2007, the *Excise Tax Act* (ETA) was amended to introduce a failure to file penalty under section 280.1 for GST/HST. Therefore, subsection 281.1(2) will allow CRA to waive or cancel all or a portion of this penalty.

See Legislation for more information.

7.1 Difference between a cancellation and a waiver

The terms cancel and waive have two distinct meanings.

When we reverse a penalty or interest that has already been assessed or charged, we cancel it.

When penalties or interest have not yet been assessed or charged, and at the taxpayer's request or on our own initiative we determine the amount will not be assessed or charged, we waive it.

7.2 Circumstances in which interest and penalties may be cancelled or waived

Interest and Penalties may be cancelled and/or waived in the following types of situations:

a. extraordinary circumstances

b. actions of the CRA

c. inability to pay or financial hardship

The Minister may also grant relief if a taxpayer's circumstances do not fall within these situations. The request must be made within the 10-year time limit.

Digitized by Google

7.3 Extraordinary circumstances

This section provides examples of various extraordinary circumstances and guidelines for evaluating them.

The types of circumstances beyond a taxpayer's control that may have prevented a taxpayer from making a payment when due, filing a return on time, or otherwise complying may be summarized, but not limited to, the following examples:

- natural or human-made disasters such as flood, heavy storms, or fire;
- civil disturbances or disruptions in services such as strikes or demonstrations;
- serious illness or accident;
- serious emotional or mental distress caused by death, serious illness, or accident in the immediate family, marital separation, or loss of employment.

7.3.1 Natural or human-made disasters

Taxpayers can ask for taxpayer relief due to natural or human-made events such as flood, heavy storms, or fire. Relief can be granted when the event destroyed books and records, or made them inaccessible, or for other obvious reasons compliance was delayed or prevented.

Guidelines for evaluating such circumstances include but are not limited to the following:

- Consider the dates and description of events, and whether they correspond to the period when an obligation or requirement was missed.
- Review the taxpayer's explanation of how the event prevented compliance.
- Review the taxpayer's explanation of what other means were explored to comply with requirements.
- Review the taxpayer's supporting documentation such as a copy of the police, fire, or insurance report to determine whether the dates and description of damages correspond to the taxpayer's presentation of the facts.

7.3.2 Civil disturbances or disruptions in services

Disruptions in services such as a postal strike, a strike within the government, or civil disturbances may give cause to a request for taxpayer relief.

Guidelines for determining if such circumstances prevented compliance include, but are not limited to, the following:

- Review the dates and description of events, and verify that they correspond to the period when an obligation or requirement was missed.

000141

Digitized by Google

- Consider the taxpayer's explanation of how the event prevented or delayed compliance corresponds to the facts. Consider how long the disruption had been ongoing before the date payments, remittances, income tax, GST/HST, or information returns were due.
- Review the taxpayer's explanation of what other means were explored to comply with the requirement. Does the taxpayer have relatively easy access to a CRA office? Does he or she live in an area with reasonably close access to a tax services office or tax centre?
- Review the taxpayer's supporting documentation such as a newspaper clipping that supports the disruption.

7.3.3 Serious illness or accident

Taxpayers can ask for taxpayer relief if they have suffered from a serious illness or an accident to such an extent that they could not meet an obligation or requirement.

Some guidelines for evaluating such requests include the following:

- Review the date(s) and nature of the illness or accident, and how it corresponds to the period for which the relief is requested.
- Review the taxpayer's explanation of how the event prevented compliance. Consider whether the taxpayer could have had someone else take care of his or her obligations.
- Consider the taxpayer's explanations of whether other personal or business obligations were impaired.
- Review any supporting documentation such as accident reports, insurance reports (accident or health), and medical or hospital reports to make sure they verify the taxpayer's description of events.

For a corporation, estate, or trust, ask if the circumstances involve an individual having sole authority to execute the return, make the deposit, pay the tax, or remit amounts owing to the CRA. If someone else was authorized to meet the obligation, consider the reasons that person did not meet the obligation when evaluating the request. For a business, if only one person was authorized, determine if this was in keeping with reasonable standards of care.

Although it is imperative that these requests be thoroughly verified, they also should be handled with consideration and tact.

7.3.4 Serious emotional or mental distress

Taxpayers can also be granted relief if compliance was delayed or prevented because they suffered serious emotional or mental distress because of a death, serious illness, or accident in the immediate family, marital separation, or loss of employment.

To resolve these types of cases in a consistent manner, consider the following factors:

- Did the taxpayer work during the period in question or do any type of activity that would be similar in complexity to filing an income tax return?

000142

Digitized by Google

- Was the taxpayer hospitalized during the timeframe in question?
- Was the taxpayer under medical care during the timeframe in question?
- Is this (non-compliance, late filing, late payment, etc.) an isolated case?
- Are the tax returns prepared by the taxpayer or a representative?

Guidelines to consider when evaluating such circumstances include those listed in serious illness or accident as well as these additional guidelines:

- Consider the relationship of the parties involved.
- Review the date of death of the family member, marital breakdown, loss of employment, or other traumatic event and how it relates to the period for which the relief is requested.
- Review any supporting documentation to make sure it verifies the taxpayer's description of events.

These types of requests should be handled with consideration and tact.

7.4 Requests that arise due to actions of the CRA

Cancelling or waiving penalties or interest may be appropriate if the penalties or interest resulted mainly because of CRA actions and through no fault of the taxpayer, such as if:

- incorrect information given by the CRA in the form of written answers or published information, or provided in person or over the telephone, led the taxpayer to file returns or make payments or remittances based on incorrect information;
- processing delays resulted in the taxpayer not being informed within a reasonable time that an amount was owing;
- errors occurred in processing; or
- delays occurred in providing information necessary to meet an obligation, such as if the taxpayer could not make the appropriate payments/remittances because the necessary publication or return was not available;
- Undue delays in resolving an objection, appeal or completing an audit.

In cases involving incorrect information provided by the CRA, the following should be assessed:

- Determine whether the taxpayer provided the CRA with accurate and complete information. Missing or inaccurate details provided by taxpayer can lead to an incorrect response on the part of the CRA.
- Assess the relationship between the taxpayer's situation, the information provided, and the penalty and interest assessed.

Digitized by Google

- Assess the degree of completeness of the details given to support a claim of incorrect verbal information. The more detailed the facts presented, (such as date, time, person spoken to, and details of the conversation), the more it could aid in strengthening the case.

In cases where it is alleged that the CRA was responsible for the delay, a determination should be made whether it was so and the period of delay should be established.

The examples, which follow, should help in identifying what is and what is not a delay caused by the CRA.

Examples

CRA delay
If for one reason or another, the CRA took more time than normal to process/complete a file (employee is on sick leave for a long period of time and the files were not reassigned, new priority), we could consider cancelling or waiving a portion of the interest.

Taxpayer delay
Let's take a project where the CRA sends letters to several taxpayers requesting supporting documentation. Some taxpayers comply, provide the requested documentation and have their files reassessed. However, a portion of the taxpayers do not cooperate for unknown reasons, and do not produce the documentation. Six months later, the CRA sends a follow-up letter to obtain the documentation or decides to reassess based on the existing available information. In this type of situation, the CRA should not consider cancelling or waiving interest because the delays have been due to the taxpayer's lack of action or response.

Whenever we review a request to cancel or waive interest and/or penalties, we must take into account the four factors used to arrive at a decision.

The four factors used to make a decision appear in the section 7.9 Factors to consider in arriving at the decision

7.4.1 Proactive taxpayer relief

Approving relief of interest and/or penalties due to the actions of the CRA without a taxpayer relief request is considered proactive taxpayer relief.

One of the circumstances where relief from interest and/or penalties may be warranted is undue delays in resolving an objection, an appeal, or in completing an audit also known as proactive taxpayer relief.

The decision to recommend a waiver/cancellation of interest and/or penalties will be based on the judgment of the CRA officer/auditor and the delegated authority after considering the facts of the case and the guidelines outlined in IC07-1, *Taxpayer Relief Provisions* and GST Memorandum Series 16-3 *Cancellation or Waiver of Penalties and/or Interest*.

Documentation to support the waiver of interest and/or penalties should include one or more of the following:

- relevant audit or appeals working papers – the information necessary to determine the appropriateness of any waiver of interest and/or penalties.

000144

DISCLOSED PURSUANT TO THE ATI

Digitized by Google

- T2020 Memo to File (or similar working paper) – this should include a chronological account of the audit/objection/appeal as well as comments relating to the cause of any delays.
- taxpayer relief report

All CRA initiated waivers of interest, or cancellation of interest and/or penalty will require a Taxpayer Relief Registry (TRR) entry number. The TRR entry should be created as soon as a proactive request is initiated. The received date must reflect the date a recommendation of proactive waiver is made. Close the TRR entry once the decision report has been approved by a delegated authority.

Prepare the decision report. In all cases, the officer/auditor must complete a decision report. All decisions made under the taxpayer relief provisions must be communicated in writing by means of a decision letter, notice of assessment/reassessment or notice of determination / redetermination.

See section 7.19 Taxpayer relief decision reports and section 6.11 Communicating decisions for more information.

See Appendices for an example of a taxpayer relief proactive decision letter.

The letter may be modified to suit the particular case and is not intended to give the taxpayer a detailed explanation, only some insight as to what is being waived/cancelled. If the taxpayer requests clarification, the officer/auditor is instructed to advise the taxpayer as to how the portion of the interest waived/cancelled was calculated and the reason(s).

All decision letters to the taxpayer should be signed by a delegated authority.

The actual interest waived will be provided on the Notice of Assessment/Reassessment (as applicable).

Forward the report and decision letter to the delegated authority and/or taxpayer relief committee for approval.

If the taxpayer disagrees with the interest and/or penalty relief that was proactively allowed by CRA and requests additional interest and/or penalty relief in respect of the same taxation year/audit period, we would consider this as a request for a second review since the Minister, or his delegate, exercised their discretion when they allowed interest and/or penalty relief proactively at the conclusion of the review/audit.

For more information, see section 6.9.2 What constitutes a second review and section 5.1.2 Second reviews.

REMEMBER, be proactive! Waive interest and penalty if it is appropriate, e.g., if there has been undue delay in completing the review/audit.

7.5 Inability to pay or financial hardship

The taxpayer relief provisions were not intended and should not be used as a way to arbitrarily reduce or negotiate settlement of a CRA account. In all circumstances, taxpayer relief requests should be reviewed independently.

000145

DISCLOSED PURSUANT TO ATIA

Digitized by Google

After confirming an inability to pay all amounts owing, it may be appropriate to consider waiving or cancelling interest in whole or in part to enable payment of the account. For example:

a. when collection had been suspended due to an inability to pay and substantial interest has accumulated or will accumulate;

b. when a taxpayer's demonstrated ability to pay requires an extended payment arrangement, consideration may be given to waiving all or part of the interest for the period from when payments start until the amounts owing are paid, as long as the agreed payments are made on time and compliance with the Act is maintained; or

c. when payment of the accumulated interest would cause a prolonged inability to provide basic necessities (financial hardship) such as food, medical help, transportation, or shelter, consideration may be given to cancelling all or part of the total accumulated interest.

Consideration would not generally be given to cancelling a penalty based on an inability to pay or financial hardship unless an extraordinary circumstance, has prevented compliance. However, there may be exceptional situations that may give rise to cancelling penalties, in whole or in part.

For example, when a business is experiencing extreme financial difficulty, and enforcement of such penalties would jeopardize the continuity of its operations, the jobs of the employees, and the welfare of the community as a whole, consideration may be given to providing relief of the penalties.

See Accounts Receivable Directorate (ARD) of this guide for references to guidelines on inability to pay and financial hardship.

7.6 Other Circumstances

There may be other circumstances in which it may be appropriate to cancel or waive penalties and/or interest. For example, a taxpayer requests relief due to a specific situation that is not considered to be an "extraordinary" circumstance. In these situations, we must consider the request to be valid and review the request in the same manner as we would for any other request.

When preparing the decision report and the letter for a request that is denied or partially denied, it is important to indicate why the specific situation presented does not warrant relief instead of indicating that the request is being denied/partially denied because the circumstance(s) was not considered "extraordinary".

In the court case, Nixon v. Canada (National Revenue) , the judge set aside the decision to deny the request for taxpayer relief. The taxpayer asked for relief due to a specific situation that prevented him from complying with his tax obligations. At the second level review process, both the report and the letter indicated that the request was denied because there were no "extraordinary" circumstances. The judge indicated that our own guidelines were not followed as we did not consider other circumstances as indicated in paragraph 24 of IC 07-01. Paragraph 24 says that the Minister may also grant relief if a taxpayer's circumstances do not fall within situations stated in paragraph 23 (extraordinary circumstances, actions of the CRA or inability to pay or financial hardship). In this case, the taxpayer had a circumstance that was not considered extraordinary and the decision to deny should not have been based on that fact alone. **7.7 Disputed assessment or amount charged**

000146

Digitized by Google

Relief should not be considered for a disputed assessment or amount charged. For example, you may have two categories of requests/situations for late filing penalties:

- Taxpayers' admit the return/document is filed late but would like the penalty to be waived/cancelled; or
- Taxpayers may dispute the correctness of the penalty (taxpayers indicate the return/document was filed on time).

The first bullet situations are clearly valid taxpayer relief requests, where you are dealing with correctly charged penalties.

The second bullet situations should not be considered a taxpayer relief request. Taxpayers may dispute the penalty informally by writing/contacting us; they may also formally dispute the penalty by filing a notice of objection.

It is the officer's responsibility to ensure, before recommending taxpayer relief or referring the correspondence to taxpayer relief, that the law was applied correctly. In other words, the assessment must be valid or the taxpayer must have late-filed a return, otherwise taxpayer relief provisions do not apply.

All evidence to either support or negate the taxpayer's claim that the return/payment was filed/made on time should be reviewed, including the taxpayer's compliance history.

7.8 Making a taxpayer relief request

This section of the guide provides guidelines on making first and second taxpayer relief requests and outlines the information needed to make requests as complete as possible.

7.8.1 First requests

Taxpayers or their authorized representative normally have to ask for the cancellation or waiver of a penalty or interest in writing. In a request, taxpayers have to give the reasons why charges should be cancelled or waived, as well as enough relevant information and documents to support the validity of their claim.

When informing taxpayers how to make a taxpayer relief request, it should be stressed to them that it helps to expedite processing when a request is identified as a taxpayer relief request, and whether it is a first or second request. This will save time in screening requests and help avoid situations where requests are held in the wrong inventories for extended periods of time.

Taxpayers or their authorized representatives can make their requests by writing to the tax centre where they file their returns, or the tax services office serving their area.

Form *RC4288, Request for Taxpayer Relief* can be used by taxpayers to request relief. Although this is not a prescribed form, field office staff should promote its use by taxpayers. The CRA will not deny a request simply because the taxpayer did not complete a RC4288. A copy of this form is available from the CRA Web site at www.cra-arc.gc.ca/formspubs/menu-e.html or by telephone at 1-800-959-2221.

000147

Digitized by Google

Addresses and telephone numbers of CRA offices may be found in the listings of the government section of telephone books and on the Contact us page of the CRA Web site at www.cra-arc.gc.ca.

7.8.2 Second requests

If taxpayers do not agree with the CRA's decision in its review of their first request, they are entitled to make a second request, in writing, to the director of the tax centre, or tax services office.

A taxpayer's second request requires the following:

- the reasons why the taxpayer disagrees with our decision (e.g., not all information was considered, certain facts or details were misinterpreted or not considered in their proper context, the taxpayer simply disagrees); and
- any relevant new documents, new facts, or correspondence.

7.8.3 Requests must be complete

Taxpayers should be encouraged to make their taxpayer relief requests as complete as possible. This allows CRA staff to exercise discretion and avoid processing delays. A proper review cannot be conducted if we do not have access to all relevant information.

Staff are encouraged to promote the requirement that taxpayer relief requests be complete when providing guidance or information to taxpayers on the taxpayer relief request process.

Note : Taxpayer relief requests cannot be processed without a valid CRA account number.

A taxpayer relief request should contain the following information, regardless of the business line:

- the type and nature of the extraordinary circumstances that prevented the taxpayer from complying;
- supporting documentation such as death certificates, doctor's statements, or insurance statements;
- in cases involving financial hardship, a meaningful payment arrangement and full financial disclosure;
- supporting details of incorrect information given by the CRA in the form of written answers, published information, or other objective evidence;
- where the incorrect information given by the CRA is of a verbal nature, the taxpayer should give all possible details such as date, time, name of CRA official spoken to, and details of the conversation;
- a complete history of events including what measures were taken (e.g., payments and payment arrangements) and when they were taken to resolve the non-compliance; and
- the name, address, and telephone number where the taxpayer may be reached if more information or explanation is needed.

Requests for the following business lines require the following information in addition to the above:

000148

Digitized by Google

Income tax

- taxpayer's social insurance number or account number
- tax years or periods involved

GST/HST

- taxpayer's GST/HST registration or account number
- reporting periods involved

7.9 Factors to consider in arriving at the decision

Consider the following factors when determining whether it is appropriate to cancel or waive penalties and/or interest:

- Past compliance
- Has the taxpayer knowingly allowed a balance to exist
- Reasonable amount of care
- Has the taxpayer acted quickly to remedy any delay or omission

7.10 Assessing reasonable care

The CRA will generally not make a decision in the taxpayer's favour unless the taxpayer took a reasonable amount of care to comply. In a normal situation, efforts should have been made to avoid, or at least minimize, delays in complying, paying, or remitting amounts due. A taxpayer should remedy any delay or omission within a reasonable time after he or she became aware of the delay or omission, or as soon as circumstances permitted.

Reasonable care is best described as whether the action or inaction of a taxpayer reflects what a person might reasonably be expected to do under comparable circumstances.

If the CRA can determine that a delay in payment or compliance arose through neglect or lack of awareness on the part of the taxpayer, relief under the taxpayer relief provisions should not be granted.

Here are some guidelines to use in determining whether reasonable care was exercised:

- Examine the taxpayer's reasons for failing to comply to determine if the dates and explanations correspond with events on which the penalties or interest are based.
- Examine the length of time between the event cited as a reason for the non-compliance and subsequent compliance, as this can indicate whether care was exercised. For example, if the taxpayer claims that he or she was unable to comply due to a fire, the reasonableness of the length of time between the fire and subsequent compliance may serve to support or refute all or part of the event's effect. This could be more difficult to assess if the reasons claimed are illness, accident,

0001451

Digitized by Google

or serious emotional or mental distress. We would normally rely on medical or professional documents or proof submitted by taxpayers.

- Review whether or not the taxpayer could have anticipated the event that caused the non-compliance and to what extent the non-compliance was within the taxpayer's control.
- Determine if the taxpayer or the taxpayer's representative has knowledge that would help in knowing what the requirements or obligations would be and the repercussions in not meeting them.

7.11 Assessing past compliance

We should normally review a taxpayer's past compliance (e.g., penalty/interest history) to help determine if reasonable care was used. This is normally achieved by consulting mainframe applications or consulting a taxpayer's past records.

Evaluating a taxpayer's compliance history is particularly relevant in a situation where a taxpayer claims that he or she was not aware of, or informed of, an obligation such as the requirement to make an instalment payment or remittance, but has been assessed late instalment or remittance penalties in the recent past. If the same type of penalty or interest charges are assessed from year to year, this may indicate that a taxpayer is not exercising reasonable care in meeting his or her obligations. How far back we should assess a taxpayer's compliance history depends on the circumstances of each case.

It should be emphasized that a taxpayer's compliance history should not be the sole basis on which a taxpayer relief decision is based. It is only one of the factors to consider. The purpose or intent of weighing the compliance history when deliberating on a taxpayer relief request is to determine the credibility of the taxpayer's description of events and facts.

Assessing a taxpayer's past compliance would be less relevant if circumstances were out of the taxpayer's control and the non-compliance was reasonably remedied.

The fact that a taxpayer has a poor compliance record would not lead to refusing the taxpayer's request if the circumstances of the case show no evidence of negligence. For example, penalties and interest could be cancelled or waived if an electronic transaction or filing was overdue because of the failure of the CRA's systems, even if a taxpayer has a poor compliance history.

7.12 Special consideration due to extraordinary events

The Minister may issue a news release to announce that special consideration will be given to providing relief due to an extraordinary event that has prevented a large number of taxpayers from meeting their tax obligations. Generally, taxpayers still need to make a written request to get relief.

CRA news releases on extraordinary events that qualify for relief can be found at www.cra-arc.gc.ca/newsroom/releases/menu-e.html.

See Communications for internal instructions issued to field office staff on TRSCD site.

000150

Digitized by Google

7.13 Third parties

A third party can be defined as a representative acting on behalf of the taxpayer/employer.

Taxpayers are responsible for meeting their obligations under the legislation we administer. As a result, taxpayers are generally considered to be responsible for errors made by third parties. Third parties who receive a fee and give incorrect advice, and make arithmetic or accounting errors should normally be regarded as being responsible to the taxpayer, if the taxpayer has suffered penalty or interest charges because of the party's actions.

In very rare situations, relief could be granted to taxpayers because of third-party errors or delays. An extraordinary circumstance beyond the control of a taxpayer's representative, which prevented the taxpayer from complying, can be a reasonable basis for granting relief. For example, it would be proper to grant relief when a taxpayer's representative cannot file a return or an election on time because the representative was just hospitalized.

This is why it is important to review all taxpayer relief requests with care when third-party error is involved. Special care should be taken in granting taxpayer relief in cases of third-party errors so as not to undermine the principles of self-assessment.

7.13.1 Bank error

There may be exceptional situations where it may be appropriate to provide relief arising from a bank error or delay, if it has been established that the error occurred from a situation beyond the taxpayer's or employer's control. For example, if the employer makes his payment on time directly at his financial institution, but a delay occurs in the transfer of funds to CRA due to a computer breakdown, then it may be possible to consider cancelling the penalty and interest charges on the remittance, providing the bank can corroborate the situation. In this case, the bank is the third party and has admitted being at fault. This is clearly a situation beyond the employer's control. As a general rule, these types of requests should be approved if the financial institution can substantiate the circumstances.

7.13.2 Employer error

An employer error is different from a third party error as the employer commits the error.

In cases of employer error, officers need to look at each taxpayer relief request on a case-by case basis. Where the CRA is satisfied that the employee had no knowledge or could not have been expected to know that the amounts on the T4 were incorrect because of an employer error, it would be reasonable to consider waiving or cancelling the interest and/or penalties.

7.14 Ignorance of the law

Generally, ignorance of the law or taxpayer error should not be accepted as a proper basis for granting relief under the taxpayer relief provisions. If the delay in compliance or in making a payment/remittance arose through neglect, carelessness, or lack of awareness on the part of the taxpayer, the penalties or interest should not normally be cancelled or waived, or the election should not normally be accepted. For example, the fact that a taxpayer was not aware of a filing requirement does not constitute by itself an acceptable reason for granting relief.

000151

Digitized by Google

7.15 Gross negligence penalties

Relief request to cancel a gross negligence penalty can be considered under subsection 220(3.1).

However, since these penalties indicate a degree of negligence and absence of care and diligence on the part of the taxpayer, the cancellation of a gross negligence penalty may be appropriate only in exceptional circumstances.

Given the nature of a gross negligence penalty, it is more appropriate for a taxpayer to dispute the assessment of the penalty by filing a notice of objection.

7.16 Erroneous refunds

Cancelling or waiving penalties and/or interest may be appropriate if the CRA made an error by issuing a cheque to a taxpayer for a greater amount than the taxpayer is entitled to without justification, foundation, or rationale. An example would be a refund cheque for $1,000 mistakenly issued for $10,000, due to a keystroke error.

The question of whether or not to waive or cancel penalties and/or interest that have accrued on a refund issued to a taxpayer in error would need to be decided based on the facts of each individual case.

The main considerations when reviewing such requests would be:

- Whether the taxpayer acted in a timely manner to bring the matter to the CRA's attention: Did the taxpayer contact the CRA within a reasonable time?
- Whether the taxpayer has taken a reasonable amount of care in trying to resolve the situation: Did the taxpayer contact the CRA to question the discrepancy?
- Whether it would have been clear to the taxpayer that an error had been made and that he or she was not entitled to the funds: Was there a discrepancy between the balance or refund calculated by the taxpayer and the amount of the refund received?

Although each case must be evaluated on its own merit, the taxpayer is normally expected to report the occurrence to the CRA within a reasonable time after becoming aware of the error, to qualify for total penalty and interest relief.

7.17 Amounts held in trust

If a taxpayer meets the criteria for taxpayer relief, it should be granted whether or not trust funds (e.g., payroll accounts or GST/HST accounts,) are involved. The fact that amounts are considered to be held in trust should not be the sole basis for denying a request under the taxpayer relief provisions. For example, a waiver or cancellation may be considered in cases of legitimate financial hardship where the continuity of business operations and the continued employment of the firm's employees are unnecessarily jeopardized because of circumstances beyond the control of the taxpayer.

000152

Digitized by Google

7.18 Reinstating cancelled or waived penalties and/or interest

After penalties and/or interest have been cancelled or waived, they generally cannot be reinstated, since there is no basis in law to allow for reinstatement. Even if penalties or interest could be reinstated, in most cases it would not be fair, expedient, or cost effective to do so after the cancellation or waiver has been granted.

7.19 Taxpayer relief decision reports/fact sheets

This section describes why reports are mandatory, what information they should include, and other essential elements.

7.19.1 Reports/fact sheets are mandatory

Officers who review requests for cancelling or waiving penalties and interest must complete a taxpayer relief decision report - fact sheet. These reports outline the taxpayer's facts and reasons of their request, our analysis of these facts and reasons, and our recommendation to allow, partially allow, or deny the request. A report and its recommendation have to receive proper approval by a delegated authority. See Delegation policies for information on delegation of authority.

Reports are often used as reference material to answer taxpayer enquiries or to help review second requests. Copies of the taxpayer relief decision reports can also be forwarded to the Federal Court to serve as evidence when there has been a request for a judicial review of a taxpayer relief decision.

Taxpayers can also ask for a copy of any taxpayer relief decision report/fact sheet through access to information legislation.

7.19.2 Information to include in a report/fact sheet

As part of the redesigned Taxpayer Relief Registry, a fact sheet has been incorporated into the registry as of April 2009. The report/fact sheet must include the following information:

- the taxpayer's identification - name, account number, social insurance number, GST/HST registration;
- the taxpayer's request -year(s) or period(s) involved, amount of penalties and/or interest sought, nature of the request, i.e., cancellation or waiver;
- the taxpayer's facts and reasons - the circumstances experienced by the taxpayer and how they prevented the taxpayer from meeting an obligation;
- a description of the supporting documents given (or an indication that there are none);
- the officer's analysis of the facts - factors considered in arriving at a recommendation, conversations with the taxpayer or the authorized representative;
- the officer's recommendation - approval, partial approval, or denial; and
- approval by a delegated authority.

000153

Digitized by Google

For more information/details on the fact sheet, see Part 4 of the *Taxpayer Relief Registry Guide* at: 08_023.cfm

7.19.3 Essential elements of a report

When reading the report/fact sheet, someone with little knowledge of the taxpayer relief provisions should be able to understand the taxpayer's request and the reasons why it was made, what steps were taken during the review, what decision was reached, and the reasons for the decision.

If a request is to be allowed in full, the officer's analysis and the resulting taxpayer relief decision report would not require great detail. If the request is to be denied or partially allowed, a more detailed analysis and taxpayer relief decision report is needed.

Here are guidelines to consider when writing a report:

- Be impartial, avoid making personal opinions and judgments.
- Stick to the facts.
- Be clear and concise. Avoid jargon.
- Present the report in a logical order (the ideas and content of the report should have a natural flow).

DISCLOSED PURSUANT TO THE ATIA

000154

Digitized by Google

8. Guidelines for refunds or reduction in amounts payable beyond the normal three-year period (income tax)

This section gives guidelines for considering taxpayer relief requests for refunds beyond the normal three-year period for individuals and testamentary trusts. These guidelines should be used in conjunction with General policies and procedures.

The Individual Returns and Payments Processing Directorate of the Assessment and Benefit Services Branch has developed additional guidelines, which can be found in functional guidelines.

The CRA may issue a refund beyond the normal three-year period or reduce an amount owing if it is satisfied that such refund or reduction would have been made if a return or request had been filed or made on time, and as long as the assessment or reassessment is correct in law and has not been previously allowed. **This only applies to individuals and testamentary trusts.**

The request must be made within the 10-year time limit.

See the Legislation section for more information.

8.1 Refunds or reducing tax payable for a statute barred return

An individual or testamentary trust may ask the CRA for a refund or a reduction of tax payable for an income tax return that is beyond the normal three-year period. This may include:

a. a request for a refund of taxes for an income tax return not previously filed;

b. a request for a refund of taxes or a reduction of tax payable due to a deduction/non-refundable tax credit not previously claimed;

c. a request for a refund of taxes or a reduction of tax payable due to a decrease in taxable income; or

d. a request for a refund of taxes due to a refundable credit not previously claimed.

In any situation that a taxpayer or testamentary trust requests a refund beyond the normal three-year period, there may be a recalculation of certain refundable tax credits such as:

a. refundable Quebec abatement for income earned in Quebec by an individual resident of Quebec under subsection 120(2);

b. refundable First Nations abatement for individuals who are subject to income tax legislation of certain First Nations under subsection 120(2.2);

c. goods and services tax/harmonized sales tax (GST/HST) credit available to eligible individuals under subsection 122.5(3);

d. refundable medical expense supplement available to eligible individuals under subsection 122.51(2);

Digitized by Google

e. refundable investment tax credit available to taxpayers under subsection 127.1(1);

f. the tax credit that a beneficiary of a mining reclamation trust can claim under subsection 127.41(3);

g. the tax credit that certain beneficiaries can claim under subsection 210.2(3) for the Part XII.2 tax paid by a trust;

h. the tax credit a Canadian partnership flows through to its partners for the Part XII.2 tax paid by a trust under subsection 210.2(4); and

i. Canada Child Tax Benefit (CCTB) payments available to eligible individuals for qualified dependants under subsection 122.61(1).

Whenever a request for a refund or reduction in amounts payable beyond the three-year period is accepted, paragraph 152(4.2)(b) allows for a redetermination of the above refundable credits.

8.2 Accepting a refund or adjustment request

The taxpayer relief provisions allow the CRA to issue a refund or reduce the amount of tax owed if it is satisfied that such a refund or reduction would have been made if the return or request had been filed or made on time.

Individuals and testamentary trusts can make a request if they were unaware of, or missed, claiming a deduction or a non-refundable tax credit that was available for the year. Individuals can also ask for refunds or reduction of amounts owing for refundable tax credits such as provincial tax credits or an overpayment of taxes.

The request may result in a calculation or recalculation of credits such as the Child Tax Benefit (CCTB) and/or the Goods and Services Tax Credit (GSTC).

There do not need to be circumstances beyond a client's control to allow these types of requests. The client needs to provide supporting documentation and the claim must be correct under law and not previously allowed.

Generally, CRA will not accept a request for an adjustment to a statue barred tax year of an individual where the adjustment would result in the increase of taxes, interest, or penalties to the returns of other individuals that are statute-barred and cannot be reassessed by the CRA.

Example 1

A taxpayer files a 2000 T1 income tax return on April 1, 2008. The taxpayer is requesting a refund of a portion of tax paid throughout the year. The return was filed more than three years from the end of the tax year but the request was made within the 10-year time limitation.

The request is accepted and the income tax return is processed. Paragraph 164(1.5)(a) of the *Income Tax Act* (ITA) allows us to refund the overpayment of tax.

0001516

Digitized by Google

Example 2

A taxpayer requests an adjustment to allow a deduction not previously claimed. The taxpayer has submitted an acceptable receipt to support the claim. The return was filed on time but the request was made outside the normal three-year reassessment period. The request was made within the 10-year time limitation. The adjustment will result in a refund of taxes and an increase in the amount of Goods and Services Tax Credit (GSTC) the individual is entitled to.

The request is accepted and the reassessment processed. Paragraph 152(4.2)(a) of the ITA allows us to reassess the return, paragraph 152(4.2)(b) of the ITA allows for the recalculation of the GSTC and paragraph 164(1.5)(b) us to refund the overpayment of tax.

8.3 Limitations and restrictions

This section provides information on limitations and restrictions regarding taxpayer's request for refunds or reduction in amounts payable beyond the normal three year period.

8.3.1 Provincial benefits or credits

Time limitations to claim provincial benefits or credits that are administered by CRA for the provinces are stipulated in the applicable provincial act. Subsection 152(4.2) and paragraph 164(1.5)(a) of the ITA do not override provincial limitations, unless provincial law allows for it.

8.3.2 Permissive deductions

CRA will not process a reassessment if the requested credit is the result of an increased claim for capital cost allowance or other allowable deductions, where the taxpayer originally claimed less than the maximum amount allowable.

See IC84-1, Revision of Capital Cost Allowance Claims and Other Permissive Deductions for more information.

8.3.3 Employment Insurance Premiums and Canada Pension Plan

Taxpayer relief provisions to allow a refund beyond the normal three year period does not affect refunds for overpayments of Employment Insurance premiums and Canada Pension Plan contributions.

The time limit for refunds is three years under the Employment Insurance Act and four years under the Canada Pension Plan.

8.3.4 Requests based in court decisions or other resolutions

Taxpayer relief requests to reassess a statue barred return will not be allowed if the request is based on another's successful appeal; negotiated settlement or consent to judgment on an appeal if the taxpayer has chosen not to protect their right of objection or appeal.

See IC75-7R3, Reassessment of a Return of Income for more information.

000157

Digitized by Google

8.4 Making a taxpayer relief request

This section provides guidelines on making first and second taxpayer relief requests and outlines the information needed to make requests as complete as possible.

8.4.1 First requests

Individuals and testamentary trusts or their authorized representatives normally have to ask for a refund in writing. They can do this by filing their income tax return(s) or requests for adjustment together with documentation to support their claim.

Requests should be sent to the tax centre where they file their returns or the tax services office serving their area.

Form RC4288, Request for Taxpayer Relief can be used by taxpayers to request relief. Although this is not a prescribed form, field office staff should promote its use by taxpayers. The CRA will not deny a request simply because the taxpayer did not complete a RC4288. A copy of this form is available from the CRA Web site at www.cra-arc.gc.ca/formspubs/menu-e.html or by telephone at 1-800-959-2221.

Addresses and telephone numbers of CRA offices may be found in the listings of the government section of telephone books and on the Contact us page of the CRA Web site at www.cra-arc.gc.ca.

A taxpayer's request for a refund or a reduction of amounts owing should include:

- the taxpayer's name, address, and social insurance number, trust account number or other account number provided by CRA
- the tax year(s) involved;
- all supporting documents; and
- an explanation of the adjustment the taxpayer wants.

To support a request, taxpayers should give the following information:

- official receipts or certified "true" copies of receipts or documents (e.g., for tuition, RRSP contributions, charitable donations, and share certificates);
- copies of information slips (e.g., T3, T4, T5);
- details or calculations of specific expenses or deductions being claimed, such as previous and revised business or rental loss statements or investment income schedules; and
- proof of payment such as cancelled cheques for rental payments or notary contracts.

8.4.2 Second requests

If taxpayers do not agree with the CRA's decision in its review of their first request, they are entitled to make a second request, in writing, to the director of the tax centre, or tax services office.

000158

Digitized by Google

A taxpayer's second request requires the following:

- the reasons why the taxpayer disagrees with our decision (e.g., not all information was considered, certain facts or details were misinterpreted or not considered in their proper context, the taxpayer simply disagrees); and
- any relevant new documents, new facts, or correspondence.

8.4.3 Requests must be complete

Taxpayers should be encouraged to make their taxpayer relief requests as complete as possible. This allows CRA staff to exercise discretion and avoid processing delays. A proper review cannot be conducted if we do not have access to all relevant information.

Staff are encouraged to promote the requirement that taxpayer relief requests be complete when providing guidance or information to taxpayers on the taxpayer relief request process.

See When more information is needed for more information.

8.5 Taxpayer relief decision reports/fact sheets

If a request is to be allowed in full, the officer's analysis and the resulting taxpayer relief decision report/fact sheet would not require great detail. For example, a notation that the claim is correct under law, and that it had not been previously allowed and is fully supported, would be sufficient. If the request is to be denied or partially allowed, a more detailed analysis and taxpayer relief fact sheet is needed.

Taxpayer relief procedures for reviewing refunds or reduction in amounts payable beyond the normal three year period are different than those for cancellation or waiver for interest and/or penalties, as there do not need to be circumstances beyond a client's control to allow these types of requests. The client needs to provide receipts, slips, etc., and the claim must be correct under law and not been previously allowed.

For more information/details on the fact sheet, see Part 4 of the *Taxpayer Relief Registry Guide* at: 08_023.cfm

9. Guidelines for accepting late, amended, or revoked elections (income tax)

This section gives guidelines for taxpayer relief requests to accept late, amended, or revoked elections. These guidelines should be used in conjunction with General policies and procedures.

The CRA may extend the filing due date for making certain elections or grant permission to amend or revoke certain election. A late, amended, or revoked election must be correct in law based on the relevant legislation in place for the applicable tax year to which the election applies.

The request must be made within the 10-year time limit.

See Legislation for more information.

000159

Digitized by Google

9.1 Elections covered by the taxpayer relief provisions

The elections for which a request can be made under the taxpayer relief provisions are found in section 600 of the Income Tax Regulations. See the Appendices for a complete list of these elections along with a brief description.

If the request to accept a late, amended or revoked election has been accepted, CRA will consider the late or amended election to have been made at the time it was required. Earlier elections will be cancelled for amended and revoked elections. CRA will reassess the affected returns for the tax years in question even if the years are beyond the taxpayer's normal reassessment period (i.e. statute-barred years).

9.2 Penalty for late filed, amended or revoked elections

Taxpayers that are allowed to late-file, amend, or revoke elections are liable, under subsection 220(3.5) of the *Income Tax Act*, to a penalty of $100 for each complete month from the due date of the election to the date the taxpayer made a complete application to CRA, to a maximum of $8,000.

The application date is when the taxpayer provided CRA with complete and accurate information for the election under review.

Taxpayers should remit the penalty amount with their request. It is CRA policy not to accept late, amended, or revoked elections, or to process the necessary adjustments unless the penalty is paid. The CRA will determine and assess any unpaid balance of the penalty. Interest will be charged on the unpaid balance of the penalty from the date of the Notice of Assessment to the date of payment.

This penalty is also subject to the taxpayer relief provisions. If the circumstances that allow for accepting a late-filed, amended, or revoked election are the same as the circumstances we would accept for cancelling or waiving penalties and interest, then we should strongly consider not levying this penalty (i.e., waiving it).

In these cases, a Taxpayer Relief Registry item must be created. See **Guidelines for cancelling or waiving penalties and/or interest** for more information.

9.3 Deemed prescribed elections

The rules and guidelines for accepting late, amended or revoked elections also apply to the following designations and allocations that are considered prescribed elections, under subsection 220(3.21):

- Paragraph 80(2)(i) of the Act allows a taxpayer to designate the order in which commercial debt obligations settled at the same time are to be applied for the purpose of the debt forgiveness rules.
- Subsections 80(5) to 80(11) allow a taxpayer who has designated a forgiven amount to apply any remaining part of the forgiven amount in certain circumstances.
- Subsection 80.03(7) allows a taxpayer to designate a capital gain that would otherwise arise under subsection 80.03(2) as a forgiven amount for the purpose of the debt forgiveness rules.
- Subsection 132.11(6) allows a mutual fund trust, as well as any electing trust with a December 15 year-end, to choose an amount designated by it for a tax year to be added in computing its income for the year.

0001680

Digitized by Google

9.4 Basis for accepting requests

A request may be accepted in the following situations:

- There have been tax consequences not intended by the taxpayer, and there is evidence that the taxpayer took reasonable steps to comply with the law. This could include, for example, a situation where the taxpayer obtained a bona fide valuation for a property, but after the CRA's review the valuation was found to be incorrect.

- The request arises from circumstances that were beyond the taxpayer's control. Such extraordinary circumstances could include natural or man-made disasters such as flood or fire; civil disturbances or disruptions in services, such as a postal strike; a serious illness or accident; or serious emotional or mental distress, such as death in the immediate family.

- The taxpayer acted on incorrect information given by the CRA. This could include incorrect written replies to queries and errors in CRA publications.

- The request results from what is clearly a mechanical error. This could include using the net book value amount (when obviously the taxpayer intended to use the undepreciated capital cost) or using an incorrect cost.

- The subsequent accounting of the transactions by all parties is as if the election had been made, or had been made in a certain way.

- The taxpayer can demonstrate that he or she was not aware of the election provision, even though the taxpayer took a reasonable amount of care to comply with the law, and undertook remedial action as quickly as possible.

9.5 Basis for denying requests

A request will not be accepted in the following instances:

1. It is reasonable to conclude that the taxpayer made the request for retroactive tax planning purposes. This could include taking advantage of changes to the law enacted after the due date of the election.
2. Adequate records do not exist to verify whether or not the request can be accepted.
3. It is reasonable to conclude that the taxpayer had to make the request because he or she was negligent or careless in complying with the law.

9.6 Making a taxpayer relief request

This section of the guide gives guidelines on making first and second taxpayer relief requests, and outlines the information needed to make requests as complete as possible.

9.6.1 First requests

000161

Digitized by Google

Taxpayers or their authorized representative normally have to request a late, amended, or revoked election in writing. In their request, taxpayers have to provide the reasons why the election should be allowed and sufficient relevant information and documents to support the validity of their claim.

When informing taxpayers how to make a taxpayer relief request, it should be stressed to them that it helps to speed processing if their requests are properly identified as taxpayer relief requests, and whether it is a first or second request. This will save time in screening requests, and help avoid situations where requests are held in the wrong inventories for extended periods of time.

Taxpayers or their authorized representatives can make their request by writing to the tax centre where they file their returns or the tax services office serving their area.

Form RC4288, Request for Taxpayer Relief can be used by taxpayers to request relief. Although this is not a prescribed form, field office staff should promote its use by taxpayers. The CRA will not deny a request simply because the taxpayer did not complete a RC4288. A copy of this form is available from the CRA Web site at www.cra-arc.gc.ca/formspubs/menu-e.html or by telephone at 1-800-959-2221.

Addresses and telephone numbers of CRA offices may be found in the listings of the government section of telephone books and on the Contact us page of the CRA Web site at www.cra-arc.gc.ca.

9.6.2 Second requests

If taxpayers do not agree with the CRA's decision in its review of their first request, they are entitled to make a second request, in writing, to the director of the tax centre or tax services office.

A taxpayer's second request requires the following:

- the reasons why the taxpayer disagrees with our decision (e.g., not all information was considered, certain facts or details were misinterpreted or not considered in their proper context, the taxpayer simply disagrees); and
- any relevant new documents, new facts, or correspondence.

9.6.3 Requests must be complete

Taxpayers should be encouraged to make their taxpayer relief requests as complete as possible. This allows CRA staff to exercise discretion and avoid processing delays. A proper review cannot be conducted if we do not have access to all relevant information.

Note: Taxpayer relief requests cannot be processed without a valid CRA account number.

A request to accept a late, amended or revoked election should contain the following elements:

- the names, addresses, social insurance numbers, partnership numbers, and corporation numbers of all the taxpayers involved;
- the dates and details of the transactions;
- the date and details of the original election including an explanation of why the taxpayer is asking to amend or revoke an election;

000162

Digitized by Google

- details of a late-filed election, and an explanation why it is being filed late;
- the election needs to be made in the appropriate manner required by the specific provisions of the Act (e.g., filing the election in a prescribed form or in a prescribed manner);
- a brief description of the income tax implications of the acceptance or refusal of the request for all the parties involved; and
- appropriate revised schedules reflecting changes, should accepting the request involve changes to continuing tax account balances.

When the request involves more than one taxpayer, an agreement to the changes requested, signed by all parties, should be included with the request.

A taxpayer relief request should also contain the following information:

- the type and nature of the extraordinary circumstances that prevented the taxpayer from complying;
- supporting documentation;
- supporting details of incorrect information given by the CRA in the form of written answers or errors in published information, or other objective evidence; and
- the name, address, and telephone number, where the taxpayer may be reached if more information or explanation is needed

9.7 Taxpayer relief decision reports/fact sheets

If a request is to be allowed in full, the officer's analysis and the resulting taxpayer relief decision report/fact sheet would not require great detail. For example, a notation that the claim is correct under law, and that it had not been previously allowed and is fully supported, would be sufficient. If the request is to be denied or partially allowed, a more detailed analysis and taxpayer relief fact sheet is needed.

For more information/details on the fact sheet, see Part 4 of the Taxpayer Relief Registry Guide at: 08_023.cfm

10. Judicial review

A judicial review of any discretionary decision made by the federal government from which there is no right of appeal, may be applied for pursuant to Section 18.1 of the Federal Courts Act, within 30 days of the date notification of the discretionary decision is communicated.

In cases where taxpayers are not satisfied with the discretion the CRA exercised in its review of their requests, taxpayers can apply for a judicial review to the Federal Court by following certain steps. Our role is to advise the taxpayer of the option of pursuing the matter to Federal Court; we are not in a position to advise the taxpayer about Federal Court rules and procedures. Officers should be careful not to give the

0001653

Digitized by Google

taxpayer an opinion about their chances of success in court. The Court will focus its review only on whether discretion was properly exercised.

During its review, the Court has access to the taxpayer relief records (e.g., taxpayer's request, taxpayer relief report, and correspondence). As well, the officer who made the decision under review may be asked to give an affidavit to the Court.

There are three possible outcomes of a judicial review:

- withdrawn: the applicant decides not to continue to Court; in this case, the CRA will be advised that the application for judicial review has been withdrawn, meaning the case never makes it to the court hearing stage.
- dismissed: the Court finds that CRA acted in good faith and finds no reviewable error to warrant intervention of the Court.
- allowed: when the Federal Court finds concerns or flaws in our review process, the application for judicial review is allowed.

If the Court rules that discretion was not properly exercised, it will refer the matter back to the minister for reconsideration, as can be seen in Gandy v. Canada Customs and Revenue Agency. As with any subsequent review, cases referred back from the Federal Court must be handled by a person or persons not previously involved. Considerations, including the Court's direction, will determine if the case is referred back to the same office, or in some situations, to a different office, for a new review and decision.

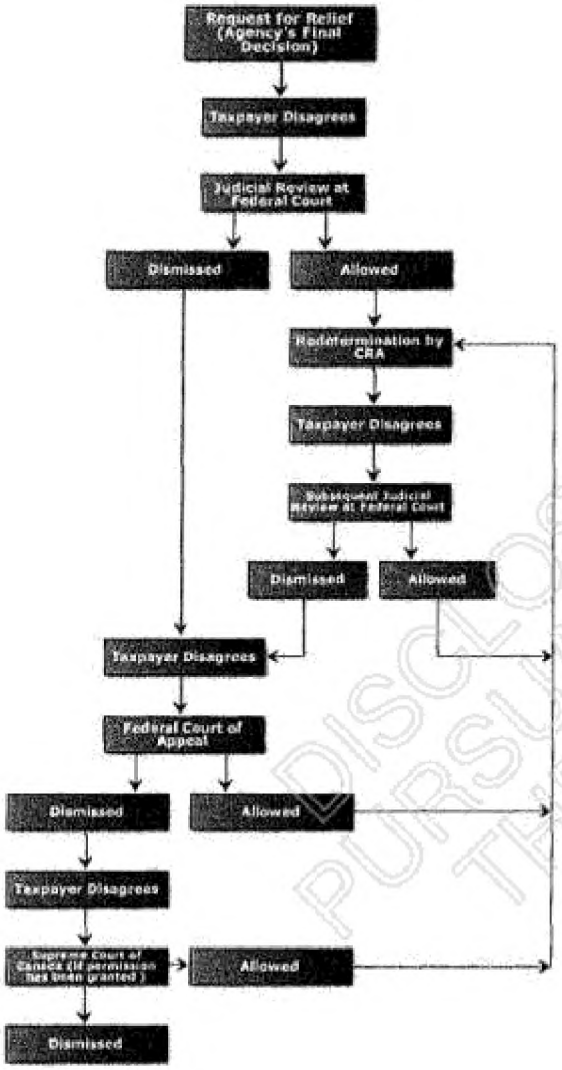
Judicial review decisions are published on the Federal Court website. Search options include the Applicant's name and the year of decision. The site also allows the search for the Federal Court of Appeals decisions.

10.1 Judicial Review Process Graph

The following graph illustrates the judicial review process:

000164

Digitized by Google



The image depicts a visual representation of the process laid out in flow chart style. It starts with the request for relief and tracks the stages, branching into scenarios for agreement and disagreement on the part of the taxpayer. The first step is Request for Relief followed by Taxpayer's Disagrees and Judicial Review at Federal Court. The image then branches into Dismissed and Allowed. Dismissed flows to Taxpayer Disagrees and Federal Court of Appeal. Allowed flows to Redetermination of CRA, Taxpayer Disagrees, Subsequent Judicial Review at Federal Court and Dismissed or Allowed. Dismissed flows to Taxpayer Disagrees and Federal Court of Appeal. This branches into Dismissed and Allowed. Dismissed

0001155

Digitized by Google

flows to Taxpayer disagrees, Supreme Court of Canada (which also has an Allowed option) and Dismissed.

10.2 Requests under Rule 317

Most Applicants (taxpayers) request copies of all materials from the Respondent (CRA) that were before the Minister's delegate who rendered the second level taxpayer relief decision, either in their Notice of Application or subsequently - Rule 317.

This section of the guide provides information on Rule 317 of the *Federal Courts Rules* and outlines the national standard process to be followed when the Canada Revenue Agency (the "respondent") is notified by the Department of Justice that the taxpayer (the "applicant") has made a Rule 317 request.

The CRA and the Tax Law Services Portfolio from the Department of Justice have come to an agreement about each of their respective roles and responsibilities to ensure requests made under Rule 317 are handled in a consistent, efficient, and timely manner.

The Tax Law Services Portfolio has issued similar procedures to all counsel in the Practice Directive 2010-002, *Rule 317 requests – judicial review of requests for taxpayer relief.*

10.2.1 Certified copy of material

Under Rule 317 of the *Federal Courts Rules*, an applicant is entitled to request a certified copy of material that is relevant to their Notice of Application for judicial review, and in possession of the CRA, but not in the possession of the applicant.

The request for certified documents may be included in the Notice of Application or made separately.

When a Rule 317 request is made, the office that conducted the taxpayer relief review and made the recommendation will:

1) Prepare the certified copy of material, and
2) Forward the taxpayer relief file, certificate (Schedule "A") and bundle of documents to the Department of Justice.

Where a separate Rule 317 request is made, and the taxpayer relief file was sent to the Litigation Office at the time the Notice of Application was filed, the Litigation Office will forward the taxpayer relief file to the officer, along with a copy of the judicial review application and the Rule 317 request to prepare the certified copy of material.

10.2.2 Time limit to produce certified copies (Rule 318)

Under Rule 318 of the *Federal Courts Rules*, the Department of Justice must transmit the certified copy of the requested material to the Federal Court and the applicant within 20 calendar days after the Rule 317 request was received by the Department of Justice. Where the Rule 317 request is made in the Notice of Application, use the Department of Justice received date stamp

0001186

Digitized by Google

of service of the Notice of Application by the Federal Court or the Department of Justice received date stamp of service of the Rule 317 request, if it was made after the Notice of Application was filed.

Three certificates (Schedule A) and three certified bundle of materials, along with the taxpayer relief file must be provided to the Department of Justice by courier or hand-delivered **at least 5 working days prior to the 20 day deadline**.

The "20 calendar days" excludes the day the request is received by the Department of Justice and includes the last day. If the last day falls on a weekend or a holiday, it is due the following business day.

Note: The "20 calendar days" does not include the court's Christmas recess from December 21 to January 7.

For example, a Rule 317 request served on the Department of Justice:

- September 10, 2009, the documentation must be transmitted on September 30.
- September 22, 2009, the documentation must be transmitted on October 13 (Thanksgiving is October 12, 2009).
- December 16, 2009, the documentation must be transmitted on January 26, 2010.

10.2.3 Rule 317 process

The following summarizes the process when a Rule 317 request is received.

1) The Department of Justice will advise the Litigation Office.

   Upon receipt of a request, the Department of Justice will advise the Litigation Office that a Rule 317 request has been made.

2) The Litigation Office will arrange for the certification of the material.

   Upon receipt, the Litigation Office will:

   - Contact the officer involved with the decision and request that the certified documents be prepared, and
   - Provide the officer with a copy of the Notice of Application and request made under Rule 317 through secure transmission.

3) Certification of the material.

   Generally, the officer who conducted the review and prepared the recommendation for the authorized delegate's approval will prepare the certified copy of material.

   The officer will review the taxpayer relief file and identify all relevant documents, including screen prints to be certified. The Justice counsel assigned to the case will be available to advise the officer preparing the certified material and will make the final decision whether documents and/or specific information should be excluded from the certified bundle of material due to:

   - relevancy to the taxpayer relief decision under judicial review;
   - third party confidential information; or

Digitized by Google

- solicitor-client privilege.

4) Prepare certificate and certified copy of the material.

Prepare three original certificates (*Schedule A*) and three certified bundle of documents. They must be forwarded along with the entire taxpayer relief file to the Department of Justice at least 5 working days prior to the 20 day deadline.

5) Update the Taxpayer Relief Registry.

Update Section IV – Info/Delay/Transfer field of the Taxpayer Relief Registry to record the date of receipt of the Rule 317 request, confirm that the certification of the material has been completed and record the date the material was forwarded to the Department of Justice.

10.2.4 Identify documents for certification

A judicial review applicant making a request for documents under Rule 317 is required to "identify the material requested", but will often make a request for all documents in the CRA's possession that are not in the applicant's possession.

To identify documents for certification, read the Notice of Application and the request for documents to determine whether the applicant is asking for:

- specific documents; or
- all documents in the CRA's possession.

A document must be produced if it is:

- relevant to the judicial review application; and
- not already in the possession of the applicant.

The officer involved with the taxpayer relief decision will review the taxpayer relief file and identify all the documents that must be certified. Consult with Justice counsel if you are uncertain whether particular documents should be included.

Note: The Department of Justice will decide whether a document should be excluded.

Relevancy

Information reviewed by the officer and the delegated authority prior to the decision being issued is relevant. All documents prepared by them are also relevant. In addition, all supporting documents submitted to the CRA for review in relation to the taxpayer relief request, prior to the decision being issued, whether or not considered, are relevant.

000168

Digitized by Google

Relevant information that was reviewed while considering the taxpayer's request for relief is detailed in the decision report/fact sheet. The fact sheet provides details of the taxpayer's request and the reasons why it was made, what steps were taken during the review, the officer's summary of recommendations, what decision was reached, and the reasons for the decision.

The following documents would generally fall within the scope of a Rule 317 request:

- first-level taxpayer relief report;
- second-level taxpayer relief report;
- all notes prepared by CRA officers that are contained in the taxpayer relief file; and
- all CRA system printouts of screens reviewed in assessing the relief request, such as ACSES Diary, ELCS Notepad, Notes for Businesses, GHRAPS, T2, BN and RAPID options.

While a document and/or screen print may be relevant to the judicial review application, only material not already in the possession of the applicant must be produced.

Material not already in the possession of the applicant

In situations where specific documents are listed on the request, certify the relevant documents (if not confidential or protected) regardless of whether they are in the applicant's possession. The request may include CRA internal procedures, such as a relevant section or part from a manual or guide. For these requests, sanitized versions available for certification can be obtained from **CRA's public reading rooms**, where available.

If the applicant requests that all documents in the possession of the CRA be produced, a determination must be made as to whether each document is already in the possession of the applicant. Only relevant documents that have not been submitted to the CRA by the applicant or authorized representative, or are not duplicate copies of documents issued by the CRA to the applicant, must be produced.

For example:
A letter issued to the taxpayer by the CRA considered during the review is relevant but does not need to be produced because the applicant already has the letter. While an Option C print-out may contain the same information as the notice of (re)assessment or notice of (re)determination issued to the applicant, it is not the same document and must therefore be produced.

To determine if documents have been issued by the CRA, review the information in the taxpayer relief file and appropriate mainframe systems, such as RAPID, ELCS, BCCS, ACSES, CSAPP and applicable diary notes.

In some cases it may be difficult to determine whether a document is already in the possession of the applicant. If uncertain, provide a copy of the document unless it is confidential or protected.

Digitized by Google

10.2.5 Prepare certified copy of the material and certificate

The certification of documents does not need to be completed by the authorized delegate who approved the taxpayer relief decision. Generally, the officer who conducted the review and prepared the recommendation for the authorized delegate's approval will prepare the certified copy of the material and certificate.

Once the relevant documents for certification have been identified, three copies of the original documents, printouts of documents retained in electronic form, and computer screen prints must be photocopied and/or printed.

While the photocopying and screen prints can be completed by support staff, the taxpayer relief officer must review each document to confirm that the photocopies and printouts are complete and accurate reproductions of the original documents.

Computer printouts

For guidelines on printing and sanitizing common individual screen printouts, see TABLE OF AVAILABLE PRINTOUTS - DOCUMENTS REQUESTED BY TAXPAYER OR THIRD PARTIES in the *Individual Services Technical Help Guide*.

The Individual Enquiries Printout Request (IEPRT) application provides sanitized printouts of taxpayer information. For example, the following information will not be printed from a RAPID, Option C screen:

- Information about others
- Internal CRA codes

Other RAPID Options available for print using IERPT are:

- Income and Deductions (Rapid Option C)
- Information Slips (Rapid Option DD.3)
- Capital Gains and Losses & Multi Year Data (Rapid Option C-MY)
- Home Buyer's Plan (Rapid Option HH.01)
- RRSP Deduction Limit & Multiyear RRSP Contributions (Rapid Option R.1) (Rapid Option R.7)
- Instalment Reminders (Rapid Option BB.1)
- Discounter Clearance (Rapid Option Q)
- Tuition and Education Amounts (Rapid Option C-MY)

For information about this application, refer to the Individual Enquiries Printout Request User Manual

For screen prints, other than IERPT, **do not forget to black out any information that is not to be disclosed, including any information that would reveal the identity of third parties** (spouse's income or SIN, employer's account number, etc.). You must then photocopy the sanitized printout.

DISCLOSED PURSUANT TO ATIA

Digitized by Google

Complete Schedule "A"

Three originals of Schedule "A", *CERTIFICATE PURSUANT TO A REQUEST MADE UNDER RULE 317 OF THE FEDERAL COURTS RULES* must be completed and forwarded to the Department of Justice along with three certified bundle of documents and the taxpayer relief file.

The Court File Number located in the top right corner should be entered by the officer. If this number is not available from the information received, the officer should consult with Justice Counsel.

A description of each document included in the certified copy of material must be listed on Schedule "A". The physical document should appear as itemized on the certificate. See Appendices for an example of descriptions included on Schedule "A".

The certificate must be signed and dated by the officer who compiled the material and who physically reviewed each photocopy and each printout.

A fillable and downloadable Word version of Schedule "A" is in the Appendices section.

DISCLOSED PURSUANT TO THE ATIA

000171

Digitized by Google

000172

Digitized by Google

11. Functional Guidelines

This section provides additional guidelines to assist in the processing of taxpayer relief requests. They were developed by various branches within Headquarters across the Agency.

11.1 Assessment and Benefit Services Branch

11.1.1 Individual Returns and Payments Processing Directorate

TOM 1933
TOM 40(10)5.3(10)3
TOM 9966, 9971
TOM 4245
TOM 19(15)
RAP Broadcast 2005-048
RAP Broadcast 2006-065
T1 adjustments
T1 assessing
T1 and T3 accounting
T3s
T1 accounts
Arbitrary Assessments
Retention Period for ELCS Letters

11.1.2 Business Returns and Payments Processing Directorate

TMAN for T2 assessing/reassessing
TMAN for T2 and other levies (OL) accounts
GST/HST Policy Statement

GST/HST Policy Statement

GST/HST Memoranda Series

INFORMATION RETURNS PRODECURES MANUAL
INFORMATION RETURNS PRODECURES MANUAL
INFORMATION RETURNS PRODECURES MANUAL
T2 Assessing Reference -
Taxpayer Relief section
Standardized Accounting (SA) Reference -
Taxpayer Relief section
P-194R - Application of Penalty and Interest when a Return and/or Rebate Application, and/or Another Return, is Received After the Due Date
P-237 - The Acceptance of a Due Diligence Defence for a Penalty Imposed Under Subsection 280(1) of The Excise Tax Act for Failure to Remit or Pay an Amount when Required
16-3-1 - Reduction of Penalty and Interest in Wash Transaction Situations

DISCLOSED PURSUANT TO THE ATI

Digitized by Google

Module 2-8
Application of **Penalties**
Module 2-11 **T5 Activities**

Module 2-12 **T5018 Returns, Fairness Request/Penalty Waivers**

11.1.3 Benefit Programs Directorate

TOM 19(27)6 Reassessment
Bulletin #112

Bulletin #176

T1 Disability Tax Credit
Impact of Fairness Provisions on Benefit Programs:
Bulletins: January - 2005 for T1 benefit programs
Impact of Fairness Provisions on Benefit Programs:
Bulletins: April - 2005 for T1 benefit programs

11.2 Compliance Programs Branch

Operational Manual -
Audit
Office Examination Procedures Manual
Fairness Procedures document
Section 116 Manual
Chapter 3.0 Fairness and Client Rights and Chapter 28.0 Penalties - on-line: Audit Directorate
Fairness Legislation section

Office Audit Resources - Manuals

re Non-Resident Dispositions

11.3 Appeals Branch

Chapter 8.7, Appeals regarding Penalty /Interest and Taxpayer relief
Section 10, Ministerial
Discretion
AR-110 Memo

AR-203 memo

AR-224 memo

00011 74

Digitized by Google

AR Memo ITC-07-04
AR Memo ITC-07-27
Directive ITC-07-33

CPP/EI Appeals Procedures Manual

Appeals Manual

Fairness Requests from O.C.G.C. Investors

Proposed amendment to subsection 220(3.1) of the Income Tax Act (ITA)
Requests for Judicial Review of Fairness Decisions- Updating Globus & Equitas
Great-West Life Inc. Acquisition of Canada Life
Mandatory Bank Remitting Penalties (MBRPs)
Taxpayer Relief Provisions or Remission of Tax Referred to in Tax Court of Canada (TCC) Judgments

Individual Services Technical Help Guide, Section H
Individual Services Technical Help Guide, Section J
Page 8 of Memo - 06/01/06
HQBW041104 BW Message - 04/11/04
Reference Guide for Business Window Agents
Reference Guide for Business Window Agents
Reference Guide for Business Window Agents
Reference Guide for Business Window Agents

Adjustments and Taxpayer Relief Provisions

Referrals re Taxpayer Relief Requests

Changes affecting 2006 Enquiries Programs
Application of Fairness Provisions during the CRA Service Disruption Period
Penalties and Interest - Module 3: GST/HST, FNT, Excise Tax and Duties
Penalties and Interest - Module 4: Employer/Payroll

Taxpayer Relief Requests - Module 6: Corporate, Penalties - Module 6: Corporate, and Interest - Module 6: Corporate
Taxpayer Relief - Module 7: Non-Corporate (Self-Employed) and Penalties and Interest - Module 7: Non-Corporate (Self-Employed)

11.4.2 Accounts Receivable Directorate (ARD)

Collections Manual
Directive ARD-03-04

Course TD8261-000

DISCLOSED PURSUANT TO THE ATIA

000175

Digitized by Google

Memorandum 02-16
Memorandum 01-21

Memorandum 02-07

Communication
TSDMB-2004-002
Communication
TSDMB-2004-004
Communication
TSDMB-2004-023
Communication
TSDMB-2004-032
Collector's Reference
Guide
Section 3
Course HQ8932-000
Communication
TSDMB-2007-005
Communication
TSDMB-2007-026
Communication
TSDMB-2007-032
Communication
TSDMB-2007-038
Taxpayer Relief
Waiver or Cancellation of Penalty and Interest
Based on an Inability to Pay
Procedures for Processing Fairness Requests
Cancellation of Late Filing Penalties under Fairness
Delegation of the Minister's Powers under the
Income Tax Act, Excise Tax Act and Customs Act
New Section 88 of the Excise Tax Act - Waiver or Cancellation of Penalty and Interest
Enhancement to ACSES following the T1 write-off changes

Amendments Related to Standardized Accounting

Standardized Correspondence for Fairness Reviews Under Section 88, E.T.A. for Part 1 to Part VII Tax
Instalment Interest Problem

HQ8919-001 Air Travellers Security Charge -
Fairness Requests
IC98-1R3 - Collections Policies
Fairness - Inability to Pay and Financial Hardship
Reinstating CINDAC debts written off prior to 2004 (where a Keep Code 04 has been set)
Mandatory Bank Remitting Penalties

DISCLOSED PURSUANT TO THE ATIA

Digitized by Google

11.4.3 Debt Management Compliance Directorate

Memorandum dated July 2003

Communication
TSDMB-2003-002
Communication
TSDMB-2004-004
Communication
TSDMB-2004-005
Communication
TSDMS-2004-030
Communication
TSDMB-2005-004
Communication
TSDMB-2005-013
Communication
TSDMB-2006-022
Communication
TSDMB-2006-017
Communication
TSDMB-2006-083
Communication
TSDMB-2006-091
Communication
TSDMB-2007-010
Communication
TSDMB-2007-007
Communication
TSDMB-2007-019
Communication
TSDMB-2007-031
Communication
TSDMB-2007-061
Communication
TSDMB-2007-107
Communication
TSDMB-2007-112
Communication
TSDMB-2008-006
Communication
TSDMB-2008-009

000177

Digitized by Google

Communication
TSDMB-2008-082
Deliquent Filer Program Procedures
Compliance Operations Manual
Compliance Operations Manual
Application of Fairness Provisions to Graduated Late Remitting Penalties
Home Care Givers

Refund Interest - Fairness Requests

Application of Fairness Provisions on Bank Chargebacks (BCB's)
Application of Fairness Provisions During Canada Revenue Agency Service Disruption
Payments Made at ATM 's

Penalty for failure to remit to a financial institution

Fairness Procedure Recommendations and New National Fairness Internal Order Number
Late issuance of PD7A-RB Remittance Booklet

Severe Storms, British Columbia, November 2006

Mandatory Bank Remitting Penalties

Delayed issuance of PD7A

Mandatory Bank Remitting Penalties

Mandatory Bank Remitting Penalties (Group 2)

Mandatory Bank Remitting Penalties

Late Filing Penalty Administrative Policy

Payment Processing Delays

NRSD system processing delay - Oct/07 non-resident tax remittances
Late issuance of PD7A-RB Remittance Booklets

Ice Storm, Prince Edward Island 2008

Bank Errors and Taxpayer Relief

Air Travellers Security Charge (ATSC) - Fairness

Taxpayer Relief

Compliance Operations Manual - Penalties and Interest

DISCLOSED PURSUANT TO THE ATIA

Digitized by Google

11.5 CPP Contributors Program *(formerly Line 104/T4A Project)*

Communication
TSDMB-2005-041
Communication
TSDMB-2005-024
CPP/EI Appeals
TSO Memorandum
CPP/EI Appeals
TSO Memorandum
Communication
TSDMB-2007-014
Communication
TSDMB-2008-12
Communication
TSDMB-2008-15
CPP/EI Appeals Memo
Fairness requests resulting from reassessment due to "line 104" project
Fairness requests resulting from reassessment due to "line 104" project
2006-02

2006-08

Line 104-T4A Project

T2 Matching Project

CPP Contributors Program (Formerly Line 104 - T4A Project)

CPE-07-02

12. Taxpayer Relief Provisions Financial Reporting

Section 24.2 of the Financial Administration Act requires that forgiveness of a debt or obligation under the acts the CRA administers is to be reported in the Public Accounts. This legal requirement applies to penalties and interest cancelled and waived under the taxpayer relief legislation. The public can access the Public Accounts of Canada through the Public Works and Government Services Canada Web site.

For the various taxpayer relief workloads, the Statistical Tracking Analysis and Reporting System (STARS) and ReportNet produce financial reports based on Taxpayer Relief Registry entries and data which are used to report on the cancellation of penalties and interest. Some of the amounts for waivers of penalties and interest are currently provided based on estimates.

Each Headquarters function is responsible for gathering, verifying, validating, and approving amounts to be reported in the Public Accounts. The Taxpayer Relief and Service Complaints Directorate (TRSCD) is responsible for consolidating this information. The Finance and Administration Branch later incorporates

000179

Digitized by Google

the information provided by TRSCD into the overall CRA financial report that is forwarded to the Public Accounts.

000130

Digitized by Google

13. Internal Order Number and Activity Types

A national taxpayer relief internal order number or dedicated activity type should be used to track the direct time associated with reviewing requests for consideration under the taxpayer relief provisions legislation.

Certain areas within the Agency have activity types dedicated solely to taxpayer relief. These areas use these dedicated activity types without the need for the internal order number.

If you are not using one of the activity types dedicated solely to taxpayer relief such as 254 or 817, then you should use internal order number **702337** along with the appropriate activity type for your area/workload

13.1 Internal Order Number

In October 2005 a national internal order number 702337 was established to track the direct time associated with handling taxpayer relief requests.

If you cannot use one of the taxpayer relief activity types, then another activity type, along with an internal order number are required. Other activity types such as 437, 537 and 827, can be used for other activities including taxpayer relief. For example, activity type 827 for PAYDAC account review includes time spent on PAYDAC workloads including taxpayer relief. Activity type 437 for T1/T3 complex accounting may include time spent on taxpayer relief requests.

The internal order number 702337 **should** include the time spent:

- screening and validating the request
- gathering information
- reviewing/analyzing the taxpayer relief request
- preparing the report and making a recommendation
- notifying the taxpayer
- updating the Taxpayer Relief Registry (TRR)

The internal order number should be used for all levels of taxpayer relief consideration; 1st review, 2nd review, and review of decisions returned from court (judicial reviews).

The internal order number **should not** be used for:

- processing interest cancellations or adjustment requests (this should be charged to the applicable activity type)
- establishing procedural guidelines
- developing policy
- training

DISCLOSED PURSUANT TO THE ATIA

Digitized by Google

13.2 Activity Types

The following activity types are dedicated solely to taxpayer relief and no other activity:

254 – Taxpayer Relief Provisions
339 - Income Tax Taxpayer Relief Activities
340 - GST/HST/Excise Taxpayer Relief Activities
416 – Functional Direction and Support - Taxpayer Relief
443 – Taxpayer Relief Requests Corporations
479 – Small Enterprises Taxpayer Relief Requests
518 - T1 TPR Validation Requests for Taxpayer Relief
617 - Medium Enterprises Taxpayer Relief Requests
683 – Specialty Audit Taxpayer Relief Requests
713 - Technical Advisor Taxpayer Relief Requests Review
817 - Taxpayer Relief Provisions - Collections/Taxpayer Services Debt Management

254 – Taxpayer Relief Provisions

SSA MANAGER: Taxpayer Services – Enquiries (SSA 11510)

VALID FOR: tax services offices (TSOs), International Tax Services Office and tax centres (TCs) only.

TIME - Record the time spent by enquiries staff reviewing requests for consideration under the taxpayer relief legislation, including:

- requesting returns, TAPMA printouts and other internal documents;
- requesting documentation from the taxpayer;
- reviewing the file to determine if the request should be accepted or denied; and
- all the time spent as a member of the taxpayer relief committee.

NOTE: Do not include time spent on activities related to other programs such as processing the reassessment, which should be charged to the applicable activity type.

PRODUCTION - Record one unit of production for each taxpayer enquiry resolved. Do not record a unit of production for an acknowledgement or interim reply. Multiple years to be counted as one unit of production.

339 - Income Tax Taxpayer Relief Activities

SSA MANAGER: Income Tax Objections, Determinations & Appeals to Courts (SSA 51110)

VALID FOR: TSOs, TCs and Headquarters only.

TIME - Record the time spent reviewing requests for the waiver or the cancellation of penalty and/or interest under section 220 of the *Income Tax Act* (taxpayer relief legislation).

PRODUCTION - Do not record a unit of production for this activity.

340 - GST/HST/Excise Taxpayer Relief Activities

SSA MANAGER: Commodity Taxes Objections, Determinations and Appeals to the Court (SSA 51200)

VALID FOR: TSOs, TCs and Headquarters only.

000182

Digitized by Google

TIME - Record the time spent reviewing requests for the waiver or cancellation of penalty and/or interest under sections 281.1(1) or 281.1(2) of the *Excise Tax Act* (taxpayer relief legislation).

PRODUCTION - Do not record a unit of production for this activity.

416 – Functional Direction and Support - Taxpayer Relief

SSA MANAGER: Appeals – Program Management (SSA 53110)

VALID FOR: Headquarters only.

TIME - Record the time spent on developing, supporting, implementing and directing plans, procedures, policies and initiatives for the taxpayer relief provisions. This activity type is for use only by the Taxpayer Relief & Service Complaints Directorate.

Record the time spent writing, screening, reviewing, researching or drafting replies for Minister's Mail and Assistant Commissioner of Appeals Branch's Mail.

PRODUCTION - Do not record a unit of production for this activity.

443 – Taxpayer Relief Requests Corporations

SSA MANAGER: Business Returns and Payment Processing (SSA 22100)

VALID FOR: International Tax Services Office and TCs only.

TIME - Record the time spent on:

- processing taxpayer relief requests received from corporations;
- performing related research; and
- transaction preparation filing of forms and correspondence.

PRODUCTION - Record a unit of production for each case closed.

479 – Small Enterprises Taxpayer Relief Requests

SSA MANAGER: Small and Medium Enterprises (SSA 41710)

VALID FOR: TSOs only.

TIME - Record the time spent by Audit staff reviewing requests for waiver or cancellation of penalty and/or interest under section 220 of the *Income Tax Act* and under sections 281 and 281.1 of the *Excise Tax Act* (taxpayer relief legislation) related to Small Enterprises activity.

PRODUCTION - Record a unit of production for this activity.

518 - T1 TPR Validation Requests for Taxpayer Relief

SSA MANAGER: Individual Returns and Payment Processing (SSA 21100)

VALID FOR: all offices.

TIME - For all TCs, International Tax Services Office and Ottawa Technology Centre, record the time spent:

- processing validation/verification and priority adjustments on T1 returns and related adjustments where the taxpayer has requested an adjustment, for years on TAPMA and off TAPMA;

000183

DISCLOSED PURSUANT TO THE ATIA

Digitized by Google

- processing adjustments referred to the TC from Client Services in the TSOs because transaction code 4 or 5 processing is required;
- setting intercepts;
- reviewing those requests where a no adjustment results, and preparing No Adjustment letters when required;
- acknowledging the taxpayer and/or stall coding the taxpayer's account if not performed by the TPR Regular Workflow Assessor;
- reviewing those requests that are to be referred to Office Audit or Audit;
- correcting adjustments that were found to be in error in the T1 Cycle. This includes cycle cancels and Error Clue Handler (ECH) disconnected adjustments assigned by the Team Leader;
- correcting adjustments/tax calculations that were rejected by Review;
- requesting any supplementary returns or TAPMA printouts that may be required to process the adjustment or no adjustment;
- preparing tax calculations and applicable penalty calculations on taxpayer requested adjustments;
- preparing tax calculations and applicable penalty calculations on files referred for tax calculation from Audit, Appeals or Office Audit in a TSO and from Appeals or the Refund Examination Section in a TC;
- preparing "hypothetical T1 tax calculations" (e.g., T420/T420A) referred from Appeals in a TSO and/or TC;
- keying the transaction code 4 and 5 adjustments and the transaction code 1 and/or 2 secondary adjustments referred from Audit, Appeals or Office Audit in a TSO and from Appeals in a TC, into the T1 Reassessment System;
- performing interest calculations including gathering material, completing forms, doing and verifying manual or machine calculations and taping returns;
- Sudbury, Shawinigan, Jonquière and Surrey TCs and International Tax Services Office only: performing tasks associated with the U.S. Social Security Benefits Project (formerly activity type 564) that are described under TPR – Validation; and
- update the Family Support Registry (formerly activity type 278).

For all TSOs, record the time spent:

- reviewing all taxpayer requested adjustments including acknowledging correspondence and stall coding the taxpayer's account;
- processing taxpayer requested adjustments returned from Audit Division as no potential;
- reviewing taxpayer requested adjustments where the request is referred to the TC for transaction code 4 or 5 processing;
- requesting returns and/or TAPMA printouts for potential adjustments;
- reviewing those requests where a no adjustment results, and preparing No Adjustment letters when required;

000184

Digitized by Google

- reviewing those requests that are to be referred to Audit;
- processing all adjustments and related adjustments where the taxpayer has requested an adjustment;
- correcting adjustments that are rejected by Review;
- correcting adjustments that were found to be in error in the T1 Cycle. This includes cycle cancels and Error Clue Handler disconnected adjustments assigned by the Team Leader;
- keying of transaction code 2 non-audit Appeals reassessments, by designated individuals; and
- quality reviewing adjustments, corrected rejects, corrected ECH disconnects and no adjustments for the TPR Validation Workflow.

PRODUCTION – For all TCs, International Tax Services Office and Ottawa Technology Centre, record a unit of production for each:

- adjustment (including secondary adjustments and years off TAPMA);
- taxation year for which an adjustment is requested, but to which none is made;
- correspondence that is referred to Office Audit or Audit;
- "hypothetical T1 tax calculation" (e.g., forms T420 and T420A);
- adjustment that cannot be processed and has to be referred back to the originator due to errors or omissions, and for which a tax cal enquiry form T138 has been prepared; and
- update to the Family Support Registry.

NOTE: Do not record a unit of production for any interest calculation performed.

For all TSOs, record a unit of production for each:

- adjustment, including secondary adjustments;
- taxation year for which an adjustment is requested, but to which none is made;
- correspondence that is referred to Audit; and
- adjustment that is reviewed and referred to a TC for transaction code 4 or 5 processing.

617 - Medium Enterprises Taxpayer Relief Requests

SSA MANAGER: Small and Medium Enterprises (SSA 41710)

VALID FOR: TSOs only.

TIME - For Medium Enterprises, record the time spent by Audit staff reviewing requests for waiver or cancellation of penalty and/or interest under section 220 of the *Income Tax Act* and sections 281 and 281.1 of the *Excise Tax Act* (taxpayer relief legislation).

NOTE: Medium Enterprises include:

- *T2 – $1M – $250M (excluding Large File population)*
- *T1 – Cat 5 $1M +*

000185

DISCLOSED PURSUANT TO THE ATIA

Digitized by Google

- *T1 – Cat 4 Doctors $0 +*
- *T1 – Cat 4 Other $500K +*
- *GST – $1M + (excluding Large File population)*

PRODUCTION - Record a unit of production for each audit completed.

683 – Specialty Audit Taxpayer Relief Requests

SSA MANAGER: Small and Medium Enterprises (SSA 41710)

VALID FOR: TSOs only.

TIME - Record the time spent by audit staff reviewing requests from the Specialty Audit areas for waiver or cancellation of penalty and/or interest under section 220 of the *Income Tax Act* (taxpayer relief legislation), sections 88, 281 and 281.1 of the *Excise Tax Act* (taxpayer relief legislation), and/or sections 30 and 55 of the *Air Travellers Security Charge Act*.

Specialty Audit includes:

- Trusts audit;
- Registered Plans audit;
- Charities audit;
- Excise Tax and Other Levies audit;
- Excise Tax Refund Claims audit;
- the Air Travellers Security Charge (ATSC) audit;
- the GST/HST Public Service Bodies (PSB) Post-Payment audit;
- Flow-through Shares audit;
- British Columbia Mining Exploration Tax Credit audit; and
- Labour-Sponsored Venture Capital Corporations audit.

PRODUCTION - Record a unit of production for this activity.

713 - Technical Advisor Taxpayer Relief Requests Review

SSA MANAGER: Audit Professional Services (SSA 41800)

VALID FOR: TSOs only.

TIME - Record the time spent by Technical Advisors reviewing requests for waiver or cancellation of penalty and/or interest under section 220 of the *Income Tax Act* or sections 281 and 281.1 of the *Excise Tax Act* (taxpayer relief legislation). The recorded time is to include the time spent by Technical Advisors reviewing a request for a waiver made at the time of an audit. Record the time spent by Technical Advisors participating in taxpayer relief committees.

PRODUCTION - Record a unit of production for each taxpayer relief request reviewed.

817 - Taxpayer Relief Provisions - Collections/Taxpayer Services Debt Management

SSA MANAGER: Accounts Receivable – Tax Collections (SSA 32310)

000186

DISCLOSED PURSUANT TO PUBLIC ATIA

Digitized by Google

VALID FOR: TSOs only.

TIME - Record the time spent on obtaining information related to the taxpayer relief file, reviewing the request, documenting the account, making a determination and notifying the taxpayer.

NOTE: Record the Activity Type and the DAC level Internal Order number, to report the time spent.

PRODUCTION - Record a unit of production for each account closed.

DISCLOSED PURSUANT TO THE ATIA

Digitized by Google

14. Appendices

This section provides various information that may be of assistance when reviewing a taxpayer relief request.

DISCLOSED PURSUANT TO THE ATIA

000188

Digitized by Google

Appendices

CRA taxpayer relief forms and information

IC07-1, Taxpayer Relief Provisions

GST 500-3-2-1, Cancellation or Waiver of Penalties and Interest

RC4288, Request for Taxpayer Relief

Web - Taxpayer relief provisions and voluntary disclosures

DISCLOSED PURSUANT TO THE ATIA

Digitized by Google

CRA contact lists

Headquarters functional taxpayer relief representatives

APPEALS BRANCH

E-mail Taxpayer Relief/Allègements pour les contribuables, General Enquiries/Demandes de renseignements généraux

TAXPAYER SERVICES AND DEBT MANAGEMENT BRANCH

Accounts Receivable Directorate

Region	Contact	Telephone Number
Atlantic Region	Randy Albertini (E)	(613) 954-1527
Québec Region	Ghislain Émond (B)	(613) 954-2468
Ontario Region	Irene Rebizant (B)	(613) 941-1598
Prairie Region	Sylvia Faulkner (E)	(613) 948-4253
Pacific Region	Sue Brennan (E)	(613) 952-6544
Headquarters	JeanPierre Lemay (B)	(613) 946-1992
Other Levies (financial hardship issues only)	Diane Rainville (B)	(613) 954-8450

Debt Management Compliance Directorate

Region	Contact	Telephone Number
Policy and Legislative Research Section	Rose Accettura (B) Lorraine Maisonneuve (B)	(613) 946-1988 (613) 957-9463

000190

Digitized by Google

Taxpayer Services Directorate

Region	Contact	Telephone Number
Individual Programs Section	Jeff Haynes (E)	(613) 957-0286

ASSESSMENT AND BENEFIT SERVICES BRANCH

Business Returns and Payments Processing Directorate

Region	Contact	Telephone Number
Business Registration Programs and Procedures Section	Barry Edwards (E)	(613) 952-1150
Business Accounting Programs Section	Sandra Barkey-Mohr (E)	(613) 952- 2933
Corporation Assessing Section	Roman Tymec (E)	(613) 946-5430
T2 Special Processing and Records Section	Yves Lemieux (B)	(613) 954-2900
Information Validation Section	Linda Panich-Langlois (E)	(613) 954-1526
Information Returns Section	Mike Branchaud (E)	(613) 957-9352

Individual Returns and Payments Processing Directorate

Region	Contact	Telephone Number
Processing Division	Cyril Best (E) Susan Charron (E)	(613) 957-9326 (613) 946-2724
Assessment Reviews & Adjustments Division	Brent Wiberg (B)	(613) 957-9936
T1 Accounting Cancellation Of Interest Waiving of Interest	Valorie Bunce (E) Cory Charron (E)	(613) 952-3661 (613) 954-1617
T3 Accounting Cancellation Of Interest Waiving of Interest	Valorie Bunce (E) Solange Deschamps (B)	(613) 952-3661 (613) 946-2749
T3 Assessments and Reassessments	Kim Craig (E)	(613) 941-4277
Assessment Reviews & Adjustments Division, Pensions Section	Deanna Dube (E)	(613) 952-1634

DISCLOSED PURSUANT TO THE

000191

Digitized by Google

Benefit Programs Directorate

Region	Contact	Telephone Number
Legislation and Partnerships Section	Susan McMullen (B)	(613) 946-5269

LEGISLATIVE POLICY AND REGULATORY AFFAIRS BRANCH

Region	Contact	Telephone Number
Legislative Policy Directorate	Terry Miszaniec (E)	(613) 957-2083
Charities Directorate	Jane Waterfall (E)	(613) 954-1262

COMPLIANCE PROGRAMS BRANCH

Region	Contact	Telephone Number
Audit	Mike Warren (B)	(613) 957-3586
International Tax Directorate	Jeffrey Miller (E)	(613) 941-1525
Small and Medium Enterprises Audit Directorate	France Beaulieu (B)	(613) 948-6989
Enforcement and Disclosures Directorate (Voluntary Disclosures)	Harold Howard (E)	(613) 946-5136

DISCLOSED PURSUANT TO THE ATIA

000192

Digitized by Google

CRA contact lists

Regional program advisors

Regions	Contact	Telephone Number
Program Advisor Atlantic Region	David Kenney	(902) 426-2167
Program Advisor Quebec Region	Pierre Gaboriault	(514) 283-2464 #8286
Program Advisor Ontario Region	Andy Schmaus	(905) 803-7316
Program Advisor Prairie Region	Barb Blacklaw	(204) 984-1026
Program Advisor Pacific Region	Agnes Liau	(604) 666-8595

DISCLOSED PURSUANT TO THE ATIA

000193

Digitized by Google

Federal Court contact list

	Federal Court of Appeal	Federal Court	Court Martial Appeal Court of Canada
PRINCIPAL OFFICE			
Ottawa, ON (613)	996-6795 TDD: 947-0407 Fax: 952-7226	PRINCIPAL REGISTRY OFFICE 90 Elgin Street Ottawa, ON **Mailing Address:** Federal Court Courts Administration Service 90 Elgin Street Ottawa, ON K1A 0H9 http://www.fct-cf.gc.ca/index_e.shtml 992-4238 TDD: 995-4640 Fax: 952-3653 995-9177 (IMM) Fax: 947-2141	996-6795 TDD: 947-0407 Fax: 952-7226
REGIONAL OFFICES			
Montréal, QC (514)	283-5200 TDD: 283-3017 Fax: 283-6004	30 McGill Street Montréal, Québec H2Y 3Z7 Bilingual service: 1-800-927-5499 283-4820 TDD: 283-3017 Fax: 283-6004	283-5200 TDD: 283-3017 Fax: 283-6004
Toronto, ON (416)	952-8006 TDD: 954-4245 Fax: 973-2154	180 Queen Street West Suite 200 Toronto, On, M5V 3L6 973-3356 TDD: 954-4245 Fax: 954-5068	973-3356 954-9823 TDD: 954-4245 Fax: 973-2154
London, ON (TCC) (519)		231 Dundas Street, 3rd Floor	666-2055 TDD: 666-9228

000194

Digitized by Google

		London, Ontario N6A 1H1	Fax: 666-8181
Vancouver, BC (604)	666-2055 TDD: 666-9228 Fax: 666-8181	Pacific Centre P.O. Box 10065 701 West Georgia Street Vancouver, BC V7Y 1B6 666-3232 TDD: 666-9228 Fax: 666-8181	
Calgary, AB (403)	292-5555 TDD: 292-5879 Fax: 292-5329	Canadian Occidental Tower 635 Eighth Avenue S.W. 3rd Floor, P.O. Box 14 Calgary, Alberta T2P 3M3 Bilingual service: 1-800-665-3329 292-5920 TDD: 292-5879 Fax: 292-5329	292-5555 TDD: 292-5879 Fax: 292-5329
Edmonton, AB (780)	495-2502 TDD: 495-2428 Fax: 495-4681	Scotia Place 10060 Jasper Avenue Tower 1, Suite 530 Edmonton, Alberta T5J 3R8 **Mailing address:** P.O. Box 51 Bilingual service: 1-800-665-3329 495-4651 TDD: 495-2428 Fax: 495-4681	495-2502 TDD: 495-2428 Fax: 495-4681
Fredericton, NB (506)	452-2036 TDD: 452-3036 Fax: 452-3584	82 Westmorland Street Suite 100 Fredericton, NB E3B 3L3 Bilingual service: 1-800-565-0541 452-3016	452-2036 TDD: 452-3036 Fax: 452-3584

DISCLOSED PURSUANT TO

000195

Digitized by Google

		TDD: 452-3036 Fax: 452-3584	
Halifax, NS (902)	426-5326 TDD: 426-9776 Fax: 426-5514	1801 Hollis Street, 17th Floor Suite 1720 Halifax, Nova Scotia B3J 3N4 **Courtroom:** The Law Courts Building 1815 Upper Water Street Halifax, Nova Scotia B3J 1S7 Courtroom # 501 Bilingual service: 1-800-565-0541 426-3282 TDD: 426-9776 Fax: 426-5514	426-5326 TDD: 426-9776 Fax: 426-5514
Quebec, QC (418)	648-4964 TDD: 648-4644 Fax: 648-4051	Palais de Justice 300 Jean Lesage Blvd Room 500A and 500E Québec, Québec G1K 8K6 648-4920 TDD: 648-4644 Fax: 648-4051	648-4964 TDD: 648-4644 Fax: 648-4051
Winnipeg, MB (204)	983-2232 TDD: 984-4440 Fax: 983-7636	363 Broadway, 4th Floor Winnipeg, Manitoba R3C 3N9 Bilingual service: 1-800-663-2096 983-2509 TDD: 984-4440 Fax: 983-7636	983-2232 TDD: 984-4440 Fax: 983-7636

	Federal Court of Appeal, Federal Court, Court Martial Appeal Court of Canada, Tax Court of Canada
Charlottetown, PE (902)	Sir Louis Henry Davies Law Courts 42 Water Street Box 2000

DISCLOSED PURSUANT TO

Digitized by Google

	Charlottetown, Prince Edward Island C1A 8B9 Bilingual service: 1-800-565-0541 368-0179 Fax: 368-0266
Iqaluit, NU **(867)**	Nunavut Court of Justice Justice Center (Building #510) P.O. Box 297 Iqaluit, Nunavut X0A 0H0 975-6100 Fax: 975-6550
Regina, SK **(306)**	The Court House 2425 Victoria Avenue Regina, Saskatchewan S4P 3V7 Bilingual service: 1-800-663-2096 780-5268 Fax: 787-7217
Saint John, NB **(506)**	The Provincial Building 110 Charlotte Street 4th Floor, Room 413 Saint John, New Brunswick E2L 2J4 Bilingual service: 1-800-565-0541 636-4990 Fax: 658-3070
Saskatoon, SK **(306)**	The Court House 520 Spadina Crescent East Saskatoon, Saskatchewan S7K 2H6 Bilingual service: 1-800-663-2096 975-4509 Fax: 975-4818
St. John's, NL **(709)**	The Court House Duckworth Street P.O. Box 937 St. John's, Newfoundland and Labrador A1C 5M3 Bilingual service: 1-800-565-0541

DISCLOSED PURSUANT TO

000197

Digitized by Google

	772-2884 Fax: 772-6351
Whitehorse, YT (867)	Andrew A. Phillipsen Law Centre 2134 Second Avenue Whitehorse, Yukon Territory Y1A 5H6 **Mailing address:** P.O. Box 2703 Whitehorse, Yukon Territory Y1A 2C6 Bilingual service: 1-800-665-3329 667-5441 Fax: 393-6212
Yellowknife, NT (867)	The Court House 4905, 49th Street P.O. Box 1320 Yellowknife, Northwest Territories X1A 2L9 Bilingual service: 1-800-665-3329 873-2044 Fax: 873-0291

(TDD): Text telephone for the hearing impaired

Digitized by Google

Examples of taxpayer relief correspondence

Acknowledgement letter

(A CRA header should be inserted here.)

Taxpayer's or authorized representative's name
6 Any Avenue
Any City, (Province)
XXX XXX

Subject: Taxpayer Relief Provisions - Acknowledgment
Account Number *XXX XXX XXX*
Taxation Year *XXXX* or Period Ending *XXXX-XX-XX*

Dear Sir or Madam:

We received your letter dated *(date)* requesting relief under the taxpayer relief provisions.

We will review your request and send you a written decision at a later date. We may contact you before making a decision if we need more information.

If you have a balance owing, interest will continue to accrue while your request is being considered. By paying your balance in full, you can avoid future interest charges.

If you have any questions, please contact me at *(XXX) XXX-XXXX*.

Yours sincerely,

(signature)
Position
XXXX Tax Services Office

(Footer with the office address should be inserted here.)

000199

Digitized by Google

Letter asking for more information

(A CRA header should be inserted here.)

Taxpayer's or authorized representative's name
6 Any Avenue
Any City, (Province)
XXX XXX

Subject:

Taxpayer Relief Request
Taxation Year *(year)*
Account Number *XXX XXX XXX*

Dear Sir/Madam:

We are writing in response to your letter of *(date)* in which you requested that the late-filing penalty and arrears interest charged on the above-noted account be cancelled in accordance with the taxpayer relief legislation.

To properly evaluate your request, the following additional information is required:

- an explanation of how your medical condition affected your ability to comply with your tax obligations; and
- a medical certificate or letter from your doctor(s) stating the nature of your illness, duration of the illness, and the dates of your treatment.

Please send this information to my attention at the address below on or before *(date to respond here 30 days)*. If we do not receive the requested information by that date, your file will be reviewed on the information available and a decision will be made.

If you have any questions or need more time to submit the information, please call me at *(XXX) XXX-XXXX*.

Yours sincerely,

(signature)
Taxpayer Relief Unit
XXXX Tax Services Office

(Footer with the office address should be inserted here.)

DISCLOSED PURSUANT TO THE ATIA

000200

Digitized by Google

Examples of approval letters

Example 1 - Approval of first request (GST/HST)

(A CRA header should be inserted here.)

Taxpayer's or authorized representative's name
3 Any Street
Anyplace, (Province)
XXX XXX

Subject:

Taxpayer Relief Request
Account Number *XXX XXX XXX*
For the period of January 1, *(year)*, to March 31, *(year)*

Dear Sir/Madam:

We are responding to your letter of *(date)* about the cancellation of the interest charged on your goods and services tax account.

After carefully considering the circumstances and facts of your case, we are pleased to inform you that we will cancel the arrears interest. We will send you a revised statement of account.

If you have questions about this matter, please call *XXXXX*, *(state position)*. He/She is aware of our correspondence and can be reached at *(XXX) XXX-XXXX*.

Yours sincerely,

(signature)
Team Leader
XXXX Tax Services Office

(Footer with the office address should be inserted here.)

DISCLOSED PURSUANT TO THE ATIA

Example 2 - Approval of first request (income tax)

(A CRA header should be inserted here.)

Taxpayer's or authorized representative's name
4 Any Street
Somewhere, (Province)
XXX XXX

Subject:

Taxpayer Relief Request
Taxation Year *(year)*
Account Number *XXX XXX XXX*

Dear Sir/Madam:

000201

Digitized by Google

We are responding to your letter of *(date)* about the cancellation of the arrears interest charged on the above-mentioned account.

Following our review, we are pleased to inform you that we will cancel the arrears interest. We will send you a refund and a revised statement of account.

If you have questions about this matter, please call *XXXXX, (state position)*. He/She is aware of our correspondence and can be reached at *(XXX) XXX-XXXX*.

Yours sincerely,

(signature)
Team Leader
XXXX Tax Centre

(Footer with the office address should be inserted here.)

Example 3 - Approval of second request

(A CRA header should be inserted here.)

Joyeux Noel Corporation
25 Reindeer Way
North Pole, NU
H0H 0H0

Dear Sir or Madam:

Subject:

Taxpayer Relief Request
Taxation Year *(year)*
Account Number *XXXXX XXXX*RC000*X*

We are writing in response to your letter of *(date)* requesting a second review of our decision concerning the interest charged on the above account.

After a thorough review and careful consideration of the circumstances and facts of the case, we are pleased to inform you that the interest charges for the *(year)* taxation year will be cancelled. The account will be adjusted accordingly.

Please note that this decision should not be construed as precedent setting. Under normal circumstances, any penalty and or interest assessed under the provisions of the Income Tax Act are payable in full when due.

If you have questions or want to discuss this matter, please contact *XXXX, (state position)*. He/She is aware of our correspondence and can be reached at *(XXX) XXX-XXXX*.

Yours sincerely,

(signature)
Manager, Assistant Director or Director *(as applicable)*
XXX Tax Services Office

(Footer with the office address should be inserted here.)

DISCLOSED PURSUANT TO THE ATIA

Digitized by Google

DISCLOSED
PURSUANT TO
THE ATIA

000203

Digitized by Google

Examples of taxpayer relief correspondence

Examples of denial letter

Example 1 - Denial of first request (income tax)

(A CRA header should be inserted here.)

Taxpayer's or authorized representative's name
123 Any Street
Someplace, (Province)
XXX XXX

Subject:

Taxpayer Relief Request
Taxation Year *(year)*
Account Number *XXX XXX XXX*

Dear Sir/Madam:

We are responding to your letter of *(date)* requesting the cancellation of the late-filing penalty and arrears interest charged on your account.

We have noted your comments about the late filing of your return. Also, we have carefully considered the facts of the case and your submission as it relates to the applicable legislation. Our review shows that the period of time that has elapsed between your illness and the filing of your return should not have reasonably prevented you from filing your return on time. As a result, we have concluded it would not be appropriate to cancel the penalty and interest charged on your account.

If you believe that we have not exercised discretion in a fair and reasonable manner, you may request in writing that the Director of your tax services office (or tax centre) review the situation.

If you have any questions or want to discuss this matter, please contact *XXXXX*, *(state position)*. He/She is aware of our correspondence and can be reached at *(XXX) XXX-XXXX*.

Yours sincerely,

(signature)
Team Leader
XXXX Tax Services Office

(Footer with the office address should be inserted here.)

Example 2 - Denial of second request

(A CRA header should be inserted here.)

Taxpayer's or authorized representative's name
2 Specific Street
Nowhere, (Province)
XXX XXX

Dear Sir/Madam:

000204

Digitized by Google

Re:

Taxpayer Relief Request
Taxation Year *(year)*
Account Number *XXX XXX XXX*

We are responding to your letter of *(date)* about the cancellation of the late-filing penalty charged on your account.

We have noted your comments about the late-filing penalty. Also, we have carefully considered the facts of the case and your submission as they relate to the applicable legislation. Our review reveals no indication that an error or delay on our part, or circumstances beyond your control, would have affected your ability to file when and as required. As a result, the late-filing penalty has been upheld.

If you feel that discretion was not properly exercised during our review of your request for relief, you can apply to the Federal Court for a judicial review within thirty (30)days of the day you received this letter. For more information on the judicial review process and how to apply, phone the Registry of the Federal Court at (613) 992-4238. This information is also available at the Federal Court Web site: http://www.fct-cf.gc.ca/index_e.shtml

If you have questions or want to discuss this matter, please contact XXXX, *(state position)*. He/She is aware of our correspondence and can be reached at *(XXX) XXX-XXXX*.

Yours sincerely,

(signature)
Director
XXX Tax Services Office

(Footer with the office address should be inserted here.)

DISCLOSED PURSUANT TO THE ATIA

000205

Digitized by Google

Appendices - Examples of taxpayer relief correspondence

Example of a proactive letter

(A CRA header should be inserted here.)

Taxpayer's or authorized representative's name
6 Any Avenue
Any City, (Province)
XXX XXX

Subject:

Taxpayer Relief Provisions
Account Number *XXX XXX XXX*
Taxation Year *XXXX* or Period Ending *XXXX-XX-XX*

Dear Sir or Madam:

Further to the audit adjustments, we are pleased to advise that we are waiving interest *[and/or penalties]* for the period _____ to _____, due to a delay caused by the Canada Revenue Agency.

We are waiving interest *[and/or penalties]* pursuant to section _____of the _____*Act*, commonly known as the taxpayer relief provisions. You will receive a Notice of Assessment/Reassessment (choose as applicable) that will show the total net tax, penalty and/or interest payable. A Statement of Account will be issued subsequently, indicating the interest *[and/or penalties]* being assessed.

If you have any questions, please contact XXXX, (state position). He/She is aware of our correspondence and can be reached at (XXX) XXX-XXXX.

Yours sincerely,

(Signature)
Team Leader
XXXX Tax Services Office/ XXXX Tax Centre (as applicable)

(Footer with the office address should be inserted here.)

DISCLOSED PURSUANT TO THE ATI

000206

Digitized by Google

List of elections covered under section 600 of the Income Tax Regulations

Section 600 of the Income Tax Regulations lists the provisions of the Income Tax Act and Regulations in respect of which a taxpayer or a partnership can apply under subsection 220(3.2) of the Act to make a late or amended election, or to revoke an election.

The list of eligible elections reflects the amendments to section 600 that were published in the Canada Gazette Part II on August 29, 2006, as SOR/2006-200.

The following is the list of the prescribed provisions and a brief description of the nature of the election:

Deferral on non-CCPC employee options

Subsection 7(8) of the Act allows an employee to defer the taxation of an employment benefit realized from a qualifying acquisition of a particular security under an agreement with the employer (or a person not dealing at arm's length with the employer) until the year in which the employee disposes of the security, becomes a non-resident of Canada or dies, whichever occurs first, if the employee elects in accordance with subsection 7(10) to have subsection 7(8) apply.

Deemed outlay or expense

Paragraph 12(2.2)(b) of the Act allows a taxpayer to elect to reduce the amount of an outlay or expense (other than an outlay or expense which relates to the cost of the property) incurred in the year, the immediately following year or any preceding year, by all or part of any related government assistance received in the year which would otherwise be included in income by virtue of paragraph 12(1)(x).

Interest income accrual rules

Former subsection 12.2(4) of the Act allowed an individual or a trust with individuals as beneficiaries to elect to report accrued interest income on an annual basis with respect to certain life insurance policies and annuity contracts last acquired before December 20, 1980, rather than on a tri-annual reporting basis under former subsection 12.2(3). Subsection 12.2(4) was repealed given the introduction of mandatory annual reporting of accrued income on life insurance policies last acquired after or materially altered after 1989.

"Available for use" rules on long-term projects

Subsection 13(29) of the Act allows a taxpayer to elect to include an amount, within limits, as undepreciated capital cost in respect of long-term project depreciable property under the "available for use" provisions of subsections 13(26) to 13(28) prior to the completion of the project.

Amounts paid for undertaking future obligations

Subsection 20(24) of the Act allows a taxpayer to deduct from income certain payments made to obtain another person's agreement to undertake certain future obligations for which an amount was included in the taxpayer's income under paragraph 12(1)(a), if the taxpayer and other person jointly elect in accordance with subsection 20(25).

000207

Digitized by Google

Cost of borrowed money

The elections contained in section 21 of the Act allow a taxpayer to elect to capitalize, instead of deducting as a current expense, the cost of borrowed money used to acquire depreciable property (subsections 21(1) and 21(3)) or used for the exploration, development or the acquisition of a resource property (subsections 21(2) and 21(4)).

Exchanges of property

Subsections 13(4), 14(6), 44(1) and (6) of the Act allow a taxpayer to elect to defer an income inclusion or the recognition of a capital gain when a replacement property is acquired for a property that was stolen, expropriated or destroyed, or for a former business property that was sold.

Adjustments to cost base

Subsections 13(7.4) and 53(2.1) of the Act allow a taxpayer to elect to reduce the capital cost of depreciable property and the adjusted cost base of non-depreciable capital property, respectively, by the amount of any related inducement, refund, reimbursement, contribution, allowance, or other assistance which would otherwise be included in income by virtue of paragraph 12(1)(x).

Election where change of use

Subsection 45(2) of the Act allows a taxpayer to elect to designate a property as his principal residence although there has been a change in use to an income producing property.

Subsection 45(3) of the Act allows a taxpayer to elect to defer a capital gain on the change of use of a property from an income producing property to a principal residence.

Debts established to be bad debts and shares of bankrupt corporation

Subsection 50(1) of the Act applies to debts established to have become bad debts in a taxation year and to certain shares and allows a taxpayer to elect to have a deemed disposition at the end of the year and a reacquisition immediately thereafter at a cost of nil.

Successor rules for resource properties

Paragraphs 66.7(7)(c), (d) and (e) and (8)(c), (d), and (e) of the Act allow a predecessor corporation and a successor corporation to elect to transfer the unused pools of resource expenses from the predecessor to the successor corporation.

Transfers or distributions to a taxpayer's spouse, common law partner or spousal/partner trust on the death of the taxpayer

Subsection 70(6.2) of the Act allows a taxpayer's legal representative to elect to have the rollover rules under subsection 70(6) and 70(6.1) not apply, thus causing the deemed disposition of assets at fair market value under subsection 70(5) and the deemed payment of amounts in Net Income Stabilization Account (NISA) Fund No.2 under subsection 70(5.4).

000208

Digitized by Google

Transfers of farm property, or family farm corporations and partnerships to child

Subsection 70(9) of the Act allows a taxpayer's legal representative to elect an amount, within limits, as proceeds of disposition for farm property that is transferred to a child on the taxpayer's death.

Subsection 70(9.1) of the Act allows a spousal or common-law partner trust to elect an amount, within limits, as proceeds of disposition for farm property that is transferred from the trust to a child on the spouse or common-law partner's death.

Subsection 70(9.2) of the Act allows a taxpayer's legal representative to elect an amount, within limits, as proceeds of disposition for a share in a family farm corporation, or an interest in a family farm partnership that is transferred to a child on the taxpayer's death.

Subsection 70(9.3) of the Act allows a spousal or common-law partner trust to elect an amount, within limits, as proceeds of disposition for a share in a family farm corporation, or an interest in a family farm partnership that is transferred from the trust to a child on the spouse or common-law partner's death.

Election by legal representative and transferee re reserves

Subsection 72(2) of the Act permits a legal representative of a deceased taxpayer to elect to claim a deduction for certain reserves, provided that the amount so deducted is subsequently included in the income of the taxpayer's spouse or common-law partner or a spousal or common-law partner trust.

Inter vivos transfers of property

Subsection 73(1) of the Act allows a taxpayer to elect to have the rollover provisions in respect of an inter-vivos transfer of assets to a spouse or common-law partner or certain trusts not apply, thus causing the assets to be considered to be transferred at fair market value for tax purposes.

Deemed settlement on winding-up

Paragraph 80.01(4)(c) of the Act allows a parent corporation to elect to reduce the amount to which subsection 80(1) (debt forgiveness rules) might otherwise apply in cases where a debt owed between a parent corporation and its subsidiary is settled on the winding up of the subsidiary for less than both the principal amount and the cost amount of the debt.

Expropriation assets acquired as compensation for, or as consideration for sale of, foreign property taken by or sold to foreign issuer

Subsection 80.1(1) of the Act applies to a Canadian resident taxpayer who has acquired "expropriation assets" issued or guaranteed by a foreign government as compensation for the expropriated or forced sale of shares of a foreign affiliate, or foreign property used to carry on business in a foreign country. The election establishes the deemed cost of the expropriation assets and the deemed proceeds of disposition of the property that was expropriated or sold.

Dividends received by taxpayer's spouse or common-law partner

Subsection 82(3) of the Act allows a taxpayer to elect to have a taxable dividend from a taxable Canadian corporation received by the taxpayer's spouse or common-law partner included in the taxpayer's income where such an inclusion increases the taxpayer's spouse or common-law partner amount under paragraph 118(1)(a).

000209

Digitized by Google

Capital dividend

Subsection 83(2) of the Act allows a private corporation to elect to have the full amount of a dividend that is payable by it to be treated as a capital dividend.

Eligible distributions of foreign spin-off shares

Paragraph 86.1(2)(f) of the Act allows a taxpayer to elect to defer the tax on eligible distributions of foreign spin-off shares.

Election to defer the 21-year deemed disposition date

Subsection 104(5.3) of the Act allowed certain family trusts to elect to defer the 21-year deemed disposition date. This provision was terminated with the result that the deferred disposition date was no later than January 1, 1999.

Preferred beneficiary election

Subsection 104(14) of the Act allows a trust and its preferred beneficiaries to elect to have the income of the trust included in the income of the preferred beneficiaries, instead of being taxed in the trust.

Deemed disposition on emigration

Paragraph 128.1(4)(d) of the Act allows an individual (other than a trust) to elect to treat certain properties that would otherwise be exempt from the deemed disposition that occurs when the individual ceases to be resident in Canada as having been disposed of.

Departure tax adjustment for a returning former resident

Paragraphs 128.1(6)(a) and 128.1(6)(c) of the Act apply to an individual (other than a trust) who ceases to be resident in Canada after October 1, 1996, and subsequently returns to reside in Canada. The effect of the election is to "unwind" the deemed disposition rule of subsection 128.1(4) for certain properties still held upon the individual's return to Canada.

Departure tax adjustment for a returning trust beneficiary

Paragraph 128.1(7)(d) and 128.1(7)(g) of the Act apply to an individual trust beneficiary (other than a trust) who ceases to be resident in Canada after October 1, 1996, receives a distribution of property from the trust while a non-resident, and subsequently returns to reside in Canada while still owning the property. These rules allow the beneficiary and the trust to jointly elect, upon the beneficiary's return to Canada, to "unwind" the deemed disposition rule in subsection 107(2.1) that was triggered when the trust distributed the property to the non-resident beneficiary.

Post-emigration loss on disposition

Paragraph 128.1(8)(c) of the Act applies to an individual (other than a trust) who disposes of taxable Canadian property, after having ceased to be resident in Canada after October 1, 1996, for proceeds that are less than the deemed proceeds that arose on the deemed disposition on emigration. The individual may elect to reduce the deemed proceeds of disposition when the individual emigrated.

DISCLOSED PURSUANT TO

000210

Digitized by Google

Allocation of income by communal organization

Subsection 143(2) of the Act allows a communal organization to elect to have its taxable income earned by the deemed trust under subsection 143(1) allocated to members of the organization.

Home buyers' plan

Subsection 146.01(7) of the Act allows a deceased taxpayer's legal representative and the surviving spouse or common-law partner to elect not to have the full outstanding balance of the Home Buyers' Plan included on the deceased taxpayer's final return. The practical effect of the election is to put the surviving spouse or common-law partner in the same position as the deceased taxpayer with respect to the balance outstanding.

Disposition of property by legal representative of deceased taxpayer

Subsection 164(6) of the Act allows a deceased taxpayer's legal representative to elect to treat certain capital losses or terminal losses of the taxpayer's estate for its first taxation year as capital losses or terminal losses of the deceased taxpayer for the year of death.

Realization of deceased employees' options

Subsection 164(6.1) of the Act allows a deceased taxpayer's legal representative to elect to treat the amount of the loss realized upon the exercise, disposition or expiration of rights to acquire certain securities within the first taxation year of the taxpayer's estate as a loss of the deceased taxpayer for the year of death.

Excess capital dividend

Subsection 184(3) of the Act allows a corporation to elect to have the amount of the elected capital dividend in excess of the balance in the corporation's capital dividend account treated as a separate taxable dividend, thereby avoiding the penalty tax otherwise payable.

Date of acquisition of control

Subsection 256(9) of the Act allows a corporation to elect not to have the acquisition of control deemed to occur at the commencement of the day on which the acquisition took place. The particular time of day that the acquisition of control took place will be recognized if the corporation makes an election.

Elections to include properties in Class 1

Subsection 1103(1) of the Regulations allows a taxpayer to elect, for capital cost allowance purposes, to include in Class 1 all properties included in Classes 2 to 10 and Classes 11 and 12.

Elections to include properties in Class 2, 4, or 17

Subsection 1103(2) of the Regulations allows a taxpayer to elect, for capital cost allowance purposes, to include in Class 2, 4, or 17, a property acquired before May 26, 1976, and included in another class when the chief depreciable properties of the taxpayer are included in Class 2, 4 or 17.

000211

DISCLOSED PURSUANT TO ATIP REQUEST

Digitized by Google

Elections to make certain transfers

Subsection 1103(2d) of the Regulations allows a taxpayer to elect to defer a capital cost allowance recapture by transferring the property disposed of to a new class of which the taxpayer has property, when the property disposed of would have been a property of the new class if it had been acquired when the property of the new class was acquired.

Earnings of a foreign affiliate

Subsection 5907(2.1) of the Regulations allows that, in calculating the active business earnings of a foreign affiliate, a corporation may make an election with respect to the cost of a foreign resource property or the cost of a capital property.

No rollover on election by trust

Subsection 107(2.001) of the Act allows a personal trust or prescribed trust resident in Canada at the time of the distribution to elect not to have subsection 107(2) applied to a distribution of certain property to a beneficiary in satisfaction of the beneficiary's capital interest in the trust.

000212

Digitized by Google

EXAMPLE of SCHEDULE "A"

CERTIFICATE PURSUANT TO A REQUEST MADE UNDER RULE 317 OF THE FEDERAL COURTS RULES

T-XXX-09

FEDERAL COURT

BETWEEN:

JOE TAXPAYER

Applicant

and

CANADA REVENUE AGENCY

Respondent

I, (name), (title) with the (Division), (Tax Services Office (TSO) or Tax Center (TC)) of the Canada Revenue Agency (CRA), certify that the documents listed below and enclosed herewith are true copies of the material requested by the applicant which are relevant to the application and are in the possession of the CRA, and not in the possession of the applicant.

Tab	Documents
1	First-level decision in respect of Joe Taxpayer's request for taxpayer relief, dated May 25, 2008.
2	First-level taxpayer relief report for Joe Taxpayer, dated May 22, 2008.
3	Second-level decision in respect of Joe Taxpayer's request for taxpayer relief, dated January 9, 2009.

000213

Digitized by Google

4	Second-level taxpayer relief report for Joe Taxpayer, dated January 12, 2009.
5	Memorandum, from Jane Smith to John Doe, dated January 20, 2009.
7	Canada Revenue Agency computer print-out "Joe Taxpayer: 1989 Interest Charges Reviewed", dated March 21, 2007.
8	Canada Revenue Agency Objection Report - Diary, for the period from November 22, 2005 to March 22, 2006.
9	Canada Revenue Agency Taxpayer Relief Registry computer print-out, dated May 7, 2006.
10	Canada Revenue Agency ACSES Diary computer print-out, dated May 7, 2006.
11	Canada Revenue Agency Rapid Option C computer print-out, dated May 18, 2006.

Dated at the City of _____, this _____ day of _____, (year).

_____
(name)
Canada Revenue Agency

Digitized by Google

SCHEDULE "A"

CERTIFICATE PURSUANT TO A REQUEST MADE UNDER RULE 317 OF THE FEDERAL COURTS RULES

T-XXX-XX

FEDERAL COURT

BETWEEN:

NAME OF APPLICANT

Applicant

and

CANADA REVENUE AGENCY

Respondent

I, (name), (title) with the (Division), (Tax Services Office (TSO) or Tax Center (TC)) of the Canada Revenue Agency (CRA), certify that the documents listed below and enclosed herewith are true copies of the material requested by the applicant which are relevant to the application and are in the possession of the CRA, and not in the possession of the applicant.

Tab	Documents
1	
2	
3	
4	
5	
7	

000215

Digitized by Google

8

9

10

11

Dated at the City of _____, _____, this _____ day of _____, (year).

_____
(name)
Canada Revenue Agency

DISCLOSED PURSUANT TO THE ATIA

000216

Digitized by Google

Digitized by Google

[25]

Limitations Period and Prescription

Definitions - S. 222.
(1) The following definitions apply in this section. "action" « *action* » "action" means an action to collect a tax debt of a taxpayer and includes a proceeding in a court and anything done by the Minister under subsection 129(2), 131(3), 132(2) or 164(2), section 203 or any provision of this Part.

"tax debt" « *dette fiscale* » "tax debt" means any amount payable by a taxpayer under this Act.

Debts to Her Majesty
(2) A tax debt is a debt due to Her Majesty and is recoverable as such in the Federal Court or any other court of competent jurisdiction or in any other manner provided by this Act.

No actions after limitation period
(3) The Minister may not commence an action to collect a tax debt after the end of the limitation period for the collection of the tax debt.

Limitation period
(4) The limitation period for the collection of a tax debt of a taxpayer
(*a*) begins
(i) if a notice of assessment, or a notice referred to in subsection 226(1), in respect of the tax debt is sent to or served on the taxpayer, after March 3, 2004, on the day that is 90 days after the day on which the last one of those notices is sent or served, and

[25] "Flower Feminine", 2011, Patricia Vertes, Howick, Quebec

Digitized by Google

(ii) if subparagraph (i) does not apply and the tax debt was payable on March 4, 2004, or would have been payable on that date but for a limitation period that otherwise applied to the collection of the tax debt, on March 4, 2004; and

(*b*) ends, subject to subsection (8), on the day that is 10 years after the day on which it begins.

Limitation period restarted

(5) The limitation period described in subsection (4) for the collection of a tax debt of a taxpayer restarts (and ends, subject to subsection (8), on the day that is 10 years after the day on which it restarts) on any day, before it would otherwise end, on which

(*a*) the taxpayer acknowledges the tax debt in accordance with subsection (6);

(*b*) the Minister commences an action to collect the tax debt; or

(*c*) the Minister, under subsection 159(3) or 160(2) or paragraph 227(10)(*a*), assesses any person in respect of the tax debt.

Acknowledgement of tax debts

(6) A taxpayer acknowledges a tax debt if the taxpayer

(*a*) promises, in writing, to pay the tax debt;

(*b*) makes a written acknowledgement of the tax debt, whether or not a promise to pay can be inferred from the acknowledgement and whether or not it contains a refusal to pay; or

(*c*) makes a payment, including a purported payment by way of a negotiable instrument that is dishonoured, on account of the tax debt.

Agent or legal representative

(7) For the purposes of this section, an acknowledgement made by a taxpayer's agent or legal representative has the same effect as if it were made by the taxpayer.

Extension of limitation period

(8) In computing the day on which a limitation period ends, there shall be added the number of days on which one or more of the following is the case:

(*a*) the Minister may not, because of any of subsections 225.1(2) to (5), take any of the actions described in subsection 225.1(1) in respect of the tax debt;

(*b*) the Minister has accepted and holds security in lieu of payment of the tax debt;

(*c*) if the taxpayer was resident in Canada on the applicable date described in paragraph

(4)(*a*) in respect of the tax debt, the taxpayer is non-resident; or

(*d*) an action that the Minister may otherwise take in respect of the tax debt is restricted or not permitted under any provision of the *Bankruptcy and Insolvency Act*, of the *Companies' Creditors Arrangement Act* or of the *Farm Debt Mediation Act*.

Bar to claims

(9) Notwithstanding any law of Canada or a province, Her Majesty is not liable for any claim that arises because the Minister collected a tax debt after the end of any limitation period that applied to the collection of the tax debt and before March 4, 2004.

Digitized by Google

Orders after March 3, 2004 and before effect
(10) Notwithstanding any order or judgment made after March 3, 2004 that declares a tax debt not to be payable by a taxpayer, or that orders the Minister to reimburse to a taxpayer a tax debt collected by the Minister, because a limitation period that applied to the collection of the tax debt ended before royal assent to any measure giving effect to this section, the tax debt is deemed to have become payable on March 4, 2004.

Markevich v. Canada, 2003 SCC 9, [2003] 1 S.C.R. 94, The Case that Changed The Act
Date: March 6, 2003

Her Majesty The Queen *Appellant*

v.

Joe Markevich *Respondent*

and

Teck Cominco Metals Ltd. *Intervener*

Indexed as: Markevich *v.* Canada Neutral citation: 2003 SCC 9.
File No.: 28717.

2002: December 4; 2003: March 6.

Present: McLachlin C.J. and Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour, LeBel and Deschamps JJ.

on appeal from the federal court of appeal

Income tax — Collection — Limitation of actions — Taxpayer failing to pay federal and provincial taxes for 1980 to 1985 taxation years as assessed by Revenue Canada in 1986 — ***Revenue Canada taking no collection action until 1998 — Whether federal and provincial limitation periods bar Revenue Canada from collecting taxpayer's federal and provincial tax debts — Crown Liability and Proceedings Act,*** *R.S.C. 1985, c. C-50, s. 32 — Limitation Act, R.S.B.C. 1996, c. 266, ss. 1, 3(5).*

Crown — Liability — Prescription and limitation — Collection of federal tax debt — Whether term "proceedings" in federal limitation provision encompasses collection procedures available under Income Tax Act — Whether cause of action arose "otherwise than in a province" — Whether Income Tax Act complete code excluding application of federal limitation period to collection procedures — Crown Liability and Proceedings Act, R.S.C. 1985, c. C-50, s. 32. Limitation of actions — Collection of provincial tax debt — Definition of action — Whether phrase "self help remedy" in definition of "action" in provincial limitation legislation encompasses collection procedures available under provincial Income Tax Act — Limitation Act, R.S.B.C. 1996, c. 266, ss. 1, 3(5).

Digitized by Google

In 1986, the respondent, a resident of British Columbia, received a Notice of Assessment from the Minister of National Revenue that indicated a federal and provincial tax liability of $234,136 arising from a series of assessments and unpaid taxes in respect of his 1980 to 1985 taxation years. The respondent did not challenge this assessment, and paid nothing on the outstanding amount. From 1987 to 1998, Revenue Canada made no effort to collect the debt, and statements issued to the respondent during that period did not reflect the 1986 balance. In 1998, Revenue Canada sent a statement of account to the respondent that indicated a balance of $770,583, which included the amount owing as of 1986 and accrued interest. The respondent applied to the Federal Court, Trial Division, for judicial review of the 1998 claim, and sought a declaration that the Crown was prohibited from taking any steps to collect his tax debts for 1990 and prior years. The motions judge dismissed the application. The Federal Court of Appeal set aside that decision and held that the Crown was, pursuant to s. 32 of the *Crown Liability and Proceedings Act* ("*CLPA*") and s. 3(5) of the B.C. *Limitation Act*, statute-barred from collecting the respondent's federal and provincial tax debt.

Held: The appeal should be dismissed.

Per McLachlin C.J. and Iacobucci, Major, Bastarache, Binnie, Arbour and LeBel JJ.: The six-year limitation period prescribed by s. 32 of the *CLPA* bars the Crown from collecting the respondent's federal tax debt. First, as a law of general application, s. 32 presumptively applies on a residual basis to all Crown proceedings. The breadth of the provision's application can be narrowed only by an Act of Parliament that has "otherwise provided", either expressly or impliedly, for limitation periods. The *Income Tax Act* ("*ITA*") does not provide for limitation periods within its collection provisions, and the legislative silence with regard to prescription in these provisions, interpreted in conjunction with the express language used in the *ITA*'s assessment provisions, supports the finding that Parliament intended that limitation provisions of general application apply to the Minister's collection of tax debts. A purposive interpretation of the *ITA* confirms this conclusion. Furthermore, the certainty, evidentiary and diligence rationales for limitation periods do not offend the principles of horizontal and vertical equity that should in part govern the *ITA* and are directly applicable to the collection of tax debts. Second, the ordinary meaning of the phrase "proceedings...in respect of a cause of action" in s. 32 encompasses the statutory collection procedures of the Minister. It would be incongruous to find that s. 32 was intended to apply to the court action but not to the statutory collection procedures that serve the identical purpose. The rationales that support the application of limitation provisions to Crown proceedings apply equally to both the court and non-court proceedings at issue here. To exclude s. 32's application to proceedings that are equivalent in purpose and effect to a court action would frustrate the object and aim of the provision. The legislative history of s. 32 also supports the inference that Parliament intended its application to extend beyond proceedings in court. Third, on both a plain and purposive reading of s. 32, the cause of action in this case arose "otherwise than in a province". Tax debts created under the *ITA* arise pursuant to federal legislation and create rights and duties between the federal Crown and residents of Canada or those who have earned income within Canada. The debt may arise from income earned in a combination of provinces or in a foreign jurisdiction. The debt is owed to the federal Crown, which is not located in any particular province and does not assume a provincial locale in its assessment of taxes.

The Minister, in its role as agent of the province of British Columbia, is also barred by s. 3(5) of the B.C. *Limitation Act* from collecting the respondent's provincial tax debt arising under the British Columbia *Income Tax Act* ("B.C. *ITA*"). Section 3(5) applies a limitation period

Digitized by Google

of six years to actions for which prescription is not "specifically provided for" in another Act. Under s. 1 of the B.C. *Limitation Act*, an action is defined as including "any proceeding in a court and any exercise of a self help remedy". The term "self help remedy" encompasses the statutory collection procedures available under the B.C. *ITA*. A statutory collection procedure is a self help mechanism by which the Minister is able to effect a result that could otherwise be achieved only through an action in court. As well, the B.C. *ITA* does not specifically provide for limitation periods in its collection provisions. Since the province's collection rights are subject to expiry six years after the underlying cause of action arose, so too are the collection rights of the federal Crown as its agent.

Per Gonthier and Deschamps JJ.: The conclusion that the cause of action arises "otherwise than in a province" is inappropriate in two ways. First, it emphasizes the residence of the creditor instead of relying on the connecting factors of the cause of action. Second, it means that the federal government is not located anywhere in Canada. Common sense dictates that the federal Crown is located in every province. Since the federal government is, by virtue of its agreement with all of the provinces (except Quebec), responsible for collecting all provincial income taxes, it is sensible to bind its federal tax claim to the limits available on the provincial one. Efficiency is thus preserved by invoking one limitation for both the federal and provincial income tax debts arising in each province other than Quebec. Here, all of the connecting factors point to British Columbia. Consequently, the British Columbia six-year limitation period should apply.

Cases Cited

By Major J.
Referred to: *Will-Kare Paving & Contracting Ltd. v. Canada*, [2000] 1 S.C.R. 915, 2000 SCC 36; *65302 British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804; *Stubart Investments Ltd. v. The Queen*, [1984] 1
S.C.R. 536; *Friesen v. Canada*, [1995] 3 S.C.R. 103; *M. (K.) v. M. (H.)*, [1992] 3 S.C.R. 6; *Symes v. Canada*, [1993] 4 S.C.R. 695; *Ross v. Canada*, [2002] 2 C.T.C. 222, 2002 FCT 401; *MacKinnon v. Canada*, [2002] 4
C.T.C. 48, 2002 FCT 824; *Royce v. MacDonald (Municipality)* (1909), 12 W.L.R. 347; *Nowegijick v. The Queen*, [1983] 1 S.C.R. 29; *Letang v. Cooper*, [1964] 2 All E.R. 929; *Domco Industries Ltd. v. Mannington Mills, Inc.* (1990), 29 C.P.R. (3d) 481; *Berardinelli v. Ontario Housing Corp.*, [1979] 1 S.C.R. 275; *E. H. Price*
Ltd. v. The Queen, [1983] 2 F.C. 841.

By Deschamps J.
Referred to: *Williams v. Canada*, [1992] 1 S.C.R. 877.

Statutes and Regulations Cited
Crown Liability and Proceedings Act, R.S.C. 1985, c. C-50, s. 32 [rep. & sub. 1990, c. 8, s. 31].
Federal Court Act, R.S.C. 1970, c. 10 (2nd Supp.), s. 38(2).
Federal Court Act, R.S.C. 1985, c. F-7, s. 39(3) [rep. 1990, c. 8, s. 10].
Income Tax Act, R.S.B.C. 1996, c. 215, ss. 1(7), 49, 69.
Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 152(4), 152(4.2), 159(3), 160(2), 160.1(3), 160.2(3), 160.3(2), 160.4(3), 222, 223(2), (3), (5) to (8), 224(1), 225(1), 225.1(1) to 225.1(4), 227(10.1).
Interpretation Act, R.S.B.C. 1996, c. 238, s. 14(1).

Digitized by Google

Limitation Act, R.S.B.C. 1996, c. 266, ss. 1 "action", 3(5), 9(1), (3).

Authors Cited

Black, Henry Campbell. *Black's Law Dictionary*, 6th ed. St. Paul, Minn.: West Publishing Co., 1990, "cause of action", "proceeding". Bouscaren, C., R. Greenstein et A. Cordahi. *Les bases du droit anglais*. Paris: Ophrys, 1981. Castel, Jean-Gabriel, and Janet Walker. *Canadian Conflict of Laws*, 5th ed. Toronto: Butterworths, 2002 (loose-leaf updated December 2002, Issue 3).Cornu, Gérard. *Vocabulaire juridique*, 8e éd. Paris: Presses universitaires de France, 2000, "poursuite", "voie de droit". Driedger, Elmer A. *Construction of Statutes*, 2nd ed. Toronto: Butterworths, 1983. Hogg, Peter W., Joanne E. Magee and Ted Cook. *Principles of Canadian Income Tax Law*, 3rd ed. Scarborough, Ont.: Carswell, 1999. Hogg, Peter W., and Patrick J. Monahan. *Liability of the Crown*, 3rd ed. Scarborough, Ont.: Carswell, 2000. *Petit Larousse, 2003*. Paris: Larousse, 2003, "poursuite". Reid, Hubert. *Dictionnaire de droit québécois et canadien avec table des abréviations et lexique anglais- français*, 2e éd. Montréal: Wilson & Lafleur, 2001, "poursuite". Reynolds, F. M. B. *Bowstead and Reynolds on Agency*, 16th ed. London: Sweet & Maxwell, 1996. Sgayias, David, et al. *The Annotated Crown Liability and Proceedings Act 1995*. Scarborough, Ont.: Carswell, 1994.

APPEAL from a judgment of the Federal Court of Appeal, [2001] 3 F.C. 449, 199 D.L.R. (4th) 255, 270 N.R. 275, 2001 D.T.C. 5305, [2001] 3 C.T.C. 39, [2001] F.C.J. No. 696 (QL), 2001 FCA 144,
reversing a judgment of the Trial Division, [1999] 3 F.C. 28, 163 F.T.R. 209, 172 D.L.R. (4th) 164, 99 D.T.C.
5136, [1999] 2 C.T.C. 104, [1999] F.C.J. No. 250 (QL). Appeal dismissed.

Graham R. Garton, *Q.C.*, and *Carl Januszczak*, for the appellant.

Ian Worland, for the respondent.

Edwin G. Kroft, and *Geoffrey T. Loomer*, for the intervener.

The judgment of McLachlin C.J. and Iacobucci, Major, Bastarache, Binnie, Arbour and LeBel JJ. was delivered by

MAJOR J. — The issue in this appeal is narrow and easily stated: that is, whether federal and provincial limitation periods when exceeded apply to the Crown's ability to exercise its statutory powers to collect tax debts. I have concluded that the limitation period prescribed by s. 32 of the *Crown Liability and Proceedings Act*, R.S.C. 1985, c. C-50 ("*CLPA*"), bars the Crown from collecting the respondent's federal tax debt, and that s. 3(5) of the British Columbia *Limitation Act*, R.S.B.C. 1996, c. 266 ("B.C. *Limitation Act*") bars the Crown from collecting the respondent's provincial tax debt.

Factual Background

The respondent was a resident of British Columbia at all times relevant to this appeal. He received a Notice of Assessment from the Minister of National Revenue (the "Minister") dated June 17, 1986, that indicated a federal and provincial tax liability of $234,136.04

Digitized by Google

arising from a series of assessments and unpaid taxes in respect of his 1980 to 1985 taxation years. The respondent did not challenge this assessment, and paid nothing on the outstanding amount after 1986. In 1987, while of no consequence to this appeal, the indebtedness was internally written off by Revenue Canada, but was not extinguished or forgiven. From 1987 to 1998, Revenue Canada made no effort to collect the debt, and statements issued to the respondent during that period did not reflect the 1986 balance. However, on January 15, 1998, approximately 12 years after the Notice of Assessment, Revenue Canada, for the first time during this period, sent a statement of account to the respondent that indicated a balance of
$770,583.42, which included the amount owing as of June 17, 1986, and accrued interest.
The respondent applied to the Trial Division of the Federal Court for judicial review of the January 15, 1998 claim, and sought a declaration that the Crown was prohibited from taking any steps to collect his tax debts for 1990 and prior years. The motions judge dismissed the application. The Federal Court of Appeal allowed the appeal from that decision, and held that the Crown was statute-barred from collecting the respondent's tax debt reflected in the 1986 Notice of Assessment. The Crown appeals from that decision.

Relevant Statutory Provisions

The following statutory provisions are relevant:

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)
222. All taxes, interest, penalties, costs and other amounts payable under this Act are debts due to Her Majesty and recoverable as such in the Federal Court or any other court of competent jurisdiction or in any other manner provided by this Act.

223. . . .

An amount payable by a person (in this section referred to as a "debtor") that has not been paid or any part of an amount payable by the debtor that has not been paid may be certified by the Minister as an amount payable by the debtor.

On production to the Federal Court, a certificate made under subsection (2) in respect of a debtor shall be registered in the Court and when so registered has the same effect, and all proceedings may be taken thereon, as if the certificate were a judgment obtained in the Court against the debtor for a debt in the amount certified plus interest thereon to the day of payment as provided by the statute or statutes referred to in subsection (1) under which the amount is payable and, for the purpose of any such proceedings, the certificate shall be deemed to be a judgment of the Court against the debtor for a debt due to Her Majesty, enforceable in the amount certified plus interest thereon to the day of payment as provided by that statute or statutes.

(1) Where the Minister has knowledge or suspects that a person is, or will be within one year, liable to make a payment to another person who is liable to make a payment under this Act (in this subsection and subsections (1.1) and (3) referred to as the "tax debtor"), the Minister may in writing require the person to pay forthwith, where the moneys are immediately payable, and in any other case as and when the moneys become payable, the moneys otherwise payable to the tax debtor in whole or in part to the Receiver General on account of the tax debtor's liability under this Act.

Digitized by Google

(1) Where a person has failed to pay an amount as required by this Act, the Minister may give 30 days notice to the person by registered mail addressed to the person's latest known address of the Minister's intention to direct that the person's goods and chattels be seized and sold, and, if the person fails to make the payment before the expiration of the 30 days, the Minister may issue a certificate of the failure and direct that the person's goods and chattels be seized.

225.1 (1) Where a taxpayer is liable for the payment of an amount assessed under this Act, other than an amount assessed under subsection 152(4.2), 169(3) or 220(3.1), the Minister shall not, for the purpose of collecting the amount, [take any collection action] until after the day that is 90 days after the day of the mailing of the notice of assessment.

Crown Liability and Proceedings Act, R.S.C. 1985, c. C-50

32. Except as otherwise provided in this Act or in any other Act of Parliament, the laws relating to prescription and the limitation of actions in force in a province between subject and subject apply to any proceedings by or against the Crown in respect of any cause of action arising in that province, and proceedings by or against the Crown in respect of a cause of action arising otherwise than in a province shall be taken within six years after the cause of action arose.

British Columbia *Limitation Act*, R.S.B.C. 1996, c. 266

1 . . .

"action" includes any proceeding in a court and any exercise of a self help remedy;

3 . . .

(5) Any other action not specifically provided for in this Act or any other Act may not be brought after the expiration of 6 years after the date on which the right to do so arose.

9 (1) On the expiration of a limitation period set by this Act for a cause of action to recover any debt, damages or other money, or for an accounting in respect of any matter, the right and title of the person formerly having the cause of action and of a person claiming through the person in respect of that matter is, as against the person against whom the cause of action formerly lay and as against the person's successors, extinguished.

. . .

(3) A cause of action, whenever arising, to recover costs on a judgment or to recover arrears of interest on principal money is extinguished by the expiration of the limitation period set by this Act for an action between the same parties on the judgment or to recover the principal money.

Judicial History

At the Federal Court, Trial Division ([1999] 3 F.C. 28), the motions judge held that s. 32 of the *CLPA* does not apply to the statutory collection procedures authorized by the *Income*

Digitized by Google

Tax Act,
R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"). He found both that the collection procedures do not qualify under s. 32 as proceedings in respect of a cause of action, and that the *ITA* is a complete code in itself that excludes the application of s. 32. The motions judge also held that the B.C. *Limitation Act* does not apply to the Crown's collection of the provincial tax debt under the British Columbia *Income Tax Act*, R.S.B.C. 1996, c. 215 ("B.C. *ITA*"). As a result, his conclusion was that neither the Crown's collection of the federal nor the provincial tax debt was subject to the limitation periods.
The Federal Court of Appeal disagreed and allowed the appeal ([2001] 3 F.C. 449, 2001 FCA 144). Rothstein J.A. decided that the *ITA* is not a complete code that excludes the application of
s. 32 of the *CLPA*, and that the statutory collection procedures qualify as proceedings in respect of a cause of action under s. 32. Consequently, the limitation period prescribed by s. 32 applies to the statutory collection procedures in the *ITA*. He held that the relevant limitation provision was s. 3(5) of the B.C. *Limitation Act*. Section 3(5) includes both court proceedings and self help remedies, and so applies to both court and statutory collection procedures under the *ITA*. Owing to this provision, the Minister was barred from collecting the federal tax debt six years after the right to do so arose. Rothstein J.A. also concluded that s. 3(5) bars the Crown, in its role as collection agent for British Columbia under the B.C. *ITA*, from pursuing the taxpayer's provincial debt.

Issues

7 The appeal raises the following issues:

(a) Are statutory collection proceedings under the *ITA* subject to a limitation period pursuant to s. 32 of the *CLPA*? This requires the determination of:

Does the *ITA* provide for limitation periods for the collection of tax debts, or otherwise exclude the operation of s. 32 of the *CLPA*?

Is the exercise of a statutory collection power a "proceeding . . . in respect of any cause of action" under s. 32?

(b) If s. 32 is found to apply to the statutory collection proceedings, does the cause of action arise in a province or otherwise than in a province?

Does the B.C. *Limitation Act* apply to statutory collection proceedings undertaken by the Crown acting as collection agent for the Province of British Columbia pursuant to the B.C. *ITA*?

Analysis

The Federal Tax Debt

Is the Federal Tax Debt Subject to Section 32 of the *CLPA*?
Prior to an analysis of the problem, it is useful to describe the broad collection powers available under the *ITA*. The Minister is authorized to collect tax debts by means of either a court action or statutory collection procedures. Section 222 of the *ITA* provides:

Digitized by Google

All taxes, interest, penalties, costs and other amounts payable under this Act are debts due to Her Majesty and recoverable as such in the Federal Court or any other court of competent jurisdiction or in any other manner provided by this Act.

The various collection mechanisms enumerated in the *ITA* provide the Minister with an extensive range of remedies to recover debts. The Minister may certify an unpaid tax amount (s. 223(2)) and register the certificate in the Federal Court (s. 223(3)), at which point the certificate is deemed to be a judgment of that court. The Federal Court can then issue a certificate, notification, or writ evidencing the s. 223(2) certificate, which can be used by the Minister to create a charge, lien, priority, or other interest on property in any province (ss. 223(5) to 223(8)). Under the garnishment provision of s. 224(1), the Minister may require a third party who is indebted to the taxpayer to make payments directly to the Minister. The Minister may also order the seizure and sale of the taxpayer's goods and chattels under s. 225(1). These collection powers cannot be exercised until 90 days after the later of the mailing of a notice of assessment or the mailing of a confirmation or variation of the assessment, or until the taxpayer's appeal has been finally determined by the Tax Court of Canada (ss. 225.1(1) to 225.1(4)).

The outcome of this appeal narrows to whether the exercise of these collection powers is subject to prescription under s. 32 of the *CLPA*. Section 32 applies limitation periods to proceedings brought by or against the Crown in all cases unless Parliament has otherwise provided. The section states:

> Except as otherwise provided in this Act or in any other Act of Parliament, the laws relating to prescription and the limitation of actions in force in a province between subject and subject apply to any proceedings by or against the Crown in respect of any cause of action arising in that province, and proceedings by or against the Crown in respect of a cause of action arising otherwise than in a province shall be taken within six years after the cause of action arose. [Emphasis added.]

The section applies to the statutory collection procedures if two criteria are met. First, the *ITA* must not otherwise provide for limitation periods with respect to the collection of tax debts. Second, the statutory collection procedures must qualify under s. 32 as "proceedings . . . in respect of a cause of action".

I agree with the reasons of the Federal Court of Appeal that each of the two criteria is met in this case, and that s. 32 must apply to the Crown's exercise of statutory collection powers.

Does the ITA Otherwise Provide for Prescription?

11 As a law of general application, s. 32 of the *CLPA* presumptively applies on a residual basis to all Crown proceedings. The breadth of the provision's application can be narrowed only by an Act of Parliament that has "otherwise provided", either expressly or impliedly, for limitation periods. It is evident that the *ITA* does not provide for limitation periods within its collection provisions.

12 The noted author E. A. Driedger in *Construction of Statutes* (2nd ed. 1983), at p. 87, stated that the modern approach to statutory interpretation requires the words of an Act "to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament". These principles have frequently been adopted by this Court both generally and in the construction of taxation legislation: see *Will-Kare Paving & Contracting Ltd. v. Canada*, [2000] 1 S.C.R. 915, 2000 SCC 36, at para. 32; *65302 British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804, both in the majority and minority concurring reasons, and

Digitized by Google

Stubart Investments Ltd. v. The Queen, [1984] 1 S.C.R. 536, at p. 578.

13 The assessment provisions of the *ITA* are clearly stated on prescription. By contrast, the collection provisions of the *ITA* are silent with respect to prescription. There is no reference in s. 222 or its accompanying provisions to either the absence or presence of a limitation period. Nonetheless, the appellant submits that the *ITA* has "otherwise provided" for prescription. In the appellant's submission, the *ITA* constitutes a complete statutory scheme for the collection of taxes, and so silence in the legislation indicates Parliament's intent to avoid fettering the Crown's collection powers with limitation periods.

There is no authority to support the proposition that the *ITA* is a complete code that cannot be informed by laws of general application. The *ITA* does not operate in a legislative vacuum: see *Will-Kare*, *supra*, at para. 31. See also P. W. Hogg, J. E. Magee and T. Cook, *Principles of Canadian Income Tax Law* (3rd ed. 1999), at p. 2, where the authors note that the "Income Tax Act relies implicitly on the general law". Accordingly, whether a statute or legal principle affects the operation of the *ITA* must be decided by an analysis of the specific provisions involved.

Absent legislation or judicial support, the appellant nonetheless requests the Court to interpret s. 222 of the *ITA* as if it permits the collection of tax debts "at any time". It is "a basic principle of statutory interpretation that the court should not accept an interpretation which requires the insertion of extra wording where there is another acceptable interpretation which does not require any additional wording": see *Friesen v. Canada*, [1995] 3 S.C.R. 103, at para. 27. This principle weighs against accepting the appellant's interpretation. The provision does not include the words "at any time", and is capable of a reasonable construction without that insertion. The legislative silence with regard to prescription gives rise to the logical inference that Parliament intended for limitation provisions of general application to apply to the Minister's collection powers.

This conclusion is supported by the explicit manner in which the *ITA* addresses limitation periods in its assessment provisions. The Court held in *Friesen*, *supra*, at para. 27, that "[r]eading extra words into a statutory definition is even less acceptable when the phrases which must be read in(sic) appear in several other definitions in the same statute". Numerous provisions in the *ITA* expressly stipulate that the Minister may make an assessment "at any time": see ss. 152(4), 152(4.2), 159(3), 160(2), 160.1(3), 160.2(3), 160.3(2), 160.4(3), and 227(10.1). Parliament has demonstrated a clear willingness to address the issue of limitation periods in the *ITA* where it sees fit to do so. As Rothstein J.A. noted at para. 22, "Parliament has put its mind to the limitation question in the *Income Tax Act* and when it intends there to be no limitation period, it has so stated." Accordingly, the unescapable conclusion is that the plain language used in the collection provisions does not support the inference that Parliament intended to exclude the application of limitation provisions to the Minister's collection powers.

In finding that the collection provisions implicitly exclude s. 32, the learned motions judge appeared to rely predominantly on s. 225.1 of the *ITA*, which prevents the Minister from initiating collection procedures pending objection or appeal of an assessment by the taxpayer. With respect, I do not agree that s. 225.1 lends any weight to the appellant's argument. The statutory stay prescribed by s. 225.1 is directed towards protecting the taxpayer from collection action pending a final determination of the validity of his or her assessment. Limitation periods, on the other hand, are meant to promote certainty, avoid stale evidence, encourage diligence, and bring repose: see *M. (K.) v. M. (H.)*, [1992] 3 S.C.R. 6, at p. 29, *per* La Forest J. The rationales outlined above for stays and limitation provisions are entirely distinct. I agree with Rothstein J.A.'s conclusion at para. 21:

The enactment of a statutory stay which specifies when collection action may commence, cannot logically support the inference that Parliament considered that no limitation period

Digitized by Google

should apply to that collection action.

18 A purposive analysis of the *ITA* confirms that the collection provisions do not by implication exclude the operation of s. 32. The application of limitation periods to the collection of tax debts does not offend the principles of horizontal and vertical equity that, as Iacobucci J. noted in *Symes v. Canada*, [1993] 4 S.C.R. 695, at p. 738, should in part govern the *ITA*. The appellant submits that applying laws of prescription to tax collection would unfairly alleviate the tax burden of individuals who experience fluctuations in income at the expense of those who enjoy a steady stream of income. This apparent problem can be averted, however, by the Minister's reasonably diligent exercise of debt collection. If a taxpayer does not have the ability to satisfy a tax debt prior to the expiration of the limitation period, the Minister can choose from a variety of means to extend the limitation period. In *Ross v. Canada*, [2002] 2 C.T.C. 222, 2002 FCT 401, the Federal Court, Trial Division, held that the registration of a certificate with the Federal Court in accordance with s. 223(3) of the *ITA* gives rise to a renewal of the limitation period. See also *MacKinnon v. Canada*, [2002] 4 **C.T.C. 48, 2002 FCT 824, where the court found that the taxpayer's acknowledgement of indebtedness by way of a hypothecation agreement with the Minister, and his partial payment of the tax debt, each served to renew the limitation period. There is no need to exhaustively set out the ways in which the Minister can extend the limitation period, other than to note that there are numerous avenues open to the Minister by which renewals may be effected. There is no credible basis to support the submission that the laws of prescription will undermine the equitable collection of taxes when minimum diligence would have the opposite effect.**

19 The appellant's submission that the rationales for limitation periods militate against their application to tax collection cannot be correct. As noted above, limitation provisions are based upon what have been described as the certainty, evidentiary, and diligence rationales: see *M. (K.)*, *supra*, at p. 29. The certainty rationale recognizes that, with the passage of time, an individual "should be secure in his reasonable expectation that he will not be held to account for ancient obligations": *M. (K.)*, *supra*, at p. 29. The evidentiary rationale recognizes the desire to preclude claims where the evidence used to support that claim has grown stale. The diligence rationale encourages claimants "to act diligently and not 'sleep on their rights'": *M. (K.)*, *supra*, at p. 30.

20 Each of the rationales submitted as applicable to there being no limitation periods affecting collection are in fact just the opposite and are directly applicable to the Minister's collection of tax debts. If the Minister makes no effort to collect a tax debt for an extended period, at a certain point a taxpayer may reasonably come to expect that he or she will not be called to account for the liability, and may conduct his or her affairs in reliance on that expectation. As well, a limitation period encourages the Minister to act diligently in pursuing the collection of tax debts. In light of the significant effect that collection of tax debts has upon the financial security of Canadian citizens, it is contrary to the public interest for the department to sleep on its rights in enforcing collection. It is evident that the rationales which justify the existence of limitation periods apply to the collection of tax debts.

The legislative silence with regard to prescription in these provisions, interpreted in conjunction with the express language used in the *ITA*'s assessment provisions, supports the finding that Parliament intended that limitation provisions of general application apply to the Minister's collection of tax debts. A purposive interpretation of the statute confirms this conclusion. There was no evidence before the Court to lend any support to the submission that laws of prescription would frustrate the equitable collection of taxes. Finally, the rationales for limitation periods for the reasons given apply directly to the collection of tax

Digitized by Google

debts.
As a result, whether s. 32 of the *CLPA* applies to the Minister's statutory collection procedures depends entirely upon whether such procedures qualify under s. 32 as "proceedings . . . in respect of a cause of action".

Do the Statutory Collection Procedures Qualify as "Proceedings . . . in Respect of a Cause of Action"?
The application of s. 32 is limited to "proceedings by or against the Crown in respect of a cause of action". Interpreted in their grammatical and ordinary sense, these words clearly encompass the statutory collection procedures in the *ITA*. Although the word "proceeding" is often used in the context of an action in court, its definition is more expansive. The Manitoba Court of Appeal stated in *Royce v. MacDonald (Municipality)* (1909), 12 W.L.R. 347, at p. 350, that the "word 'proceeding' has a very wide meaning, and includes steps or measures which are not in any way connected with actions or suits". In *Black's Law Dictionary* (6th ed. 1990), at p. 1204, the definition of "proceeding" includes, *inter alia*, "an act necessary to be done in order to obtain a given end; a prescribed mode of action for carrying into effect a legal right".
The statutory collection procedures closely resemble various proceedings in court. The registration of a certificate in Federal Court is deemed by s. 223(3) to be a judgment of that court. As Rothstein J.A. notes at para. 35:

> A requirement to pay under section 224 (as am. by S.C. 1994, c. 21, s. 101) is analogous to a garnishing order issued by a court. . . . Seizure and sale of chattels under subsection 225(1) is a provision closely parallel to a writ of execution issued by a court.

By granting the power to effect the collection of tax debts in this manner, Parliament has provided the Minister with an efficient and expeditious alternative to bringing a court action. However, the court and non- court collection procedures are identical in purpose. Both are mechanisms by which the Minister is able to enforce the collection of tax debts and thereby carry into effect the legal rights of the Crown. It is evident that both kinds of procedures are appropriately characterized as legal proceedings.
The appellant's submission turns on whether these proceedings are undertaken "in respect of a cause of action". The words "in respect of" have been held by this Court to be words of the broadest scope that convey some link between two subject matters. See *Nowegijick v. The Queen*, [1983] 1
S.C.R. 29, at p. 39, *per* Dickson J. (as he then was):
The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters.

In the context of s. 32, the words "in respect of" require only that the relevant proceedings have some connection to a cause of action.
A "cause of action" is only a set of facts that provides the basis for an action in court: see *Letang v. Cooper*, [1964] 2 All E.R. 929 (C.A.), at p. 934; *Domco Industries Ltd. v. Mannington Mills, Inc.* (1990), 29 C.P.R. (3d) 481 (F.C.A.), *per* Iacobucci C.J. (as he then was), at p. 496; and *Black's Law Dictionary*, *supra*, at p. 221. In this case, s. 222 of the *ITA* provides that unpaid taxes constitute a debt recoverable by means of a court action, subject to the stay of collection action prescribed by s. 225.1. As a result, as Rothstein J.A. notes at para. 37, the cause of action here involves "the existence of a tax

Digitized by Google

debt and the expiry of the delay period entitling the Minister to take collection action".
In light of the above analysis, the ordinary meaning of the phrase "proceedings . . . in respect of a cause of action" encompasses the statutory collection procedures of the Minister. The exercise of the statutory proceedings is entirely dependent upon a set of facts that would support action by the Minister, i.e., the existence of a tax debt and the expiry of the delay period prescribed by s. 225.1.
I now turn to the French version of s. 32, which states:
Sauf disposition contraire de la présente loi ou de toute autre loi fédérale, les règles de droit en matière de prescription qui, dans une province, régissent les rapports entre particuliers s'appliquent lors des poursuites auxquelles l'État est partie pour tout fait générateur survenu dans la province. Lorsque ce dernier survient ailleurs que dans une province, la procédure se prescrit par six ans.

The words "*poursuite*", "*procédure*" and "*instance*" are all used to render the term "proceedings" in different contexts. "*Procédure*" is even used to describe a cause of action, as demonstrated by the wording of s. 32 of the *CLPA*. This can also be verified in some French publications on the translation of English law (see for instance Bouscaren, Greenstein & Cordahi, *Les bases du droit anglais* (1981)). It is therefore difficult to consider the definition of a single expression to determine the common meaning of the English and French versions of s. 32. Indeed, the legislative history of s. 32, beginning with s. 38(2) (R.S.C. 1970, c. 10 (2nd Supp.)) and later s. 39(3) (R.S.C. 1985, c. F-7) of the *Federal Court Act* ("*FCA*"), which as discussed below were its precursors, also denotes both that context matters and that changes in terminology are not necessarily meant to bring about a change in the substantive law.

If we were to confine our analysis to the word "*poursuite*", we would find that generally, in Canada, that word excludes non-court proceedings: the term is defined in H. Reid, *Dictionnaire de droit québécois et canadien* (2nd ed. 2001), in the following way, at p. 425:

[TRANSLATION]

Court action brought by a person in order to assert his right or obtain a sanction against the perpetrator of an offence. E.g.: A creditor's proceedings [*poursuite*] against his debtor.

But French dictionaries, which are also used in Canada, ascribe a broader definition to "*poursuite*". G. Cornu, in *Vocabulaire juridique* (8th ed. 2000), at p. 654, writes:

[TRANSLATION] Exercise of a remedy [*voie de droit*] to compel someone to perform his obligations or submit to the orders of the law or of the public authority.

Cornu further defines "*voie de droit*" as follows (at p. 909):

[TRANSLATION] Means given by the law to citizens to have their rights recognized and respected or to defend their interests; generic term encompassing court action, means (jurisdictional) of redress, executions, administrative recourses; by ext., any jurisdictional proceeding even initiated by the prosecution.

General dictionaries such as *Le Petit Larousse* (2003) define "*poursuite*" as a court proceeding, but also as [TRANSLATION] "[a]n action by the tax authorities to collect treasury debts".

Digitized by Google

It would therefore be difficult to conclude definitively that "*poursuite*" is more restrictive than "proceedings" and that this is determinative in the context of s. 32. It is then necessary, in this case, to conclude that the common meaning of the English and French versions of the provision is unclear and that resort to the other rules of statutory interpretation is necessary in order to discern Parliament's intent. Applying those rules, construing s. 32 in context, harmoniously with the purpose of the *CLPA*, I have concluded that it was meant to include administrative mechanisms that enable the Crown to achieve exactly the same result as it would through a formal action in court.

At common law, the Crown was not bound by limitation periods unless a federal statute expressly provided otherwise. On the other hand, the Crown was entitled to the benefit of a limitations defence in proceedings brought against it: see D. Sgayias et al., *The Annotated Crown Liability and Proceedings Act 1995* (1994), at pp. 135-36, and P. W. Hogg and P. J. Monahan, *Liability of the Crown* (3rd ed. 2000), at p. 71. The purpose of s. 32 is obviously, in the search for equity, to extend the same benefit of laws of prescription to subjects defending themselves against proceedings brought by the Crown.

A court action brought by the Minister to recover tax debt in this appeal would be subject to the limitation provisions in s. 32. It would be incongruous to find that s. 32 of the *CLPA* was intended to apply to the court action but not to the statutory collection procedures that serve the identical purpose. The certainty, evidentiary and diligence rationales that support the application of limitation provisions to Crown proceedings apply equally to both the court and non-court proceedings at issue here. See *Berardinelli v. Ontario Housing Corp.*, [1979] 1 S.C.R. 275, *per* Estey J., at p. 284:

When one interpretation can be placed upon a statutory provision which would bring about a more workable and practical result, such an interpretation should be preferred if the words invoked by the Legislature can reasonably bear it . . . .

There is no reason to infer that Parliament intended for s. 32's application to turn solely upon the technicality of whether the relevant proceeding took place in court. To exclude s. 32's application to proceedings that are equivalent in purpose and effect to a court action would frustrate the object and aim of the provision.

The legislative history of s. 32 of the *CLPA* supports the inference that Parliament intended for its application to extend beyond proceedings in court. Section 38 of the *FCA* was enacted in 1971 (R.S.C. 1970, c. 10 (2nd Supp.)), and later renumbered as s. 39 of R.S.C. 1985, c. F-7. Section 38(2), which was succeeded by s. 39(3), applied limitation provisions to proceedings brought by or against the Crown. Section 39 of the *FCA* stated:

39. (1) Except as expressly provided by any other Act, the laws relating to prescription and the limitation of actions in force in any province between subject and subject apply to any proceedings in the Court in respect of any cause of action arising in that province.

A proceeding in the Court in respect of a cause of action arising otherwise than in a province shall be taken within six years after the cause of action arose.

Except as expressly provided by any other Act, the laws relating to prescription and the limitation of actions referred to in subsections (1) and (2) apply to any proceedings brought by or against the Crown.

Prior to 1992, s. 32 of the *CLPA* (then entitled the *Crown Liability Act*), applied only to tort actions against the Crown. By S.C. 1990, c. 8, ss. 10, and 31, s. 39(3) of the *FCA* was repealed and s. 32 of the *CLPA* was amended to apply to all proceedings in respect of a

Digitized by Google

cause of action brought both by and against the Crown.

It is readily apparent, as the Federal Court of Appeal notes at para. 49, that s. 38(2) and later s. 39(3) were the predecessors to the current s. 32 of the *CLPA*. In determining the legislative intent behind the current wording in s. 32, it is useful to examine the judicial interpretation given to the provisions that came before it. In *E. H. Price Ltd. v. The Queen*, [1983] 2 F.C. 841, the Federal Court of Appeal considered whether s. 38(2) of the *FCA* applied to the Minister's registration of a certificate under the *Excise Tax Act*. In *obiter*, Clement D.J. held at pp. 847-48 that in the absence of the limiting words "in the Court" that were contained in s. 38(1), "proceedings" under s. 38(2) were not limited to court proceedings and included the Minister's registration of a certificate. In its subsequent amendment of s. 32 of the *CLPA*, Parliament did not include the words "in the court" or words of a similar limiting effect. As Rothstein J.A. found at para. 50, "it is a fair inference that Parliament, not having done so, meant to adopt the interpretation in *E. H. Price* so that 'proceedings' in section 32 include all legal processes in respect of a cause of action, whether court or otherwise". Although the words "in respect of a cause of action" were not included in s. 39(3), for the reasons I have outlined, the inclusion of these words in s. 32 does not have the effect of limiting the provision's application to proceedings in court.

I conclude that the English version best reflects the intent of the legislator. As a result, it should be determined which particular limitation period provided by s. 32 applies to these proceedings. This depends upon whether the cause of action on the federal tax debt arose in a province or otherwise than in a province.

(2) Does the Cause of Action Arise in a Province, or Otherwise than in a Province?

Section 32 applies provincial limitation laws to proceedings in respect of a cause of action arising in a province, and a six-year limitation period to those which arise otherwise than in a province. The motions judge, at para. 59, would have found that the cause of action arose otherwise than in a province. The Court of Appeal applied the provincial limitation provision and so, implicitly at least, found that the cause of action arose in a province. In this appeal, the matter is of no particular consequence, because in either case the limitation period runs for six years from the date upon which the cause of action arose. Nonetheless, I conclude that the appellant's cause of action arose otherwise than in a province, and hence that the six-year limitation period provided by s. 32 applies.

Tax debts created under the *ITA* arise pursuant to federal legislation and create rights and duties between the federal Crown and residents of Canada or those who have earned income within Canada. The debt may arise from income earned in a combination of provinces or in a foreign jurisdiction. The debt is owed to the federal Crown, which is not located in any particular province and does not assume a provincial locale in its assessment of taxes. Consequently, on a plain reading of s. 32, the cause of action in this case arose "otherwise than in a province".

A purposive reading of s. 32 supports this finding. If the cause of action were found to arise in a province, the limitation period applicable to the federal Crown's collection of tax debts could vary considerably depending upon the province in which the income was earned and its limitation periods. In addition to the administrative difficulties that potentially arise from having to determine the specific portions of tax debts that arise in different provinces, the differential application of limitation periods to Canadian taxpayers could impair the equitable collection of taxes. Disparities amongst provincial limitation periods could foreseeably lead to more stringent tax collection in some provinces and more lenient collection in others. The Court can only presume that in providing for a limitation period of six years to apply to proceedings in respect of a cause of action arising otherwise than in a province, Parliament intended for limitation provisions to apply uniformly

Digitized by Google

throughout the country with regard to proceedings of the kind at issue in this appeal.

I conclude that the collection proceedings under the *ITA* are subject to prescription six years after the cause of action arose. As noted above, the cause of action in this case comprised the respondent's tax debt and the expiry of the 90-day delay period after the mailing of the Notice of Assessment dated June 17, 1986. As a result, the cause of action arose on September 16, 1986. The Minister undertook no action in the six years after that date to effect a renewal of the limitation period. Consequently, as of September 16, 1992, s. 32 of the *CLPA* barred the Minister from collecting the respondent's 1986 federal tax debt. Limitation periods have traditionally been understood to bar a creditor's remedy but not his or her right to the underlying debt. In my view, this is a distinction without a difference. For all intents and purposes, the respondent's federal tax debt is extinguished.

The Provincial Tax Debt

The final issue is whether the Minister, in his or her role as agent of the province of British Columbia, is barred by the B.C. *Limitation Act* from collecting tax debts arising under the B.C. *ITA*.

Section 49 of the B.C. *ITA* provides that s. 222 of the *ITA* applies for the purposes of the B.C. *ITA*, subject, as *per* s. 1(7), to such modifications as the circumstances require to make it applicable to British Columbia. Accordingly, tax debts arising under the B.C. *ITA* are debts owed to the province.

Section 69 of the B.C. *ITA* authorizes British Columbia's Minister of Finance and Corporate Relations to enter into a collection agreement whereby the federal government agrees to collect taxes payable under the B.C. *ITA* and remit those taxes to the provincial government. A collection agreement of this kind between British Columbia and the Government of Canada has been in place since 1962: Memorandum of Agreement, January 28, 1962. Subsection 1(1) of this agreement states as follows:

> Canada, as agent of the Province, will collect for and on behalf of the Province the income taxes imposed under the [B.C. *ITA*] . . . . [Emphasis added.]

As a result, the provincial government, as principal, has delegated its right to collect tax debts to the federal government, its agent. It has long been accepted that the authority, express or implied, of every agent is confined within the limits of the powers of his or her principal: see F. M. B. Reynolds, *Bowstead and Reynolds on Agency* (16th ed. 1996), at p. 110. Accordingly, in order to determine the collection rights that are delegated to the federal government, it is necessary to determine the collection rights of the province.

The B.C. *Limitation Act* governs the law on limitations of actions within British Columbia. Section 14(1) of the British Columbia *Interpretation Act*, R.S.B.C. 1996, c. 238, states that unless an enactment specifically provides otherwise it is binding on the Government of British Columbia. The B.C. *Limitation Act* does not provide otherwise, and so its provisions apply to proceedings brought by and against the provincial government.

Section 3(5) of the B.C. *Limitation Act* applies a limitation period of six years to actions for which prescription is not "specifically provided for" in another Act. Under s. 1 of the B.C. *Limitation Act*, an action is defined as including "any proceeding in a court and any exercise of a self help remedy". I agree with both the motions judge and the Court of Appeal that the term "self help remedy" encompasses the statutory collection procedures available under the B.C. *ITA*. A statutory collection procedure is a self help mechanism by which the Minister is able to effect a result that could otherwise be achieved only through an action in court. As well, the B.C. *ITA* does not specifically provide for limitation periods in its collection provisions.

Consequently, the province's right to pursue collection proceedings under the B.C. *ITA* is

Digitized by Google

subject to the limitation period set out in s. 3(5) of the B.C. *Limitation Act*. Moreover, pursuant to s. 9(1) of the B.C. *Limitation Act*, on the expiration of the limitation period, the province's right and title to the tax debt is extinguished, and pursuant to s. 9(3), the province's right and title to interest on the tax debt is extinguished.

As noted above, the federal Crown's right to collect provincial taxes in this case is no greater than the right delegated to it by the province. Since the province's collection rights are subject to expiry six years after the underlying cause of action arose, so too are the collection rights of the federal Crown as its agent.

The cause of action here consisted of the tax debt and the expiry of the delay period allowing collection action to be taken on September 16, 1986. The Minister undertook no action in the six years after that date to effect a renewal of the limitation period. Consequently, as of September 16, 1992, the federal Crown became statute-barred from collecting the provincial tax debt. As well, the right and title of any claimant to the respondent's provincial tax debt, and its accrued interest, were extinguished on that date.

Conclusion

For the foregoing reasons, I would dismiss the appeal with costs.

The reasons of Gonthier and Deschamps JJ. were delivered by

DESCHAMPS J. — I agree with the reasons of my colleague, Justice Major, except on one point.

In determining where the cause of action arises under s. 32 of the *Crown Liability and Proceedings Act*, R.S.C. 1985, c. C-50, Major J. focusses on the location of the federal government. The conclusion that the cause of action arises "otherwise than in a province" is, in my view, inappropriate in two ways. First, it emphasizes the residence of the creditor instead of relying on the connecting factors of the cause of action and second, it means that the federal government is not located anywhere in Canada or, as the French version of s. 32 reads, the federal government would be located "*ailleurs que dans une province*". Common sense, rather, would dictate that the federal Crown is located in every province and not "otherwise than in a province".

The cause of action concept is more readily understood in negligence cases. Here, however, the claim has a statutory foundation. It may be characterized as a right *in personam*, i.e. the right of the Crown against the taxpayer. This Court, in *Williams v. Canada*, [1992] 1 S.C.R. 877, dealt with a similar problem in a case concerned with a tax exemption. Although the residence criterion was modified in favour of a test encompassing all connecting factors, the *situs* analysis was upheld to determine the location of the debt. This concept is also used in private international law in order to determine where enforcement of a claim can be pursued: J.-G. Castel and J. Walker, *Canadian Conflict of Laws* (5th ed. (loose-leaf)), at para. 22.2.

Applying the connecting factors test used in *Williams*, the factors would be the respondent's residence, his place of employment and the place where his income was received. All of these factors point to British Columbia. The British Columbia six-year limitation period should apply.

Since the federal government is, by virtue of its agreement with all of the provinces (except Quebec), responsible for collecting all provincial income taxes, it is sensible to bind its federal tax claim to the limits available on the provincial one. Efficiency is thus preserved by invoking one limitation for both the federal and provincial income tax debts arising in each province, other than Quebec.

Digitized by Google

Appeal dismissed with costs.

Digitized by Google

The Queen v. Gibson, 2005 FCA 180, Acknowledgment of Tax Debt Through Loss Carry-back as The Trigger

Date: 20050513
Docket: A-442-04 Citation: 2005 FCA 180
CORAM: DÉCARY J.A. LÉTOURNEAU J.A. PELLETIER J.A. BETWEEN:

HER MAJESTY THE QUEEN

and
D. KENNETH GIBSON

and

Appellant Respondent

DÉCARY J.A.
THE ATTORNEY GENERAL
FOR ONTARIO Intervener

REASONS FOR JUDGMENT

[1] The respondent is seeking a declaration that, due to the expiry of certain limitation periods, the Canada Customs and Revenue Agency (the Agency) is prohibited from taking collection action against him for tax debts allegedly owing for the 1990 and 1991 taxation years.

[2] In *Markevich v. Canada*, [2003] 1 S.C.R. 94, the Supreme Court of Canada held that a six-year limitation period applied to collection proceedings under the *Income Tax Act*. The six-year limitation periods at issue in this appeal were to expire on March 18 and 29, 1999, for the 1990 and 1991 tax debts.

[3] On March 2, 1999, i.e. a few weeks before the expiry of the limitation periods, the respondent requested that his losses from subsequent tax years be carried back and applied to the 1990 and 1991 taxation years. The request was granted by the Agency on September 28, 2000. Eventually, notices of reassessment were issued to the respondent for the 1990 and 1991 taxation years in September 2000 and August 2002 respectively.

[4] The Agency having taken no action to collect the tax debts before the expiry of the limitation periods, the respondent filed his application for judicial review on June 11, 2003 to prevent the Agency from taking any further action.

[5] On June 4, 2004, Mosley J. granted the application. With respect to the federal portion of the tax debt, he found that the carry back request did not amount to an acknowledgment by the respondent of his tax debt such as contemplated in *Markevich* and could not have the effect of extending the six-year limitation period provided in section 32 of the *Crown Liability Proceedings Act* (R.S.C. 1985, c. C-50). With respect to the collection by the Agency of that part of the tax debt which was owed to the Government of Ontario, he found that such collection would be beyond the two-year limitation period set out in subsection 45(1)(*h*) of the former *Limitations Act* (Ontario).

Digitized by Google

[6] The Crown appealed to this Court. In addition to the ground it had raised below (i.e. acknowledgment of tax debt resulting from the carry back request), it argued that reassessments made in September 2000 and August 2002 were events that renewed the federal and provincial limitation periods, that the ten-year limitation period recently set out in section 222 of the *Income Tax Act*, as amended by S.C. 2004, c. 22, section 50, applied with respect to the federal tax and that the twenty-year limitation period set out for "specialty" in paragraph 45(1)(*b*) of the *Limitations Act* (Ontario) applied with respect to the provincial tax.

[7] The Attorney General for Ontario was granted leave to intervene in the appeal. He argued that under Ontario legislation, the Crown is not bound by a statute unless it is stated therein that the Crown is bound thereby (s. 11 of the *Interpretation Act* (Ontario)); that the former *Limitations Act* (Ontario) contains no provision stating that the Act is binding on the Crown; that paragraph 45(1)(*h*), upon which Mosley J. relied, does bind the Crown but applies only to actions that are penal in nature; and, should the Court find that the Act is binding on the Crown, that the relevant provision would be paragraph 45(1)(*b*), which sets out a twenty-year limitation period.

[8] The relevant statutory provisions are the following:

Income Tax Act
(as amended by the
B*udget Implementation Act, 2004*, S.C. 2004, c. 22, s. 50)

222. ...

A tax debt is a debt due to Her Majesty and is recoverable as such in the Federal Court or any other court of competent jurisdiction or in any other manner provided by this Act.

The Minister may not commence an action to collect a tax debt after the end of the limitation period for the collection of the tax debt.

The limitation period for the collection of a tax debt of a taxpayer
begins
if a notice of assessment, or a notice referred to in subsection 226(1), in respect of the tax debt is mailed to or served on the taxpayer, after March 3, 2004, on the day that is 90 days after the day on which the last one of those notices is mailed or served, and
if subparagraph (i) does not apply and the tax debt was payable on March 4, 2004, or would have been payable on that date but for a limitation period that otherwise applied to the collection of the tax debt, on March 4, 2004; and
ends, subject to subsection (8), on the day that is 10 years after the day on which it begins.

The limitation period described in subsection (4) for the collection of a tax debt of a taxpayer restarts (and ends, subject to subsection (8), on the day that is 10 years after the day on which it restarts) on any day, before it would otherwise end, on which
the taxpayer acknowledges the tax debt in accordance with subsection (6);
the Minister commences an action to collect the tax debt; or
the Minister, under subsection 159(3) or 160(2) or paragraph 227(10)(a), assesses any person in respect of the tax debt.

...

Notwithstanding any order or judgment made after March 3, 2004 that declares a tax debt not to be payable by a taxpayer, or that orders the Minister to reimburse to a taxpayer a tax debt collected by the Minister, because a limitation period that applied to the collection of the tax debt ended before royal assent to any measure giving

Digitized by Google

effect to this section, the tax debt is deemed to have become payable on March 4, 2004.

...

ontario
Interpretation Act
(R.S.O. 1990, c. I.11)

11. No Act affects the right of Her Majesty, Her heirs or successors, unless it is expressly stated therein that Her Majesty is bound thereby.

...

ontario
Limitations Act
(R.S.O. 1990, c. L.15)

45. (1) The following actions shall be commenced within and not after the times respectively hereinafter mentioned,

...

(*b*) an action upon a bond, or other specialty, except upon a covenant contained in an indenture of mortgage made on or after the 1st day of July, 1894;

...

within twenty years after the cause of action arose,

...

(*h*) an action for a penalty, damages, or a sum of money given by any statute to the Crown or the party aggrieved, within two years after the cause of action arose; ...

ontario
Limitations Act, 2002
(as amended by the *Justice Statute Law Amendment Act, 2002*,
S.O. 2002, chapter 24, Schedule B)

...

3. This Act binds the Crown.

...

16. (1) There is no limitation period in respect of,

...

(*i*) a proceeding to recover money owing to the Crown in respect of,
fines, taxes and penalties, or
interest that may be added to a tax or penalty under an Act; ...

[9] I wish to point out at the outset that the appeal before us was essentially argued on grounds that had not been argued or well articulated in the Federal Court. With respect to the federal tax, the Crown had not raised the argument (which, as we shall see, ends up being a decisive one) based on the 2004 amendment to section 222 of the *Income Tax Act*. **With respect to the provincial tax, it appears that none of the case law which was cited to us by the intervener had been brought to the attention of the Federal Court judge.**

<u>The federal limitation period</u>

[10] The hearing before Mosley J. proceeded on April 28, 2004. Bill C-30, which introduced the amendment noted above, received Royal Assent on May 14, 2004. The impugned decision was rendered on June 4, 2004. One is at a loss to understand why the matter was not brought to the attention of the Federal Court

Digitized by Google

judge by counsel for the Crown.

[11] The amended section 222 of the *Income Tax Act* is, to use the words of Linden J.A. in *C.I. Mutual Funds Inc. et al v. The Queen* (1999), 99 G.T.C. 7075 (F.C.A.) at 7076, "amply clear so as to rebut any presumption against retroactive application." The amendment was introduced as a Parliamentary response to the Supreme Court of Canada decision in *Markevich*. It sets up, at subsection (4), a ten-year limitation period in income tax matters that replaces the six-year general limitation period set out in subsection 32(1) of the *Crown Liability and Proceedings Act*. It goes on in subsection (10) to ensure that the amendment applies to any judgment made after March 3, 2004 that declares a tax debt not to be payable by a taxpayer because a limitation period ended before Royal Assent was given. Subsection (10) goes even further in deeming such tax debt to have become payable on March 4, 2004. The impugned judgment having been made on June 4, 2004, there is no doubt that the tax debt here at issue is deemed to have become payable on March 4, 2004 and that the limitation period expires on March 3, 2014.

[12] Counsel for the respondent was gracious enough to recognize that the amendment suffered from no ambiguity. He timidly suggested that the amendment was inoperative by virtue of section 1(*a*) of the *Canadian Bill of Rights*. Such an argument cannot, of course, be entertained by this Court absent service of a constitutional question to all Attorneys General (see s. 57 of the *Federal Courts Act*). In any event, the argument would have no chance of success in view, notably, of the decision of the Supreme Court of Canada in *Authorson v. Canada (Attorney General)*, [2003] 2 S.C.R. 40, at 60. The amendment, here, is "clear and unambiguous" and satisfies the "due process of law" required by section 1(*a*). There being no conflict with the protections afforded by the *Canadian Bill of Rights*, there is no need for an express declaration that the provision operates notwithstanding the *Canadian Bill of Rights*.

[13] In view of the conclusion I have reached with respect to the retroactivity of the 2004 amendment to section 222 of the *Income Tax Act*, I need not examine the other grounds argued by the appellant with respect to the federal tax.

The provincial limitation period

[14] Section 11 of the *Interpretation Act* (Ontario) provides that no Act affects the right of Her Majesty, unless it is expressly stated therein that Her Majesty is bound thereby.

[15] The former *Limitations Act* (Ontario) does not expressly state that it binds the Crown. The Ontario Court of Appeal has held that section 11 of the *Interpretation Act* "reinforces the ancient maxim *nullum tempus occurrit regi*" and that the Crown is only bound by those provisions of the former *Limitations Act* in which it is expressly mentioned (*Ontario (Attorney General) v. Watkins* (1975), 8 O.R. (2d) 513, at 514-515 (C.A.).

[16] Counsel for the intervener concedes that paragraph 45(1)(*h*) upon which Mosley J. relied does, by its very words, bind the Crown. He points out, however, and correctly in my view, that the jurisprudence interpreting that paragraph and its predecessors establishes that it only applies to actions that are penal in nature **(see *Thomson v. Lord Clanmorris*, [1900] 1 Ch. 718 (C.A.), per Lindley M.R. at 725; *Johnson Controls Inc. v. Varta Batteries Ltd.* (1984), 80 C.P.R. (2d) 1 (F.C.A.), per Urie J.A. at 18; *West End Construction Ltd. v. Ontario (Ministry of Labour)* (1989), 62 D.L.R. (4th) 329 (Ont. C.A.), per Finlayson J. at 340; *Abraham v. Canadian Admiral Corp. (Receiver of)* (1998), 39 O.R. (3d) 176 (Ont. C.A.), per**

Digitized by Google

McKinlay J.A. at 181-182).

[17] An action taken to collect Ontario income taxes, which, by virtue of section 30 of the *Income Tax Act* (Ontario), "are debts due to Her Majesty in right of Ontario," is not a penal action. The two-year limitation period set out in paragraph 45(1)(*h*) did not apply.

[18] Counsel for the intervener also submits that paragraph 45(1)(*b*) is not applicable as it does not bind the Crown. I agree. In any event, that paragraph would have been of no use to the respondent as it sets out a twenty-year limitation period.

[19] It is worth noting, before closing, that in the new *Limitations Act, 2002* (Ontario), section 3 states that "[t]his Act binds the Crown" and paragraph 16(1)(*i*) provides that "[t]here is no limitation period in respect of ... a proceeding to recover money owing to the Crown in respect of (i) fines, taxes and penalties, or (ii) interest that may be added to a tax or penalty under an Act." If there was uncertainty before - and I have found none - with respect to the imprescriptibility of tax collection proceedings in Ontario, there can be none now.

Costs

[20] With respect to the intervention, the Attorney General for Ontario was granted leave on the express condition that he "pay to the respondent on a party-to-party basis all extra fees and disbursements incurred by the respondent as a result of his intervention, including costs of the intervention." I would assess the whole of these fees and disbursements at $1,000.00.

[21] With respect to the appeal, had the amendment to section 222 been brought to the attention of the Federal Court judge, this appeal might have been unnecessary. In all likelihood, the judge would have dismissed the application insofar as the federal tax was involved and, in all likelihood, the respondent would not have appealed. On the other hand, the amendment to the federal legislation was of no consequence with regard to the provincial tax and the respondent would have seen that segment of his application dismissed by our Court in any event. At the end of the day, in fairness to the respondent, there should be no costs in the Federal Court and the respondent should be entitled to his costs against the appellant in the appeal, these costs to be assessed, as per rule 407, in accordance with column III of the table to Tariff B.

Disposition

[22] I would allow the appeal, set aside the decision of the Federal Court and dismiss the application for judicial review. There should be no order as to costs in the Federal Court. The respondent should have his costs on the appeal as against the appellant, these costs to be assessed in accordance with column III of the table to Tariff B. The intervener should pay costs, assessed at $1,000.00, to the respondent.

"Robert Décary" J.A.

"I agree.

Gilles Létourneau, J.A."

"I agree.

J.D. Denis Pelletier, J.A."

Richard Collins v. CCRA, 2005 FC 1431, An Interpretation of The New Prescription Statute

Digitized by Google

Docket: T-950-05 Citation: 2005 FC 1431

Ottawa, Ontario, this 21st day of October, 2005

Present: THE HONOURABLE MR. JUSTICE SIMON NOËL BETWEEN:

RICHARD COLLINS

Applicant and

CANADA CUSTOMS AND REVENUE AGENCY

Respondent

REASONS FOR ORDER AND ORDER

[1] This is an application by Richard Collins (the Applicant), a self-represented applicant, for judicial review of a decision of the Canada Customs and Revenue Agency ("CCRA") to seize his pension proceeds in payment of his tax debts. The Applicant, a former resident of Nova Scotia, asks for an order to require the CCRA to cease its collection of tax debts, and for the restitution of the amounts already seized. The applicant now lives in the United States and has requested, pursuant to Rule 369 of the *Federal Court Rules*, SOR/98-106, for this motion to be decided on the basis of written representations only. The respondent did not oppose.

FACTS

[2] The Applicant's records with the CCRA are summarized in Lucie Allaire's affidavit dated September 30, 2005. According to this affidavit, the seizure of the Applicant's proceeds were executed in relation with 1986, 1988 and 1994 taxation years.

1. 1986 and 1988 Taxation Years

[3] As per Ms. Allaire's affidavit, Notices of Assessment were issued by the Minister of National Revenue ("Minister") for the 1986 and 1988 taxation years on October 14, 1987 and August 8, 1989, respectively. The

Minister reassessed the applicant's tax payable for the 1986 and 1988 taxation years by Notices of Reassessment dated October 16, 1989, which were confirmed on or about August 1st, 1990. On October 27, 1989, the Applicant filed Notices of Objection with regards to the 1986 and 1988 taxation years. The

applicant then filed a Notice of Appeal to the Tax Court of Canada on December 13, 1990 for the 1986 taxation year. This appeal was dismissed on September 29, 1992. The Notice of Objection for the 1988 taxation year was partly granted. Pursuant to this decision, the tax payable by the Applicant for the 1988 taxation year was reassessed on September 25, 1990. The applicant also filed an application for an extension of time to appeal to the Tax Court of Canada on November 10, 2004, for the 1986 and 1988 taxation years. This application was dismissed on March 23, 2005.

[4] According to Ms. Allaire's affidavit, as of September 28, 2005, the Applicant's outstanding federal and provincial tax liability amounts to $42 025,82 and $13 408,25, respectively, for the 1986 and the 1988 taxation years.

1994 Taxation Year

[5] The Applicant was assessed for the 1994 taxation year on June 15, 1995.

[6] As of September 28, 2005, the Applicant's outstanding federal and provincial tax liability was $799,11 with respect to his 1994 taxation year.

The Respondent's letters and the seizure

[7] As per Ms. Allaire's affidavit, the Respondent decided to collect arrears from the Applicant's pension proceeds from April 2004 to April 2005. A total amount of $1 724, 43 has been seized to date. Between May and September 1995, letters were sent to

Digitized by Google

the applicant asking for the payment of arrears.

ISSUE

Was the Respondent lawfully entitled to collect the Applicant's tax debts in respect of his 1986, 1988 and 1994 taxation years?

Were tax debts of the Applicant prescribed as a result of the decision of the Supreme Court in *Markevich v. Canada* [2003] 1 R.C.S. 94, 2003 CSC 9?

ANALYSIS

[8] In *Markevich v. Canada, supra*, the Supreme Court of Canada held that, under section 32 of the *Crown Liability and Proceedings Act*, R.S. 1985, c. 50, the limitation period for the collection of federal income tax debt was six years. As for the collection of provincial tax debt, the Supreme Court held that the "federal Crown's right to collect provincial taxes is no greater than the right delegated to it by the province". Therefore, the time limitation found in the provincial law was applicable to the CCRA. The Applicant's argument is primarly based on this judgement of the Supreme Court of Canada. In his view, the CCRA should have been more diligent, and is therefore no longer entitled to the collection of arrears by reason of prescription.

[9] In response to this decision, Parliament amended section 222 of the *Income Tax Act*, R.S.C. 1985 (5th Suppl.) ("Federal Act") by enacting Bill C-30, *An act to implement certain provisions of the budget tabled in Parliament*, 3rd Sess., 37th Parl, 2004 (received Royal Assent on May 14, 2004) ("Bill C-30"). Subsection 222(4) of the Federal Act reads :

The limitation period for the collection of a tax debt of a taxpayer

begins

if a notice of assessment, or a notice referred to in subsection 226(1), in respect of the tax debt is mailed to or served on the taxpayer, after March 3, 2004, on the day that is 90 days after the day on which the last one of those notices is mailed or served, and if subparagraph (i) does not apply and the tax debt was payable on March 4, 2004, or would have been payable on that date but for a limitation period that otherwise applied to the collection of the tax debt, on March 4, 2004; and

ends, subject to subsection (8), on the day that is 10 years after the day on which it begins. (*my emphasis*)

(4) Le délai de prescription pour le recouvrement d'une dette fiscale d'un contribuable :

commence à courir :

si un avis de cotisation, ou un avis visé au paragraphe 226(1), concernant la dette est posté ou signifié au contribuable après le 3 mars 2004, le quatre-vingt-dixième jour suivant le jour où le dernier de ces avis est posté ou signifié,

si le sous-alinéa (i) ne s'applique pas et que la dette était exigible le 4 mars 2004, ou l'aurait étéen l'absence de tout délai de prescription qui s'est appliquépar ailleurs au recouvrement de la dette, le 4 mars 2004

prend fin, sous réserve du paragraphe (8), dix ans après le jour de son début. (*je souligne*) [10] The wording of subparagraph 222(4) ii) is clear. The word « tout » in the French version leaves no room for interpretation (the English version uses the general expression "a limitation"). Subparagraph 222(4)ii)

Digitized by Google

overrules any limitation period that existed prior to the adoption of Bill C-30. The Federal Court and the Federal Court of Appeal jurisprudence is unambiguous on this issue (See *C.I. Mutual funds Inc. v. Canada*, [1999] F.C.J. No. 199, [1999] F.C. 613; *Gibson v. Canada*, [2005]
No. 817, 2005 FCA 180). A tax debt that was prescribed prior to the adoption of Bill C-30 can nevertheless be enforced by the CCRA under the Act.
[11] As for provincial tax liability, the applicant was a resident of the province of Nova Scotia in 1986, 1988 and 1994. In virtue of a tax collection agreement between this province and the Federal government, the latter is responsible for the collection of taxes on behalf of the former. Section 81 of Nova Scotia's *Income Tax Act*, R.S.N.S. 1989, c. 217 ("N.S. Act") provides that section 222 of the Federal Act applies to the collection of provincial tax debts. In fact, most of the "enforcement" sections of the N.S. Act refer and make applicable different sections of the Federal Act. Subsection 2(10) further provides that :
Where a provision, in this subsection referred to as "that section", of the Federal Act or the Federal Regulations is made applicable for the purpose of this Act, that section, as amended from time to time, applies with such modifications as the circumstances require for the purpose of this Act as though it had been enacted as a provision of this Act, and in applying that section for the purpose of this Act, in addition to any other modifications required by the circumstances [...]
Therefore, subparagraph 222(4)ii) is applicable to the provincial tax liability, and empowers the CCRA to collect the tax debts owed by the Applicant to the Province of Nova Scotia, until March 4, 2014. [12] For all these reasons, the Respondent was entitled to collect the Applicant's tax debts in respect of his 1986, 1988 and 1994 taxation years.
[13] In the Applicant's view, « the new legislation can in no way revive an alleged fiscal debt that was already extinguished one year earlier by the aforementioned ruling of the Supreme Court of Canada [*Markevich v. Canada, supra*], for if that were the case, it would have for effect the retroactive annulment of the actual ruling by the Supreme Court of Canada, which makes absolutely no sense » . With deference for the Applicant, the Parliament has discretion to overrule Supreme Court judgments. The principle of parliamentary supremacy is a foundation of Canadian constitutional law: the judiciary must abide by the statutes adopted by Parliament.

COSTS
[14] The Respondent asked for this judicial review application to be dismissed with costs. Having in mind the particularities of this case, no costs are allowed.

ORDER
THIS COURT ORDERS THAT:
- The application is dismissed without costs.
"Simon Noël"
"Judge"

Digitized by Google

Hugh Doig v. Her Majesty The Queen, 2011 FC 371, a 25 Yr-Old Debt

REASONS FOR JUDGMENT AND JUDGMENT

[1] The tax debt at issue in this application arose more than 25 years ago. While death and taxes may be certain, the collection of the latter is not.

[2] Mr. Doig seeks a declaration from this Court that he has no debt for taxes for the 1971 to 1984 taxation years. He says that he paid that debt but that Canada Revenue Agency or its predecessor agency (collectively referred to throughout as "CRA") failed to properly give him credit for payments he made.

[3] For the reasons that follow, I am unable to issue the declaration that is sought. Mr. Doig has waited too long to bring this application, and he has failed to prove on the balance of probabilities that he paid his tax debt.

Background

[4] CRA says that as of June 16, 2009 Mr. Doig was indebted to the Crown in the amount of

$323,738.31, comprised of unpaid taxes, interest and penalties "from taxation years prior to and including 1982, 1983, 1984, 1985, 1986, 1987, 1988, 1989, 1991, 1992, and 1993."

[5] Mr. Doig does not dispute the amounts claimed by CRA to be owed with respect to taxation year 1985 and following; he disputes the claim of CRA that there is any debt owed for 1984 and prior taxation years (collectively the "prior period"). He says that he paid the tax debt of the prior period.

[6] This litigation has taken a circuitous route. The applicant initially took the position that the Notices of Assessment for the taxation years 1984 and prior had not been sent to or received by him. However, when the application came on for hearing, the position advanced by the applicant was that the debt from the prior period had been paid by him but that his payments had not been credited to his account by CRA. On consent, the hearing was adjourned and fresh records and memoranda were filed.

[7] I will follow the applicant's division of the prior period into three separate time periods: 1971- 1973, 1974-1979, and 1980-1984.

1971-1973

[8] On January 21, 1975, a Certificate filed by the respondent issued from the Federal Court of Canada – Trial Division in favour of the Crown stating that Mr. Doig had an unpaid tax debt, plus interest for the taxation years 1971 to 1973, in the amount of $14,277.19. A writ of *fieri facias* was issued and the record indicates that it was paid on or about February 3, 1975. The applicant submits that he was not properly credited with the payment and that the 1971 to 1973 tax liability is included in the amount CRA claims is owed for the prior period.

[9] The respondent agrees that the debt for this period was paid but asserts that no part of the tax debt claimed for the prior period includes or relates to this period of time.

1974-1979

[10] Mr. Doig swears that he made two payments to CRA in the period from 1974 to 1979 in satisfaction of the tax debt that arose within this period.

[11] He attests that: "On March 17, 1978, my wife, Helen Doig (nee Helen Teahen) placed a mortgage on her cottage property for $5,000.00." He says that despite the high interest rate of 13%, "the mortgage was placed on the cottage so that funds could be raised to pay my income tax arrears." He asserts that "my wife gave me the funds and I paid the proceeds to the CRA as partial payment of my outstanding taxes and interests [*sic*]."

Digitized by Google

[12] Mr. Doig then attests that in the fall of 1979, CRA in Ottawa contacted him and told him that he had outstanding tax arrears of approximately $17,000.00. Again, his wife placed a mortgage on her cottage property from which she received $16,000.00. Mr. Doig says that he contributed $1,000.00 of his own money and swears that he paid $17,000 to CRA "as payment against my outstanding taxes and interest." He says that:

From 1979 to January 1984, no collections [*sic*] actions were taken by the CRA's Ottawa or Sudbury collections offices against me and I was not advised of any outstanding tax debt. As such, I conducted my affairs on the basis that I had no tax debt outstanding.

It is my belief that when the Sudbury collections office became aware of the 1975 Certificate that it mistakenly concluded that I had never paid the tax debt.

[13] CRA submits that its records do not show that either payment was made, that the applicant has failed to prove on the balance of probabilities that these payments were made, and that the applicant's behaviour contradicts his claim that he made these payments.

1980-1984

[14] The applicant states that there were no collection steps taken by CRA and that he regularly paid his taxes in this period. He says that he only became aware of the alleged debt in 2005 when CRA withheld a small refund due to him. Following an inquiry to determine why it was withheld, he learned that CRA's records showed a balance forward from January 19, 1986, of $57,575.06.

[15] The respondent states that as a consequence of a change in its computer systems in 1986 a new statement of account was created. The system took the balance owed by the applicant on January 20, 1986 (relating to the 1984 and prior taxation years) and merged it with the tax debt owed on account of the 1985 taxation year and recorded the sum as one amount in July 1986. It states that from that date onward, the computer system labelled the merged debt as the "1985 debt"; however, it was a debt that related to the 1985 and prior taxation years. The respondent submits that its records filed in this proceeding show that it is comprised of debt from the 1985, 1984, 1983, 1982, and prior taxation years.

[16] CRA says that it has filed the best evidence available to prove the debt. It says that because the applicant waited more than 30 years to raise the allegation that he made payments that were not credited to his account, CRA is unable to provide statements of account from the 1970s showing the payments made and credited because all documents from that period have been destroyed.

[17] The respondent also submits that this application is time-barred under the *Crown Liability and Proceedings Act*, RSC 1985, c C-50, s. 32 of which establishes a 6-year limitation period for launching proceedings against the Crown. CRA submits that the applicant knew or ought to have known of the debt he now disputes since at least 1986.

[18] The applicant says that the limitation period for his application is 10 years as provided for in s. 222(4) of the *Income Tax Act*, RSC 1985, c 1 (5th Supp). He says that he was unaware of the debt at issue until, in response to his inquiry, he received correspondence from CRA dated January 5, 2006, enclosing a

Statement of Account that showed a balance forward as at January 19, 1986 of $57,575.06.

[19] In addition to the limitation period, CRA further submits that this application is time-barred based on the doctrines of undue delay, laches and acquiescence.

Issues

[20] The parties addressed three questions:

What is the applicable limitation period prescribed for the applicant's application, and when did the limitation period commence?

If the application is not proscribed by a limitation period, is the applicant barred from obtaining the relief requested on the basis of the doctrines of undue delay,

Digitized by Google

laches, and acquiescence?

Is there a debt owed by the applicant to the respondent for any of the following taxation years: (i) 1971 to 1973; (ii) 1974 to 1979; or (iii) 1980 to 1984?

Analysis

1. The Limitation Period

[21] The Supreme Court of Canada in *Markevich v Canada*, 2003 SCC 9, disagreed with the view of CRA that no limitation period applied with respect to its collection of tax debts as none was provided in the *Income Tax Act*. The Supreme Court held that s. 32 of the *Crown Liability and Proceedings Act* applied to impose a six-year limitation period on the Crown's right to collect federal tax debts of a taxpayer.

[22] Section 32 of the *Crown Liability and Proceedings Act* provides as follows:

32. Except as otherwise provided in this Act or in any other Act of Parliament, the laws relating to prescription and the limitation of actions in force in a province between subject and subject apply to any proceedings by or against the Crown in respect of any cause of action arising in that province, and proceedings by or against the Crown in respect of a cause of action arising otherwise than in a province shall be taken within six years after the cause of action arose.

[23] In response to the decision in *Markevich* the government amended the *Income Tax Act*: SC 2004, c 22, s 50. Section 222 of the Act was amended to read, in relevant part, as follows:

222. (1) The following definitions apply in this section. "action"

« action »

"action" means an action to collect a tax debt of a taxpayer and includes a proceeding in a court and anything done by the Minister under subsection 129(2), 131(3), 132(2) or 164(2), section 203 or any provision of this Part.

"tax debt"

« dette fiscale »

"tax debt" means any amount payable by a taxpayer under this Act.

A tax debt is a debt due to Her Majesty and is recoverable as such in the Federal Court or any other court of competent jurisdiction or in any other manner provided by this Act.

The Minister may not commence an action to collect a tax debt after the end of the limitation period for the collection of the tax debt.

The limitation period for the collection of a tax debt of a taxpayer

begins

if a notice of assessment, or a notice referred to in subsection 226(1), in respect of the tax debt is sent to or served on the taxpayer, after March 3, 2004, on the day that is 90 days after the day on which the last one of those notices is sent or served, and

if subparagraph (i) does not apply and the tax debt was payable on March 4, 2004, or would have been payable on that date but for a limitation period that otherwise applied to the collection of the tax debt, on March 4, 2004; and

ends, subject to subsection (8), on the day that is 10 years after the day on which it begins.

The limitation period described in subsection (4) for the collection of a tax debt of a taxpayer restarts (and ends, subject to subsection (8), on the day that is 10 years after the day on which it restarts) on any day, before it would otherwise end, on which

the taxpayer acknowledges the tax debt in accordance with subsection (6);

the Minister commences an action to collect the tax debt; or

the Minister, under subsection 159(3) or 160(2) or paragraph 227(10)(a), assesses any person in respect of the tax debt.

[24] The respondent submits that there is no provision in the *Income Tax Act* setting out a limitation period for taxpayers who claim that they made payments that were not credited

Digitized by Google

to their account. Therefore, it says, s. 32 of the *Crown Liability and Proceedings Act* applies and the applicant had six years from the date on which he became aware, or ought to have become aware, that the payments he now claims were made were not credited to his tax account to commence this application.

[25] The applicant submits that s. 222 of the *Income Tax Act* applies. He says that the respondent's submission that s. 222 permits the Minister to wait ten years to collect taxes but does not permit the taxpayer to defend the Minister's actions is "innovative" but "not tenable." He relies, in part, on the following statement made by the Minister at the time s. 222 was amended:

The Government agrees that a limitation period for the collection of taxes is needed. We believe a 10-year limitation period is appropriate and recognizes the special reporting and assessment system in federal tax acts. It provides a reasonable amount of time for the Canada Revenue Agency and taxpayers to deal with tax debts.

[emphasis added] (Minister of Finance Ralph Goodale, Media Release, "March 4, 2004 Press Release: Minister of Finance Proposes Amendments to Change the Limitation Period for the Collection of Federal Tax Debts" (4 March 2004).)

[26] The approach to the correct interpretation of s. 222 of the *Income Tax Act* is set out by the Supreme Court in *Trustco Mortgage v Canada*, [2005] 2 SCR 601, at para. 10:

It has been long established as a matter of statutory interpretation that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": see *65302 British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804, at para. 50. The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole. [emphasis added]

[27] In my view, the words of s. 222 of the *Income Tax Act* are precise and unequivocal – the section applies to the "collection" by the Minister of a tax debt and only to that type of action. Subsection 222(3) provides: "The Minister may not commence an action to collect a tax debt after the end of the limitation period." It is beyond question that the section is directed to actions commenced by the Minister, and, in my view, it is equally beyond question that it applies only to such actions for there is no reference to any others.

Had Parliament intended the limitation period to apply equally to an application by a taxpayer claiming that the debt was paid, it could have easily said so – but it did not. The matter before this Court is an application commenced by the taxpayer, not a proceeding by the Minister to collect a tax debt, and I find that s. 222 of the *Income Tax Act* has no bearing on this application.

[28] The applicant submits that it is contrary to justice that the Minister may sue to recover a tax debt at any time within the 10 year limitation period but the taxpayer cannot raise a defence that he or she has paid the debt if that payment was made more than six years prior to the Minister's action being commenced. There is nothing in either the *Income Tax Act* or the *Crown Liability and Proceedings Act* which prevents a taxpayer from asserting as a defence to a claim that a debt is owed that the debt was paid, even in circumstances where the taxpayer is otherwise prevented by a limitation period from commencing an application seeking a declaration to that effect in anticipation of collection

Digitized by Google

litigation. It is always a defence to debt collection to assert that there is no debt owed; the burden is on the debt collector to establish on the balance of probabilities that there is an unpaid debt.

[29] Having found that s. 222 of the *Income Tax Act* does not apply to this application, it follows that the limitation period set out in s. 32 of the *Crown Liability and Proceedings Act* may apply. The question to be answered is thus when, on the facts before us, this limitation period began running.

[30] A cause of action is "[a] group of operative facts giving rise to one or more bases for suing; a factual situation that entitles one person to obtain a remedy in court from another person," or, more simply, "a set of facts that provides the basis for an action in court" (*Black's Law Dictionary*, 9th ed.; *Markevich*, above, at para. 27). I agree with the respondent that the facts giving rise to the applicant's cause of action consist of the assertion by the respondent of a tax debt owed by the applicant for the years 1985 and prior and the respondent's collection actions against the applicant to recover the tax debt.

[31] The limitation period provided in the *Crown Liability and Proceedings Act* begins to run when an applicant knew or ought to have known that a cause of action existed: *Central Trust v Rafuse*, [1986] 2 SCR 147, at para. 77; *Canada (Attorney General) v Lameman*, 2008 SCC 14, at para. 16. This principle, discoverability, applies to statutory limitation periods unless it is displaced by clear legislative language: *Ermineskin Indian Band and Nation v Canada*, 2006 FCA 415, at para. 333, aff'd 2009 SCC 9. Mr. Doig says that he only realized that he had an alleged tax debt when CRA retained a refund in 2005 and he investigated and was then informed by letter dated January 5, 2006, that there was a balance forward, as at January 19, 1986, of $57,575.06. He further asserts in his affidavit of January 15, 2009: "From on or about 1992 until on or about 2004, I do not recall receiving any statements relating to this alleged debt."

[32] The applicant's credibility is brought into question when one contrasts his statement with the following:

in July 1986 the applicant was sent a Notice of Assessment that showed taxes owed for the 1985 taxation year of $1,717.13 and a total outstanding balance of $58,798.87;

in each year from 1985 through 1996, the applicant received a Notice of Assessment that reflected a balance forward that far exceeded the tax incurred in the taxation year under assessment;

the applicant was quoted his outstanding balance forward in an amount that included the balance for the prior period 23 times from September 17, 1987 to November 17, 1988;

the applicant was sent 13 statements from February 23, 1989 to September 8, 1992, showing the balance owing for the prior period;

the applicant received 21 "legal warnings" from CRA from June 22, 1989 to November 26, 1993 about the outstanding balance owed; and

in the period between June 22, 1989 and January 29, 1997, the applicant made 10 promises to pay the balance owing or to make arrangements to pay it.

[33] The applicant no longer disputes that he received annual notices of assessment from CRA. The evidence in the record establishes that the applicant was aware of the claim that there was a tax debt related to the prior period at least as early as July 1986 when his 1985 Notice of Assessment reflected that debt. Accordingly, the six-year limitation period expired in July 1992, at the latest. Throughout that entire period of time notices were sent to the applicant and conversations were had with him concerning his outstanding tax debt. Indeed, the record shows that on January 29, 1997, after the expiration of the limitation period, the applicant met with a collection officer and stated that he thought he would be able to obtain approximately $68,000 from various sources to settle his account with CRA.

Digitized by Google

[34] The evidence before the Court simply does not support the applicant's assertion that he was unaware of this tax debt during the relevant period of time. Each notice of assessment sent to him reflected the tax debt he now challenges. The first, the 1985 taxation year assessment notice, showed that there was a tax debt due with respect to the applicant's income for that taxation year of $1,717.13 and a total balance outstanding of $58,798.87. Each of the following assessment notices through to 1996 showed the outstanding debt, albeit increased due to interest charges. Further, the respondent has filed evidence of repeated attempts by CRA to recover the tax debt: see Affidavit of Brian Just, paras. 23, 27, 28, and 31 and related Exhibits at Tab 1 of Respondent's Record. Therefore, I find that throughout the 1990s the applicant had knowledge of the facts that form the basis of his application.

[35] Accordingly, the application falls under the limitation period prescribed by s. 32 of the *Crown Liability and Proceedings Act* and it is statute-barred.

Undue Delay, Laches and Acquiescence

[36] The same facts supporting the operation of the statutory limitation period underlie the respondent's argument that the applicant is precluded from proceeding with this application on the basis of the equitable doctrines of laches and acquiescence. In light of my holding above, it is not necessary to deal with this defence to the application, however, in the event that a higher court should disagree with my finding regarding the limitation period, the submissions made by the parties shall be briefly addressed.

[37] The respondent relies on the equitable defence of laches, as adopted by the Supreme Court of Canada in *M. (K.) v M. (H.)*, [1992] 3 SCR 6. At para. 98, quoting R.P. Meagher *et al*, *Equity Doctrines and Remedies*, 2d ed (Sydney: Butterworths, 1984), the Supreme Court explained the conditions for the application of this defence:

[the plaintiff has either] (a) acquiesced in the defendant's conduct or (b) caused the defendant to alter his position in reasonable reliance on the plaintiff's acceptance of the status quo, or otherwise permitted a situation to arise which it would be unjust to disturb ...

[38] CRA relies on the applicant's knowledge of the tax debt, its attempts to collect the debt, and the prejudice caused to it by the delay in bringing this application – namely the destruction of records. For the same reasons the application is statute-barred, had the statutory limitation period not applied, I would find that the doctrine of laches would prevent the application from succeeding. Particularly important is the fact that the applicant has delayed for so long in bringing this application, knowing full well of the tax debt claimed by CRA. It is as a direct consequence of that delay that documents were destroyed and the respondent's ability to prove its position has been compromised. It would be unjust and unfair to permit this application to proceed in such circumstances even if it were not statute-barred.

[39] I would add that although the applicant suggested during an earlier pre-hearing motion that the document destruction policies of CRA might provide evidence proving his position that the past debts were paid, no submissions were made in this regard at the hearing.

Is there a debt owed by the applicant to the respondent for any of the following taxation years: (i) 1971 to 1973; (ii) 1974 to 1979; or (iii) 1980 to 1984?

[40] It must first be noted that the Federal Court does not have jurisdiction to entertain an application questioning the validity of tax assessments; that is a matter within the exclusive jurisdiction of the Tax Court: *Optical Recording v Canada* (1990), 116 NR 200 (FCA); *Roitman v Canada*, 2006 FCA 266; *Walker v Canada*, 2005 FCA 393.

[41] Mr. Doig states that he is not questioning the validity of the assessments made nor

Digitized by Google

is he suggesting that he never received those notices of assessment. Rather, he says that he paid the debts owing but was not credited with payment. The burden of proof falls squarely on him to satisfy the Court on the balance of probabilities that he paid the debts.

1971 to 1973

[42] The parties agree that the debt owed with respect to these three taxation years was paid by Mr. Doig, as evidenced by the Certificate filed in the Federal Court – Trial Division on May 21, 1976.

[43] Mr. Doig asserts that this past debt was improperly carried forward and that he was not credited with having paid it. However, there is no evidence at all to support this assertion. There is no evidence that the 1971 to 1973 debt was carried forward and now forms part of the debt that CRA claims is owed, nor is there any evidence that CRA failed to credit Mr. Doig's account with his payment. Mr. Doig has failed to meet his burden of proof and the Court finds that no part of the debt now claimed arises from the tax once owed for the period 1971 to 1973.

[44] I agree with the submission of the respondent that "a payment made in 1975, in relation to a 1971 [to] 1973 tax debt is not sufficient evidence to contradict a statement of account which shows in January 1984, taxes were owed for years prior to 1982." The applicant's assertion that part of the debt now claimed relates to this period in the early 1970s amounts to no more than supposition and speculation. His own evidence is to that effect: "It is my belief that when the Sudbury collections office became aware of the 1975 Certificate that it mistakenly concluded that I had never paid the tax debt" [emphasis added]. The applicant fails to provide any grounds for that belief and, given that there are eight taxation years after 1973 and prior to 1982 to which the debt recorded at January 1984 could relate, much more than the applicant's belief would be required to find that the payment he made had not been credited to his tax account.

1974 to 1979

[45] The applicant attests that he made two payments to CRA in this period from funds his wife raised by placing mortgages on her cottage property. He has filed as exhibits copies of these two mortgages. He says that there were no collection efforts taken by CRA from 1979 to January 1984 and he was not advised of any outstanding tax debt. He states that he believed that he had no outstanding debt. As noted previously, the respondent has no record of the applicant having made either payment.

[46] There is no objective evidence filed by the applicant to support his assertion that the money from these mortgages was paid over to him by his wife and that he then paid the money to CRA. The applicant did not file, as one would have expected, an affidavit from his now former wife supporting his statement that she borrowed this money in order that he could satisfy the tax debt nor were any cancelled cheques provided from either the applicant or his former wife showing a payment to CRA. There was no explanation offered for why such evidence was not provided.

[47] The applicant's evidence is not consistent with the documentary record and brings into question his credibility concerning these alleged payments. In his affidavit sworn September 1, 2010, he attests: "The 1975 Certificate was lifted to allow me to make the payments from the mortgage proceeds." The 1975 Certificate related to the arrears for taxation years 1971 to 1973. A copy of the 1975 Certificate filed with the Court on May 21, 1976, shows that it was paid, and paid almost two years before the payments the applicant alleges he made from the mortgage proceeds.

[48] The record reveals that this cottage property had been owned by Mr. Doig until March 13, 1978, when he transferred title to it to Helen Teahen for $2.00 and other consideration. She took out the first mortgage on the property only five days later. The transfer of the property could not have occurred if the writ of *fieri facias* filed with the local

Digitized by Google

Sherriff's office had been active.

[49] I accept that the property was mortgaged twice and for the amounts that the applicant states. However, in light of questions relating to the applicant's credibility, his assertion that he made the payments to CRA requires some objective evidence to support it. There is none. The applicant has failed to establish, on the balance of probabilities, that he made payments of some $22,000.00 in the period 1974 to 1979 that CRA failed to credit to his tax account.

1980 to 1984

[50] Mr. Doig says that he heard nothing from CRA from 1979 to 1984 and therefore he was unaware that CRA was of the view that he owed any tax arrears. At the hearing, his counsel confirmed his position that he had paid all amounts owing as of January 1, 1984.

[51] However, the record before the Court relating to the tax situation in the early 1980s brings into serious question the applicant's statement that he was of the view that his account with CRA was current.

[52] Between January 1, 1984 and July 5, 1984, the applicant made payments to the CRA totalling
$3,527.00 and the CRA seized a total of $25.88 from him. This was despite allegedly knowing that his account with the CRA was clear as of January 1, 1984.

[53] In July 1984, the applicant was assessed taxes for the 1983 taxation year of $5,677.76. Thereafter he made payments of $11,066.45 and had $1,430.41 seized from him. Accordingly, in 1984 he paid to the CRA and had seized a total amount ($12,496.86) greater than the amount he owed specifically in relation to the 1983 taxation year ($5,677.76). If Mr. Doig had not had a debt relating to years earlier than 1983, CRA would have been indebted to him for an overpayment of $6,819.10, in addition to the $3,552.88 the CRA would have owed him for the earlier excess payments and seizure. Despite having allegedly paid off all amounts owing to the CRA as of January 1, 1984, the applicant continued to make regular payments to the CRA without ever demanding a refund of the $10,371.98 that would have been owed to him by the CRA.

[54] If one accepts the applicant's claim that he did not know that there was a debt claimed for the prior period, then one must find it reasonable that the applicant, without objection, made tax payments and permitted CRA to garnish sums from him when CRA was indebted to him and not vice versa. One would also have to find it reasonable that the applicant did not question why he did not receive a refund from CRA. I find neither to be a reasonable or expected response, particularly the latter given that in 2005 he questioned why CRA retained what he described as a "small refund" owed to him.

[55] As the respondent submits, not only did the applicant not dispute the debt from the prior period, he made promises to pay the debt on a number of occasions.

[56] I find that the conduct of the applicant, as described above, coupled with the evidence of the respondent that the notices of assessment sent to him reflected the tax owed from the prior period, puts into serious question the applicant's statement that he was led to believe that there was no tax debt from the prior period.

[57] I find that a taxpayer, in light of these facts, would have to be wilfully blind not to be aware that CRA was claiming that a debt was owed from the prior period.

Conclusion

[58] The applicant's application is statute-barred. If it were not statute-barred, then it would have been dismissed due to the applicant's undue delay and the application of the doctrine of laches. In any event, the applicant has failed to establish on the balance of probabilities that he made the necessary payments on account of tax arrears for the period prior to the 1985 taxation year. His application is dismissed.

[59] The parties are agreed that an appropriate award of costs to the successful party

Digitized by Google

in this matter is
$15,000.00, inclusive of fees, disbursements and taxes.

JUDGMENT
THIS COURT'S JUDGMENT is that this application is dismissed and the respondent is awarded costs fixed at $15,000.00, inclusive of fees, disbursements and taxes.
"Russel W. Zinn"
Judge

Glenn Alexander Ross v. The Queen, 2002 FCT 401, Latent Issue of Requirement to Pay

Docket: T-1881-01
Neutral Citation: 2002 FCT 401

Toronto, Ontario, Wednesday, the 10th day of April, 2002 PRESENT: THE HONOURABLE MADAM JUSTICE DAWSON BETWEEN:
GLENN ALEXANDER ROSS
Applicant
- and -
HER MAJESTY THE QUEEN IN RIGHT OF CANADA
Respondent

REASONS FOR ORDER AND ORDER
[1] The issue raised on this application for judicial review is whether on May 16, 2001, by application of certain limitation provisions, the Canada Customs and Revenue Agency ("CCRA") was out of time to issue a Requirement to Pay ("Requirement") in respect of a tax debt owed by Mr. Ross, the applicant in this proceeding.

THE FACTS
[2] At all relevant times Mr. Ross has been resident in British Columbia.
[3] On or about May 25, 1993, Revenue Canada, the predecessor to the CCRA, issued notices of reassessment to Mr. Ross in respect of the 1989 and 1990 taxation years. Mr. Ross filed notices of objection in respect of those assessments, but on January 3, 1995 the assessments were confirmed. While he was entitled to appeal those decisions to the Tax Court, Mr. Ross filed no appeal.
[4] By application of subsection 225.1(1) of the *Income Tax Act*, R.S.C. 1985 (5th Supp.) c.1 ("Act") Revenue Canada was therefore at liberty to commence collection activities with respect to Mr. Ross' indebtedness in respect of the 1989 and 1990 tax years as of April 3, 1995.
[5] On September 30, 1999, a certificate in respect of this debt was registered in this Court as authorized by section 223 of the Act. Also on September 30, 1999, a writ of seizure and sale was issued by the Court. On October 7, 1999, the debt was registered in the British Columbia Personal Property Registry.
[6] On May 16, 2001, CCRA issued a Requirement to Mr. Ross' wife in an effort to collect the monies owed to it by Mr. Ross. The Requirement alleged that Mr. Ross was indebted to the CCRA in the amount of
$139,530.48.
[7] Mr. Ross denied, and continues to deny, liability in that amount on the ground that the

Digitized by Google

debt has been statutorily extinguished by operation of subsection 9(1) of the *Limitation Act*, R.S.B.C. 1996, c.266 ("Limitation Act"). Parenthetically, it should be noted that at the hearing it was common ground between Mr. Ross and the Crown that Mr. Ross properly owes the sum of $250.00 to the CCRA in respect of a Heating Rebate issued in January, 2001. The balance of the claimed indebtedness is agreed to arise in respect of the 1989 and 1990 taxation years. In these reasons, the word "debt" will be used to mean the monies owing in respect of the 1989 and 1990 years, exclusive of the sum of $250.00 and any interest attributable thereto.

[8] This application for judicial review is brought "in respect of a decision of the Minister of National Revenue ["Minister"] which was communicated on May 16, 2001 in a Requirement to Pay [...] wherein it is claimed that the applicant is indebted to the respondent in the total amount of $139,530.48". The relief sought is as follows:

an order, pursuant to sections 18 and 18.1 of the *Federal Court Act*:

declaring invalid, quashing or setting aside the said decision of the Minister;

declaring that the applicant is not indebted to the respondent for the applicant's 1990 and prior taxation years;

prohibiting the Minister from taking any steps to collect amounts not due and owing by the applicant to the respondent;

directing the Minister to redetermine the amount due and owing by the applicant to the respondent on the basis that the applicant's debt for income taxes as at May 1, 1995 was nil;

declaring invalid, quashing or setting aside certificate ITA-8972-99 issued by the Minister against the applicant on September 30, 1999;

declaring invalid, quashing or setting aside the WRIT OF SEIZURE AND SALE issued at the request of the Minister on September 30, 1999 by the Registry Officer, Federal Court - Trial Division against the applicant;

declaring invalid or unlawful, quashing or setting aside the REQUIREMENT TO PAY issued by the Minister through the Canada Customs and Revenue Agency, on May 16, 2001 to Heather Petrea Ross-Siemens in respect of the alleged tax debt of the applicant; and

compelling the registrar of the British Columbia personal property registry to discharge the base registration # 8501434 filed on October 7, 1999 by the Minister in respect of certificate ITA-8972-99.

costs.

ANALYSIS

[9] Consideration of whether the debt has been extinguished begins with the decision of the Federal Court of Appeal in *Markevich v. Canada,* 2001 FCA 144 (CanLII), [2001] 3 F.C. 449; 2001 FCA 144, leave to appeal to the Supreme Court of Canada granted [2001] S.C.C.A. No. 371. Mr. Ross relies upon *Markevich*. The Crown, prosecuting its appeal in *Markevich*, acknowledges the decision to be binding upon this Court.

[10] Mr. Markevich was a resident of British Columbia who, as of June, 1986, had a total liability for federal and provincial income tax of $234,136.04. In January, 1998, Mr. Markevich was advised that the Minister intended to take collection action for the full amount of the indebtedness. Mr. Markevich challenged the Minister's right to so proceed and the Federal Court of Appeal held that by virtue of the combined effect of section 32 of the *Crown Liability and Proceedings Act*, R.S.C. 1985, c. C-50 ("CLPA") and subsection 3(5) of the *Limitation Act*, the Minister was statute-barred from collecting the amount owing, whether by court action or statutory collection procedures.

[11] As to the nature of this type of indebtedness and permitted collection methods, the Act provides in section 222 that monies owing in respect of taxes, interest, penalties, costs and the like are debts due to Her Majesty and are recoverable as such in the Federal Court,

Digitized by Google

or any court of competent jurisdiction, or in any other manner provided by the Act.
[12] As to the timing of collection efforts, section 225.1 of the Act prohibits the Minister from effecting collection until the happening of certain events. The limit relevant in this case is found in subsection 225.1(2) which precludes collection activity until 90 days after the notice was mailed to Mr. Ross advising him that the re-assessments were confirmed.
[13] Thereafter, the following provisions of the Act deal with collection proceedings both in Court and through the Minister's statutory authority.
(1) For the purposes of subsection 223(2), an "amount payable" by a person means any or all of
an amount payable under this Act by the person;
an amount payable under the Employment Insurance Act by the person; (b.1) an amount payable under the Unemployment Insurance Act by the person;
an amount payable under the Canada Pension Plan by the person; and
an amount payable by the person under an Act of a province with which the Minister of Finance has entered into an agreement for the collection of taxes payable to the province under that Act.
An amount payable by a person (in this section referred to as a "debtor") that has not been paid or any part of an amount payable by the debtor that has not been paid may be certified by the Minister as an amount payable by the debtor.
On production to the Federal Court, a certificate made under subsection 223(2) in respect of a debtor shall be registered in the Court and when so registered has the same effect, and all proceedings may be taken thereon, as if the certificate were a judgment obtained in the Court against the debtor for a debt in the amount certified plus interest thereon to the day of payment as provided by the statute or statutes referred to in subsection 223(1) under which the amount is payable and, for the purpose of any such proceedings, the certificate shall be deemed to be a judgment of the Court against the debtor for a debt due to Her Majesty, enforceable in the amount certified plus interest thereon to the day of payment as provided by that statute or statutes.
All reasonable costs and charges incurred or paid in respect of the registration in the Court of a certificate made under subsection 223(2) or in respect of any proceedings taken to collect the amount certified are recoverable in like manner as if they had been included in the amount certified in the certificate when it was registered.
Charge on property
A document issued by the Federal Court evidencing a certificate in respect of a debtor registered under subsection 223(3), a writ of that Court issued pursuant to the certificate or any notification of the document or writ (such document, writ or notification in this section referred to as a "memorial") may be filed, registered or otherwise recorded for the purpose of creating a charge, lien or priority on, or a binding interest in, property in a province, or any interest in such property, held by the debtor in the same manner as a document evidencing
a judgment of the superior court of the province against a person for a debt owing by the person, or an amount payable or required to be remitted by a person in the province in respect of a debt owing to Her Majesty in right of the province may be filed, registered or otherwise recorded in accordance with or pursuant to the law of the province to create a charge, lien or priority on, or a binding interest in, the property or interest.
A document issued by the Federal Court evidencing a certificate in respect of a debtor registered under subsection 223(3), a writ of that Court issued pursuant to the certificate or any notification of the document or writ (such document, writ or notification in this section referred to as a "memorial") may be filed, registered or otherwise recorded for the purpose of creating a charge, lien or priority on, or a binding interest in, property in a province, or any interest in such property, held by the debtor in the same manner as a document evidencing

Digitized by Google

a judgment of the superior court of the province against a person for a debt owing by the person, or
an amount payable or required to be remitted by a person in the province in respect of a debt owing to Her Majesty in right of the province
may be filed, registered or otherwise recorded in accordance with or pursuant to the law of the province to create a charge, lien or priority on, or a binding interest in, the property or interest.

(1) Where the Minister has knowledge or suspects that a person is, or will be within one year, liable to make a payment to another person who is liable to make a payment under this Act (in this subsection and subsections 224(1.1) and 224(3) referred to as the "tax debtor"), the Minister may in writing require the person to pay forthwith, where the moneys are immediately payable, and in any other case as and when the moneys become payable, the moneys otherwise payable to the tax debtor in whole or in part to the Receiver General on account of the tax debtor's liability under this Act.

[14] The limitation provisions considered by the Federal Court of Appeal in *Markevich, supra,* and relied upon by Mr. Ross, are section 32 of the CLPA and subsections 3(5) and 9(1) of the *Limitation Act*. They, respectively, provide as follows:
The Crown Liability and Proceedings Act
32. Except as otherwise provided in this Act or in any other Act of Parliament, the laws relating to prescription and the limitation of actions in force in a province between subject and subject apply to any proceedings by or against the Crown in respect of any cause of action arising in that province, and proceedings by or against the Crown in respect of a cause of action arising otherwise than in a province shall be taken within six years after the cause of action arose.
The Limitation Act
3(5) Any other action not specifically provided for in this Act or any other Act may not be brought after the expiration of 6 years after the date on which the right to do so arose.
[...]
9(1) On the expiration of a limitation period set by this Act for a cause of action to recover any debt, damages or other money, or for an accounting in respect of any matter, the right and title of the person formerly having the cause of action and of a person claiming through the person in respect of that matter is, as against the person against whom the cause of action formerly lay and as against the person's successors, extinguished.
[15] In *Markevich*, Justice Rothstein, writing for the Court, considered the scope of the phrase "proceedings [...] in respect of any cause of action" found in section 32 of the CLPA, and considered whether it applies to the Minister's statutory collection procedures under the Act. At paragraph 51 Justice Rothstein wrote:
Statutory collection procedures parallel court proceedings after a judgment is obtained. By enacting the statutory collection procedures under the *Income Tax Act*, Parliament gave the Minister direct access to enforceable collection procedures that would otherwise only be available after a court action and judgement. The issuance of a requirement to pay by the Minister has substantially the same effect as a garnishing order issued by the Court. It binds a third party debtor to pay to the Crown amounts to which the taxpayer is entitled from that third party. A direction to seize and sell chattels is analogous to a writ of execution issued by a court. In fact, subsection 225(5) provides that such goods and chattels that would be exempt from seizure under a writ of execution issued out of a superior court of the province in which the seizure is made are exempt from seizure by the Minister. To construe the term "proceedings" in section 32 as including these procedures, it seems to me,

Digitized by Google

recognizes the substantial similarity between statutory and court collection procedures.
[16] At paragraphs 65 and 66 Justice Rothstein continued:
I conclude therefore that proceedings brought by the Crown in respect of a cause of action in section 32 of the *Crown Liability and Proceedings Act* include both court and statutory collection procedures under the *Income Tax Act*. The applicable limitation provision is subsection 3(5) of the British Columbia *Limitation Act.* Under subsection 3(5), an action may not be brought after the expiration of six years after the date on which the right to do so arose. Action is defined as including a self help remedy. Its scope is obviously intended to be broad and not limited to a court action.
The statutory collection procedures under the *Income Tax Act* are available to the Minister in his own right, exercisable by himself alone, without the necessity of court action. I have no difficulty concluding that statutory collection procedures under the *Income Tax Act* are self help remedies for purposes of subsection 3(5) of the British Columbia *Limitation Act*. In any event, by subsection 9(1) of the *Limitation Act,* after expiry of the relevant limitation period, the cause of action is extinguished.
[17] The predominant feature before the Court in *Markevich, supra,* was that from 1987 to 1998 Revenue Canada took no steps to collect the debt. Thus, the Federal Court of Appeal had to address the question of whether the Crown might pursue collection of tax debts indefinitely, despite prolonged inaction.
[18] That is not the fact situation now before the Court because within what the Federal Court of Appeal found to be the applicable six-year limitation period the Crown took steps to collect the debt. The Minister filed a certificate in respect of the debt in this Court, obtained a writ of seizure and sale, and registered the debt in the applicable personal property registry.
[19] Mr. Ross argues, however, that those actions do not avail the Minister because the Requirement was issued beyond the applicable six-year limitation period. The parties agree that by application of the principles articulated in *Markevich*, the limitation period commenced running on April 3, 1995 and so had expired on April 4, 2001.
[20] Mr. Ross says that the filing of the certificate did not protect the Minister's position because:
The Minister' s certificate is not a judgment of this or any Court. The making of a certificate is simply an exercise of statutory authority. To protect against the limitation period the Minister should have commenced proceedings in the Court in respect of the tax debt. This is said to be reflected in the fact that Rule 425(a) of the *Federal Court Rules, 1998* ("Rules") provides:
425. An order for the payment of money may be enforced by
(*a*) a writ of seizure and sale in Form 425A. (Underlining added)
Mr. Ross submits that there is no "order" to support the writ because the certificate is not an order. If the certificate is an order, Mr. Ross argues that he should have been served with it on its filing and should have been able to "mount a defense" to it.
The writ of seizure and sale "is fruit of the same poison tree that gave life to the certificate". It would be anomalous if the effect of obtaining and registering the writ would be to allow enforcement proceedings to continue more than six years after the debt became collectible. All enforcement efforts must cease after six years, unless a judgment has been obtained as defined in the *Limitation Act*.
The limitation period provided in the *Limitation Act* with respect to judgments does not apply because the certificate does not fall within the definition of "judgment" in the *Limitation Act*.
[21] In advancing these arguments Mr. Ross relies upon authority such as the *Minister of National Revenue*
Bolduc, [1961] Ex. C.R. 115; *The Queen v. Star Treck Holdings Limited*, [1978] 1 F.C. 61

Digitized by Google

(T.D.); *Her Majesty the Queen v. T.H. Parker* (1981), 2 C.E.R. 181 (F.C.T.D.); and *E.H. Price Limited v. The Queen*, [1983] 2 F.C. 841 (F.C.A.), all to the effect that a certificate is not a judgment of this Court.

[22] Although expressed in different fashions, the linch-pin of Mr. Ross' position is that the effect of filing the Minister's certificate is so different qualitatively from that of obtaining a judgment that filing a certificate is ineffective to preserve the Minister's rights.

[23] With respect to this position, it is correct that in the context of issues such as how a certificate may be attacked or amended, the Court has stated in the authorities cited by Mr. Ross that a certificate is not, and does not become, a judgment of the Court. But the Court has also in those same cases held that the effect of the making and the registration of a certificate is precisely as is stated in the Act. In the words of Justice Thurlow, as he then was, in *Bolduc, supra* at page 118, registration of a certificate "has the same force and effect and the same proceedings may be taken upon it as if it were a judgment".

[24] This means that upon registration of the certificate within six years of the commencement of the limitation period, the certificate was capable of supporting the issuance of writs of execution pursuant to Rule 434(1).

[25] While it is true that there is no "order" in the sense of a judgment rendered in a contested proceeding in this Court between Mr. Ross and the Crown, the wording of subsection 223(3) of the Act makes such order unnecessary because through this provision Parliament has made clear its intent that the certificate "has the same effect" of "a judgment obtained in the Court" and all proceedings may be taken on the basis of the certificate as if it were a judgment of the Court.

[26] The answer to Mr. Ross' concern that he should have been notified of the filing of the certificate and given an opportunity to defend his position or appeal the certificate is found in subsection 165(1) of the Act, which requires that a taxpayer challenge the Minister's assessment within 90 days, and in subsection 169(1) of the Act, which requires that an appeal to the Tax Court be brought within 90 days of confirmation by the Minister of an assessment or re-assessment. See: *Olympia Interiors Ltd. v. Canada*, 2001 F.C.A. 360 at paragraph 5, and 2001 F.C.A. 361 at paragraph 6. Here, no appeal was taken to the Tax Court from the confirmation of the notices of assessment. That was the proper forum for attacking the propriety of the debt. [27] The above analysis deals with the Minister's right to take proceedings on the certificate pursuant to section 223 of the Act. Given the determination of the Federal Court of Appeal in *Markevich, supra,* that the limitation period also applies to the statutory collection proceedings, I have considered whether the Minister may pursue those remedies more than six years after the debt accrued where a certificate has been filed within the six-year period.

[28] At first blush there may seem little to connect filing a certificate in the Court with preservation of the Minister's right to exercise her statutory collection procedures.

[29] Counsel for the Minister submits that the answer is found in the wording of subsection 224(1) of the Act which allows the Minister to issue a requirement to pay where it is known or suspected that within one year a third party will be liable to make a payment to a person "who is liable to make a payment under" the Act. Because the effect of the filing of the certificate makes a person liable to execution, it is submitted that such person continues to be "liable to make a payment under this Act".

[30] I have been persuaded that this submission is correct for the following reasons.

[31] First, the effect of *Markevich* is that the limitation period provided in section 32 of the CLPA is applicable to both statutory collection procedures and court collection procedures, and that after the expiry of the relevant limitation period the cause of action is extinguished. This requires the Minister to take remedial steps to collect a tax debt within the limitation period. *Markevich* does not require the Minister to obtain a judgment of

Digitized by Google

the Court to preserve her rights, nor does *Markevich* require the Minister to exhaust all collection efforts within the limitation period. *Markevich* recognizes the similarity between statutory and court collection procedures, and applies limitation laws irrespective of the remedial steps taken to collect a tax debt.

[32] Limitation provisions have the effect of requiring a cause of action to be merged in a judgment which is obtained in a proceeding commenced within the limitation period. Given that the filing of a certificate is the mechanism which the Act provides for the Minister to obtain the "same effect" as a judgment, it seems to me that the filing of a certificate must protect the Minister's right to collect a tax debt whether by statutory or court collection procedures.

[33] Subsection 224(1) of the Act allows the issuance of a requirement to pay where the tax debtor is "liable to make a payment under this Act". The tax debtor is not so liable where the Minister is statute-barred from enforcing collection. Where, however, the Minister has preserved the debt by filing a certificate, which has the same effect as a judgment, the debt is not extinguished, the debtor remains liable to pay monies owing under the Act (tax, penalties, interest and the like) and a requirement to pay may be issued.

[34] Moreover, section 3 of the *Limitation Act* would permit an action to be brought on the certificate, which would be deemed to be a judgment of this Court, within six years. That six-year period has not expired so that the debt so certified has not been extinguished.

[35] Second, this interpretation avoids the incongruity that the Minister could enforce the tax debt through a writ of execution, but not through the statutory collection remedies.

[36] Third, this interpretation is consistent with the rationales for limitation legislation because the filing of the certificate brings about certainty and diligence and avoids the need to rely on stale evidence.

[37] It follows, and I have concluded, that the debt has not been extinguished and that the Requirement was properly issued. The application for judicial review will therefore be dismissed.

[38] The Crown seeks the costs of this application. I can see no reason why the costs should not follow the result of the application, as more particularly set out in the following order.

[39] For these reasons:

ORDER

The application for judicial review is dismissed.

The applicant shall pay to the respondent the costs of this application, to be assessed in accordance with Column III of the table to Tariff B of the *Federal Court Rules, 1998.*

"Eleanor R. Dawson"

J.F.C.C.

Norman John Raymond MacKinnon v. The Queen, 2003 FCA 158, Limitation Period Starts When Tax is Due, Not Income that Produces it, while Tax Debt Certification Does Renew the Limitation Period

REASONS FOR JUDGMENT

NOËL

J.A.

Digitized by Google

[1] This is an appeal from a decision of a learned Motions Judge in which he found that the majority of the tax debt pertaining to the Appellant's 1979 through 1982 and 1997 taxation years, had not been extinguished by operation of the *Limitation Act* R.S.B.C. 1996, c.266. The Respondent cross-appeals that part of the decision holding that the remaining portion of the Appellant's tax debt was statute barred.

[2] Having regard to the recent decision of the Supreme Court in *Markevich v. Canada*, 2003 S.C.C. 9, the Respondent abandoned her cross-appeal at the beginning of the hearing. The Appellant on the other hand chose to proceed with his appeal, but it is clear that the aforementioned decision of the Supreme Court is equally dispositive of his appeal.

[3] In particular, it can no longer be argued that the applicable limitation period for the collection of taxes and related interests and penalties begins to run when income is earned. As was found by the Motions Judge and confirmed by the Supreme Court in *Markevich* (paragraphs 27 and 28), that period begins to run as of the time when a tax debt comes into existence and the delay prescribed by section 225.1 of the *Income Tax Act* (ITA) expires (i.e. 90 days after the mailing of the notice of assessment).

[4] The argument that the registration of a certificate with the Federal Court in accordance with subsection 223(3) of the ITA does not operate to renew the limitation period is equally no longer open to the Appellant. In *Markevich* the Supreme Court after referring to *Ross v. Canada*, 2002 D.T.C. 6885 (T.D.) (affirmed 2002 D.T.C. 7462) expressly refers to the registration of this certificate as a means of renewing the limitation period (*Markevich*, paragraph 18).

[5] It is therefore clear, in light of *Markevich* that the Appellant's appeal must suffer the same fate as the cross-appeal. However, it became apparent during the course of the hearing that there are issues arising from the reasons of the Motions Judge which could usefully be clarified.

[6] The Motions Judge noted in his reasons that the indebtedness in issue before him arose from assessments and reassessments which he summarized in the following table (reasons, paragraph 2).

Taxation year	Assessment/reassessment	Date
1979	Assessment	July 14, 1980
	Reassessment	April 16, 1984
1980	Assessment	August 4, 1981
	Reassessment	April 16, 1984
1981	Assessment	August 10, 1982
	Reassessment	April 16, 1984
1982	Assessment	September 16, 1983
1983	Assessment	June 25, 1984
1984	Assessment	July 22, 1985
	Reassessment	January 15, 1988
1997	Assessment	June 4, 1998

[7] The conclusion which he reached is stated at paragraph 13 of his reasons in the form of a declaration:

...because they are statute barred, the Minister shall not enforce collection of any amounts for Taxes, Canada Pension Plan, interest or penalties pertaining solely to the Minister's July 14, 1980, and August 4,

Digitized by Google

1981, assessments of the applicant's 1979 and 1980 taxation years. In all other respects, the application for judicial review should be dismissed.

[8] It follows from this declaration that to the extent that the Minister's certificate dated January 20, 1988 (Appeal Book p. 73) reflects amounts relating to the 1979 and 1980 taxation years, they are statute barred unless they are additional income taxes or Canada Pension Plan contributions and related interest and penalties arising from the April 16, 1984 reassessments issued in respect to the Appellant's 1979 and 1980 taxation years.

[9] As well, it is useful to state that the certificate only operates to renew the limitation period with respect to the amounts reflected therein that were not statute barred as of the date of the registration of the certificate. Amounts which were statute barred as of that date, if any, are excluded. [10] It became apparent during the course of the hearing that the Appellant had yet to receive a revised statement of account giving effect to the decision of the Motions Judge. Needless to say, the Appellant is entitled to a detailed statement of account demonstrating that the Motion Judge's decision, insofar as it is favourable to him, has been complied with.

[11] The appeal and the cross-appeal will both be dismissed. There will be no order as to costs. (Sgd.) "Marc Noël"

J.A.

"I agree.

Robert Décary J.A." "I agree.

Karen R. Sharlow J.A."

Digitized by Google

[26]

The Certification of Tax Debt and Realization

Definition of "amount payable" - S. 223(1)
223. (1) For the purposes of subsection 223(2), an "amount payable" by a person means any or all of

> **(*a*) an amount payable under this Act by the person;**
> **(*b*) an amount payable under the *Employment Insurance Act* by the person;**
> **(*b.1*) an amount payable under the *Unemployment Insurance Act* by the person;**
> **(*c*) an amount payable under the *Canada Pension Plan* by the person; and**

(*d*) an amount payable by the person under an Act of a province with which the Minister of Finance has entered into an agreement for the collection of taxes payable to the province under that Act. .[27]

---

[26] "Flower Garden", 2011, Patricia Vertes, Howick, Quebec

[27] The certification need not carry an original signature of the appropriately delegated CRA authority to be valid. It can be simply rubber-stamped by the appropriate delegate. See In The Matter Of An Assessment Or Assessments By The Minister Of National Revenue Under The One Or More Of The Income Tax Act (Canada), Canada Pension Plan, Unemployment Insurance Act, Employment Insurance Act And Alberta Income Tax Act, Against: Patricia L. Whitfield, 2001 FCT 777, where it was held:

> [15] The respondent urged that the certification process followed against her was simply because the Certificate issued under section 223 of the *Income Tax Act* was improperly signed under the relevant delegation of authority from the responsible Minister. Counsel for CCRA placed before the Court the appropriate delegation document. She also referred me to *R.* v. *Ehli*[5] and *The Queen* v. *Galbraith*[6] as authority for the proposition that the delegation here was properly exercised albeit that a rubber-stamp impression of the appropriate signature was relied upon. I adopt these authorities and find no irregularity in the certification process here followed by CCRA.

Digitized by Google

Certificates
(2) An amount payable by a person (in this section referred to as a "debtor") that has not been paid or any part of an amount payable by the debtor that has not been paid may be certified by the Minister as an amount payable by the debtor.

Registration in court
(3) On production to the Federal Court, a certificate made under subsection 223(2) in respect of a debtor shall be registered in the Court and when so registered has the same effect, and all proceedings may be taken thereon, as if the certificate were a judgment obtained in the Court against the debtor for a debt in the amount certified plus interest thereon to the day of payment as provided by the statute or statutes referred to in subsection 223(1) under which the amount is payable and, for the purpose of any such proceedings, the certificate shall be deemed to be a judgment of the Court against the debtor for a debt due to Her Majesty, enforceable in the amount certified plus interest thereon to the day of payment as provided by that statute or statutes.

Costs
(4) All reasonable costs and charges incurred or paid in respect of the registration in the Court of a certificate made under subsection 223(2) or in respect of any proceedings taken to collect the amount certified are recoverable in like manner as if they had been included in the amount certified in the certificate when it was registered.

Charge on property
(5) A document issued by the Federal Court evidencing a certificate in respect of a debtor registered under subsection (3), a writ of that Court issued pursuant to the certificate or any notification of the document or writ (such document, writ or notification in this section referred to as a "memorial") may be filed, registered or otherwise recorded for the purpose of creating a charge, lien or priority on, or a binding interest in, property in a province, or any interest in, or for civil law any right in, such property, held by the debtor in the same manner as a document evidencing

> **(*a*) a judgment of the superior court of the province against a person for a debt owing by the person, or**
>
> **(*b*) an amount payable or required to be remitted by a person in the province in respect of a debt owing to Her Majesty in right of the province may be filed, registered or otherwise recorded in accordance with or pursuant to the law of the province to create a charge, lien or priority on, or a binding interest in, the property or interest.**

Creation of charge
(6) If a memorial has been filed, registered or otherwise recorded under subsection (5),

> **(*a*) a charge, lien or priority is created on, or a binding interest is created in, property in the province, or any interest in, or for civil law any right in, such property, held by the debtor, or**

Digitized by Google

(*b*) such property, or interest or right in the property, is otherwise bound, in the same manner and to the same extent as if the memorial were a document evidencing a judgment referred to in paragraph (5)(*a*) or an amount referred to in paragraph (5)(*b*), and the charge, lien, priority or binding interest created shall be subordinate to any charge, lien, priority or binding interest in respect of which all steps necessary to make it effective against other creditors were taken before the time the memorial was filed, registered or otherwise recorded.

Proceedings in respect of memorial

(7) If a memorial is filed, registered or otherwise recorded in a province under subsection 223(5), proceedings may be taken in the province in respect of the memorial, including proceedings

(*a*) to enforce payment of the amount evidenced by the memorial, interest on the amount and all costs and charges paid or incurred in respect of

(i) the filing, registration or other recording of the memorial, and

(ii) proceedings taken to collect the amount,

(*b*) to renew or otherwise prolong the effectiveness of the filing, registration or other recording of the memorial,

(*c*) to cancel or withdraw the memorial wholly or in respect of any of the property, or interests or rights, affected by the memorial, or

(*d*) to postpone the effectiveness of the filing, registration or other recording of the memorial in favour of any right, charge, lien or priority that has been or is intended to be filed, registered or otherwise recorded in respect of any property, or interest or right, affected by the memorial, in the same manner and to the same extent as if the memorial were a document evidencing a judgment referred to in paragraph 223(5)(*a*) or an amount referred to in paragraph 223(5)(*b*), except that if in any such proceeding or as a condition precedent to any such proceeding any order, consent or ruling is required under the law of the province to be made or given by the superior court of the province or a judge or official of the court, a like order, consent or ruling may be made or given by the Federal Court or a judge or official of the Federal Court and, when so made or given, has the same effect for the purposes of the proceeding as if it were made or given by the superior court of the province or a judge or official of the court.

Presentation of documents

(8) If

(*a*) a memorial is presented for filing, registration or other recording under subsection (5) or a document relating to the memorial is presented for filing, registration or other recording for the purpose of any proceeding described in subsection (7) to any official in the land registry system, personal property or movable property registry system, or other registry system, of a province, it shall be accepted for filing, registration or other recording, or

(*b*) access is sought to any person, place or thing in a province to make the filing, registration or other recording, the access shall be granted in the same manner and to the same extent as if the memorial

Digitized by Google

or document relating to the memorial were a document evidencing a judgment referred to in paragraph 223(5)(*a*) or an amount referred to in paragraph 223(5)(*b*) for the purpose of a like proceeding, as the case may be, except that, if the memorial or document is issued by the Federal Court or signed or certified by a judge or official of the Court, any affidavit, declaration or other evidence required under the law of the province to be provided with or to accompany the memorial or document in the proceedings is deemed to have been provided with or to have accompanied the memorial or document as so required.

Sale, etc.
(9) Notwithstanding any law of Canada or of a province, a sheriff or other person shall not, without the written consent of the Minister, sell or otherwise dispose of any property, or publish any notice or otherwise advertise in respect of any sale or other disposition of any property pursuant to any process issued or charge, lien, priority or binding interest created in any proceeding to collect an amount certified in a certificate made under subsection 223(2), interest on the amount and costs, but if that consent is subsequently given, any property that would have been affected by such a process, charge, lien, priority or binding interest if the Minister's consent had been given at the time the process was issued or the charge, lien, priority or binding interest was created, as the case may be, shall be bound, seized, attached, charged or otherwise affected as it would be if that consent had been given at the time the process was issued or the charge, lien, priority or binding interest was created, as the case may be.

Completion of notices, etc.
(10) If information required to be set out by any sheriff or other person in a minute, notice or document required to be completed for any purpose cannot, by reason of subsection 223(9), be so set out, the sheriff or other person shall complete the minute, notice or document to the extent possible without that information and, when the consent of the Minister is given under that subsection, a further minute, notice or document setting out all the information shall be completed for the same purpose, and the sheriff or other person having complied with this subsection is deemed to have complied with the Act, regulation or rule requiring the information to be set out in the minute, notice or document.

Application for an order
(11) A sheriff or other person who is unable, by reason of subsection 223(9) or 223(10), to comply with any law or rule of court is bound by any order made by a judge of the Federal Court, on an *ex parte* application by the Minister, for the purpose of giving effect to the proceeding, charge, lien, priority or binding interest.

Deemed security
(11.1) When a charge, lien, priority or binding interest created under subsection 223(6) by filing, registering or otherwise recording a memorial under subsection 223(5) is registered in accordance with subsection 87(1) of the *Bankruptcy and Insolvency Act*, it is deemed

Digitized by Google

(*a*) to be a claim that is secured by a security and that, subject to subsection 87(2) of that Act, ranks as a secured claim under that Act; and
(*b*) to also be a claim referred to in paragraph 86(2)(*a*) of that Act.

Details in certificates and memorials
(12) Notwithstanding any law of Canada or of a province, in any certificate made under subsection 223(2) in respect of a debtor, in any memorial evidencing the certificate or in any writ or document issued for the purpose of collecting an amount certified, it is sufficient for all purposes
(*a*) to set out, as the amount payable by the debtor, the total of amounts payable by the debtor without setting out the separate making up that total; and
(*b*) to refer to the rate of interest to be charged on the separate amounts making up the amount payable in general terms as interest at the rate prescribed under this Act applicable from time to time on amounts payable to the Receiver General without indicating the specific rates of interest to be charged on each of the separate amounts or to be charged for any particular period of time.

Application of ss. 223(1) to (8) and (12)
223.1 (1) Subsections 223(1) to 223(8) and 223(12) are applicable with respect to certificates made under section 223 or section 223 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, after 1971 and documents evidencing such certificates that were issued by the Federal Court and that were filed, registered or otherwise recorded after 1977 under the laws of a province, except that, where any such certificate or document was the subject of an action pending in a court on February 10, 1988 or the subject of a court decision given on or before that date, section 223 shall be read, for the purposes of applying it with respect to that certificate or document, as section 223 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, read at the time the certificate was registered or the document was issued, as the case may be.

Application of ss. 223(9) to (11)
(2) Subsections 223(9) to 223(11) are applicable with respect to certificates made under section 223, or section 223 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, after September 13, 1988.

Subsection 223(1) provides the primary basis upon which CRA will take steps, if other primary collection efforts fail, to reinforce their interest in the taxes payable by a taxpayer. The scope of the provision relates only to under the Acts cited. Pursuant to subsection 223(3) the step is accepted by the Registar of the Federal Court and registered as a judgment requiring no hearing of fact. It is at the discretion of the taxpayer to commence proceedings to attempt to have the certificate vacated but upon registration it radiates as a certificate against any property of the taxpayer thus preventing its clandestine liquidation. There is a statutory two step process with the certification, the registration of the certificate and then the registration of the charge on any property of the taxpayer.

Digitized by Google

The Need to Have A Foundation of an Expectedly-Received Notice of Assessment

There have been a few cases in which the taxpayer attempted to argue that since they did not receive a Notice of Assessment of the tax debt the certificates were void. The issue was brought up, in a deduction at source case involving director liability in Dupont Roofing & Sheet Metal Inc. v. MNR[28] where only because of the nature of DAS (that do not require a notice of assessment though in this case the taxpayer was given a trust account audit report) that pursuant to Frederick J. Buccini v. Her Majesty The Queen[29] (which cited Continental Bank of Canada v. R[30]) with:

> **ISSUES:**
> [11] The several issues raised by the parties can be reduced to two:
> 1. Was it necessary for the Minister to issue notices of assessment to the taxpayer for unpaid payroll taxes and if so, has it been established that notice was given?
> 2. If notice of assessment was required and was not given to the taxpayer, should the certificate be declared a nullity?
>
> **ARGUMENTS & ANALYSIS:**
>
> *Standard of Review*
> [12] In the present matter, the Minister's discretion to certify the debt was exercised by a designate relying upon the historics record maintained in the CRA electronic database. To the extent that questions of natural justice, legitimate expectation and procedural fairness arise in this matter, the Court must determine whether fairness requires that the decision be overturned: *eBay Canada Limited et al. v. MNR*, 2008 FCA 348 at para. 36. Otherwise, the issues involve questions of mixed fact and law in which the legal question cannot be extricated from the factual findings and deference should be shown: *Canada (Citizenship and Immigration) v. Khosa* 2009 SCC 12, [2009] 1 S.C.R. 339 at para. 89.
> [13] This matter is, in my view, analogous to a judicial review of a fairness decision by tax officials as the applicant is, in effect, seeking relief from the negative decision he received in response to his objection to the derivative liability assessment. As stated by Justice James O'Reilly in *Sandler v. Canada (Attorney General)*, 2010 FC 459, 2010 D.T.C. 5073 at para. 7, this Court "can overturn the Minister's decision under the fairness provision only if it was unreasonable, in the sense that it falls outside the range of possible acceptable outcomes based on the facts and the law", citing *Telfer v. Canada (Revenue Agency)*, 2009 FCA 23 at para. 25. See also: *Osborne v. The Attorney General of Canada*, 2010 FC 673. The overall standard of review on this application should therefore be reasonableness.
> *Assessment and Notice Requirements*
> **[14] The applicant's case essentially rests on the argument that the formal requirements of notice under the ITA and other tax statutes**

[28] 2011 FC 160
[29] A-611-98
[30] [1998] 2 S.C.R. 358

Digitized by Google

apply to assessments for failure to remit payroll taxes. The applicant does not dispute that a tax liability arose from the corporate activities but argues that the obligation to actually pay the debt does not arise until a notice of assessment is issued and mailed to the taxpayer. The applicant submits that a certificate can only be issued upon default of payment following these actions. Failing proof of issuance of the assessment and proof of mailing of the notice to the taxpayer, the certificate is invalid and must be quashed.

[15] The applicant alleges that notices of the underlying corporate assessments were never issued, or, if issued, were never mailed to Dupont. While it is not necessary to prove receipt, the burden of proving the existence of the notices and the date of mailing falls on the Minister. This, asserts the applicant, is within the Minister's knowledge and the respondent alone controls the means of adducing evidence of the completion of either act.

[16] In this case, the applicant contends, the Minister's evidence contains significant inconsistencies and falls short of establishing that notices of assessment were in fact created and mailed to the applicant. The respondent has been unable to produce the corporate assessments. Moreover, the evidence pertaining to the respondent's mailing practices at the relevant time was not first hand knowledge but was based on "information and belief", contrary to Rule 81 of the *Federal Courts Rules*, SOR/98-106. It was within the power of the respondent to provide direct evidence of CRA's mailing procedures, especially in light of the importance of mailing procedures in this application. As witnesses with that knowledge did not provide evidence, the applicant could not directly cross-examine the source of the information relied on by the respondent.

[17] The applicant further submits that its right to procedural fairness has been breached by the Minister's certification of the amount payable without first issuing Notices of Assessment. The scheme of the tax legislation provides that a taxpayer may object to a liability imposed after the taxpayer has been assessed: subsection 165(1) of the ITA; Sections 27.1, 92, 22 CPP, EI and ITA (Ontario) respectively. The respondent is required to "give a taxpayer adequate notice of the basis of reassessment, so that a taxpayer can fairly appeal or respond": *Frederick J. Buccini v. Her Majesty the Queen*, 2000 DTC 6685 (FCA), at para. 16, referring to *Continental Bank of Canada v. R.* [1998] 2 S.C.R. 358.

[18] The applicant argues it is fair and reasonable for it to have the legitimate expectation that before the Minister "certifies" an "amount payable" pursuant to subsection 223(2) of the ITA, the Minister would have first ascertained the amount payable via the normal assessment process and then would have completed that assessment process by issuing (i.e. mailing) a Notice of Assessment to the applicant. This would allow the applicant the opportunity to respond by objecting. In the result, the certificate should be nullified as the Minister has not satisfied the burden of proving that the assessment had been mailed.

[19] The respondent's position is that the CRA is not required to

Digitized by Google

mail notices for failure to remit payroll taxes before certifying a payroll tax debt. The ITA requires all employers to calculate, withhold and remit payroll taxes from employee wages. There is no requirement for the mailing of notices of assessment prior to these amounts becoming due. Employers regularly become liable to pay amounts to the Crown without being assessed by the Minister. If the Minister assesses an employer for failure to remit payroll taxes that have become payable, those outstanding amounts are payable to the Receiver General, even if they are in dispute. If an employer fails to comply with source deduction requirements, any outstanding "amount payable", plus interest, may be certified by the Minister of National Revenue for the purpose of securing the debt or as a precursor to collection: *In the Matter of an Assessment or Assessments by the Minister of National Revenue Under the Income Tax Act, the Canada Pension Plan and the Unemployment Act Against 92000 Holdings Limited*, 93 DTC 5047 at para. 5. Collections restrictions, which otherwise prevent the Minister from certifying a tax debt until a notice of assessment has been mailed, do not apply to payroll taxes, in the respondent's submission: ITA s. 225.1(6)(b); *Canada (Minister of National Revenue) v. Swiftsure Taxi Co*, 2004 FC 980, [2004] 4 C.T.C. 304 at para. 16; *Jus D'Or Inc. v. CCRA,* 2007 FC 754 at paras. 12-15.

[20] Further, the respondent submits, mailing requirements are procedural fairness requirements material to pursuing rights of appeal. They do not restrict the collection of payroll debts. Should there have been a true error on the part of the Minister in failing to mail the assessment, the respondent contends that Dupont's remedy is to request an extension of time for filing a Notice of Objection prior to appealing to the Tax Court of Canada.

[21] I agree with the applicant that where proof of the issuance and mailing of a notice of assessment is required, the onus falls on the Minister. This is because the facts are "peculiarly within his [the Minister's] knowledge and he alone controls the means of adducing evidence of them": *Aztec Industries Inc. v. Her Majesty the Queen*, 95 DTC 5235, [1995] 1 C.T.C. 327 (FCA) at para. 12. Here, the applicant's counsel has effectively pointed out shortcomings in the Minister's evidence concerning the mailing of the underlying assessments such as the lack of direct evidence from a mailroom employee and inconsistencies in the evidence of the Minister's witnesses as to the procedures followed in 2003. But, if it is necessary to find that notices of assessment were mailed, I am satisfied on the basis of the Minister's evidence that the two notices of failures to remit payroll assessments for the 2001 and 2002 tax years were placed into the CRA mail stream and mailed to Dupont in 2003.

[22] As stated by Justice Marshall Rothstein in *Kovacevic v. Canada,* 2003 FCA 293, 308 N.R. 266 at para. 16:

> **[w]hen legislation requires that documents be sent by a large organization such as a government department by ordinary mail, but does not require registered or certified mail or evidence of a more formal means of sending … [G]enerally it would be sufficient to set out in an affidavit, from the last**

Digitized by Google

individual in authority who dealt with the document before it entered the normal mailing procedures of the office, what those procedures were.

That standard, in my view, was satisfied by Mr. Gentile's evidence.

[23] I note that in *Kovacevic*, the legislation required the use of registered mail and the evidence fell short of proving that was done. However, I do not think it was necessary in this case for the Minister to prove that notices of assessment were mailed to Dupont in order to establish that certification of the tax debt was reasonable. There is no factual dispute in this matter that Dupont, through its controlling directors, was aware of the outstanding tax liability. They had met with Mr. Pizzonia and had received from him the trust report setting out the amounts owing for the unpaid payroll taxes in 2001 and 2002.

[24] Mr. Gomes acknowledged in his evidence that he was aware of the debt and that it was roughly the same amount that Dupont was owed by Applewood. Mr. Gomes also acknowledged not having attended to his tax records between the time Dupont and Applewood separated in 2003 and the fire that occurred in January, 2005, thereby displaying a degree of negligence with respect to his corporate responsibilities, tantamount to wilful blindness. He could not say whether the notices were in his box of records or not as he did not examine the contents of the box. The urgency of the matter was only brought home to him when he received the Director's Derivative Liability Assessment in 2005 which attributes the corporation's tax debt to him in his personal capacity.

[25] The jurisprudence relied upon by the applicant to advance the claim that the Minister is required to provide the taxpayer with a notice of assessment involve cases pertaining to **personal income tax, not payroll taxes**. So, although the Minister may be obliged to provide an individual with a notice assessment, the same is not true for the withholding and remitting of payroll taxes. Section 153 of the ITA explicitly instructs those persons who pay out wages to deduct a certain percentage of the salary for taxes and remit that amount to the Receiver General:

153. (1) Every person paying at any time in a taxation year	153. (1) Toute personne qui verse au cours d'une année d'imposition l'un des montants suivants :
(*a*) salary, wages or other remuneration, other than amounts described in subsection 115(2.3) or 212(5.1),	*a*) un traitement, un salaire ou autre rémunération, à l'exception des sommes visées aux paragraphes 115(2.3) ou 212(5.1);
[…]	[…]
shall deduct or withhold from the payment the amount determined in	doit en déduire ou en retenir la somme fixée selon les modalités réglementaires et

Digitized by Google

accordance with prescribed rules and shall, at the prescribed time, remit that amount to the Receiver General on account of the payee's tax for the year under this Part or Part XI.3, as the case may be, and, where at that prescribed time the person is a prescribed person, the remittance shall be made to the account of the Receiver General at a designated financial institution.	doit, au moment fixé par règlement, remettre cette somme au receveur général au titre de l'impôt du bénéficiaire ou du dépositaire pour l'année en vertu de la présente partie ou de la partie XI.3. Toutefois, lorsque la personne est visée par règlement à ce moment, la somme est versée au compte du receveur général dans une institution financière désignée.

[26] See also s.108 of the *Income Tax Regulations*, C.R.C., c. 945 ("Regulations") which further requires payment of taxes not remitted to the Receiver General within 7 days of ceasing to carry on a business:

108.	108.
[…]	[…]
(2) Where an employer has ceased to carry on business, any amount deducted or withheld under subsection 153(1) of the Act that has not been remitted to the Receiver General shall be paid within 7 days of the day when the employer ceased to carry on business.	(2) Lorsque l'employeur a cessé d'exploiter une entreprise, tout montant déduit ou retenu en vertu du paragraphe 153(1) de la Loi qui n'a pas été remis au Receveur général doit l'être dans les 7 jours de la date à laquelle l'employeur a cessé d'exploiter l'entreprise.

[27] Section 153 of the ITA and s. 108 of the Regulations both apply to the applicant Dupont. In allowing Applewood to transfer only net amounts to Dupont to pay its employees, it failed to adhere to the tax scheme.

[28] Further, the provisions in subsections 225.1(1) and following prohibit the Minister from, among other things, certifying an assessed tax debt or giving notice of such a liability until after the collection-commencement day in respect of the amount. Subsection 225.1(6)(b) makes it clear that these provisions do not apply to amounts <u>required to be deducted or withheld</u>:

225.1 (1) If a taxpayer is liable for the payment of an	225.1 (1) Si un contribuable est redevable du montant

Digitized by Google

amount assessed under this Act, other than an amount assessed under subsection 152(4.2), 169(3) or 220(3.1), the Minister shall not, until after the collection-commencement day in respect of the amount, do any of the following for the purpose of collecting the amount:

(*a*) commence legal proceedings in a court,

(*b*) certify the amount under section 223,

(*c*) require a person to make a payment under subsection 224(1),

(*d*) require an institution or a person to make a payment under subsection 224(1.1),

(*e*) [Repealed, 2006, c. 4, s. 166]

(*f*) require a person to turn over moneys under subsection 224.3(1), or

(*g*) give a notice, issue a certificate or make a direction under subsection 225(1).

[…]

(6) Subsections 225.1(1) to 225.1(4) do not apply with respect to

d'une cotisation établie en vertu des dispositions de la présente loi, exception faite des paragraphes 152(4.2), 169(3) et 220(3.1), le ministre, pour recouvrer le montant impayé, ne peut, avant le lendemain du jour du début du recouvrement du montant, prendre les mesures suivantes :

a) entamer une poursuite devant un tribunal;

b) attester le montant, conformément à l'article 223;

c) obliger une personne à faire un paiement, conformément au paragraphe 224(1);

d) obliger une institution ou une personne visée au paragraphe 224(1.1) à faire un paiement, conformément à ce paragraphe;

e) [Abrogé, 2006, ch. 4, art. 166]

f) obliger une personne à remettre des fonds, conformément au paragraphe 224.3(1);

g) donner un avis, délivrer un certificat ou donner un ordre, conformément au paragraphe 225(1).

[…]

(6) Les paragraphes (1) à (4) ne s'appliquent pas :

Digitized by Google

(*b*) an amount required to be deducted or withheld, and required to be remitted or paid, under this Act or the Regulations;	*b*) aux montants à déduire ou à retenir, et à remettre ou à payer, en application de la présente loi ou de son règlement;

[29] Therefore, as correctly argued by the respondent, it is not necessary to mail notices of assessment prior to these amounts becoming due. This is consistent with the duty of the Minister to promote and protect the public interest by ensuring the ITA is applied fairly: *Canada (Minister of National Revenue) v. Swiftsure Taxi Co.,* 2004 FC 980, [2004] 4 C.T.C. 304 at para. 16; *Jus D'Or Inc. v. CCRA,* 2007 FC 754 at paras. 12-15.

[30] Subsection 227(9.4) of the *Act* places the liability for paying taxes resulting from failure to remit an amount deducted or withheld on the person responsible for failing to do so:

227.	227.
[…]	[…]
(9.4) A person who has failed to remit as and when required by this Act or a regulation an amount deducted or withheld from a payment to another person as required by this Act or a regulation is liable to pay as tax under this Act on behalf of the other person the amount so deducted or withheld.	(9.4) La personne qui ne remet pas, de la manière et dans le délai prévus à la présente loi ou à son règlement, un montant déduit ou retenu d'un paiement fait à une autre personne conformément à la présente loi ou à son règlement doit payer, au nom de cette autre ersonne, à titre d'impôt en vertu de la présente loi, le montant ainsi déduit ou retenu.

[31] Subsection 227(10.1) adds to this, stating that the Minister may at any time assess the amount in question:

(10.1) The Minister may at any time assess	(10.1) Le ministre peut, en tout temps, établir une cotisation :
(*a*) any amount payable under section 116 or subsection 227(9), 227(9.2), 227(9.3) or 227(9.4) by any person,	*a*) pour un montant payable par une personne en vertu de l'article 116 ou des paragraphes (9), (9.2), (9.3) ou (9.4);
(*a.1*) [Repealed, 1997, c. 25, s. 67(7)]	
(*b*) any amount payable	*b*) pour un montant payable

Digitized by Google

under subsection 227(10.2) by any person as a consequence of a failure by a non-resident person to remit any amount, and	par une personne en vertu du paragraphe (10.2) pour défaut par une personne non-résidente d'effectuer un versement;
(*c*) any amount payable under Part XII.5 or XIII by any non-resident person, and, where the Minister sends a notice of assessment to the person, sections 150 to 163, subsections 164(1) and 164(1.4) to 164(7), sections 164.1 to 167 and Division J of Part I apply with such modifications as the circumstances require.	*c*) pour un montant payable par une personne non-résidente en vertu des parties XII.5 ou XIII. Si le ministre envoie un avis de cotisation à la personne, les articles 150 à 163, les paragraphes 164(1) et (1.4) à (7), les articles 164.1 à 167 et la section J de la partie I s'appliquent, avec les adaptations nécessaires.

[32] In other words, the CRA is entitled to verify that payroll taxes have been properly remitted to the Receiver General. Nothing in the present matter suggests that the CRA pursued a course of action that was beyond the ambit of its power as provided by the ITA. The applicant Dupont did fail to withhold employee tax and remit that tax to the Receiver General. The CRA had the statutory authority to follow up on that failure through the certification of the tax debt.

[33] Having found that it was unnecessary for the Minister to issue notices of assessment to the taxpayer Dupont for unpaid payroll taxes, the question of whether the applicant received these assessments becomes moot. In any event, and has already been suggested, the applicant may apply to the Minister to request an extension of time for filing a notice of objection prior to appealing to the Tax Court of Canada: ITA s. 166.1(1); ITA s. 166.2(5) (b) (iii).

[34] Based on the foregoing, I cannot find that it was unreasonable for the Minister to certify the debt in the amount of $204,704.21 plus interest. The ITA does not require the Minister to provide notices of assessments to corporate taxpayers who have an ongoing obligation to remit payroll taxes. Furthermore, it is clear from the evidence that the applicant was either fully aware, or ought to have been aware, of the debt owed and the obligation to pay it. As such, the certificate shall not be declared a nullity and this application for judicial review is dismissed with costs to the respondent.

JUDGMENT

IT IS THE JUDGMENT OF THIS COURT that:

1. the Certificate filed in the Federal Court Registry under s.223 of the *Income Tax Act* on June 11, 2004 as Court File No. 6552-04 that the amount of $204, 704.21 plus interest from May 15, 2004 was payable by the applicant and had not been paid is valid;

Digitized by Google

2. the application for judicial review of the decision to certify the applicant's tax debt and the Certificate is dismissed; and
3. the respondent is awarded costs fixed at $2000.00.

"Richard G. Mosley"
Judge

Any Type of Property Can Be Certified

Any type of property can be certified against under the Act. This was the issue in In the Matter against Don McDonald[31] there the taxpayer contested the Minister certificate against his interest in an unadministered estate. The Court held:

> [5] The interest in question in this case – Mr. McDonald's interest in the real estate that falls to be distributed under his father's will to Mr. McDonald and his sisters – arises for consideration under Rule 458(1)(*a*)(i) as "an interest in real property."
>
> [6] Rule 458(1)(*a*) places no limitation on the nature or extent of the judgment debtors "interest in real property or immoveables." As Justice Martineau pointed out in *Canada (Minister of National Revenue- M.N.R.) v. Laguerre*, 2008 FC 460, [2008] F.C.J. No. 578 at paragraph 3, the registration of a certificate of the Minister is "equivalent to a judgment of this Court" which means that the Minister "may immediately register an interim charge against any immovable (*sic*) belonging to the judgment debtor mentioned in the certificate in question." Justice Martineau's words are equally applicable to "any" interest in real property.
>
> [7] Justice Martineau also makes several points at paragraph 5 of his reasons in *Laguerre* that, in my view, are also applicable to the case before me:
>
> > 5. Rule 459(1) reads, "At a show cause hearing referred to in paragraph 458(1)(b), the Court shall make the interim charge absolute, in Form 459, or discharge it. In this case, then, the Court has two options: to make the charge absolute or to discharge it. I note that rules 458 and 459 do not require a judgment creditor to seize the immovable immediately (although he could); the goal is rather to charge it with the equivalent of a judicial hypothec to ensure the protection of his rights: R. v. Mullin, [1985] 2 C.T.C. 128. More specifically, the purpose and effect of these rules is the creation of a charge on the debtor's immovable pursuant to a judgment, affecting the said immovable when that judgment is enforced: Re Beaudry, [1979] 2 FC 138. Given that we are simply dealing with a judgment execution measure and that under rule 462, the Court may,

[31] 2010 FC 340

Digitized by Google

> on a motion by the judgment debtor or any other person having a right in the property charged with an interim or absolute charge, discharge or vary the charging order on such terms as it considers just with respect to costs, I do not find it premature to issue a charging order absolute in this case.

[8] Mr. McDonald does not deny that, under his father's will, he has an "interest in real property." He characterizes this interest as "indirect/contingent, beneficial," but it is still an interest in real property.

[9] As Justice Martineau pointed out in *Laguerre*, Rule 462 allows a discharge or variance on motion of the judgment debtor or any other person with an interest in property subject to an interim or absolute charge under rule 458 or 459, at any time, on such terms as to costs as the Court considers just. In my view, there is sufficient flexibility within the rules to deal with the charge in question should it be necessary to do so as part of the estate administration process. There is really no evidence before me that the charge in question will lead to problems or "chaos" in the administration of the estate. I regard Mr. McDonald's concerns in this regard as speculative and unlikely, given the Court's ability to discharge or vary with suitable terms as to costs.

[10] As regards the scope of "an interest in real property" under 458(1), there is simply nothing in the governing legislation or the Rules to suggest that such an interest should be limited in some way. Mr. McDonald argues that there is nothing to suggest that the wording was intended to encompass the interest he has in the land under his father's estate. In my view, however, it is Mr. McDonald who is seeking to limit the plain and obvious meaning of "an interest in real property or immoveables" and there is nothing in the scheme of the governing legislation, the Rules, or the jurisprudence to suggest that such a limitation should apply. An interest in land is an interest in land, even if it is a beneficial and contingent interest in land. To embark upon a process of trying to carve out certain interests in land that should not be subject to Rule 458 would, in my view, be extremely difficult and would result in the kind of confusion for which I can see no justification in principle or authority.

[11] Jowitt's dictionary of English Law, 2nd ed. (1977) p. 995 (as cited in Words & Phrases, volume 4 at page 1178), establishes that a person has an interest in something when "he has rights, advantages, duties, liabilities, losses or the like, connected with it, whether present or future, ascertained or potential…"

[12] Based on such an expansive definition, I believe that there is little question that the property interests in the land currently maintained by the Respondent would fall within the scope of Rule 458.

[13] Black's Law Dictionary also contains an expansive interpretation of the term "interest." Black's considers an interest to be "a legal share in something; all or part of a legal or equitable claim to or right in property." Black's 7th edition at page 816.

[14] Moreover, in *Williams v. Papworth*, [1900] A.C. 563, 69 LJPC (as cited in *Rystephaniuk v. Prosken*, 59 Man R. 142 and *Words and Phrases*, above,) Lord Macnagten said with regard to the term interest in land,

Digitized by Google

> It could not, of course, be disputed that the expression "interest in land," unless there was something to restrict the meaning, must include equitable as well as legal interests.

[15] Based on the expansive definition of the word "interest" and the phrase "interest in land," it is my view that the Respondent's interest is encompassed in Rule 458. Furthermore, contrary to the Respondent's argument, there is nothing in the wording of Rule 458 that restricts the meaning of "an interest in real property." As such, on an interpretive basis, it appears that the Respondent's interest is included in Rule 458.

[16] Because the estate has yet to be distributed, the Respondent has a concern that it could be premature to require the Respondent to pay tax on an asset he has yet to acquire. I think that such a concern, although potentially valid, does not arise on these facts.

[17] In this case, it appears the Respondent is attempting to delay distributing the property in question to the beneficiaries, himself included, so that he can avoid paying his share of taxes on the property. As stated by the Applicant, his "failure to convey the legal interest of this real property to the devisees is ostensibly keeping his one quarter beneficial interest in this asset outside the reach of the tax collector." Hence, on these facts, I see no reason not to allow Rule 458(1)(*a*) to take effect in accordance with the interpretation set out above. As Justice Martineau pointed out in *Laguerre*, given that we are dealing with a judgment execution measure, there is enough flexibility to deal with anomalies and injustices if and when they arise. They do not arise here.

[18] Consequently, I believe that the interim change in this case should be made absolute in accordance with Rule 459.

CHARGING ORDER ABSOLUTE

UPON MOTION made returnable on January 18, 2010 by Order of Justice Pinard, dated November 30, 2009;

AND UPON reading the material filed on behalf of the Attorney General of Canada in its application for an *ex parte* interim charging order and on hearing the submissions of counsel for Don McDonald and counsel for the Attorney General of Canada, and upon reading further written submissions filed by both counsel;

IT IS ORDERED THAT:

1. The interest of Don McDonald in the assets specified in the real property described as:
   a. PCL 34570 SEC DKF; PT LOCATION 460P UNSURVEYED TERRITORY PT OF GALT ISLAND, LAKE OF THE WOODS, PT 9, 10, 11, 12, 13 23R5964 and PT 3 and 4 KR341 S/T PT 10 and 13, 23R5964 AS IN LT30027; S/T LT222465; DISTRICT OF KENORA; and
   b. PDL 35264 SEC DKF; PT LOCATION 460P UNSURVEYED TERRITORY BEING PT OF GALT ISLAND, LAKE OF THE WOODS, PT 8, 23R5964; DISTRICT OF KENORA.

   stand charged with the payment of $2,546,249.27, the amount due from Don McDonald to Her Majesty the Queen in Right of Canada as represented by the Minister of National Revenue pursuant to a certificate

Digitized by Google

registered in this Honourable Court on or about May 8, 2008, said certificate having the force of a judgment pursuant to subsection 223(3) of the *Income Tax Act*, together with any applicable interest, compounded daily, at the rate prescribed under the *Income Tax Act* and the costs of this motion, which are to be added to the judgment debt.

In MNR v. Marcel Malachowski (also known as …)[32] the Minister based a charging order under Federal Court Rule 458 on an alleged beneficial interest in a piece of real estate when there was a lease with option to buy and the tax debtor had consistently recognized that he would be buying the property in his internal ledgers. The legal owner sought to have the charge removed and there was the following discussion about burden to establish that the certificate must be clearly an unambiguously founded when presented for order:

Issues

[33] The Moving Party requests an order discharging the interim charging order on the following grounds:

1. Suzanne Fishwick is the legal owner of the property described in the charging order;
2. Mr. Malachowski, the Judgment Debtor, has no interest in the property;
3. It was unreasonable for the Minister to pursue the charging order when her representatives knew, in light of the evidence known to them, that the Judgment Debtor had no interest in the property;
4. Rule 462.

[34] In my view, the proper issues in this proceeding are:

1. Who bears the onus in a motion to set aside an interim charging order made under Rule 458?
2. Does Rule 458 of the *Rules* apply to beneficial interests in real property?
3. Did Mr. Malachowski have a beneficial interest in Nun's Point?

Analysis

Preliminary Matters

[35] Two preliminary matters arise in this motion.

[36] The first is an application by the Moving Party to have the affidavit evidence appending the last wills and testaments of both Ms. Fishwick and Mr. Donihee accepted. Their wills make no mention of Mr. Malachowski. This evidence had not been previously provided and was not subject to cross-examination on affidavit. The Minister takes no position on this application. Given that the Minister has led similar evidence to the effect that the Moving Party and Mr. Donihee treated Mr. Malachowski "like a son" as well as evidence of their involvement as executors of Mr. Malachowski's will, I will admit this evidence.

[37] Second, a letter was sent to the Federal Court by Mr. Malachowski, in which he makes a number of statements. Understandably, Mr. Malachowski has not attended because of his incarceration. However,

[32] 2011 FC 413

Digitized by Google

the evidence discloses he has had resources to draw on. He has been served with the interim charging order and has not taken steps to be represented in these proceedings as a party. Moreover, Mr. Malachowski's statements in the letter have not been presented by way of affidavit or statutory declaration, a step that would be feasible even if he is now in more constrained financial circumstances. Accepting the letter as is would be unfair to the parties adverse in interest. I do not admit Mr. Malachowski's letter either as a submission or as evidence and I will not have any further regard to Mr. Malachowski's letter.

Burden of Proof with respect to the Motion

[38] The Moving Party submits that the ultimate burden is on the Minister to demonstrate on a balance of probabilities that the interim charging order should be made absolute and disputes the interim charging order should have even been granted in the first place.

[39] The Moving Party has emphasized that the Minister had a duty to be completely candid with the Court in bringing the *ex parte* application for an interim charging order. She submits that the Minister failed to discharge this duty by not first obtaining evidence from the Moving Party about her ownership of Nun's Point or by not disclosing to the Court that she held the legal title to the property.

[40] Although Rule 399 provides that an *ex parte* motion shall be set aside if the party against whom the order is made discloses a *prima facie* case why the order should not have been made, I consider Rule 399 not to apply since the interim charging order was made under Rule 458. In this case Rules 458 to 465 govern.

[41] Rules 458 to 465 of the *Rules* establish a procedure for obtaining a charging order. Where a charge is imposed on the land of the judgment debtor on the *ex parte* motion of the judgment creditor, the property owner is entitled to object to the charging order granted. In particular, Rule 462 provides:

> 462. The Court may, on the motion of a judgement debtor or any person with an interest in property subject to an interim or absolute charge under rule 458 or 459, at any time, discharge or vary the charging order on such terms as to costs as it considers just.
> (emphasis added)

[42] The Moving Party submits that the Federal Court has confirmed during an analysis of Rule 2400, the predecessor to Rule 458, that such an application must recognize the rights of both the judgement debtor and the third party owner of the land at issue: *R v Couillard Enterprises Inc,* [1978] F.C. 181. She states that the Court must consider the basis of a third party's objection prior to making an interim order absolute.

[43] The Moving Party makes an analogy to the 'jeopardy collection' rules under the *ITA*. The general rule set out in subsection 225.1(1) of the *ITA* is that the Minister is ordinarily restricted from collecting from a taxpayer until 90 days after the Notice of Assessment was mailed but under section 225.2, where a court is satisfied that there are reasonable grounds to believe the collection of all or part of the amount assessed would be jeopardized by a delay in collection, the court shall authorize the Minister to

Digitized by Google

proceed to collect prior to the expiry of the 90 days.

[44] The Moving Party submits that the Court may set aside an order if it finds the motion record in support of the *ex parte* authorization contained shortcomings. She refers to Justice Lemieux`s decision in *Re Gravel,* 2005 FC 1252 (*Re Gravel*) at para 7 where he quoted and relied on the principles applicable to "jeopardy collection" that had been previously summarized in *Canada (Minister of National Revenue) v Services M.L. Marengère Inc*, [2000] 176 F.T.R. 1 (*MNR v Marengère Inc*):

> In terms of burden, an applicant under subsection 225.2(8) has the initial burden to show that there are reasonable grounds to doubt that the test required by subsection 225.2(2) has been met, that is the collection of all or any part of the amounts assessed would be jeopardized by the delay in collection. However, the ultimate burden is on the Crown to justify the jeopardy collection order granted on an *ex parte* basis. However, the mere suspicion or concern that delay may jeopardize collection is not sufficient *per se.*
>
> …
>
> An *ex parte* collection order is an extraordinary remedy. Revenue Canada must exercise utmost good faith and insure full and frank disclosure.

[45] The Moving Party also relies on *Minister of National Revenue v Landru,* [1993] 1 CTC 93 (SKQB) (*Landru*) as the authority for the proposition that there must be compelling evidence beyond mere suspicion or conjecture that would be likely to jeopardize the collection of the amount assessed.

[46] The Minister's position is that the onus is on the Moving Party bringing this particular motion.

[47] The difficulty with the Moving Party's analogy to the "jeopardy provision" in the *ITA* is twofold.

[48] First, subsection 225.2(2) sets out a statutory pre-condition that there be reasonable grounds that the collection of the assets would be jeopardized by a delay in collection pending any appeal of the assessment. Rules 458 to 465 of the *Federal Court Rules* do not contain an analogous precondition that the collection of the assets be jeopardized by delay.

[49] Second, in *Re Gravel*, counsel for the Minister acknowledged shortcomings in the motion record filed on that *ex parte* application about the alleged jeopardy. No such admission is made here.

[50] Also in *Landru,* the taxpayer filed an affidavit attesting to having adequate income to meet his obligations and expressing a *bona fide* intention to pay the tax debt. Here, there is no declaration by Mr. Malachowski about having income or any intention to pay the outstanding tax debt.

[51] Accordingly neither the statutory provisions nor the evidence in the motion record are in accord with the section 225.1 jeopardy analogy proposed by the Moving Party.

Digitized by Google

[52] In result, I do not agree that the Moving Party's burden to set aside the interim charging order is merely to show that there are reasonable grounds to doubt the validity of the Order. The Moving Party's burden to set aside the interim charging order in advance of any consideration on whether or not to make the Order absolute is the same as with any motion, that is, on the balance of probabilities.

Equitable interest in land

[53] The Minister submits there is evidence to support its position that Mr. Malachowski had a beneficial interest in Nun's Point:

i) the ledger found during the RCMP 2006 raid of the Nun's Point records a $1,000,000 purchase price for the property as well as payments totalling $222,234 between October 19, 2005 and February 22, 2006;

ii) at the time of the RCMP search, Ms. Hooper, Mr. Malachowski's common law spouse, described Ms. Fishwick and Mr. Donihee as the former owners of Nun's Point;

iii) while at the Nun's Point, Mr. Malachowski ordered and had installed in the residence custom built cabinets worth more than $30,000, and

iv) Mr. Malachowski also ordered extensive landscaping at a cost of at least $35,000.

[54] The Moving Party submits that the primary onus is on the Minister to prove Mr. Malachowski has a legal interest in Nun's Point. She argues that for an interest in real property to exist or be proven, there must be a document in writing. She cites the *Statute of Frauds* R.S.O. 1990, c. S.19, as am. S.O. 1994, c. 27, s. 55:

> 1. (1) *Every estate or interest of freehold and every uncertain interest of, in, to or out* of any messuages, lands, tenements or hereditaments *shall be made or created by a writing signed by the parties making or creating the same*, or their agents thereunto lawfully authorized in writing, *and, if not so made or created, has the force and effect of an estate at will only*, and shall not be deemed or taken to have any other or greater force or effect.
>
> 2. Subject to section 9 of the *Conveyancing and Law of Property Act*, *no* lease, *estate or interest, either of freehold or term of years*, or any uncertain interest of, in, to or out of any messuages, lands, tenements or hereditaments shall be *assigned, granted or surrendered unless it be by deed or note in writing signed by the party so assigning, granting, or surrendering* the same, or the party's agent thereunto lawfully authorized by writing or by act or operation of law.
>
> ....

Digitized by Google

> 4. *No action shall be brought* to charge any executor or administrator upon any special promise to answer damages out of the executor's or administrator's own estate, or to charge any person upon any special promise to answer for the debt, default or miscarriage of any other person, or *to charge any person upon any contract or sale of lands, tenements or hereditaments, or any interest in or concerning them, unless the agreement upon which the action is brought, or some memorandum or note thereof is in writing and signed by the party to be charged therewith* or some person thereunto lawfully authorized by the party.
> 1994, c. 27, s. 55
> …
> 9. Subject to section 10, *all declarations or creations of trusts or confidences of any lands, tenements or hereditaments shall be manifested and proved by a writing signed by the party who is by law enabled to declare such trust*, or by his or her last will in writing, *or else they are void and of no effect.*
> (emphasis by Moving Party)

[55] The Moving Party submits that the onus is on the Minister to prove that Mr. Malachowski has a legal interest in Nun's Point, and can only do so if the evidence satisfies the requirements under the *Statute of Frauds*. She submits that there is no evidence to prove that Nun's Point was sold or transferred to Mr. Malachowski and, in the alternative; the Moving Party submits that she has satisfied the onus to prove she is the legal owner of the Nun's Point.

[56] The Moving Party cites *R v Mullins*, [1985] 2 CTC 128 (FCTD) where the Federal Court held that a co-owner of the land has the right to object to a charging order and was successful in setting aside such a charge.

[57] These submissions skirt the real issue. The proper question, in my view, is firstly whether there can be an equitable interest in land and secondly, whether Rule 458 can attach to such an equitable interest.

[58] The *Statute of Frauds* itself recognizes an equitable interest in land. Subsection 1(1) of that Act states that every interest in lands shall be made in writing but "*if not so made or created, has the force and effect of an estate at will only*". Consequently, there may an equitable interest in lands even if not in writing but the legislation gives it limited application.

[59] Moreover, the doctrine of part performance may take an oral agreement for the purchase of land outside the operation of the *Statute of Frauds.*

[60] In *Erie Sand and Gravel Limited v Seres' Farms Limited et al.*, (2009) 97 O.R. (3d) 241, the Ontario Court of Appeal considered a situation where Erie Sand and Gravel Limited (Erie) wanted to buy a parcel of land from Seres' Farms Limited (Seres' Farms). Erie was aware of a right of first

Digitized by Google

refusal held by a third party, Tri-B Acres Inc. (Tri-B). Erie and Seres' Farm met to discuss the purchase. During the meetings, Seres' Farms insisted on a written offer that it could present to Tri-B. Erie made it clear that it would only provide a written offer when all terms of the sale and purchase were finalized. Erie understood their oral arrangement to be that unless Tri-B matched its offer, it would acquire the land. Erie then made an offer in writing along with a cheque for the full price. Seres' Farms presented this written offer to Tri-B. Tri-B responded by offering to match the selling price but with a partial deposit rather than the full purchase payment. Seres' Farms then sold the land to Tri-B.

[61] The Ontario Court of Appeal held that the purpose of section 4 of the *Statute of Frauds* is to prevent fraudulent dealings in land based on perjured evidence. However, it added that equity created the doctrine of part performance to prevent the *Statute of Frauds* from being used as a variant of unconscionable dealings. Since Tri-B did not match the Erie offer, namely the Erie's delivery of the full purchase price along with its offer, Seres' Farms was not entitled to accept the Tri-B offer. The partial performance by Erie in delivering a written offer along with the cheque for payment in full took the agreement outside the operation of section 4 of the *Statute of Frauds*.

[62] I conclude that an equitable interest in land can exist when partial performance takes an oral agreement outside the scope of the *Statute of Frauds*.

Rule 458 and Equitable Interests in Land

[63] In *Re Laquerre*, 2008 FC 460 (*Laquerre*), Justice Martineau considered a challenge to having an interim charging order made absolute. In the course of ruling the charging order absolute, he considered the effect of a charging order on immoveable property, stating:

> "I note that rules 458 and 459 do not require a judgment creditor to seize the immovable immediately (although he could); the goal is rather to charge it with the equivalent of a judicial hypothec to ensure the protection of his rights: *R. v. Mullin*, [1985] 2 C.T.C. 128. More specifically, the purpose and effect of these rules is the creation of a charge on the debtor's immovable pursuant to a judgment, affecting the said immovable when that judgment is enforced: *Re Beaudry*, [1979] 2 FC 138.

[64] In *Canada (Minister of National Revenue) v McDonald,* 2010 FC 340 (*MNR v MacDonald*), the respondent sought to have an interim charging order against his interest in an estate discharged claiming that he did not have an interest in the property under Rule 458(1)(a). The property in question was his entitlement to land as provided in his father's will. The respondent admitted having "an indirect, contingent, beneficial interest" but argued that Rule 458 did not encompass this kind of an interest.

[65] Justice Russell found Justice Martineau's words in *Laquerre* were equally applicable to an interest in real property. Justice Russell stated:

> 10 As regards the scope of "an interest in

Digitized by Google

real property" under 458(1), there is simply nothing in the governing legislation or the Rules to suggest that such an interest should be limited in some way. Mr. McDonald argues that there is nothing to suggest that the wording was intended to encompass the interest he has in the land under his father's estate. In my view, however, it is Mr. McDonald who is seeking to limit the plain and obvious meaning of "an interest in real property or immoveables" and there is nothing in the scheme of the governing legislation, the Rules, or the jurisprudence to suggest that such a limitation should apply. An interest in land is an interest in land, even if it is a beneficial and contingent interest in land. To embark upon a process of trying to carve out certain interests in land that should not be subject to Rule 458 would, in my view, be extremely difficult and would result in the kind of confusion for which I can see no justification in principle or authority.

11 Jowitt's [D]ictionary of English Law, 2nd ed. (1977) p. 995 (as cited in Words & Phrases, volume 4 at page 1178), establishes that a person has an interest in something when "he has rights, advantages, duties, liabilities, losses or the like, connected with it, whether present or future, ascertained or potential..."

12 Based on such an expansive definition, I believe that there is little question that the property interests in the land currently maintained by the Respondent would fall within the scope of Rule 458.

13 Black's Law Dictionary also contains an expansive interpretation of the term "interest." Black's considers an interest to be "a legal share in something; all or part of a legal or equitable claim to or right in property." Black's 7th edition at page 816.

14 Moreover, in *Williams v. Papworth*, [1900] A.C. 563 (New South Wales P.C.), 69 LJPC (as cited in *Rystephaniuk v. Prosken* (1951), 59 Man. R. 142 (Man. K.B.) and *Words and Phrases*, above,) Lord Macnagten said with regard to the term interest in land,

> It could not, of course, be disputed that

Digitized by Google

> the expression "interest in land," unless there was something to restrict the meaning, must include equitable as well as legal interests.
>
> 15 Based on the expansive definition of the word "interest" and the phrase "interest in land," it is my view that the Respondent's interest is encompassed in Rule 458. Furthermore, contrary to the Respondent's argument, there is nothing in the wording of Rule 458 that restricts the meaning of "an interest in real property." As such, on an interpretive basis, it appears that the Respondent's interest is included in Rule 458.

[66] Justice Russell then held the interim charging order in that case should be made absolute.

[67] I would add to the above analysis consideration of the following emphasized words in Rule 458:

> 458. (1) On the ex parte motion of a judgment creditor, the Court may, for the purpose of enforcing an order for the payment of an ascertained sum of money,
>
> (a) make an order imposing an interim charge for securing payment of that sum and any interest thereon
>
> (i) on real property or immoveables, or on an interest in real property or immoveables, of a judgment debtor, in Form 458A,
>
> (emphasis added)
>
> … and
>
> (b) order the judgment debtor to show cause, at a specified time and place, why the charge should not be made absolute.

[68] Rule 458 not only provides for an interim charge on the real property or immoveables of a judgment debtor but also “on an interest in real property or immoveables”. All words in a statute must not be ignored, but rather attributed a meaning and interpretation that would not render it pointless or redundant, otherwise it is mere surplusage: Ruth Sullivan, *Driedger on the Construction of Statutes*, 3rd ed. (Toronto: Butterworths, 1994) at 88; *R v Proulx*, 2000 SCC 5 at para 28; *Morguard Properties Ltd v Winnipeg*, [1983] 2 SCR 493.

[69] The latter phrase “on an interest in real property” would be redundant given the earlier phrase “on real property” if only legal interests in real property were contemplated. In my view, the addition of these words demonstrates a clear intention by the legislator that the interim charging order could also apply to equitable interests in real property.

[70] I conclude that Rule 458 of the *Rules* does include equitable interests in real property.

Does Mr. Malachowski have an Equitable Interest in Nun’s Point?

[71] The Moving Party insists there is no evidence that Mr. Malachowski purchased Nun’s Point or made any payments towards purchase. Where there is no evidence of any consideration for the alleged

Digitized by Google

oral agreement, the Moving Party contends the claim for an interest in property should be dismissed: *Palkowski et al v Ivancic,* 2008 ONCA 419.

[72] Contrary to the Moving Party's submission, there is evidence that points to partial performance by Mr. Malachowski for the purchase of Nun's point pursuant to the oral agreement.

[73] First, the Moving Party does not dispute that there was an oral agreement to rent with an option to buy Nun's Point.

[74] Next, there is no issue that Mr. Malachowski moved to Nun's Point and took up residence. He had effective control of the property since there is no evidence the other tenants, his younger brother and friend and his common law spouse and her daughter, were there other than on his approval.

[75] There is the ledger found at Nun's Point during the period Mr. Malachowski resided there showing two payments towards the agreed purchase price for Nun's Point. This ledger was found in a safe in the barn, which is an unusual place to keep a safe, but it matches Mr. Malachowski's practice of concealing his financial activities. The Moving Party denies ownership of the safe and no other competing explanation exists for the safe's presence. Since the property was under Mr. Malachowski's control, I make the inference that the safe, and therefore the ledger, were his.

[76] There is also the evidence of Mr. Malachowski's investment of some $65,000 in improvements to Nun's Point, the kitchen cabinets and the landscaping. Both sets of expenditure clearly relate to improvements on real property. Given the Moving Party's evidence that she cautioned that improvements would be regarded as fixtures, Mr. Malachowski's conduct is consistent with a person who sees the land as his or becoming his property.

[77] Returning to the matter of the ledger, the purchase price for "NUNSPOINT PROPERTY" listed on the ledger, $1,000,000, is the same as the purchase price in the oral agreement that the Moving Party admits to having with Mr. Malachowski. I draw the inference that the ledger records payments he made to the Moving Party pursuant to the oral agreement for the sale and purchase of Nun's Point.

[78] The evidence satisfies me that Mr. Malachowski was engaged in partial performance of the oral agreement with the Moving Party such that he had an equitable interest in Nun's Point. The partial performance is such that his interest would fall outside of the scope of the *Statute of Frauds*. This type of beneficial interest is indeed contemplated by Rule 258 of the *Federal Court Rules*.

The Applicant's Burden on the Motion

[79] I now turn to whether the Moving Party has met her burden to show that the interim order should be discharged.

[80] The Moving Party submits the Minister's evidence amounts to mere suspicion that Mr. Malachowski gained a beneficial interest in Nun's Point. She has led evidence to show she holds the legal title to Nun's Point.

[81] I note that the Moving Party and Mr. Donihee twice lent Mr. Malachowski significant amounts of money for bridge financing of his land deals without securing the loans in any written form. The Moving Party also advanced money to pay for Mr. Malachowski's U.S. lawyer and his subsequent bail application which she says was either raised or repaid by Mr. Malachowski's common law spouse, all in cash and undocumented.

Digitized by Google

[82] I find that these financial arrangements are consistent with Mr. Malachowski's purchase of Nun's Point from the Moving Party under terms of an oral agreement. All these transactions are based on oral agreements not documented by written agreements. I have already concluded that Mr. Malachowski was engaged in partial performance of the oral agreement to purchase Nun's Point. The Moving Party has not proven otherwise.

[83] Finally, to address one last point, the Moving Party lead evidence to support her contention that she and her spouse do not have any relationship with Mr. Malachowski other than landlord and tenant. She has submitted evidence that to show that she and Mr. Donihee have sufficient income to maintain their expenses and life style without any payments from Mr. Malachowski for the Nun's Point.

[84] The Minister questions Ms. Fishwick's claim that Mr. Malachowski merely rented Nun's Point. Much of the Minister's evidence was directed at showing that Ms. Fishwick and Mr. Donihee did not have the income or funds to make the expenditures they did without money that only could be explained by cash payments from Mr. Malachowski. Much of Ms. Fishwick's evidence was directed to proving she and Mr. Donihee had income and funds to make the expenditures they did during this period.

[85] I find that the evidence provided to support the Moving Party's assertions of having significant cash resources of their own to draw upon is no better than the Minister's evidence that they dispute. The evidence tendered by the Moving Party does not negate the Minister's evidence.

[86] I conclude that the Moving Party has not satisfied the burden of proof she must meet to support setting aside the interim charging order in advance of a hearing to determine whether the Order should be made absolute.

Conclusion

[87] The motion to set aside the interim charging order by the Moving Party is dismissed and costs of this motion are in favour of the Responding Party.

[88] The evidence before me does not show that Mr. Malachowski completed partial performance for Nun's Point such that he would have been entitled to claim transfer of title in accordance with the terms of the oral agreement between him and the Moving Party. The interim charging order, on its wording, only applied to "Mr. Malachowski's interest in the real property". The question of what his interest, if any, was caught by the making of the interim charging order remains to be determined.

Digitized by Google

ORDER

THIS COURT ORDERS AND ADJUDGES that:

1. The motion to set aside the interim charging order is dismissed.
2. Costs of the motion are in favour of the Responding Party.
3. A show cause motion on making the interim charging order absolute or on determining the degree to which the proceeds of the property sale were caught by the interim charging order be set down for hearing at a date to be determined by the Case Management Prothonotary.

"Leonard S. Mandamin"

In some instances the peculiarities of the property may require different routes for realization on top of the certification process due to the nature of the property, such as the case of intangible property as was described in Her Majesty v.Timothy Douglas Langevin[33] where the court held:

> [3] The British Columbia Motor Carrier Commission, issuer of the tax debtor's taxicab licence, will not permit a transfer of the licence without receiving a transfer form signed by Mr. Langevin, since he is not now personally exploiting his licence. There is some elderly Ontario jurisprudence to the effect that a liquor vendor's licence cannot be seized under a writ: *Walsh v. Walper* (1901) III O.L.R. 158, and the Motor Carrier Board seems to adhere to that decision. Historically one cannot seize a licence (tab. 9) M.N.R's authorities: *Frederick L. Foster ats William Tuz*, creditor 519 at 525, because a licence is considered to be intangible personal property.
>
> [4] Section 44 of this Court's statute provides:
>
> 44. Mandamus, injunction, specific performance or appointment of receiver -- In addition to any other relief that the Court may grant or award, a mandamus, injunction or order for specific performance may be granted or a receiver appointed by the Court in all cases in which it appears to the Court to be just or convenient to do so, and any such order may be made either unconditionally or on such terms and conditions as the Court deems just.
>
> [5] So when a person who ought to pay his income tax, in effect impoverishes all taxpayers who do pay, by making a favourable exception for himself and keeping his tax payments to himself, it appears to be unquestionably just to compel the defaulter to contribute some of his own personal property to relieve the taxpayers and to contribute to the commonwealth. The Minister of National Revenue moves (on notice the Minister attempted to serve on the tax defaulter) and did serve on the Motor Carrier Commission to have a receiver (the bailiff) appointed. Rule 375 runs as follows:
>
> 375.(1) *Motion to appoint receiver* -- On motion, a judge may appoint a receiver in any proceeding.
>
> (2) *Remuneration and security* -- An order under subsection (10 shall set out the

[33] 2001 FCT 18

Digitized by Google

remuneration to be paid to, and the amount of security to be given by, the receiver.

[6] That motion is granted.

[7] Rule 425 of the Act gives the following means:

425. *Enforcement of order for payment of money* -- An order for the payment of money may be enforced by

(d) the appointment of a receiver; . . .

[8] As can be seen the M.N.R. is certainly not seeking to exclude the licence-issuing Motor Carrier Commission from these proceedings. Having been served, the Commission simply elected not to participate herein. The M.N.R's counsel brought to this Court's attention the decision of Mr. Justice Meredith of British Columbia in *336026 Ltd. v. 355398 B.C. Ltd.* [1993] B.C.J. No.2472. Meredith, J. thought that particular situation illustrated a matter between the liquor control authorities and the plaintiff without the need of the Court's intervention. Here, the Motor Carrier Commission has been served with full notice of this proceeding, but does not appear before this Court. Because the tax debtor's taxicab licence is a valuable asset, this Court holds that it is not just that he should continue to enjoy it, while the rest of the taxpayers have to pay for his selfish default and lack of concern. It is just that a receiver should lawfully deprive the tax debtor of the value of that asset.

[9] The Minister's motion to appoint a receiver is allowed. John William Edward Bradshaw of Comox Valley Bailiffs Ltd. is now appointed as receiver, without bond or security, of M.C.C. taxi licence number 11566 currently held by Timothy Douglas Langevin. The receiver may sell the licence subject to the M.C.C.'s approval, and the receiver must apply to the Commission to approve the transfer of the licence to the purchaser. Further, the receiver shall exercise his powers granted hereunder to:

- pay out the proceeds of sale of the taxi licence all amounts owing by Timothy Douglas Langevin under Certificate No. ITA-5685-99 issued by this Court on June 18, 1999, after deducting and paying to himself the reasonable fees and expenses incurred in carrying out his duties under this order;

- pay the balance of the proceeds, if any, of the sale of the taxi licence to Timothy Douglas Langevin; and

- apply to this Court for directions and guidance in the discharge of his duties.

[10] No action at law, or in equity or other proceeding may be taken or continued against the receiver, as receiver, and no proceeding may be taken or continued in respect of the taxi licence without leave of this Court and the Motor Carrier Commission upon notice to the receiver, the Commission and any other parties to this proceeding.

(Sgd.) "F.C. Muldoon"
Judge

Digitized by Google

Was Ownership Properly Certified?

In all instances the property that is certified must actually be owned by the tax-debtor, otherwise other parties may stand forward to claim an ownership interest that undermines the certificate and eventual writ and realization. This was the case in In The Matter Of The *Income Tax Act* v. Patricia L. Whitfield[34] a mother tax-debtor attempted to argue that her son had full ownership interest in her truck, the reason being of economics for his age, and that the funds had come from the son's grandmother had intended the funds to come to him. The court held however:

> [18] Finally, the respondent urged that her son Kyle had a security interest in the Dodge Dakota equal to its full value and that therefore the truck should, without further ado, be turned over to Kyle. The respondent based her argument in this regard on the following: first, an amount of $40,000.00 was deposited into the respondent's bank account by her mother, Kyle's grandmother. It required three signatures to withdraw the money from that account. Those signatures, one of which was that of the respondent, were obtained on a cheque written in favour of the respondent in the amount of $40,000.00. That cheque was used by the respondent to purchase three money orders, one of which was in an amount of somewhere between thirty-one and thirty-two thousand dollars, and that money order was used to purchase the Dodge Dakota.
>
> [19] The respondent urged that, at all times, it was her intention and that of her mother that the Dodge Dakota would be Kyle's and not hers. The vehicle was, she urged, registered in her name simply because Kyle was, at the time of purchase, 17 years of age and the cost of insurance on the vehicle would have been prohibitive if it were registered in his name. As evidence of this arrangement, the respondent referred me to a "truck agreement" bearing an "effective date" of December 17, 1998 and purporting to be signed on that date by Kyle and the respondent which included the following paragraph:
>
> Pat Whitfield agrees to purchase the above-mentioned truck on Kyle's behalf, using Kyle's money in order to accommodate the above [the insurance concerns]. Pat also agrees to register and insure the above-mentioned truck in her name until such time as Kyle reaches the age of 21 or until Kyle decides to sell the truck. Pat also agrees to have Kyle register a security interest on the above-mentioned truck after he reaches the age of 18, in order to protect his interest and his investment. In return, Kyle agrees to practice safe
>
> driving habits. Kyle also agrees that he will pay for the gas for the truck.[7]
>
> On the 26th of November, 1999, almost a year later, and presumably after Kyle reached the age of 18, a security agreement as contemplated by the foregoing paragraph was entered into in favour of Kyle with the debtor indicated to be the respondent. The security document was registered the same day.
>
> [20] On the basis of the foregoing, the respondent urged that, under

[34] 2001 FCT 777

Digitized by Google

the *Personal Property Security Act* of Alberta[8] and the *Civil Enforcement Act* of Alberta[9], Kyle's interest to the full value of the Dodge Dakota takes precedence to that of CCRA.

[21] Once again I reject these arguments. By reference to the above-quoted paragraph from the truck agreement entered into by Kyle and the respondent, there was simply no evidence before me, other than what I consider to be the self-serving evidence of the respondent to which I give no weight, that the Dodge Dakota was purchased "...using Kyle's money" and that therefore the Dodge Dakota represented "...his investment." The respondent acknowledged that the funds used to purchase the Dodge Dakota were drawn in her favour from a bank account that she described as hers, although three signatures were required to draw money out of it. Certainly none of those signatures was that of Kyle. The source of the money in the respondent's bank account was apparently her mother. There was absolutely no evidence that her mother intended the $40,000.00 that was transferred into the respondent's bank account to be in whole or in part a gift or a loan to Kyle. I am satisfied that, at least for the purposes of this matter, the Dodge Dakota is the property of the respondent with whose money it was purchased and in whose name it is registered.

In Her Majesty V. Rodney Charles Maxwell Stickle[35] the court recited a substantial amount of jurisprudence on the onus of proving ownership in a seizure situation where it held:

ONUS OF PROOF

[13] I think it helpful before reviewing the evidence to consider who bears the onus of establishing ownership of seized property. This Court has held that where a seizure of property is made and a third party claims ownership of some or all of the assets seized, the onus is on the third party to establish ownership of those assets: *384238 Ontario Ltd. v. The Queen*, [1981] C.T.C. 295 (F.C.T.D.); aff'd (1983), 52 N.R. 206 (F.C.A.); leave to appeal refused (1984), 8 D.L.R. (4th) 676 (S.C.C.).

[14] Alberta jurisprudence, made relevant by Rule 448 of the *Federal Court Rules, 1998* because the seizure occurred in Alberta, is to similar effect in circumstances as are now before the Court. In *Riczu v. Indigion Holdings Ltd.* (1997), 207 A.R. 318, Master Waller canvassed the law stating as follows:

In general circumstances, the onus lies with the execution creditor to prove that the goods seized

are the goods of the debtor. claiming the goods.That onus however shifts in certain circumstances to the party

In Korpus v. W.F. Botkin Construction Ltd. [1994] S.J. No. 6 p. 1 a 1935 Pierce Arrow automobile was seized from the debtor's father. The father produced a bill of sale which the creditor alleged was a sham. Halverson, J. discussed the applicable principles in this way:

[para 4] Generally, the onus is upon the execution creditor to prove a right to seize particular goods of the debtor. But where the goods are in the

[35] 2001 FCT 1019

Digitized by Google

possession of the debtor, there is a presumption they are his, and the onus shifts to the claimant to establish his title thereto (see Hudson Bay Company v. Macaskill et. al. (1983), 27 Sask.R. 81 (Sask.Q.B.)). Applying this to the instant case leads to the requirement that the plaintiff establish his ownership of the vehicle.

[para 5] There are three other useful principles arising from the authorities. Firstly, the claimant must show a bona fide sale accompanied by immediate delivery and a continued change of possession (see Morrow v. Western Empire Life Assurance Company, Limited, [1933] 2 W.W.R. 393 (Sask. C.A.) and Belair v. banque d'Hochelaga, [1923] 2 W.W.R. 771 (Sask. C.A.)). Secondly, where the goods belonged to the execution debtor before the seizure and were conveyed to a near relative under suspicious circumstances, the onus is again upon the claimant to prove ownership (see Massey-Harris Company, Limited et al. v. Dell, [1919] 1 W.W.R. 1032 (Sask. C.A.)). Thirdly, corroboration of the claimant's assertion is desirable where the disposition is to a relative (see Kushner v. Yasinka, [1927] 3 W.W.R. 328 (Sask. C.A.) and Avco Financial Services Canada Limited
v. Zacharias et al. and Stevens, [1977] 3 W.W.R. 697 (Sask. D.C.)). As stated earlier, these principles are not binding in the present situation, but they are helpful in assessing the burden upon the plaintiff.

I am satisfied given the family relationship that exists here and the fact that the debtor tenant had possession of the goods at the time of the distraint that a strong onus lies with the applicant father to show his ownership of the goods. In the absence of any concrete documentation a sworn statement is not adequate.

In Cisakowski v. Fikete (1984) 35 Alta L.R. (2d) 392 a tenant attempted to assert that certain distrained goods were actually the property of a corporation other distinct from the tenant. In dismissing the claim, Miller, A.C.J.Q.B., clearly defines the degree the proof necessary using the following terms:

In my view, there is an onus on 112600 to adduce at least some evidence beyond a bold statement in an affidavit establishing 112600's ownership of Abbotsfield Optical. To hold otherwise would require the landlord to prove a negative. Especially where there is some evidence to the contrary, I think it is crucial for a party asserting ownership of seized chattels to put forward strong evidence that should be within his knowledge, if it exists, to support his claim.

[underlining added]

[15] I now turn to the evidence adduced at the hearing.

THE EVIDENCE

The Ditch Witch

[16] Mr. Stickle testified that: the ditch witch is owned by Mr. Bushfield; it is worth about $4,000.00; Mr. Stickle rented it from Mr. Bushfield pursuant to an oral agreement; Mr. Stickle had last used the ditch witch two or three weeks prior to the seizure; and "if and when I'm renting it, if I'm using it, then I pay him accordingly". Mr. Stickle produced no documentation to establish either ownership or rental payments, although he said that he "probably would have [documentation] somewhere". Mr. Stickle said

Digitized by Google

that when seized there were not too many weeds around the ditch witch.

[17] Mr. Bushfield did not testify because, according to Mr. Stickle, he was watching for rain and waiting to get his hay crops off.

[18] Mr. Stickle called a representative of the CCRA to testify as to her conversations with Mr. Bushfield. That representative said that Mr. Bushfield had told her that the ditch witch was his, but that he had no documents to prove that.

[19] With respect to the evidence of the CCRA representative, I conclude that the evidence as to Mr. Bushfield's assertion of ownership is not admissible as evidence proving the truth of that assertion. I reach that conclusion because I do not find the statement to be sufficiently reliable to fall within the hearsay exception, nor do I see any necessity for the admission of that evidence to prove the truth of the statement. [20] On the evidence set out above, I would be prepared to find that Mr. Stickle failed to meet the onus upon him to overcome the presumption referred to in *Riczu, supra,* that goods in his possession are his. However, there is sufficient evidence that it is unnecessary for me to decide this issue simply on the basis of onus.

[21] The bailiff who effected the seizure testified that at the time the seizure was effected Mr. Stickle made no objection to the removal of the ditch witch. Mr. Stickle did not challenge or contradict that evidence. The bailiff also testified that the ditch witch was found with weeds growing around it, it took 30 minutes for the tow truck driver to get the ditch witch "up and running", there was no battery, and it had a flat tire. The bailiff was of the opinion that in view of its condition the equipment could not have been used in the prior few weeks.

[22] I found the bailiff to give his testimony in a forthright, clear way. He agreed with many of the suggestions put to him by Mr. Stickle in cross-examination evidencing a candour in his testimony. He had nothing directly to gain from his testimony on matters touching the ownership of assets. I accept his testimony about the ditch witch.

[23] When I consider the paucity of the evidence adduced by Mr. Stickle, the evidence of the bailiff that Mr. Stickle failed to object to the seizure of the ditch witch at the time of seizure (in circumstances where he was objecting to the removal of other items on the ground that he did not own them) and the evidence of the condition of the ditch witch which was inconsistent with Mr. Stickle's assertion that he was renting and using the equipment, I am satisfied for the purpose of this matter that the ditch witch is the property of Mr. Stickle. [24] I have considered that Mr. Sawatzky, who was assisting Mr. Stickle at the hearing, testified that he attended at the seizure and heard Mr. Stickle tell the bailiff that the ditch witch belonged to Mr. Bushfield. In view of Mr. Stickle's failure to testify or challenge the bailiff's evidence on the point I place no weight on Mr. Sawatzky's testimony. I also note that while Mr. Stickle had excluded all of the other witnesses who he called to testify, Mr. Sawatzky was not excluded and remained in the courtroom. The fact that Mr. Sawatzky had heard prior testimony including that of the CCRA representative, and Mr. Stickle's advice that Mr. Bushfield would not be testifying, are factors which I find also go to reduce the weight to be given to Mr. Sawatzky's testimony.

Digitized by Google

Certification with Ancillary Proceedings of Actual Tax Determination

The certification process follows the lengthy process of filing and assessment and reassessment all of which have specific mechanical time-frames provided in the Act. As was provided in Her Majesty, Represented By MNR and CRA v. Rodney Charles Maxwell Stickle[36] the court has no jurisdiction to inquire into the correctness of an assessment when the subject of the litigation is the certificate itself. If an assessment is contested, after the certificate has been filed, it will not be successful since the two are independent of each other. This was provided as far back as Olympia Interiors Ltd. and Mary David v. Her Majesty The Queen and The Attorney General of Canada[37] where the taxpayer attempted to state that the certificates were void and unenforceable since the assessment was being contested:

> "[3] On May 1, 1998, MacKay J. referred to the validity of the Contested Certificates when he refused the appellants' motion to join various actions then before the Trial Division of the Federal Court (reported at [1998] F.C.J. No. 576). He wrote as follows: ...[A]ssessments of tax under the *Excise Tax Act*, or of payments due on behalf of employees under the *Income Tax Act*, if not questioned by the party assessed and thereafter revised by the Minister, and here those steps did not occur, are ultimately recoverable by the Crown by filing of a certificate in this Court which certificate is then enforceable as a judgment of the Court. Here the assessments were not contested within the 90 day limitation periods applicable under the respective statutes, a period that terminated long before the certificates were filed. Moreover, the validity of those certificates does not appear to have been contested for more than two years after the certificates were filed. In the case of the certificate in Court file GST-41-92 filed in November 1992 and amended in December 1992, the first step by Mrs. David to contest the certificates appears from the file to have been initiated in August 1995. In the case of the certificate in Court file ITA-8447-92 filed in November 1992, the first step initiated by the plaintiffs, an application for an order for particulars, was made in August 1995. As I have noted, long before those first steps were initiated, indeed before the certificates were filed, the 90-day limitation period, fixed by statute, for questioning the assessments underlying the certificates, had expired.
>
> …

---

[36] 2001 FCT 1019

"**[9]** Written arguments were served and filed in accordance with the time and page limits imposed in the order. However, Mr. Stickle made extensive arguments as to the existence of the underlying debt, alleged errors by CCRA, and whether, contrary to the order of Justice Campbell, he was entitled to exemptions as a farmer. Mr. Stickle also purported to append documents not tendered at trial. I have not had regard to any of the above-noted arguments and evidence for the following reasons.

[10] First, the Act is a comprehensive code for the collection of taxes. A taxpayer who receives a notice of assessment and who disputes his or her obligation may file a notice of objection, and potentially may appeal to the Tax Court of Canada. However, when a certificate is filed in this Court pursuant to section 223 of the Act, the Court has no jurisdiction to inquire into the correctness of the assessment. See: Marcel Grand Cirque Inc. v. Canada (Minister of National Revenue) (1995) 107 F.T.R. 18, and by analogy with the Excise Tax Act, R.S., c. E-15 see Olympia Interiors Ltd. v. Canada (1998) 98 DTC 6306."

[37] 2001 FCA 361

Digitized by Google

[6] We need not deal with the *res judicata* issue as we agree with MacKay J. that the issue of the validity of the Contested Certificates is separately time-barred by statute, namely by subsections 165(1) of the *Income Tax Act* and 301(1.1) of the *Excise Tax Act*. There is no material on the record that demonstrates that the appellants ever filed a notice of objection to the assessment upon which the Contested Certificates are based.

[7] The appeal will be dismissed with costs."[38]

Gregorina Alessandro v. Her Majesty The Queen[39] is an interesting case that illustrates what happens when the taxpayer is successful in merely launching an accompanying Tax Ct. of Canada Appeal in res-establishing the actual amount of debt certified. In this case the taxpayer attempted to have the certificate

vacated when she was challenging her tax liability and while the statutory provisions below cited would have operated to allow the Minister to vacate, it was found that they were discretionary[40]:

[3] Ms. Alessandro contends that the subsequent acceptance of her Tax Court appeal obliges the Agency to remove its Certificate of indebtedness from this Court and the two liens registered against her real properties. The Agency declined to accommodate those demands and Ms. Alessandro is now seeking an Order to cancel the Certificate and to vacate the liens. She contends that the collection restrictions contained within section 225.1 of the Act can be applied, after the fact, to reverse the enforcement steps that were lawfully carried out by the Agency before her appeal was launched.

[4] Although the Agency concedes that section 225.1 of the Act prevents it from taking fresh collection steps against Ms. Alessandro, it says that the Act does not require that it reverse any enforcement steps which were lawfully taken at the time. In furtherance of that view, the

---

[38] See also The Matter Of An Assessment Or Assessments By The Minister Of National Revenue Under One Or More Of The *Income Tax Act, Canada Pension Plan, Employment Insurance Act*, against James Andrew Piccot, 2002 FCT 1116, where the Court didn't even respond to the taxpayer's allegation that he hadn't received his assessment thus the need to vacate the seizure of his assets.

> [8] Mr. Piccott advances a similar argument relative to the certificate executed under the *Income Tax Act*. He says that he received no notice of assessment in connection with alleged outstanding income tax. Further, he alleges that he received no notice of the certificate or of pending enforcement action and he argues that the actions of the Minister were unjustified and contrary to the scheme of the *Income Tax Act*.

[39] 2006 FC 895

[40] See also In the Matter of the *Income Tax Act v.* Mario Laquerre, Fiducie Mario Laquerre, Fiducie ML, 9075-3153 Québec Inc., 9015-7769 Québec Inc., 9067-6388 Québec Inc., 9029-0065 Québec Inc., 9011-1345 Québec Inc. Below where the issue was again raised where the court held :

> [18] The respondents argue that they are entitled not to pay any tax debts before their validity under the circumstances has been confirmed by the Tax Court of Canada. Unfortunately, they do not cite any relevant authorities or cases in support of this proposition. I am also of the opinion that the non-payment of the tax debts would constitute a contravention of a rule of public order in this case. It may also bear repeating that according to rule 462, the respondents may ask the Court (by way of a motion) to discharge or vary the charging order absolute if the Tax Court of Canada allows their appeal and refuses to confirm the validity of the reassessments issued by the Minister on August 31, 2006, and April 25, 2007.

Digitized by Google

Agency did withdraw an outstanding and active Notice of Garnishment that had been sent to Ms. Alessandro's bank; however, it refused any further relief.

[5] In the ordinary course, section 225.1 of the Act does preclude the Agency from taking any collection action against a taxpayer within ninety days of the mailing of a Notice of Assessment. Thereafter, the affected taxpayer can hold the Agency at bay by filing a Notice of Objection or a Notice of Appeal to the Tax Court within the prescribed time. In those instances, section 225.1 of the Act continues to apply. So long as the taxpayer acts in a timely way, section 225.1 of the Act offers seamless protection from collection of claimed tax arrears up to the conclusion of a Tax Court appeal.

[6] This case is anomalous because Ms. Alessandro's Tax Court appeal was initiated well beyond the ninety day filing deadline and, during that time, the Agency proceeded lawfully to enforce its claim by filing a Certificate of indebtedness and by registering its liens.

[7] Counsel for Ms. Alessandro concedes that the Act does not expressly oblige the Agency to reverse lawful collection steps in the face of a subsequently launched appeal; however, he contends that the failure by the Agency to withdraw the Certificate and to vacate its liens violates the spirit or intent of this protective statutory provision.

…

[9] The fact that the Act does not address the problem arising in this case does not mean that the spirit or underlying intent of this protective scheme has been breached by the Agency's conduct. If Parliament had intended that the Agency ought to be required to take active steps to reverse its previous and lawful collection actions, it could easily have said so. Indeed, in other provisions of the Act, the Agency is expressly required to repay funds or to release security in the face of challenges by a taxpayer (see section 164).

[10] It is also noteworthy that Ms. Alessandro has obtained a substantial benefit from the statutory collection restrictions which are created by these provisions. The Agency is prevented from taking further steps to collect the amount it claims to be owed. The Certificate of indebtedness and liens merely constitute passive security interests in favour of the Agency. If the liens are interfering with Ms. Alessandro's ability to deal with her real estate holdings, she has the ability to substitute the security or to negotiate reasonable alternate arrangements with the Agency.

[11] Although the circumstances in the case of *Topol v. Canada (Minister of National Revenue - M.N.R.)* [2003] F.C.J. No. 858, 2003 FCT 658 were somewhat different from those arising here, I accept as correct the following statements by Justice Carolyn Layden-Stevenson concerning the scope of section 225.1 of the Act:

22 Moreover, submits Topol, the position that the writ was lawfully obtained is inconsistent with the purpose of the provision. Referring again to section 225.1, he maintains that the Minister is precluded from taking steps to collect the taxes in dispute for the duration of the dispute, i.e., from assessment through to objection and appeal to the Tax Court. Topol argues that there is, however, a gap in section 225.1 because it does

Digitized by Google

not address the situation where a taxpayer begins the objection or appeal process outside of the time limits specifically prescribed within the section. To give effect to their purpose, the provisions must be interpreted liberally to protect taxpayers when the objection or appeal procedure is commenced beyond the prescribed times. Topol contends that to conclude otherwise means that a taxpayer, unable to adhere to the prescribed time limitation for reasons beyond his or her control and subject to a garnishment issued by the Minister, who is subsequently granted leave to file a notice of objection, will not be able to have the garnished funds returned to him. That taxpayer will have paid the taxes in dispute before an impartial hearing has been concluded. Since he was permitted to file a notice of objection to the 1996 and 1998 tax years on September 24, 2001, more than 90 days after the relevant notices of assessment, if the writ is not lifted, Topol contends that he will have, in effect, paid the taxes in dispute before an impartial hearing has been concluded. Such a result is inconsistent with the purpose of both section 225.1 and subsection 164(1.1) of the Act and should not be permitted in the absence of express wording to that effect in the Act.

…

29 I note Topol's hypothetical argument that a taxpayer, who for reasons beyond his or her control fails to file a notice of objection within the prescribed time limits and who is subsequently granted leave to file a notice of objection, may be prejudiced and lose the benefit of subsection 164(1.1) if the meaning I have ascribed to "security" is adopted. My observations in this respect are twofold. First, there is nothing in the record to indicate that Topol was unable to file his notices of objection in a timely manner because of reasons beyond his control. In this sense, it may be said that he is the author of his own misfortune. Second, if indeed there exists a gap in the legislation, it is for Parliament, not the court, to remedy. Neither the statute nor the provision support the meaning of the word "security" advanced by Topol. Thus, I conclude that the Minister's decision was not only reasonable, it was correct. This does not and should not be taken to mean, however, that the Minister is at liberty to execute on the writ while the objections with respect to the 1996 and 1998 taxation years remain alive.

[12] In this case, there is no legal basis for requiring the Agency to withdraw the Certificate of indebtedness filed with the Court or to lift the liens against Ms. Alessandro's real properties.

[13] In the result, this application is dismissed with costs payable to the Respondent in the amount of $1,250.00 inclusive of disbursements.

Her Majesty The Queen v. George F. Besselt[41] illustrates the peculiarity of a certificate that should attend to all the details and some ancillary steps that should be concerned with in which it was provided:

[1] The motion before me seeks leave to issue a (new) Writ of Execution. Presumably a Writ of Seizure and Sale in form 425 A. Once leave has been given the creditor is entitled to requisition a Writ from the Registry. The form of Writ is such as to necessitate that the amount of the debt, the

[41] ITA-8787-93

Digitized by Google

rate of interest and the dates from which interest is to run are to be shown. [The amount of costs, if any, and the rate of interest on costs and the dates from which such interest runs is also to be shown where appropriate].

[2] I note that *Rule 425* permits enforcement of an Order by, *inter alia*, a Writ of Seizure and Sale, the "Order" is the certificate filed. Leave in the ordinary way would permit the Registry to issue a Writ to collect the amounts shown in the certificate plus interest from the date shown in the certificate.

[3] If it is desired to obtain a Writ for a different amount than the amount shown in the certificate (which has the effect of an Order or Judgment of this Court) affidavit evidence to justify the deferring amount should be filed and the Order for leave will indicate any change from the amount shown in the certificate. I question whether any increase in amount shown in the certificate could be done *ex parte*.

[4] In this case a certificate indicates a sum owing to Her Majesty by virtue of an assessment by the Minister of National Revenue. If the creditor has assigned Her rights by statute or otherwise reference should be made to that assignment in the supporting affidavit.

[5] I note that the certificate herein was that of an official of the Department of National Revenue whereas the supporting affidavit to this motion states the debtor is indebted to Canada Customs and Revenue Agency. If that is in fact the case, some indication of the transfer in the supporting affidavit is required. If, however, the agency is merely a publican the debt remains owing to Her Majesty who will be shown in the Writ and the creditor is not the agency.

[6] As previously indicated, this matter should be clarified. It is useful to have the indication that the debt is for income tax. If it were for employment insurance repayments evidence would be required to show that the 6 year limitation period had not expired or was not applicable, so that the duration of the Writ could be appropriately limited.

[7] It has been a customary requirement in Toronto to be advised whether the debtor is aware of the existence of a certificate in the hope that third parties attempting to close real estate transactions will not be unnecessarily surprised.

[8] In this particular case the request for an Order relieving the applicant from complying with the record formal requirements of *Rule 364* is denied. The motion is therefore dismissed with leave to reapply *ex parte* with a motion record containing representations explaining the circumstances."

No Argument for Over-Certification

Pursuant to In the Matter Against Gordon Victor Buck[42] where the taxpayer had contended that the Minister had **over-secured** his certificate and seized both house and company shares the court held:

"At the conclusion of the hearing on January 13, 1997, with the concept in mind that there must be some balance between the creditor's right to payment and the debtor's right not to be abused, I mentioned *Gawler v. Chaplin* (1848), 2 Ex. 503, 154 E.R. 590, in which Baron Parke said "The

[42] ITA-1325-96

Digitized by Google

duty of the Sheriff, when he receives a process of execution against a man's goods, is to seize only such quantity of goods as would be reasonably sufficient to pay the amount indorsed on the writ." (E.R. p. 592)[1]. I raised this principle not to detract from the right of the Crown to have properly arrived at tax certificates paid, but, as I say, to make certain that there is a proper balance between creditor and debtor and no abuse of the latter by an excess of recovery procedures. I reserved my decision. Subsequently, and before I had come to a conclusion, counsel for the Crown sought leave to make further written submissions, noting that the seized shares would not be put up for sale until the outcome of the motion had been determined. As it seemed in the interests of justice that both sides have an opportunity, within given time limits, to consider and comment upon the principle in *Gawler v. Chaplin*, I gave leave. The Crown has made further submissions. Mr. Buck has not.

The shareholder's equity in Mr. Buck's company, at least in 1995, was some $112,000.00. The debt owing, on the Crown's figures, is about $46,000.00. Counsel for the Crown points out that there is what he calls a one-valuable-asset exception to the rule in *Gawler v. Chaplin* to the effect that if the judgment debtor has only one asset, worth substantially more than the judgment, the Sheriff may still seize, sell and pay to the judgment creditor his or her due, holding the balance for the judgment debtor: see for example *Wooddye v. Coles Baily of Southwark*, [1595] Noy 59, 74 E.R. 1027. Dunlop on Creditor-Debtor Law in Canada, Carswell, 1995, refers at p. 298 to more modern affirmations of this exception, including *Anderson v. Liddell* (1967- 1968), 117 C.L.R. 36 at 45 and 50-51, a decision of the Australian Court of Appeal involving the sale of a block of land valued at perhaps twice the amount of the judgment. In the *Anderson* case the Sheriff was found entitled to seize one large item, no matter what excess sum it might bring, that being his duty to the judgment creditor. But this seizure of a share certificate representing the voting shares in Mr. Buck's company, worth somewhat in excess of twice the value of the tax liability, is not the real concern. Rather it is the seizure of the company shares combined with the registration of the certificates, as the equivalent of judgments, against Mr. Buck's home. Certainly a creditor's remedies are cumulative. However, cumulative enforcement can be an abuse of process.

Part of the answer lies in the concept that the registration against property of a judgment, or a certificate in this case, is in itself neither a seizure nor an execution: see for example *Power v. Grace*, [1932] 2 D.L.R. 793 at 798 (Ont. Court of Appeal) and *Re Roadburg and Cedarhurst Properties Ltd.* (1979), 93 D.L.R. (3d) 582 at 587 (B.C.C.A.). There must be at least advertisement of a sale and probably a transfer of a special interest in the property to the Sheriff by seizure before the process can go on to become an execution to which the rule in *Gawler v. Chaplin* might apply.

Taking a slightly different approach, the rule in *Gawler v. Chaplin* is based on a balancing of the duty of the Sheriff, in favour of the judgment creditor, a duty constrained by fairness to the judgment debtor and reasonableness of the seizure. Is it fair and reasonable for the Crown to both register a certificate against Mr. Buck's property and then seize company shares, thus curtailing Mr. Buck's business activities, with a view to realizing on the shares in order to pay the tax arrears owing under the tax

Digitized by Google

certificates? All the more so taking into account that at least half of the tax debt has been cleared, in part by payments, but largely through tax carry backs. The answer to this lies in the fact that the Crown is entitled to be paid. The Crown is neither in the business of holding mortgages, a third charge in this instance, in the form of registered tax certificates on which interest accrues, nor in the business of selling homes.

On balance the actions of the Crown, to secure the debt against the home and then to find a more manageable asset against which to execute, are fair and reasonable. All the more so in that, as I noted earlier, the Crown has not been hasty in its procedure, but has allowed time for Mr. Buck to make payment."

Layer-Piercing for Other Assets

It is not just the taxpayer's property that can be certified on, her shares in corporations as well as corporate assets themselves may serve as appropriate means to realize tax debt if the corporate shell is so hollow as to be deserved to have its veil pierced. This was the case in In the Matter of the *income Tax Act v.* Mario Laquerre, Fiducie Mario Laquerre, Fiducie ML, 9075-3153 Québec Inc., 9015-7769 Québec Inc., 9067-6388 Québec Inc., 9029-0065 Québec Inc., 9011-1345 Québec Inc.[43] where the Minister attempted to assert a charging order against corporate assets[44] in a purely alter-ego corporate setting where the taxpayer had
sheltered all his substantial assets away from the Minister thus reducing his personal debtor exposure. On the issue of whether the Minister could pierce the veil the court held:

> [9] On October 3, 2007, the applicant filed an *ex parte* motion seeking to have the corporate veil lifted and seeking an interim charging order against the immovables at issue pursuant to rule 458 of the Rules. According to the applicant's written submissions, the judgment debtors' only assets of value that the Agency has yet to seize or charge with a hypothec belong to 9067 and 9011. The equity in these assets is estimated at $315,000.00 and $320,000.00 respectively. The applicant alleges that lifting the corporate veil is justified because [TRANSLATION] "several [of Laquerre's] non-arm's length companies were established so

---

[43] 2008 FC 460

[44] The action was actually founded on Rule 459 of the Federal Court Rules whereby the court held:

> [5] Rule 459(1) reads, "At a show cause hearing referred to in paragraph 458(1)(*b*), the Court shall make the interim charge absolute, in Form 459, or discharge it." In this case, then, the Court has two options: to make the charge absolute or to discharge it. I note that rules 458 and 459 do not require a judgment creditor to seize the immovable immediately (although he could); the goal is rather to charge it with the equivalent of a judicial hypothec to ensure the protection of his rights: *R. v. Mullin*, [1985] 2 C.T.C. 128. More specifically, the purpose and effect of these rules is the creation of a charge on the debtor's immovable pursuant to a judgment, affecting the said immovable when that judgment is enforced: *Re Beaudry*, [1979] 2 FC 138. Given that we are simply dealing with a judgment execution measure and that under rule 462, the Court may, on a motion by the judgment debtor or any other person having a right in the property charged with an interim or absolute charge, discharge or vary the charging order on such terms as it considers just with respect to costs, I do not find it premature to issue a charging order absolute in this case.

Digitized by Google

that he and some of his companies could evade taxes". In fact, the investigation and audit conducted by the Agency reveal that Laquerre and his *alter ego* companies knowingly set up their distinct legal personalities to escape their tax liabilities and avoid paying the amounts owing to the Minister under the Act. This is against public order and constitutes fraud within the meaning of article 317 of the *Civil Code of Québec*, S.Q. 1991, c. 64 (C.C.Q.).

[10] The respondents claim that imposing a charge (whether interim or absolute) unduly prevents them from carrying on their legitimate business activities of buying and selling immovable property and will force them into bankruptcy. They also claim that none of the payments referred to in Mr. Ferland's two affidavits (one sworn October 1, 2007, and the other November 20, 2007) were made for the purpose of mingling the assets of the various entities. In this case, the respondents committed no fraudulent acts. Moreover, the non- payment of tax debts does not constitute a contravention of a rule of public order: the judgments debtors are entitled not to pay the tax debts in question before the validity of the impugned notices of assessment has been confirmed by final judgment on the appeals brought before the Tax Court of Canada. The lifting of the corporate veil can only be permitted in limited circumstances. There is nothing to indicate that Laquerre's *alter ego* companies are being used to dissemble fraud.

[11] A corporation may be considered the *alter ego* of another corporation when there is such a close relationship between them that what apparently concerns one actually pertains to the activities of the other: *Buanderie centrale de Montréal Inc. v. Montreal (City),* [1994] 3 S.C.R. 29 at para. 34 (*Buanderie centrale*). A large number of factors can be identified to determine the existence of such a relationship, but according to the Supreme Court of Canada, the one that is most explicit and most likely to cover all aspects of the concept is control: *Buanderie centrale, supra*.

[12] According to article 317 C.C.Q., "[i]n no case may a legal person set up juridical personality against a person in good faith if it is set up to dissemble fraud, abuse of right or contravention of a rule of public order." This legislative text prohibits one from setting up the separate legal personality of a corporation to dissemble fraud, abuse of right or contravention of a rule of public order: *Québec (Commission des droits de la personne et des droits de la jeunesse) c. Coutu*, [1998] A.Q. no 2779 (QL) (C.A.Q.). This decision clearly applies to this case.

[13] As a general rule, I am of the opinion that the non-payment of tax debts may constitute contravention of a rule of public order. Authors Paul and Maurice Martel wrote the following in *La Compagnie au Québec*, Montréal, Wilson et Lafleur, Martel Ltée., 2005, at page I-64 :

[TRANSLATION]

The expression "contravention of a rule of public order" refers in particular, according to the Minister of Justice, to [TRANSLATION] "contraventions of environmental, public security, communications and public utilities regulations". They are contraventions to legal rules that are imperative in nature and that cannot be derogated from by contract, such as those set out in legislation regarding the organization of the state, as well as administrative and fiscal laws and laws regarding the organization of

Digitized by Google

professional bodies, criminal legislation, labour legislation and the charters of rights and freedoms. This codifies another series of the above-mentioned exceptions established in case law, namely, the use of companies as screens to dissemble a contravention of a rule of public order.
[Emphasis added]

[14] Moreover, in *Quebec (Deputy Minister of Revenue) v. Couverture C.G.L. Inc. and Les Entreprises Yvon Latouche Inc.* (Unpublished decision, rendered February 15, 1995 – Docket No. GST-100-94), the Federal Court applied the principle set out in article 317 C.C.Q. in the context of an applicant (Les Entreprises Yvon Latouche) objecting to a seizure made by the Deputy Minister of Revenue of Quebec against the defendant (Couverture C.G.L. Inc.). It is clear from Mr. Justice Denault's decision that the applicant had engineered a whole series of transactions to avoid paying the amounts it owed to the Minister of Revenue:

In the case at bar, after hearing the testimony of Yvon Latouche and his wife Ginette Giroux, I have no hesitation in concluding that Yvon Latouche is the alter ego of Les Entreprises Yvon Latouche Inc., as he admitted in his testimony, but most importantly he is the prime mover in Couverture C.G.L. Inc. The incorporation of various companies by Yvon Latouche, sometimes in his own name and sometimes in that of his wife, taking care never to transfer the assets of the company he was discarding to the name of the company he was preparing to do business with, was manifestly done in order to deceive creditors, avoid the payment of debts and, as here, avoid having to reimburse money which he had collected as a trustee but had neglected to reimburse. Clearly, the Court cannot be a tool or accomplice in such machinations.

[15] The judge then concludes as follows:

In the case at bar the Court considers that the applicant cannot set up the legal personality of an artificial person other than the defendant as a means of objecting to the seizure and sale of the property seized. In the circumstances at bar the applicant's opposition constitutes an abuse of right and an attempt by the prime mover in the defendant as well as by the applicant to avoid its obligations. Its opposition therefore cannot be allowed.

[16] In this case, there is no doubt as to the non-payment by Laquerre and his companies and trusts of their tax debts. Despite the collection measures taken following the issuance of the two jeopardy collection orders on September 28, 2007, the full tax debt owed by Laquerre, 9122, 9075, 9015, 9029, ML, Fiducie Laquerre and MJ amounted to $2,809,313.22 (paragraph 23 of Mr. Ferland's affidavit sworn November 20, 2007, filed in response to the respondents' motion to strike). I note that the total debt owed to the judgment creditor by the respondents covered by the seven certificates registered under section 223 of the Act amounts to $1,720,588.80 (see Exhibit 19.1 to Mr. Ferland's affidavit sworn October 1, 2007).

[17] Furthermore, according to the evidence in the docket, I have no doubt that Laquerre attempted to camouflage his actions through his many companies, which constituted a planned business structure. According to the affidavit of Annie Valois, sworn August 31, 2006, Laquerre and the non-arm's length companies or the trusts of which he was one of the beneficiaries were employing a number of tax evasion schemes.

Digitized by Google

…

[19] Finally, I note that Laquerre's personal property is mingled with that of his non arm's-length companies. I agree with the following statements of Mr. Justice Barbe in *Échafaudages Fast Montréal Inc. c. Alfredo Masciotra*, [2001] AZ-01036292.7:

[TRANSLATION]

The personal use of company property does not benefit the company; it constitutes a dishonest act. Article 317 C.C.Q. allows us to disregard the legal person when juridical personality is set up to dissemble fraud. The involvement of the shareholder as sole administrator and president of the company in the company's actions is a key criterion for lifting the corporate veil. Using the company's money to cover personal tanning expenses and failing to inform the applicant of the company's precarious financial situation constitute abuse within the meaning of article 317 C.C.Q.

[Emphasis added]

[20] On the facts in the docket, I find that Laquerre is making personal use of property belonging to his companies and trusts. According to Mr. Ferland's affidavit sworn October 1, 2007, the personal property used by Laquerre (such as his vehicles and his residence) is in the name of his companies and trusts. Moreover, 9122 issued cheques in 2006 to pay off Laquerre's personal credit cards. I note that in 2005, company 9067 issued cheques to entities controlled by the judgment debtor in amounts totalling

$195,643.19. There are several other examples in the docket showing that Laquerre has mingled his personal affairs with those of his companies and trusts: see Mr. Ferland's affidavit sworn October 1, 2007, at paras.113 to 135.

[21] This mingling constitutes an act that entitles us to lift the corporate veil. According to the Court of Québec (Civil Division) in *Buccaneer Industries Ltd. c. Bresee*, [2003] J.Q. no 369 (QL), by mingling a company's account with his personal account, an individual places himself in an uncomfortable situation of conflict, allowing the corporate veil to be lifted:

[TRANSLATION]

The burden of proof is therefore reversed, and he must demonstrate that he has never benefited from the company's income. This mingling of the Bresee family's affairs with those of the company constitutes an act enabling us to lift the corporate veil. It is a blameworthy act.

[22] In conclusion, the respondents' arguments in favour of the dismissal of the judgment creditor's motion to have the corporate veil lifted are not persuasive. Given the convincing evidence presented by the applicant in dockets T-1574-06 and T-699-07, I find that it is in the interests of justice that the judgment debtors be considered one and the same person with a single patrimony for the purposes of all of the measures to collect the judgment debtors' tax debts.

Subsection 223(7) provides flexibility in the tailoring of the application of the certificate to both shorten or prolong its life though there have been some cases where they have lapsed and must be re-registered.

Subsection 223(9) draws in the Minister's ability to postpone action on the realization of the certificate through obtaining a writ of seizure, if in her discretion it is warranted.

Digitized by Google

Certification the First Step, No Need for Writ to Seize, Second.

The ITA provisions set out a complete set of collection rules that do not extensively depend on provincial money judgment Acts. Generally certification of the tax debt is only the first step of the realization of the property that sets out the ranking of the Minister's preference. It's execution to realization through seizure and sale is the second. However, the courts need not be approached to actually get a writ since the ITA contains a complete set of rules that allow it to operate in counterance to any provincial Acts. While the court need not be approached for hearing in the former, the Writ must be heard in court to accomplish the latter. This was the case in In The Matter Of The *Income Tax Act,* R.S.C. (5th Supp.) C.1 and In The Matter Of An Assessment Or Assessments By The Minister Of National Revenue Under One Or More Of The *Income Tax Act, Canada Pension Plan, Employment Insurance Act*, against James Andrew Piccot[45] **where the court, initially, held that the Federal Court was the venue for all proceedings for certificate placement and enforcement and that an Writ of seizure should have been obtained rather than merely acting on a certificate**. It held:

> [10] The Minister argues that this Court lacks jurisdiction to entertain a challenge to the manner in which the certificates were issued. It further submits that this Court lacks jurisdiction to stay or quash the certificates and that any challenge to the process leading to issuance of the certificates lies solely within the jurisdiction of the Tax Court of Canada.
>
> [11] As well, the Minister characterizes Mr. Piccott's complaint as relating to the quantification of the amount claimed rather than with the fact that he owes money on account of both income tax and the goods and services tax.
>
> [12] The Minister argues that proper procedure was followed for enforcement purposes. The relevant sections of both the *Income Tax Act* and the *Excise Tax Act* provide that a certificate executed under these statutes is deemed to be a judgment of the Federal Court of Canada and enforceable as such. Both the *Income Tax Act* and the *Excise Tax Act* authorize the filing of a memorial, as defined in the legislation, for the purpose of creating a charge or binding interest in property in a province. The respective legislation also provides a process for the enforcement and collection of the debt as recorded in the memorial.
>
> [13] The Minister argues that the certificate is such a memorial and that it was not necessary to obtain a writ from the Federal Court of Canada in order to authorize and instruct the Sheriff to seize and sell the property of Mr. Piccott.
>
> [14] Further, the Minister argues that the Province of Newfoundland and Labrador no longer relies on a writ for the enforcement of a judgment. The applicable provincial legislation is the *Judgment Enforcement Act* and the Minister relies on the definition of "judgment" contained in section 2(1)(bb) of that legislation.
>
> [15] Otherwise, the Minister takes the position that monies were owing from Mr. Piccott, the certificates were properly executed and proper

[45] 2002 FCT 1116

Digitized by Google

steps were taken to enforce collection of the outstanding taxes.

…

[18] In each case, the legislation provides that a certificate produced by the Minister to the Federal Court can be registered in that Court and following registration, it has the same effect as a judgment. **However, the certificate when registered is not a judgment and does not become a judgment of the Federal Court. In this regard, I refer to *Marcel Grand Cirque Inc.* v. *Quebec* (1995), 107 F.T.R. 18, *Olympia Interiors Limited* v. *Canada* (1998), 98 D.T.C. 6306 (F.C.T.D.) and *Glenn Alexander Ross* v. *Her Majesty the Queen in Right of Canada* (2002 D.T.C. 6884), affirmed by the Federal Court of Appeal at [2002] FCA 359. In *Marcel Grand Cirque Inc.* v. *Quebec, supra*, the Court said at paragraph 6:**

This Court does not have jurisdiction to determine this issue. The Excise Tax Act, like the Income Tax Act, R.S.C. 1985 (5th Supp.), c. 2, contains in effect a complete code for the collection of taxes pursuant to which a taxpayer, after receiving a notice of assessment, may file a notice of opposition and possibly appeal to the Tax Court of Canada. Thus this Court does not have jurisdiction to determine the amount of the assessment and the expenses to which a taxpayer may claim to be entitled.

…

[21] I am satisfied that it is beyond the jurisdiction of this Court to go behind the execution of the certificates. However, the issue of enforcement of those certificates is within the jurisdiction of this Court in light of the clear statutory language that once registered, a certificate is deemed to be a judgment of the Court against the debtor for a debt due to Her Majesty and enforceable as such.

[22] In both the *Income Tax Act* and the *Excise Tax Act*, "court" is defined in terms of the Federal Court of Canada for the purposes of recording and enforcing certificates executed under these statutes. This means, in my opinion, that enforcement proceedings relative to the certificates must be conducted pursuant to the applicable provisions of the *Federal Court Act*, R.S.C. 1985, c.F-7, as amended, and the *Federal Court Rules, 1998*, SOR/98-106.

…

[30] There is nothing in the record before me, including the court files, to show that any documents were issued by the Federal Court of Canada. The recorded entries show merely that certificates were filed. No writs were issued, and this is admitted by the Minister. The Minister takes the position that a writ is not necessary, having regard to the manner in which judgments are enforced in the Province of Newfoundland and Labrador.

[31] As noted above, section 56 of the *Federal Court Act* provides that provincial processes will be engaged for the purposes of enforcing judgments or orders of the Federal Court. While it is clear that a certificate executed under the *Income Tax Act* or the *Excise Tax Act* is not a judgment of the Federal Court of Canada, it is equally clear that for the purposes of enforcement, such certificate is deemed to be a judgment. In my view, this deeming provision means that the enforcement processes provided under the *Federal Court Act* and the *Federal Court Rules, 1998*

Digitized by Google

are engaged.

[32] The proper procedure in the present case would have been for the Minister to obtain a writ from the Federal Court of Canada and to forward that writ to the Sheriff. The Sheriff would then be obliged to handle the writ subject to section 56 of the *Federal Court Act* and the applicable provincial legislation.

[33] The Minister did not obtain writs to enforce payment of the money allegedly due from Mr. Piccott. He should have done so. It follows that the seizure of Mr. Piccott's goods was improperly made and those goods should be immediately returned to Mr. Piccott.

On Appeal[46] the court considered quite a few issues on the interaction of provincial realization and Federal authority under the ITA. It held:

…Copies of these certificates were then put into the hands of the High Sheriff of Newfoundland and Labrador (the Sheriff) pursuant to the *Judgment Enforcement Act*, S.N.L. 1996, c. J-1.1, with instructions to seize and sell as much of Mr. Piccott's property as necessary to satisfy the amounts owing under the certificates. The Sheriff did his duty. Mr. Piccott challenged the seizure and sale in the Federal Court. Heneghan J. in a decision reported at [2002] F.C.J. No. 1500, 2002 FCT 1116, set aside the seizure and sale because no writ of execution had been issued. Was she right to do so?

…

[6] The motions judge reviewed the provisions of the *Income Tax Act*, the *Excise Tax Act,* the *Federal Court Act*, and the *Judgment Enforcement Act* before coming to the conclusion that the seizure of Mr. Piccot's goods was irregular and should be set aside. She was persuaded that the applicable legislation required that seizure could only occur on the basis of process issued from the Court. The Court held that in order to proceed to execution, the CCRA was bound to have a writ of execution issued out of the Court and put into the hands of the Sheriff. Since that had not occurred, the seizures were irregular and were set aside. The motions judge also found that the enforcement provisions of the *Income Tax Act* could not be relied upon to justify the seizure, since they require that the document evidencing the judgment under execution be issued by the Court. Since she could find no evidence of any document being issued, the motions judge found that the seizure was made without authority.

[7] The motions judge began her analysis by reviewing the relevant sections of the *Income Tax Act*, specifically subsection 223(3) which allows the Minister to register a certificate setting out the amount owed by a taxpayer in the Court. Upon registration, the certificate has the same effect, "and all proceedings may be taken thereon", as if it were a judgment of the Court.

[8] While acknowledging that the certificates had the same effect as a judgment, the motions judge held that the certificates were not, in fact, judgments of the Court. She was supported in this conclusion by the decisions in *Marcel Grand Cirque Inc. v. Canada (Minister of National Revenue - M.N.R.)* (1995), 107

F.T.R. 18 , *Olympia Interiors Limited v. Canada* (1998), 98 D.T.C 6306 (F.C.T.D) and *Glenn Alexander Ross v. Canada*, 2002 D.T.C. 6884, aff'd at

[46] A-651-02

Digitized by Google

(2002), 301 N.R. 23 (F.C.A.). However, she was of the view that since the certificates were enforceable as judgments of the Court, enforcement proceedings with respect to the certificates had to be conducted in accordance with the provisions of the *Federal Court Act*, R.S.C. 1985, c. F-7, and the *Federal Court Rules, 1998* (the Rules).

[10] The fact that certificates issued under the *Income Tax Act* are deemed to be judgments of the Court for enforcement purposes led the motions judge to conclude that the provisions of section 56 of the *Federal Court Act* were engaged. This, in turn, led to the conclusion that the enforcement provisions of the *Federal Court Act* and Rules were also engaged. Since the Rules require that a writ of execution be issued before execution can be levied (see Rules 433 and following), CCRA was bound to have a writ of execution issued. As a result, the judge concluded that CCRA was required to put the writ in the hands of the Sheriff before calling upon him to seize goods to satisfy the debt certified in the certificates.

[11] The motions judge rejected the argument based upon subsection 223(5) of the *Income Tax Act* that the registration of a certificate in the Court was sufficient to initiate enforcement proceedings.

…

[16] Counsel pointed out that while the *Judgment Enforcement Act* of Newfoundland no longer contemplates the issuance of a writ of execution, the requirements of the *Income Tax Act* and the *Federal Court Act* must be satisfied before the provisions of the *Judgment Enforcement Act* can be invoked. The *Federal Court Act* required that another step be taken before the certificate became enforceable, namely, the issuance of a writ, and in the absence of such a document, the filing in the provincial system was of no effect.

[17] Finally, counsel made the point that the enforcement provisions of the *Judgment Enforcement Act* required the filing of a money judgment, which is defined as:

> "money judgment" means a judgment requiring a person to pay money, or that part of a judgment which requires a person to pay money but does not include money payable under an order for contempt;

Since there is nothing in the certificate which requires anyone to pay anything, the certificate itself cannot be a money judgment. For that reason, something further is required to turn the certificate into an enforceable order.

[18] Counsel for the appellant took a different view of the scope and effect of the legislation. He pointed out that the intent of section 56 of the *Federal Court Act* is to permit the enforcement of Federal Court orders and judgments through provincial enforcement mechanisms. This desire to integrate the federal and provincial systems is reflected in the terms of subsection 56(3) which direct that every writ of execution or other process against property "shall ... be executed, with respect to the property liable to execution and the mode of seizure and sale, as nearly as possible in the same manner as similar writs or process, issued out of the superior courts of the province in which the property to be seized is situated...". Accordingly, counsel for the appellant argued that "The writ is not a necessary precursor to execution so long as the method of execution is

Digitized by Google

one sanctioned in law in the province." Consequently, if the law of Newfoundland recognized the certificate for purposes of enforcement, then nothing in the *Federal Court Act* required the issuance of a writ which is not required in Newfoundland.

…

[26] I am satisfied that the original Certificate of Judgment was filed with the Sheriff as proof of the judgment. The questions which remain are whether the Certificate of Judgment is a memorial within the meaning of subsection 223(5), and if it is, whether it must be accompanied by a writ of execution.

[27] Before considering those questions, I note that the *Judgment Enforcement Act* also provides that notice of registration of a notice of judgment must be provided to the debtor:

(5) A statement verifying the registration of a notice of judgment shall be served on the debtor and the creditor within 30 days after it is registered. This is significant to the extent that part of Mr. Piccott's complaint is that if a writ of execution had been obtained, he would have received notice of the writ before it was executed and could therefore have challenged it prior to his inventory being seized.

[29] The fact that such certificates are enforceable as judgments of the Court brings into play the provisions of the *Federal Court Act* dealing with enforcement of judgments, specifically section 56 and Rule 423 cited earlier in these reasons. It appears that the motions judge concluded that since the procedure provided for the enforcement of Court judgments includes the issuance of a writ of execution, the enforcement of a certificate which is deemed to be a judgment of the Court also requires the issuance of a writ of execution (see paragraphs 31 and 32 of the motions judge's reasons).

[30] It is clear that Parliament declined to establish a separate federal judgment enforcement system and chose instead to have Federal Court orders enforced through the provincial judgment enforcement systems. This scheme was recognized by this court in *Forest v. Hancor*, [1996] 1 F.C. 725 (C.A.) where Décary J.A. said:

[22] ... The clear purpose of subsections 13(2) and 56(3) of the Act and Rule 5... is to ensure that the federal and provincial schemes of execution are complementary and to fill any possible gaps by resorting where necessary to the provincial schemes. These provisions are all invitations to the Court to refrain from inflexibility and adopt the interpretation that best facilitates the integration of the two schemes.

...

[23] The reasons for this are easy to explain. The Federal Court is in a way a court of exception that was grafted onto the existing network of superior courts. Its judgments have significant civil implications and it is essential, if they are to be understandable to litigants and if these implications are to be at all uniform, for execution procedures to be as similar as possible to those of the superior courts. This is all the more essential in that the Court as a general rule uses officers of the court appointed, and the seizure and judicial sale machinery established by, provincial authorities. Thus, reasons of administrative convenience as much as of certainty in civil rights matters have led the federal authorities to rely for all practical

Digitized by Google

purposes on provincial practices.

…

[31] But just as Parliament is free to have Federal Court judgments enforced in the provincial systems, it is also free to provide for other means of enforcing its claims. This is what Parliament did when it enacted section 223 of the *Income Tax Act*. In addition to deeming certificates to be enforceable as judgments of the Court upon registration, the section goes on to provide a specific method of enforcement of those certificates. If subsection 223 did nothing more than deem registered certificates to be enforceable as judgments of the Court, then the motions judge's conclusion would be beyond challenge. The Minister would be bound to take those steps which are required to enforce a judgment under the *Federal Court Act*, including the issuance of a writ of execution. But, subsection 223 does not stop there. It goes on to provide a specific means of enforcing these certificates. The scope and detail of those dispositions can be seen from the extracts below:

[32] Parliament has enacted comprehensive provisions for the enforcement of tax liabilities, and has provided for modalities of enforcement which differ from the normal scheme. It is clear that Parliament is competent to legislate specific enforcement provisions for the collection of tax payable, even if those provisions deal with what would otherwise be questions of property and civil rights in a province (see *TransGas Ltd. v. Mid-Plains Contractors Ltd.*, [1994] 3 S.C.R. 753, aff'g (1993), 105 Sask. R. 211 (C.A.)). As a result, the Minister can rely upon those specific provisions as they appear in the *Income Tax Act*, even if they differ from the enforcement provisions of the *Federal Court Act*.

Seizure Causes Fair Market Value Dispositions in Debtor's Hands, and Her Accompanying Tax Consequences

When CRA seizes a property is deemed disposed of since there is a change in ownership. This causes differing tax consequences immediately and it is the reponsiblity of the taxpayer to satisfy them. Merely because CRA has ostensibly not given the taxpayer enough notice to arrange his affairs to minimize those tax consequences is not a ground for making a claim for damages as was attempted in the Appeal case of Rochelle L. Moss v. Her Majesty The Queen[47] where the taxpayer attempted to argue that the certificate against some insurance policies, that caused the insurance company to lock them up from her as well, was grounds for higher tax damages she incurred as a consequence. The Court found:

[1] This is an appeal from a decision of Campbell J. (the "trial judge") of the Federal Court (2008 FC 768) dated June 19, 2008, dismissing an action for damages claimed by Rochelle L. Moss (the "appellant") against Her Majesty the Queen (the "respondent"). The appellant's claim alleges that conduct of the Minister of National Revenue (the "Minister") in relation to the collection of income taxes payable by her, pursuant to the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA"), prevented her from organizing her affairs in a tax advantageous manner and as a result, she

[47] 2009 FCA 92

Digitized by Google

incurred an income tax liability that she would not have otherwise incurred.

…

[4] The insurance companies had contractual arrangements ("insurance policies") with the appellant under which funds were payable to her. Nonetheless, they declined to make any payments to the Minister pursuant to the Requirements and took the position that the insurance policies were exempt from seizure. After soliciting opinions from the Minister, the insurance companies determined that they would not permit the appellant to withdraw any amounts owing to her under the insurance policies until the exemption from seizure issue was settled.

[5] In her statement of claim, the appellant alleges that the Minister caused the insurance companies to "freeze" her insurance policies, which prevented her from restructuring them in such a way that all of the income generated by them would have been immune from income tax. Accordingly, she claims that the actions of the Minister caused damage to her in that the income from her insurance policies was taxable when it need not have been.

…

[9] The trial judge dismissed the appellant's claim on the basis that she failed to prove that her income tax liability was caused by any action of the Minister. The main findings of the trial judge are succinctly summarized at paragraph 7 of his reasons, where he stated:

… I find that: it is Ms. Moss' conduct that caused the jeopardy order to be issued; as stated, no wrong was committed by the Minister in applying for the order; and no wrong was committed by the Minister in attaching the insurance policies.

…

[13] The appellant argues that the trial judge erred in failing to consider her allegation that the Minister acted in bad faith in relation to the collection actions that were taken. This argument is without merit because there was no allegation of bad faith on the part of the Minister in the appellant's statement of claim. As such, whether the Minister acted in bad faith was not an issue that was before the trial judge.

[14] In addition, the appellant contends that the trial judge failed to consider whether it was "fair, equitable and reasonable" for the Minister to have caused the appellant to become subject to additional income taxes. This contention was covered by the trial judge's finding that the Minister's actions did not cause the additional income taxes that were assessed against the appellant. That finding – one that we have declined to overturn – made it unnecessary for him to consider whether the Minister's actions were, or were not, "fair, equitable and reasonable".

Note that the case turned on whether the CRA had acted in bad faith of the collection effort via the issuance of the jeopardy order.

Damages on Pushed to Bankruptcy

Does CRA not have a duty to act fairly on voting for proposals in bankruptcy or does it have unfettered discretion? This was the case in Stephen Anthony Edell

Digitized by Google

v. Her Majesty The Queen et al.[48] where the taxpayer made a proposal in bankruptcy, which was voted against by CRA, which automatically deemed the taxpayer to be recognized as bankrupt. The taxpayer attempted to aruge that the CRA owed him a duty of care and that he had suffered damages while the court held:

> [1] This proceeding is an action commenced by the Plaintiff, Stephen Edell, against Canada Revenue Agency (CRA), the Superintendent of Bankruptcy (the Superintendent), and Risman & Zysman (the Trustee) for, among other things: an order requiring the CRA to accept his proposal pursuant to the provisions of the *Bankruptcy and Insolvency Act*, R.S.C. 1985 c. B-3 (the Act), a stay of the deemed bankruptcy under s.57 of the Act, and damages.
>
> [2] The Plaintiff alleges that the CRA acted in a malicious manner with reckless disregard for commercial reasonableness, for the recommendation of the Trustee, and for its duties as a public agency. He alleges that he has incurred damages and will continue to incur damages due to the unlawful conduct of the CRA.
>
> …
>
> [5] The Plaintiff also filed a motion on June 20, 2008 seeking an interim stay of the deemed assignment into bankruptcy pending final determination of this action on its merits and also seeking Court directions concerning his payment obligations during the course of the action.
>
> Issue
>
> [6] The main issues to be determined in the three motions are:
>
> Is it plain and obvious that the Plaintiff's Claim discloses no reasonable cause of action?
>
> Should a stay of the deemed assignment provision section 57 of the Act be issued by this Court.
>
> Background
>
> [7] The Plaintiff is indebted to the CRA for outstanding income taxes (inclusive of interests and penalties) and Goods and Services taxes. On January 24, 2008, the Plaintiff made a formal proposal (the Proposal) pursuant to section 50 of the Act listing CRA was his sole creditor.
>
> [8] The Plaintiff proposed to settle the debt he owed to the CRA for a payment of $75,000.00 over four years; a sum that was less that his total indebtedness to the CRA. In making the Proposal, the Plaintiff had the assistance of the Trustee, who recommended that the CRA accept the Proposal.
>
> [9] The meeting of creditors stipulated by the Act was scheduled for February 20, 2008. The CRA delivered its Proofs of Claim and its Voting Letter setting out its vote against the Proposal on February 18, 2008. As a result of the vote against by the CRA, the Proposal failed.
>
> …
>
> Submissions
>
> [11] The Plaintiff alleges that the failure of the CRA to accept his Proposal

[48] 2008 FC 1306

Digitized by Google

was unlawful, contrary to its duties as a public official, and a violation of public policy. He submits that the CRA is required to conduct its affairs and exercise its discretion in a commercially reasonable manner, in good faith and in the public interest. He submits that the CRA owes a higher and more objective standard of care than other creditors because it must act in the public interest.

…

[14] Furthermore, the Defendant Superintendent submits that pursuant to section 71 of the Act, once an assignment in bankruptcy has been filed, the bankrupt ceases to have any capacity to dispose of or deal with their property. Pursuant to section 181 of the Act, if the debtor does not believe that the assignment into bankruptcy ought to be filed they can apply to the court with jurisdiction to have the bankruptcy annulled.

[15] There is no authority under the Act to stay the deemed assignment into bankruptcy. Rather, the bankrupt can apply to have the bankruptcy annulled, or bring its concerns to the official receiver for adjudication. The Defendant Superintendent argues that the bankrupt no longer has any right to bring an action in damages.

…

[17] The Defendant CRA submits that there is no stay available to the Plaintiff against the operation of statute, that there is no cause of action in tort or negligence, and there are no damages that were suffered by the Plaintiff. Furthermore, the Defendant CR A submits that the only way to challenge the Defendant CRA's decision is by judicial review, which the Plaintiff chose not to do.

[18] The Defendant CRA submits that there is no provision in the Act to stay the effect of section 57 and that, while the *Federal Courts Act*, R.S., 1985, c. F-7 permits this Court to stay proceedings, it contains no provision authorizing it to stay the effect of statutory provisions. Even the Ontario Superior Court of Justice, which has exclusive jurisdiction in bankruptcy matters, cannot exercise that jurisdiction if it conflicts with the provisions of the Act.

[19] The Defendant CRA submits that it has done nothing unlawful in voting down the Proposal. Rather, it carried out its duties in accordance with the Act. The CRA filed its Proofs of Claim and voted on the Pro osal using the Voting Letter as it was permitted to do under the Act. The Act does not require: creditors to attend the meeting; to enter into negotiations; or to accept the Trustee's recommendation. Therefore, the Defendant CRA submits that it cannot be liable for any damages suffered by the Plaintiff under the tort of public misfeasance.

[20] The Defendant CRA submits that it did not act negligently in declining the Plaintiff's Proposal. For the CRA to have a duty of care to the Plaintiff giving rise to negligence there would have to be a sufficiently close relationship between the parties, and no public policy reason to limit or negate the duty owed to him.

The Defendant CRA submits that there is no dut of care owed to an individual proponent who seeks to compromise his tax debt to the CRA.

[21] Furthermore, if the Court was to find a proximate relationship and a duty of care owed to the debtor by the creditor, the Defendant CRA

Digitized by Google

submits that it would run contrary to the scheme for proposals set out in the Act by adding a duty of care that was not mandated by Parliament when it enacted the proposal provisions.

[22] The Plaintiff acknowledges that according to the Act once a creditor rejects a proposal the debtor is deemed assignment into bankruptcy. Accordingly, the Plaintiff has sought an order that this deemed assignment be stayed until this action is determined. The Plaintiff claims that an assignment into bankruptcy would be prejudicial to both the interests of the Plaintiff and the public.

…

Motion to Strike by the Defendant CRA

[36] The Plaintiff alleges that the CRA's failure to accept his Proposal or to negotiate in good faith to amend the terms of the Proposal is unlawful, and contrary to the terms of its duties as a public official and a violation of public policy. The formulation suggests an allegation in the tort of public misfeasance also known as "abuse of public office". The Plaintiff must then show that the CRA: engaged in deliberate and unlawful conduct; knew that its actions were unlawful; and knew that the actions would likely harm the Plaintiff. *Odhavji* at paragraph 23.

[37] The Plaintiff has not identified any unlawful or deliberate conduct of the CRA other than the rejection of the recommended Proposal without explanation. The Act provides the procedure by which a creditor may respond to or reject a proposal; the CRA followed this procedure. The Act does not require the CRA to provide an explanation for its decision. Without more, the action by the CRA was lawful when considered in the context of the Act.

[38] The Plaintiff also resorted to the language that arises in the tort of negligence. For negligence, he must show that the CRA: owed him a duty of care; breached the standard of care by its actions; foresaw the harm its actions would lead to; and caused the Plaintiff to suffer injury or damages.

[39] Under the Act, the CRA stands in the same position as any creditor. It is entitled to evaluate the Proposal as any debtor would. It is not under any legal duty to accept less than the debt that it is owed. If anything, the CRA has an obligation to the Government of Canada to collect on income tax and goods and services taxes owed to the government. The CRA, as a debtor, does not owe a duty to the Plaintiff.

[40] The Plaintiff contends that in voting against his Proposal, the CRA acted "in a high-handed, arbitrary and capricious manner … in a reckless disregard for the interests of reasonableness and the lawful exercise of its discretion". In his submissions he states:

"It is also well-established law that a public authority exercising a judicial or quasi-judicial or decision- making power has a mandatory obligation to furnish the interested person with written reasons for its decision."

[41] It is clear the Plaintiff is focussed on the CRA's decision as the source of the harm that he alleges. The Plaintiff's choice of proceeding prompts me to consider the Federal Court of Appeal decision in *Grenier v. Canada,* 2005 FCA 348.

[42] In *Grenier,* Justice Létourneau, at paragraph 20, held that a litigant who disputes a federal agency's decision was not free to choose

Digitized by Google

between an action and judicial review. A decision made by a federal agency retains its legal force and authority and is judicially operative as long as it has not been invalidated. The Federal Court of Appeal decided that it was necessary that a decision of a federal agency be first attacked by way of judicial review before bringing an action in damages.

[43] The Plaintiff has brought an action in damages by which he seeks to challenge the decision of the CRA not to accept his Proposal in the bankruptcy proceeding. He has chosen an impermissible course of action. However, I express no opinion whether a decision by the CRA in relation to a proposal under the Act may be challenged by way of judicial review instead of by the processes provided for in the legislation.

Seizure of goods, chattels or movable property - S. 225

225. (1) If a person has failed to pay an amount as required by this Act, the Minister may give 30 days notice to the person by registered mail addressed to the person's latest known address of the Minister's intention to direct that the person's goods and chattels, or movable property, be seized and sold, and, if the person fails to make the payment before the expiration of the 30 days, the Minister may issue a certificate of the failure and direct that the person's goods and chattels, or movable property, be seized.

Sale of seized property

(2) Property seized under this section shall be kept for 10 days at the cost and charges of the owner and, if the owner does not pay the amount owing together with the costs and charges within the 10 days, the property seized shall be sold by public auction.

Notice of sale

(3) Except in the case of perishable goods, notice of the sale setting out the time and place thereof, together with a general description of the property to be sold shall, a reasonable time before the goods are sold, be published at least once in one or more newspapers of general local circulation.

Surplus returned to owner

(4) Any surplus resulting from the sale after deduction of the amount owing and all costs and charges shall be paid or returned to the owner of the property seized.

from seizure

(5) Goods and chattels, or movable property, of any person in default that would be exempt from seizure under a writ of execution issued out of a superior court of the province in which the seizure is made are exempt from seizure under this section.

CRA Internal Operations Manual - Certificates

(See below image pages)

Digitized by Google

CERTIFICATES, WRITS AND OTHER LEGAL PROCEEDINGS 1

Overview 1

Legislation 1
When a Debt May Be Certified 1
Federal Court Certificates Registered under Provincial Registration Systems 2

General Information 2
Certificate 3
Memorial 3
Writ of Seizure and Sale 3
Order 3

Policy 3
Initiation of Court Action 4
Amounts that are Not Certifiable 4
When to Certify a Debt 5
Validity Time Period of a Certificate 5
Identification of Seizable Assets 5
Seizable Assets 5
Non-Seizable Assets 6
The Validity Time Period of a Writ of Seizure and Sale 6
Renewal of a Writ of Seizure and Sale 6
When are Writs of Seizure and Sale Not Renewed 7
Release of a Writ of Seizure and Sale or Memorial 7
When to Release a Writ of Seizure and Sale or Memorial 7
Approval Authority for Instructions to Sheriffs or Bailiffs 7

PROCEDURES 7
Certifying a Debt 8
Recommending Court Action to Certify a Debt (Form T518) 9
To Recommend Court Action to Certify a Debt for a Memorandum Assessment 11
Rejection of Requests by LDPU 13
Actioning the Certificate (Pre July 2003) 14
Actioning the Certificate (Post July 2003) 14
Obtaining a Certified True Copy of a Certificate (Pre July 2003) 15
Obtaining a Certified True Copy of a Certificate (Post July 2003) 15
Naming Conventions 15
Individual 16
Deceased Individual 16
Corporation 17
Partnerships 17
Partnerships in Quebec 18
Urgent Requests for Court Documents 19
Obtaining a Concurrent Writ of Seizure and Sale or Memorial 19
Recommending Court Action to Obtain a Concurrent Writ of Seizure and Sale or Memorial 20
Actioning the Concurrent Writ of Seizure and Sale or Memorial 20
Requesting a Non-concurrent Writ of Seizure and Sale or Memorial 21
How to Request a Non-concurrent Writ of Seizure and Sale or Memorial (pre July 2003) ... 21
How to Request a Non-Concurrent Writ of Seizure and Sale or Memorial (post July 2003) 22
Renewing a Writ of Seizure and Sale or Memorial 22
How to Renew a Writ of Seizure and Sale that has Not Expired 22

Digitized by Google

How to request a Re-issuance of an Expired Writ of Seizure and Sale When More than Six Years Have Elapsed 23
Amending a Certificate, Writ of Seizure and Sale or Memorial (pre July 2003) 24
How to Amend a Certificate (pre July 2003) 24
How to Amend a Memorial (pre July 2003) 25
How to Amend a Writ of Seizure and Sale where the original document is available (pre July 2003) 25
How to Amend a Writ of Seizure and Sale where the original document is not available (pre July 2003) 26
Amending a Certificate, Writ of Seizure and Sale or Memorial (post July 2003) 27
How to Amend a Certificate (post July 2003) 27
How to Amend a Memorial (post July 2003) 28
How to Amend a Writ of Seizure and Sale where the original document is available (post July 2003) 28
How to Amend A Writ of Seizure and Sale where the original document is not available (post July 2003) 28
Control of Credits 29
Obtaining an Order 30
How to Obtain an Order 30
Completing an Affidavit 31
Affidavit for the Amendment of a Writ of Seizure and Sale (where the original document is not available) 32
Affidavit for a Re-Issuance of a Writ of Seizure and Sale that has expired 32
Affidavit for a Charging Order on Land or an Order to Sell 32
Affidavit for a Charging Order On Securities 33
Affidavit to prepare a Garnishee Order 33
Affidavit to prepare an Examination of Judgment Debtor 33
Charging Law and Court Costs 34
Charging Law and Court Costs 34
Recoverable Costs 34
Non-Recoverable Costs 35
Allowing Passage of Title 35
How to Allow the Passage of Title 35
Seizing Assets 36
How to Seize and Sell Personal Property 36
How to Seize and Sell Real Property 37
How to Respond to a Motion Opposing Seizure 39
Releasing a Writ of Seizure and Sale or Memorial 39
How to Release a Writ of Seizure and Sale or Memorial (pre & post July 2003) 39
What to do with legal documents when they are no longer required 40
Requesting a Satisfaction of Certificate 40

Digitized by Google

Certificates, Writs and Other Legal Proceedings

Collections Manual Updates

Overview

An outstanding liability may be collected through the Courts. Court proceedings begin with the Federal Court registration of a Certificate that is prepared by Legal Document and Processing Unit (LDPU). Once a Certificate has been registered in the Federal Court it has the same force and effect as if it were a Judgment for a creditor. Once the Certificate is obtained, a Writ of Seizure and Sale, Memorial or other legal document; depending on the province in which the proceedings are initiated; is required to seize and sell personal or real property or to encumber real property in order to protect the interests of the Crown.

Legislation

This section identifies the legislative provisions relating to Certificates, Writs and Other Legal Proceedings:

- *Canada Pension Plan*, sections 23 and 36
- *Excise Tax Act*, sections 83, 316 and 321
- *Excise Act, 2001*, sections 288 and 293
- *Federal Courts Act*
- *Federal Courts Rules, 1998*
- *Income Tax Act*, section 223 and the applicable Provincial and Territorial Income Tax Acts
- *Unemployment Insurance Act*, sections 65 and 127
- *Employment Insurance Act*, sections 86 and 98
- *Air Travellers Security Charge Act*, sections 74 and 79

Key Legislative Items

- **When a Debt May Be Certified**
- **Federal Court Certificates Registered under the Provincial Registration Systems**

When a Debt May Be Certified

Amounts that may be certified immediately following the day of the mailing of the Notice of Assessment include:

Digitized by Google

- amounts payable under the *Income Tax Act*, Part VIII (includes related interest and penalties)
- GST/HST amounts (includes related interest and penalties)one half the amount assessed on large corporation taxes, under the *Income Tax Act*, Part 1.3 as well as one half of the amount assessed if the corporation is related to a large corporation.

  Note: For 2006 and subsequent tax years, large corporations must file the required returns or be subject to penalty.
- taxes payable by non-residents under the *Income Tax Act*, sections 116 and 215(4) (includes related interest and penalties)
- unremitted source deductions (includes related interest and penalties)

Except for cases where a jeopardy order is issued, all other Tax and Excise amounts can only be certified 90 days after the day of mailing of the Notice of Assessment and/or upon conclusion of a Notice of Objection or appeal. Some examples where the amounts can only be certified 90 days following the day of mailing include:

- individual tax
- corporate tax
- third party liabilities
- director's liability

Federal Court Certificates Registered under Provincial Registration Systems

Section 223 of the *Income Tax Act* and section 316 of the *Excise Tax Act* allows the Canada Revenue Agency (CRA) to register with the Federal Court a Certificate evidencing various amounts payable by a taxpayer. At the time of registration of a Federal Court Certificate, Writ or any other notification thereof (referred to as a Memorial), using the procedure established by the applicable provincial legislation for creating a lien, charge, priority or binding interest in or on land or personal property, in respect of a judgment in the province or debt owing to the province, CRA will register Memorials in the appropriate provincial registry systems. This Memorial will be equally effective for the purpose of binding land and personal property in that province.

A lien, charge, priority or binding interest created under subsection 223(6) of the *Income Tax Act* and subsection 316(5) of the *Excise Tax Act* is deemed to give rise to a secured claim in bankruptcy upon registration. This will enable federal tax and GST/HST claims to compete in bankruptcy with other secured claims. As provided in the *Bankruptcy and Insolvency Act*, prior registration will allow prior ranking amongst secured claims.

For further details refer to the Directive RCD 98-04 **Bill C-28 Impacts on Accounts Receivable Program - Lien and Charge Registration** and Directive RCD 98-06 **Lien and Charge Registration**

General Information

This section provides general information on certain legal actions that may be initiated:

Digitized by Google

- **Certificate**
- **Memorial**
- **Writ**
- **Order**

Certificate

A "Certificate" is a formal written assertion, attesting that an amount payable by a tax debtor is outstanding. The registration of a Certificate in the Federal Court has the same force and effect as a judgment of a Court against the tax debtor, for the amount due to the Crown. Amounts are certified in accordance with legislative provisions and certain criteria. Once the debt is certified, additional legal proceedings may be commenced in accordance with the *Income Tax Act*, *Excise Tax Act*, *Federal Courts Act*, *Federal Courts Rules* and the Execution Acts of the provinces.

Memorial

A "Memorial" is a document issued by the Federal Court and may be filed, registered or otherwise recorded as creating a charge or lien against real or personal property registered to a debtor, and/or any property the tax debtor holds an interest in.

Writ of Seizure and Sale

A "Writ" is a written command or formal order in favour of the Crown. It is issued for the purpose of directing a person to comply with what is indicated by the Federal Court. In some provinces a Writ is used to place a lien, or charge against real property registered to a debtor.

Writs can be used to implement enforcement measures, for example: Writ of Seizure and Sale.

Order

An "Order" is a written decision and/or direction of a Judge, or under special circumstances, by the Court Registrar. The order requires the parties that receive it to execute or carry out the Court's decision.

Policy

This section provides policy related to Certificates, Writs and Other Legal Proceedings:

- **Initiation of Court Action**
- **Amounts that are not Certifiable**
- **When to Certify a Debt**

Digitized by Google

- **Validity Time Period of a Certificate**
- **Identification of Seizable Assets**
- **The Validity Time Period of a Writ of Seizure and Sale**
- **Renewal of a Writ of Seizure and Sale**
- **Release of a Writ of Seizure and Sale or Memorial**
- **Approval Authority for Instruction to Sheriffs or Bailiffs**

Initiation of Court Action

Court proceedings are initiated by registering a Certificate in the Federal Court. Prior to initiating court action consider the following:

- amount of the debt
- cost of the court action in relation to the potential dollar recovery
- danger of loss
- tax debtor's ability to pay

  Refer to **Ability to Pay** of the Payment Arrangements chapter for further detail.

- type of assets to be seized

Note: If a Writ, Order or Memorial is registered on the title of a property where the tax debtor resides permanently, the sale of the property is not normally forced by CRA. However, a review of the relevant facts may warrant the sale of the property . Where an exception to this policy is considered Collection officers are required to refer the matter to their assigned **Field Support Programs Officer**.

Amounts that are Not Certifiable

The following circumstances will generate recoverable amounts that are not certifiable. In the event that these amounts require court action refer the matter to the Department of Justice, and Field Support Programs Officer.

- duplicate refund cheque cashed by the tax debtor
- refund cheque cashed by a person having the same name as the tax debtor
- the cashing of a refund cheque issued following the processing of a fraudulent return, in the name of an alias

Digitized by Google

When to Certify a Debt

A debt may be certified in the following circumstances:

- all other action was ineffective
- assets are available for seizure
- a lien or charge is placed to protect the Crowns interest
- collection of an amount is at risk if immediate action is not taken
- lack of co-operation from the tax debtor
- no satisfactory payment arrangement reached

Validity Time Period of a Certificate

The Certificate remains valid as long as the certified debt is collectible. For further details, refer to Communication TSDMB-2005-024 **Limitation Periods Applicable to the Collection of Tax Debts**.

Identification of Seizable Assets

A Writ of Seizure and Sale is required to seize and sell a tax debtor's assets to reduce or satisfy a debt. Before seizing assets it is essential to determine whether the assets held by the tax debtor are seizable.

Related Topics:

- **Seizable Assets**
- **Non-Seizable Assets**

Seizable Assets

Seizable assets include:

- business chattels, for example: furnishings, equipment, inventory, livestock, computer equipment
- cash, guaranteed investment certificates, notes receivable, mortgages, bonds, safety deposit box contents,
- RRSPs, refer to Communication TSDMB-2003-004 **Funds Held in RRSPs**
- exclusive rights, for example: copyrights, patents, exploration rights
- licences and permits, for example: fishing rights, timber licence, taxi licence

Digitized by Google

- personal property, for example: works of art, jewellery, furniture, cars, boats, recreational vehicles
- real estate, for example: building and/or land, interest in property, leases
- principal residence in exceptional circumstances. In situations where a seizure and sale is considered Collection officers are required to refer the matter to their assigned **Field Support Programs Officer**. One exceptional circumstance may include the expiry of the limitation period. For further details, refer to Communication TSBMB 2005-024 **Limitation Periods Applicable to the Collection of Tax Debts**

Non-Seizable Assets

The Agency will not ordinarily seize the following assets:

- personal property of an Indian or Indian Band when deemed located on a reserve, refer to the ***Indian Act*-Collection Guidelines**
- irrevocable trust funds, or trust funds set up with clauses prohibiting seizure.
- tools necessary to, and used by the taxpayer in his profession, business, trade or calling

  Note: Refer to the applicable provincial legislation provisions to determine the precise exemptions applicable to your area.

Although these assets are not ordinarily seized, review the relevant facts of each case to determine if seizure action is warranted under the circumstances. Where an exception to this policy is considered Collection officers are required to refer the matter to their assigned **Field Support Programs Officer**.

The Validity Time Period of a Writ of Seizure and Sale

A Writ is valid for a period of six years. Prior to the expiration of a Writ, an additional six-year period may be requested.

Note: Subsection 437(1) of the *Federal Courts Rules* states a Writ of Execution is valid for 6 years after it's date of issuance. The date of issuance refers to the certification date, not the date the Writ was registered.

Renewal of a Writ of Seizure and Sale

When a property is under seizure, the renewal of a Writ of Seizure and Sale has the benefit of not interrupting the Agency's priority. It is imperative that potential recovery is not jeopardized by the loss of priority because a renewal application was not made to the Court prior to the expiration of a Writ of Seizure and Sale. For further instructions on how to renew a Writ refer to **Renewing a Writ of Seizure and Sale or Memorial**

Related Topic:

- **When are Writs of Seizure and Sale Not Renewed**

Digitized by Google

When are Writs of Seizure and Sale Not Renewed

Do not renew Writ of Seizure and Sale when:

- known assets are exempt from seizure
- severe hardship exists
- law and court costs are higher than the net realization

Release of a Writ of Seizure and Sale or Memorial

When a Writ of Seizure and Sale or Memorial is released, the Agency's priority on the asset no longer exists.

Related Topic:

- When to Release a Writ of Seizure and Sale or Memorial

When to Release a Writ of Seizure and Sale or Memorial

Release a Writ of Seizure and Sale or Memorial when:

- the account status is nil and the possibility of a cheque being returned by the bank has expired
- the Writ is expired and renewal is not required

Note: Cases where the tax debtor has filed an Assignment into Bankruptcy or a Proposal in Bankruptcy refer to the following Directives:

RCD-98-04 Bill C-28 Impacts on Accounts Receivable Program

RCD-98-06 Lien and Charge Registration

RCD-02-01 Deemed Security Interest – The Crown As A Secured Creditor In A Bankruptcy

Approval Authority for Instructions to Sheriffs or Bailiffs

Note: Depending on provincial requirements, the use of Bailiffs may apply to execute a Writ. Local procedures should be followed.

Instructions to Sheriffs or Bailiffs to execute seizure and sale under a Writ or any other legal process must be issued under the signature of the Assistant Director – Taxpayer Services and Debt Management.

Procedures

Digitized by Google

This section provides procedures related to Certificates, Writs and Other Legal Proceedings:

- Certifying a Debt
- Naming Conventions
- Urgent Request for Court Documents
- Obtaining a Concurrent Writ of Seizure and Sale or Memorial
- Requesting a Non-Concurrent Writ of Seizure and Sale or Memorial
- Renewing a Writ of Seizure and Sale or Memorial
- How to request a Re-Issuance of an Expired Writ of Seizure and Sale When More than Six Years Have Elapsed
- Amending a Certificate, Writ of Seizure and Sale or Memorial (pre July 2003)
- Amending a Certificate, Writ of Seizure and Sale or Memorial (post July 2003)
- Obtaining an Order
- Completing an Affidavit
- Charging Law and Court Costs
- Allowing Passage of Title
- Seizing Assets
- Releasing a Writ of Seizure and Sale or Memorial
- What to do with Legal Documents when they are no longer required
- Requesting a Satisfaction of Certificate

Certifying a Debt

Certifying a debt is the process of registering a Certificate in the Federal Court, certifying that an amount payable by a tax debtor was not paid. On July 2, 2003, the procedure for certifying debts and obtaining court action was automated. Consequently, in this section, you will note references to pre and post July 2003, as applicable.

The stages to certify a debt include:

- Recommending Court Action to Certify a Debt (Form T518)
- Recommending Court Action to Certify a Debt for a Memorandum Assessment
- Selection of Request by LPDU

Digitized by Google

- **Actioning the Certificate (Pre July 2003)**
- **Actioning the Certificate (Post July 2003)**
- **Obtaining a Certified True Copy of a Certificate (Pre July 2003)**
- **Obtaining a Certified True Copy of a Certificate (Post July 2003)**

Note: Local procedures may differ.

Recommending Court Action to Certify a Debt (Form T518)

To recommend Court action to certify a debt, complete the T518 form on ACSES (Request for Certificate – Regular (T518)):

You may access the Request for Certificate online via the "Letter, Forms and Transcripts" option.

1. Request for Certificate - Regular (T518) "Identification" Screen

   This screen will provide the user with the taxpayer's account number, name, address, account number and revenue type. If a Certificate already exists for the account, a screen showing a list of outstanding Certificates will be displayed. This will allow the user to review all existing certificates and ensure there is no duplication.

   Key in the required information in the following fields:

   - Language of Documents
   - Number of copies required
   - Date of Birth
   - Primary Name (should include the account name and any aliases (AKA) or trade names, according to the Naming Conventions).
   - Address information, see note below
   - Occupation of taxpayer (for example: doctor for T1, construction for GST/HST, PAYDAC, T2).

   Note: Residents outside of Canada and the United States:

   If the country code is not Canada or the US key the name of the city and country on the City line. Leave the Prov/State Code blank and key "EX" on the Country line.

   Note: "c/o"
   When requesting a Certificate with a "c/o" mailing address, the reason must be clearly indicated in the "Recommendation" field.

   Once the required information has been entered, press PF8.

2. Request for Certificate – "Amount" Screen

Digitized by Google

The blank fields on this screen must be completed before the user will be allowed to continue to the next section of the Certificate:

- Amount to be certified
- Interest calculated to date
- Provincial amount (if applicable)
- Other certified amount(s)
- Notice of Objection
- Last legal warning
- Once the information on this screen is entered, press F8

3. Request for Certificate – "Assessment Details" Screen

   This screen will allow the user to key in the assessment details relating to the Certificate.

   The user will also be allowed to modify or delete data prior to the approval of the Certificate.

   Press "Enter" when complete.

   Note: Do not include previously certified amounts.
   For example: if the tax for a taxation year or period is already certified and a reassessment results in an increase in the debt, only the increased tax, related penalty and interest thereon are to be certified.

4. Request for Certificate – "Assets" Screen

   Requires the user to enter the date of the last property search.

   This screen also allows the user to enter the details of the assets (asset description, market value, encumbrances, equity)

5. Request for Certificate – Recommendation Screen

   This screen allows the user to complete a brief history of the account. Once the history is entered the user ID of the person who completed the last update will be displayed.

   Note: Text editing features similar to ELCS to allow the user to modify the text without having to delete it. For further details refer to Communication TSDMB-2005-006 **System Enhancements - February 2005 ACSES Text Editing Federal Court Actions New TSO**

6. Federal Court Actions – "Actioning" Request Screen

   This screen will allow the collection officer to submit the request for Certificate for approval by keying an "x" beside Submit, then pressing enter.

   Note: The manager will receive the referral on their ACSES referral list for approval.

Digitized by Google

Immediately notify the L.D.P.U. of any financial transaction that results in an increase or decrease of the amount to be certified. If the T518 request remains outstanding, the L.D.P.U. officer will modify the balance owing accordingly.

Forward an email to:
mailto:NOR-Ottawa, NAT-LDPU OTC.

The subject line must read "Balance Changed".
For any additional assessments, it will be necessary to wait for the amount to become legally collectible before it can be certified.

In the event that the Certificate has already been registered in Federal Court refer to **CONTROL OF CREDITS** for proper court document annotation.

To Recommend Court Action to Certify a Debt for a Memorandum Assessment

To recommend Court Action to certify a debt for a Memorandum Assessment, the user must complete the T518 form on ACSES (Request for Certificate – Memorandum Assessment T518) via the primary file account:

The user can access Request for Certificate online via the "Letters, forms & transcripts" option

1. If a certified amount is already on file, a list of the current Certificates is provided. Key in an "x" to create a new Certificate.

2. Request for a Certificate (T518) "Identification" Screen

   This screen is used to enter the name and address of the third party who has already been assessed and against whom legal measures will be initiated.

   Key in the required information in the following fields:

- Third party account number, if no account exists key in an "x" in the No Account Number field
- Language of Document
- Number of copies required
- Date of Birth (if applicable)
- Primary Name
- Name of third party assessed (includes aliases/AKA or trade names) Refer to **Naming Conventions**
- Information with respect to the address of the third party assessed (refer to note below)
- Occupation of the third party assessed (mandatory) for example: doctor for individual, construction for a business

Note: Residents outside of Canada and the United States:

Digitized by Google

If the country code is not Canada or the United States, key in the name of the city and country on the City line. Leave the Prov/State code blank and key "EX" on the Country line.

Note: "c/o"
When submitting a request for Certificate that includes a "c/o" mailing address, the reason must be clearly indicated in the "Recommendation" field.

Once the requested information has been entered, press PF8.

3. Request for Certificate – "Amount" Screen

All blank fields on this screen must be completed to continue to the next section of the Certificate.

- Amount to be certified
- Interest calculated to date
- Provincial amount (if applicable)
- Other certified amount(s)
- Notice of Objection
- Last legal warning

Once completed press PF8.

4. Request for Certificate – Memorandum Assessment "Details" Screen

   This screen will allow the user to key in Memo Assessment details. The user will also be allowed to modify or delete data prior to the approval of the Certificate.

   - Memo Assessment Date
   - Authority for Joint and Several Liability, by keying an "x" in the check box, a list of the sections of the Act under which the third party was assessed can be viewed

   Once complete press "Enter".

5. Request for Certificate – "Assets" Screen

   Requires the user to enter the date of the last property search.

   This screen also allows the user to enter details of assets (asset description, market value, encumbrances and equity.)

6. Request for Certificate – "Recommendation" Screen

   This screen allows the user to complete a brief history of the account. Once the history is entered, the user ID of the person who completed the last update will be displayed.

   Note: Text editing features similar to ELCS are detailed in the ARD-2005-006 Communication **System Enhancements - February 2005 ACSES Text Editing Federal Court Actions New TSO**

Digitized by Google

7. Federal Court Actions – "Actioning Request" Screen

This screen will allow the Collections Officer to submit for approval the request for Certificate by keying an "x" beside Submit, press Enter.

Note: The manager will receive the referral on their ACSES referral list for approval.

Immediately notify the L.D.P.U. of any financial transaction that results in an increase or decrease of the amount requested for certification. If the T518 request remains outstanding, the LDPU officer will modify the balance owing accordingly.

Forward an email to:
NOR-Ottawa, NAT-LDPU OTC.

The subject line must read "Balance Changed".

For any additional assessments, it will be necessary to wait for the amount to become legally collectible before it can be certified.

In the event that the Certificate has already been registered in Federal Court, refer to **CONTROL OF CREDITS** for proper court document annotation.

Rejection of Requests by LDPU

L.D.P.U. enters the reason for the rejection in the legal document item of the work in progress (WIP) menu. The reject types experienced most often are:

- **Mailing Address containing a c/o mention**

  When submitting a request for Certificate containing a mailing address with "c/o", the reason should be clearly indicated in the Recommendation field. This will help L.D.P.U. to process the documents rapidly. For information, please refer to the Communication TSDMB-2005-003 **Certification (T518) Process**.

- **Different Address**

  A different address is entered on the Request for action. If for any reason you want to certify a debt with an address that differs from the one on file, you must explain why. Whether the request for action is submitted on paper or electronically, an explanation must be entered in the Brief History of Account for paper processing or via the Recommendation screen for online processing.

- **Portion of the Debt is Already Certified**

- **Payment Arrangement or Cash-In Transit**

  Since the recommendation for action was submitted, an agreement was reached for the balance of the debt or a payment was in transit and L.D.P.U. had not been informed of the changes.

- **Bankruptcy**

Digitized by Google

The debtor has filed an Assignment in Bankruptcy, a Notice of Intention to File a Proposal, or has filed a Proposal, under the *Bankruptcy and Insolvency Act (BIA)*. The Stay of Proceedings pursuant to section 69 of the BIA applies to the Minister.

- **Request for Memorandum Assessment**

  The recommendation for court action is initiated in the wrong account. A request must be made from the primary account.

Actioning the Certificate (Pre July 2003)

To action the Certificate:

1. Review the following Court documents, received from the L.D.P.U., for typing errors, for example: name, address, and missing information:

   - copy of the Certificate form T305
   - copy of the form letter T305A-P advising the taxpayer of the registration of the Certificate in the Federal Court
   - copies 1 and 2 of the T312 form

   Note: If there are errors in the document(s), refer to the section **How to Amend a Certificate (pre July 2003)** for more details.

2. Allow the tax debtor 30 days from the mailing date of the notification letter sent by the L.D.P.U., advising of the registration of the Certificate, to:

   - conclude a satisfactory arrangement
   - pay the account
   - provide security

3. If at the end of the 30 days, the tax debtor fails to comply in a satisfactory manner, request a Writ of Seizure and Sale, Memorial or other legal document by forwarding copy 1 of the T312 form to the L.D.P.U. Provide the name and address of the person making the request to facilitate prompt return of the completed documents.

4. Provide the following information on the T312 form to the L.D.P.U.:

   - amounts of all credit transactions made after the date of certification, and
   - dates of all credit transactions made after the date of certification.

Actioning the Certificate (Post July 2003)

To action the Certificate:

1. Review the following Court documents, received from the L.D.P.U., for typing errors, for example: name address, and missing information:

Digitized by Google

- copy of the Certificate form T305
- copy of the form letter T305A-P advising the taxpayer of the registration of the Certificate in the Federal Court

Note: If there are errors in the document(s), refer to the section **How to Amend a Certificate (post July 2003)** for more details.

2. Allow the tax debtor 30 days from the mailing date of the notification letter sent by the L.D.P.U., advising of the registration of the Certificate, to:

- conclude a satisfactory arrangement
- pay the account
- provide security

3. If at the end of the 30 days, the tax debtor fails to comply, request a Writ of Seizure and Sale, Memorial or other legal document by requesting Court Action under existing Certificate (T312) on ACSES.

Obtaining a Certified True Copy of a Certificate (Pre July 2003)

Send the L.D.P.U. an email to **NOR-Ottawa, NAT-LDPU-OTC** including::

- Account number
- Federal Court number
- Number of copies

Obtaining a Certified True Copy of a Certificate (Post July 2003)

An online request must be made to obtain a true copy of a Certificate.

Procedure to be followed :

- Access the "Letters, Forms & Transcripts" Menu
- Select "Collections Legal Documents Sub-Menu"
- Select "Federal Court Action"
- Select "Request for a Certified True Copy of the Certificate" Should more than one Certificate exist, select the one for which a Certified True Copy is required
- Key an "x" in the checkbox defined to create a Certified True Copy of the Certificate
- Action the "F4" key to activate the request and key an "x" in the box "Submit"
- Confirm your request and forward it for approval

For further details refer to Communication TSDMB-2005-015 Federal **Court System (T518)**

Naming Conventions

Digitized by Google

To prepare a recommendation for Court Action, identify the tax debtor using the Naming Conventions listed below:

- **Individual**
- **Deceased Individual**
- **Corporation**
- **Partnerships**

Individual

Individual

Tax debtor's full given name followed by the surname in the identical style as contained on the Notice of Assessment, for example, John William Brown.

Individual - Using Alias

Tax debtor's full first name followed by the surname; include known aliases, for example, John Brown (sometime known as John Doe and John Smith).

Individual - Sole Proprietor

Tax debtor's full given name followed by the name of the proprietorship, for example, John Doe (sometime carrying on business as Doe's Doings).

Individual - Operating under a Registered Business Name

Tax debtor's full given name followed by the name of the registered business name, for example, John Doe (sometime carrying on business under the name and style of Doe's Doings Reg.).

Deceased Individual

Deceased Individual - Intestate

Tax debtor's name in the identical style as contained on the Notice of Assessment ifthe next of kin indicates no willingness to apply for a Letter of Administration

Deceased Individual - Testate

Name of the Executor/Executrix, for example, John Doe, Executor of the Last Will and Testament of "deceased."

Deceased Individual - Intestate (Administrator appointed)

Name of the Administrator, for example, Administrator of the Estate of the late "deceased."

Note: In the province of Quebec Liquidator is used instead of the terms Executor/Executrix or Administrator, for example Liquidator of the Estate of "deceased" or Liquidator of the last Will and Testament of "deceased".

Digitized by Google

Corporation

Corporation

The exact legal name of the business, for example, J.D. Holdings Company Ltd.

Corporation - Assets Registered in a Trade Name

The trade name used to register the corporations assets, for example, the designation J.D. Holdings Company Limited (sometime carrying on business as The Doings).

Corporation a Division of Another Corporation

If you know the division is a separate legal entity, the division's name, if in doubt, the division's name followed by the name of the parent company, for example, XYZ, a division of ABC Inc.

Corporation - Amalgamated into a New Entity

The name of the amalgamated corporation followed by the name of the corporation before amalgamation, for example, Company A, an amalgamated corporation and continuation of Company B.

Partnerships

GST/HST Partnerships, except the Province of Quebec:

In cases where the partnership is the debtor, only the partnership name is required, prior to the issuance of the memorandum assessment against the individual partners.

Note: Pursuant to subsection 123(1) of the *Excise Tax Act*, a partnership is a separate entity, separate from the partners, for GST/HST purposes. Subsection 272.1(1) of the *Excise Tax Act* stipulates that, for GST/HST purposes, we are dealing with the partnership, and not the partners.

To affect recovery from the individual partners it will be necessary to issue a memorandum assessment against the partners. For further details refer to the chapter **Memorandum Assessments**

After the memorandum assessments have been issued, Writs of Seizure and Sale and Memorials may be obtained against any partner. There is no requirement to register Certificates against all of the partners.

Prepare a T518 for each partner we are pursuing; and include the partnership name. For further details refer **To Recommend Court Action to Certify a Debt for Memorandum Assessment**

For example:
John Smith (sometime carrying on business as J & J's Painting)
Jane Smith (sometime carrying on business as J & J's Painting)

For further details refer to Memorandum 03-05, **Liability of Partnerships and Partners for GST/HST**.

ITA Partnerships, except the Province of Quebec

i) If the partners and the business are all at the same address:

Digitized by Google

The name of each partner followed by the business address and include the partnership name, for example: John Doe and Jane Doe (sometime carrying on business as ABC Doings), jointly and severally, 20 Lake Road, Anytown, British Columbia.

ii) If the business is at a different address:

The name of each partner followed by their address and include the partnership name and address, for example: John Doe and Jane Doe (7 Country Lane, Anytown, British Columbia) (sometime carrying on business as ABC Doings, 20 Lake Road, Anytown, British Columbia), jointly and severally.

Individual Partners of a Partnership for a Partnership ITA Debt, except in the Province of Quebec:

Court action should be taken against each partner using the same parameters for an individual debtor:

The name of the partner (sometime carrying on business as INSERT NAME OF PARTNERSHIP), followed by the known address of the partner.

For example:

John Doe (sometime carrying on business as ABC & Associates) 123 Lake Street, Anytown, Ontario, Postal Code

Where an individual partner within a partnership has a tax liability for an amount separate from the partnership:

A Requirement to Pay in the name of the partner debtor is issued to the known partnership entity.

Partnerships in Quebec

Partnerships are either general partnerships, limited partnerships or undeclared partnerships.

In Quebec, they are governed by the Civil Code of Quebec, Book Five, Title two, Chapter X.

The Tax Debtor is a Partner

As a rule, the assets of a partnership cannot be seized to satisfy a partner's personal liability. The exception lies in the undeclared partnership where, in respect of creditors, each partner has retained the ownership of the property constituting his contribution to the undeclared partnership. Such contribution can therefore be seized to satisfy a partner's personal liability.

When contemplating the seizure of a partner's share in partnership, refer to Department of Justice for assistance.

The Tax Debtor is a General or Limited Partnership Indebted for Payroll Deductions

The Civil Code of Quebec, Article 2221 reads:

In respect of third persons, the partners are jointly liable for the obligations contracted by the partnerships but they are jointly and severally liable if the obligations have been contracted for the service or operation of an enterprise of the partnership.

Digitized by Google

Before instituting proceedings for payment against a partner, the creditors shall first discuss the property of the partnership. Meaning, that creditors must first proceed against the partnership's assets. When proceedings are instituted against a partner, the property of the partner is not applied to the payment of creditors of the partnership until after his own creditors are paid.

Despite the clarity of article 2221 and again, in the absence of significant case law on the subject of Collections pursuant to the ITA and partnerships, cases involving the responsibility of a partnership or its partners for Payroll Deductions should be referred to the Department of Justice for legal advice.

The Tax Debtor is an Undeclared Partnership indebted for Payroll Deductions

The Certificate is issued in the partners' name followed by the partnership name, for example, John Doe and Mary Doe sometime operating a partnership together or a firm under the name of Doe's Carpet Cleaner.

An undeclared partnership is not bound to make declarations in the manner prescribed by the legislation concerning the legal publication of partnerships. For this reason it may be difficult to thoroughly identify current members. Verify with the financial institution that there has not been any recent change in partners.

Urgent Requests for Court Documents

For all requests for Court documents where the normal delay in processing by the L.D.P.U. could result in a loss to the Crown, an urgent request may be made.. The Field Support Programs Officer is authorized to contact the L.D.P.U. and will ensure that the Court documents are processed on a priority basis.

Collections Officer must complete the request for Court documents electronically or on paper, whichever is applicable, and indicate the reason for the urgency. Once the Manager approves the request, they will forward an email to the **Field Support Programs Officer** who will contact the L.D.P.U. for priority processing.

Obtaining a Concurrent Writ of Seizure and Sale or Memorial

When a concurrent Writ of Seizure and Sale or Memorial is requested at the same time as the Certificate, it is referred to as "concurrent". A concurrent Writ of Seizure and Sale or Memorial is requested in the following instances:

- when imminent danger of loss exists
- to obtain the required Court documents for execution, in order to pursue the directors of a company

Related Topics:

- **Recommending Court Action to Obtain a Concurrent Writ of Seizure and Sale or Memorial**
- **Actioning the Concurrent Writ of Seizure and Sale or Memorial**

Note: Refer to the applicable provincial legislation provisions to determine local procedures.

Digitized by Google

Recommending Court Action to Obtain a Concurrent Writ of Seizure and Sale or Memorial

To recommend a Court Action, complete the T312 form on ACSES.

When you select this function on ACSES, if more than one Certificate exists the system will prompt you to select the Certificate you wish to attach it to.

Complete the required fields of T312 on this screen:

The required information is:

- Language of documents
- Number of copies required
- The Proposed action; key an "x" beside the proposed action line, this will display a list of available actions, select one, then press « F3 ».
- Same process for the Judicial District, select the province and Sheriff or Bailiff then enter.
- Once completed F4 to action the request
- Obtain authorization for the recommendation. The manager will receive the referral on their ACSES referral list.

Note: Where assets are located in multiple Judicial Districts multiple Writs or Memorials may be required depending on provincial legislation. For each additional Judicial District an additional T312 may be required.

Actioning the Concurrent Writ of Seizure and Sale or Memorial

To action the Concurrent Writ of Seizure and Sale or Memorial:

1. Review the following Court documents received from the L.D.P.U. for typing errors, for example: name, address, and missing information:

   - copy of the Certificate
   - original and copy of Writ of Seizure and Sale or Memorial

   Note: If there is an error on the documents, refer to the section **Amending a Certificate, Writ of Seizure and Sale, or Memorial (post July 2003)** for more details.

2. Complete and immediately mail out ELCS Letter verse 19656 to the tax debtor. For further details, refer to Communication TSDMB-2005-003 **Certification (T518) Process**

3. Complete any registrations as applicable to your provincial legislation.

4. Issue instructions to the Sheriff or Bailiff of the appropriate Judicial District as applicable.

Digitized by Google

Note: Refer to **Contacts and Addresses** for a list of Sheriffs' or Bailiffs' addressee.

Requesting a Non-concurrent Writ of Seizure and Sale or Memorial

When a Writ of Seizure and Sale or Memorial is **not** requested at the same time as the Certificate, it is referred to as "Non-concurrent". A Non-concurrent Writ of Seizure and Sale is usually obtained to seize and sell assets. However, in the following provinces a Memorial is required to place a lien on real property only, prior to executing a sale.

- British Columbia
- Manitoba
- New Brunswick
- Nova Scotia
- Prince Edward Island

Related Topics:

- **How to Request a Non-concurrent Writ of Seizure and Sale or Memorial (pre July 2003)**
- **How to Request a Non-concurrent Writ of Seizure and Sale or Memorial (post July 2003)**

How to Request a Non-concurrent Writ of Seizure and Sale or Memorial (pre July 2003)

To request a Non-concurrent Writ of Seizure and Sale or Memorial:

1. Complete the middle portion of copy 1 of the T312 form.
2. Enter:
   - number of Writs of Seizure and Sale, Memorials or other legal documents
   - name(s) of the Judicial District(s)

     Refer to Contacts and Addresses for further details on judicial districts.
   - collections officer name, TSO name, address and telephone number
3. Obtain authorization from the Manager or other authorized person
4. Forward the recommendation for processing to the Legal Document Processing Unit, 2215 Gladwin Crescent, Area 500, Ottawa K1B 4K9

Note: Where assets are located in multiple Judicial Districts, multiple Writs or Memorials may be required depending on provincial legislation. If required photocopy the T312 prior to completion to enable completion of additional T312s.

Digitized by Google

How to Request a Non-Concurrent Writ of Seizure and Sale or Memorial (post July 2003)

Having requested the Certificate on ACSES, you will now request for Court Action under existing Certificate (T312) on ACSES.

When you select this function in ACSES, if more than one Certificate exists, the system will prompt you to select the Certificate you wish to attach it to.

Complete the required fields of T312 on this screen:

The information required is:

- language of documents
- number of copies required
- proposed action; key an "x" beside the proposed action line, the system will display a list of available actions, select one, then press F3
- same process for the Judicial District, select the province and Sheriff or Bailiff then press enter
- once completed press F4 to action the request
- obtain authorization for the recommendation. The manager will receive the referral on their ACSES referral list

Note: Where assets are located in multiple Judicial Districts multiple Writs or Memorials may be required depending on provincial legislation. For each additional Judicial District an additional T312 may be required.

Renewing a Writ of Seizure and Sale or Memorial

A Writ of Seizure and Sale that has not been wholly executed may be extended beyond the validity period of six years. The renewal procedure is different for Writs of Seizure and Sale before and after they have expired.

Note: subsection 437(1) of the Federal Court Rules states that a Writ of Execution is valid for 6 years after the date of issuance. The date of issuance refers to the certification date, not the date when the Writ was registered.

Related Topics:

- **How to Renew a Writ of Seizure and Sale that has Not Expired**
- **How to request a Re-Issuance of an Expired Writ of Seizure and Sale When More than Six Years Have Elapsed**

How to Renew a Writ of Seizure and Sale that has Not Expired

To renew a Writ of Seizure and Sale that has not expired:

Digitized by Google

1. Ninety days prior to the expiration of the Writ of Seizure and Sale, send a memorandum requesting the renewal to the Department of Justice. The request for renewal must provide an explanation as to why the extension is required.

Note: The Department of Justice makes a motion to the Court to issue an Order extending the validity of the Writ of Seizure and Sale for an additional six years. The order is sent to the Tax Services Office.

2. When the extension is received, forward the following documents to the appropriate Sheriff or Bailiff prior to the expiry date of the original Writ of Seizure and Sale:

- a copy of the Writ of Seizure and Sale endorsed with a notice setting out the date, or
- a certified copy of the Court Order, where the Court Order directs that the Writ be extended

A Writ of Seizure and Sale that has been extended prior to its expiration, continues without interruption.

How to request a Re-issuance of an Expired Writ of Seizure and Sale When More than Six Years Have Elapsed

In this instance, a Court Order to renew the Writ cannot be obtained. The Department of Justice must obtain Leave of the Court to re-issue the Writ. Historically, the Courts have not been entirely sympathetic to the position that the deadline was simply missed. Sworn evidence of the reason for the re-issuance of the Writ, which is acceptable to the Court, is usually required for Leave to be granted. If granted, a Court Order will be issued stating that the Writ is to be re-issued.

To request a re-issuance of an expired Writ of Seizure and Sale:

1. Prepare a referral to the Department of Justice, requesting assistance in obtaining Leave of the Court to re-issue a Writ of Seizure and Sale.

Include the following information:

a) tax debtor's name, account number and current address

b) dates and amounts of all payments

c) current balance

d) details of the collection actions taken

e) explanation as to why the re-issuance is required

2. Attach the following documentation to the memorandum

   copy of the Certificate

   copy of the Writ of Seizure and Sale

3. Obtain the appropriate Tax Services Office authorization.

Digitized by Google

4. Prepare an **affidavit**.

Refer to **Completing an Affidavit**.

5. Send the request for legal assistance and the affidavit to the Department of Justice.

Note: If and when Leave of the Court is obtained, the Department of Justice forwards the Court Order to the Tax Services Office.

6. Send a copy of the Court Order to the L.D.P.U. to obtain the new Writ of Seizure and Sale.

Note: Once the new Writ of Seizure and Sale is obtained, the L.D.P.U. forwards the documents to the Tax Services Office.

7. Forward the following documents to the Sheriff or Bailiff for execution:

   Court Order

   new Writ of Seizure and Sale

Refer to **Contacts and Addresses** for a list of Sheriffs' and Bailiffs' addresses.

Amending a Certificate, Writ of Seizure and Sale or Memorial (pre July 2003)

An amended Certificate, Writ of Seizure and Sale or Memorial is required when:

- an error is identified on the court documents including the Certificate, for example: typographical error, incorrect amount. Where the Certificate contains no errors return the Writ and/or Memorial (as applicable) to the L.D.P.U. for correction by the Court.

  Note: In all cases, the Certificate evidencing the debt must be amended prior to obtaining the Writ of Seizure and Sale or Memorial. Where possible this is done concurrently.

Related Topics:

- **How to Amend a Certificate (pre July 2003)**
- **How to Amend a Memorial (pre July 2003)**
- **How to Amend a Writ of Seizure and Sale when the original document is available (pre July 2003)**
- **How to Amend a Writ of Seizure and Sale when the original document is not available. (pre July 2003)**

How to Amend a Certificate (pre July 2003)

To amend a Certificate:

Send a memorandum requesting the amendment to the L.D.P.U. with the following information:

- name of tax debtor

Digitized by Google

- account number
- Federal Court number
- clearly indicate where the discrepancy exists and provide the correct information

Note: Attaching the original Certificate to the memorandum is not necessary. The L.D.P.U. obtains from the Court the Notice of Amendment of Certificate and forwards it to the Tax Services Office. This Amendment of Certificate must be attached to your original Certificate; it is a supplementary document and does not replace the Certificate.

How to Amend a Memorial (pre July 2003)

To amend a Memorial:

Send the L.D.P.U. an email to **NOR-Ottawa, NAT-LDPU OTC** including:

- account number
- Federal Court number
- type of document and name of the province
- clearly indicate where the discrepancy exists and provide the correct information

Note: The L.D.P.U. obtains the Amendment of Certificate and the amended Memorial and forwards them to the Tax Services Office.

How to Amend a Writ of Seizure and Sale where the original document is available (pre July 2003)

To amend a Writ of Seizure and Sale where the original Writ is available:

1. Send an email to the L.D.P.U. to **NOR-Ottawa, NAT-LDPU OTC** including:
   - account number
   - Federal Court number
   - clearly indicate where the discrepancy exists and provide the correct information
2. Send a memorandum to the L.D.P.U. referencing the email and attaching the following documents.
   - copy of the Certificate
   - copy of the T312
   - original Writ of Seizure and Sale (for the Province of Ontario, please refer to **How to Amend a Writ of Seizure and Sale where the original documents are not available**)

Digitized by Google

- additional copies of the court documents, if applicable

Note: The L.D.P.U. obtains an Amendment of Certificate, and a new Writ of Seizure and Sale and forwards them to the Tax Services Office.

How to Amend a Writ of Seizure and Sale where the original document is not available (pre July 2003)

To amend a Writ of Seizure and Sale where the original document is not available:

1. Prepare a referral for legal assistance to the Department of Justice requesting the amendment to the Writ of Seizure and Sale. Provide the following information:

a) Tax debtor's name, account number and current address.

b) Federal Court number.

c) Current balance.

d) State which information on the Writ of Seizure and Sale is incorrect.

e) State that the original Writ of Seizure and Sale is unavailable.

2. Attach the following documentation to the referral:

- copy of the Amendment of Certificate

3. Obtain the appropriate authorization from the Tax Services Office (TSO).
Refer to Memorandum 01-21 **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act*, and *Customs Act***.

4. Prepare an **affidavit**.

Refer to **Completing an Affidavit**.

5. Forward the request for legal assistance and the affidavit to the Department of Justice.

Note The Department of Justice makes an application to the Court for an Order to amend the Writ of Seizure and Sale and forwards the Court Order to the TSO.

7. Forward the Court Order to the L.D.P.U. to obtain the new Writ of Seizure and Sale.

Note: Once the new Writ of Seizure and Sale is obtained, the L.D.P.U. forwards the documents to the TSO.

8. Forward the following documents to the Sheriff or Bailiff for execution:

- Court Order
- new Writ of Seizure and Sale

Digitized by Google

Refer to **Contacts and Addresses** for a list of Sheriffs' or Bailiffs' addresses.

Amending a Certificate, Writ of Seizure and Sale or Memorial (post July 2003)

- An amended Certificate, Writ of Seizure and Sale or Memorial is required when:
- a payment is made on the debt to be certified prior to registration in the Court and the balance was not adjusted to indicate the revised amount.
- an error is identified on the court documents including the Certificate, for example: typographical error, incorrect amount (where the error exists on the Writ and or Memorial, but not the Certificate, then no amendment is required on the Certificate. Simply return the Writ and/or Memorial to the L.D.P.U for correction via the Court).

Note: In all cases, the Certificate evidencing the debt must be amended prior to obtaining the Writ of Seizure and Sale or Memorial. Where possible this is done concurrently.

Related Topics:

- **How to Amend a Certificate (post July 2003)**
- **How to Amend a Memorial (post July 2003)**
- **How to Amend a Writ of Seizure and Sale where the original document is available (post July 2003)**
- **How to Amend a Writ of Seizure and Sale where the original document is not available (post July 2003)**

How to Amend a Certificate (post July 2003)

To amend a Certificate:

It is possible to amend Certificates on-line via the "Letters, Forms & Transcripts" option.

- Access the option "Request for Amendment of Issued Certificate"
- Select the Certificate to be amended
- Make the required changes on the screen
- Submit the request to the Manager for approval

Note: Where an amendment is required to a field that is unavailable in the system such as interest date, provincial code, the amendment may be made on-line by requesting the changes within the WIP comments. If changes are required to the assessment dates, years or periods and no change is required to the total amount, the amendment request should be made within the WIP to ensure an audit trail is maintained.

Where additional information must be provided to L.D.P.U. for clarification.

- Forward an email to NOR-Ottawa, NAT-LDPU OTC, including:

Digitized by Google

- Federal Court number
- clearly indicate where the discrepancy exists and provide the correct information

The L.D.P.U. will make the changes and the Amendment of Certificate will be sent to your TSO. The L.D.P.U will also amend the Memorial if applicable.

How to Amend a Memorial (post July 2003)

To amend a Memorial:

Once the request to amend a Certificate has been made on-line to the L.D.P.U. they will amend the Memorial.

How to Amend a Writ of Seizure and Sale where the original document is available (post July 2003)

To amend a Writ of Seizure and Sale where the original Writ is available:

1. Send an email to the L.D.P.U. to **NOR-Ottawa, NAT-LDPU OTC** including:

- account number
- Federal Court number
- clearly indicate where the discrepancy exists and provide the correct information

2. Forward a Memorandum to the L.D.P.U. referencing the email and attaching the following documents:

- Certificate
- original Writ of Seizure and Sale (for the Province of Ontario, refer to **How to Amend a Writ of Seizure and Sale when the original document is not available)**
- additional copies of documents, if applicable

Note: The L.D.P.U. obtains a new Writ of Seizure and Sale and forwards it to the TSO.

Note: CRA security policy states that emails containing the tax debtor's account number alone are not protected. For further details refer to **Use of Email for Requesting or Communicating Taxpayer Information within the Agency.**

How to Amend A Writ of Seizure and Sale where the original document is not available (post July 2003)

1. Prepare and send a request for legal assistance to the Department of Justice for the amendment to the Writ of Seizure and Sale. Provide the following information:

a) Tax debtor's name, account number and current address

Digitized by Google

b) Federal Court number

c) current balance

d) Clearly indicate where the discrepancy exists and provide the correct information

2. Attach the following documentation to the memorandum:

- Copy of Certificate
- All copies of the Writ of Seizure and Sale

3. Obtain the appropriate authorization from the Tax Services Office.
Refer to Memorandum 01-21 **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act*, and *Customs Act***.

4. Prepare an **affidavit**.

Refer to **Completing an Affidavit**.

5. Send the request for legal assistance and the affidavit to the Department of Justice.

Note 1: The Department of Justice makes an application to the Court for an Order to amend the Writ of Seizure and Sale and forwards the Court Order to the TSO.

6. Forward the Court Order to the L.D.P.U. to obtain the new Writ of Seizure and Sale.

Note: Once the new Writ of Seizure and Sale is obtained, the L.D.P.U. forwards the documents to the TSO.

7. Forward the following documents to the Sheriff or Bailiff for actioning:

- the Court Order
- the new Writ of Seizure

Refer to **Contacts and Addresses** for a list of the Sheriffs' and Bailiffs' addresses.

Control of Credits

Between the time a Collection Officer submits a T518 and the time LDPU registers the Certificate in Federal Court, a payment may be received in reduction of the debt.

If the L.D.P.U. is not informed of the reduced balance in time to correct the Certificate, enforcement action can be taken via a Writ of Seizure and Sale or Memorial in accordance with the provinces, provided that CRA does not collect more than the balance owing. You are required to provide details of any credits received in the "Direction to Enforce Writ" which is sent to the Sheriff or Bailiff.

It is important that the balance owing always be included in our correspondence with Court Officials.

Digitized by Google

Obtaining an Order

An order is a directive or decision of the Federal Court of Canada. The following are some orders that the Agency can obtain:

Garnishee Order

Charging Order on Land or an Order to Sell

Charging Order on Securities

Order for Examination

Related Topic:

- How to obtain an Order

How to Obtain an Order

To obtain an Order:

1. Prepare a memorandum for approval to the appropriate delegated authority for a referral to the Department of Justice with the following information: refer to Memorandum 01-21, **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act*, and *Customs Act*.**

- amount of debt
- reasons the Order is sought
- potential effectiveness of the proposed actions
- details of actions taken and other collection avenues available

Note: For a **Charging Order on Securities** state the location of the securities, name and address of the transfer agent and Head Office of the corporation.

- type of Order requested

2. Prepare an **affidavit.**

Refer to **Completing an Affidavit**.

3. Prepare a request for legal assistance to the Department of Justice to file a motion to obtain an Order on behalf of the Agency.

4. Forward the request for legal assistance, Affidavit and supporting documents to the Department of Justice.

Note: The Department of Justice files a motion with the Federal Court. The Federal Court grants an interim Order to Show Cause specifying the time and place for further consideration of the

Digitized by Google

matter and imposing a charge until that time. The Department of Justice forwards the Interim Order to Show Cause to the Tax Services Office (TSO).

5. Prepare the instructions specifying the actions to take for the Sheriff or Bailiff of the Judicial District where the property is located.

6. Send copies of the Interim Order to Show Cause and the instructions to the Sheriff or Bailiff. Refer to **Contacts and Addresses** for a list of Sheriffs' or Bailiffs' addresses.

Note: The judgment debtor must be served at least seven days before the time stipulated on the Order to Show Cause. Upon conclusion of the hearing to Show Cause, the Court will either grant the Order Absolute or discharge the Order. The Department of Justice forwards the Order Absolute to the TSO.

7. Prepare the instructions for the Sheriff or Bailiff (of the Judicial district where the property is located) to proceed with the actions specified in the Order Absolute.

8. Send the Order Absolute and the instructions to the Sheriff or Bailiff.

Note: With the availability of other collection tools, the use of Charging Orders has declined in importance. Where appropriate, it is better to register the debt in a public property registry system, thereby obtaining a deemed security interest in the debtor's property.

For further details, refer to Directive RCD 00-21, **Charging Orders**

Once an Order is obtained, it is necessary to make an entry on the "Security Screen on ACSES".

Refer to Communication TSDMB-2005-014 **System Enhancements - April 2005 ACSES Security Screen** for the steps to follow to navigate through this screen.

Completing an Affidavit

An affidavit is required in many instances where Court action is taken. The contents of the affidavit vary depending on the type of action initiated. Verify all information on the affidavit before a motion is made to the Court by the Department of Justice. Affidavits must be sworn or affirmed to in the presence of a Commissioner of Oaths. Please refer to the applicable Tax Services Office for a listing of these individuals.

Related Topics:

- **Affidavit for the Amendment of a Writ of Seizure and Sale (where the original document is not available)**
- **Affidavit for a Re-issuance of a Writ of Seizure and Sale that has expired**
- **Affidavit for a Charging Order on Land or an Order to Sell**
- **Affidavit for a Charging Order on Securities**
- **Affidavit to prepare a Garnishee Order**
- **Affidavit for an Examination of a Judgment Debtor**

Digitized by Google

Affidavit for the Amendment of a Writ of Seizure and Sale (where the original document is not available)

To complete an affidavit for amendment of a Writ of Seizure and Sale (where the original document is not available) include the following information:

- a copy of the Writ of Seizure and Sale
- reason(s) why the Writ is not available
- amendments that are required

Affidavit for a Re-issuance of a Writ of Seizure and Sale that has expired

To complete an affidavit for the re-issuance of an expired Writ of Seizure and Sale include the following information:

original issuance date of the Certificate and the Writ of Seizure and Sale attach the original Writ of Seizure and Sale, or a copy of the Writ of Seizure and Sale if the original document is not available, and a copy of the new order for any subsequent renewal or a photocopy endorsed by the Sheriff or Bailiff

- Certificate to which the Writ of Seizure and Sale relates
- amounts originally due
- amounts due at the date of application
- reasons why:
  - the original Writ of Seizure and Sale is not available (if applicable)
  - assets were seized but not sold
  - debt was not satisfied
  - reason the new Writ of Seizure and Sale is required

Affidavit for a Charging Order on Land or an Order to Sell

To complete an affidavit to obtain a Charging Order on Land or an Order to Sell include the following information:

- description of the **Judgment** or **Order** to be enforced
- name of the **Judgment debtor** on whose land it is sought to impose a charge
- amount unpaid under the **Judgment** or **Order** at the time of the application
- legal description of the land, as documented at a Registry or Land Titles Office. (Provide a copy of the property search, if available)

Digitized by Google

- land or interest in the land to be charged is the Judgment Debtor's, as documented at a Registry or Land Titles Office
- sources of the information, for example: a Registry or Land Titles Office, or grounds for such belief

Affidavit for a Charging Order On Securities

To complete an affidavit for a **Charging Order on Securities** include the following information:

- the securities or the **judgment debtor's** interest on which it is sought to impose the charge and in whose name they stand
- state that the judgment debtor is beneficially entitled to an interest in the securities in question
- the interest the judgment debtor has in the securities
- the sources of information and grounds for such belief
- the Judgment or Order to be enforced by stating the amounts unpaid under it at the date of application
- that the applicant is entitled to enforce the Judgement or Order

Affidavit to prepare a Garnishee Order

To complete an affidavit for a **Garnishee Order** include the following information:

- the third parties name and address
- amount of indebtedness
- nature of the debt
- source(s) of the information and the name of the person who obtained it
- reasons why it is believed such indebtedness exists

Affidavit to prepare an Examination of Judgment Debtor

To complete an affidavit for an Examination of a **Judgment debtor** include the following information:

- the appropriate statement indicating the individual or company's knowledge of the indebtedness:

a) If the tax debtor is an individual include the statement:

Digitized by Google

"that the said judgment debtor has knowledge of his business affairs which is relevant to this indebtedness, on which it is sought to have him orally examined"

b) If the tax debtor is a corporate body include the statement:

"that I am informed that (name of officer/director of the corporation) of (address) of the City of (name) in the Province of (name) is (debtor's position with the corporation – officer/director) of the said (name of corporate body) and I verily believe that he/she has knowledge of the business affairs of the said company relevant to this indebtedness, on which it is sought to have him/her orally examined"

Charging Law and Court Costs

When Court action is taken against a tax debtor certain costs incurred during the process may be recovered from the tax debtor.

Related Topics:

- Charging Law and Court Costs
- Recoverable Costs
- Non-Recoverable Costs

Charging Law and Court Costs

The procedure for charging law and court costs by revenue type is as follows:

- T1 create an ERA item
- T2 memorandum to the appropriate Tax Centre
- T4 diary code 34, refer to compliance
- GST create a SA case

Note: Include in all requests the type of law cost, and the amount.

Recoverable Costs

Recoverable costs from a tax debtor include:

- advances to the Sheriff and Bailiff
- costs of registering or releasing a mortgage or other similar procedures
- costs of registering Writs, and Memorials
- court costs awarded to the Minister of National Revenue
- court fees
- fees and incidental expenses

Digitized by Google

- removal costs on the asset
- Sheriff's or Bailiff's fees

Note: In the case of Writs, law and court costs should be raised by the TSO upon receipt of the Writ from Headquarters. The cost is indicated on the back of the Writ.

- amounts recoverable in respect of litigation. Refer to section 222.1 ITA, and subsection 313(4) ETA.
- For further details, refer to Directive RCD-98-04 Bill C-28 **Impacts on Accounts Receivable Program - RCD-01-02 Bill C-24**

Non-Recoverable Costs

Non-recoverable costs from a tax debtor are paid by CRA, including:

- administrative fees, for example: costs incurred for property searches

  Note: These amounts are paid out of the Tax Services Office's contingent account.

- lawyers' fees for services rendered to the Department of Justice and National Revenue

  Note: These amounts are approved by the Department of Justice and forwarded to Headquarters for processing and payment.

Allowing Passage of Title

Once the Writ of Seizure and Sale is registered against immovable property, the tax debtor or authorized representative may request the passage of title when disposing or refinancing of property. Accommodate these requests only where a benefit exists for the Crown.

A **Quit Claim Deed** or **Postponement Agreement** are the instruments used to allow the passage of title.

Related Topic:

- **How to Allow the Passage of Title**

How to Allow the Passage of Title

To allow the passage of title:

1. Request the tax debtor's representative to prepare a draft **Quit Claim Deed** or **Postponement Agreement**.

2. Prepare a memorandum for the Department of Justice:

a) Identify the particulars of the case, including details regarding the execution.

b) State the intended purpose of the Quit Claim Deed or the Postponement Agreement

Digitized by Google

c) Identify the status of the Crown's registration in relation to the balance outstanding.

d) Obtain the appropriate Tax Services Office authorization.

3. Conduct a search at the Land Registry or Land Titles Office.

4. Send the memorandum and the draft Quit Claim Deed or the Postponement Agreement to the Department of Justice for approval.

Note: The Department of Justice returns to the Collections Officer the original Quit Claim Deed if approved.

5. Prepare in duplicate the Quit Claim Deed or the Postponement Agreement.

6. Return two copies of the Quit Claim Deed or the Postponement Agreement to the tax debtor's representative for registration. (Note: Refer to local TSO procedures for offices with electronic registration capabilities.)

7. Conduct a search at the Land Registry or Land Titles Office to ensure CRA's position is not compromised.

Seizing Assets

Once a Writ of Seizure and Sale or Memorial is obtained, a tax debtor's property can be seized and sold and applied to a debt.

Related Topics:

- How to Seize and Sell Personal Property
- How to Seize and Sell Real Property
- How to Respond to a Motion Opposing Seizure

How to Seize and Sell Personal Property

To seize and sell personal property:

1. Identify the property and determine the following:

a) physical location and condition

b) description, including serial numbers, as applicable

c) encumbrances

d) market value

e) cost of seizure

2. Calculate the equity and determine the possible net return of the seizure.

Digitized by Google

3. Prepare a letter in ELCS verse 19665 to the Sheriff or Bailiff to seize and sell a tax debtor's personal property, include the following information:

a) tax debtor's name

b) description(s) and location(s) of the property

c) address(es) for service

d) Collection officer's name and phone number

4. Obtain the appropriate Tax Services Office signature on the ELCS letter. Refer to Memorandum 01-21 **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act*, and *Customs Act***.

5. Obtain advance cheque for the Sheriff or Bailiff where required.

6. Attach the applicable

- court documents, for example: Writ of Seizure and Sale
- advance cheque

Note: Usually, a collection officer will not accompany the Sheriff or Bailiff during a seizure.

When extenuating circumstances arise and the Assistant Director determines that a collections officer should accompany the Bailiff or Sheriff, both the Regional Program Advisor and Headquarters Field Support Programs Officer should be advised.

For further details, refer to Memorandum 99-01, **Seizure of Property**.

7. The Sheriff or Bailiff will action the request as required by the applicable provincial legislation.

Note: Procedure may vary by province depending on provincial execution acts, refer to your local procedure or **Field Support Programs Officer**.

How to Seize and Sell Real Property

To seize and sell a tax debtor's real property:

1. Identify the property by obtaining a Land Title or Land Registry search review and determine the following:

- Registered owner(s), ownership type for example joint tenants or tenants in common
- legal description
- encumbrances, copies of all mortgages, liens, and/or charges. Determine the current balances outstanding.

2. It is recommended to establish the property's valuation through a **Request for Appraisal Assistance form T104R (02)**

Digitized by Google

3. Calculate the equity and determine the possible net return of the sale. Which could include the cost of real estate fees, legal fees, sheriff or bailiff fees and any other applicable costs.

4. Obtain the appropriate Tax Services Office authorization.
Refer to Memorandum 01-21, **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act*, and *Customs Act***.

5. If the sale involves a principal residence field support approval will be required. For further details, refer to **Seizable Assets**.

Note local procedures may involve:

6. When approval from Headquarters is obtained complete a letter to Department of Justice to obtain the appropriate court documents, if applicable in your province.

Include the following information:

- tax debtor's name, account number, current address, and current balance
- legal description

Attach the following documentation:

- Land Title/Registry searches, and applicable mortgages, liens or charge documents
- copies of documents registered by CRA such as Writs of Seizure and Sale or Memorials

7. The Department of Justice will obtain and return the necessary court documents, depending on provincial requirements.

8. Obtain the Sheriff's or Bailiff's advance cheque.

9. Prepare a letter to the Sheriff or Bailiff to seize and sell a tax debtor's real property, include the following information:

- tax debtor's name
- legal description
- civic address of the property
- address for service
- Collection officer's name and phone number

Attach the applicable

- court documents, i.e. Writ of Seizure and Sale, Memorial, Order to Sell
- advance cheque

10. The Sheriff or Bailiff will action the request based on the applicable provincial legislation.

Digitized by Google

Note: Procedures may vary by province depending on the provincial legislation; refer to your local procedures or Field Support Programs Officer.

How to Respond to a Motion Opposing Seizure

To respond to a motion opposing seizure (of assets):

Note: The motion is filed through the Court.

1. Contact the Department of Justice.

Note: The Department of Justice prepares a request to the Court to vacate the opposition if applicable..

2. If the Court grants an Order to Vacate the opposition, send the following information to the Sheriff or Bailiff:

- a letter granting consent to the sale signed by the Director of the Tax Services Office
- the Order to Vacate the opposition

Releasing a Writ of Seizure and Sale or Memorial

A Writ of Seizure and Sale or Memorial is released when a debt is paid in full or when it is no longer required due to the tax debtor's circumstances.

Related Topics:

- How to Release a Writ of Seizure and Sale or Memorial (pre & post July 2003)
- What to do with Legal Documents when they are no longer required
- Requesting a Satisfaction of Certificate or a Satisfaction Piece

How to Release a Writ of Seizure and Sale or Memorial (pre & post July 2003)

To release a Writ of Seizure and Sale or Memorial:

- provide a written request to the Sheriff, Bailiff or Land Title Office to remove the instrument and, where necessary complete and provide any discharge documents as may be required by the province.
- CRA will release a Memorial or Writ of Seizure and Sale; registered on real property; when there is a shortfall to CRA; allowing the title to transfer; under the following conditions:
- the property is transferred at fair market value
- all charges are paid in priority of registration

Digitized by Google

What to do with legal documents when they are no longer required

The L.D.P.U. must be informed of the current file status when legal documents are no longer required. The L.D.P.U. must request a Satisfaction of Certificate from the Federal Court to close the file. The L.D.P.U. will transfer the current WIP to the diary once completed. The legal documents must not be returned to the Legal Document Processing Unit (L.D.P.U.) when they are no longer required (Certificate, Writ or Memorial, etc.).

Refer to the following instructions on how the L.D.P.U. must be informed.

Legal Documents pre July 2003

The ELCS letter 82200 must be sent to the L.D.P.U. This letter will inform the L.D.P.U. of the current status of the debt. These documents must be filed and archived, within the TSO, for a minimum of two years.

Legal Documents post July 2003

- Press "F18" browse diary
- Key an "x" on the question mark "?" next to the legal document that is no longer required
- Press F23 to access the document
- Press "F4" Actions
- Key an "x" in the space to return to Headquarters, press "Enter"
- Select the reason for return and press "F3" to continue
- Press "F6" to confirm the action and refer to Manager for approval
- Include a diary entry in the work in progress (WIP) "All legal documents filed in docket"
- Press "F12" confirm
- The L.D.P.U. will action and move the WIP to the dairy

The documents must be filed and archived, within the TSO, for a minimum of two years.

Note: For the provinces that require a Certificate of Satisfaction or a Satisfaction Piece, the letter of request must continue to be sent to the L.D.P.U.

The accounts submitted as uncollectible where:

- a charge has been registered on real property
- and it has been determined that the charge will remain on title

These accounts will remain in TSO inventory, due to the outstanding WIP, and will be maintained pursuant to local TSO policy.

For further details, refer to **The Write-Off of All Accounts Where a Certificate is Registered Against the Principal Residence**

Requesting a Satisfaction of Certificate

1. Press "F18" browse diary
2. Key an "x" on the question mark "?" next to the applicable legal document.

Digitized by Google

3. Press "F4" Actions

4. Key an "x" in the space to Return to Headquarters, press "Enter"

5. Key an "x" in the reason code "other"

6. Press "F8" for Satisfaction Piece or Certificate of Satisfaction

7. Satisfaction Piece/Certificate Instructions menu, type instructions for the L.D.P.U. , press "F3" to continue

8. Press "F6" to confirm

9. Press "F12" to confirm on ACSES

This request will be forwarded to the Manager for approval.

Resource Material

Communication TSDMB-2005-024 **Limitation Periods Applicable to the Collection of Tax Debts**

Communication TSDMB-2005-022 **Collection Restrictions following Reassessments Under the *Income Tax Act*, *Excise Act 2001* and *Excise Tax Act* – Non-GST**

Communication TSDMB-2005-019 **Large Corporation Collection Provisions**

Communication TSDMB-2005-015 **Federal Court System (T518)**

Communication ARD-2005-014 **System Enhancements - April 2005 ACSES Security Screen**

Communication TSDMB-2005-006 **System Enhancements - February 2005 ACSES Text Editing Federal Court Actions New TSQ**

Communication TSDMB-2005-005 **Requesting Memo Regular Certificate on Non-Resident director without Social Insurance Number**

Communication TSDMB-2005-003 **Certification (T518) Process**

Communication TSDMB-2004-042 **Process for returning automated T518/T312 to LDPU**

Communication TSDMB-2003-004 **Funds Held in RRSPs**

Directive RCD-02-01 **Deemed Security Interest – The Crown As A Secured Creditor In A Bankruptcy**

Directive RCD-00-21 **Charging Orders**

Directive RCD-98-06 **Lien and Charge Registration**

Directive RCD-98-04 **Bill C-28 impacts on Accounts Receivable Program**

Memorandum 02-17 **Air Travellers Security Charge**

Memorandum 01-21 **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act***

Digitized by Google

Memorandum 03-05 Liability of Partnerships and Partners for GST/HST

Memorandum 00-02 Writ(s) of Seizure and Sale-Renewals

Memorandum 99-01 Seizure of Property

Training and Learning Directorate, HQ8919-001 Air Travellers Security Charge Collection's Reference Guide

Training and Learning Directorate, TD8350-000 Recommendation for Court Action and Seizure of Property

Glossary

Affidavit

A statement in writing verifying the facts relied on by the applicant. Affidavits must be sworn or affirmed to in the presence of a Commissioner of Oaths.

Charging Order

An Order issued by the Court imposing a charge on land or an interest in land of a judgment debtor.

Charging Order on Land

An Order issued by the Court permitting a judgment creditor to seize and hold land.

Charging Order on Securities

An Order issued by the Court permitting a judgment creditor to seize and hold securities such as shares and bonds or the interest held in those securities.

Ex parte

A judicial proceeding taken or granted at the request of and for the benefit of one party only and without notice to, or the presence of the other party.

Garnishee Order

An Order issued by the Court requiring a third party who owes money to a debtor to pay the Crown the lesser of the amount owed the Crown and the amount the third party owes the debtor.

Inter Vivos Trust

A trust where the transfer of property occurs during the lifetime of the settlor (one who creates the trust).

Joint Tenancy

A form of shared real property ownership, with two or more co-owners who take identical interests. The owners are entitled to the right of survivorship, which provides that upon the death of one owner the property reverts to the surviving owner(s).

Digitized by Google

Judgment

The official and authentic decision of a court resolving a dispute and determining the rights and obligations of the parties.

Judgment Debtor

A person against whom judgment has been recorded and which remains unsatisfied.

Large Corporation

A corporation of which the total of the taxable capital employed in Canada in a particular taxation year, including the one of any related corporation, exceeds $10 million.

Motion

An application made to a court or judge for the purpose of obtaining a rule or order directing an act be performed in favour of the applicant.

Order for Examination

An Order issued by the Court requiring an individual to appear and give evidence under oath.

Order to Show Cause

An Order issued by the Court giving the debtor an opportunity to object.

Order Absolute

An Order issued by the Court at the conclusion of the hearing to show cause.

Order to Vacate

An Order issued by the court to annul, set aside or rescind an act.

Personal Property

Everything that is the subject of ownership that does not come under the denomination of real estate. Personal property is property that is moveable.

Real Property

Is land and whatever is erected or growing upon or affixed to land.

Postponement Agreement

An agreement used when the tax debtor wishes to mortgage or refinance a property. The Agreement postpones the execution in favour of the mortgage and allows the mortgagee priority over the Crown.

Quit Claim Deed

A deed of conveyance operating by way of release; that is intended to pass any title, interest or claim which the grantor may have in the premises but not professing that such title is valid nor containing any warranty or covenants for title.

Digitized by Google

Tenants In Common

A form of real property ownership in which two or more co-owners, in equal or unequal undivided interest, without the right of survivorship.

Digitized by Google

Digitized by Google

Digitized by Google

49

The Primary Garnishment Provisions and the Requirement to Pay Process

Subsections 224(1) through (1.2) provide the primary garnishment abilities of CRA to intercept funds flowing to a tax-debtor from practically any party that will be used to extinguish the tax debt. They have gone through some evolution that expand their scope to any payments payable with on year of service of the requirement to pay (RTP). The target of the RTP isn't funds gratuitously given: it captures any and all commercially recognizable payments that are to be made to the tax-debtor.

It should be noted that the RTP does not create a trust in the recipient's hands of the funds, merely an obligation to pay to the Minister the amount specified. This was the topic in Lamarre and University of Calgary v. Morrison and Receiver-General Of Canada[50] which was further cited in Canada (Attorney- General) v. Royal Bank of Canada[51]which provided:

> [4] We are all of the view that the decision of this Court in re LAMARRE and UNIVERSITY OF CALGARY -v- MORRISON and RECEIVER-GENERAL OF CANADA (1978) 2 W.W.R., 465, enunciated two propositions:- firstly, that a Demand made under Section 224 does not convey the indebtedness to the Crown, nor does it impress it with a trust; and secondly, that the Minister does not, by virtue of the Demand, become a holder of a security. In short, the Crown does not acquire an equitable interest in the indebtedness.[52]

---

[49] "Sun Geometry", 2011, Patricia Vertes, Howick, Quebec

[50] (1978) 2 W.W.R., 465

[51] 1978 AltaSCAD 354

[52] See "The Legality of Administrative Garnishments Under the Income Tax Act and Other Federal Law" by

Digitized by Google

Garnishment - S. 224(1)

224. (1) Where the Minister has knowledge or suspects that a person is, or will be within one year, liable to make a payment to another person who is liable to make a payment under this Act (in this subsection and subsections 224(1.1) and 224(3) referred to as the "tax debtor"), the Minister may in writing require the person to pay forthwith, where the moneys are immediately payable, and in any other case as and when the moneys become payable, the moneys otherwise payable to the tax debtor in whole or in part to the Receiver General on account

Idem

(1.1) Without limiting the generality of subsection 224(1), where the Minister has knowledge or suspects that within 90 days

> **(*a*) a bank, credit union, trust company or other similar person (in this section referred to as the "institution") will lend or advance moneys to, or make a payment on behalf of, or make a payment in respect of a negotiable instrument issued by, a tax debtor who is indebted to the institution and who has granted security in respect of the indebtedness, or**
>
> **(*b*) a person, other than an institution, will lend or advance moneys to, or make a payment on behalf of, a tax debtor who the Minister knows or suspects**
>
> > **(i) is employed by, or is engaged in providing services or property to, that person or was or will be, within 90 days, so employed or engaged, or**
> >
> > **(ii) where that person is a corporation, is not dealing at arm's length with that person, the Minister may in writing require the institution or person, as the case may be, to pay in whole or in part to the Receiver General on account of the tax debtor's liability under this Act the moneys that would otherwise be so lent, advanced or paid and any moneys so paid to the Receiver General shall be deemed to have been lent, advanced or paid, as the case may be, to the tax debtor.**

Garnishment

(1.2) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act*, any other enactment of Canada, any enactment of a province or any law, but subject to subsections 69(1) and 69.1(1) of the *Bankruptcy and Insolvency Act* and section 11.09 of the *Companies' Creditors Arrangement Act*, if the Minister has knowledge or suspects that a particular person is, or will become within one year, liable to make a payment

> **(*a*) to another person (in this subsection referred to as the "tax debtor") who is liable to pay an amount assessed under subsection 227(10.1) or a similar provision, or**
>
> **(*b*) to a secured creditor who has a right to receive the payment that, but for a security interest in favour of the secured creditor, would be payable to the tax debtor, the Minister may in writing require the particular person to pay forthwith, where the moneys are immediately payable, and in any other case as**

David Schulze in the Canadian Tax Journal (2002) vol. 50, no 5 Pg.1597 for a discussion on whether this commonly applied set of provisions have any legality, actually, in the face of the Charter and/or the Bill of Rights.

Digitized by Google

and when the moneys become payable, the moneys otherwise payable to the tax debtor or the secured creditor in whole or in part to the Receiver General on account of the tax debtor's liability under subsection 227(10.1) or the similar provision, and on receipt of that requirement by the particular person, the amount of those moneys that is so required to be paid to the Receiver General shall, notwithstanding any security interest in those moneys, become the property of Her Majesty to the extent of that liability as assessed by the Minister and shall be paid to the Receiver General in priority to any such security interest.

Definitions (1.3) In subsection 224(1.2),

"secured creditor" « *créancier garanti* » "secured creditor" means a person who has a security interest in the property of another person or who acts for or on behalf of that person with respect to the security interest and includes a trustee appointed under a trust deed relating to a security interest, a receiver or receiver- manager appointed by a secured creditor or by a court on the application of a secured creditor, a sequestrator or any other person performing a similar function;

"security interest" « *garantie* » "security interest" means any interest in, or for civil law any right in, property that secures payment or performance of an obligation and includes an interest, or for civil law a right, created by or arising out of a debenture, mortgage, hypothec, lien, pledge, charge, deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for;

"similar provision" « *disposition semblable* » "similar provision" means a provision, similar to subsection 227(10.1), of any Act of a province that imposes a tax similar to the tax imposed under this Act, where the province has entered into an agreement with the Minister of Finance for the collection of the taxes payable to the province under that Act.

Garnishment
(1.4) Provisions of this Act that provide that a person who has been required to do so by the Minister must pay to the Receiver General an amount that would otherwise be lent, advanced or paid to a taxpayer who is liable to make a payment under this Act, or to that taxpayer's secured creditor, apply to Her Majesty in right of Canada or a province.

Minister's receipt discharges original liability
(2) The receipt of the Minister for moneys paid as required under this section is a good and sufficient discharge of the original liability to the extent of the payment.

Idem
(3) Where the Minister has, under this section, required a person to pay to the Receiver General on account of a liability under this Act of a tax debtor moneys otherwise payable by the person to the tax debtor as interest, rent, remuneration, a dividend, an annuity or other periodic payment, the requirement applies to all such payments to be made by the person to the tax debtor until the liability under this Act is satisfied and operates to require payments to the Receiver General out of each

Digitized by Google

such payment of such amount as is stipulated by the Minister in the requirement.

Failure to comply with s. (1), (1.2) or (3) requirement
(4) Every person who fails to comply with a requirement under subsection 224(1), 224(1.2) or 224(3) is liable to pay to Her Majesty an amount equal to the amount that the person was required under subsection 224(1), 224(1.2) or 224(3), as the case may be, to pay to the Receiver General.

Failure to comply with s. (1.1) requirement
(4.1) Every institution or person that fails to comply with a requirement under subsection 224(1.1) with respect to moneys to be lent, advanced or paid is liable to pay to Her Majesty an amount equal to the lesser of
(*a*) the total of moneys so lent, advanced or paid, and
(*b*) the amount that the institution or person was required under that subsection to pay to the Receiver General.

Service of garnishee
(5) Where a person carries on business under a name or style other than the person's own name, notification to the person of a requirement under subsection 224(1), 224(1.1) or 224(1.2) may be addressed to the name or style under which the person carries on business and, in the case of personal service, shall be deemed to be validly served if it is left with an adult person employed at the place of business of the addressee.

Idem
(6) Where persons carry on business in partnership, notification to the persons of a requirement under subsection 224(1), 224(1.1) or 224(1.2) may be addressed to the partnership name and, in the case of personal service, shall be deemed to be validly served if it is served on one of the partners or left with an adult person employed at the place of business of the partnership.

Rank in The Face of Provincial Liens and Claims

In combination with the other provisions of the ITA federal claims for income tax and deductions at source rank over provincial security schemes and other types of interests that may arise in the tax-debtor. This has been commented on in numerous cases which include Canada (Minister of National Revenue) v. W. Mullner Trucking Ltd.[53] where the Prov. Appeal Ct. held:

> [1] The issue on this appeal is whether woodworkers in British Columbia have priority over the Minister of National Revenue with respect to competing claims to funds owing for labour and services in connection with logging. The woodworkers' claims arise under the *Woodworker Lien Act*, R.S.B.C. 1996, c. 491. The Minister's claim is made under the"super priority" provisions of the *Income Tax Act*, R.S.C. 1985 (5th Supp.),
> 1, and the *Excise Tax Act*, R.S.C. 1985, c. E-15. A Supreme Court chambers judge decided that the woodworkers' lien claims had priority. The Minister appealed.
> [2] It is my opinion that the chambers judge erred. **On a plain reading of the relevant provisions of the *Income Tax Act*, the *Excise Tax Act*, and the *Woodworker Lien Act*, the Minister's claims had priority over the lien claims.** The relevant

[53] 2010 BCCA 90

Digitized by Google

authorities clearly establish that provincial legislation cannot create a priority scheme that overrides a priority created by federal legislation. Matters relating to the contractual terms under which the funds arose, whether the tax provisions were effectively expropriation of the labour and services of the woodworkers, and any inequity in the result are irrelevant to the determination of priority. It follows that I would allow the appeal.

...

Statutory Provisions Taxation Statutes

[12] Employers are required under s. 153(1) of the *Income Tax Act* to withhold amounts from their employees' wages and remit them to the Receiver General for Canada by a specified due date. The *Excise Tax Act* requires taxpayers to collect and remit GST. Both statutes provide mechanisms to ensure that these requirements are met.

[13] Under the "requirement to pay" provisions in ss. 224(1.2) of the *Income Tax Act,* the Minister may intercept payments to be made to a tax debtor or a secured creditor of a tax debtor:

Garnishment

224(1.2) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act*, any other enactment of Canada, any enactment of a province or any law, but subject to subsections 69(1) and 69.1(1) of the *Bankruptcy and Insolvency Act* and section 11.09 of the *Companies' Creditors Arrangement Act*, if the Minister has knowledge or suspects that a particular person is, or will become within one year, liable to make a payment to another person (in this subsection referred to as the "tax debtor") who is liable to pay an amount assessed under subsection 227(10.1) or a similar provision, or to a secured creditor who has a right to receive the payment that, but for a security interest in favour of the secured creditor, would be payable to the tax debtor, the Minister may in writing require the particular person to pay forthwith, where the moneys are immediately payable, and in any other case as and when the moneys become payable, the moneys otherwise payable to the tax debtor or the secured creditor in whole or in part to the Receiver General on account of the tax debtor's liability under subsection 227(10.1) or the similar provision, and on receipt of that requirement by the particular person, the amount of those moneys that is so required to be paid to the Receiver General shall, notwithstanding any security interest in those moneys, become the property of Her Majesty to the extent of that liability as assessed by the Minister and shall be paid to the Receiver General in priority to any such security interest.

Definitions

(1.3) In subsection 224(1.2), "secured creditor"

« créancier garanti »

"secured creditor" means a person who has a security interest in the property of another person or who acts for or on behalf of that person with respect to the security interest and includes a trustee appointed under a trust deed relating to a security interest, a receiver or receiver-manager appointed by a secured creditor or by a court on the application of a secured creditor, a sequestrator or any other person performing a similar function;

"security interest"

« garantie »

"security interest" means any interest in property that secures payment or

Digitized by Google

performance of an obligation and includes an interest created by or arising out of a debenture, mortgage, hypothec, lien, pledge, charge, deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for; [Emphasis added]

...

Discussion

Statutory Priority

[20] On a plain reading of s. 224(1.2) of the *Income Tax Act*, the Minister's claim to the moneys paid into court by Canfor has priority over the woodworkers' claims under the *Woodworker Lien Act*.

[21] Section 224(1.2) applies "[n]otwithstanding ... any enactment of a province". It is well-settled that a province cannot create a priority scheme that overrides a federally-created scheme: see *Husky Oil Operations Ltd. v. M.N.R.*, 1995 CanLII 69 (SCC), [1995] 3 S.C.R. 453 at para. 32; *Japan Canada Oil Sands Ltd. v. Stoney Mountain Steel Corp.* reflex, (2001), 290 A.R. 251 at para. 25 (Q.B.).

[22] Thus, s. 2(3) of the *Woodworker Lien Act*, which purports to make the lien under s. 2(2) "a first lien or charge" that has "precedence over all other claims or liens", has no effect on the priority scheme created by s. 224(1.2) of the *Income Tax Act* and s. 317(3) of the *Excise Tax Act*.

Canfor's Liability to Pay Baer

[23] The Minister may issue a requirement to pay under s. 224(1.2) "if the Minister has knowledge or suspects that a particular person [in this case, Canfor] is, or will become within one year, liable to make a payment (a) to another person (in this subsection referred to as the"tax debtor") [in this case, Baer] who is liable to pay an amount assessed under subsection 227(10.1) [unremitted source deductions]".

[24] In this case, the Minister became aware that Canfor was, or would within one year become, liable to make a payment to Baer under the harvesting contract. In fact, Canfor owed Baer for harvesting services provided up to February 17, 2000. The Minister issued the requirements to pay on February 21 and 22, 2000.

[25] The respondents contest the Minister's claim that Canfor was liable to make a payment to Baer. The chambers judge appears to have concluded that Canfor's liability to Baer was conditional, because Canfor acknowledged that it owed Baer $175,491.30 "provided the logs are free and clear of all liens and claims". He also referred to provisions of the harvesting contract under which Canfor could have held back or set off monies owing for Baer's failure to perform certain obligations. He concluded that "the money due to Baer depends on the satisfaction of the lien claims" (at para. 66). [26] At the time the requirements to pay were issued, the liens were in existence, though they had not been filed (see *Woodworker Lien Act*, s. 3(5)). They gave the lien holders rights to seize and sell the logs, but no claim against Canfor for the moneys owed to Baer. Canfor's liability to pay Baer was not conditional on the satisfaction of the lien claims. Although Canfor stated that it was not prepared to pay the amount owing until the logs were no longer subject to the liens, it did not invoke any contractual impediment to the liability. What it did was use the remedy provided in s. 16 of the *Woodworker Lien Act*: it paid into court the amount for which the liens were claimed, and the liens were vacated, all in accordance with the order made April 3, 2000.

[27] A similar argument was made in *Dias v. MacLean* 1993 CanLII 4569 (NS

Digitized by Google

SC), (1994), 123 N.S.R. (2d) 231 (S.C.), an application to determine entitlement to funds paid into court as between a claimant under the *Mechanics'Lien Act*, R.S.N.S. 1989, c. 277, and the Minister under a requirement to pay. The issue was the meaning of "liable to pay" and of "liable to make a payment" in s. 224.(1.2) of the *Income Tax Act*. The lien claimant argued that at the time the requirement to pay was issued the owners of the property were under no obligation to pay the contractor, which had ceased work on the property. The chambers judge responded (at para. 31):

The argument that the funds paid into Court would never become "payable to, the tax debtor (Fundy), [the contractor], is initially attractive. Those funds are, however, under the contract, payable by the owners to Fundy and to no one else. The *Mechanics Lien Act* simply creates a statutory scheme to divert those funds to the lien claimants in certain circumstances. Although diverted through the operation of the *Act*, the funds are nevertheless payable (to the lien claimants) on behalf of Fundy. The *Act* simply operates to suspend the movement of funds to ensure the security interest of the lien claimants is satisfied.

[28] In *Ledcor Construction Ltd. v. 544033 B.C. Ltd.*, 2006 BCSC 2097 (CanLII), 2006 BCSC 2097, it was similarly argued that monies subject to holdback provisions in the *Builders Lien Act*, S.B.C. 1997, c. 45 were not owed to the tax debtor (at para. 14). The chambers judge rejected that argument (at para. 17):

This language makes it clear that but for the liens Ledcor would have paid the money to Barnston [the tax debtor], as opposed to paying the money into court for distribution among the lien claimants. In other words the monies are owed to Barnston and but for the security interest would be the property of Barnston.

...

Security Interest

[31] Under s. 224(1.2) of the *Income Tax Act*, "the moneys otherwise payable to the tax debtor ... notwithstanding any security interest in those moneys, become the property of Her Majesty ... and shall be paid to the Receiver General in priority to any such security interest."

[32] "Security interest" is defined in s. 224(1.3). It "means any interest in property that secures payment or performance of an obligation and includes an interest created by or arising out of a ... lien ... of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for".

[33] Section 224(1.3) also defines "secured creditor" as "a person who has a security interest in the property of another person".

[34] The chambers judge concluded (at para. 87) that the woodworkers were not "secured creditors" with "security interests" within the meaning of s. 224(1.3) of the *Income Tax Act* for the lien claims they are given by the legislation are *in rem* claims against logs which were the property of Canfor and not that of the tax debtor (Baer).

[35] He did not discuss why the liens were not "liens" within the meaning of the term "security interest".

[36] For the purpose of determining the Minister's priority to the funds in court under the requirements to pay, it is sufficient that Canfor was liable to make a payment to Baer, and that the lien claimants' interest was a "security

Digitized by Google

interest". On the plain wording of s. 224(1.3) and the *Woodworker Lien Act*, the lien claimants' interest in the monies payable to Baer, or in the logs, or in the funds in court, was an interest arising out of a "lien", and was therefore a "security interest". The amount Canfor was liable to pay Baer was payable to the Receiver General, notwithstanding the lien claimants' "security interest[s]".

[37] The respondents maintained that they did not have a "security interest" in the monies otherwise payable to Baer, for two reasons. First, they argued that the "security interest" had to be in property of the tax debtor, Baer. Second, they claimed that their interest in the logs was an *in rem* interest, and not a "security interest".

[38] Contrary to the respondents' argument, there is nothing in the definition of "security interest" for these purposes that requires that the interest be in the property of the tax debtor. In support of their argument, they cite *Caisse populaire Desjardins de l'Est de Drummond v. Canada*, 2009 SCC 29 (CanLII), [2009] 2 S.C.R. 94, 2009 SCC 29 at para. 15, where Rothstein J. for the majority, said:

So long as the creditor's interest in the debtor's property secures payment or performance of an obligation, there is a "security interest" within the meaning of this section. [Emphasis added]

[39] This statement cannot be taken to be a general rule or interpretation of the definition of "security interest" within the meaning of s. 224(1.3) of the *Income Tax Act*, for two reasons. First of all, the interest in property with which the Court was concerned in *Caisse populaire* was an agreement between a creditor and a debtor, not, as in this case, a lien claimed by a third party. Secondly, the Court was considering the application of the deemed trust provisions in s. 227(4.1) of the *Income Tax Act*. While the definition of "security interest" for the purposes of that section is found in s. 224(1.3), that section provides expressly that the deemed trust attaches to "property of the person [who has failed to remit source deductions– the "tax debtor" as defined in s. 224(1.2)] and property held by any secured creditor ... of that person that but for a security interest ... would be property of the person" (emphasis added).

[40] That is, s. 227(4.1) provides that the deemed trust attaches to property held by a secured creditor who is the secured creditor of the tax debtor, who has a security interest in property that but for the security interest would be property of the tax debtor.

[41] Section 224(1.2) does not contain the same limitation. It provides, in s. 224(1.2)(a), that money otherwise payable by Canfor to Baer is required to be paid to the Receiver General notwithstanding any security interest in those monies. A "security interest"is "any interest in property", including a lien.

[42] If s. 224(1.2)(b) were applicable, the respondents might have an argument that the lien claimants were not secured creditors who had a right to receive the payment that, but for a security interest in their favour, would be payable to Baer, because the lien claimants did not have a right, under their liens, to the payment Canfor owed Baer under the contract. The Minister does not have to rely on s. 224(1.2)(b), however, in this case. Section 224(1.2)(a) clearly applies.

[43] The respondents' argument that they did not have a "security interest", but an *in rem* or possessory interest in the logs, relies on the analysis in *First Vancouver Finance v. M.N.R.*, 2002 SCC 49 (CanLII), [2002] 2 S.C.R. 720, 2002 SCC 49. The issue in that case was whether the deemed trust provisions applied to property that had been sold to third party purchasers in

Digitized by Google

the ordinary course of business. The Supreme Court of Canada held that the Minister could not claim an interest in the property.

[44] *First Vancouver Finance*, like *Caisse populaire*, is clearly distinguishable, and does not assist the respondents. Again, it dealt with the deemed trust provisions in ss. 227(4) and (4.1) of the *Income Tax Act*, not with s. 224(1.2), in issue here. Secondly, it considered the position of third party purchasers, not lien claimants.

[45] The decision of this Court in *DaimlerChrysler Financial Services (debis) Canada Inc. v. Mega Pets Ltd.*, 2002 BCCA 242 (CanLII), 2002 BCCA 242, is similarly distinguishable.

[46] Applying the plain wording of s. 224(1.2)(a), the liens secured payment or performance of Baer's obligation to pay the woodworkers for their work. In order to clear the title to the logs, Canfor had to provide for Baer's obligation, subject to the determination of priorities among Baer's creditors (including the lien claimants), by paying the funds into court. It did so in accordance with s. 16 of the *Woodworker Lien Act*.

[47] Thus, the monies otherwise payable by Canfor to Baer became "the property of Her Majesty" upon the issuance of the requirements to pay, "notwithstanding [the] security interest [of the lien claimants] in those monies".

[48] The payment into court served to clear Canfor's title to the logs, and in effect, gave a "security interest" in the funds in court to the lien claimants, to secure the payment of the liens. The interest of the lien claimants was always, however, subject to the prior claims of other creditors, in this case, the Minister.

[49] The method by which woodworkers' liens are enforced under the *Woodworker Lien Act* is irrelevant to this analysis, which turns on the plain wording of the statutes.

Inequity

[50] The chambers judge commented (at paras. 97-98) that in enforcing its claim under s. 224(2.1) of the *Income Tax Act*, the Crown was seeking to "expropriate the labour and services of those lien claimants and leave them unpaid, by claiming priority." He concluded: "The inequity of such a result is patent."

[51] Similar observations challenging the Minister's priority under these provisions were rejected by the Supreme Court of Canada, in *Alberta (Treasury Branches) v. M.N.R.*, 1996 CanLII 244 (SCC), [1996] 1 S.C.R. 963, and the Saskatchewan Court of Appeal, in *TransGas Ltd. v. Mid-Plains Contractors Ltd.* 1993 CanLII 4413 (SK CA), (1993), 101 D.L.R. (4th) 238, aff'd 1994 CanLII 30 (SCC),

[1994] 3 S.C.R. 753.

[52] In *Alberta (Treasury Branches)*, Cory J., for the majority, described the high priority ascribed by Parliament to the collection of source deductions, and rejected the argument that the statutory collection provisions amounted to expropriation (at para. 38):

It is clear that in enacting the sections of the *ITA* and *ETA* under consideration Parliament was attempting to ensure the priority of the claim of the MNR over that of other creditors. The primary task of collecting and remitting taxes and contributions under both Acts rests with those who are employers and those who sell goods and services. **These amounts so collected could be said to belong not to the**

Digitized by Google

collecting debtor entities but to the government. In a sense the funds collected but not remitted might be considered to be held in a form of trust since the entities that have collected these funds are not in any circumstances entitled to retain them. Rather they must remit the funds. In those circumstances the priority granted to the MNR to recover such funds cannot possibly be said to be expropriation without compensation. [Emphasis added.]

[53] In *TransGas*, the Saskatchewan Court of Appeal expressed the purpose of these provisions as follows (at 248, 251):

Therefore, in our opinion, the purpose of the impugned provision is clear – to effect expedient collection of the withheld tax money and thereby prevent its misappropriation or diversion to the tax debtor's other creditors.

…

The provision enables the Minister to collect withheld taxes by garnisheeing funds payable to the delinquent employer – funds that would not have been available to other creditors if they had been remitted as required by law. In order to ensure the collection of "withheld" tax money, the government has enacted this garnishment provision with the result that it constitutes an integral and essential part of the collection scheme as it is clearly designed to attack the problem of tax deficiencies due to conversion or other types of misappropriation at the source of the deductions.

[54] The direct effect of these provisions on the lien claimants is of course unfortunate, but the fact is that through these provisions amounts deducted from their wages for income tax and other statutory deductions, and payments made for GST, are paid to the Minister, who, under the taxation statutes, was always entitled to them. Sympathy for the lien claimants does not override the plain meaning of the statutes.

Deemed Trust

[55] The Minister claimed in the alternative that the deemed trust provisions applied to the amount payable by Canfor to Baer.

[56] It is not necessary to decide this question, as the Minister's claim under s. 224(1.2) has priority over that of the lien claimants to the funds in court.

Is Underlying Debt Prescribed?

The underlying debt must be in existence in order for the RTP to be valid: if the loan or payable has ceased to exist then there is no "payable" for purposes of the Act and the RTP is ineffective. This was the issue in Imperial Pacific Greenhouses Ltd. v. The Queen[54] where there was considerable issue on the reliability of the witnesses where there was a verbal agreement that the loan was basically contingent on another out-come of ancillary proceedings and no written evidence of such could be produced: it purportedly deferred payment on the underlying debt. In respect of loans that were no t repayable and thus undermining the RTP see also Debra Browning v. The Queen[55] where the Tax Court had to contend with an instance where a debtor to a tax-debtor corporation argued that the debt had been prescribed and "fallen off the table" and thus there was no "payable" with the scope of s. 224(1). It held:

Analysis

[27] In my view, the Respondent's lack of attention to the Minister's power to assess

[54] 2011 FCA 79

[55] 2010TCC487

Digitized by Google

underpins the essential weakness of his position. The starting point for any appeal of an assessment under the *Income Tax Act* is the validity of the assessment. For an assessment under subsection 227(10) to be valid, all of the prerequisites of subsections 224(1) and (4) must first be fulfilled.[24] Until that substantive determination has been made, I
agree with counsel for the Appellant that section 222 does not come into it.

[28] In the present case, the Minister's assessments hinge on the factual assumption that at the time of the Current Requirements to Pay, Ms. Browning was "liable to make a payment" to Berkeley and is accordingly, liable under subsection 224(1) for Berkeley's tax debt[25]. Although her potential tax liability was initiated by the issuance under subsection 224(1) of the Current Requirements to Pay, it is the resulting subsection 227(10)
assessment that is under appeal; in challenging that assessment, it is open to Ms. Browning to prove wrong the assumptions upon which it was based.

[29] In *Maritime Life Assurance Company v. Her Majesty the Queen*[26], for example, the taxpayer succeeded in
its challenge of the Minister's assessment for failure to comply with a requirement to pay by showing that it was not liable to make a payment to the tax debtor at the time the requirements to pay were made:

6 The effectiveness of the Minister's Requirements to Pay turns, at least initially, upon the answer to the question whether or not the cash values of the policies were "payable", within the meaning of that word as it is used in subsection 224(1), when the Requirements were made. I understood both counsel to accept that the answer to this question depends simply upon whether or not SK and RK could, at that time, require the Appellant company to pay the cash value of the policies to them forthwith. That this is so is placed beyond dispute by a number of authorities, the most recent of which is the decision of the Federal Court of Appeal in Canada (*Attorney General*) *v. Yannelis*. It was held there that the word "payable", as used in the Unemployment Insurance Regulations, subparagraph 58(8)(*b*)(i)

... refers to the point in time when vacation pay is due to a claimant in the sense that he is entitled by his contract of employment or by the general law to have it paid to him and his employer is under an obligation to pay it. In other words, it is payable when a claimant is in a position at law to enforce payment. That point in time, as was held in *Legge*, *supra*, should not depend on when unpaid vacation pay happened to have been requested if, as a matter of law, it became payable in the above sense at an earlier time. [Emphasis added; original footnotes omitted.]

[30] Thus, while subsection 224(1) permits the Minister to send to a third party a written requirement to pay "the moneys otherwise payable by the tax debtor" on nothing more than a suspicion, no liability will attach if the third party can show that when the requirements to pay were issued, no amount was "due" and that he was under no "obligation to pay it". One possible defence "under the general law" could be to show that as of the effective date of the requirement to pay, the debt was unenforceable by the tax debtor against the third party by operation of a provincial limitation of action statute.

[31] This is the basis of Ms. Browning's defence. In this regard, her situation is quite different from that of the taxpayer in *Markevich.* Unlike Ms. Browning, Mr. Markevich had been directly assessed and was challenging the enforceability of his otherwise admitted "tax debt" solely by invoking limitation periods under the same provisions of the British Columbia legislation. Although counsel for the Respondent described the question in *Markevich* as "whether ... the [Minister] was out of time with respect to

Digitized by Google

requirements to pay"[27], as can be seen from Justice Evans' (as he then was) findings of fact in the first instance, references to requirements to pay were only incidental to the substantive issue under appeal; namely, Mr. Markevich's direct liability to the Crown:

…

The applicant, Mr. Markevich, has been at all material times a resident in the province of British Columbia. In the early 1980s he failed to pay taxes on income that he had earned in the promotion of stocks. He has never challenged the validity or correctness of the notices of assessment issued by the Minister.

In 1986 he was assessed as owing $267,437.61 to Revenue Canada. In 1987 his house was sold and Revenue Canada took the proceeds of sale to reduce his indebtedness. Later in that same year Revenue Canada decided to "write-off" the amount of tax still owed by the applicant, on the ground that he had no other assets and no income, and there were no realistic prospects of collecting the tax from him within the foreseeable future.

"Writing-off" a tax debt does not extinguish or forgive it; it is an internal book-keeping device that removes a taxpayer's tax debt from Revenue Canada's active collection list. Subsection 25(3) of the Financial Administration Act, R.S.C. 1985, c. F-11 [as amended] provides that "[t]he writing off of any debt, obligation or claim pursuant to this section does not affect any right of Her Majesty to collect or recover the debt, obligation or claim."

From 1992 the applicant reported income on his tax returns; in some years he was late in paying the amount for which he was assessed. After making payments in respect of those years, he received a statement of account in September 1993 showing the balance owing to Revenue Canada as $0.00. In the years 1995 to 1997 he again fell into arrears, and requirements to pay were issued to creditors informing them of the tax owing by the taxpayer and requiring them to pay to Revenue Canada money that they owed to the applicant. During the period 1995 to 1997, the statements of account sent to the applicant, and the requirements to pay issued to its creditors, showed him as owing only the tax due in respect of those years, not the larger amount owing from the years before 1986.

However, in January 1998 the applicant was informed that he also owed unpaid taxes assessed in the years up to 1986 in the amount $770,583.42, which comprised $267,437.61 of unpaid taxes and $503,145.81 of accrued interest. Apparently as a result of a change of policy, previously written-off tax debts are now included by Revenue Canada in both the statements of account sent to taxpayers, and any requirements to pay issued to taxpayers' creditors.

Having heard virtually nothing about this debt in any of his communications with Revenue Canada since 1986, and having neither acknowledged nor made any payments in respect of this indebtedness since 1986, the applicant was taken aback when he received this information in January 1998. In particular, he feared that the inclusion of this large amount in any requirements to pay that Ms. Kara indicated would be issued to his creditors would be extremely damaging to him in the conduct of his business. However, it should also be noted that in August 1996 the applicant had been told that the assessment notice issued for the tax year 1993 did not include a previously unpaid tax liability and that a detailed statement would follow. It did not.[28][Emphasis added.]

[32] Unlike Mr. Markevich (and, for that matter, the taxpayers in the few cases decided after the consequential amendments to section 222, *Gibson v. R.*[29] and *Collins v.*

Digitized by Google

R.[30]), Ms. Browning is not herself directly indebted to the Crown for her own unpaid taxes. And unlike the taxpayer in *Bleau v. Canada*[31], she is not attempting to argue that the underlying tax debt of Berkley is statute-barred: in that case, the taxpayer became liable to pay the tax debt of the section 160 transferor at the moment of transfer, long before the expiry of any limitation periods that might have applied. Ms. Browning, however, invokes the limitation period in the provincial statute not as a bar to the Minister's action to collect an already proven tax debt but rather, to show that no such debt ever came into existence.

[33] Turning, then, to the question of whether Ms. Browning was "liable to make a payment" to Berkeley as of the effective dates of the Current Requirements to Pay, I accept Mr. Browning's evidence that, after January 1, 1994, the Appellant made no further payments under the mortgage and Berkeley took no action to enforce its payment. In these circumstances, as of that date, the Appellant was in default under the mortgage and pursuant to the British Columbia *Limitation Act*, Berkeley had until January 1, 2000 to bring a cause of action to enforce its right of repayment under the mortgage. As this was not done and Ms. Browning did nothing to confirm the debt before the expiry of the limitation period, as of January 1, 2000, the mortgage debt became unenforceable and was extinguished under subsections 3(5), 5(1), 5(2) and 9(1) of the British Columbia *Limitation Act.*

[34] From this it follows that when the Current Requirements to Pay were issued (October 2000 to July 2007), Ms. Browning was no longer liable to Berkeley under the mortgage. That being the case, the triggering criteria under subsections 224(1) and (4) have not been satisfied, the Minister was without power to assess Ms. Browning under subsection 227(10)and the assessment is, therefore, invalid.

[35] In these circumstances, there is no need to consider the Respondent's arguments in respect of section 222. The Minister cannot use that provision to bootstrap his way over the criteria in section 224 upon which his power to assess under subsection 227(10) depends.

[36] Notwithstanding the amendments to section 222 consequent to *Markevich*, that case still stands for the proposition that the Minister has a duty to act with some dispatch in collecting tax debts. Here, the Minister's practice of issuing requirements to pay to Ms. Browning in dribs and drabs over a 15-year period in respect of Berkeley's 1989-90 tax debt falls somewhat short of the ideal expressed by Major, J. in paragraph 20 of the Supreme Court of Canada decision:

… If the Minister makes no effort to collect a tax debt for an extended period, at a certain point a taxpayer may reasonably come to expect that he or she will not be called to account for the liability, and may conduct his or her affairs in reliance on that expectation. As well, a limitation period encourages the Minister to act diligently in pursuing the collection of tax debts. In light of the significant effect that collection of tax debts has upon the financial security of Canadian citizens, it is contrary to the public interest for the department to sleep on its rights in enforcing collection. …[32]

[37] The appeals are allowed, with costs, and the assessments of the Minister of National Revenue are vacated.

No Need for Assessment or Certificate to be Issued

There is no need for CRA to issue an assessment or certificate of indebtedness of the tax-debtor in order for the RTP to be legitimate. This was the case in Dr.:Lenard-Zephirin:Gagne

Digitized by Google

v. MNR et al[56] where the Fed. Ct. held:

> [21] The Applicant submits that the Requirement to Pay is invalid since no certificate was issued by a competent court. As the Minister pointed out, section 224 of the *Income Tax Act* does not require any formal document to be processed by a competent court before garnishee proceedings can be initiated. Powers are granted to the Minister under this section of the Act: "as soon as the Minister becomes aware that a third person may make a payment to another person who is liable to make a payment in to a tax debtor...may require payment". Section 224(1.2) provides for garnishment procedure. Further, this initiative taken by the Minister is confirmed by the Federal Court of Appeal in *Sorenson v. M.N.R.* 82 D.T.C. at 6246, Thurlow CJ wrote:
> We have not been persuaded that there is any error in the judgment under appeal. Of the various matters referred to, the only point worthy of mention is the submission that procedure to file a certificate under section 223 of the *Income Tax Act* must be followed by the Minister before he may exercise the power given him by section 224 to require a person who is or is about to become indebted or liable to a taxpayer to make payment to the Receiver General for Canada on account of the taxpayer's liability under the Act. In our opinion, there is no merit in the submission.

No Notice, Right of Judicial Review

Stanley Dingman v. MNR[57] is a wonderful case illustrating some of the parameters in which a RTP can be contested, though unsuccessfully. It is reproduced at length.

Issues

> [7] The applicant has submitted the following issues for consideration:
> There were no legal warnings sent to the applicant prior to the requirement to pay.
> There were no provisions for a statutory right of appeal in the requirement to pay.
> The applicant did have contractual agreements contrary to the respondent.
>
> [8] I would rephrase the issues as follows:
> What is the appropriate standard of review?
> Did the Minister commit a reviewable error in not providing warning to the applicant that a requirement to pay would be sent to 1094238 Alberta Ltd. and 870413 Alberta Ltd.?
> Did the Minister commit a reviewable error in not providing the opportunity for an appeal?
> Did the Minister commit a reviewable error when he issued a requirement to pay to 1094238 Alberta Ltd. and 870413 Alberta Ltd.?

Applicant's Submissions

> [9] The applicant alleges that he is not an employee of 870413 Alberta Ltd. and has suffered damages through breach of privacy and confidentiality and defamation of character, from this requirement to pay. He also submits that he has never received a response from his November 6, 2002 letter requesting all information pertaining to the tax assessment so as to dispute and/or disprove tax arrears.
> [10] The applicant alleges that according to the Tax Payer Bill of Rights #7, "You have the right, as an individual, not to pay income tax amounts in dispute before you

[56] 2003 FCT 18
[57] 2009 FC 395

Digitized by Google

have had an impartial review." The applicant alleges that he did have a contractual agreement contrary to the respondent's "Exhibit B" ruling, therefore solid grounds for an impartial review exists.

[11] The applicant submits that in the event that a review does not concur with the applicant's position, then the Taxpayer's Bill of Rights #12 should come into force which states, "You have the right to relief from penalties and interest under tax legislation because of extraordinary circumstances."

Respondent's Submissions

[12] The respondent submits that there are three issues in this application for judicial review. First, the respondent submits that unless the applicant submits a motion pursuant to Rule 302 of the *Federal Court Rules*, S.O.R./98-106 (the Rules), permitting him to seek judicial review of both requirements to pay within a single application, the application is "technically invalid".

[13] Second, the respondent submits that the applicant has named the wrong respondent to the application. The respondent submits that the "Minister of National Revenue" is the proper respondent because of subsections 244(1) and 248(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (ITA), and states that it is the Minister of National Revenue who has the statutory right to issue a requirement to pay. The respondent also submits that CRA and the collections officer, G. Gregory Roy, act on behalf of the Minister and perform functions in the Minister's name. Therefore, the respondents will make a motion to remove the respondents named in the style of cause and substitute "The Minister of National Revenue" as the sole respondent to this application for judicial review.

[14] Third, the respondent argues that decisions by the Minister to issue requirements to pay were reasonable which the respondent argues, is the standard of review to be applied in this case. It is argued that the decision by the Minister is a discretionary one under subsection 224(1) of the ITA which states:

Where the Minister has knowledge or suspects that a person is, or will be within one year, liable to make a payment to another person who is liable to make a payment under this Act (in this subsection and subsections 224(1.1) and 224(3) referred to as the "tax debtor"), the Minister may in writing require the person to pay forthwith, where the moneys are immediately payable, and in any other case as and when the moneys become payable, the moneys otherwise payable to the tax debtor in whole or in part to the Receiver General on account of the tax debtor's liability under this Act.

[15] The purpose of the provisions, the respondent submits, is to "effectively intercept" the debt owed to the tax debtor and that this is one of many tools used by the Minister in collecting tax debts.

[16] The respondent states that the evidence shows that the Minister was reasonable in issuing a requirement to pay to Graham's Backhoe Service because numerous cheques were payable to the applicant in 2007 and 2008, and these were in turn deposited into the applicant's corporation.

[17] The respondent submits that requirements to pay were a "proper attempt" to collect the applicant's outstanding tax debt and within the power and discretion of the Minister as conferred under the ITA.

[18] The respondent rejects the applicant's argument that the requirements to pay were issued "with no legal warning". The respondent states that this argument could "be construed as a complaint that absent advance notice he was denied a right to be heard by the decision maker". The respondent submits that there is no

Digitized by Google

requirement to issue a legal warning in the ITA. The respondent argues that even if there was a requirement to issue a legal warning, the evidence shows that this would have been "generously met" by the notice of assessment dated June 13, 2002; at least six letters between October 2002 and February 2006 requesting payment, of which at least five warned that legal action might be taken without further notice; and a letter dated October 31, 2002 requesting payment with an explicit warning that legal action may be taken without further notice.

[19] The respondent submits that the Federal Court does not have jurisdiction to review the employment insurance ruling referred to in the letter dated October 30, 2000 which led to the notice of assessment because it is barred by operation of sections 91 and 103 of the *Employment Insurance* Act,
R.S.C. 1996, c. 23 (EIA), which states that an employment insurance ruling would have to be appealed to the Tax Court of Canada within the prescribed period. Further, when applying section 18.5 of the *Federal Courts Act*, R.S.C. 1985, c. F-7 (FCA), this Court has said that when attacking a requirement to pay, it cannot be an attack on the underlying assessment where the appeal goes to the Tax Court of Canada. In any case, the respondent argues that the applicant is barred because it was not argued in the notice of application.

[20] Relief from interest and penalties is also barred because it was not argued in the notice of application and there is no evidence that the applicant applied to the Minister of National Revenue for such relief pursuant to subsection 220(3.1) of the ITA.

[21] The respondent submits that this judicial review should be dismissed with costs after allowing the applicant's single application for judicial review to address both requirements to pay, and after amending the style of cause.

Analysis and Decision

[22] There are two preliminary issues to address: the motion to amend the style of cause naming the Minister of National Revenue rather than the collections officer, G Gregory Roy and CRA and whether the two requirements to pay that were issued are judicially reviewable under a single application. The Federal Court of Appeal in *Stevens v. Canada (Commissioner, Commission of Inquiry)* 1998 CanLii 9074 (F.C.A.) noted the legal principle from an English case, that dealt with joinder of a party: *Amon v. Raphael Tuck & Sons Ltd.*, [1956] 1 Q.B. 357 which stated that a party named in an action should be bound by the result of that action. In this case the collections officer exercises his discretion in collection activities on behalf of the Minister and would not personally be bound by the Court's order in this case, pursuant to subsections 244(1) and 248(1) of the ITA. Therefore, the style of cause should be amended naming the Minister of National Revenue and deleting G Gregory Roy, Collection Enforcement Officer and the Canada Revenue Agency as respondents.

[23] At the hearing of this matter, the parties agreed that pursuant to Rule 302 of the *Federal Court Rules*, I could order that both requirements to pay could be dealt with in the same judicial review application.

[24] **Issue 1**

What is the appropriate standard of review?

The questions under review involve questions of mixed law and fact and questions of law. Last year in *Dunsmuir v. New Brunswick*, [2008] 1 S.C.R. 190, the Supreme Court of Canada reviewed the standard of review analysis in Canada and eliminated the standard of patent unreasonableness. In doing so, the Supreme

Digitized by Google

Court stated the following about the reformed standard of review analysis at paragraph 62:

In summary, the process of judicial review involves two steps. First, courts ascertain whether the jurisprudence has already determined in a satisfactory manner the degree of defence to be accorded with regard to a particular category of question. Second, where the first inquiry proves unfruitful, courts must proceed to an analysis of the factors making it possible to identify the proper standard of review.

[25] In *Beaulieu v. Canada (Attorney General)*, 2008 FC 1236, Mr. Justice Shore examined the case law on discretionary decisions made by the Canada Revenue Agency:

In *Barron v. Canada (Minister of National Revenue - M.N.R.)*, 97 D.T.C. 5121, [1997] F.C.J. No. 175 (QL), the Federal Court of Appeal states the reasons serving as the basis for reviewing the exercise of the discretionary power by the Minister's delegate. Indeed, the judge flags and reiterates the comments of Mr. Justice Louis Pratte:

[79] ... when an application for judicial review is directed against a decision made in the exercise of discretion, the reviewing Court is not called upon to exercise the discretion conferred upon the person who made the decision and "the Court may intervene and set aside the discretionary decision upon review only if that decision was made in bad faith, if its author clearly ignored some relevant facts or took into account irrelevant facts or if the decision is contrary to law.

(As quoted by Mr. Justice J. François Lemieux in *Wyse v. Canada (Minister of National Revenue - M.N.R.)*, 2007 FC 535, 313 F.T.R. 161; also, *Plattig v. Canada (Attorney General)*, 2003 FC 1074, 239 F.T.R. 290 at paragraph 22.)

In a similar case, Mr. Justice Michel Beaudry stated: "The Court will intervene only where the decision is based on an unreasonable explanation. The Court must assess whether the reasons for the decision are tenable." (*Gagné v. Canada (Attorney General)*, 2006 FC 1523, 2007 D.T.C. 5087 at paragraph 15.)

[26] Therefore, although jurisprudence has not determined what standard of review to apply on requirement to pay decisions specifically, I find that the case law on discretionary decisions of CRA point to a reasonableness standard. This is in accordance with *Dunsmuir* above, where discretionary decisions are to be afforded a high degree of deference. For a decision to be unreasonable, it must be also determined to be improper within the meaning of subsection 18.1(4) of the FCA.

[27] **Issue 2**

Did the Minister commit a reviewable error in not providing warning to the applicant that a requirement to pay would be sent to 1094238 Alberta Ltd. and 870413 Alberta Ltd.?

The applicant alleges that he is not an employee of 870413 Alberta Ltd. and has suffered damages through breach of privacy and confidentiality and defamation of character from this requirement to pay and that he has never received a response from the November 6, 2002 letter requesting all information pertaining to the tax assessment so as to dispute and/or disprove tax arrears.

[28] I find, however, that the applicant received ample warning that legal action may be taken to collect the debt owing to the Crown. It was incumbent on the applicant to pursue an appeal on his reassessment for the 2000 taxation year and he chose not to. Since then the applicant received multiple letters requesting payment. These letters stated:

If you fail to pay the full amount within 14 days, we may have to take appropriate

Digitized by Google

legal action without further notice.

[29] In any case, I agree with the respondent that there is no legal requirement to issue a warning. I would not allow the judicial review on this ground.

[30] **Issue 3**

Did the Minister commit a reviewable error in not providing the opportunity for an appeal?

The jurisprudence on the jurisdiction of the Federal Court to review tax assessments is clear: there is no jurisdiction according to section 18.5 of the *Federal Courts Act* and sections 91 and 103 of the *Employment Insurance Act*. The applicant would have had to appeal through the Tax Court of Canada. I would not allow the judicial review on this ground.

[31] **Issue 4**

Did the Minister commit a reviewable error when he issued a requirement to pay to 1094238 Alberta Ltd. and 870413 Alberta Ltd.?

The Minister of National Revenue has a statutory duty to collect debts owing to the Crown under subsection 224(1) of the *Income Tax Act*. I cannot accept that this decision was made in bad faith, that the Minister "clearly ignored some relevant facts or took into account irrelevant facts or that the decision is contrary to law" (see *Barron* above). The applicant was given ample opportunity to pay the debt over six years.

[32] The applicant argues that it was not reasonable to issue a requirement to pay to 870413 Alberta Ltd. because he was not an employee. Subsection 224(1) of the ITA states in part:

Where the Minister has knowledge or suspects that a person is, or will be within one year, liable to make payment to another person who is liable to make payment under this Act…

[33] The section does not stipulate that the applicant would have had to be an employee only that "another person" would be liable to him for payment. The decision of the Minister to issue requirements to pay was therefore reasonable. I would not allow the judicial review on this ground.

[34] The application for judicial review is therefore dismissed.

Harold Coombs And Joan Coombs v. Canada Revenue Agency, 2012 FC 1499, DAS Collection through RTP Without Notice still Valid

Date: 20121218
Docket: T-1658-11
Citation: 2012 FC 1499
Toronto, Ontario, December 18, 2012
PRESENT: The Honourable Mr. Justice Manson
BETWEEN:

HAROLD COOMBS AND JOAN COOMBS

Applicants

and

Digitized by Google

CANADA REVENUE AGENCY

Respondent

REASONS FOR JUDGMENT AND JUDGMENT

I. Overview

[1] This is an application for judicial review pursuant to section 18.1 of the *Federal Courts Act*, RSC 1985, c F-7, of the discretionary decision by the Canada Revenue Agency [CRA] to issue a Requirement to Pay [RTP] to the applicants.

[2] The applicants seek an order to quash or invalidate the RTP and a mandamus order to restrict the CRA from instituting any further collection actions until such time that a Notice of Confirmation or variation of assessments has been issued to the applicants.

II. Background

[3] The applicants, Harold Coombs and Joan Coombs, are the directors and controlling shareholders of Select Travel Inc [Select Travel].

[4] Harold Coombs is also the president of Select Travel, a company incorporated under the laws of Ontario.

[5] On March 23, 2010, Select Travel was reassessed by the CRA for the 2004 and 2008 taxation years and was found to owe 6,651.84$ and 597.28$, respectively. On March 24, 2010, the CRA sent a notice of reassessment for those two years and advised Mr. Coombs of an outstanding balance of 8,094.61$. On June 24, 2011, Mr. Coombs filed a Notice of Objection to the reassessment with the Chief of Appeal.

[6] On March 24, 2011, Select Travel was reassessed for the 2009 and 2010 taxation years and was found to owe 1,612.45$ and 1,349.78$, respectively. On August 11, 2011, CRA sent Select Travel a Statement of Account which indicated a tax debt of 12,692.84$. By September 2, 2011, that amount had increased to 12,729.40$.

[7] It is submitted by the respondent, and not contested by the applicants, that the 12,729.40$ amount consists only of Select Travel's source deduction tax liability.

[8] On September 2, 2011, CRA sent the RTP to TD Canada Trust, Select Travel's financial institution, for the amount owing: 12,729.70$. On September 8, 2011, TD Canada Trust complied with the RTP and paid the full amount of 12,729.70$. On September 28, 2011, Harold Coombs filed an application for judicial review on behalf of Select Travel Direct Inc. (file T-1597-11).

[9] On October 7, 2011, Harold Coombs filed another application for judicial review, this time on behalf of himself and his wife, Joan Coombs (file T-1658-11). On November 24, 2011, the respondent sought a motion to strike one of the two Notices of Application on the grounds that they were virtually identical and sought the same relief.

[10] On December 19, 2011, Justice Roger Hughes issued an order stating that both applications would be heard together. However, file T-1597-11 was discontinued on December 7, 2011. The remaining file, T-1658-11 is the object of this application for judicial review.

[11] It should be noted that the applicants are self-represented and submitted no memorandum of argument. Respondent's counsel made a preliminary objection that the Coombs did not have status to appear on behalf of the corporate entity Select Travel in

Digitized by Google

respect of which the complaint concerning the issuance of the RTP and collection has been raised. In the interest of justice, and given their roles as sole directors and shareholders, I granted status to the Coombs to make representations on behalf of Select Travel.

[12] The applicants seek the following:

A. An order quashing the RTP;

B. A declaration that the RTP is unlawful and in violation of paragraph 225.1(d) and subsection 225.1(2) of the *Income Tax Act*, RSBC 1996, c 215 [ITA];

C. An order restricting the CRA from making further collection actions until a notice of confirmation or variation has been mailed to the applicants;

D. An order stating that the CRA must comply with subsections 225.1(a) to (g) of the ITA;

E. An order compelling the CRA to fulfill its duties pursuant to sections 225.1 and 225.1(2) of the ITA.

III. Issues

[13] The issues, as reformulated, are as follows:

A. Does the Federal Court have jurisdiction to determine the present application regarding whether Select Travel's tax assessments are valid?

B. Was the CRA legally permitted under the ITA to issue the RTP on September 2, 2011 to collect the tax debt?

C. Was the CRA obligated, through the Taxpayers Bill of Rights or for any other reason, to provide reasons for its assessment and collections actions and if so, were these obligations met?

IV. Standard of review

[14] Neither party submitted an evaluation of the applicable standard of review, however, the applicable standard of review for discretionary decisions of the CRA is reasonableness (*Dingman v Canada (Minister of National Revenue - MNR)*, 2009 FC 395).

V. Analysis

[15] Federal Court does not have jurisdiction to hear challenges of tax assessments which are solely within the jurisdiction of the Tax Court of Canada (*Walker v Canada*, 2005 FCA 393 at para 13). Therefore, to the extent the applicants wish to challenge the validity of the reassessments, the application must fail. Moreover, collection actions taken in respect of a valid assessment are lawful (*Krahn v Canada (Customs and Revenue Agency)*, 2005 FC 471 at paras 9 and 10).

[16] To the extent the applicants challenge the CRA's decision to issue the RTP on September 2, 2011, the Court has jurisdiction.

[17] The applicants submit that CRA erred when it issued the RTP, in failing to consider their Notice of Objection filed on June 2, 2010, and on proceeding with the collection measures before the collection commencement-day, pursuant to subsection 225.1(1) of the ITA.

[18] However, given that the applicants' tax debt represents payroll source deductions, which are required to be deducted or withheld and to be remitted or paid, subsections 225.1(1) to 225.1 (4) do not apply, and CRA was entitled to issue the RTP to collect that debt. The notice of objection is not relevant here (*Gagne v Minister of Revenue*, 2003 FCT 18 at paras 17, 28, and subsections 225.1(6) (b), (d) and (e) of the ITA).

Digitized by Google

[19] Where there is no stay of such a collection action, the CRA can take immediate collection action as long as the assessment is valid (*Canada (Minister of National Revenue - MNR) v Vu*, 2004 FC 1783 at para 3; aff'd 2005 FC 788).

[20] Lastly, while CRA was not obligated to provide reasons for its assessment and collections action, pursuant to section 152 of the ITA, nevertheless the evidence shows through the affidavits of Lynn Watson sworn February 6, 2012 and Nancy Arnold sworn November 23, 2011, that sufficient reasons were given to the applicants to explain CRA's reassessment and collections (*Newfoundland and Labrador Nurses' Union v Newfoundland and Labrador (Treasury Board)*, 2011 SCC 62). In reviewing that evidence, I gave little or no weight to references to third party conversations contained in the affidavit of Lynn Watson, but did give weight to the Exhibits to her affidavit, and particularly Exhibits A, B and C, relating to Automated Collections and Source Deduction System business records, evidencing communications with Select Travel and Harold Coombs.

[21] For the reasons stated above, this application is dismissed.

JUDGMENT

THIS COURT'S JUDGMENT is that the application for judicial review is dismissed with costs.

"Michael D. Manson"
Judge

Failure to Respond to RTP and Intercept – Payor Becomes Liable

Subsection 244(4) transfers the liability to pay from the tax-debtor to the non-responding payor in the event that the payment is not paid accordingly to the Minister. It automatically causes the payor to become liable up to the amount paid that was referenced in the RTP. This was the issue in The Queen v. National Trust Company[58] where a bank did not take proper steps when cashing in an RRSP and instead remitted the funds to a party other than the Minister. The issue taken by the bank was that they were acting as a trustee of the RRSP funds and that they were not a debtor purportedly what the provision called for. The Fed. Appeal Ct. held:

Issues

[25] This appeal raises two issues: first, whether the respondent was required to comply with the subsection 224(1) requirement issued and served upon it on 1 February 1994; secondly, if so, whether it is liable to pay to the appellant, pursuant to subsection 224(4), the amount it was required to pay to the Receiver General pursuant to the subsection 224(1) requirement.

[26] The learned Tax Court Judge considered the first issue only. Having determined that issue adversely to the appellant, he did not find it necessary to deal with the second.

[27] Although, as will presently appear, the parties directed their submissions and their oral argument to the first issue, it is clear, at least from the points in issue raised by the appellant in Her memorandum, that both issues were at play during argument of the appeal.

Position of the Parties

[58] A-969-96

Digitized by Google

[28] In support of the contention that the Tax Court Judge erred in allowing the respondent's appeal and vacating the Minister's assessment, the appellant made four submissions. First, that at all relevant times subsequent to 24 February 1993, when the GIC matured, the respondent was a "person liable to make a payment" to the tax debtor and the proceeds of the RRSP and GIC which were deposited in the daily interest savings account were "payable" by the respondent to the tax debtor within the plain meaning of subsection 224(1) of the Act. Accordingly, the respondent is liable to pay the amount assessed pursuant to subsection 224(4) as a consequence of its failure to comply with the subsection 224(1) requirement of 1 February 1994. Secondly, the plain meaning of subsection 224(1) does not require that there be a debt owing from the respondent to the tax debtor. Thirdly, and in any event, if a debtor-creditor relationship between the tax debtor is required by subsection 224(1), such a relationship existed in this case. Furthermore, a debtor-creditor relationship may co-exist with that of trustee and *cestui que trust*. Finally, that the true commercial and practical nature of the relationship between the respondent and the tax debtor was not a true trustee- *cestui que trust* relationship.

[29] For its part, the respondent makes four submissions in support of the judgment in appeal. The respondent contends, firstly, that subsection 224(1) of the Act applies only in circumstances where a debtor- creditor relationship exists between the person "liable to make payment" and the tax debtor; secondly, that, in this case, such a relationship between the respondent and the tax debtor never existed; thirdly, that the respondent was not a person "liable to make payment" to the tax debtor within the meaning of subsection 224(1) of the Act; and finally, that the respondent could not comply with the Minister's requirement to pay without incurring liability to the tax debtor for damages for breach of its obligations as a trustee under the memorandum of agreement between the respondent and the tax debtor.

Analysis

[30] In their written memoranda and in oral argument, counsel for the parties attempted to support their submissions by referring to passages from the reasons for judgment in a number of reported decisions in which various courts have pronounced upon the meaning of the phrase "liable to make a payment" and the word "payable" as found in subsection 224(1) of the Act. I will deal with those cases later in these reasons. For the present, however, I need only say that those judicial pronouncements were made in factual contexts different from that with which we are concerned in this appeal.

[31] What we have to decide in this appeal are first, whether the respondent was required to comply with the subsection 224(1) requirement issued on 1 February 1994. Secondly, if it was, whether it is liable to pay to the appellant the amounts described in subsection 224(4) by reason of its failure to comply.

[32] If both questions are answered affirmatively, then the Minister was right in assessing the respondent and the appeal should be allowed. If they are answered negatively, a contrary result would be mandated.

[33] For convenience, I repeat here the text of subsections 224(1) and (4):

…

[34] In subsection 224(1) Parliament has invested the Minister with a discretion to issue a requirement in writing pursuant to the subsection if the following conditions precedent are satisfied:

the Minister has knowledge or a suspicion,

a person is or will be within 90 days liable to make a payment to a tax debtor, and

Digitized by Google

the amount must be payable immediately or in the future.

[35] If those conditions are satisfied, the Minister may, in writing, require the person liable to make the payment to pay to the Receiver General on account of the tax debtor's liability under the Act, forthwith, if the moneys are payable immediately, or in any other case, as and when the moneys otherwise become payable to the tax debtor.

[36] Subsection 224(4) imposes a penalty for failure to comply with the requirement to pay. The penalty is a civil one and is an amount equal to the amount that is required to be paid pursuant to subsection 224(1). **[37] The critical issue for determination is whether the respondent was a person liable to make a payment to the tax debtor on 1 February 1994, when the requirements to pay were served upon it. [38] It must be recalled that on that date, the GIC had matured for almost one year; that the tax debtor had not only issued instructions to the respondent to cancel the plan, but he had also instructed the respondent either to deposit the proceeds in a daily interest savings account or to pay the proceeds directly to him after deducting therefrom withholding tax.**

[39] In these circumstances, is the respondent "a person liable to make a payment" to the tax debtor within the meaning of subsection 224(1)? Secondly, were the proceeds of the GIC "payable" to the tax debtor either immediately or within 90 days?

[40] I deal first with the question of whether the respondent was "a person liable to make payment" to the tax debtor within the meaning of subsection 224(1).

[41] *Friesen v. The Queen*[13] instructs that in interpreting sections of the Act, the correct approach is to

apply the plain meaning rule. That is the approach I propose to take in construing subsections 224(1) and (4) of the Act.

[42] In his reasons, the Tax Court Judge accepted the contentions of the respondent that subsection 224(1) would have had application only if it were proved that a debtor-creditor relationship exists between the respondent and the tax debtor. He explained his view in the following passage of his reasons[14]:

"Liable" and "liability" point to a debtor status with the person liable to pay being the debtor. A person who is liable to pay has the quality of a debtor and conversely the person to whom he is liable to make the payment is his creditor. In subsection 224(1), the person must be one who is liable to make a payment, not just that such a person will make a payment otherwise than under an obligation to do so. This again gives credence to the view that the person making the payment is a debtor. Here that relationship does not exist as the Appellant was not liable to make any payment to the tax debtor.

[43] He came to this conclusion purportedly because of the reliance he placed upon a passage from the reasons of Stratton C.J., writing for a unanimous court, in *DeConinck v. Royal Trust Corp. of Canada*[15] I reproduce in full the paragraph of the reported decision at page 183, which the Tax Court Judge emphasized:

In my opinion, it is difficult to distinguish the *Morgan Trust Company* case from the present one. Moreover, with respect, I am unable to agree with the conclusion of the judge of first instance in the present case that a trustee who holds funds that are fully vested in a cestui que trust would fall within the definition of a person "liable to make a payment" pursuant to subsection 224(1) of the *Income Tax Act*. Rather it is my opinion that until a cestui que trust requests payment of the proceeds of an

Digitized by Google

from his trustee, which he is able but not bound to do under the rule in *Saunders v. Vautier* (1841), 41 E.R. 482, no moneys are payable to him nor is his trustee liable to make a payment to him within the meaning of subsection 224(1) of the Act. Thus, in my view, the Request to Pay pursuant to subsection 224(1) of the *Income Tax Act* was not sufficient authority for Royal Trust to collapse Mr. DeConinck's R.R.S.P. and pay the net proceeds to Revenue Canada.

[44] In his memorandum and in oral argument, counsel for the respondent placed great reliance on this passage and upon the other authorities cited in his memorandum.[16]

[45] I have read each of these authorities with care. Although instructive on the issue of whether moneys in an RRSP are held in trust, I am of the opinion, nevertheless, that they do not assist the respondent in the circumstances of this case. Firstly, the cases such as *Re Bliss, Kirsh and Doyle et al, supra*, decided in the context of provincial garnishee legislation, turned on the phrase whether there were "debts owing and accruing due" to the judgment debtor. Secondly, in none of them had the debtor, as here, expressly instructed the trustee to cancel the plan and directed that the proceeds be remitted to him. **In all these cases, it might be appropriate to say, as the Tax Court Judge did in this case, that: " 'liable' and 'liability' point to a debtor status with the person liable to pay being the debtor". But that is not what the plain words of subsection 224(1) require.**

[46] **The ordinary meaning of the word "liable" in a legal context is to denote the fact that a person is responsible at law[17]. Hence, I am in respectful agreement with McLachlin J. (as she then was) when she stated in *Discovery Trust Company v. Abbott et al*,[18] a case in which a section 224(1) requirement was served upon a trustee, that:**

... the demand on third parties [a subsection 224(1) requirement] by which the Crown's claim is made in this case is not confined to a debtor-creditor relationship, as is a garnishee order; it is stated to extend to any case where the trustee is "liable to make a payment to the taxpayer."

[Emphasis added.]

[47] **It is my respectful view, therefore, that the Tax Court Judge was wrong in law to limit the phrase "liable to make a payment" only to situations where a debtor-creditor relationship exists**. In so doing, he precluded himself from asking the only relevant question when one is confronted with construction of the subsection. **It is this: did the respondent have a responsibility at law to make a payment to the tax debtor on 1 February 1994?**

[48] For the reasons that follow, I am of the opinion that the respondent did have such a responsibility. [49] It is useful, in my view, to reproduce here portions of the memorandum of agreement which contained the terms and conditions of the tax debtor's RRSP with the respondent[19]:

Your National Trust Company, Retirement Savings Plan consists of this Memorandum of Agreement and an Application when the following conditions have been met:

The Application is completed and signed by you the "Annuitant" or the "Planholder".

The completed and signed Application is accepted by an authorized Officer of National Trust Company as the Plan Trustee (we, us) and

The Application and Memorandum of Agreement are accepted for registration by the taxation authorities under the Income Tax Act (Canada) and any applicable Provincial Income Tax Act (both of which are referred to in this material as "the

Digitized by Google

applicable tax legislation".)

…

As long as this Plan remains as a Retirement Savings Plan it is a trust as provided by the applicable tax legislation. The assets and retirement income under the plan may not be pledged as collateral, assigned, or otherwise encumbered.

As a planholder, neither you nor any person with whom you are not dealing at arm's-length is entitled to any loan, benefit or special consideration other than those set out in the Income Tax Act (Canada) paragraph 146(2)(C.4).

…

Contributions made to us for your Plan will be invested (and reinvested from time to time) in accordance with your written instructions in investments offered by us, from time to time, for your plan.

….

The maturity of a Registered Retirement Savings Plan means it's conversion into an investment which will provide a "retirement income" in the form of an annuity and/or a Registered Retirement Income Fund. A retirement income in the form of an annuity must provide for equal annual or more frequent periodic payments until such time as there is a payment in full or partial commutation of that annuity and where such commutation is partial, equal annual or more frequent periodic payments thereafter. In the event of your death, the commuted value of any remaining payments payable under the annuity may be payable to the designated beneficiary or to your estate. Where payments continue after your death such payments in a year may not exceed the aggregate of the payments in a year before your death.

…

As permitted in the applicable tax legislation, you may, upon thirty (30) days written notice withdraw all or any portion of the assets of your Plan. Any withdrawal is subject to the terms and conditions of the investments in the Plan and is subject to any withholding tax as prescribed in the applicable tax legislation.

[50] There is no issue here that the memorandum of agreement contemplates the establishment of a trust, under which the tax debtor is the settlor and *cestui que trust* and the respondent is the trustee. The memorandum is also a contract in which the rights and obligations of the parties are specified.

[51] It should be noticed that the memorandum gives the tax debtor as settlor and *cestui que trust* a right, exercisable at his discretion, to withdraw all or a portion of the trust *res* on thirty days written notice to the respondent.

[52] On 24 February 1993, the tax debtor wrote to the respondent at its Winnipeg offices in part[20]:

Further to our recent telephone conversation regarding the above noted plan, this will confirm my earlier instructions to you to collapse same, deduct the requisite amount of withholding tax and release the net proceeds directly to me...

[53] After informing the respondent that it should make no payment to Revenue Canada, because, in his view, the RRSP was not amenable to a subsection 224(1) requirement to pay, the letter continued:

Therefore, I trust that my original instructions will be followed. Pending completion of my instructions, please maintain my R.R.S.P. and convert the type of funding from G.I.C. to a daily savings account that would provide the flexibility of collapse on any date which may be selected.

As additional security for you, I am prepared to provide a Bond of Indemnity. Alternatively, I direct application of the Plan proceeds to the following loans:

Digitized by Google

...
As you are aware, the present Requirement to Pay expires on April 27, 1993. Should nothing be done until that date, my instructions are to collapse same on April 28, 1993 and immediately release the net proceeds to me.

[54] Similar instructions were sent to the respondent at its Stratford office by letter dated 8 March 1993[21]. [55] Paragraph 25 of the statement of agreed facts indicates that it was the respondent's practice to accede to requests of the kind made by the tax debtor to collapse the RRSP and to remit the funds to him and that the respondent would have done so if Revenue Canada had not served upon it the requirement to pay. It is true that this practice does not give rise to any legal obligation on the respondent's part to make any payment. However, it is a contextual element in the appeal which one cannot ignore.

[56] The tax debtor's instructions were clear. After the GIC had matured, he wished to have the net proceeds of the RRSP for his own use and enjoyment. With deference to the Tax Court Judge, I am unable to discern any ambiguity or contradiction in those instructions.

[57] The tax debtor had a contractual right, enforceable in law, to have the net proceeds paid to him. The respondent had a corresponding contractual obligation to make the payment requested. In my respectful view, this legal obligation was sufficient to bring the respondent within the scope of the phrase "a person liable to make a payment" to the tax debtor within the meaning of subsection 224(1).

[58] **I find support for this view in the penultimate sentence of the passage from *DeConinck, supra,***

to which reference was earlier made. I repeat that sentence here for emphasis:

Rather it is my opinion that until a cestui que trust requests payment of the proceeds of an

R.R.S.P. from his trustee, ..., no moneys are payable to him nor is his trustee liable to make a payment to him within the meaning of subsection 224(1) of the Act.

[59] See to the same effect, *Hutterian Brethren Church of Smoky Lake et al. v. Provincial Treasurer (Alta.) et al*[22].

[60] For these reasons, I conclude that the respondent was a person "liable to make a payment" of the proceeds of the RRSP to the tax debtor within the meaning of subsection 224(1) of the Act.

[61] I turn now to consider the issue whether the proceeds were "payable" within the meaning of subsection 224(1). In my view this issue is governed by *DeConinck, supra*, and the decision of this Court in *Canada v. Yannelis*[23] where Stone J.A., for the Court, said at 636:

The word "payable" is not a term of art. Nor is it defined in the regulations. I do not see that it was used in any special sense. In my view, therefore, it should be interpreted in the light of ordinary dictionary definitions.

[62] and 638:

I have come to the conclusion that the word "payable" in s. 58(8)(*b*)(i) [of the *Unemployment Insurance Act*] refers to the point in time when vacation pay is due to a claimant in the sense that he is entitled by his contract of employment or by the general law to have it paid to him and his employer is under an obligation to pay it. In other words, it is payable when a claimant is in a position at law to enforce payment.

Digitized by Google

[63] Based on those authorities, I am of the view that the proceeds of the RRSP were payable to the tax debtor at the time he requested payment following the maturity of the GIC.

[64] Consequently, on 1 February 1994 when he issued the subsection 224(1) requirement and served it upon the respondent, the Minister had satisfied the three conditions precedent to which I have already referred. The requirement to pay was therefore a valid one and the respondent was obliged to comply with it.

[65] The respondent, being a person "liable to make a payment" to the tax debtor within the meaning of subsection 224(1) was required by that subsection to pay the proceeds of the RRSP to the Receiver General on account of the tax debtor's liability. By letter dated 7 February 1994[24], the respondent expressly refused to comply with the requirement to pay.

[66] In these circumstances, since the respondent did not offer any explanation or excuse to avoid the application of subsection 224(4), I conclude that the Minister was right to assess the respondent as he did and that the Tax Court Judge was in error in reaching a contrary conclusion.

[67] In view of the conclusion I have reached on the narrow issues in this appeal, I do not find it necessary to deal with the broader issues raised by the appellant, such as whether the trust established by the memorandum of agreement is a "true trust", whether a trust and a debt may co-exist and a definition of practical and commercial nature of an RRSP.

[68] I would therefore allow the appeal with costs, both here and below, set aside the judgment of the Tax Court, pronounced on 7 November 1996, and affirm the Minister's assessment.

"Julius A. Isaac" C.J.

"I agree.

A.M. Linden J.A."

Though partially dissenting:

[1] I have read the reasons of the Chief Justice and, while I agree with him in the result, I prefer to set out my own reasons for so holding. Whereas I am of the view that subsection 224(1) applies to the respondent for the reasons set out by the Chief Justice, **I feel it is necessary to clarify what I consider to be the limited application of this subsection to the *trustee/cestui que trust* relationship as well as express my concern about placing a trustee in the awkward position of being compelled to breach his or her fiduciary duties to a tax debtor in order to comply with a letter of demand issued pursuant to subsection 224(1) of the Act.**

[2] As the respondent notes, there is a strong argument to be made that given the equitable obligations placed upon a trustee, in the absence of express language stating that subsection 224(1) applies to a trustee, it should be confined to a creditor-debtor relationship. Such clear wording is found in subsection 153(1)(l) of the Act.[25] **For this reason, I would have liked to limit subsection 224(1) to a creditor-debtor relationship as the Tax Court Judge did.**

[3] The language of the section is broad and encompasses the *trustee/cestui que trust* relationship. In my view, to confine it to a creditor-debtor relationship would be to ignore its breadth. In the future, however, when dealing with situations which require a trustee to breach its fiduciary obligation it would be helpful if the legislation set out clearly that this was the intent and the desired result. While the collection of tax is of

Digitized by Google

the utmost importance, so also is the maintenance of the *trustee/cestui que trust* relationship which, I would note, is what the respondent sought at all times to uphold.

[4] I would also stress that the applicability of this subsection to a trustee is limited. **The only reason the respondent falls within the confines of subsection 224(1) is because the tax debtor instructed the trustee to pay the proceeds of his RRSP directly to him and because this instruction occurred within 90 days of the respondent receiving Revenue Canada's demand letter. The respondent, therefore, became a person liable to make a payment to the tax debtor. If the terms of the trust forbid the tax debtor from cashing out the trust, the respondent would not fall within the confines of subsection 224(1).** Similarly, if there had been no request for payment made by the tax debtor the respondent would not be required to make a payment as subsection 224(1) would not apply. This reasoning is consistent with the decision of the New Brunswick Court of Appeal in *DeConinck v. Royal Trust Corporation of Canada* [1989] 1 C.T.C. 179 (N.B.C.A.). In that case Stratton C.J.N.B., speaking for the court, states at page 183:

I am unable to agree with the conclusion of the judge of first instance in the present case that a trustee who holds funds that are fully vested in a *cestui que trust* would fall within the definition of person ,liable to make a payment' pursuant to subsection 224(1) of the *Income Tax Act.* **Rather, it is my opinion that until a *cestui que trust* requests payments of the proceeds of an R.R.S.P. from his trustee, which he is able to do but not bound to do under the rule in *Saunders v. Vautier* (1841), 41 E.R. 482, no moneys are payable to him nor is his trustee liable to make a payment to him within the meaning of subsection 224(1) of the Act.**

[5] The same result was reached in *Morgan Trust Corporation v. Dellelce* [1985] 2 C.T.C. 370 where Gratton D.J.C. of the Ontario Supreme Court found at page 373:

In my view since the trustee has no moneys which the trustee would be within 90 days liable to pay to the debtor, then there is no obligation to pay any moneys nor to sell any of the assets which the trustee holds on behalf of Dellecle pursuant to the declaration of trust. Consequently, the only obligation in this case is to reply to the Taxation Office in order to avoid liability under subsection 224(4) of the Act. However, had Morgan Trust within the 90 day period become liable to pay moneys to the debtor, then the trustee would have been bound to pay over such moneys to Revenue Canada

.

[6] I would also note that subsection 224(1) implies that a trustee is only caught under this provision if the payment requested is being paid directly to the tax debtor and not to someone else. The relevant portion of this subsection states: "Where the Minister has knowledge or suspects that a person is, or will be liable within 90 days to make a payment to another person *who is liable to make a payment under this Act*..." As the Chief Justice notes in his reasons, the tax debtor's instructions in this case were to pay the proceeds directly to him. Thus, the subsection applied.

[7] The unfortunate result in this case, therefore, is that the respondent is liable to the government for refusing to breach what it believes was its fiduciary duty to the tax debtor.

[8] I would reluctantly dispose of the appeal in the manner set out by the Chief Justice. "F.J. McDonald"

J.A.

Digitized by Google

In re the *Income Tax Act, against* A Corporation Steckmar/Steckmar Corporation (Judgment debtor) and Steckmar National Realty And Investment Corporation (Garnishee), 2004 FC 1568, Unspecified "Term" loans and Issues of Payability to be Decided by Court

REASONS FOR ORDER AND ORDER

[1] The purpose of the motion at bar is to appeal an order by the prothonotary pursuant to subsection 51(1) of the *Federal Court Rules (1998)*, SOR/98-106 (the Rules). **The latter made a final order of garnishment in favour of Her Majesty the Queen against Steckmar National Realty and Investment Corporation (the garnishee), regarding advances which it received without interest over the last 25 years from Corporation Steckmar/Steckmar Corporation (the judgment debtor).**

POINT AT ISSUE

[2] Did the prothonotary err in granting Her Majesty the Queen a final order of garnishment against the garnishee?

[3] For the following reasons, I must answer this question in the negative and I will dismiss the appeal from the prothonotary's decision.

FACTUAL BACKGROUND

[4] Her Majesty the Queen (the creditor) obtained an order of garnishment against Steckmar National Realty and Investment Corporation (the garnishee) to recover a debt of $126,666.39 plus interest owed her by Steckmar Corporation (the judgment debtor).

[5] **The judgment debtor advanced sums totalling $4,255,534.41 to the garnishee over a 25-year period. The garnishee, for its part, used part of this amount, namely the sum of $1,929,767, to make a loan to an American company, Marina Development Inc.**

[6] **The judgment debtor and the garnishee are related companies, since 49% of the judgment debtor's shares are held by Mr. Steckler, 49% by his sister and 2% by his mother, while the shares of the garnishee all belong to Mr. Steckler. The latter is also 100% owner of Marina Development Inc.**

[7] Mr. Steckler acted, *inter alia*, as manager and director of the garnishee, and claimed to be representative of the judgment debtor and garnishee for the purposes of these proceedings.

[8] The loan between the judgment debtor and garnishee was not confirmed in writing, but they agreed it would be repayable when the garnishee's financial situation permitted. To date, only **$776,525 has been repaid.**

[9] **In his examination in 2000, Mr. Steckler said that the garnishee and judgment debtor were in financial difficulty. He admitted that the debt held by the judgment debtor was regarded as a bad debt as the garnishee was unable to repay its debt.**

IMPUGNED DECISION

[10] In making the order, the prothonotary relied *inter alia* on section 453 of the Rules. In the prothonotary's view, payability is an important aspect of the debt as it concerns the time the term expires. Consequently, a dispute regarding the term is sufficient to make section 453 of the Rules applicable.

Summary determination of liability

453. Where a garnishee disputes liability to pay a debt claimed to be due or accruing to the judgment debtor, the Court may summarily determine any question of liability of the garnishee or order that it be

Digitized by Google

determined in such a manner as the Court may direct.

Jugement sommaire quant à l'obligation du tiers

453. Lorsque le tiers saisi conteste l'obligation de payer au débiteur judiciaire la dette échue ou à échoir, la Cour peut juger par procédure sommaire toute question concernant l'obligation du tiers saisi ou ordonner qu'elle soit instruite de la manière qu'elle précise.

Digitized by Google

[11] The garnishee maintained that the application of section 453 does not give rise to the relief sought by Her Majesty the Queen. The Federal Court does not have jurisdiction to determine the expiry of the term, based on articles 1512 and 1627 of the *Civil Code of Quebec* (C.C.Q.).

[12] **In response to these allegations, the prothonotary indicated that it is well settled that the Federal Court has the power necessary to resolve questions of provincial law incidental to the principal application. He mentioned that, from reading the relevant rules, it is clear that the payability of the debt was incidental to the question of the garnishments.**

[13] **Additionally, the prothonotary mentioned that section 453 of the Rules allows the Court to determine "any question of liability of the garnishee or order that it be determined in such a manner as the Court may direct".**

[14] To determine whether the garnishee's debt was due, the prothonotary analyzed the kind of obligation which existed between the judgment debtor and the garnishee. As the term of that obligation was uncertain, the prothonotary applied article 1512 of the C.C.Q. to fix it.

[15] However, that article provides that upon the application of one of the parties the Court may intervene to fix the term. In the case at bar, the garnishee alleged that Her Majesty the Queen was not a party to the obligation. However, referring to article 1627 C.C.Q., the prothonotary's conclusion was in favour of Her Majesty the Queen.

ANALYSIS

Preliminary question: What are the Federal Court's powers on appeal from a prothonotary's decision?

[16] In *Merck & Co. v. Apotex*, [2003] F.C.J. No. 1925 (F.C.A.) (QL), at paragraph 19, the Court explained the standard of review applicable to discretionary orders by prothonotaries. This standard had previously been developed in *Canada v. Aqua-Gem Investments Ltd.*, [1993] 2 F.C. 425 (C.A.).

[17] **It has been held that a judge hearing an appeal from a prothonotary's discretionary order should not intervene except in the following two cases:**
the order deals with a question vital to the final issue of the principal matter;
the order is clearly wrong, in the sense that the exercise of discretion by the prothonotary was based upon a wrong principle or a misapprehension of the facts.

[18] The effect of the prothonotary's order was that the garnishee was directed to pay the sum of
$126,666.39. That surely is a question which is vital to the final issue of the principal matter. **The Court must redo the analysis *de novo* in order to exercise its discretion.**

What powers does the Federal Court have regarding execution of a judgment?

[19] **The Federal Court derives its powers from federal legislation which expressly confers its jurisdiction. In *ITO-International Terminal Operators Ltd. v. Miida Electronics*, [1986] 1 S.C.R. 752, at 766, the Supreme Court of Canada set out the conditions for this:**
there must be a statutory grant of jurisdiction by the federal Parliament;
there must be an existing body of federal law which is essential to the disposition of the case and which nourishes the statutory grant of jurisdiction;
the law on which the case is based must be "a law of Canada" as the phrase is used in s. 101 of the *Constitution Act, 1867*.

[20] I feel that these three criteria are met in the case at bar. In this regard, Her Majesty the Queen first obtained a certificate confirming the amount owed her by the debtor pursuant to subsection 223(2) of the *Income Tax Act* (I.T.A.). Later, she filed this certificate in the

Digitized by Google

Federal Court to have it registered (subsection 223(3) of the I.T.A.). The result of registration is to give the certificate the same effect as if an order had been made by this Court. The two subsections of the I.T.A. provide the following:

Certificates

An amount payable by a person (in this section referred to as a "debtor") that has not been paid or any part of an amount payable by the debtor that has not been paid may be certified by the Minister as an amount payable by the debtor.

Registration in court

On production to the Federal Court, a certificate made under subsection 223(2) in respect of a debtor shall be registered in the Court and when so registered has the same effect, and all proceedings may be taken thereon, as if the certificate were a judgment obtained in the Court against the debtor for a debt in the amount certified plus interest thereon to the day of payment as provided by the statute or statutes referred to in subsection 223(1) under which the amount is payable and, for the purpose of any such proceedings, the certificate shall be deemed to be a judgment of the Court against the debtor for a debt due to Her Majesty, enforceable in the amount certified plus interest thereon to the day of payment as provided by that statute or statutes.

Certificat

Le ministre peut, par certificat, attester qu'un montant ou une partie de montant payable par une personne -- appelée "débiteur" au présent article -- mais qui est impayé est un montant payable par elle.

Enregistrement à la cour

Sur production à la Cour fédérale, un certificat fait en application du paragraphe (2) à l'égard d'un débiteur est enregistré à cette cour. Il a alors le même effet que s'il s'agissait d'un jugement rendu par cette cour contre le débiteur pour une dette du montant attesté dans le certificat, augmenté des intérêts courus jusqu'à la date du paiement comme le prévoit les lois visées au paragraphe (1) en application desquelles le montant est payable, et toutes les procédures peuvent être engagées à la faveur du certificat comme s'il s'agissait d'un tel jugement. Dans le cadre de ces procédures, le certificat est réputé être un jugement exécutoire rendu par cette cour contre le débiteur pour une dette envers Sa Majesté du montant attesté dans le certificat, augmenté des intérêts courus jusqu'à la date du paiement comme le prévoit ces lois.

Digitized by Google

[21] As the certificate is deemed to have the same effect as a judgment of the Court, Her Majesty the Queen may make use of Part 12 of the Rules to obtain enforcement of the judgment. In this regard, section 449 of the Rules provides that it is possible to obtain garnishment for payment of the debt recorded in the judgment.

2. Does the Federal Court have jurisdiction to consider questions of provincial law?

[22] In *ITO, supra*, at 781, the Supreme Court of Canada recognized that the Federal Court has jurisdiction to decide questions of provincial law when such questions are incidental to the principal application:

The Federal Court is constituted for the better administration of the laws of Canada. It is not, however, restricted to applying federal law in cases before it. Where a case is in "bith and substance" within the Court's statutory jurisdiction, the Federal Court may apply provincial law incidentally necessary to resolve the issues presented by the parties . . .

[23] To the same effect, we may refer to *Bois de Construction du Nord (1971) Ltée v. Charles Guilbault Inc.* (1986), 77 N.R. 392 (F.C.A.):

Parliament's right under s. 101 of the *Constituion Act, 1867* to create "additional courts for the better administration of the laws of Canada" necessarily implies a right to give those courts the power to ensure that their judgments are executed; similarly, Parliament's power over taxation undoubtedly includes that of ensuring that taxes are collected by a provision such as s. 223 of the *Income Tax Act* (RSC 1952, c. 148, amended by SC 1970-71-72, c. 63). The power which the Court has to enforce its judgments (and orders and certificates, which the law treats like judgments) would be illusory if it did not carry with it a power to resolve problems raised by such enforcement, whether those problems are governed by federal or by provincial law. Thus, a court which has the jurisdiction to order that the property of a debtor be garnished must necessarily have that of ruling on any objections put forward by third parties claiming to own the garnished property.

[24] At page 223 of that judgment, Marceau J.A. said the following:

Just as the Court has the power to rule on a question of provincial law which arises incidentally in the course of exercising its jurisdictional power, so it has the power to dispose of a question of provincial law which arises in exercising its power of execution. Accordingly, it cannot be concluded merely from the fact that in the case at bar the objection made by the respondent to negative declarations raises questions of provincial law that the Court does not have jurisdiction to determine their legitimacy.

[25] A bit further on, he acknowledged there were some limits:

That is not to say that the Court can rule on all arguments which a garnisher may think it proper to make against a garnishee. The Court's jurisdiction in the matter is merely the corollary of its power to garnish debts owed to a debtor against whom it has rendered judgment: it follows that in the case of an objection to a negative declaration the only arguments which the Court can decide are those which seek to establish that, at the time of the garnishment, the judgment debtor had a claim against the garnishee which had the necessary characteristics for it to be garnished.

[26] The Court must now determine whether the question of provincial law is incidental to the principal matter or whether it is a question of substance.

Application of section 449 of Rules

[27] The question of the payability of the debt is a question incidental to a garnishment. The rule is set out in paragraph 449(1)(*a*) of the Rules:

Garnishment Proceedings

449. (1) Subject to rules 452 and 456, on the *ex parte* motion of a judgment creditor, the Court may order

Digitized by Google

Saisies-arrêts

449. (1) Sous réserve des règles 452 et 456, la Cour peut, sur requête *ex parte* du créancier judiciaire, ordonner :

(*a*) that

a) que toutes les créances suivantes du débiteur judiciaire dont un tiers lui est redevable soient saisies-arrêtées pour le paiement de la dette constatée par le jugement :

(i) a debt owing or accruing from a person in Canada to a judgment debtor . . .

(i) les créances échues ou à échoir dont est redevable un tiers se trouvant au Canada . . .

be attached to answer the judgment debt . . .

[28] Subsections 451(1) and (2) and section 453 determine the Court's powers when various scenarios mentioned occur. They read as follows:

Garnishment order

451. (1) Where a garnishee has not made a payment into court under rule 450 and does not dispute the debt claimed to be due to the judgment debtor, or does not appear pursuant to a show cause order made under subsection 449(1), on motion, the Court may make an order for payment to the judgment creditor or payment into court of the debt.

Ordonnance de paiement

451. (1) Lorsque le tiers saisi n'a pas fait de consignation à la Cour selon la règle 450 et qu'il ne conteste pas la dette dont on le prétend redevable au débiteur judiciaire, ou lorsqu'il ne se présente pas en application de l'ordonnance rendue en vertu du paragraphe 449(1), la Cour peut, sur requête, rendre une ordonnance exigeant le paiement au créancier judiciaire ou la consignation à la Cour.

Order for future payment

(2) Where a debt owed to a judgment debtor is not payable at the time an order is sought under subsection 449(1), an order may be made for payment of the debt to the judgment creditor under subsection (1) as at the time the debt becomes payable.

Dette non exigible

Si la dette à payer au débiteur judiciaire n'est pas exigible au moment où l'ordonnance visée au paragraphe 449(1) est demandée, une ordonnance peut être rendue en vue du paiement de la dette à son échéance au créancier judiciaire selon les modalités prévues au paragraphe (1). Jugement sommaire quant à l'obligation du tiers

Summary determination of liability

453. Where a garnishee disputes liability to pay a debt claimed to be due or accruing to the judgment debtor, the Court may summarily determine any question of liability of the garnishee or order that it be determined in such a manner as the Court may direct.

453. Lorsque le tiers saisi conteste l'obligation de payer au débiteur judiciaire la dette échue ou à échoir, la Cour peut juger par procédure sommaire toute question concernant l'obligation du tiers saisi ou ordonner qu'elle soit instruite de la manière qu'elle précise.

[29] In short, the Federal Court has the power to resolve this kind of question. Before applying these principles to the case at bar, the type of debt existing here must be determined.

Type of obligation existing between judgment debtor and garnishee

[30] The parties were agreed in saying that this was a term obligation. The garnishee acknowledged its debt to the debtor, but the term itself was in dispute, **that is, exactly when the obligation became payable.** It argued that the Court had jurisdiction under subsection 451(2), not section 453. In its submission, the

Digitized by Google

Court should have made an order limited to requiring the garnishee to pay only when its financial situation allowed it make such a payment. This is what the writers Baudouin and Jobin (J-L. Baudouin and P-G. Jobin,

Les Obligations, 5th ed., Cowansville, Les Éditions Yvon Blais inc., 1998) say at pages 452 and 453, No. 573. [TRANSLATION]

A debtor's obligation to pay "when he can" or "when he has the means to do so" is not a potestative conditional obligation, but rather a term obligation: then the Court is sometimes required to intervene to determine whether the term has actually expired.

[31] Article 1512 of the C.C.Q. provides as follows:

1512. Where the parties have agreed to delay the determination of the term or to leave it to one of them to make such determination and where, after a reasonable time, no term has been determined, the court may, upon the application of one of the parties, fix the term according to the nature of the obligation, the situation of the parties and the circumstances.

The court may also fix the term where a term is required by the nature of the obligation and there is no agreement as to how it may be determined.

1512. Lorsque les parties ont convenu de retarder la détermination du terme ou de laisser à l'une d'elles le soin de le déterminer et qu'à l'expiration d'un délai raisonnable, elles n'y ont point encore procédé, le tribunal peut, à la demande de l'une d'elles, fixer ce terme en tenant compte de la nature de l'obligation, de la situation des parties et de toute circonstance appropriée.

Le tribunal peut aussi fixer ce terme lorsqu'il est de la nature de l'obligation qu'elle soit à terme et qu'il n'y a pas de convention par laquelle on puisse le déterminer.

[32] The first paragraph of this article expressly states that the Court may fix the term upon the application of one of the parties. In the second paragraph, two conditions must be met: the obligation must be a term obligation and there must be no agreement as to how this is to be determined.

[33] In the case at bar, the term is [TRANSLATION] "as the garnishee's financial situation permits". There is nothing in the evidence indicating that any procedure was created to decide on the time of repayment. For example, should the garnishee wait until it has accumulated four million before beginning to make payment? Will periodic payments be made? - how often? **However, one thing is certain: there was no written agreement to indicate this.**

[34] Consequently, I consider that the Court may decide the question of the expiry of the term, relying on article 1512 of the C.C.Q.

[35] **The judgment debtor and garnishee maintained that the Court does not have the powers to decide this question of payability, as they argued that article 1512 specifically provides that the Court may fix the term only upon the application of one of the parties. The respondent, for her part, asked the Court to allow her to exercise in the debtor's name the rights and actions which the latter has regarding the garnishee, pursuant to article 1627 of the C.C.Q.:**

1627. A creditor whose claim is certain, liquid and exigible may exercise the rights and actions belonging to the debtor, in the debtor's name, where the debtor refuses of neglects to exercise them to the prejudice of the creditor.

However, he may not exercise rights and actions which are strictly personal to the debtor.

Digitized by Google

1627. Le créancier dont la créance est certaine, liquide et exigible peut, au nom de son débiteur, exercer les droits et actions de celui-ci, lorsque le débiteur, au préjudice du créancier, refuse ou néglige de les exercer.

Il ne peut, toutefois, exercer les droits et actions qui sont exclusivement attachés à la personne du débiteur.

Digitized by Google

[36] The Court finds in favour of the respondent as in the circumstances, in view of the number of years which have elapsed without requiring the garnishee to repay the loan, the judgment debtor may surely be regarded as negligent.

Oblique action and garnishment

[37] The debtor and the garnishee argued that the creditor should proceed by action instead of a motion by summary proceeding, as we see in the case at bar. Some writers agree that garnishment is a form of oblique action:

[TRANSLATION]

Garnishment is a means of enforcement on a personal action provided for in the second paragraph of article 569, which states that in all cases the creditor may garnish from a third party monies and property owed or belonging to its debtor. It is a special form of oblique action which allows the creditor, under article 1627 of the *Civil Code of Quebec*, to exercise the debtor's rights and actions. The creditor thus has a practical remedy of a subrogatory nature which puts the debtor's debt in the hands of the court so it can be transferred to the creditor. (B. EMERY and D. FERLAND, *Précis de procédure civile du Québec*, vol. 2, 3d ed., Cowansville, Les Éditions Yvon Blais Inc., 1997, p. 198.) [Emphasis added.]

[38] The Court is not dealing here with a situation in which a judgment debtor neglected, for example, to sue the garnishee for damages to obtain what was owed. In that scenario, the judgment creditor would have to bring the action against the garnishee itself in the judgment debtor's place.

[39] In the case at bar, the parties admitted that the debt existed, that the debt was a term obligation. The dispute was as to payability. With respect for the contrary view, the Court feels that the solution is to be found in section 453 of the Rules, with the words "where a garnishee disputes liability to pay . . . the Court may summarily determine": *Canada (Minister of National Revenue - M.N.R.) v. Gadbois*, 2002 FCA 228, [2002] F.C.J. No. 836 (C.A.) (QL). Incidentally, articles 1512 and 1627 C.C.Q. may be used.

Whether debt payable or to become payable

[40] Several points must be considered before determining the payability of the debt. As I said earlier, the parties are agreed that this is a term obligation. No written agreement was made to determine when the term expired. The judgment debtor began making advances to the garnishee 25 years ago, without interest. Some $749,330 were repaid in 1995 and 1996 on a loan of $4,255,534.41. The interim order of garnishment was dated in December 1999. The judgment debtor and garnishee are related businesses.

[41] Taking all these factors into account, the Court finds that the debt is due.

[42] Prothonotary Morneau made no error of law or fact requiring the Court's intervention. His analysis was in great detail, painstaking and well supported by precedent and commentary.

[43] Consequently, the motion is dismissed with costs. ORDER

THE COURT ORDERS: the motion is dismissed with costs.

"Michel Beaudry"

Judge

In the Arena of Bankruptcy

When a RTP has been filed on a tax-debtor, who subsequently enters into bankruptcy prior to payment to the Minister, when it has been held that there is no trust impressed on the

Digitized by Google

amount in the recipient's hands, what happens? Does the property of the tax-debtor entirely pass to the trustee or is there a rank of the RTP in respect of that amount that doesn't become the trustee's patrimony. (While argued on the basis of unremitted GST, there is same comment on s. 224(1.2) RTPs.) This was the issue in Toronto Dominion Bank and Her Majesty the Queen[59] where the Appeal Ct. held:

> DECISION OF THE TCC JUDGE
>
> [18] After having summarized the facts, the TCC judge identified numerous issues that he considered relevant to his analysis, including the following (Reasons, paragraph 2):
>
> . . . Is there a transfer of the ownership of money following . . . [the Requirement to Pay] and, if so, did the Notice to Stay cancel the right of ownership?
>
> [19] First, the TCC judge reviewed the decisions by his own court in *Wa-Bowden Real Estate Reports Ltd. v. Her Majesty*, [1997] T.C.J. No. 582 (*Wa-Bowden*) and *Absolute Bailiffs Inc. v. Canada*, [2002] T.C.J. No. 549, both of which support the point of view that subsection 317(3) of the ETA gives the Crown absolute ownership of the moneys identified in the requirement to pay on receipt thereof by the garnishee (Reasons, paragraphs 4 to 6).
>
> [20] The TCC judge also addressed the decisions of the Courts of Appeal for Ontario and Saskatchewan in *Bank of Montreal v. Canada (Attorney General)*, 66 O.R. (3d) 161 (*Bank of Montreal*) and *Encor Energy Corp. v. Slaferek's Oilfield Services (1983) Ltd.*, [1995] G.S.T.C. 54, as well as the decision of the Supreme Court of British Columbia in *Canoe Cove Manufacturing Ltd. (Re)*, 2 GTC 7151, [1994] B.C.J. No. 982, which are all to the same effect (Reasons, paragraphs 7 to 12).
>
> [21] Third, the TCC judge dealt with the decisions from Quebec, namely *Giguère et le Ministre du Revenu du Québec v. Lloyd Woodfine et la Banque Nationale du Canada*, [2001] R.J.Q. 2584, *Forget et Druker & Associés Inc. v. Le sous-ministre du Revenu du Québec*, [2003] J.Q. No. 1026 and *De Courval* (Reasons, paragraphs 16 to 19). Those decisions conclude that according to subsection 317(3) of the ETA — and the corresponding provisions of the AMR —the BIA prevails in the event of conflict. In this case, since the amounts subject to the requirement to pay were not fully settled at the time of the bankruptcy, there would be a conflict with subsection 70(1) of the BIA.
>
> [22] The TCC judge refused to follow the trend in Quebec case law. According to him, the Supreme Court's decision in *Alberta (Treasury Branches) v. M.N.R.*, [1996] 1 SCR 963 (*Alberta*) must be taken into account, which concluded that Parliament's intention in enacting subsection 317(3) was to create a superior garnishing right that may be set up against all (Reasons, paragraphs 20 to 25).
>
> [23] The TCC judge concluded his analysis as follows (Reasons, paragraph 27):
>
> Regardless of the fact that subsection 317(3) of the ETA excludes the application of all federal, provincial or other enactments, with the exception of the BIA, that could have an effect on the application of subsection 317(3), it is still clear that its application here does not contradict the provisions of the BIA, especially subsection 70(1) of the BIA, which only applies to a bankrupt's property. So the tax debtor's property in this case became the property of Her Majesty the Queen at the time the notice pursuant to subsection 317(3) of the ETA was sent, which was before the bankruptcy proposal was made to the creditors.

[59] 2010 FCA 174

Digitized by Google

POSITIONS OF THE PARTIES

[24] The appellant is relying on the interpretation adopted by the Quebec courts, particularly the reasons of the Court of Appeal of Québec in *De Courval*, which contain the most complete and exhaustive analysis on the subject. The appellant submits that subsection 70(1) of the BIA trumps the effects of subsection 317(3) of the ETA because, by its language, only executions that are not completely settled by payment are unaffected by bankruptcy. In this case, since that condition was not met when the notice of stay was filed and since subsection 317(3) of the ETA gives priority to the BIA in the event of conflict, subsection 70(1) of the BIA applies.

[25] The appellant submits that the Supreme Court of Canada's recent decision in *Quebec (Revenue)*
v. Caisse populaire Desjardins de Montmagny, 2009 SCC 49 (*Caisse de Montmagny*) supports that conclusion. The appellant places particular emphasis on the key finding that deemed trusts for unpaid GST and QST cease to exist at the time of bankruptcy. The Supreme Court thus rejected the tax authorities' argument that at no time could those moneys have been part of the bankrupt's patrimony and, therefore, part of the property to be liquidated in compliance with the settling scheme established under the BIA (*Caisse de Montmagny*, paragraphs 18 and 28).

[26] The respondent for her part readily admits that any deemed trusts for the GST which remained unpaid by 9161 (the tax debtor) necessarily ceased to exist at the time of bankruptcy. However, the respondent takes the position that this has no bearing on the operation of the recovery measure set out at subsection 317(3) of the ETA, which was not engaged in *Caisse de Montmagny*.

[27] According to the respondent, it is well settled since the Supreme Court's decision in *Alberta* that subsection 317(3) of the ETA, like subsection 224(1.2) of the ITA, has the effect of transferring ownership, which transfer occurs upon the garnishee's receipt of a requirement to pay. In the case at bar, the appellant received the requirement to pay before the notice of stay was filed.

[28] The respondent further submits that, the Court of Appeal of Québec's reasoning in *De Courval* is based on an incorrect interpretation of the phrase "other than the [BIA]" in subsection 317(3) of the ETA. The effect of those words is not to give precedence to the BIA in the event of conflict, but rather to delimit the time during which the power given to the Minister may be exercised (*Bank of Montreal*, paragraph 14). Thus, the Minister cannot use that power after bankruptcy proceedings have been initiated. In this case, since the power was exercised before the bankruptcy, it remains fully applicable.

ANALYSIS

[29] The question at issue is the following: When the Minister issues a requirement to pay under subsection 317(3) of the ETA before a notice of stay under section 69 of the BIA is filed and, on the date of that notice, the payment owing in respect of the requirement to pay still has not been made (in whole or in part), does subsection 70(1) of the BIA give priority to the assignment of the tax debtor's property over the Minister's requirement to pay?

[30] The answer to that question depends on the meaning to be given to the words "other than the [BIA]" ("à l'exception de la [LFI]" in the French text) as they appear at subsection 317(3) of the ETA.

Digitized by Google

[31] The appellant, relying on the ordinary meaning of the words, contends that this phrase causes subsection 317(3) to apply despite any other enactment, except the BIA. It follows that where a provision of the BIA conflicts with the operation of subsection 317(3), it prevails.

[32] However, the respondent is of the opinion that the phrase has the effect of delimiting the time within which the Minister's power may be exercised, by preventing that power from being exercised after the BIA comes into play. Since, in this case, the requirement to pay was served before the notice of stay was filed, the power was validly exercised.

[33] Thus put, the question asked is one of pure statutory interpretation. In this respect, it is useful to recall that the provisions of any enactment, including tax statutes, must be construed contextually having regard to the statute read as a whole (R. Sullivan, *Sullivan on the Construction of Statutes* (5th Ed., 2008, page 276)).

[34] Before we deal with that question, it is appropriate to address the decision of the Court of Appeal of Québec in *De Courval* to which the appellant devoted all of its submissions. The facts underlying that decision are similar to those at issue here, except with regard to the nature of the unpaid taxes (Quebec Sales Tax or QST) and the statute under which a requirement to pay was issued (the AMR).

[35] In that case, the Deputy Minister of Revenue (the Deputy Minister) argued that the unpaid taxes were part of the deemed trust created in favour of the Crown, that this trust was unaffected by the bankruptcy and that the requirement to pay issued under the provision equivalent to subsection 317(3) of the ETA had the effect of crystallizing a pre-existing right of ownership. In effect, according to the Deputy Minister, the deemed trust meant that at no time could the unpaid taxes (or **moneys in lieu thereof) have been part of the bankrupt's patrimon y (*De Courval*, paragraphs 13 and 14).**

[36] Correctly anticipating the Supreme Court's decision in *Caisse de Montmagny*, the Quebec Court of Appeal rejected the argument that the deemed trust remained in effect despite the bankruptcy (*De Courval*, paragraphs 28 to 32). Indeed, as the Supreme Court confirmed (*Caisse de Montmagny*, paragraphs 12 to 29), since the 1992 amendments (the *Act to amend the Bankruptcy Act and to amend the Income Tax Act in consequence thereof*, S.C. 1992, c. 27), the deemed trusts established for GST and QST that have been collected but not remitted or recover able under section 222 of the ETA and section 20 of the AMR cease to exist at the time of the bankruptcy (subsection 67(2) of the BIA). This treatment differs from that applicable to deemed trusts pertaining to source deductions under the ITA, a comprehensive pension plan or the federal employment insurance program, which do survive bankruptcy (subsection 67(3) of the BIA).

[37] The Court of Appeal of Québec then dealt with the argument that section 15.3.1 of the AMR (the provision that is equivalent to the part of subsection 317(3) of the ETA providing that the claimed moneys "become" the property of the Crown) had, in any event, effected a complete transfer of ownership to the Crown before the bankruptcy (*De Courval*, paragraphs 35 to 37). According to the Court of Appeal, the Supreme Court's decision in *Alberta*, which attributed that effect to subsection 317(3) of the ETA, is distinguishable because, first, section 70 of the BIA was not at issue and, second, the events in *Alberta* took place before the 1992 amendments came into force (*De*

Digitized by Google

Courval, paragraph 36). The Court of Appeal also declined to follow the decision of the Ontario Court of Appeal in *Bank of Montreal* (*De Courval*, paragraphs 38 and 39) on the ground, amongst others, that it was reached in reliance of the decision of the Supreme Court in *Alberta*, which is no longer good law.

[38] Aware of the different treatment that the 1992 amendments afforded to source deductions, the Court of Appeal emphasized subsection 224(1.2) of the ITA, which was intended to facilitate recovery of those deductions in the event of default. Unlike subsection 317(3) of the ETA, that provision applies notwithstanding the BIA and, therefore, notwithstanding subsection 70(1) (*De Courval*, paragraph 37).

[39] According to the Court of Appeal, the right of ownership conferred by subsection 317(3) of the ETA (and section 15.3.1 of the AMR) operates subject to the tax debtor not going bankrupt and, if that happens, subject to the amount claimed by the requirement to pay being settled in full before the bankruptcy. Otherwise, subsection 70(1) of the BIA prevails.

[40] The Court of Appeal drew this conclusion at the end of its reasons (*De Courval*, paragraph 45):

[TRANSLATION]

. . ., since the notice under section 15 AMR is an "other process" under section 70 BIA, in order for the BIA not to prevail, the payment must be completed before the bankruptcy date. In this case, such a payment was not made and the amounts owing to the Minister were in a deemed trust on the bankruptcy date. In addition, they were held with other moneys from various sources, so they were not held in a real trust. Consequently, subsection 67(2) BIA applies and the moneys held by the Bank are the property of the bankrupt debtor.

[41] The opinion expressed above, which is based on the Court of Appeal's analysis of subsection 317(3) of the ETA, rests entirely on the premise that the phrase ("other than the [BIA]") causes that statute to prevail in the event of a conflict. That premise is held as true without any discussion. Although in its reasons the Court of Appeal did analyze and distinguish numerous aspects of the Ontario Court of Appeal's decision in *Bank of Montreal*, it did not address the following conclusion (*Bank of Montreal*, paragraph 14):

The appellant submits that under [subsection] 70(1) of the [BIA] a receiving order takes precedence over a garnishment that has not been completely executed by payment being made because [subsection] 317(3) of the ETA is made subject to the BIA. Otherwise, the appellant submits the court would not be giving effect to the words, "other than the BIA". The words "other than the BIA" have meaning apart from the interpretation suggested by the appellant. They mean that any [Goods and services taxes (GST)] payments that become due after a receiving order in Bankruptcy has been made no longer can be collected in priority to other creditors. [Emphasis added.]

[42] This interpretation of the words "other than the [BIA]" is not new. It has been expressed previously, in particular by Justice Sarchuk of the Tax Court of Canada in *Wa-Bowden* (paragraph 5):

... Subsection 317(3) also specifies that its application is subject to the [BIA]. This has been interpreted in a number of instances to mean that where monies were immediately due and owing prior to the date of bankruptcy, those monies are subject to the application of the Act, but where service of the

Digitized by Google

Requirement occurs after the date of bankruptcy, or where the amount at issue was not immediately due and payable prior to the date of bankruptcy, any monies otherwise payable in the latter two instances are not available to the Respondent. [internal citations omitted] [Emphasis added.]

Adopting that interpretation, Justice Sarchuk found that the moneys subject to the requirement to pay became the property of the Crown on the garnishee's receipt of the requirement and, therefore, were no longer the tax debtor's property at the time of the ensuing bankruptcy (*Wa-Bowden*, paragraph 6).

[43] Therefore, the issue surrounding the interpretation of the words "other than the [BIA]" remains unresolved.

[44] The interpretation proposed by the appellant according to which the BIA prevails in the event of a conflict seems, at first glance, to stem from the natural meaning of the words.

[45] However, the respondent asks this Court to consider the legislative and jurisprudential context surrounding the adoption of subsection 317(3) in 1990 and the amendment to subsection 224(1.2) of the ITA in that same year, which enactments were intended to confirm, once

and for all, the Crown's right of ownership over the amounts subject to a requirement to pay. From

that angle, the Supreme Court's decision in *Alberta* is of particular interest since it sets out the precise state of the law in 1990, when those provisions were adopted.

[46] In that case, the Supreme Court considered the legislative history surrounding subsections 224(1.2) of the ITA and 317(3) of the ETA and, in particular, Parliament's attempts, until then fruitless, to give the Crown right of ownership having priority over all computing claims (*Alberta*, paragraphs 11 to 14). Both Justice Cory, writing for the majority, and Justice Major, dissenting (but not on this point) expressed the view that the language of subsection 224(1.2) of the ITA, as amended in 1990, was clear enough to give the Crown the right of ownership which had been sought (the amended text and the text it replaced are reproduced at paragraphs 12 and 13, above). Both judges also expressed the view that subsection 224(1.2) of the ITA and subsection 317(3) of the ETA were, in that regard, identical (*Alberta*, paragraph 1, Justice Cory; and paragraph 58, Justice Major). Among other things, each concluded that on receipt of the requirement, the claimed moneys "become" the property of Her Majesty.

[47] Justice Major, after having specified that he would focus his analysis on subsection 224(1.2) of the ITA rather than subsection 317(3) of the ETA "[f]or the sake of convenience" (*idem*), wrote the following (*Alberta*, paragraphs 65, 66 and 69):

Apparently in order to deal with the competing lines of authority as to whether [subsection] 224(1.2) was sufficient to grant a priority to the [Minister of National Revenue] MNR, Parliament amended the section in 1990 by adding the following to the end of the section:

. . . and on receipt of that letter [i.e. the garnishment summons] by the particular person, the amount of those moneys that is required by that letter, to be paid to the Receiver General shall, notwithstanding any security interest in those moneys, become the property of Her Majesty and shall be paid to the Receiver General in priority to any such security interest.

Digitized by Google

This 1990 amendment was made to both the [ITA] and the relevant provisions of the [ETA]. The three trial decisions in the cases at issue in these appeals are principally concerned with the issue of whether this amendment constituted the "something further" which [*Lloyds Bank of Canada c. International Warranty Co.*, (1989), 64 Alta. L.R. (2d) 340 (B.R.), overturned by (1989), 68 Alta. L.R. (2d) 356 (C.A.) (*Lloyds Bank*)] had held was necessary to transfer the property interest in the funds to the MNR or to grant a priority to the MNR.

…

69. I agree with Forsyth J. that the 1990 amendments to the [ITA] and the [ETA] were sufficient to provide the "something further" which the Alberta Court of Appeal thought to be necessary in *Lloyds Bank*. . . .
[Emphasis added.]

No one takes issue with the fact that this "something further" resulted in the Crown becoming the owner of the moneys subject to the requirement upon the garnishee's receipt of the requirement to pay (*Alberta*, paragraphs 5 and 6).
[48] According to the respondent, it is the time when this ownership-transferring power may be exercised which Parliament had in mind when it provided, in the case of subsection 224(1.2) of the ITA, that it applies "[n]otwithstanding . . . the [BIA]" and, in the case of subsection 317(3) of the ETA, despite any enactment "other than the [BIA]". While Parliament intended that the unpaid source deductions identified at subsection 224(1.2) of the ITA be subject to this power at all times — both before and after bankruptcy — Parliament also intended that the equivalent power under subsection 317(3) only be exercised before bankruptcy. The respondent submits that this is the way in which the words "Notwithstanding . . . the [BIA]" and "other than the [BIA]" must be understood. [49] In my view, that is the correct interpretation. Returning to 1990, deemed trusts had the same effect whether they pertained to source deductions or GST. Both took effect at the time of the default and survived bankruptcy (see paragraph 67(1)(*a*) of the BIA, as it read before the 1992 amendments), such that the moneys held in those trusts could not, at any time, become part of the tax debtor's patrimony. Therefore, even if a requirement to pay was issued at a time which coincided with the tax debtor's bankruptcy, there was no conflict possible between the BIA and the right of ownership conferred upon the Crown under subsection 317(3) of the ETA, or between the BIA and the right of ownership granted under 224(1.2) of the ITA. It was only after the 1992 amendments that this state of affairs changed and that deemed trusts for unpaid GST ceased to have effect upon the tax debtor's bankruptcy (*Caisse de Montmagny*, paragraphs 12 to 16).
[50] In this context, it cannot be said that the words "other than the [BIA]" were inserted into subsection 317(3) to give precedence to the BIA in the event of conflict since no conflict was possible. Rather, keeping in mind the principle according to which Parliament does not speak in vain, it seems that the purpose of this phrase was to prevent the power set out at subsection 317(3) from being exercised after bankruptcy.
[51] Subsection 317(3) could not be read otherwise in 1990 and was

Digitized by Google

deliberately left intact when the BIA was amended in 1992, as was subsection 224(1.2) of the ITA. Since the power set out at that subsection may not be exercised after bankruptcy, it is in keeping with the spirit of those amendments to the effect that only source deductions were special and were to be given priority after bankruptcy. This explains why the exercise of the power set out at subsection 224(1.2) is not subject to that limitation and why, since the amendments, the BIA stipulates that bankruptcy does not affect the exercise of that power (subsection 86(3) of the BIA).

[52] Aside from that important difference, the powers set out at subsections 317(3) of the ETA and 224(1.2) of the ITA, when validly exercised, both have the effect of transferring ownership to the Crown of the moneys subject to the requirement to pay on receipt thereof by the garnishee (*Alberta*, above).

[53] Since the requirement to pay was received by the appellant before the notice of stay was filed, the TCC judge rightly concluded that the Crown became the owner of the moneys required before the bankruptcy occurred and that those moneys were therefore not part of the tax debtor's patrimony at the time of the bankruptcy. Consequently, the appellant had an obligation to pay the amount required and, having failed to do so, is personally liable for making that payment.

[54] I would dismiss the appeal with costs.

"Marc Noël"
J.A.

"I agree.
Pierre Blais C.J."

"I agree.
Johanne Trudel J.A."

You're invited to read s. 224(1.2), particularly with respect to its ending syllables in this regard, to note that there is no issue now. The Minister's interest ranks.

Norman A. Mintzer v. Her Majesty the Queen, A-68-95, Seizure of CPP Proceeds as Set-off

Norman A. Mintzer (*Appellant*) (*Plaintiff*)
v.
Her Majesty the Queen (*Respondent*) (*Defendant*)
Indexed as: Mintzer v. Canada (C.A.)
Pensions " Appeal from F.C.T.D. decision dismissing motion for summary judgment MNR not entitled to set- off unpaid income taxes against Canada Pension Plan retirement benefits " Minister requiring debt be retained by way of statutory set-off " C.P.P., ss. 65(1), 108(3)(a) not affecting right of deduction or set-off in Income Tax Act, s. 224.1 " Set-off, attachment distinguished " Retirement benefits not trust funds in hands of Crown " New s. 65(1.1) not intended to bind Crown " Minister entitled to set-off " Genuine issue for trial under R. 432.2(1).
Income tax " Whether MNR may set-off unpaid income tax against C.P.P. retirement benefits " Under Income Tax Act, s. 224.1 MNR may require retention by set-off where person indebted to Her Majesty " Set-off at law distinguished from equitable set-off " No necessity for legal process as statutory authority " 1995 C.P.P. amendments not overriding s. 224.1. Crown " Creditors and debtors " Unpaid income taxes retained by deduction or set-off under

Digitized by Google

Income Tax Act,
s. 224.1 " Taxpayer not released from paying debt " Crown not bound by Canada Pension Plan, s. 65(1.1) " Set-off not equivalent to attachment under Ontario law " Not requiring legal process for execution under s.
224.1 " "Seizure and execution" in s. 65(1.1) not including set-off " Crown entitled to set-off.
This was an appeal from a Trial Division decision dismissing a motion for summary judgment in which the taxpayer claimed that the Minister of National Revenue was not entitled to set-off unpaid income taxes against *Canada Pension Plan* retirement benefits payable to him. In March 1993, the Minister executed a form of "statutory set-off" requiring that $75,245.22 be retained by way of deduction or set-off, for taxes owing for the years 1986 to 1991, from amounts payable to the taxpayer under the *Canada Pension Plan* . Although not admitted in pleadings, the Crown admitted in affidavit evidence that the taxpayer was under no liability to pay taxes for the taxation years 1986 to 1991 because he was not a resident of Canada in any of those years. The Crown did, however, maintain that Revenue Canada had not at any time released him from, or forgiven him for unpaid taxes for the taxation years 1973, 1974 and 1976 to 1979 inclusive. The Motions Judge ruled that subsection 65(1) of the *Canada Pension Plan* does not affect the right of deduction or set-off in section 224.1 of the *Income Tax Act* and concluded that the dispute raised a genuine issue for trial, which could not be decided on summary judgment. **There were two principal issues in this appeal:**
1) whether the Crown was entitled to set-off unpaid income taxes against retirement benefits payable to the appellant, and 2) if so, whether the 1995 amendment to the *Canada Pension Plan* prevented the Crown from exercising its right of set-off.

Held, the appeal should be dismissed.
Section 224.1 of the *Income Tax Act* authorizes the Minister to require retention by way of deduction or set-off "where a person is indebted to Her Majesty". Although the set-off may have been executed with the debt thought to exist for the 1986-1991 taxation years in mind, it was not by its terms limited to that particular debt. In this case the statutory set-off broadly applied to any benefits payable to the appellant under the *Canada Pension Plan* for any unpaid income taxes including that owing for the 1973, 1974 and 1976 to 1979 taxation years, up to the limit of $75,245.22 specified therein. This "set-off" is not equivalent in law to "attachment" as understood under the law of Ontario where the set-off was executed. **This is a set-off at law as distinguished from equitable set-off.** "Attachment" refers to an attachment under legal process while "set-off", in the context of section 224.1 of the *Income Tax Act* , neither depends on nor requires legal process for its execution. The statute itself provides the necessary authority. The word "attached" in subsection 65(1) of the *Canada Pension Plan* signifies something that is given to or exercised by a third party rather than by the Crown. The benefits payable to the appellant were not insulated from set-off on the basis that they constitute trust funds in the hands of the Crown under paragraph 108(3)(*a*) of the *Canada Pension Plan*. It is not the contributions which are paid into the Consolidated Revenue Fund that are subject to the statutory set-off but the "benefits" which are or become "payable" to a beneficiary under the *Canada Pension Plan* . **This statute manifests no intention to create a trust either in respect of contributions or benefits. The role of the Crown with respect to monies credited to the Canada Pension Plan Account or to benefits not yet paid is that of an administrator in the exercise of its governmental functions rather than that of a trustee.**
Appellant's submission was that the provisions of subsection 65(1.1) of the *Canada Pension Plan*, which became effective on July 13, 1995, prohibits the setting-off of benefits

Digitized by Google

against a debt for unpaid taxes because such a set-off amounts to "seizure and execution". The new subsection was not intended to bind the Crown and to override the provisions of section 224.1 of the *Income Tax Act* . If Parliament had intended to nullify the right of set-off in section 224.1, it could easily have done so by express language in subsection 65(1.1). **"Set-off" is a quite different legal concept than either "seizure" or "execution" at common-law or in equity. "Seizure and execution" in subsection 65(1.1) are not intended to include a set-off so as to nullify the rights conferred on the Minister under section 224.1 of the *Income Tax Act* . The Crown's right of set-off against the appellant was not affected by the 1995 amendment.** As moving party for summary judgment under subsection 432.2(1) of the Rules, the appellant failed to bring forth evidence showing that there was no genuine issue for trial. The respondent has satisfied the requirement of that subsection in showing that there was a genuine issue for trial. The Motions Judge did not err in dismissing the appellant's motion for summary judgment.
statutes and regulations judicially considered
Canada Pension Plan, R.S.C., 1985, c. C-8 , ss. 2(1) "benefit", 62(2), 65(1),(1.1) (as enacted by S.C. 1995,
c. 33, s. 29), 65.1(1) (as enacted by R.S.C., 1985 (2nd Supp.), c. 30, s. 33), 108(1),(2) (as am. by S.C. 1995,
c. 33, s. 46), (3)(*a*).

Canadian Charter of Rights and Freedoms, being Part I of the *Constitution Act, 1982*, Schedule B, *Canada Act 1982*, 1982, c. 11 (U.K.) [R.S.C., 1985, Appendix II, No. 44], ss. 7, 8, 12, 15, 26.
Civil code of Québec, S.Q. 1991, c. 64, Art. 1676.
Code of Civil Procedure, R.S.Q., c. C-25, Art. 553(12).
Federal Court Rules, C.R.C., c. 663, RR. 341, 432.1 (as enacted by SOR/94-41 , s. 5), 432.2 (as enacted
idem), 432.3 (as enacted *idem*), 432.4 (as enacted *idem*), 432.5 (as enacted *idem*), 432.6 (as enacted *idem*),
432.7 (as enacted *idem*).
Income Tax Act, R.S.C., 1985 (5th Supp.), c. 1, s. 224.1.
Interpretation Act, R.S.C., 1985, c. I-21 , s. 17. cases judicially considered
considered:
Alberta Government Telephones v. Canada (Canadian Radio-television and Telecommunications Commission), 1989 CanLII 78 (SCC), [1989] 2 S.C.R. 225; [1989] 5 W.W.R. 385; (1989), 26 C.P.R. (3d) 289;
98 N.R. 161; *Overseas Aviation Engineering (G.B.) Ltd., In re*, [1963] Ch. 24 (C.A.); *Bankruptcy Notice, A, In re*, [1934] Ch. 431 (C.A.); *Sigurdson v. The Queen in right of British Columbia* 1982 CanLII 416 (BC CA), (1982), 132 D.L.R. (3d) 131; [1982] 2 W.W.R. 579; 33 B.C.L.R. 190; 41 C.B.R. (N.S.) 113 (B.C.C.A.).
referred to:
Holt v. Telford, 1987 CanLII 18 (SCC), [1987] 2 S.C.R. 193; (1987), 81 A.R. 385; 41 D.L.R. (4th) 385; [1987]
6 W.W.R. 385; 54 Alta. L.R. (2d) 193; 39 B.L.R. 241; 21 C.P.C. (2d) 1; 78 N.R. 321; *Atlantic Lines &*
Navigation Co. Inc. v. Didymi (The), reflex, [1988] 1 F.C. 3; (1987), 39 D.L.R. (4th) 399; 78 N.R. 99 (C.A.);
Aero Trades (West.) Ltd. (Receiver of) v. Can., reflex, [1989] 1 W.W.R. 723; (1988), 71 C.B.R. (N.S.) 97; 18
C.E.R. 139; reflex, [1989] 1 C.T.C. 142; 89 DTC 5050; 2 TCT 4042 (F.C.A.); *W. C. Fast*

Digitized by Google

Enterprises Ltd. v. All-Power Sports (1973) Ltd., Astrope and Royal Bank of Canada 1981 ABCA 178 (CanLII), (1981), 29 A.R. 483; 126 D.L.R. (3d) 27; 16 Alta. L.R. (2d) 47; 40 C.B.R. (N.S.) 182 (C.A.); *Paterson (D.S.) & Co. Ltd., Re*, [1931] O.R. 777 (S.C.); *R. v. Guerin*, reflex, [1983] 2 F.C. 656; (1982), 143 D.L.R. (3d) 416; [1983] 2 W.W.R. 686; [1983] 1 C.N.L.R. 20; 13 E.T.R. 245; 45 N.R. 181 (C.A.); *Friends of the Oldman River Society v. Canada (Minister of Transport)*, 1992 CanLII 110 (SCC), [1992] 1 S.C.R. 3; (1992), 88 D.L.R. (4th) 1; [1992] 2 W.W.R. 193; 84 Alta. L.R. (2d) 129; 3 Admin. L.R. (2d) 1; 7 C.E.L.R. (N.S.) 1; 132 N.R. 321; *Johnston v. Hogg* (1882-83), 10 Q.B.D. 432; *Feoso Oil Ltd. v. Sarla (The)*, 1995 CanLII 3605 (FCA), [1995] 3 F.C. 68; (1995), 184 N.R. 307 (C.A.).
authors cited
Dunlop, C. R. B. *Creditor-Debtor Law in Canada*, 2nd ed. Toronto: Carswell, 1995.
Halsbury's Laws of England, vol. 42, 4th ed. London: Butterworths, 1983, para. 406.
Judge, J. A. M. and M. E. Grottenthaler. "Legal and Equitable Set-Offs" (1991), 70 *Can. Bar Rev.* 91.
Law Reform Commission of British Columbia. *Report on Set-Off* (LRC 97). Vancouver: Ministry of Attorney General, 1988.
Palmer, K. R. *The Law of Set-Off in Canada*. Aurora, Ont.: Canada Law Book, 1993.
APPEAL from Trial Division decision (reflex, [1995] 1 C.T.C. 220) dismissing appellant's motion for summary judgment under subsection 432.3(1) of the *Federal Court Rules*. Appeal dismissed.
counsel:
Norman A. Mintzer on his own behalf. *Harley R. Nott* for respondent (defendant). solicitors:
Norman A. Mintzer on his own behalf.
Deputy Attorney General of Canada for respondent (defendant).

The following are the reasons for judgment rendered in English by
Stone J.A.: By a motion brought in this action the appellant seeks relief by way of summary judgment on the basis that, at law, the Minister of National Revenue is not entitled to have set-off against *Canada Pension Plan* [R.S.C., 1985, c. C-8] retirement benefits payable to him for any alleged debt for income taxes owing under the *Income Tax Act* [R.S.C., 1985 (5th Supp.), c. 1]. The learned Motions Judge, Rothstein J., dismissed the motion [reflex, [1995] 1 C.T.C. 220]. In argument before this Court the appellant relies as well on a recent amendment of the *Canada Pension Plan*, from which he argues that the Minister is prohibited from continuing to set-off any benefits payable from and after the date the amendment became law.
A form of "statutory set-off" of March 31, 1993, directed to the "Canada Pension Plan, Income Security Programs, Health & Welfare Canada", was executed by the Director" Taxation, Toronto District Office of the Department of National Revenue Taxation. It reads in part as follows:
PURSUANT to one or more of the following acts, the undersigned hereby requires that $75,245.22 be retained by way of deduction or set-off from such amounts as may be or may become payable by you to the taxpayer whose name appears above, at the rate of an amount each month equal to 100 per centum of each amount which may be or may become payable to the said taxpayer, in respect of the transaction(s) detailed below plus any other amounts that may be or may become payable to the taxpayer, and where the taxpayer is an employee, any amount payable upon termination of employment to such taxpayer by Her Majesty in Right of Canada until such time as this requirement is withdrawn or the amount owed by the taxpayer has been satisfied.
THIS REQUIREMENT has been executed under one or more of the following Acts:
the Income Tax Act, the Canada Pension Plan, the Unemployment Insurance Act, the

Digitized by Google

Petroleum and Gas Revenue Tax Act.

Requisition for payment is to be forwarded monthly in accordance with interdepartmental settlement procedures and must be identified with Intra Number, Creditor Account Code, the taxpayer's name, address, Social Insurance Number, where applicable and Account Number.

The appellant alleges that in April 1992 the Minister advised him to file returns for the taxation years 1986 to 1991, inclusive, in order to be eligible for Canada Pension Plan benefits. He also alleges that prior to filing for those years he "did not owe any monies". He further alleges that he began receiving benefits of $372.30 per month in August 1992. By paragraphs 8 and 9 of his pleading, the appellant alleges as follows:

In or about the month of May 1993 the Defendant seized the plaintiff's Canada pension Plan retirement payments allegedly for taxes owing for the years 1986 through 1991. The last of such payments was received by the plaintiff in April 1993, and there were no taxes owing.

The plaintiff alleges that the seizure of his Canada Pension Plan Benefits is invalid and void under the Canada Pension Plan Act, R.S.C. 1985, chap C-8, as amended, in that:

It is an assignment, charge, attachment, anticipation or giving or taking as security of the plaintiff's benefits in contravention of section 65: and

It is not an authorized payment under section 108. Paragraph 14 of this pleading contains the following allegation:

14. The plaintiff alleges that the Canada Pension Plan Act is a contributory, earnings related plan that offsets loss of income due to retirement, disability and death, and its funds are held in trust by the defendant for the benefit of the contributors one of whom was the plaintiff.

The appellant acknowledges in paragraphs 16 and 18 of his pleading that his income for the years 1973 and 1974 was reassessed by Revenue Canada and that he appealed. By paragraph 19, he alleges:

19. In or about the year 1988 the defendant released and forgave the plaintiff from any debt owing by him to Her for taxes to date, and the appeals were not pursued.

The appellant goes on in paragraphs 20 to 26 to allege that the Minister illegally seized monies standing in his trust account, that the respondent admitted "the impropriety of their actions" and that in or about 1988 "the defendant released and forgave the plaintiff from any debt owing to him to Her for taxes to compensate for the harm injury and damage caused to the plaintiff and his family by their illegal actions". He also alleges certain infringements and denials of rights and freedoms guaranteed by sections 7, 8, 12, 15 and 26 of the *Canadian Charter of Rights and Freedoms* [being Part I of the *Constitution Act, 1982*, Schedule B, *Canada Act 1982*, 1982, c. 11 (U.K.) [R.S.C., 1985, Appendix II, No. 44]]. These allegations were not pursued in argument before this Court.

The respondent raises the following defences in paragraphs 9-13 of the statement of defence:

As a result of the aforementioned assessments for taxation years 1986 to 1991 taxes were levied against the Plaintiff in the amount of $70,178.51, including penalties and interest.

After unsuccessful attempts to contact the plaintiff in order to collect the aforementioned debt owing to Her Majesty the Queen, the Minister of National Revenue, pursuant to s. 224.1 of the *Income Tax Act*, required the detention by way of deduction or set-off in the amount of $75,245.22 which was the amount then owing, including accrued interest, from the amounts payable to the Plaintiff under the *Canada Pension Plan*. The requisition for this statutory set-off was sent to Health and Welfare Canada on March 31, 1993 and notice was sent to the plaintiff by mail on the same day at his last recorded mailing address.

Pursuant to the statutory set-off required by the Minister of National Revenue, the full amount of the retirement pension payable to the Plaintiff was retained commencing in May, 1993 and continuing to the present date.

The Defendant states that the set-off required by the Minister of National Revenue was and

Digitized by Google

is valid and is not precluded by any provision of the *Canada Pension Plan*, and, in particular, s. 65. The Defendant states that the set-off is not an assignment, charge, attachment, anticipation or giving or taking as security within the meaning of the said provision. Moreover, the set-off does not constitute and (*sic*) additional charge to the Canada Pension Plan account and therefore s. 108 of the *Canada Pension Plan* has no application. The Defendant accordingly denies paragraph 9 of the Plaintiff's Statement of Claim.

With respect to paragraph 14 of the Statement of Claim, the Defendant denies that the monies in the Canada Pension Plan account are held in trust by the Crown for the benefit of contributors to or recipients of money from the account.

Paragraphs 20 and 21 of this pleading allege as follows:

On or about November, 1993 Revenue Canada Taxation received from the Plaintiff T1 Adjustment Requests dated October 18, 1993 with respect to his individual tax returns for taxation years 1986 to 1991 inclusive. The Plaintiff thereby seeks an adjustment on the basis that he was a non-resident of Canada during the said years, that none of the income reported in those tax returns was earned in Canada or received from Canadian sources and that he had filed the returns in order to be eligible for *Canada Pension Plan* benefits. The said T1 Adjustment Requests have not to date been disposed of and the Defendant, therefore, denies the allegations in paragraphs 7 and 8 of the Statement of Claim. In the event that the Plaintiff's requests are granted, there would be no tax liability by the Plaintiff during those taxation years as currently being set-off in the amount of $75,245.22.

The Plaintiff has a previous unpaid debt to the Defendant for unpaid taxes for taxation years 1973, 1974 and 1976 to 1979 inclusive. The Defendant denies that the Plaintiff was released and forgiven for this debt as alleged in paragraph 19 of the Statement of Claim. On or about December 21, 1988 the outstanding balance then owing in the amount of $117,400.74 was deleted by Revenue Canada as being uncollectible. The debt with accrued interest remains outstanding and may be re-instated for collection at any time whenever circumstances indicate that collection is possible. The Defendant further denies the allegations of fact contained in paragraphs 7 and 8 of the Statement of Claim in this regard.

In paragraph 23, the respondent alleges that the appellant did not pursue his assessment appeals and denies "that the appeals were not pursued because the debt was forgiven by Revenue Canada" as alleged by the appellant in paragraph 19 of his pleading. By its affidavit evidence, however, the respondent admits that the appellant is under no liability to pay any taxes under the *Income Tax Act* for the taxation years 1986 to 1991 because he was not a resident of Canada in any of those years, but that "Revenue Canada did not at anytime release the plaintiff from, or forgive him for" unpaid taxes for the taxation years 1973, 1974 and 1976 to 1979 inclusive[1] even though the debt was "deleted by Revenue Canada Taxation as uncollectible in 1988".[2] This evidence is not controverted.

Shortly after the defence was filed, the appellant launched the motion for judgment upon the grounds set forth in the notice of motion, which read:

Pursuant to Rules 432.1(1) and 432.3, in that the seizure of the Canada Pension Plan Benefits by the Defendant is prohibited by section 65 of the Canada Pension Plan Act R.S.C. 1985, chapt C-8 and amendments thereto, and is null and void;

Pursuant to Rules 432.1(1) and 432.3, in that the payment of the plaintiff's Canada Pension Plan Benefits to the Defendant or to its behalf is prohibited by section 108 of the Canada Pension Plan Act and is null and void;

Pursuant to Rules 341, 432.1(1) nd (sic) 432.2, in that the Defendant has admitted that the debt upon which the Plaintiff's Canada Pension Plan Benefits were seized by it is not

Digitized by Google

owing by the plaintiff to the defendant and is therefore not a debt upon which the said Benefits could be so seized.

Rules 341, 432.1(1) [as enacted by SOR/94-41 , s. 5] and 432.3 [as enacted *idem*] of the *Federal Court Rules* [C.R.C., c. 663] read:

Rule 341. A party may, at any stage of a proceeding, apply for judgment in respect of any matter

upon any admission in the pleadings or other documents filed in the Court, or in the examination of another party, or

in respect of which the only evidence consists of documents and such affidavits as are necessary to prove the execution or identity of such documents,

without waiting for the determination of any other question between the parties.

. . .

Rule 432.1 (1) A plaintiff may, after the defendant has filed a defence, or earlier with leave of the Court, and at any time prior to the fixing of the time and date for trial, make a motion to a judge, with supporting affidavit material or other evidence, for summary judgment on all or part of the claim in the statement of claim.

. . .

Rule 432.3 (1) Where a judge is satisfied that there is no genuine issue for trial with respect to a claim or defence, the judge shall grant summary judgment accordingly.

Where a judge is satisfied that the only genuine issue is the amount to which the moving party is entitled, the judge may order a trial of that issue or grant summary judgment with a reference to determine the amount.

Where a judge is satisfied that the only genuine issue is a question of law, the judge may determine the question and grant summary judgment accordingly.

Where a judge decides that there is a genuine issue with respect to a claim or defence, the judge may nevertheless grant summary judgment in favour of any party, either upon an issue or generally, unless

the judge is unable on the whole of the evidence to find the facts necessary to decide the questions of fact or law; or

the judge considers that it would be unjust to decide the issues on the motion for summary judgment.

Where a motion for summary judgment is dismissed, either in whole or in part, a judge may order the action, or the issues in the action not disposed of by summary judgment, to proceed to trial in the usual way, but upon the request of any party, a judge may order an expedited trial under rule 327.1.

The appellant does not actually seek a judgment pursuant to Rule 341 but, rather, relies on admissions of the kind referred to in that Rule to support his motion for summary judgment.

In dismissing the motion, the Motions Judge dealt with the issue of whether a debt for unpaid income taxes was owing at the time the statutory set-off was executed, and concluded at page 221 of his reasons:

On this motion, it was agreed by the parties that no income tax moneys were owing by the plaintiff for the years 1986 to 1991. The seizures were originally effected to recover a debt owed for this period. It has been determined that the plaintiff was not a resident of Canada during that period. Nonetheless, the defendant says that the plaintiff owes more than $117,000 in income tax from a period during the 1970s and that the Canada Pension Plan moneys seized should apply to this debt. The plaintiff says he was released from this obligation or that the obligation has been forgiven. On this dispute there is a genuine issue for trial and it cannot be decided on summary judgment.

He dealt next with the appellant's submission that the *Canada Pension Plan* benefits are insulated from the set-off by virtue of subsection 65(1) and paragraph 108(3)(*a*) of that

Digitized by Google

statute. At pages 222- 223 of his reasons, the Motions Judge stated:

Section 224.1 [of the *Income Tax Act*] uses the words "retention by way of deduction or set-off. . .out of any amount that may be or become payable to such person by Her Majesty in right of Canada." Subsection 65(1) of the Canada Pension Plan refers to assignments, charges, attachments and security. A deduction or set-off under section 224.1 is between Her Majesty on the one hand and the recipient of moneys from Her Majesty on the other. The assignment, charge, attachment, or security envisaged by subsection 65(1) is to be given to or exercised by a third party, pertaining to moneys payable by Her Majesty as a benefit under the Canada Pension Plan to the recipient thereof. Subsection 65(1) does not affect the right of deduction or set-off in section 224.1 of the *Income Tax Act*.

Paragraph 108(3)(a) of the Canada Pension Plan provides that all amounts payable under the Canada Pension Plan on account of benefits shall be paid out of the Consolidated Revenue Fund and charged to the Canada Pension Plan Account. Section 224.1 allows the Minister to retain, by way of deduction or set-off, amounts that may be or become payable to a person by Her Majesty. Clearly the amounts that are payable to a person in respect of the Canada Pension Plan are amounts that may be retained by way of deduction or set-off by the Minister under section 224.1.

The plaintiff's arguments, based on subsection 65(1) and paragraph 108(3)(a) of the Canada Pension Plan are without merit. This finding is without prejudice to any other basis for claim the plaintiff may have. The matter is otherwise inappropriate to be decided by way of summary judgment and shall be referred to trial.

The statutory provisions in issue are section 224.1 of the *Income Tax Act*, R.S.C., 1985 (5th Supp.), c. 1, as amended:

224.1 Where a person is indebted to Her Majesty under this Act or under an Act of a province with which the Minister of Finance has entered into an agreement for the collection of the taxes payable to the province under that Act, the Minister may require the retention by way of deduction or set-off of such amount as the Minister may specify out of any amount that may be or become payable to the person by Her Majesty in right of Canada.

and subsection 65(1) and paragraph 108(3)(*a*) of the *Canada Pension Plan*, R.S.C., 1985, c. C-8, as amended:

65. (1) A benefit shall not be assigned, charged, attached, anticipated or given as security, and any transaction purporting to assign, charge, attach, anticipate or give as security a benefit is void.

. . .

108. . . .

There shall be paid out of the Consolidated Revenue Fund and charged to the Canada Pension Plan Account

all amounts payable under this Act as or on account of benefits or otherwise;

The appellant also relies on an amendment of the *Canada Pension Plan* adopted by section 29 of S.C. 1995, c. 33:

29. Subsections 65(2) and (3) of the Act are replaced by the following:

(1.1) A benefit is exempt from seizure and execution, either at law or in equity.

This amendment came into force July 13, 1995.

The principal issues in this appeal are twofold. The first is whether by law the Crown is entitled to a set-off of retirement benefits payable to the appellant against a debt for unpaid income taxes. The second is whether, if the Crown is so entitled, the 1995 amendment of the *Canada Pension Plan* prohibits the Crown from setting-off those benefits against a debt for unpaid income taxes from and after the date that amendment came into force. These issues must be analyzed with the relief sought on the motion in mind

Digitized by Google

that of securing a judgment before trial pursuant to Rule 341 or Rules 432.1 to **432.7 [as enacted by SOR/94-41 , s. 5] of the *Federal Court Rules* .**

I shall deal with the issues in the order in which they were presented in argument at the hearing. Crown's right of set-off prior to July 13, 1995

The appellant submits that the statutory set-off, if valid, cannot be used to set-off retirement benefits against any debt for unpaid income tax owing for any taxation year other than the taxation years 1986 to 1991, both inclusive. He then contends that the set-off is expressly prohibited by subsection 65(1) of the *Canada Pension Plan* and that, in any event, it cannot be effected against monies held in trust by the Crown pursuant to the provisions of that statute.

A summary judgment under Rules 432.1 to 432.7, is available in a proper case. Under paragraph 341(*a*) of the Rules, judgment may be sought "upon any admission" contained in one of the source documents therein mentioned. In the present case, the respondent did admit that the International Audit Section of Revenue Canada, Toronto District Office, "has deemed Mr. Mintzer to be a non- resident of Canada for taxation purposes for the taxation years 1986 to 1991, inclusive", that the appellant was not required to file income tax returns for those years and that his arrears balance **would be adjusted accordingly "to reflect that the particular debt thought to have arisen from these years does not exist".[3] However, it states that a decision was made "to apply any credit balance resulting from the above adjustments, to set-off any subsequent *Canada Pension Plan* benefits that Mr. Mintzer receives following appropriate adjustments, against the aforementioned debt of Mr. Mintzer in the amount of $117,400.34 owing by him from the taxation years 1973, 1974, and 1976 to 1979".[4]**

The appellant submits that he is entitled to judgment under the Rules on the basis of these admissions. He contends that as the statutory set-off expressly required that the sum of "$75,245.22" be retained by way of deduction or set-off from such amounts as may be or may become payable to him under the *Canada Pension Plan* . He argues that as he owes no taxes for any of the 1986 to 1991 taxation years, the statutory set-off cannot be applied to benefits in respect of a debt for any taxes he may owe for the taxation years 1973, 1974 and 1976 to 1979. I have difficulty in accepting this contention. **Section 224.1 of the *Income Tax Act* authorizes the Minister to require retention by way of deduction or set-off "[w]here a person is indebted to Her Majesty". Although the statutory set-off may have been executed with the debt thought to exist for the 1986 to 1991 taxation years in mind, it is not by its terms limited to the collection of that particular debt. It requires only that the amount of "$75,245.22" be retained by way of deduction or set-off and states that it "has been executed under . . . the Income Tax Act", without identifying a particular taxation year or years for which the debt is owing. It seems to me that the statutory set-off broadly applies to any benefits payable to the appellant under the *Canada Pension Plan* for any unpaid income taxes including that owing for the 1973, 1974 and 1976 to 1979 taxation years, up to the limit of $75,245.22 specified therein unless the statutory set-off should earlier be withdrawn.**

The appellant next argues that by the statutory set-off the Minister has "attached" the benefits in question contrary to subsection 65(1) of the *Canada Pension Plan* . I do not agree. In my view, this "set-off" is not equivalent in law to "attachment" as understood under the law of Ontario where the set-off was executed. What we have here is set-off at law as distinguished from equitable set-off.[5] By **subsection 224.1 of the *Income Tax Act* the Minister is broadly entitled to a**

Digitized by Google

deduction or set-off according to its provisions. In my view, however, "attachment" and "set-off" are distinct legal concepts. As I understand it, "attachment" refers to an attachment under legal process. See e.g. *W. C. Fast Enterprises Ltd. v. All-Power Sports (1973) Ltd., Astrope and Royal Bank of Canada* 1981 ABCA 178 (CanLII), (1981), 29 A.R. 483 (C.A.), at pages 497-498, where McGillivray, C.J.A. relied, *inter alia*, on the opinion of Sedgewick J. in *Paterson (D.S.) & Co. Ltd., Re*, [1931] O.R. 777 (S.C. in bankruptcy), at page 780,

that the words "seizure or attachment" in an Ontario statute were "intended to cover exercise of judicial power".[6] **I do not see that "set-off", in the context of section 224.1 of the *Income Tax Act* , depends on or requires legal process for its execution. The statute itself provides the necessary authority. No** resort to legal process is required. I respectfully agree with the Motions Judge that the word "attached" in subsection 65(1) of the *Canada Pension Plan* signifies something that is given to or to be exercised by a third party rather than by the Crown. The subsection appears to be aimed at ensuring that benefits payable under the statute be for the beneficiary's own use by preventing that person from alienating or encumbering them. The exception

contained in subsection 65.1(1), allowing an assignment in favour of a spouse, supports this contention. That subsection reads:[7]

65.1 (1) Notwithstanding subsection 65(1) but subject to this section, the Minister may approve the assignment of a portion of a contributor's retirement pension to his spouse, on application in prescribed manner and form by the contributor or his spouse, if the circumstances described in either subsection (6) of (7) exist.

But for this subsection the prohibitions in subsection 65(1) would clearly prevent such an assignment. I can find no indication from the language of the subsection that it was meant to prevent the Minister from exercising the power conferred by section 224.1 of the *Income Tax Act*.

I am also of the view that the benefits payable to the appellant are not insulated from set-off on the basis that they constitute trust funds in the hands of the Crown under paragraph 108(3)(*a*) of the *Canada Pension Plan*. Subsection 62(2) in Part II of that statute indicates at what point in time benefits are deemed to become payable to a beneficiary. It reads:

62. . . .

(2) For the purposes of this Act, where a benefit is payable under this Part commencing with any month, the benefit shall be deemed to have become payable at the beginning of that month.

Subsection 108(1) of the *Canada Pension Plan* establishes in the accounts of Canada "an account to be known as the Canada Pension Plan Account". Subsection 108(2) [as am. by S.C. 1995, c. 33, s. 46] requires specified amounts and interest to be paid into the Consolidated Revenue Fund and be credited to the Canada Pension Plan Account. Pension "benefits" are, by paragraph 108(3)(*a*), to be "paid out of the Consolidated Revenue Fund and charged to the Canada Pension Plan Account".

On the basis of section 108 the appellant contends that the "benefits" are held in trust by the Crown and cannot be set-off against a debt for unpaid taxes. In my opinion this argument is without merit. It is not the contributions which are paid into the Consolidated Revenue Fund that are subject to the statutory set-off but the "benefits" which are or become "payable" to a beneficiary under the *Canada*

***Pension Plan* . It seems to me that the "benefits"[8] as such would no longer be subject to any trust for which the appellant contends, if a trust there be. I am not satisfied, in any event, that the statute manifests an intention to create a trust either in**

Digitized by Google

respect of contributions or benefits.[9] **As I read the *Canada Pension Plan* the role of the Crown with respect to monies credited to the Canada Pension Plan Account or to benefits not yet paid, is that of an administrator in exercise of its governmental functions rather than of a trustee.**

Crown's right of set-off after July 13, 1995

The appellant submits that the provisions of subsection 65(1.1), which became effective on July 13, 1995, prohibits the setting-off of benefits against a debt for unpaid taxes because such a set-off amounts to "seizure and execution". The respondent advances three arguments against the words "seizure" and "execution" being construed so as to override the right of set-off under section 224.1 of the *Income Tax Act* . First, the amending statute does not purport to expressly qualify the right of set-off under section 224.1, as would have been the case had subsection 65(1.1) of the *Canada Pension Plan* been introduced with such words as: "Notwithstanding the provisions of any other statute", and that the absence of some such words indicates an intention that the right of set-off be in no way affected by the amendment. Secondly, that just as "set-off" and "attachment" are distinct legal concepts, so too are "set-off", "seizure" and "execution". Finally, by virtue of section 17 of the *Interpretation Act* , R.S.C., 1985, c. I-21, the Crown is not bound by the restrictions in the 1995 amendment. That section reads:

17. No enactment is binding on Her Majesty or affects Her Majesty or Her Majesty's rights or prerogatives in any manner, except as mentioned or referred to in the enactment.

The respondent argues that nothing in the 1995 amendment manifests an intention to bind the Crown, upon any of the tests laid down in *Alberta Government Telephones v. Canada (Canadian Radio-television and Telecommunications Commission)*, 1989 CanLII 78 (SCC), [1989] 2 S.C.R. 225, at pages 270-283, which held that the Crown will be bound by express words in a statute or by a clear intention revealed by the context of other textual provisions or where the purpose of a statute would be wholly frustrated if the government were not bound. (See also *Friends of the Oldman River Society v. Canada (Minister of Transport)*, 1992 CanLII 110 (SCC), [1992] 1 S.C.R. 3, *per* La Forest J. at pages 52-63.) I do not find in subsection 65(1.1) or in the context any intention to bind the Crown including that the purpose of the statute would be wholly frustrated if the Crown were not bound by its provisions.

I cannot see that the new subsection was intended to override the provisions of section 224.1 of the *Income Tax Act*. The terms used in that section are "deduction or set-off", neither of which appear in subsection 65(1.1). Parliament was obviously well aware of the distinction between attachment and deduction or set-off. If Parliament had intended to nullify the right of set-off in section 224.1 of the *Income Tax Act* , it could easily have done so by express language in subsection 65(1.1) of the *Canada Pension Plan*.

Moreover, in its ordinary and natural meaning "seizure" as understood at common law is "a forcible taking possession": *Johnston v. Hogg* (1882-83), 10 Q.B.D. 432, *per* Cave J., at page 434.[10] The word "execution" was defined by Lord Denning M.R. in *Overseas Aviation Engineering (G.B.) Ltd., In re* , [1963] Ch. 24 (C.A.),

at page 39, as "the process for enforcing or giving effect to the judgment of the court".[11] The term "set-off" has been defined in *Bankruptcy Notice, A, In re* , [1934] Ch. 431 (C.A.) by Lord Hanworth M.R., at page 437

as follows:

With regard to the word "set-off", that is a word well known and established in its meaning; it is something which provides a defence because the nature and quality of the sum so relied upon are such that it is a sum which is proper to be dealt with as diminishing the claim which is made, and against which the sum so demanded can be set

Digitized by Google

off.

In *Halsbury's Laws of England*, 4th ed. (London: Butterworths, 1983), vol. 42, paragraph 406, the following definition of that term appears:

Where A has a claim for a sum of money against B and B has a cross-claim for a sum of money against A such that B is, to the extent of his cross-claim, entitled to be absolved from payment of A's claim, and to plead his cross-claim as a defence to an action by A for enforcement of his claim, then B is said to have a right of set-off against A to the extent of his cross-claim. [Footnotes omitted.]

In *Sigurdson v. The Queen in right of British Columbia* 1982 CanLII 416 (BC CA), (1982), 132 D.L.R. (3d) 131 (B.C.C.A.), Carrothers J.A., speaking for a majority, dealt with the concept of set-off at page 592, as follows:

The law relating to true set-off is well settled. A true set-off of indebtedness can take place only between two debtors who are at the same time one another's creditors. A set-off is merely the remission or cancellation *pro tanto* of reciprocal debts by applying one's credit receivable from another against one's debt owed to that other. A set-off is a cross-claim for money's worth respecting mutual or reciprocal debts due and owing from and to the same parties in the same right.

It is apparent that "set-off" is a quite different legal concept than either "seizure" or "execution" at common law or in equity.[12]

In my view, the 1995 amendment does not in this case prevent the Crown from exercising its right of set-off under section 224.1 of the *Income Tax Act*. It seems to me that "seizure and execution" in subsection 65(1.1) of the *Canada Pension Plan* are not intended to include a set-off so as to nullify the rights conferred on the Minister under section 224.1 of the *Income Tax Act*. These words, it appears, were intended to be additions to the list of prohibitions already contained in subsection 65(1). The Crown's right of set-off against the appellant under section 224.1 of the *Income Tax Act* is not, in my view, affected by the amendment.

I am satisfied that the Motions Judge did not err in dismissing the appellant's motion for summary judgment. **As already stated, as a matter of law section 224.1 of the *Income Tax Act* entitles the Minister to set- off for any unpaid taxes owing under that statute for the taxation years 1973, 1974 and 1976 to 1979, inclusive, against benefits payable to the appellant from time to time under the *Canada Pension Plan* up to the limit specified in the statutory set-off, unless that set-off be earlier withdrawn.** I further agree that the respondent's admissions do not provide a valid basis for granting a summary judgment under Rules

432.1 to 432.7. The admissions relate only to the absence of liability for taxes in the taxation years 1986 to 1991, inclusive. They have no bearing on whether the appellant is indebted to Her Majesty for unpaid taxes assessed for the years 1973, 1974 and 1976 to 1979, inclusive. While the appellant pleads that the debt of

$117,400.74 has been forgiven and that he has been released from paying it, he neither offers any supporting evidence nor contradicts the respondent's evidence to the opposite effect. As moving party for summary judgment, he was required by subsection 432.2(1) of the Rules to bring forth evidence, if available, showing that there is no genuine issue for trial within the meaning of subsection 432.3(1) of the Rules: *Feoso Oil Ltd. v. Sarla (The)*, 1995 CanLII 3605 (FCA), [1995] 3 F.C. 68 (C.A.), at page 82. That he has failed to do.

The respondent appears to have satisfied the requirement of subsection 432.2(1) of the Rules of showing by affidavit or other evidence that there is a genuine issue for trial.[13] The defence raised is not clearly without foundation. I respectfully agree with the Motions Judge that the appellant is not entitled to summary judgment at this stage of the proceeding.

I would dismiss the appeal with costs if requested by the respondent.

Digitized by Google

Strayer J.A.:
I agree.
Linden J.A.:
I agree.

[1] Affidavit of Nazim Zaver sworn January 26, 1995, par. 6, A.B., at p. 56. Par. 11 of this affidavit, at pp. 57 and 58 of the A.B., is to the same effect as par. 6 thereof. In par. 2 of an affidavit of Brian Murphy sworn October 4, 1993, opposing the appellant's motion, the deponent states that this debt was outstanding as of December 21, 1988 but that it "was not collected and was written off by Revenue Canada" (A.B., at p. 37). There is no evidence that the debt was forgiven or that the appellant was released from paying it.

[2] Affidavit Nazim Zaver, *ibid.*, par. 13, A.B., at p. 58.

[3] *Ibid.*, par. 10, A.B., at p. 57.

[4] *Ibid.*, par. 11, A.B., at p. 57-58.

[5] ;*Holt v. Telford*, 1987 CanLII 18 (SCC), [1987] 2 S.C.R. 193; *Atlantic Lines & Navigation Co. Inc. v. Didymi (The)*, reflex, [1988] 1 F.C. 3 (C.A.). Cf. *Aero Trades (West.) Ltd. (Receiver of) v. Can.*, reflex, [1989] 1
W.W.R. 723 (F.C.A.). See generally K. R. Palmer, *The Law of Set-Off in Canada* (Canada Law Book: Aurora, 1993), at pp. 5-6; J. A. M. Judge and M. E. Grottenthaler, "Legal and Equitable Set-Offs" (1991), 70 *Can. Bar Rev.* 91; and the Law Reform Commission of British Columbia, *Report on Set-Off* (LRC 97, July, 1988).

[6] For a detailed discussion of the concept of attachment or garnishment of debts either before or after judgment, see C. R. B. Dunlop, *Creditor-Debtor Law in Canada*, 2nd ed. (Toronto: Carswell, 1995), chapters
6 and 11.

[7] As enacted by R.S.C., 1985 (2nd Supp.), c. 30, s. 33.

[8] The word "benefit" is defined in s. 2(1) of the statute as meaning "a benefit payable under this Act and includes a pension".

[9] See *R. v. Guerin*, [1983] 2 F.C. 656 (C.A.), at pp. 692-696.

[10] For a further discussion of this concept, see Dunlop, *supra*, note 6, at pp. 281-288.

[11] "Execution" including "equitable execution" is discussed in detail in Dunlop, *supra* , note 6, chapters 9, 10 and 12.

[12] For definitions of "set-off", see also Palmer, *supra* , note 5, at pp. 1-4. The result, however, could well be
different under the civil law of Quebec. It is noted that the French text of s. 65(1.1) provides that benefits are, in law or in equity, "*exemptes d'exécution de saisie et de saisie-arrêt*". The word "*saisie*" in s. 65(1) and (1.1) of the *Canada Pension Plan* is to be contrasted with the word "*compensation*" in the French text of s. 224.1 of the *Income Tax Act* wherein the Minister "*peut exiger la retenue par voie de déduction ou de compensation d'un tel montant qu'il peut spécifier*". Art. 1676 of the *Civil Code of Québec* [S.Q. 1991, c. 64] appears to prohibit "*compensation*" (set-off) if the object of the debt is property exempted from seizure. Art. 553(12) of the *Code of Civil Procedure* [R.S.Q., c. C-25] exempts from seizure anything declared to be unseizable by law. The Court's attention has not been drawn to any similar law in Ontario where it appears that the common law concepts will operate unless modified by statute.

[13] Rule 432.2(1) reads:

Digitized by Google

Rule 432.2 (1) In response to affidavit material or other evidence supporting a motion for summary judgment, a responding party may not rest on the mere allegations or denials of the party's pleadings, but must set out, in affidavit material or other evidence, specific facts showing that there is a genuine issue for trial.

Bertrand Bouchard and Attorney General of Canada, 2009 FCA 321, Rank of Provincial Set-off and Compensation Laws in Federal Environment When Not Referred To

REASONS FOR JUDGMENT NOËL J.A.

[1] This is an appeal from a decision of Justice Harrington of the Federal Court (Federal Court judge) dated March 10, 2009 (2009 FC 249), dismissing the appellant's application for judicial review of the decision of the Minister of National Revenue (the Minister) to retain by way of deduction or set-off, under section 224.1 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act), part of the retirement benefits and income supplement owed to him.

[2] Section 224.1 allows the Minister to require the retention of certain monies under the circumstances specified in that section:

224.1 Where a person is indebted to Her Majesty under this Act or under an Act of a province with which the Minister of Finance has entered into an agreement for the collection of the taxes payable to the province under that Act, the Minister may require the retention by way of deduction or set-off of such amount as the Minister may specify out of any amount that may be or become payable to the person by Her Majesty in right of Canada.	**224.1** Lorsqu'une personne est endettée envers Sa Majesté, en vertu de la présente loi ou en vertu d'une loi d'une province avec laquelle le ministre des Finances a conclu un accord en vue de recouvrer les impôts payables à la province en vertu de cette loi, le ministre peut exiger la retenue par voie de déduction ou de compensation d'un tel montant qu'il peut spécifier sur tout montant qui peut être ou qui peut devenir payable à cette personne par Sa Majesté du chef du Canada.

[3] The appellant, who acted (and continues to act) without the assistance of counsel, submits that the preconditions for applying this provision have not been met in this case and that the Federal Court Judge was required to reverse the retention effected by the Minister and order the reimbursement.

FACTS

[4] The appellant does not challenge the fact that, in February 2008, he owed $68,789.23 in taxes (the tax debt). The evidence also shows that, at the same time, he was a Crown creditor under the *Canada Pension Plan,* R.S.C. 1985, c. C-8 (CPP) and the *Old Age Security Act*, R.S.C. 1985, c. O-9 (OASA). The appellant had been receiving $965.33 per month in benefits under these plans.

[5] In March 2008, the Minister began deducting 30% of the monthly amount payable to the appellant and applying it to his tax debt, with the result that the total monthly benefit amount paid to the appellant was reduced to $675.74.

Digitized by Google

[6] Subsections 65(1) and (1.1) of the CPP and 36(1) and (1.1) of the OASA respectively stipulate that the benefits paid under these acts are exempt from seizure:

65. (1) A benefit shall not be assigned, charged, attached, anticipated or given as security, and any transaction purporting to assign, charge, attach, anticipate or give as security a benefit is void.	**65.** (1) Une prestation ne peut être cédée, grevée de privilège, saisie, escomptée ou donnée en garantie. Toute opération qui vise à céder, grever, saisir, escompter ou donner en garantie une prestation est nulle.
(1.1) A benefit is exempt from seizure and execution, either at law or in equity.	(1.1) Les prestations sont, en droit ou en equity, exemptes d'exécution de saisie et de saisie-arrêt.

36. (1) A benefit shall not be assigned, charged, attached, anticipated or given as security, and any transaction purporting to assign, charge, attach, anticipate or give as security a benefit is void.	**36.** (1) Les prestations sont incessibles et insaisissables et ne peuvent être ni grevées ni données pour sûreté; il est également interdit d'en disposer par avance. Toute opération contraire à la présente disposition est nulle.
(1.1) A benefit is exempt from seizure and execution, either at law or in equity.	(1.1) Les prestations sont, en droit ou en equity, exemptes d'exécution de saisie et de saisie-arrêt.

[7] On April 17, 2008, the appellant sought the cancellation of the statutory set-off and reimbursement of the monies retained. When his request went unanswered, the appellant brought his case to the Minister's attention. After receiving a negative response, the appellant challenged the Minister's decision by way of an application for judicial review in Federal Court.

[8] In support of his request, the appellant raised two arguments. First, he submitted that, since the amounts deducted are exempt from seizure under the sections of the CPP and OASA, set-off cannot be effected according to the applicable private law, in particular article 1676 of the *Civil Code of Québec*, R.S.Q. 1991, c. 64 (CCQ), which reads as follows:

1676. Compensation is effected regardless of the cause of the obligation that has given rise to the debt.	**1676.** La compensation s'opère quelque soit la cause de l'obligation d'où résulte la dette.
Compensation does not take place, however, if the claim results from an act perform with intention to harm or <u>if</u>	Elle n'a pas lieu, cependant, si la créance résulte d'un acte fait dans l'intention de nuire <u>ou si la dette a pour</u>

Digitized by Google

the object of the debt is property which is exempt from seizure.	objet un bien insaisissable.

Digitized by Google

[Emphasis added.]

[9] In the alternative, the appellant argued before the Federal Court that the benefits to which he is entitled are held in trust for him and are not debts that can be subject to the set-off mechanism under section 224.1 of the Act.

DECISION OF THE FEDERAL COURT

[10] The Federal Court judge identified the issue as follows: does the term "set-off" ("compensation" in the French version) in section 224.1 of the Act incorporate civil law concepts of compensation, more specifically, paragraph 2 of article 1676 of the CCQ, according to which compensation "does not take place . . . if the object of the debt is property which is exempt from seizure"? He recognizes that, if so, compensation could not take place, as the "property" in question is exempt from seizure (reasons, paras. 1 to 5).

[11] The Federal Court judge began his analysis by explaining the role of provincial private law in federal law. In this regard, he cites sections 8.1 and 8.2 of the *Interpretation Act*, R.S.C. 1985, c. I-21, which read as follows:

8.1 Both the common law and the civil law are equally authoritative and recognized sources of the law of property and civil rights in Canada and, unless otherwise provided by law, if in interpreting an enactment it is necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights, reference must be made to the rules, principles and concepts in force in the province at the time the enactment is being applied.

Le droit civil et la common law font pareillement autorité et sont tous deux sources de droit en matière de propriété et de droits civils au Canada et, s'il est nécessaire de recourir à des règles, principes ou notions appartenant au domaine de la propriété et des droits civils en vue d'assurer l'application d'un texte dans une province, il faut, sauf règle de droit s'y opposant, avoir recours aux règles, principes et notions en vigueur dans cette province au moment de l'application du texte.

Unless otherwise provided by law, when an enactment contains both civil law and common law terminology, or terminology that has a different meaning in the civil law and the common law, the civil law terminology or meaning is to be adopted in the Province of Quebec and the common law terminology or meaning is to be adopted in the other provinces.

8.2 Sauf règle de droit s'y opposant, est entendu dans un sens compatible avec le système juridique de la province d'application le texte qui emploie à la fois des termes propres au droit civil de la province de Québec et des termes propres à la common law des autres provinces, ou qui emploie des termes qui ont un sens différent dans l'un et l'autre de ces systèmes.

Digitized by Google

[Emphasis added.]

[12] In this case, the Federal Court judge asked [TRANSLATION] "whether Parliament intended paragraph two of article 1676 to be available to a tax debtor" (reasons, para. 15). He then referred to the decision of the Court of Appeal in *Mintzer v. Canada*, [1996] 2 F.C. 146 (*Mintzer*) and the distinction made therein regarding the potentially distinct effect of civil law (reasons, paras. 15 and 16).

[13] **The Federal Court judge went on to explain that, for section 224.1 of the Act to apply, the two debts must be liquid and that, surely, Parliament was therefore referring to legal set-off, not judicial liquidation (reasons, para. 17). He added that the Minister can, in exercising his discretion, determine the extent of the set-off amount (for example, here, he requires only 30% of the amounts paid to the appellant) and that [TRANSLATION] "[i]t is therefore clear that Parliament did not intend to make all the compensation provisions of the *Civil Code of Québec* applicable in such circumstances" (reasons, para. 18). In the Federal Court judge's opinion, Parliament could not have intended to provide tax debtors with another way to avoid seizure (reasons, paras. 19 and 20).**

[14] **Lastly, relying on *Mintzer*, the Federal Court judge dismisses the appellant's argument that the monies owed to him [TRANSLATION] "are not debts in the hands of Her Majesty" but rather sums that are held in trust for him.**

GROUNDS OF APPEAL

[15] **In support of his appeal, the appellant repeats the arguments he raised before the Federal Court judge. First, he submits that the Federal Court judge erred in law in declining to give effect to the civil law as suppletive law. Second, the Federal Court judge should not have relied on *Mintzer* to find that the benefits owed to the appellant are not held in trust. According to the appellant, the conclusion in *Mintzer*, to the extent that it established that the benefits payable to him are debts, was incorrect.**

ANALYSIS AND DECISION

[16] **The first issue is as follows: on the basis of sections 8.1 and 8.2 of the *Interpretation Act*, must the term "compensation" found in the French version of section 224.1 of the Act be interpreted in reference to the concept of compensation as defined at articles 1672 to 1682 of the CCQ? More specifically, must paragraph 2 of article 1676 of the CCQ, which states that property that is exempt from seizure cannot be subject to compensation, apply? This is a matter of pure statutory interpretation that is subject to the standard of correctness.**

[17] **According to sections 8.1 and 8.2 of the *Interpretation Act*, it is appropriate to refer to the** civil law when it is "necessary" to do so, except where "otherwise provided by the law" (see on this point *St-Hilaire v. Canada (Attorney General)*, 2001 FCA 63, [2001] F.C.J. No. 444 (QL), para. 43). The burden is therefore on the appellant to show that it is necessary to incorporate the civil law notions on which he relies and that there is no provision to the

Digitized by Google

contrary in federal law.

[18] **The purpose of the collection measures set out in section 224.1 of the Act is to allow the tax authority to collect debts owing to that authority. At first glance, Parliament wanted to allow the Minister to retain the amounts owing by the Crown to a tax debtor to ensure payment of that person's tax debt. Contrary to what the appellant seems to believe, that the Minister may satisfy the appellant's debts from the amounts payable to the appellant is consistent with the objective sought (appellant's memorandum, paras. 42 and 43).**

[19] **Like any statutory provision, section 224.1 must be read in its "entire context and in [its] grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament" (*Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, para. 21). The context of section 224.1 obviously includes the provisions of the Act that pursue the same objective.**

[20] **In this respect, a reading of subsection 225(5) of the Act reveals that, when Parliament wishes to make its collection measures subject to the seizure exemption rules made by the provinces, it does so expressly:**

225. (5) Such goods and chattels of any person in default as would be exempt from seizure under a writ of execution issued out of a superior court of the province in which the seizure is made are exempt from seizure under this section.	**225.** (5) Les biens meubles de toute personne en défaut qui seraient insaisissables malgré un bref d'exécution décerné par une cour supérieure de la province dans laquelle la saisie est opérée sont exempts de saisie en vertu du présent article.

Digitized by Google

[21] *This Court also upheld the effect of this recognition in circumstances similar to the ones here. In Marcoux v. Canada (Attorney General), 2001 FCA 92, [2001] F.C.J. No. 493 (QL), the issue was whether the seizure exemption rules set out in article 553(7) of the Quebec Code of Civil Procedure, R.S.Q. c. C-25, prevented the Minister from exercising his power to collect. The Court dealt with this argument as follows (para. 13):*

. . . As Décary J.A. noted in St-Hilaire, supra, at para. 30 of his reasons, Parliament may derogate from the civil law when it legislates on a subject that falls within its jurisdiction. Section 224, when read with s. 225, shows that in creating the methods of seizure mentioned in those sections Parliament had in mind the exemptions from seizure enacted in private law, and chose to take them into account in s. 225 and not take them into account in s. 224. Contrary to what was argued by counsel for the appellant, Parliament has spoken on the point at issue.

[Emphasis added.]

[22] *Similarly, paragraph 122.61(4)(b) of the Act states that child tax benefits "cannot be assigned, charged, attached or given as security". However, at paragraph 122.61(4)(d), Parliament deemed it necessary to specify that these benefits "cannot be retained by way of deduction or set-off under the Financial Administration Act".*

[23] **It is therefore clear that, when Parliament wishes to limit its power to effect a set-off, it does so expressly. The inevitable conclusion is that there is no such limitation imposed on section 224.1.** [24] Beyond the context of section 224.1, the statutory set-off mechanism set out in this section is fundamentally different from the one underlying compensation under Quebec civil law. For example, unlike article 1673 of the CCQ, which states that compensation is effected "by operation of law", section 224.1 provides that "the Minister may require the retention". Similarly, section 224.1 grants the Minister the power to determine the amount that will be subject to the set-off, whereas, under article 1673 of the CCQ, mutual debts are automatically extinguished up to the amount of the lesser debt. Lastly, the right to effect a set-off provided at section 224.1 is exercised in respect of an "amount [. . .] payable" and not a debt, as stipulated in article 1676 of the CCQ.

[25] These characteristics reveal that the statutory set-off described in section 224.1 is inspired by common law and is a complete departure from the civil law concept of compensation. Not only is it unnecessary to refer to civil law to give effect to section 224.1, but the law underlying this provision, in particular the concept of set-off borrowed from common law, requires otherwise. In my respectful view, the argument that Parliament relied on civil law as suppletive law cannot succeed, and the Federal Court judge was correct in law in rejecting it.

[26] *Next, the appellant submits that the Minister cannot effect set-off, as the benefits payable to him are held in trust and not "debts" owing to him by the Crown. In Mintzer, this Court already decided this issue (Mintzer, para. 17):*

On the basis of section 108 the appellant contends that the "benefits" are held in trust by the Crown and cannot be set-off against a debt for unpaid taxes. In my opinion this argument is without merit. It is not the contributions which are paid into the Consolidated Revenue Fund that are subject to the statutory set-off but the "benefits" which are or become "payable" to a beneficiary under the Canada Pension Plan. It seems to me that the "benefits" as such would no longer be subject to any trust for which the appellant contends, if a trust there be. I am not satisfied, in any event, that the statute manifests an intention to create a trust either in respect of contributions or

Digitized by Google

benefits. As I read the Canada Pension Plan the role of the Crown with respect to monies credited to the Canada Pension Plan Account or to benefits not yet paid, is that of an administrator in exercise of its governmental functions rather than of a trustee. (endnotes omitted)
[Emphasis added.]

[27] The appellant challenges that decision, citing subsection 8(3) of the *Pension Benefits Standards Act*, 1985, R.S.C. 1985, c. 32 (2nd Supp.), whose full title is *An Act respecting pension plans organized and administered for the benefit of persons employed in connection with certain federal works, undertakings and businesses*. Subsection 8(3) states, among other things, "The administrator shall administer the pension plan and pension fund as a trustee . . .". **The appellant contends that, according to this provision, the funds of the plans to which he contributes are held in trust.**

[28] It is unclear whether this provision applies to the CPP or the OASA, but, in any event, this has no bearing on the reasoning of this Court in *Mintzer*, according to which the benefits to be paid, once payable, are no longer part of the trust.

[29] **Lastly, and in any case, the Crown is not bound by the seizure exemption provisions set out in the CPP and OASA. Under section 17 of the *Interpretation Act*, "[n]o enactment is binding on Her Majesty or affects Her Majesty or Her Majesty's rights or prerogatives in any manner", unless otherwise indicated. The provisions of the CPP and OASA appear to be aimed at "ensuring that benefits payable under [these] statute[s] be for the beneficiary's own use by preventing that person from alienating or encumbering them" (*Mintzer*, para. 15). Although these provisions apply to third parties, there is no indication of any intention to bind the Crown (*idem*, para. 18).**

[30] I would dismiss the appeal with costs.

"Marc Noël"
J.A.

"I agree
J.D. Denis Pelletier J.A."

"I agree
Johanne Trudel J.A."

Acquisition of debtor's property – 224.2

For the purpose of collecting debts owed by a person to Her Majesty under this Act or under an Act of a province with which the Minister of Finance has entered into an agreement for the collection of taxes payable to the province under that Act, the Minister may purchase or otherwise acquire any interest in the person's property that the Minister is given a right to acquire in legal proceedings or under a court order or that is offered for sale or redemption and may dispose of any interest so acquired in such manner as the Minister considers reasonable.

Payment of moneys seized from tax debtor – 224.3(1)

(1) Where the Minister has knowledge or suspects that a particular person is holding moneys that were seized by a police officer in the course of administering or enforcing the criminal law of Canada from another person (in this section referred to as the "tax debtor") who is liable

Digitized by Google

to make a payment under this Act or under an Act of a province with which the Minister of Finance has entered into an agreement for the collection of taxes payable to the province under that Act and that are restorable to the tax debtor, the Minister may in writing require the particular person to turn over the moneys otherwise restorable to the tax debtor in whole or in part to the Receiver General on account of the tax debtor's liability under this Act or under the Act of the province, as the case may be.

Receipt of Minister – 224.3(2)

Digitized by Google

(2) The receipt of the Minister for moneys turned over as required by this section is a good and sufficient discharge of the requirement to restore the moneys to the tax debtor to the extent of the amount so turned over.

Writs of Seizure

Section 225 sets out the mechanics by which taxpayer property can be seized in payment of her tax debt. The provisions apply only to income tax. Subsection (2) through (6) deal with the mechanics while ss. (1) deals with the primary charging on property with a certificate of indebtedness that prevents the taxpayer from dealing with clear title to it.

Seizure of chattels – 225(1)

225. (1) Where a person has failed to pay an amount as required by this Act, the Minister may give 30 days notice to the person by registered mail addressed to the person's latest known address of the Minister's intention to direct that the person's goods and chattels be seized and sold, and, if the person fails to make the payment before the expiration of the 30 days, the Minister may issue a certificate of the failure and direct that the person's goods and chattels be seized.

Sale of seized property – 225(2)

Property seized under this section shall be kept for 10 days at the cost and charges of the owner and, if the owner does not pay the amount owing together with the costs and charges within the 10 days, the property seized shall be sold by public auction.

Notice of sale – 225(3)

Except in the case of perishable goods, notice of the sale setting out the time and place thereof, together with a general description of the property to be sold shall, a reasonable time before the goods are sold, be published at least once in one or more newspapers of general local circulation.

Surplus returned to owner – 225(4)

Any surplus resulting from the sale after deduction of the amount owing and all costs and charges shall be paid or returned to the owner of the property seized.

Exemptions from seizure – 225(5)

Such goods and chattels of any person in default as would be exempt from seizure under a writ of execution issued out of a superior court of the province in which the seizure is made are exempt from seizure under this section.

Digitized by Google

Digitized by Google

The Primary Collection Mechanics

Subsection 225.1(1) details some of the steps that the Minister can take realize tax debt that basically start upon the expiry of the 90 day pause on objection detailed below. They can be used in any combination and are:

Straight action in court without support of registered certificates

Placing certificates against the taxpayer's property that advertise the Minister's interest therein

Making requirements to pay of various parties related the taxpayer (employers, banks, debtors)

Subsection 225.1(1.1) details the period during which they cannot be started depending on how the income tax was charged.

Collection restrictions - S. 225.1(1)

225.1 (1) If a taxpayer is liable for the payment of an amount assessed under this Act, other than an amount assessed under subsection 152(4.2), 169(3) or 220(3.1), the Minister shall not, until after the collection-commencement day in respect of the amount, do any of the following for the purpose of collecting the amount:

(*a*) commence legal proceedings in a court,

(*b*) certify the amount under section 223,

(*c*) require a person to make a payment under subsection 224(1),

(*d*) require an institution or a person to make a payment under subsection 224(1.1),

(*e*) [Repealed, 2006, c. 4, s. 166]

(*f*) require a person to turn over moneys under subsection 224.3(1), or

(*g*) give a notice, issue a certificate or make a direction under subsection 225(1).

Collection commencement day

(1.1) The collection-commencement day in respect of an amount is

(*a*) in the case of an amount assessed under subsection 188(1.1) in respect of a notice of intention to revoke given under subsection 168(1) or any of subsections 149.1(2) to (4.1), one year after the day on which the notice was mailed;

(*b*) in the case of an amount assessed under section 188.1, one year after the day on which the notice of assessment was sent; and

(*c*) in any other case, 90 days after the day on which the notice of assessment was sent.

No action by Minister

(2) If a taxpayer has served a notice of objection under this Act to an assessment of an amount payable under this Act, the Minister shall not, for the purpose of collecting the amount in controversy, take any of the actions described in paragraphs (1)(*a*) to (*g*) until after the day that is 90 days after the day on which notice is sent to the taxpayer that the Minister has confirmed or varied the assessment.

Idem

(3) Where a taxpayer has appealed from an assessment of an amount payable under this Act to the Tax Court of Canada, the Minister shall not, for the purpose of collecting the amount in controversy, take any of the actions described in paragraphs 225.1(1)(*a*) to 225.1(1)(*g*) before the day of mailing of a copy of the decision of the Court to the taxpayer or the day on which the taxpayer discontinues the appeal, whichever is the earlier.

Digitized by Google

Idem

(4) Where a taxpayer has agreed under subsection 173(1) that a question should be determined by the Tax Court of Canada, or where a taxpayer is served with a copy of an application made under subsection 174(1) to that Court for the determination of a question, the Minister shall not take any of the actions described in paragraphs 225.1(1)(*a*) to 225.1(1)(*g*) for the purpose of collecting that part of an amount assessed, the liability for payment of which will be affected by the determination of the question, before the day on which the question is determined by the Court.

Idem

(5) Notwithstanding any other provision in this section, where a taxpayer has served a notice of objection under this Act to an assessment or has appealed to the Tax Court of Canada from an assessment and agrees in writing with the Minister to delay proceedings on the objection or appeal, as the case may be, until judgment has been given in another action before the Tax Court of Canada, the Federal Court of Appeal or the Supreme Court of Canada in which the issue is the same or substantially the same as that raised in the objection or appeal of the taxpayer, the Minister may take any of the actions described in paragraphs 225.1(1)(*a*) to 225.1(1)(*g*) for the purpose of collecting the amount assessed, or a part thereof, determined in a manner consistent with the decision or judgment of the Court in the other action at any time after the Minister notifies the taxpayer in writing that

(*a*) the decision of the Tax Court of Canada in that action has been mailed to the Minister,

(*b*) judgment has been pronounced by the Federal Court of Appeal in that action, or

(*c*) judgment has been delivered by the Supreme Court of Canada in that action, as the case may be.

Where ss. (1) to (4) do not apply

(6) Subsections 225.1(1) to 225.1(4) do not apply with respect to

(*a*) an amount payable under Part VIII;

(*b*) an amount required to be deducted or withheld, and required to be remitted or paid, under this Act or the Regulations;

(*c*) an amount of tax required to be paid under section 116 or a regulation made under subsection 215(4) but not so paid;

(*d*) the amount of any penalty payable for failure to remit or pay an amount referred to in paragraph 225.1(6)(*b*) or 225.1(6)(*c*) as and when required by this Act or a regulation made under this Act; and

(*e*) any interest payable under a provision of this Act on an amount referred to in this paragraph or any of paragraphs 225.1(6)(*a*) to 225.1(6)(*d*).

One-half collection

(7) If an amount has been assessed under this Act in respect of a corporation for a taxation year in which it was a large corporation, or in respect of a particular amount claimed under section 110.1 or 118.1 where the particular amount was claimed in respect of a tax shelter, then subsections (1) to (4) do not limit any action of the Minister to collect

(*a*) at any time on or before the particular day that is 90 days after the day of the sending of the notice of assessment, 1/2 of the amount so assessed; and

(*b*) at any time after the particular day, the amount, if any, by which the amount so assessed exceeds the total of

(i) all amounts collected before that time with respect to the assessment, and

(ii) 1/2 of the amount in controversy at that time.

Digitized by Google

Collections Policies
IC 98-1R3
DATE: February 12, 2008

This version is only available electronically.
This document cancels and replaces Information Circular 98-1R2, Collection Policies, dated December 3, 2006 concerning collection policies.
This circular gives you a general overview of many of the collections policies that we at Canada Revenue Agency (CRA) have for individuals, businesses, and organizations that owe money to the Crown. It will help you understand your rights and responsibilities when dealing with us. However, it does not provide in-depth details of the topics it discusses.
Therefore, if you have questions about policies not covered in this circular, would like confirmation of specific aspects of those discussed, or need any additional information, please contact the Revenue Collections Division of your tax services office. For the telephone number of your tax services office, see the listing in the government section of your telephone book.
We have to modify our collections policies periodically since legislative provisions and requirements can change at any time. We make every effort to provide updates in a timely manner. However, if a discrepancy should arise between Information Circular 98-1R3, *Collections Policies,* and current legislation or our most recent policies, the latter shall take precedence.
The circular describes collections policies for taxes, duties, charges, contributions, and premiums that you are required to pay or remit under the *Income Tax Act*, *Excise Tax Act, Excise Act 2001, Air Travellers Security Charge Act, Excise Act, Customs Act, Softwood Lumber Products Export Charge Act, 2006, Canada Pension Plan , Unemployment Insurance Act ,* and *Employment Insurance Act.*
Please note that this circular only deals with those aspects of the *Canada Pension Plan, Unemployment Insurance Act,* and *Employment Insurance Act* most directly related to collections. You can get more information about payroll deductions in the employers' guide T4001, *Payroll Deductions and Remittances,* or by contacting your tax services office.
This circular discusses the following topics:
1. Payment and other obligations
2. Collection and enforcement
3. Taxpayer Relief Provisions
4. Disagreement with an amount owing
5. Acceptance of security
6. Legal action to collect
7. Collection restrictions
8. Exceptions to collection restrictions
9. Objections and appeals
10. Repayment of disputed amounts
11. Refunds applied to other debts
12. Special provisions
13. Amounts owing by estates of deceased persons
14. Confidentiality
15. Trust funds
16. Customs
17. A final word

Sections 1 to 14 of this circular describe general policies on amounts owing under the *Income Tax*

Digitized by Google

Act, the *Excise Tax Act*, the *Excise Act 2001*, the *Air Travellers Security Charge Act*, the *Excise Act*, the *Softwood Lumber Products Export Charge Act, 2006,* the *Canada Pension Plan*, the *Unemployment Insurance Act* and the *Employment Insurance Act*. Some requirements related to source deductions are also discussed.

Section 15 discusses collections policies regarding payroll and other source deductions, Goods and Services Tax/Harmonized Sales Tax (GST/HST) and charges on air transportation (*Air Travellers Security Charge Act*). These are amounts that are deemed to be held in trust, under either the *Income Tax Act,* the *Excise Tax Act* or the *Air Travellers Security Charge Act*. These amounts, deducted from employees' wages and other individuals, GST/HST that registrants collect on supplies of goods and services and charges in respect of air transportation service, are treated differently from other amounts owing. Also discussed is the possible liability of directors for amounts owing under the *Income Tax Act*, the *Excise Tax Act*, and the *Air Travellers Security Charge Act*. Furthermore, although amounts owing under the *Excise Act 2001* and the *Softwood Lumber Products Export Charge Act, 2006,* are not considered trust funds, directors can be held liable.

Section 16 deals **only** with the collection of **amounts owing** under the *Customs Act* and other legislation related to goods imported into Canada. While you can get more information about collection of such amounts from your tax services office, you should direct questions on any other issues related to the importation of goods to your nearest customs office.

Section 17 provides a final word and explains how to get more information.

In this circular, we use the term **person** to include, as applicable, individual and corporate taxpayers, partnerships, employers and remitters of source deductions, GST/HST registrants, individuals and corporations that receive GST/HST rebates, licencees, importers/exporters, customs brokers, and international travellers.

1. Payment and other obligations

Employees who file an income tax return each spring will likely have paid part or all of their taxes through amounts their employers deducted from their income. The amount an employer deducts depends on the credits employees claimed on Form TD1, *Personal Tax Credits Return*. If an employee's situation changes during the year, or if the information on the form is out-of-date, the employee should fill out a new TD1 form so that the employer can deduct the proper amount of tax from the employee's income. If the employer makes regular deductions, it is less likely that the employee will have to pay a large tax balance when it is time to file an income tax return.

Self-employed and other individuals whose income tax is not payroll or source deducted, or only partially so, may have to make instalment payments. Doing so will help them avoid a large balance owing when it is time to file their income tax return. Please see the pamphlet P110, *Paying Your Income Tax by Instalments,* to determine if you should be making instalment payments for your **current** tax year. We charge interest and in some cases a penalty, on late or insufficient instalments.

Most corporations have to make monthly income tax instalment payments throughout the year for their **current** tax year or fiscal year. This measure helps ensure that any balance owing at the end of a corporation's fiscal year will be minimal. We charge interest on late or insufficient corporation income tax instalments. For more details on corporation income tax instalments, please see publications T4012, *T2 Corporation – Income Tax Guide,* T7B-CORP*, Corporation Instalment Guide*. Effective April 1, 2007, a new penalty applies when a person fails to file a return for a reporting period as and when required under the *Excise Tax Act,* the *Excise Act 2001*, the *Softwood Lumber Products Export Charge Act, 2006* and the *Air Travellers Security Charge Act*. The amount of the penalty payable by the person is based on the total of all amounts required to be paid for a reporting period that were not paid on the day on which the return was required to be filed and the number of complete months that the return remains oustanding. Specifically, the amount of penalty that becomes payable will first be calculated by taking 1 per cent of the total of all amounts, each of

Digitized by Google

which was required to be paid for the period and which were not paid on the day on which the return was required to be filed. To that amount an additional amount will be added, equal to ¼ per cent of the total of all amounts determined above multiplied by the number of complete months, not exceeding 12, that the return remains outstanding. A person shall pay a failure to file penalty if the person misses a due date for filling a return required under the Act. The Minister of National Revenue is not required to first serve the person with a demand for a return. This new penalty is modelled after the failure to file penalty under the *Income Tax Act*, although the rates applied under these Acts are lower.

Balances owing under the *Income Tax Act* are payable no later than:
• April 30 of the following tax year, for **individuals**;
• 90 days after the end of the tax year, for a **trust** (T3);
• April 30 of the following year, for a **deceased person** who has died within the period of January 1 to October 31;
• six months after the date of death, for a **deceased person** who has died within the period of November 1 to December 31. (For greater detail, see publication T4011*, Preparing Returns for Deceased Persons*.)
• two months or, in some cases, three months from the end of the fiscal period, for **corporations** (even though they have up to 6 months to file their T2 return); and
• the 15th day of the month after the month they were deducted (must be **received** on or before the 15th) for **payroll deductions**, except for:
(i) **accelerated remitters** who must remit more frequently; or
(ii) **small business employers** who are notified by us that they qualify for quarterly remittances of payroll deductions.
(For greater detail, see the employers' guide T4001, Payroll Deductions and Remittances)

Balances owing for GST/HST under Part IX of the *Excise Tax Act* are payable no later than:
• the end of the month following the end of the reporting period, for a GST/HST registrant **who is a monthly or quarterly filer**; or
• the end of the third month following the end of the reporting period, for a GST/HST registrant **who is an annual filer**.
(For greater detail, see publication RC4022, *General Information for GST/HST Registrants*.)

Balances owing under Parts I to VII of the *Excise Tax Act* for other taxes are payable as follows:
• not later than the last day of the month following the end of the reporting periods.

Balances owing under the *Excise Act 2001* are payable as follows:
• not later than the last day of the first month after each fiscal month of the person;
• differently for duties on tobacco (see sections 42 and 43 of the EA 2001).

Balances owing under the *Air Travellers Security Charge Act* are payable as follows:
• not later than the last day of the first month after each fiscal month of the carrier.

Balances owing under the *Excise Act* are payable as follows:
• no later than the second to last business day of the month following the month during which the beer was produced.

Balances owing under the *Softwood Lumber Products Export Charge Act, 2006* are payable as follows:

Digitized by Google

• not later than the last day of the first month after each fiscal month of the person.

Under the *Income Tax Act*, on any unpaid amount assessed, we charge interest that is compounded daily from the date the amount is due until it is paid. Also, where a person fails to deduct, withhold, remit or pay an amount deducted or withheld, the person is liable to a penalty of 10% of the amount. If the failure was made knowingly or under circumstances amounting to gross negligence the penalty is 20% of the amount. Under the *Excise Tax Act*, we charge interest on unpaid GST/HST and these are also compounded daily until the amount owing is paid. For taxes other than GST/HST, we charge interest that is compounded daily from the date the amount is due until the day the amount owing is paid.
Under the *Excise Act 2001*, we charge interest that is compounded daily from the date the amount is due until the day the amount owing is paid.
Under the *Air Travellers Security Charge Act*, we charge interest that is compounded daily from the date the amount is due until the day the amount owing is paid.
Under the *Excise Act*, we charge penalty and interest that is compounded daily from the date the amount is due until the day the amount owing is paid.
Under the *Softwood Lumber Products Export Charge Act, 2006,* we charge interest that is compounded daily from the date the amount is due until the day the amount owing is paid.

2. Collection and enforcement
Except for the types of assessments listed in section 8 of this circular, "*Exceptions to collection restrictions*," we will not usually start legal action until 90 days after the day we mail a *Notice of Assessment* or a *Notice of Reassessment.* Effective April 1, 2007, the 90 day collection restriction does not apply anymore on deductions or Set-offs which can be sent following the issuance of the Notice of Assessment or Notice of Reassessment except for the *Softwood Lumber Products Export Charge Act, 2006, which still has the 90-day collection restriction*.
Any amount you owe is payable immediately when assessed or reassessed. If you do not agree with the assessment or reassessment, see Section 9 of this circular. If you cannot pay the total amount owing immediately, please contact the Revenue Collections Division of your Tax Services Office to discuss a mutually satisfactory short-term payment arrangement based on your ability to pay. We will consider payment arrangements when you have tried all reasonable ways of getting the necessary funds, either by borrowing or rearranging your financial affairs, and you still cannot pay the balance in full.
To help us determine your ability to pay, you will have to make full disclosure and give evidence of your income, expenses, assets, and liabilities. Collection officers may verify the information you provide before accepting an arrangement.
Should you not agree with the decision made by a collections officer, you have the right to discuss the matter with his or her supervisor. Officers will provide you with their supervisor's name and telephone number on request. However, if your debt remains unpaid with no mutually acceptable payment arrangement, we may take legal action such as garnisheeing your income (i.e., we may intercept funds payable to you) or initiate other legal actions such as issuing a set-off or directing a sheriff to seize and sell your assets. (See section 6 of this circular, "Legal action to collect.")
If you cannot make a payment on your liability, we may allow you to postpone payment until your financial situation improves. During that time, any interest and/or penalties that apply will continue to accrue on the liability. There may be exceptional situations when we may waive or cancel penalties and interest under the Taxpayer Relief Provisions. (See section 3 of this circular for greater detail.)

3. Taxpayer Relief Provisions
The "taxpayer relief provisions" apply to interest and penalty only.

Digitized by Google

We may waive or cancel part or all of penalty and interest charged on amounts owing, for ten calendar years after:
• the end of a taxation year under the *Income Tax Act*;
• the end of a reporting period for GST/HST under the *Excise Tax Act*;
• the end of a reporting period under Parts I to VII of the *Excise Tax Act;*
• the day an amount was required to be paid under the *Excise Act 2001*; and
• the end of a fiscal month under the *Air Travellers Security Charge Act*.
• the end of a reporting period under the *Softwood Lumber Products Export Charge Act, 2006,*
We may consider these actions when you are prevented from making a payment when due, or otherwise complying with the above acts because of circumstances beyond your control.
Such circumstances include:
• natural or man-made disasters, such as a flood or fire;
• civil disturbances or disruptions in services such as a postal strike;
• a serious illness or accident; and
• serious emotional or mental distress caused by a death in the immediate family.
We may also cancel or waive interest or penalty charges if such charges were mainly the result of our own actions, such as if material available to the public contained errors which led taxpayers to file returns or make payments based on incorrect information.
Also, we may waive or cancel all or part of interest and/or penalty charges where there is an inability to pay beyond your control. For example:
• collection has been suspended because of an inability to pay caused by the loss of employment and the person is experiencing financial hardship; or
• a person is unable to conclude a reasonable payment arrangement because the interest and penalty charges absorb a significant part of the payments. In such a case, we may consider waiving interest and penalties in full or in part, for the period from when payments start until amounts owing are paid, provided the agreed payments are made on time in accordance with your ability to pay.
You, or your authorized representative, can make a written request to your tax services office to cancel or waive interest and penalties. You can get more details in Information Circular IC07-1, *Taxpayer Relief Provisions*, and in GST Memorandum 500-3-2-1, *Cancellation or Waiver of Penalties and Interest.*
We can usually finalize a taxpayer relief request within four to six weeks, if we have all the supporting information.

4. Disagreement with an amount owing

If you disagree with, or if you do not understand an assessment or a reassessment, you should contact the Client Services Division of your tax services office immediately for an explanation. If you cannot resolve the matter in this manner, you can file an objection. In section 9 of this circular, we discuss objections and appeals.

5. Acceptance of security

We will accept adequate security instead of payment under some circumstances.
For example, if the Tax Court of Canada or the Canadian International Trade Tribunal dismisses your appeal and you exercise your right to appeal to a higher court, we will ask you to immediately pay the full amount owing regardless of your further rights to appeal. However, we will accept adequate security instead of payment, such as a Bank Letter of Guarantee (Letter of Credit).
In addition, for certain elections under the *Income Tax Act,* you have to provide adequate security for us to accept the election.
You or your representative should contact the Revenue Collections Division of your tax services office for more information about security, such as mandatory clauses for Bank Letters of Guarantee or Mortgages.

Digitized by Google

6. Legal action to collect

If you do not pay an amount voluntarily, we may take legal action to:

- garnishee wages or other income sources;
- seize and sell assets; or
- use any other means under any applicable statutes or laws to collect an amount owing.

Garnishment action allows us to intercept funds payable to you by a third party, such as wages or other income sources. Similarly, if any other federal government department owes you money, we can issue a requirement for set-off to that department to have all or part of that money sent to us. We will then apply this amount against your outstanding balance. We will notify you by mail of the garnishment or set-off action.

The *Income Tax Act*, the *Excise Tax Act,* the *Excise Act 2001*, *the Softwood Lumber Products Export Charge Act, 2006* and the *Air Travellers Security Charge Act* provide for the registration of a certificate in the Federal Court of Canada for unpaid amounts. Once registered, the certificate has the same force and effect as a judgment obtained in the Court. When the debt is certified, we will usually notify you by mail. If you still do not pay the amount, we may obtain a writ or memorial and seize assets and/or property, and have it advertised and sold by the sheriff. You have to pay all reasonable costs and charges incurred to collect the amount certified, and are still liable for any remaining balance. All proceeds from the sale remaining after costs and charges are paid will be applied to the debt. Once we undertake set-off, garnishment, or other legal proceedings, we will not usually withdraw them until the account is paid in full, or it can be shown that the action is causing undue hardship.

7. Collection restrictions

Except as outlined in section 8 of this circular, we cannot normally initiate the following types of legal action until 90 days after the day we mail the *Notice of Assessment* or *Notice of Reassessment*:

- begin legal proceedings in a court;
- certify the amount in the Federal Court under section 223 of *the Income Tax Act*, section 83 of the *Excise Tax Act*, section 88 of the *Softwood Lumber Products Export Charge Act, 2006* or section 288 of the *Excise Act 2001*;
- require a third party who owes a person money to make a payment under subsection 224(1) of the *Income Tax Act*, subsection 84(1) of the *Excise Tax Act*, subsection 89(1) of the *Softwood Lumber Products Export Charge Act, 2006* or subsection 289(1) of the *Excise Act 2001*;
- require an institution or other third party who is lending or advancing a person money to make a payment under subsection 224(1.1) of the *Income Tax Act*, subsection 84(3) of the *Excise Tax Act,* subsection 89(2) of the *Softwood Lumber Products Export Charge Act, 2006* or subsection 289(2) of the *Excise Act 2001*;
- require a person to turn over money under subsection 224.3(1) of the *Income Tax Act*, subsection 92(1) of the *Softwood Lumber Products Export Charge Act, 2006* or subsection 292(1) of the *Excise Act 2001*;

and

- give a notice, issue a certificate, or make a direction under subsection 225(1) of *the Income Tax Act,* subsection 93(1) of the *Softwood Lumber Products Export Charge Act, 2006* or subsection 293(1) of the *Excise Act 2001*.

8. Exceptions to collection restrictions

The restrictions to our ability to take legal action, outlined in section 7 of this circular, **do not apply** to assessments issued for the following items:

- Amounts deemed to be held in trust, (see section 15 of this information circular, “Trust funds.”)

Digitized by Google

including:
(i) an amount deducted or withheld, and required to be remitted or paid under the *Income Tax Act,* the *Canada Pension Plan, Unemployment Insurance Act*, *Employment Insurance Act,* or a regulation made under those Acts (i.e., payroll and other source deductions);
(ii) GST/HST collected as or on account of tax under Division II, Part IX of the *Excise Tax Act*; and
(iii) charges collected under the *Air Travellers Security Charge Act*.
The restrictions also do not apply to the following:
Under the *Income Tax Act*:
• Scientific research and experimental development tax credits – an amount payable under Part VIII of the *Income Tax Act*.
• Non-resident tax – an amount of tax required to be paid under section 116, or under a regulation made under subsection 215(4) of the *Income Tax Act*, that has not been paid.
• Penalties – the amount of any penalty payable for failure to remit or pay a deemed trust amount, as and when required by the *Income Tax Act*, *Canada Pension Plan*, *Unemployment Insurance Act*, *Employment Insurance Act*, or a regulation made under those Acts.
• Interest – any interest payable under a provision of the *Excise Tax Act, Income Tax Act*, *Canada Pension Plan*, *Unemployment Insurance Act*, and *Employment Insurance Act* on an amount referred to in any of the above paragraphs.
• Large corporations – for income tax purposes only, where a large corporation as defined in subsection 225.1(8) of the *Income Tax Act* has been assessed, we may take action to collect half of the amount assessed at any time during the first 90 days after the amount is assessed, regardless of whether an objection or appeal has been filed. After this 90-day period, if there is no objection or appeal, we can collect the outstanding balance. After the 90-day period, where an objection or appeal is filed, we can collect up to half of the amount under dispute and any balance not in dispute.
• A reassessment with the taxpayer's consent under subsection 152(4.2).
• A reassessment after the dispostion of an appeal with the consent in writing from the taxpayer under subsection 169(3).
• A reassessment after the waiver of penalty and/or interest under subsection 220(3.1).
Under the *Excise Tax Act*:
• Any penalties or fines imposed pursuant to a conviction for an offence under the act.
• A reassessment issued following an objection pursuant to subsection 81.15(4) or an appeal pursuant to subsection 81.38(1).
• Amounts payable after the dispostion of an appeal or further appeal under subsection 81.39(2) and (3).
Under the *Excise Act 2001*:
• If the total of all amounts assessed that remain unpaid exceeds $1,000,000, 50% of the total amounts.
In addition, the collection restrictions, outlined in section 7 of this circular, do not apply if collection of all or part of an assessed amount would be jeopardized if there were a delay in collecting it. Section 12 of this circular, "Special provisions," discusses collections in jeopardy.

9. Objections and appeals

If you do not agree with an income tax assessment, you can file an objection by either writing a letter or by completing Form T400A, *Objection – Income Tax Act*, and sending it to the Assistant Director, Appeals, in your tax services office or tax centre.
To file an objection to a CPP or EI assessment for the premiums that we indicate you owe, either write a letter or complete Form CPT100, *Appeal Under the Canada Pension Plan and/or Employment Insurance Act,* and send it to the Assistant Director, Appeals, in your tax services office. If you do not agree with a GST/HST assessment or determination under Part IX of the *Excise*

Digitized by Google

Tax Act, you can file an objection by completing Form GST159, *Notice of Objection (GST/HST),* and sending it to the Assistant Director, Appeals, of your tax services office. Form E413, *Notice of Objection (Excise Tax Act)*, must be used for objections to other taxes assessed under the *Excise Tax Act*. If you do not agree with an assessment under the *Excise Act 2001*, you can file an objection by completing Form E680 Notice of Objection (*Excise Act 2001*) and send it to the Assistant Director, Appeals, at your tax services office.

If you do not agree with an assessment under the *Air Travellers Security Charge Act*, you can file an objection by completing Form E676 Notice of Objection (*Air Travellers Security Charge Act*) and send it to the Assistant Director, Appeals, at your tax services office.

If you do not agree with an assessment under the *Softwood Lumber Products Export Charge Act, 2006*, you can file an objection by completing Form Notice of Objection (*Softwood Lumber Products Export Charge Act, 2006*) and send it to the Assistant Director, Appeals, at your tax services office.

The time limit for individuals (other than trusts) and testamentary trusts to object to income tax assessments is the later of the following two dates: one year from the return's filing due date or 90 days after the date of the mailing of the assessment or reassessment notice. The time limit to object to an income tax assessment in all other cases and to an assessment made under the *Excise Tax Act* (including GST/HST), the *Excise Act 2001,* the *Softwood Lumber Products Export Charge Act, 2006* and the *Air Travellers Security Charge Act* is 90 days after the date of mailing of the *Notice of Assessment* or *Notice of Reassessment*.

Under the *Income Tax Act*, the *Excise Tax Act*, the *Excise Act 2001,* the *Softwood Lumber Products Export Charge Act, 2006* and the *Air Travellers Security Charge Act* you may request in writing an extension of time to file an objection. You can get more information from your tax services office.

For income tax purposes:

• When you file an objection, we normally do not take any legal action on the disputed balance until 90 days after the date the Appeals Division mails a notice confirming or varying the assessment under objection. If you appeal the decision to the Tax Court of Canada or the Canadian International Trade Tribunal, we do not normally take any legal action until the court mails its decision or you discontinue the appeal. (See section 8 of this circular for exceptions.)

• If the court dismisses your appeal or you discontinue it, we will ask you to immediately pay the full amount owing regardless of any further rights of appeal or judicial review you may have or wish to exercise. If you do not pay or provide acceptable security, we may initiate legal action to collect the debt. However, under the *Income Tax Act* we will refund to you what you have paid on disputed amounts for which you have been successful in subsequent appeals, with applicable interest. (See section 5 of this circular, "Acceptance of security.")

• If, under subsections 225.1(5) of the *Income Tax Act*, 286(7) of the *Excise Act 2001,* 86(5) of the *Softwood Lumber Products Export Charge Act, 2006* or 86(8) of the *Excise Tax Act*, you file an objection or appeal to the Tax Court of Canada, the Canadian International Trade Tribunal or the Federal Court of Appeal, and you agree in writing to delay proceedings until judgment has been given in a similar action before the Tax Court of Canada, Federal Court of Appeal, or the Supreme Court of Canada, we cannot take legal action until we notify you in writing of the Court's decision.

• When a large corporation, as defined in subsection 225.1(8) of the *Income Tax Act*, has been assessed, we may take action to collect under subsection 225.1(7) of the *Income Tax Act* half of the amount assessed at any time during the first 90 days after the amount is assessed, regardless of whether the assessment is under dispute. Where an objection or appeal is filed, we can collect up to half of the amount under dispute and any balance not in dispute.

• When an assessed amount is under dispute and a delay would jeopardize its collection, there are provisions to permit us to take immediate collection action. (See section 12 of this circular, "Special provisions.") Interest under the *Income Tax Act,* the *Excise Tax Act,* the *Excise Act 2001,* the *Air Travellers Security Charge Act,* the *Softwood Lumber Products Export Charge Act, 2006* and the *Excise Tax Act* is charged at the prescribed rate on all amounts owing, regardless of whether they

Digitized by Google

are disputed or not. We can take action to collect amounts owed as a result of assessments listed in section 8 of this circular **even if you file an objection or an appeal**.

10. Repayment of disputed amounts (Income Tax Act)

If the Appeals Division has not confirmed or varied an income tax assessment within 120 days of the date a notice of objection is served, you can apply in writing for the return of all amounts paid with respect to amounts in dispute, or the release of any security provided for the tax in dispute. A disputed amount may include taxes, interest, penalties, or other amounts payable.

Similarly, if you appeal an income tax assessment to the Tax Court of Canada, you can request the return of any disputed amount which has been paid, or the return of any security provided for the amount in dispute. This does not apply to security provided or amounts paid by non-resident persons for amounts in dispute regarding the disposition of particular types of taxable Canadian properties and Canadian resource properties.

A large corporation, within the meaning assigned by subsection 225.1(8) of the *Income Tax Act*, is entitled to a repayment or return of security of one half of the disputed amount.

However, if making a repayment or surrendering security could jeopardize collection of the disputed amount, we may apply for a judicial order to permit us to retain the payment or the security.

Under the other acts, there is no requirement to reimburse any amount paid or return security pledged on a disputed assessment.

11. Refunds applied to other debts

A refund will not be paid to a person until the person has filed with the Minister all returns and other records of which the Minister has knowledge that the person is required to file under the *Income Tax Act*, the *Excise Tax Act,* the *Excise Act 2001* and the *Air Travellers Security Charge Act*.

We can offset (apply against another debt) your repayment or refund to debts for which you are liable. However, for debts that relate to the *Income Tax Act*, we will not usually offset a refund against an outstanding amount, other than a deemed trust debt, if the amount owing is the subject of an objection or appeal on which neither CRA's Appeals Division nor the Court has made a decision.

12. Special provisions

It is our policy to approach tax compliance consistently and responsibly. There are cases when we must use the enforcement provisions of the *Income Tax Act*, the *Excise Tax Act,* the *Softwood Lumber Products Export Charge Act, 2006* or the *Excise Act 2001* because our ability to collect taxes has been, or is likely to be, defeated by the transfer, sale, loss, relocation, or other disposition of a person's assets.

a) Collection in jeopardy

When we have reasonable grounds to believe that the collection of all or part of an amount we have assessed would be jeopardized if there were a delay in collecting it, we can take action. Under the *Income Tax Act,* the *Softwood Lumber Products Export Charge Act, 2006* and the *Excise Act 2001*, a judge of a superior court of a province or of the Federal Court of Canada can authorize us to take collection action at once. When we are granted such an authorization, you have the right to apply to a court for a judicial review of it. Since we are not restricted from taking collection action for payroll or other source deduction amounts, we do not have to apply to the courts before taking such action.

A similar provision is available under the *Excise Tax Act* for amounts other than Part IX (GST/HST) amounts, with the exception that the Minister of National Revenue or a delegated authority may approve the action. For GST/HST amounts under Part IX, we do not have to apply to the courts before taking such action on amounts that have already been assessed. However, for the net tax of a reporting period that is remittable but not yet payable, the agency can apply to a judge of the superior court of a province or the Federal Court to obtain judicial authorization to assess the

Digitized by Google

amount determined by the Minister to be remittable by a registrant at the time the application is heard and to take action to recover that amount.
If we believe that you have left or are about to leave Canada, we can require you to immediately pay all amounts owed, whether or not due at the time. If you do not make the payment, we can seize your goods and chattels.

b) Property transfers

If you have an amount owing under the *Income Tax Act,* Part IX (GST/HST) of the *Excise Tax Act*, the *Softwood Lumber Products Export Charge Act, 2006* or the *Excise Act 2001* for the tax year or reporting period in which you transfer property, or previous tax years or reporting periods, the following rules under section 160 of the *Income Tax Act,* section 325 of the *Excise Tax Act,* section 96 of the *Softwood Lumber Products Export Charge Act, 2006* and section 297 of the *Excise Act 2001* apply.
Under the above conditions, if you transfer property to

- a spouse or a person who has since become your spouse,
- a person under 18 years of age, or
- a person with whom you were not dealing at arm's length, the person to whom you transfer property becomes liable for the lesser of the amount you owe, or the excess of the fair market value of the property over the consideration given for the property.

These rules do not apply to a transfer of property between you and your spouse under a decree, order, or judgment of a competent tribunal, or under a written separation agreement where, at the time of transfer, you and your spouse were separated and living apart as a result of the breakdown of your marriage. For transfers occurring after 1992, marriage includes a common-law relationship.

c) Prosecution for failing to file a return

If you fail to file a return as and when required under the *Income Tax Act*, Part IX (GST/HST) of the *Excise Tax Act* or the *Air Travellers Security Charge Act*, you are guilty of an offence. If you are convicted, you are liable to a fine of between $1,000 and $25,000, or both a fine and imprisonment for up to 12 months. For failure to file returns other than GST/HST returns, the *Excise Tax Act* provides for a fine of between $10 and $100. Under the *Excise Act 2001* the liability on summary conviction to a fine is not more than $100,000 or to imprisonment for a term of not more than 12 months, or both.

13. Amounts owing by estates of deceased persons

If a deceased person's estate has amounts payable or remittable, we will contact the executor or administrator of the estate and ask for payment of the outstanding amounts. If the executor or administrator does not comply, we may take legal action to collect the debt.
Before distributing the assets of an estate, the executor or administrator must get a clearance certificate from us. The certificate will state that all amounts assessed or liable to be assessed have been paid or secured by the estate.
If executors or administrators distribute some of the assets of the estate before they get a clearance certificate, they will be liable, to the extent of the value of the assets distributed, for any amounts that have not been paid or are assessed later. For more information, contact your tax services office. (For greater detail, see publication T4011*, Preparing Returns for Deceased Persons*.)

14. Confidentiality

To preserve the right to confidentiality, we will only release your confidential information to your authorized representatives, or as the law authorizes us. It is our policy to confirm the identity and authorization of all parties concerned before we release confidential information. However, if it is necessary for us to take legal action, the legal documents will contain certain aspects of a person's tax liability, such as the amount and type of debt owed.

Digitized by Google

15. Trust funds

The collection restrictions outlined in section 7 of this circular do not apply to trust funds described in this section.

You are deemed to hold the following amounts in trust:

Under *the Income Tax Act*

• amounts that are deducted from employees and other individuals for:

(i) income tax;

(ii) Canada Pension Plan (CPP) contributions; and

(iii) Employment Insurance (EI) premiums.

Under Part IX of the *Excise Tax Act*

• amounts collected as or on account of GST/HST, less allowable input tax credits.

Under the *Air Travellers Security Charge Act*

• amounts collected as or on account of charges on air transportation service.

You have to send us these amounts as the legislation requires. You must also include the employer's portion of CPP and EI when remitting source deductions. For a GST/HST amount, you can deduct allowable input tax credits before remitting it.

If you do not comply with the legislation that applies, we will assess the amount owing and ask you to immediately pay the full balance, including interest and any penalties that apply. If you do not pay the balance owing, we may, at the time we issue a *Notice of Assessment*, garnishee your sources of funds (including trade receivables, bank deposits, loans, advances, and other income), or we may begin to seize and sell assets. Any assets we seize will be sold by sheriff's auction, unless the account is promptly paid in full, including any costs resulting from this action.

We may hold the directors of a corporation jointly and severally liable if the corporation fails to deduct, withhold, or remit amounts deemed to be held in trust, and we are unable to collect from the corporation. In addition, the directors are jointly and severally liable, with the corporation, to pay any penalty or interest that has accrued or will accrue on outstanding amounts.

Once we have issued assessments against directors, we will not usually start legal action against them before 90 days have passed from the day we mail the *Notice of Assessment*, or while the assessments are under objection or appeal. When these limitations do not apply, we may without delay garnishee the personal income of the directors that have been held liable, or we may seize and sell their personal assets if they do not voluntarily remit the amounts the corporation failed to deduct or remit. For more information about the rights and obligations of directors of a corporation, contact your tax services office. Information Circular 89-2R2, *Directors' Liability – Section 227.1 of the Income Tax Act, Section 323 of the Excise Tax Act, Section 81 of the Air Travellers Security Charge Act and subsection 295(1) of the Excise Act 2001*, also gives more information on this topic.

It is an offence to withhold amounts but fail to remit them to the Receiver General for Canada or willfully fail to pay, collect, or remit GST/HST, or net tax. Under the *Income Tax Act* and the *Air Travellers Security Charge Act*, if convicted, you are liable to a fine of between $1,000 and $25,000, or both a fine and imprisonment for up to 12 months. Under the *Excise Tax Act*, if convicted, you are liable to a fine of $1,000 plus 20% of the GST/HST or net tax that you should have paid, collected, or remitted, or both a fine and imprisonment for up to six months.

16. Customs – Canada Borders Service Agency (CBSA)

This section deals only with certain general aspects of the customs collection policy that applies to any duty, tax, fee, penalty, charge, or other amount owing to the Crown related to goods imported into Canada. These amounts may be owing under the *Customs Act, Customs Tariff, Excise Tax Act, Special Import Measures Act,* and/or related regulations, referred to as the applicable Acts. For further information on collection policy, contact your tax services office. For information on any other customs issue, contact the nearest customs office.

Digitized by Google

Payment obligations
A person must present a complete entry document to customs for goods imported. Such a document includes declarations on the value for duty, origin, and tariff classification of those goods. The person must also pay any duties and taxes owing, or post security where applicable, when goods enter Canada. Customs will not release goods for which these amounts are not paid or secured at the time of arrival. More information about security can be found in CBSA Memorandum D17-1-5, *Importing Commercial Goods*.

Re-determination
CBSA may re-determine the origin, tariff classification, or value for duty of the goods. As a result, the person may owe additional duties, taxes, or other charges such as interest back to the 31st day after the person should have paid the duties and taxes. The person must normally pay these amounts within 30 days of CBSA decision.

Interest
Where authorized by the applicable Acts, we will charge daily compound interest at either the prescribed or specified rate, from the day after the amount was owed to the Crown up to and including the day the amount owing is paid. Where authorized by the *Special Import Measures Act*, we will charge simple monthly interest at the prescribed rate up to and including the day the amount owing to the Crown is paid. Under the *Special Import Measures Act*, any fraction of a month is considered to be a full month. More information on interest provisions can be found in CBSA Memorandum D11-6-5, *Interest and Penalty Provisions: Determinations/Re-Determinations, Appraisals/Re-Appraisals and Duty Relief*, or *CBSA* Memorandum D14-1-6*, Liability for Payment of Provisional*
Duty, Anti-dumping Duty and Countervailing Duty Under the Special Import Measures Act.

Enforcement
When goods are not reported, or are reported falsely to customs, the *Customs Act* allows CBSA to seize the goods. In cases where the goods are not available for seizure or are impractical to seize, section 124 of the *Customs Act* allows for the issuance of a *Notice of Ascertained Forfeiture*, assessing an amount of money in lieu of a seizure. A *Notice of Penalty Assessment* may also be issued under section 109.3 for a contravention of the *Customs Act*. Any amount of money demanded in a *Notice of Ascertained Forfeiture* or a *Notice of Penalty Assessment* becomes payable on the day the notice is served on the person. That person is in default and subject to collection action unless the person pays the amount owing or, within 90 days after the date of service of the notice, requests a decision of the Minister under section 131 of the *Customs Act*.

Notice of Arrears
If a person does not pay the amounts owing within 30 days of the date the amount was due, CRA will issue a *Notice of Arrears*.

Collection and legal action
If you do not pay an amount voluntarily, we may take legal action to:
• garnishee wages or other income sources;
• seize and sell assets; or
• use any other means under the applicable statutes or laws to collect an amount owing.
Garnishment action allows us to intercept funds payable to you by a third party, such as wages or other income sources. Similarily, if any other federal government department owes you money, we can issue a requirement for set-off to that department to have all or part of that money sent to us.

Digitized by Google

We will then apply this amount against your outstanding balance. We will notify you by mail of the garnishment or set-off action. The Act provides for the registration of a certificate in the Federal Court for unpaid amounts. Once registered, the certificate has the same force and effect as a judgment obtained in the Court. When the debt is certified, we will usually notify you by mail. If you still do not pay the amount, we may obtain a writ of memorial and seize assets/or property, and have it advertised and sold by the sheriff. You have to pay all reasonable costs and charges incurred to collect the amount certified, and are still liable for any remaining balance. All proceeds from the sale remaining after costs and charges are paid will be applied to the debt. Once we undertake set-off, garnishment, or other legal proceedings, we will not usually withdraw them until the account is paid in full, or it can be shown that the action is causing undue hardship. We may suspend your importation privileges as well as take lien action against goods imported by or reported for exportation by you. These goods may be detained and sold to satisfy the amount demanded in the notice. We will continue to detain and sell imported and exported goods or continue other legal proceedings against you, until the amount owing to the Crown is paid in full, unless other acceptable payment arrangements are made to suspend these actions.

Collection restrictions

If a person is liable for the payment of an amount under this Act, if an amount is demanded in a notice served under section 109.3 or 124, or if an amount is demanded under paragraph 133(1)(c) or subsection 133(1.1) in a notice served under subsection 131(2), we will not take the following actions until the ninety-first day after the day the notice is given to the debtor:

- begin legal proceedings in court;
- certify the amount under section 97.24 of the *Customs Act*;
- garnishee a person's wages; and
- require the retention of an amount the federal government owes to a person by way of deduction or set-off under section 97.26 of the *Customs Act*.

Alternative payment arrangements

We will consider alternative payment arrangements when you have tried all reasonable ways of getting the necessary funds, either by borrowing or rearranging your financial affairs, and you still cannot pay the balance in full. In this situation, you should contact the Revenue Collections Division of your tax services office, or the office shown on the *Notice of Arrears,* to discuss a mutually satisfactory short-term payment arrangement based on your ability to pay.

When determining ability to pay, we will expect you to make a full disclosure and give tangible evidence of your income, expenses, assets, and liabilities. Collections officers may verify the information you provide before accepting an arrangement. However, if your debt stays outstanding with no mutually acceptable payment arrangement, we may take legal action such as garnisheeing your income (i.e., we may intercept funds payable to you) or directing a sheriff to seize and sell your assets.

If you cannot make a payment for your liability, we may allow you to defer payment until your financial situation improves. During that time any interest or penalty that apply will continue to accrue on the liability. There may be exceptional situations when we may consider waiving or canceling interest or penalties under the interest and penalty provisions.

Interest and penalty provisions

We may waive or cancel part or all interest or penalty charges payable under the *Customs Act* and the *Customs Tariff*. We may consider these actions when you are prevented from making a payment when due, or otherwise complying with the *Customs Act* or *Customs Tariff* because of circumstances beyond your control. Such circumstances include:

- natural or human-made disasters, such as flood or fire (which destroy the records of the importer);

Digitized by Google

• civil disturbances or disruptions in service, such as a postal strike;
• death or incapacity of the person who is directly responsible for ensuring the importer's compliance;
• errors proven to have been committed by employees of the CRA or CBSA which resulted in incorrect information being supplied to the importer; and
• material published by the CRA or CBSA, directed to the importing public, which contained errors that resulted in the importer's actions giving rise to the interest or penalty.

It may also be appropriate to waive or cancel all or part of interest and penalty charges where there is an inability to pay beyond your control. For example:
• when collection action has been suspended due to an inability to pay; or
• when an importer is unable to conclude a reasonable payment arrangement because the interest charges absorb a significant portion of the payments.

In such cases, we may consider waiving interest and penalties, in whole or in part, for the period when payments start until the amounts owing are paid. However, the agreed payments have to be made on time. You, or your authorized representative, can make a written request to the tax services office or the office shown on the *Notice of Arrears* for a waiver or cancellation of interest and/or penalties. More information about the guidelines for canceling and waiving interest and penalties can be found in CBSA Memorandum D11-6-5, *Interest and Penalty Provisions: Determinations/Re-Determinations, Appraisals/Re-Appraisals and Duty Relief*.

Under the *Special Import Measures Act*, there is no authority to cancel or waive any interest payable.

Disputes and appeals

Appeals of Notices of Arrears

Section 97.23 of the *Customs Act* provides that a person to whom a *Notice of Arrears* is sent or delivered under subsection 97.22(1) may appeal the notice up to 30 days after the notice is sent or delivered by way of an action in the Federal Court, if no appeal is or was available under section 67 or 68 of the *Customs Act*. This, therefore, excludes assessments resulting from CBSA decisions concerning the origin, tariff classification, or value for duty of imported goods.

Seizures and forfeitures appeal process

Where a contravention of the *Customs Act* has been alleged and a seizure made or a *Notice of Ascertained Forfeiture* or a *Notice of Penalty Assessment* issued, you may request a decision of the Minister under section 131 of the *Customs Act* within 90 days of the date of the seizure or the service of the notice.

Where you have requested a decision of the Minister and the decision rendered demands payment of an amount of money, you may within 90 days after being notified of the decision, appeal the CBSA decision by way of an action in the Federal Court. For more information on the appeal process or request for a CBSA review, write to the following address:

Recourse Directorate
Adjudications Division
Admissibility Branch
Canada Border Services Agency
Ottawa ON K1A 0L5

Disputes and appeals concerning origin, tariff classification, or value for duty

If you are not satisfied with a CBSA decision about the origin, tariff classification, or value for duty of goods (and its related determination or re-determination), you may dispute that decision by filing

Digitized by Google

Form B2, *Canada Customs – Adjustment Request*, within 90 days of that decision. Before doing so, you must pay any amounts owing or post security satisfactory to the Minister.
More information about the dispute resolution process can be found in CBSA Memorandum D11-6-7, *Importers' Dispute Resolution Process for Origin, Tariff Classification, and Value for Duty of Imported Goods*. You may subsequently appeal a CBSA dispute decision with which you are not satisfied to the Canadian International Trade Tribunal within 90 days after the date the notice of dispute decision was given. A further appeal is available to the Federal Court of Appeal on any question of law. For more information on the CBSA dispute resolution process or your rights of appeal, contact the Recourse section of your regional customs office.

Appeals under the Special Import Measures Act
Under the *Special Import Measures Act*, an appeal will not be accepted unless the amounts owing are paid in full. For information on this appeal or request for a re-determination process, write to the following address:
Trade Programs Directorate
Anti-dumping and Countervailing Program
Admissibility Branch
Canada Border Services Agency
Ottawa ON K1A 0L5
More information can be found in CBSA
Memorandum D14-1-3, *Procedures for Filing an Appeal or to Make a Request for Re-Determination of Goods Under the Special Import Measures Act*.

17. A final word
Our collection policies help us apply the law fairly. Our procedures are designed to allow us to consider each person's financial situation. At the same time, we have an obligation to uniformly and fairly apply the provisions of the *Income Tax Act, Excise Tax Act, Excise Act 2001, Air Travellers Security Charge Act, Excise Act, Customs Act, Softwood Lumber Products Export Charge Act, 2006, Customs Tariff, Special Import Measures Act*, and other acts and regulations, such as the *Canada Pension Plan* and the *Employment Insurance Act*, that we administer for other government departments. We have to ensure that all individuals, corporations, employers, licensees, registrants, importers/exporters, customs brokers, international travellers, and all other persons pay the required amount of tax, duties, fees, penalties, and other amounts owing to the Crown.
You can obtain copies of this information circular and other related forms and publications by calling or visiting the forms area of your tax services office. If you have access, you can also find similar information by accessing our Internet site at **www.cra-arc.gc.ca**.
If you have any comments or suggestions that would help us improve the information in this circular, we would like to hear from you. Please send your comments to:
Taxpayer Services and Debt Management Branch
Revenue Collections Operations Directorate
Canada Revenue Agency
10th floor, Tower C
25 McArthur Road
Ottawa ON K1A 0L5

Digitized by Google

The 90 Day Pause to Collection When Objection
Subsection 225.1(2) details that the Minister shall not start any of the collection mechanics described in Sec. 225.1(1) until 90 days past the date that the objection to the assessment was made.

Appeals Prevent Collection Acts to Start
Subsection 225.1(3) details an opportunity for the taxpayer to contest an assessment to the TCC whereby while the appeal is still in controversy collection actions cannot be commenced.

James Walker v. Her Majesty the Queen, 2005 FCA 393, "I Didn't Receive the Assessment and The Collectors Started Calling": Whether s. 18.5 of the *Federal Court Rules* can Stop Collection Activity when the Underlying Process Hasn't Been Properly Pursued

REASONS FOR JUDGMENT
MALONE J.A.
Introduction
[1] **This appeal canvasses the scope of section 18.5 of the *Federal Courts Act* R.S.C. 1985, c. F-7 (the *Act*) and the powers of the Federal Court where the statutory authority of the Minister of National Revenue (the Minister) to carry out collection proceedings against a taxpayer under the *Income Tax Act* R.S.C. 1985, c.1 (5th Suppl.) (the *ITA*), is challenged. Section 18.5 of the *Act* reads as follows:**
…
[2] The order under appeal was rendered by Beaudry J., a judge of the Federal Court (the Applications Judge), on August 11, 2004. Reasons in support are reported as 2004 FC 1105.

Background
[3] Mr. Walker filed his 1998 tax return on April 30, 1999, and received a notice of assessment for that taxation year on May 20, 1999.
[4] According to affidavit evidence filed by a manager of the Canada Revenue Agency, a notice of reassessment for the 1998 tax year was sent by registered mail to the appellant on May 13, 2002, and was returned unclaimed. Mr. Walker deposes that he never received the notice of reassessment. The first he claims he heard of it was when he was contacted in August of 2002 by a collections officer regarding an amount allegedly due for 1998. The Minister's collection efforts rest on the alleged mailing of the notice of reassessment to the appellant.
[5] On October 7, 2003, the appellant commenced an application for judicial review in the Federal Court for an order declaring that no debt was owing in respect of the 1998 taxation year, since no notice of

Digitized by Google

reassessment was ever sent, and restraining the Minister from further collection action.

[6] On October 31, 2003, a document purporting to be a copy of the 1998 notice of reassessment was provided to Mr. Walker's lawyer. The appellant filed a notice of objection to this document on December 19, 2003 and subsequently a notice of appeal in the Tax Court of Canada. That proceeding is now in abeyance as the Minister has filed a motion, as yet unheard, to the effect that the notice of objection is out of time pursuant to subsection 165 (1) of the *ITA*. That subsection reads:...

The Decision Below

[7] **The application for judicial review was heard by Beaudry J. on July 20, 2004. The Applications Judge concluded that section 18.5 of the *Act* barred Mr. Walker from judicial review because he had a right of appeal under subsection 169 (1) of the *ITA*.** That subsection reads as follows:

…

[8] In reaching this conclusion, Beaudry J. relied on the decision of this Court in *Optical Recording Corp. v. Canada*, [1991] 1 F.C. 309 (C.A) [*Optical*], which decided that the *ITA* provided the Tax Court of Canada with the full and appropriate procedure for appealing all issues regarding assessments and reassessments, including whether the notice of the reassessment was sent on May 13, 2002.

[9] **The appellant now appeals, asserting that section 18.5 of the *Act* allows the Federal Court to review the legality of the Minister's collection process and, incidentally, to decide whether the Minister has established that the notice of reassessment was sent. The appellant argues that any question as to the mailing of the notice of reassessment is necessarily collateral to a review of the Minister's conduct.**

Standard of Review

[10] The issue under review is whether section 18.5 of the *Act* allows the Federal Court to judicially review these collection proceedings, or if the Court is precluded by the exclusive jurisdiction granted to the Tax Court of Canada by section 169 of *the ITA.* Since this inquiry involves a question of law the appropriate standard is one of correctness.

V. Analysis

[11] **In enacting section 18.5, Parliament intended to avoid parallel proceedings in the Federal Court in those instances where a federal statute expressly provides for an appeal in another forum. Here, the notice of reassessment is an administrative act of a government official that falls within the broad parameters of section 18.1 of the *Act* giving rise to judicial review (see Evans, J., as he then was, in *Markevich v. the Queen*, [1999] 3 F.C. 28 at paragraph 14). At the same time, Parliament has enacted sections 165, 169 and 180 of the *ITA*, which comprise a complete appeal procedure which allows the appellant to raise in the Tax Court of Canada all issues relating to his reassessment.**

[12] The appellant acknowledges that in the Tax Court proceeding the issue of whether a notice of reassessment for the 1998 taxation year was

Digitized by Google

sent to him within the statutory time limit would be raised. In this case, the resolution of that issue will require a determination as to whether a notice of reassessment for the 1998 taxation year was mailed to the appellant by May 20, 2003, the end of the "normal reassessment period" as defined in subsection 152 (3.1) of the *ITA*.

[13] Put another way, the legal efficacy of the key document in this case, the document entitled "notice of reassessment" which the Minister alleges was mailed on May 13, 2002, is a matter to be determined by the Tax Court of Canada in an income tax appeal. **Section 18.5 of the *Act* should be interpreted, as far as possible, to preclude parallel proceedings in the Federal Court and the Tax Court of Canada in respect of substantially the same underlying issue. In this case, section 18.5 should preclude the Federal Court from entertaining an application for judicial review in which the critical issue is the legal efficacy of that key document. In my view, it makes no difference that the appellant claims to be seeking such a determination, not as an end in itself, but in support of his application for an order precluding the Minister from relying on the key document as a basis for collection action.**

[14] In support of his submissions, the appellant relied on a decision of the Supreme Court of Canada in *Markevich v. the Queen*, [2003] 1 S.C.R. 94. In that case, the Federal Court undertook a judicial review of the Minister's decision to collect a tax debt that was time barred, but in so doing that Court was not required to determine anything that could also have been determined by the Tax Court of Canada. Accordingly the *Markevich* decision is of no assistance to the appellant in the present appeal.

[15] An application for judicial review may be made to the Federal Court to challenge the legality of collection measures taken by the Minister to collect taxes allegedly due. However, the Federal Court's jurisdiction does not extend to an application involving an attack on the underlying reassessment on which collection measures are based. In the present case, the appellant says that the Minister cannot justify collection measures by relying on a reassessment allegedly made in May 1998 without proving that notice of it was mailed to him. This is sufficient to engage section 18.5.

[16] For this reason, I would dismiss this appeal with costs. "B. Malone" J.A.

"I agree
Alice Desjardins J.A."

"I agree
John M. Evans J.A."

Test Case Abeyances

Subsection 225.1(4) allows the taxpayer to perhaps agree with the Minister to place the collection of a debt in abeyance until a similar Tax Court of Canada case has been determined to better clarify whether tax is in fact payable. It's to be noted that this provision only applies to TCC proceedings and not Federal Court Appeals

Idem – 225.1(4)

Digitized by Google

) Where a taxpayer has agreed under subsection 173(1) that a question should be determined by the Tax Court of Canada, or where a taxpayer is served with a copy of an application made under subsection 174(1) to that Court for the determination of a question, the Minister shall not take any of the actions described in paragraphs 225.1(1)(a) to 225.1(1)(g) for the purpose of collecting that part of an amount assessed, the liability for payment of which will be affected by the determination of the question, before the day on which the question is determined by the Court.

Abeyance not Relevant When Clear Decision On A "Same Or Substantially The Same" Issue

Subsection 225.1(5) provides that the Minister can proceed with any collection actions cited in Sec. 225.1(1) when the TCC, FC or SCC does render a judgment on a "same or substantially the same" issue, notwithstanding that the taxpayer has made an Objection or has appealed to the Tax Court.

Idem – 225.1(5)

Notwithstanding any other provision in this section, where a taxpayer has served a notice of objection under this Act to an assessment or has appealed to the Tax Court of Canada from an assessment and agrees in writing with the Minister to delay proceedings on the objection or appeal, as the case may be, until judgment has been given in another action before the Tax Court of Canada, the Federal Court of Appeal or the Supreme Court of Canada in which the issue is the same or substantially the same as that raised in the objection or appeal of the taxpayer, the Minister may take any of the actions described in paragraphs 225.1(1)(a) to 225.1(1)(g) for the purpose of collecting the amount assessed, or a part thereof, determined in a manner consistent with the decision or judgment of the Court in the other action at any time after the Minister notifies the taxpayer in writing that

the decision of the Tax Court of Canada in that action has been mailed to the Minister,

judgment has been pronounced by the Federal Court of Appeal in that action, or

judgment has been delivered by the Supreme Court of Canada in that action, as the case may be.

Charles Webster v. The Minister Of National Revenue et al., 2003 FCA 442, Agreement on Ancillary Test Case does not Prompt Statutory Collection Delay Protections if Test Case Not Favourable

REASONS FOR JUDGMENT

ROTHSTEIN J.A.

[1] The issue in this appeal from Heneghan J. of the Trial Division (as it then was) is the interpretation of subsection 225.1(5) of the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1 as amended. The appeal involves when the Minister of National Revenue may take collection action after a decision

Digitized by Google

is issued in another action, pending which the taxpayer and the Minister had agreed to hold a Notice of Objection in abeyance pursuant to subsection 225.1(5).

FACTS

[2] The appellant, Charles Webster, was reassessed in respect of his 1991, 1992 and 1993 taxation years. He filed a Notice of Objection with the Minister. While the Notice of Objection was pending before the Minister, the appellant and the Minister, as contemplated by subsection 225.1(5), entered into an agreement to delay proceedings on the objection until judgment was given in another case - *Global Communications v. The Queen*. Global's appeal was allowed in part in the Tax Court, 97 D.T.C. 1293, but on appeal to this Court, [1999] F.C.J. No. 966, its appeal was dismissed and the Minister's cross-appeal allowed. The judgment of this Court was issued on June 18, 1999. On October 27, 2000, the Minister issued a notice to the appellant confirming the reassessments against him. By letter dated November 7, 2000, the Minister indicated his intention to proceed with collection action in respect of the amounts at issue in the reassessments. On December 7, 2000, the appellant filed a Notice of Appeal in the Tax Court of Canada in respect of the reassessments.

[3] **The appellant, relying on subsection 225.1(3), says the Minister is precluded from taking collection action against him until his appeal in the Tax Court is determined and a copy of the Tax Court decision is mailed to him. The Minister says that the appellant, by agreeing to delay proceedings on his Notice of Objection by an agreement in writing of the kind referred to in subsection 225.1(5), waived any protection against collection provided by subsection 225.1(3). The Minister could therefore commence collection action at any time after notifying the appellant of the decision of the Tax Court in *Global*.**

[4] The appellant brought an application for judicial review in the Trial Division seeking a declaration, injunction, and writ of prohibition enjoining the Minister from taking any collection action. Heneghan J. dismissed the appellant's judicial review. I agree that the judicial review was properly dismissed.

RELEVANT STATUTORY PROVISIONS

[5] The relevant provisions of the Act are subsections 225.1(1), (2), (3) and (5). Subsections 225.1(1), **and (3) provide a continuum of protection precluding the Minister from taking collection action against the taxpayer:**

> **first, until after the day that is 90 days after the day of mailing of a Notice of Assessment;**
>
> **second, if the taxpayer serves a Notice of Objection, until after the day that is 90 days after the day the Minister has mailed to the taxpayer a Notice of Confirmation or Variation of the assessment;**
>
> **third, if the taxpayer appeals from the Confirmation or Variation to the Tax Court, until the day of mailing of a copy of the decision of the Tax Court to the taxpayer.**

Digitized by Google

[6] Subsections 225.1(1), (2) and (3) provide:

7] Subsection 225.1(5) provides that where the Minister and a taxpayer enter into a written agreement to delay proceedings on an objection or appeal until a decision is given in another action, the Minister may take collection action in a manner consistent with the judgment of the Court in the other action at any time after the Minister notifies the taxpayer in writing of the decision in the other action. Subsection 225.1(5) provides:

ANALYSIS

[8] **It appears that subsection 225.1(5) is intended to save the taxpayer and the Minister the administrative and litigation costs of pursuing an objection or appeal if it is thought that the decision in a case in which the issue is the same, or substantially the same, may be dispositive of the taxpayer's objection or appeal.**

[9] **An agreement under subsection (5), however, only deals with collection. It is not an agreement whereby the Minister and the taxpayer are necessarily bound by the decision in the other action. The taxpayer is not precluded from filing an appeal or continuing with an appeal irrespective of the decision in the other action.**

[10] **However, once the Minister notifies the taxpayer of the decision in the other action, the Minister is free to take collection action against the taxpayer. The plain meaning of subsection (5) supports this view.** The combination of the opening words of the subsection "Notwithstanding any other provision in this section" ... and the empowering words which come later " the Minister may take any of the actions described ... at any time after the Minister notifies the taxpayer..." leave little doubt as to the legislator's intention. The immunity from collection action found in subsections (2) and (3) is subordinated to the Minister's right to proceed under subsection (5).

[11] The appellant argues that the words "as the case may be" in subsection (5) should be interpreted to mean that an agreement to delay proceedings on an objection does not constitute an agreement to delay an appeal to the Tax Court. As a result, an agreement to delay an objection will not prevent subsection (3) from protecting the taxpayer against collection action if a notice of appeal is filed in the Tax Court after notification of the decision in the other action.

[12] I am of the opinion that the words "as the case may be" are intended to ensure that an agreement to delay proceedings is specific to the stage of the taxpayer's proceedings with the Minister. That is, if the agreement is made at the objection stage, it delays the objection; if it is made at the appeal stage, it delays the appeal. **But once the delay is ended by notification of the decision in the other action, the Minister is free to take collection action at any time.**

[13] I think the appellant's interpretation of subsection (5) would lead to two unexplained anomalies. First, if the appellant's interpretation is correct, a taxpayer who agreed to a delay at the objection stage would be in a better position than a taxpayer who agreed to a delay at the appeal stage**. If an agreement is made at the objection stage and the taxpayer files a Notice of Appeal after being notified of the decision in the** other

Digitized by Google

action, protection against collection under subsection (3) would apply. However, in the case of a taxpayer who had already filed a Notice of Appeal in the Tax Court before making the agreement, that protection would be lost by reason of subsection (5). There is no logical reason to support such a difference in treatment. The right of the Minister to take collection action arises when the taxpayer is notified of the decision in the other action irrespective of whether the taxpayer's case is at the objection or appeal stage.

[14] Second, the appellant concedes that the words "at any time" in subsection (5) mean that the Minister may take collection action at any time after notification of the decision in the other action. Yet he says that as soon as the taxpayer files a Notice of Appeal in the Tax Court, the Minister would have to stop that collection action. However, it seems to me that, if the intent of subsection (5) was to give collection protection to a taxpayer once a Notice of Appeal was filed in the Tax Court, the wording of subsection (5) would parallel the wording in subsection (2). That is, the taxpayer would be given 90 days to file a Notice of Appeal in the Tax Court before collection action could be taken. **On the contrary, the words "at any time" are used, which are the antithesis of the continuum of protection against collection provided by subsections (1)-(3).** [15] **In the alternative, the appellant says that the judgment in the *Global* case is not the same or substantially the same as the issues in his case and cites a number of differences. He says that on judicial review, the Court must determine if the issues in his Notice of Objection and in the *Global* decision are or are not the same or substantially the same, and, if they are not, the Minister may not invoke subsection (5) to take collection action. Rather, he says, once an appeal is filed in the Tax Court, he should be entitled to protection from collection action under subsection (3).**

[16] I cannot agree. For the purposes of subsection (5), the issue is whether an agreement in writing to delay proceedings pending the outcome in the other action has been entered into. Where the parties agree in writing that the issues in the other case are the same or substantially the same, a Court on judicial review will not go behind that agreement.

[17] The actual decision in the other action only becomes relevant when determining how much of the amount assessed may be collected. I do not preclude the possibility of a dispute over the amount assessed against the taxpayer "determined in a manner consistent with the decision or judgment of the court in the other action." **However, that is a dispute as to what amount the Minister may collect, not whether he is free to take collection action at all.**

CONCLUSION

[18] I conclude that once an agreement is entered into under subsection (5), the taxpayer is bound by the subsection (5) procedure and collection action may be taken at any time after notification of the decision in the other action, notwithstanding subsections (2) and (3). The taxpayer is not required to enter into such an agreement but if he elects to do so, he is bound by the agreement and the right of the Minister to take collection

Digitized by Google

action at any time after notification of the decision in the other action.
[19] For these reasons, I would dismiss the appeal.
[20] The Court was requested to permit written submissions on the matter of costs. Within 7 days of the date of these reasons, the Minister shall serve and file written submissions of not more than 2 pages. The Court will entertain a request for a lump sum of costs inclusive of fees and disbursements. Within 7 days of receipt of the Minister's submissions as to costs, the appellant shall serve and file written submissions of not more than 2 pages in respect of costs. Of course, it is open to the parties to agree to costs if they are able to do so and to so advise the Court.

"Marshall Rothstein" J.A.
"I agree
John M. Evans J.A." "I agree
J.D. Denis Pelletier J.A."

CRA Internal Operations Manual - Garnishment

(See below image pages)

Digitized by Google

GARNISHMENT 1

Overview 1

Legislation 1

Background Information 2
Security Under the *Bank Act* 2
Agencies Under the Bank Act 2
Registration of the Notice of Intention to Enforce Security 3
Security Debenture Given to a Bank and Other Lenders 3
When is a Fixed Charge Debenture Created 3
When is a Floating Charge Debenture Created 3
When is a Combination Charge Debenture Created 4
Crystallizing a Floating Charge Debenture 4
Personal Property Security Legislation 4
Collection Restrictions on Reassessments 4
Collection Measure Undertaken Prior to Reassessment 5
Alberta Workers' Compensation Board Entitlement to Set Off 6
Business Access Canada (formerly Contracts Canada) 6

Policy 6
Factors to Consider Before Issuing a Requirement to Pay 7
When to Issue a Requirement to Pay 8
When to Issue a Requirement to Pay on Joint Bank Accounts 9
Garnishable Sources 9
Non Garnishable Sources 11
Foreign governments, Diplomatic Mission, Embassy or Consulate 11
Category 4 Criteria 12
Issuing a Requirement to Pay with an "x" in Category 4 to Financial Institutions 12
Issuing a Requirement to Pay with an "x" in Box 4 to an Individual 12
Validity Period 13
Garnishment and the *Indian Act* 13
Service of the Requirement to Pay to a Designated Branch 13
Enhanced Requirement to Pay (ERTP) 14
What Amounts to Include in an Enhanced Requirement to Pay 14
When to Use an Enhanced Requirement to Pay 15
When Not to Assert Priority Under An Enhanced Requirement to Pay 17
Memoranda of Understanding 17
Enhanced Requirement to Pay in Receivership Situations 18
Enhanced Requirement to Pay in Construction Setting 18
Enhanced Requirement to Pay in Consumer Proposal 18
Enhanced Requirement to Pay under the Companies' Creditors Arrangement Act 18
Service of Enhanced Requirements To Pay 19
Requirement to Pay Restorable Monies 19
What Happens to Funds Seized by Police 20
When is a Requirement to Pay Restorable Monies Issued 21
When is a Requirement to Pay Restorable Monies not Appropriate 21
When do Monies Become Available to CRA 21
Monies Not Available To Satisfy a Debt 21
Function of the Requirement to Pay Restorable Monies Covering Letter 22
Approval Authority Requirement to Pay Restorable Monies 23
Approval Authority for a Requirement to Pay 23

Digitized by Google

Sensitive Income Sources 23
Financial Institutions Loans and Advances (Category '4') 24
Withdrawal of a Requirement to Pay 24
Withdrawal of a Requirement to Pay Under Routine Circumstances 24
Withdrawal of a Requirement to Pay When Category 4 Activated 25
Withdrawal of Enhanced Requirements to Pay 25
Withdrawal of Enhanced Requirements to Pay and Directors' Liability Disclaimer Letter 25
Refund on Garnished Amounts 26

Procedures 26
Issuing a Requirement to Pay 27
Completing a Requirement to Pay 27
Naming Conventions 29
Individual 29
Individual Deceased 30
Corporation 30
Partnerships 31
Partnerships in Quebec 32
Financial Institutions 33
Verifying a Completed Requirement to Pay 33
Items to Verify Prior to the Issuance of a Requirement to Pay 33
Garnishment of Construction Holiday Pay in Quebec 33
Requirement to Pay Issued to Joint Bank Accounts in Quebec 34
Requirement to Pay Issued to Joint Bank Accounts in Other Provinces 34
Issuing a Requirement to Pay Restorable Monies 35
Conducting the Initial Investigation 35
Completing a Requirement to Pay Restorable Monies 36
Delivering a Requirement to Pay Restorable Monies 37
Recovering Monies Held by the Seized Property Management Directorate (SPMD) 37
Garnishing Non-Redeemable Term Deposits, Guaranteed Investment Certificates (GICs) or Registered Retirement Savings Plans (RRSPs) 37
Garnishing Term Deposits or Guaranteed Investment Certificates (GICs) Requiring the Original Document 37
Garnishing Ontario Statute Credits 38
Garnishments to the Province of Ontario 38
Garnishing Pension Benefits in Ontario 39
Garnishing Workers Compensation Benefits in Alberta 40
Garnishing Workplace Safety and Insurance Board Benefits in Ontario 40
Garnishing Federal Annuities 41
Garnishing Canadian Pacific Railway Employees 41
Garnishing Canadian National (CN) Employees 42
Garnishing Canadian Wheat Board Payments 42
Garnishing House of Commons Employees 42
Garnishing the Ontario Legal Aid Plan 43
OLAP Account Maintenance 44
OLAP Client Enquiries 44
Withdrawal of a Requirement to Pay Issued to Ontario Legal Aid Plan 44
Renewal of a Requirement to Pay Issued to Ontario Legal Aid Plan 45
Garnishee Summons in Alberta 45
Collecting a Tax Debt under Bankruptcy and Proposals in Bankruptcy Situations 45
Collecting When an Individual Files for Bankruptcy 45
Collecting When a Notice of Intention to File a Proposal is Filed 46
Collecting When a Proposal in Bankruptcy is Filed 46
Collecting When a Receiver is Appointed Pursuant to a Security Instrument 46
Collecting a Tax Debt in Receivership Situations 46

Digitized by Google

Determining if Funds are Eligible to Crown 47
Determining if Funds May be Shared with Receiver 47
Determining if Funds May be Payable to the Receiver 48
Delivering a Requirement to Pay 48
Hand Delivering a Requirement to Pay 49
Completing a Requirement to Pay when Serving a Designated Branch 50
Issuing an Amended Requirement to Pay 50
Issuing a Letter to Amend the Requirement to Pay 50
Delivering a Letter Amending a Requirement to Pay 50
Delivering a Requirement to Pay Withdrawal 51
Non-Compliance with a Requirement to Pay 51
Ways in Which Non-Compliance Can Occur 52
Obtaining Evidence of Non-Compliance from a Third Party 52
Obtaining Evidence of Non-Compliance from a Financial Institution 53
Requesting Payment 53
Requesting an Opinion on Non-Compliance 54
Obtaining Approval for a Non-Compliance Assessment 55
Crediting Amounts Deducted But Not Remitted 55

Resource Material 56

Digitized by Google

Background Information

This section identifies background information related to Requirement to Pay:

- Security Under the *Bank Act*
- Registration of the Notice of Intention to Enforce Security
- Security Debenture Given to a Bank and Other Lenders
- Personal Property Security Legislation
- Collection Restrictions on Reassessments
- Alberta Workers' Compensation Board Entitlement to Set-off
- Business Access Canada (formerly Contracts Canada)

Security Under the *Bank Act*

Section 427 of the *Bank Act* authorizes a bank to lend money against the security of the borrower's equipment and products, including the book debts arising from the sale of these products. Pledging such security transfers ownership of the book debts to the bank. In order for the security to be effective against other creditors, a Notice of Intention must be registered in the **appropriate agency** not more than three years before the security is given. Registration of a Notice of Intention with one agency will not be reflected at any other agency. If the Notice of Intention is not registered with the correct office, then the security is not valid against third parties.

Therefore, it is important that Collectors investigate the correct office and the time frame to ensure that the security agreement is valid.

For more details refer to Memoranda 03-09, Validating Bank Act Security (S.427 *Bank Act*).

Related Topic:

- Agencies Under the Bank Act

Agencies Under the Bank Act

Agencies under the *Bank Act* include:

- the respective offices of the Bank of Canada in a province

  Note: This does not include its Ottawa office.

- the office of the clerk of the court in each of the Yukon Territory, the Northwest Territories and Nunavut
- TD Canada Trust in Newfoundland
- Central Trust in Prince Edward Island

Digitized by Google

Registration of the Notice of Intention to Enforce Security

Registration of the Notice of Intention to Enforce Security must occur at:

a) the agency for the province in which is located the place of business of the person by whom or on whose behalf a Notice of Intention is signed

b) if that person has more than one place of business in Canada and the places of business are not in the same province, the agency for the province in which is located the principal place of business of that person, or

c) if that person has no place of business, the agency for the province in which the person resides

Registration of a Notice of Intention to Enforce Security with one office of the Bank of Canada or an authorized representative of the Bank of Canada, or Clerk of the Court will not be reflected at any other office.

Security Debenture Given to a Bank and Other Lenders

A security debenture given to a bank or other lenders in return for a loan or advance constitutes a continuing charge on the assets of the company, which may include the book debts. Three types of charges are:

- a fixed charge debenture
- a floating charge debenture
- combination of a fixed charge and a floating charge debenture

Related Topics:

- When is a Fixed Charge Debenture Created
- When Is a Floating Charge Debenture Created
- When Is a Combination Charge Debenture Created
- Crystallizing a Floating Charge Debenture

When Is a Fixed Charge Debenture Created

A fixed charge debenture is created when the security document specifies and describes the assets covered by the charge.

When Is a Floating Charge Debenture Created

Digitized by Google

A floating charge debenture is created when there is a continuous charge on the assets of the company but the company is permitted to deal freely with those assets in the usual course of business until the security holder intervenes to enforce his claim. The pool of assets over which the charge floats will be constantly changing, unless something happens to cause the floating charge to crystallize. The bank will then intervene to enforce its claim. In Quebec, a Movable Hypothec without delivery would constitute a similar charge.

When Is a Combination Charge Debenture Created

A combination charge is created when there is a fixed charge on certain assets and a floating charge on certain assets. The security document describes which assets are covered by the fixed charge and which assets are covered by the floating charge.

Crystallizing a Floating Charge Debenture

Crystallizing or transforming a floating charge debenture into a fixed charge debenture occurs when the security becomes enforceable allowing the bank to take action.

Under the terms of a floating charge debenture, certain acts or events described in the security document will cause the security to become enforceable by the bank. These may include default in payment, the commission of an act of bankruptcy, a bulk sale of assets, etc.

The action or actions necessary for the bank to effect crystallization are also stated in the security document and usually include the giving of notice and the appointment of a Receiver. When crystallization occurs, the bank's customer is no longer free to deal with the assets covered by the security.

Personal Property Security Legislation

The provincial personal property security legislation or other similar provincial legislation provide for the registration of a general assignment of book debts or a debenture. The personal property security legislation has its own security document and it can, depending on its terms, supplement or replace a general assignment of book debts and debenture.

Collection Restrictions on Reassessments

Previously, the Agency had taken the position that collection restrictions, imposed by section 225.1 of the *Income Tax Act*, applied only to additional amounts assessed in a reassessment, provided that the 90-day restriction period had expired on the original assessment. There was no policy on this subject in relation to the *Excise Act 2001*. Although the old policy and procedures manual for the *Excise Tax Act* – Non-GST did contain the collection restriction on reassessments, we will include the *Excise Tax Act* – Non-GST in this new policy for consistency purposes.

Since subsection 248(1) of the *Income Tax Act* (*ITA*), section 2 of the *Excise Act 2001* (*EA 2001*) and subsection 58.1(1) of the *Excise Tax Act* (*ETA*) define an assessment to include a reassessment, collection restrictions, imposed by section 225.1 of the *ITA*, section 286 of the *EA 2001* and section 86 of the *ETA*, apply to the full amount of a reassessment. Therefore, once the Agency has issued a notice of reassessment, we will not continue or initiate collection actions, in respect of the amounts reassessed:

Digitized by Google

- until after the day that is 90 days after the day of the mailing of the notice of reassessment (*ITA*, *EA 2001* and *ETA*);

- until after the day that is 90 days after the day on which a notice is mailed to the debtor that the Agency has confirmed or varied the assessment, following the filing by the debtor of a notice of objection to the reassessment, in respect of the amount in controversy (*ITA*, *EA 2001* and *ETA*);

- before the day of mailing of a copy of the decision of the Court to the debtor or the day on which the debtor discontinues the appeal, whichever is the earlier following the filing of a notice of appeal on the reassessment, in respect of the amount in controversy (*ITA*, *EA 2001* and *ETA*); and

- **This applies to the *ITA* only:** before the day on which the Court has determined a question, where a taxpayer has agreed, under ss. 173(1), that the Tax Court of Canada should determine a question, or where a taxpayer is served with a copy of an application, made under s. 174(1) to that Court, for a determination of a question, in respect of that part of an amount assessed, the liability for payment of which will be affected by the determination of the question (*ITA* only).

  Exception: Under the *ITA* only, collection restrictions do not apply to a reassessment made following the waiver of penalty or interest under subsection 220(3.1).

Related Topic:

- **Collection Measure Undertaken Prior to Reassessment**

Collection Measure Undertaken Prior to Reassessment

A reassessment of a particular tax year under the *ITA* or an amount owing under the *EA 2001* or *ETA* does not affect or destroy the validity of collection actions in respect of the amount owing, when such action was taken before the reassessment. Accordingly, the Agency is not legally required to withdraw a requirement to pay, pursuant to subsection 224(1) or (1.1) of the *ITA*, subsection 289(1) or (2) of the *EA 2001* and subsection 84(1) of *ETA* or return monies collected before the reassessment.

If the reassessment has resulted in a lesser amount owing, and the new amount, arising from the reassessment, has been satisfied by the amounts already collected, any collection taken will have to be cancelled.

If the Agency had issued a Requirement to Pay or a Set-off on the initial assessment or an earlier reassessment, in respect of a particular tax year under the *ITA* or an amount owing under the *EA 2001* or the *ETA* that has been reassessed, the policy is that the TSO will immediately advise the third parties not to comply with the Requirement to Pay or Set-off until further notice, or, if they prefer, cancel the Requirement to Pay or Set-off and reissue a new one after the 90-day collection restriction has expired. If the Requirement to Pay or Set-off had not been cancelled the Agency will instruct those third parties to resume remitting garnishee payments to the Receiver General or effecting set-off when collection restrictions expire.

For further information see Communication ARD-2005-022 entitled, **Collection Restrictions following Reassessments Under the *Income Tax Act*, *Excise Act 2001* and *Excise Tax Act* – Non-GST**.

Digitized by Google

Alberta Workers' Compensation Board Entitlement to Set Off

Where benefits have been paid in error, the Workers' Compensation Board (WCB) of Alberta is entitled to set-off against benefits in priority to a Requirement to Pay issued by CRA. Also, by virtue of section 44 of the *Worker's Compensation Act* the WCB has the discretion to redirect periodic compensation benefits to either:

- a spouse or child dependent of the worker and residing in Alberta without adequate means of support
- a spouse or child in the case of Court ordered maintenance or alimony whether or not residing in Alberta

Business Access Canada (formerly Contracts Canada)

Business Access Canada's site provides information with respect to all federal government contracts that have been awarded through Public Works and Government Services Canada (PWGSC). For example, if the Department of Agriculture is purchasing cleaning services for their offices, the information with respect to who was awarded the contract would be displayed on the Business Access Canada site. Consequently, collection officers should conduct routine searches of this readily available site. For further details, refer to **Business Access Canada**.

Policy

This section provides policies related to Garnishments:

- **Factors to Consider Before Issuing a Requirement to Pay**
- **When to Issue a Requirement to Pay**
- **When to Issue a Requirement to Pay on Joint Bank Accounts**
- **Garnishable Sources**
- **Non-Garnishable Sources**
- **Category 4 Criteria**
- **Validity Period**
- **Garnishment and the *Indian Act***
- **Service of the Requirement to Pay to a Designated Branch**
- **Enhanced Requirement to Pay (ERTP)**
- **Requirement to Pay Restorable Monies**
- **Approval Authority for a Requirement to Pay**

Digitized by Google

- **Withdrawal of a Requirement to Pay**
- **Refund on Garnished Amounts**

Factors to Consider Before Issuing a Requirement to Pay

In the case of Taxation amounts refer to the *Income Tax Act*, section 225.1 for the collection restrictions that are effective for 90 days after the day of the mailing of the notice of assessment.

Factors to consider before issuing a Requirement to Pay:

- ensure that all amounts are legally collectible
- the tax debtor has not sought protection under a provision of the *Bankruptcy and Insolvency Act* (with the exception of Enhanced Requirement to Pay issued in respect of a source deductions liability)
- ensure that the debt is not under appeal
- recognize the consequences of putting an X in category 4 of the Requirement to Pay
- set the terms of the Requirement to Pay according to the tax debtor's ability to pay

  Note: For additional information, refer to Directive ARD 02-04, **Garnishment - Calculation of Deductions** **except for the province of Quebec where this Directive is in abeyance.**

- apply good judgement when issuing a Requirement to Pay
- a financial institution has a right to offset if it is owed an amount on a loan that is payable on demand; any surplus of funds must be remitted to CRA
- trust accounts are used by lawyers, notaries, Real Estate companies, trustees in bankruptcy, Executors of estate etc. Bank accounts opened " in trust " hold funds for third parties and therefore can be seized only under exceptionally rare circumstances, usually by obtaining a Garnishee Court Order (GCO) rather than by issuing a Requirement to Pay. Also, the GCO will generally aim at seizing funds held in trust by a third person, for example, a lawyer, on behalf of a specific tax debtor known to be this lawyer's regular client.

  Note: There is another type of trust account, which may be attached by garnishment. At times, in order to escape the scope of a garnishment, a tax debtor will do his banking transactions via a so called "in trust" account opened usually for a related family member such as a child. In this particular case, a detailed review of the bank account is required to identify if the deemed owner of such a bank account is actually the debtor and therefore providing proof to justify its seizure via garnishment. It should be noted that a Requirement for Information will be required to access these banking records to demonstrate that the funds are held for and used by the tax debtor and not the person named in the trust account. Also, we should research the Bank's policy with respect to trust accounts to determine who they deem to be the actual owner of that account.

Digitized by Google

Note: Please ensure that a National Early Warning System (NEWS) Report has been completed in advance of any Collection action against sensitive sources (for e.g. Media threat) or in any circumstance deemed applicable by a local TSO.

The NEWS Report's instruction sheet and form are accessible electronically through the CRA website.

When to Issue a Requirement to Pay on Joint Bank Accounts

Issue a Requirement to Pay (RTP) on joint bank accounts when:

- the signatories on the joint bank account are jointly and severally liable as a result of a partnership debt on account of income tax, source deductions or GST
- the signatories on the joint bank account have, in their capacity as corporate directors, each been assessed in respect of the corporation's failure to remit source deductions or GST
- where one of the signatories is liable for personal taxes and the other signatory has been assessed, under the *Income Tax Act*, section 160 or the *Excise Tax Act*, section 325 in respect of a non-arm's length transfer, in which case the liability is, to the extent of the amount assessed against the transferee, owed jointly and severally

  Note: This circumstance is not restricted to taxes due by an individual, but is equally applicable in the case of a proprietor owing source deductions or GST and making a non-arm's length transfer to a co-signatory of a jointly held bank account.

- in the province of Québec, some financial institutions may comply with a garnishee on a joint bank account where the tax debtor is one of the two holders and bank deposits can be traced to the tax debtor. Some other financial institutions will comply with the extent of freezing the joint bank account. Other financial institutions will comply by merely remitting the total contents of the joint account in the name of the Receiver General and the second holder of the joint bank account. When this is the case, unless we are able to have the other holder endorse the remittance, the RTP is not valid.
- except for the province of Québec, do not garnish joint bank accounts when only one of the joint bank account holders is indebted to CRA
- the joint bank account holders are both indebted but for different debts

For further detail refer to the procedures, **Requirement to Pay Issued to Joint Bank Accounts in Québec** and **Requirement to Pay Issued to Joint Bank Accounts in Other Provinces** and to the directive, RCD-95-01, **Garnishment of Joint Accounts**.

Garnishable Sources

Garnishable sources include:

Digitized by Google

- salaries
- wages

  Note: If there is any doubt that the tax debtor is still employed by an employer confirm employment by telephone prior to issuing a garnishment.

  Refer to Directive ARD 02-04, **Garnishment - Calculation of Deductions**, for guidelines for computing the amounts from employment that are subject to application of a Requirement to Pay **except for the province of Quebec where the Directive is in abeyance**.

- bank accounts, including joint bank accounts

  Refer to **When to Issue Requirement to Pay on Joint Bank Accounts** for policy and **Requirement to Pay Issued to Joint Bank Accounts in Quebec** and **Requirement to Pay on Joint Bank Accounts in Other Provinces** for the appropriate procedures.

  Note: A bank account may constitute the first enforced funds to clear all or most of the tax arrears. However, be aware that this action could also close a business.

- unused line of credit to the extent that it will freeze the account as the financial institution will require the debtor's consent to satisfy the Requirement to Pay
- irregular payments made to individuals who provide property and/or services to a person
- term deposits, guaranteed investment certificates (GIC)
- Refer to **GarnishingTerm Deposits or GICs Requiring the Original Document** and **Garnishing Non-Redeemable Term Deposits, GICs or RRSPs** for further detail.
- Registered Retirement Savings Plans (RRSP)

  Note: RRSPs are used as a last resort because deregistration can generate an additional tax liability for the year in which it is cashed. Refer to Directive ARD-2003-004 **Funds Held in RRSP's**.

- Rental income

  Refer to Communication ARD-2004-011 **Changes to Requirements to Pay Issued to Tenants where the Landlord Debtor is an Individual** for instructions on how to complete a Requirement to Pay where the tax debtor is an individual landlord and the third parties his tenants.

- Integrated Proceeds of Crime

  Refer to **Requirement to Pay Restorable Monies** for further details.

- other sources of income, for example, pension income, dividend payment etc.

  Refer to **Garnishing Pension Benefits in Ontario** for further detail.

Digitized by Google

- companies that have been awarded government contracts

  Refer to **Background Information**, **Business Access Canada** for further detail.

- alimony payments providing they are granted to and for support of the spouse debtor and not for child support and, as in all cases, the RTP does not create an undue hardship to the tax debtor. Memoranda 01-21 **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act***, delegates authority approval to the Team Leader as the lowest level of approval

Non Garnishable Sources

Non-garnishable sources include:

- accounts receivable and assets of a partnership to satisfy a personal tax liability of one of the partners. The Quebec Civil Code makes exception for an undeclared partnership where, in respect of third persons, each partner retains the ownership of the property constituting his contribution to the undeclared partnership

- accounts receivable in which a third party has a security interest duly registered to the extent of the unpaid portion of the secured creditor's debt and, providing the secured creditor has enforced its security

  Note: This does not apply to accounts receivable garnished with an Enhanced Requirement to Pay.

- amounts payable to a spouse in accordance with a separation agreement or divorce decree for the maintenance and support of dependent children

- in any situation where the financial institution freezes the trust account of our client and Agency officials have no evidence to suggest that the account is being used to facilitate non-trust transactions, the financial institution should be advised that the Requirement to Pay is not effective against these funds

- income earned by a Canadian citizen employed by a foreign government

- provincial legislation exempts specific types of life insurance registered retirement savings plans from seizure

  Refer to Directive ARD-2003-004 **Funds Held In RRSPs** for further detail.

Related Topic:

- **Foreign governments, Diplomatic Mission, Embassy or Consulate**

Foreign governments, Diplomatic Mission, Embassy or Consulate

Collection Officers are not to issue Requirements to Pay against property of these entities. They are entitled to certain privileges and immunities under various Acts and International conventions. Accounts that cannot be resolved voluntarily should be referred to the HQ Account Receivable Division, **Field Support** section.

Digitized by Google

Refer to Communication TSDMB-2007-117 **Collection Procedures on foreign governments, Diplomatic Missions, Embassies/Consulates** for further detail.

Category 4 Criteria

The provisions of category 4 on the requirement to pay only become operative when an "x" is identified in box 4. A requirement to pay with an "x" identified in box 4 is issued to a financial institution or an individual in different situations and is effective, under subsection 224(1.1) or 317(2) *ETA*, for 90 days. All other terms of the requirement under subsections 224(1), 224(1.2), and 317(1) & (3) *ETA* will remain in effect of a period of one year.

Related Topics:

- **Issuing a Requirement to Pay with an "x" in Box 4 to Financial Institutions**
- **Issuing a Requirement to Pay with an "x" in Box 4 to an Individual**

Issuing a Requirement to Pay with an "x" in Category 4 to Financial Institutions

Issue a requirement to pay to a financial institution with an "x" identified in box 4, in the following situations:

- all accounts receivable are pledged pursuant to a valid security agreement and all other assets are fully encumbered
- the tax debtor is receiving payments in the form of loans or advances that are secured
- the tax debtor becomes indebted to the financial institution at some point during the effective period of the requirement to pay and has provided security for the indebtedness
- the tax debtor is already indebted and it is suspected that the tax debtor may, within 90 days, for garnishments issued pursuant to the *Excise Tax Act*, section 317 and the Income Tax ss. 224(1.1) and one year for garnishments issued pursuant to the Income Tax, ss. 224(1), borrow further and provide security to the financial institution

When box 4 is activated, the Requirement to Pay under subsection 224(1.1) will remain in effect for 90 days. All other terms of the Requirement to Pay will remain in effect for one year. Be sure to advise the bank that was served with the Requirement to Pay of these timeframes.

Issuing a Requirement to Pay with an "x" in Box 4 to an Individual

Issue a requirement to pay to an individual with an "x" identified in box 4, in the following situations:

- grounds exist to suspect that within 90 days for requirements to pay issued pursuant to the *Income Tax Act*, ss. 224(1.1) and the *Excise Tax Act*, ss. 317(2) that:

Digitized by Google

- a person will loan or advance moneys to the tax debtor
- a person will make a payment on behalf of the tax debtor who is suspected to be employed or engaged in providing services or property to the person
- the tax debtor is not dealing at arm's length with a person which is a corporation and it is suspected that the corporation will loan or advance moneys, to or will make payments on behalf of the tax debtor

  Note: Where there is evidence of moneys owed to the tax debtor in the form of a loan for which no repayment date is stipulated, CRA considers the loan payable on demand.

- it is unclear whether a payment constitutes an advance or other type of payment
- the tax debtor is receiving payments in the form of loans or advances

When box 4 is activated, the Requirement to Pay under subsection 224(1.1) will remain in effect for 90 days. All other terms of the Requirement to Pay will remain in effect for one year.

Validity Period

A Requirement to Pay when issued is valid for the following periods:

- garnishments issued pursuant to subsections 224(1) and 224(1.2) *ITA* or 317(1) and 317(3) *ETA* attach funds payable or that become payable to the tax debtor within one year
- where these monies include periodic payments, the garnishee remains valid during or after the one year period until such time as the liability captured by the Requirement to Pay is satisfied. Periodic payments are defined as recurring payments not necessarily at precise time intervals, (*Callwood v. Her Majesty the Queen*, 2006 FCA 188).
- in circumstances where Box 4 has been "Xed", the garnishee will attach those funds that would otherwise be lent, advanced or paid to a tax debtor, and is valid only for 90 days from the date of service. However, the remaining terms of the garnishee still remain valid for up to one year from the date of service, unless the monies being received are periodic payments in which case the garnishee will remain valid for up to one year or until such time as the liability captured by the requirement to pay is satisfied

Garnishment and the *Indian Act*

Refer to the ***Indian Act* – Collection Guidelines'** Chapter for information on how to determine whether funds payable to a First Nation's member may be eligible for garnishment.

Service of the Requirement to Pay to a Designated Branch

The *Bank Act* now allows the serving of a Requirement to Pay to designated branches for the Chartered Banks. These service points are to be used when the Bank may be known, but the particular branch is unknown.

Digitized by Google

Under no circumstances may the use of this new facility be used as a method to arbitrarily search for bank account(s). You must have reasonable expectation that the taxpayer does in fact deal with a particular financial institution.

For a list of designated branches, refer to **Appendix A** of Communication TSDMB-2006-020 (ARD), Changes to the *Bank Act* allowing a Designated Branch for the point of Service for Requirements to Pay and Requirements for Information.

Refer to the Procedures section entitled **Completing a Requirement to Pay when Serving a Designated Branch**.

Enhanced Requirement to Pay (ERTP)

Since its enactment, in 1987, the policy surrounding the application of an ERTP has evolved from their initial use of attaching account/trade receivables to a broader use, similar in scope to the application of the Deemed Trust provisions.

However, an ERTP will usually represent an amount greater that what can be claimed under the Deemed Trust provisions.

ERTP enable the Agency to claim priority over amounts payable to a debtor, despite the fact that secured creditors may have claims against the funds.

Related Topics:

- **What Amounts to Include in an Enhanced Requirement to Pay**
- **When to Use an Enhanced Requirement to Pay**
- **When Not to Assert Priority Under An Enhanced Requirement to Pay**
- **Memorandum of Understanding**
- **Enhanced Requirement to Pay in Receivership Situations**
- **Enhanced Requirement to Pay in Construction Setting**
- **Enhanced Requirement to Pay in Consumer Proposal**
- **Enhanced Requirement to Pay Under the Companies' *Creditors Arrangement Act***
- **Service of Enhanced Requirement to Pay**

What Amounts to Include in an Enhanced Requirement to Pay

ERTP issued under the *ITA* only apply to liabilities arising as a result of amounts deducted from employees' remuneration that have not been remitted. Such liabilities include amounts for federal and provincial income tax, employees' and employers' share of CPP contributions and EI premiums as well as related penalty and interest.

ERTP issued under the *ITA* must not be used to collect a debt:

Digitized by Google

- arising from assessments raised for failure to deduct amounts from employees' remuneration such as income tax, Part XIII tax, CPP contributions or EI premiums (whether or not the assessment has been issued on a notional basis)
- arising from assessments raised for directors' liability issued pursuant to the *ITA* or the *ETA*.
- amounts arbitrarily assessed
- late-filed T-4 Information Return penalties
- penalties or interest related to any of the above amounts
- amounts deducted or withheld before December 17, 1987

In the instances noted above use a regular Requirement to Pay.

An ERTP issued under the *Excise Tax Act* captures any debt assessed pursuant to Part IX of the Act. Consequently, it would be appropriate to use the ERTP provisions to claim priority over the interests of secured creditors, to recover assessed and not remitted net GST plus related penalties and interest whether or not the assessment has been issued on a notional basis, provided the circumstances are within the guidelines provided in Communication ARD-2004-009, **Deemed Trusts and Enhanced Requirements To Pay - Non-Construction Sector**.

It should be noted the net GST is to be remitted by the registrant regardless of whether the registrant has collected the tax.

Whether issued pursuant to provisions of the *ITA* or *ETA* care must be exercised to ensure that the ERTP only refer to amounts that can be legitimately included on the garnishment document to avoid the possibility of a Court ruling the ERTP to be invalid.

An ERTP issued pursuant to the *Air Travellers Charge Security Act* applies to any assessed liability under that Act, including penalties and interest. Accordingly, the use of an ERTP is appropriate to claim priority over the interests of secured creditors, whether or not the assessment has been issued on a notional basis.

When to Use an Enhanced Requirement to Pay

The question of whether an ERTP is valid and enforceable in a given situation is a matter of related facts and provincial statutes as applicable to where the property is located. For further details refer to Communication ARD-2004-009, **Deemed Trusts and Enhanced Requirements To Pay - Non-Construction Sector**.

One test that the ERTP provisions must pass in order to apply is that the funds sought to be intercepted "...but for the security interest...would be payable to the tax debtor". It may be that this "but for" requirement has not been met when the funds resulted from a sale that the debtor did not initiate, or consent to. Regardless, Collection Officers are encouraged to issue the ERTP in such circumstances and, upon being challenged, contact the Department of Justice immediately to determine if there is an amount "...that but for the security interest...would be payable to the tax debtor".

Counsel will advise when and if the Collection Officer must:

- claim priority on another basis

Digitized by Google

- withdraw the ERTP; or
- let the ERTP stand

Issue an ERTP to intercept the following:

Note: The following list is not exhaustive; moreover it is not applicable to the construction industry:

- accounts receivable
- to intercept proceeds from real property that are surplus after property taxes attributable to the specific property have been paid to the municipality and all prescribed security interests have been satisfied
- when the debtor is also a secured creditor, to intercept any payments or disposition of proceeds that the debtor is entitled to receive because of the security interest, despite the fact that the debtor's security may be a prescribed security interest
- to intercept payments due to a debtor under rental or lease arrangements for real or personal property

  Note: In the case of real property see Directive RCD-00-31 **Mortgagee in Possession and Attornment of Rent** and obtain the assistance of Department of Justice if necessary.

- when a secured creditor is taking action to realize from security to intercept proceeds from the disposition of personal property that is subject to a chattel mortgage, purchase money security interest, or any other form of voluntary or non-consensual security interest

  Note: It is recommended that DOJ be contacted to determine if the secured creditor has met the "but for" test. Please refer to the exception concerning a landlord's distress action for rent arrears as set out within the section **When Not to Assert Priority Under An Enhanced Requirement to Pay** and within Communication ARD-2004-009, **Deemed Trusts and Enhanced Requirements To Pay - Non-Construction Sector**.

- to intercept amounts deposited or invested with a third party, such as a financial institution
- to intercept amounts receivable by a debtor for goods or services, whether or not they were provided in the course of a debtor's usual business activities; (e. g. old equipment that has been replaced or sold)
- to intercept proceeds of insurance claims payable such as those that pertain to a debtor's inventory
- to intercept the proceeds of insurance claims in the case of real property to obtain surplus funds that remain after prescribed security interests have been satisfied

Note: Please ensure that a National Early Warning System (NEWS) Report has been completed in advance of any Collection action against sensitive sources (for e.g. Media threat) or in any circumstance deemed applicable by a local TSO.

Digitized by Google

The NEWS Report's instruction sheet and form are accessible electronically through the CRA website.

When Not to Assert Priority Under An Enhanced Requirement to Pay

Specific circumstances where an ERTP must not be used to assert priority are set below. For further detail refer to Communication ARD-2004-009 **Deemed Trusts and Enhanced Requirements To Pay - Non-Construction Sector**. Please note this section does not apply to the construction sector.

- to claim priority over a sheriff's fee that pertains to seizure and sale of a debtor's property (Note: when a sheriff's or bailiff's fee if acting in the capacity of a sheriff, appears excessive, contact Headquarters)
- to intercept the proceeds from dispositions resulting from a landlord's distress action for rent arrears (Note: it may be possible to claim priority on the basis of the deemed trust provisions)
- to intercept proceeds from real property dispositions that are required to satisfy a creditor's prescribed security interest
- to intercept proceeds from real property dispositions required to satisfy property tax arrears due to a municipality
- to intercept proceeds of insurance claims payable to secured creditors to the extent that they relate to property that is subject to prescribed security interests
- to intercept proceeds of insurance claims that pertain to the repair or restoration of real property that is subject to prescribed security interests; and
- to intercept proceeds of insurance claims that relate to the repair or restoration of either real property or personal property when:
  - i. the work has been authorized by the insurance company
  - ii. the person authorized to do the work is at arm's length with the debtor; and
  - iii. the work has been completed or substantially completed

Memoranda of Understanding

When administering the policies set out in Communication ARD-2004-009, **Deemed Trusts and Enhanced Requirements To Pay - Non-Construction Sector**, Tax Services Offices must take into account the implications of funds sharing "Memoranda of Understanding" when a MOU exists between the Agency and a province or territory. It is emphasized that such a MOU does not apply when:

- a case comes under the jurisdiction of either the *Bankruptcy and Insolvency Act* or the *Companies' Creditors Arrangement Act*; or
- a case is brought before the court

Digitized by Google

Enhanced Requirement to Pay in Receivership Situations

The use of enhanced requirements to pay in receivership situations is flexible and each case should be decided on its own merits. The application of an enhanced requirement to pay will require the cooperation of receivers. Further, the circumstances of individual cases may, in some instances, cause concern to some receivers. Therefore, give consideration to the receiver's concerns, although it may not always be possible to accommodate every concern.

For further detail refer to the procedure, **Collecting a Tax Debt in Receivership Situations** and to the Directive (RCD 95-5) **The Use of Enhanced Garnishment in Receivership**.

Enhanced Requirement to Pay in Construction Setting

The Supreme Court of Canada, has confirmed in the case, **TransGas Ltd. vs. Mid-Plains Contractors Ltd.** that enhanced requirements to pay issued under the *Excise Tax Act*, subsection 317(3) and the *Income Tax Act*, subsection 224(1.2) take precedence over the rights of lien claimants pursuant to builder's lien legislation.

The enhanced garnishment is not to be enforced in respect of percentage holdbacks under provincial building lien registration providing the lien claims are valid. For further details refer to Memorandum 01-07 entitled **Directive CO-88-13 and Memorandum CO-92-13 Construction Lien Claims and Double Jeopardy**.

Enhanced Requirement to Pay in Consumer Proposal

Although the *Bankruptcy and Insolvency Act* imposes no impediment on the Agency from issuing an Enhanced Requirement to Pay to recover source deductions in a consumer proposal, it should only be done if the insolvent debtor is reluctant to guarantee payment of those amounts within six months of the approval of the proposal. For further details, refer to Directive RCD-01-05, **The Status of Source Deductions in a Consumer Proposal**.

> Note: If an Enhanced Requirement to Pay has been issued prior to a tax debtor filing a Notice of Intention to file a proposal, the third party should be instructed to remit any funds to the tax debtor. The effect of the Enhanced Requirement to Pay is not to be released merely suspended. For further details and examples of release letters to be used, refer to Directive RCD-01-06, **Liquidation Proposals**.

Enhanced Requirement to Pay under the *Companies' Creditors Arrangement Act*

Usually, a company will ask the Court to stay the Agency from issuing Enhanced Requirements to Pay to collect the Payroll Deductions debt. In so doing, the company is committed to pay the entire Payroll Deductions debt due within six months of the approval of the plan. As well, the company must remain up to date on current remittances.

If the company does not ask the Court to prohibit the use of Enhanced Requirements to Pay, the "notwithstanding" clause of the Enhanced Requirement to Pay provision (Subsection 224 (1.2) of the *ITA*) applies, and Enhanced Requirements to Pay can be issued provided that:

- the stay of proceedings order does not bar the Agency from doing so; or

Digitized by Google

- the company is liquidating its assets; or
- the stay of proceedings terminates as per one of the following:
  - the order expires
  - the plan is rejected by the creditors or the Court
  - there is a default on any of the terms of the plan
  - six months has elapsed since the sanctioning of the plan
  - creditors realize on their security on property which could be subject to an Enhanced Requirement to Pay issued pursuant to Subsection 224 (1.2)

    Note: In all instances, an opinion on this issue should be obtained from the Dept. of Justice.

For additional details, refer to the Directive ARD 01-02, ***The Companies' Creditors Arrangement Act***.

Service of Enhanced Requirements To Pay

The information regarding the service of an ERTP is applicable whether issued pursuant to the *ITA*, *ETA* or the *Air Travellers Security Charge Act*.

The ERTP provisions provide for service by any means. Accordingly, Enhanced Requirements To Pay can be issued by using a variety of methods such as, for example, use of regular or registered mail, as well as being served personally.

The Income Tax Act, the *Excise Tax Act* and the *Air Travellers Security Charge Act* deem anything, sent by first class mail, to have been received by the person to whom it was sent on the day it was mailed.

In the case *Adele Schafer v. Her Majesty The Queen* , (1998) T.C.J. No.459 Court File APP-478-96-GST, the court ruled:

> In a large organization, such as government department, a law or accounting firm or a corporation, where many pieces of mail are sent out every day, it is virtually impossible to find a witness who can swear that he or she put an envelope addressed to a particular person in the post office. The best that can be done is to set out in detail the procedures followed, such as addressing the envelopes, putting mail in them, taking them to the mailroom and delivering the mail to the post office.

In the Schafer case, The Federal Court of Appeal confirmed the use of this standard and, in doing so, determined service cannot be rebutted as it is deemed to have been made.

It is suggested that local procedures include that the Revenue Collections Division be notified by the mailroom whenever there is a disruption in the regular flow of outgoing mail so that a corresponding notation is made in the account's diary.

Requirement to Pay Restorable Monies

Digitized by Google

When is a Requirement to Pay Restorable Monies Issued

A Requirement to Pay Restorable Monies is issued to intercept monies:

- to satisfy a debt, due as a result of an assessment raised by the Investigations Division

  Note: The basis for the assessment is usually the monies seized by the police.

- where an **Order of Disposition** is granted returning the monies to the tax debtor

Collection officers should be mindful that officials are required to deal with seized property according to the time lines set out within the Criminal Code. Collections must first determine from Investigations, under which section of the Criminal Code the funds or assets were seized and the date the seizure took place. Most importantly, it needs to be determined when the detention order will expire and/or when the funds or property seized may become otherwise restorable to the tax debtor.

Please refer to Communication ARD-2004-006, **Collections Policy for Integrated Proceeds of Crime (IPOC) Cases**, for further details.

When is a Requirement to Pay Restorable Monies not Appropriate

A Requirement to Pay Restorable Monies is not appropriate when CRA seeks to seize:

- jewellery
- gold wafers
- vehicles
- real property

A Certificate registered within an applicable Provincial Registry System and/or a Writ of Seizure and Sale is required to effect the seizure of the above. Refer to the **Certificates and Writs** chapter for further detail.

When do Monies Become Available to CRA

Monies become available to CRA when:

- an **Order of Restoration** is given by a magistrate
- an **Order of Disposition** is given
- any portion of the money becomes otherwise returnable to the tax debtor

Monies Not Available To Satisfy a Debt

Digitized by Google

Concerns arise when all of the assets and/or funds of an accused have been seized. In some cases, the accused could make an application for restoration of some of the seized funds in order to finance their legal defence or living expenses by way of an application under section 462.34 of the Criminal Code. The Criminal Code provides that where an accused has no other means to fund a legal defence other than the assets that are seized and held, then a judge may make an order varying the original seizure and allow some of the funds to be dispersed to the accused or their counsel for these purposes. Be aware that an erosion of the funds can occur when the accused applies to have their legal defence or living expenses paid out from seized funds.

It is recommended that Collections should defer the collections of seized funds unless informed by investigations or the prosecuting lawyer that a successful forfeiture is no longer likely.

Monies not available to satisfy a debt also include:

- any monies used for the purchase of narcotics, where the tax debtor is convicted of an offence

  Note: The funds are disposed of by the SPMD.

- monies forfeited to the Crown
- monies where SPMD is unable to make an order for disposition
- monies held indefinitely by the police or SPMD
- when it is found that the tax debtor is not the owner of the money

Please refer to Communication ARD-2004-006, **Collections Policy for Integrated Proceeds of Crime (IPOC) Cases**, for further details or contact **HQ Field Support** or the Department of Justice for assistance in these matters.

Function of the Requirement to Pay Restorable Monies Covering Letter

The function of the Requirement to Pay Restorable Monies covering letter is to:

1) Advise police and/or the SPMD not to release the monies to the Canada Revenue Agency (CRA) until:

   - an Order of Restoration is granted by the Magistrate ordering the monies be returned to the tax debtor
   - an Order is made by the Magistrate to return monies seized pursuant to a court order to the tax debtor
   - an Order of Disposition is issued by the SPMD ordering the monies returned to the tax debtor
   - any of the monies become otherwise restorable to the tax debtor

2) Request the police and/or the SPMD to notify CRA when one of these circumstances takes place.

Digitized by Google

Approval Authority Requirement to Pay Restorable Monies

For details regarding the authority level required for the issuance of a Requirement to Pay Restorable Monies for both Tax and GST refer to Memorandum 01-21, **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act***.

Approval Authority for a Requirement to Pay

The approval authority for a requirement to pay is different for routine circumstances and sensitive circumstances.

For further details, refer to Memoranda 01-21 **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act***, and Communication TSDMB-2008-017 Correct Signatures for Requirement for Information (RFI) and Requirement

Related Topics:

- **Sensitive Income Sources**
- **Financial Institutions Loans and Advances (Category '4')**

Sensitive Income Sources

Sensitive income sources include:

- alimony payments
- bank accounts, loans and advances where category "4" is activated
- funds where there is evidence of unemployment
- pension benefits
- social assistance payments
- tenants for the interception of rental income

  Note: If there is the possibility that the requirement to pay could create an extremely serious situation consult the Director, Tax Services Office (TSO) prior to the issuance of the requirement to pay.

Note: Please ensure that a National Early Warning System (NEWS) Report has been completed in advance of any Collection action against sensitive sources (for e.g. Media threat) or in any circumstance deemed applicable by a local TSO.

The NEWS Report's instruction sheet and form are accessible electronically through the CRA website.

Digitized by Google

Financial Institutions Loans and Advances (Category '4')

Under circumstances where loans and advances are being intercepted at a financial institution by activating Category '4', the following is the signing authority for a Requirement to Pay or an amended Requirement to Pay:

- the personal signature of the Director, Tax Services Office or
- the facsimile signature of the Director, Tax Services Office affixed with a rubber stamp by a designated official in a position of either Assistant Director, Manager, Team Leader of Revenue Collections or Resource Complex Case Officer in the Revenue Collections Division authorized, in writing, to do so or
- either the personal signature of a designated official in a position of Assistant Director, Manager, Team Leader of Revenue Collections or Resource Complex Case Officer in the Revenue Collections Division authorized, in writing, to do so or a rubber stamp facsimile of his or her signature

Withdrawal of a Requirement to Pay

The withdrawal of a requirement to pay may occur for various reasons depending on the type of requirement to pay and the particulars of the requirement to pay.

For details regarding the release of a Requirement to Pay issued to the Royal Bank of Canada, refer to Communication ARD-2004-017, **Instructions in the preparation and withdrawal of Requirement to Pay issued to Royal Bank of Canada**.

Related Topics:

- **Withdrawal of a Requirement to Pay Under Routine Circumstances**
- **Withdrawal of a Requirement to Pay When Category 4 Activated**
- **Withdrawal of Enhanced Requirements to Pay**
- **Withdrawal of Enhanced Requirement to Pay and Directors' Liability Disclaimer Letter**

Withdrawal of a Requirement to Pay Under Routine Circumstances

Withdraw a requirement to pay under routine circumstances when:

- an offset or reassessment results in a nil or credit balance
- when a stay of proceedings is in effect by virtue of the Bankruptcy and Insolvency Act
- where acceptable security is provided

Digitized by Google

- the source deduction and/or GST balance exceeds $10,000; or
- where a cumulative balance between source deductions and GST exceeds $10,000

Refund on Garnished Amounts

When a credit balance appears on an account as a result of garnishment action and the taxpayer requests a refund, the collection officer should ensure that no other monies are owed to CRA (including Memo Assessments). The amount may then be refunded to the taxpayer. If the surplus funds came from the courts, they will have to be returned to the courts for the benefit of other creditors.

Procedures

This section provides procedures related to Requirements to Pay:

- Issuing a Requirement to Pay
- Verifying a Completed Requirement to Pay
- Garnishment of Construction Holiday Pay in Quebec
- Requirement to Pay Issued to Joint Bank Accounts in Quebec
- Requirement to Pay Issued to Joint Bank Accounts in Other Provinces
- Issuing a Requirement to Pay Restorable Monies
- Garnishing Non Redeemable Term Deposits or GICs or RRSPs
- Garnishing Term Deposits or GICs Requiring the Original Document
- Garnishing Ontario Statute Credits
- Garnishments to the Province of Ontario
- Garnishing Pension Benefits in Ontario
- Garnishing Workers' Compensation Benefits in Alberta
- Garnishing Workplace Safety and Insurance Board Benefits in Ontario
- Garnishing Federal Annuities
- Garnishing Canadian Pacific Railway Employees
- Garnishing Canadian National (CN) Employees
- Garnishing Canadian Wheat Board Payments

Digitized by Google

- Garnishing House of Commons Employees
- Garnishing the Ontario Legal Aid Plan
- Garnishee Summons in Alberta
- Collecting a Tax Debt Under Bankruptcy and Proposals in Bankruptcy Situations
- Collecting a Tax Debt in Receivership Situations
- Delivering a Requirement to Pay
- Completing a Requirement to Pay when Serving a Designated Branch
- Issuing an Amended Requirement to Pay
- Delivering a Requirement to Pay Withdrawal
- Non-compliance with a Requirement to Pay

Issuing a Requirement to Pay

A requirement to pay is issued to third parties to seize or intercept moneys payable to or to be loaned or advanced by a third party to or on behalf of the tax debtor.

Related Topics:

- Completing a Requirement to Pay
- Naming Conventions

Completing a Requirement to Pay

To complete a requirement to pay:

1. Choose the appropriate requirement to pay:
   - enhanced requirement to pay
   - regular requirement to pay
2. Identify the tax debtor by:
   - account number
   - address
   - name

   Refer to Naming Conventions for further detail.

Digitized by Google

3. Identify the third party by:

   - address
   - name

4. Determine the total amount to be garnished:

   - applicable interest
   - penalty

   Note: Do not include amounts under appeal.

5. Identify, if applicable, the type of assets:

   - bank account

   Note: Do not make reference to "joint bank account" in the description area.

   - term deposit
   - registered retirement savings plan

6. If applicable, indicate an "x" in the box beside category 4.

   Refer to **Category 4 Criteria** for further detail.

7. If multiple requirements to pay are issued place the letter "m" in red ink, on the lower right hand side of the requirement to pay remittance form.

   When payments are received record the name of the third party and the amount of any payment. Notify the remaining parties immediately when a substantial remittance is made to avoid overpayment.

8. Choose the appropriate terms after consideration is given to:

   Note: A variation to the terms describing the deduction requirements is made only in exceptional cases and with the approval of Tax Services Office management and the Department of Justice.

   If you select the terms in option 8, it is mandatory that the information be inserted in both official languages, complete both section 8A and 8B.

   - the quickest method of collecting the arrears without creating undue hardship

   Refer to **Ability to Pay** for further detail.

   - the provincial exemptions

   Note: The Crown is not legally bound by provincial exemptions however, under normal circumstances these are respected. For additional information, refer to Directive ARD 02-04, **Garnishment - Calculation of Deductions** **except for the province of Quebec where the Directive is in abeyance.**

Digitized by Google

9. Ensure the signature block, of the Requirement to Pay, reflects the correct title for the work description of the delegated authority approving the Requirement to Pay.

   For further details, refer to Memoranda 01-21 **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act*** and Communication TSDMB-2006-017 **Correct Signatures for Requirement for information (RFI) and Requirement to Pay (RTP)**

Naming Conventions

To identify a tax debtor and third parties on a requirement to pay, use the naming conventions for each category under which they may fall:

- **Individual**
- **Individual Deceased**
- **Corporation**
- **Partnerships**
- **Partnerships in Quebec**
- **Financial Institutions**

Individual

- Individual

  Tax debtor's full given name followed by the surname in the identical style as contained on the Notice of Assessment, for example, John William Brown.

- Individual - Using Alias

  Tax debtor's full first name followed by the surname, include known aliases, for example, John Brown (sometime known as John Doe and John Smith).

- Individual - Using Alias and Different Social Insurance Numbers (S.I.N.s)

  Tax debtor's full given name followed by the surname, the alias, and the S.I.N., for example, John Brown (sometime known as John Doe and John Smith).

  Note: Include all aliases and social insurance numbers.

- Individual - Sole Proprietor

  Tax debtor's full given name followed by the name of the proprietorship, for example, John Doe (sometime carrying on business as Doe's Doings).

Digitized by Google

- Individual - Operating under a Registered Business Name

  Tax debtor's full given name followed by the name of the registered business name, for example, John Doe (sometime carrying on business under the name and style of Doe's Doings Reg.).

Individual Deceased

- Individual Deceased

  Tax debtor's name in the identical style as contained on the Notice of Assessment if:

  - the tax debtor died intestate
  - the next of kin indicates no willingness to apply for a Letter of Administration

- Individual Deceased - Probated Will in Existence

  Name of the Executor or Liquidator in the province of Quebec, for example, John Doe, Executor of the Last Will and Testament of deceased

- Individual Deceased - Intestate

  Name of the Administrator or Liquidator in the province of Quebec, for example, Administrator of the Estate of deceased or for the province of Quebec, for example, Liquidator of the Estate of deceased.

Corporation

- Corporation

  The exact legal name of the business, for example, J.D. Holdings Company Ltd.

- Corporation - Assets Registered in a Trade Name

  The trade name used to register the corporations assets, for example, the designation J.D. Holdings Company Limited (sometime carrying on business as The Doings).

- Corporation a Division of Another Corporation

  If you know the division is a separate legal entity, the division's name, if in doubt, the division's name followed by the name of the parent company, for example, XYZ, a division of ABC Inc.

- Corporation - Amalgamated Into a New Entity

  The name of the amalgamated corporation followed by the name of the corporation before amalgamation, for example, Company A, an amalgamated corporation and continuation of Company B.

Digitized by Google

Partnerships

- Partnerships, except the Province of Quebec:

  In cases where the partnership is the debtor, only the partnership name is required.

  If the debt is for GST/HST:

  i) If the partners and the business are all at the same address:

  The name of each partner followed by the business address and include the partnership name, for example: John Doe and Jane Doe (sometime carrying on business as ABC Doings)..., 20 Lake Road, Anytown, British Columbia.

  ii) If the business is at a different address:

  The name of each partner followed by their address and include the partnership name and address, for example: John Doe and Jane Doe (7 Country Lane, Anytown, British Columbia) (sometime carrying on business as ABC Doings, 20 Lake Road, Anytown, British Columbia).

  Note: A partnership is a person under the *ETA*, and is the primary debtor in cases where it has failed to remit GST/HST. In order to hold the individual partners jointly and severally liable for the partnership debts a memorandum assessment must be raised against each individual partnership debt.

  For further details refer to Memorandum 03-05, **Liability of Partnerships and Partners for GST/HST**.

- Individual Partners of a Partnership for a Partnership Debt except in the Province of Quebec:

  Legal action should be taken against each partner using the same parameters used when issuing a Requirement to Pay for an Individual debtor:

  The name of the partner (sometime carrying on business as INSERT NAME OF PARTNERSHIP), followed by the known address of the partner.

  For example:

  John Doe (sometime carrying on business as ABC & Associates) 123 Anytown Street, Ontario, Postal Code

- Service of Partnership Garnishee:

  Pursuant to subsection 224(6) *ITA* where persons carry on business in partnership, notification to the persons of a requirement under subsection (1), (1.1) or (1.2) may be addressed to the partnership name and, in the case of personal service, it is deemed to be validly served if it is served on one of the partners or left with an adult person employed at the place of business of the partnership.

- Where an individual partner within a partnership holds a tax liability for an amount separate from the partnership:

Digitized by Google

A Requirement to Pay in the name of the partner debtor is issued to the known partnership entity.

Partnerships in Quebec

Partnerships are either general partnerships, limited partnerships or undeclared partnerships. In Quebec, they are governed by the Civil Code of Quebec, Book Five, Title two, Chapter X.

- The Tax Debtor is a Partner

  In Quebec, little case law has dealt with the subject of Collections pursuant to the ITA and partnerships. It is therefore recommended to exercise care and address one Requirement to Pay in the partnership name as well as others to the partners' name citing the operating name of the partnership when aiming to attach sums that are liable to be paid to a tax debtor partner such as his share of the profits in the partnerships.

  As a rule, the assets of a partnership cannot be seized to satisfy a partner's personal liability. The exception lies in the undeclared partnership where, in respect of creditors, each partner has retained the ownership of the property constituting his contribution to the undeclared partnership. Such contribution can therefore be attached to satisfy a partner's personal liability.

  When contemplating the seizure of a partner's share in partnership, refer to Department of Justice for assistance.

- The Tax Debtor is a General or Limited Partnership Indebted for Payroll Deductions

  The Civil Code of Quebec, Article 2221 reads:

  > In respect of third persons, the partners are jointly liable for the obligations contracted by the partnerships but they are jointly and severally liable if the obligations have been contracted for the service or operation of an enterprise of the partnership.

  Before instituting proceedings for payment against a partner, the creditors shall first discuss the property of the partnership. Meaning, that creditors must first procede against the partnership's assets. When proceedings are instituted against a partner, the property of the partner is not applied to the payment of creditors of the partnership until after his own creditors are paid.

  Despite the clarity of article 2221 and again, in the absence of significant case law on the subject of Collections pursuant to the *ITA* and partnerships, cases involving the responsibility of a partnership or its partners for Payroll Deductions should be referred to the Department of Justice for legal advice.

- The Tax Debtor is an Undeclared Partnership Indebted for Payroll Deductions

  A garnishee is issued in the partners' name followed by the partnership name, for example, John Doe and Mary Doe sometime operating a partnership together or a firm under the name of Doe's Carpet Cleaner.

  An undeclared partnership is not bound to make declarations in the manner prescribed by the legislation concerning the legal publication of partnerships. For

Digitized by Google

this reason it may be difficult to thoroughly identify current members. When a garnishee is issued to a bank, verify with the financial institution that there has not been any recent change in partners.

Financial Institutions

The task of identifying "legal entities" is complex, it is nevertheless vital to do so, in order to ensure that RTPs are issued to valid third parties. For example, some well-intentioned bank employees may direct you for instance to simply using the corporate brand name to capture all legal entities. This should not be done, as this could jeopardize the Crown's position in the event of an eventual non-compliance.

For example, there are a large number of legal entities providing an array of financial services under the "TD Canada Trust" and other brand names. Collection Officers should anticipate, in some instances, significant effort in order to locate and identify a valid legal entity as a bank garnishment source.

For further details refer to Memorandum 02-09 **Requirements To Pay Naming Conventions TD Canada Trust**.

Verifying a Completed Requirement to Pay

A requirement to pay is a legal document and must be completed without errors or corrections made on the requirement to pay. All items that may affect the issuance of a requirement to pay are reviewed immediately prior to mailing.

Related Topic:

- **Items to Verify Prior to the Issuance of a Requirement to Pay**

Items to Verify Prior to the Issuance of a Requirement to Pay

Verify the following items prior to the issuance of a requirement to pay:

- a Notice of Assessment was issued
- the debt is legally collectible
- an unanswered enquiry does not exist
- legal warning was given
- no financial transaction is in process
- accuracy of tax debtor or third party information, for example, spelling of names, addresses
- accuracy of the present balance outstanding, including accrued interest to date

Garnishment of Construction Holiday Pay in Quebec

Digitized by Google

Twice a year, the Commission de la construction du Québec pays allowances to construction workers through a cheque sent by mail; at the end of June and in November. Since construction workers are without pay during their construction holiday and because their payroll deductions are made pursuant to a government decree and collective agreements, HQ policy is that the provisions in ss. 553(11) of the Code de Procédure Civile du Québec apply to the vacation pay.

Therefore, any Requirement to Pay issued to capture this type of holiday pay is limited to a maximum of 30% after exemptions.

Requirement to Pay Issued to Joint Bank Accounts in Quebec

To garnish joint bank accounts in Quebec:

> Note: The seizing of joint bank accounts for the debt of one of the signatories is possible if the origin of the funds on deposit is traceable to the tax debtor. The account can be garnished to the extent of the monies traceable to the tax debtor. Refer to the policy on **When to Issue Requirement to Pay on Joint Bank Accounts** for further detail.

1. Prepare the requirement to pay. Refer to **Issuing a Requirement to Pay** for further detail.

   In the case of a joint debt, for example, partnership, director's liability, or property transfer, issue separate requirements to pay and send them in the same envelope with the explanatory letter ELCS #19688 to provide clarification to the third party.

2. Send/Serve the requirement to pay to the financial institution.

   Note: Do not make reference to "Joint Bank Account" in the description area of the assets to be garnished.

3. If no response is received, establish the relevant facts by investigation for example, bank requirement for information.

4. Establish that the funds are indeed contributed by both parties from separate sources, for example, individual employment, investment.

5. Establish that a portion or all of the funds on deposit are those of the tax debtor.

6. Request the bank honour the requirement to pay to the extent of the funds belonging to the tax debtor.

7. If the bank refuses, refer the matter to the Department of Justice for possible non-compliance action.

Requirement to Pay Issued to Joint Bank Accounts in Other Provinces

To garnish joint bank accounts in other provinces:

> Note: The seizing of joint bank accounts for the purpose of satisfying the debt due by only one of the joint debtors is not possible. However, where the joint bank account holders are both indebted but for different debts, separate requirements to pay may be issued. Refer to the policy on **When to Issue a Requirement to Pay on Joint Bank Accounts** for further details.

Digitized by Google

- the authority under which the money was seized, for example: Controlled Drugs and Substances Act, Criminal Act
- if the funds seized are being used by the tax debtor to pay for their legal defense fees or living expenses

Completing a Requirement to Pay Restorable Monies

To complete a Requirement to Pay Restorable Monies:

1. Identify the person or section responsible for holding the monies, for example: constable, department name, at the:
   - local detachment of Royal Canadian Mounted Police (RCMP)
   - provincial police
   - municipal police
   - the SPMD

   Note: When monies are held by a magistrate or other court official, issue the Requirement to Pay Restorable Monies to the clerk of the court and the person who authorized the warrant or seizure.
2. If monies are held by a magistrate or the Court official, issue the Requirement to Pay Restorable Monies to both:
   - clerk of the court, and
   - person who authorized the warrant or seizure
3. Identify the tax debtor, including:
   - name
   - account number
   - address
4. Identify the amount to garnishee, including:
   - tax
   - applicable penalty
   - applicable interest
5. Attach the Requirement to Pay Restorable Monies covering letter available on the Electronic Letter Creation System (ELCS # 19636).
6. Obtain the appropriate Tax Services Office authorization. Refer to **Approval Authority Requirement to Pay Restorable Monies**, for further detail.

Digitized by Google

1. Request a copy of the contract from the tax debtor.

2. Send the copy to the Department of Justice for review to ensure that the condition is binding against the requirement to pay.

3. If the Department of Justice confirms that the contract is not binding against the requirement to pay, send a requirement to pay to the financial institution.

Refer to **Issuing a Requirement to Pay** for details on completing a requirement to pay.

Garnishing Ontario Statute Credits

To garnish Ontario Statute Credits, e.g., gasoline tax credit, issue a Requirement to Pay to:

The Director
Ministry of Finance for Ontario
Collections and Compliance Branch
33 King Street West, 6th Floor
Oshawa ON L1H 8H5

Refer to **Issuing a Requirement to Pay** for details on completing a Requirement to Pay.

Garnishments to the Province of Ontario

To garnish earnings or business income paid by the Province of Ontario:

Note: This includes amounts payable by Ontario Government ministries, agencies, boards or commissions.

1. Complete a Requirement to Pay.

   Refer to **Issuing a Requirement to Pay** for further details.

2. Identify how the tax debtor is employed:

   - an employee, include: employee number, paylist number and social insurance number
   - contractor
   - supplier
   - trades person
   - corporation

3. Provide the name of the Ontario Government ministry, agency, board or commission, which employs or has a contract with the tax debtor.

4. The Agreement in place between the CRA and the Province limits us to claiming 20% of the net pay of the employee or such percentage set out in section 7 of the

Digitized by Google

Wages Act (Ontario) as amended from time to time and the CRA has agreed not to attempt to force compliance against the Province in respect of a Requirement to Pay which claims more than 20% of an employee's net pay.

A Requirement to Pay issued by the CRA respecting amounts payable to a tax debtor who is not an employee but is a supplier, tradesperson, contractor or similar person can claim the entire amount payable by the Province.

5. Address the completed Requirement to Pay to:

For provincial employees:

Government of the Province of Ontario
Ontario Shared Services
Attention: Supervisor, HRSDB – Pay and Benefits Section
C/O MacDonald Block Facility
2nd Floor
77 Wellesley Street
PO Box 500
Toronto ON M7A 1N3

For self-employed or business income:

Government of the Province of Ontario
Ontario Shared Services
Attention: Supervisor, Collection Management Unit
40 Elm Street
Suite 41A
Sudbury ON P3S 1S3

Garnishing Pension Benefits in Ontario

CRA has a Memorandum of Understanding with the Ontario Pension Board facilitating the requirement to pay of Ontario civil service pension benefits. Garnish pension benefits only as a last resort and after a tax debtor's **ability to pay** is determined, unless the benefit results from an over funded contribution.

The terms of the requirement to pay are normally set at 20%, unless the tax debtor has other income of more significance. When the terms of the requirement to pay are increased to more than 20%, the appropriate Tax Services Office (TSO) approval is required. CRA can garnish 100% of contributions in excess of that required to fund a pension benefit.

Mail to:

The Vice-President
Plan Administration
The Ontario Pension Board
One Adelaide St. East
Suite 1200
Toronto ON M5C 2X6

Digitized by Google

Refer to **Issuing a Requirement to Pay** for further details.

Garnishing Workers Compensation Benefits in Alberta

CRA has a Memorandum of Understanding with the Workers Compensation Board (WCB) of Alberta regarding the administration of Requirements to Pay. Issue a Requirement to Pay to the WCB only as a last resort and after a tax debtor's **ability to pay** is determined. If the tax debtor complains to the WCB of hardship the WCB will refer the complaint to the Tax Services Office for review and will hold the Requirement to Pay in abeyance until further direction is provided. The WCB is entitled in certain cases to set-off benefits, refer to section **Alberta Workers' Compensation Board Entitlement to Set Off** for further detail.

The terms of the requirement to pay are determined by the type of benefit paid by the WCB:

- 30% of the recipient's earning loss supplement, where the tax debtor re-enters the workforce and becomes entitled to an earnings loss supplement
- 30% of a commutation (lump sum) payable
- 50% in respect of a **non-economic loss award**

For more details regarding then issuance of Requirement to Pay to the WCB of Alberta, including the proper terms to be used, refer to Communication ARD-2004-016, **Requirements to Pay Issued to the Workers' Compensation Board of Alberta**.

Mail the Requirement to Pay to:

Worker's Compensation Board - Alberta
Finance Department
9912 - 107 Street, 8th Floor
Edmonton AB T5K 1G4

Attn.: Betty Wolfe, Payment Specialist II

Telephone: (780) 498-4084
Fax: (780) 498-7590

Refer to **Issuing a Requirement to Pay** for further details.

Garnishing Workplace Safety and Insurance Board Benefits in Ontario

CRA has a Memorandum of Understanding with the Workplace Safety and Insurance Board of Ontario (WSIB) regarding the administration of Requirements to Pay. Issue a Requirement to Pay to the WSIB only as a last resort and after a tax debtor's **ability to pay** is determined. Should the tax debtor complain to the WSIB of hardship, the WSIB will refer the complaint to the Tax Services Office for review and continue to remit funds under the terms of the Requirement to Pay until notified in writing of a withdrawal on through the issuance of a revised Requirement to Pay.

The WSIB shall exercise the right of set-off and prioritize redirection of benefits in the following order:

Digitized by Google

- overpayment of benefits
- assignment of benefits
- child support obligations; and
- Requirement to Pay

The terms of the Requirement to Pay are determined by the type of benefit paid by the WSIB:

- 20% of benefits payable or
- 50% of a **non-economic loss award**, or
- lump sum survivor award

Mail the Requirement to Pay to:

Workplace Safety and Insurance Board
200 Front Street West
Toronto ON M5V 3J1

Attention: Legal Services Division

Refer to **Issuing a Requirement to Pay** for further details.

Garnishing Federal Annuities

To garnish any federal annuities such as Canadian Government Annuities, Fisheries and Older Workers Adjustment Program, Northern Cod Early Retirement Program or Atlantic Fisheries Early Retirement Program, send the requirement to pay to:

Human Resources Development Canada
Annuities Branch
P.O. Box 12,000
Station Main
Bathurst NB E2A 4Z9

Refer to **Issuing a Requirement to Pay** for further details.

Garnishing Canadian Pacific Railway Employees

To garnish any income of an employee of CP Rail, complete a requirement to pay and send to:

Canadian Pacific Railway
Company
Attention: Tom Mannion
401 - 9 Avenue
Suite 600
Calgary AB T2P 4Z4

Digitized by Google

Refer to **Issuing a Requirement to Pay** for further details.

Garnishing Canadian National (CN) Employees

To garnish any income of an employee of CN, complete a requirement to pay and send to:

For current employees:

Canadian National Railway Company
Attention: Jean-Marc Lambert
935 De La Gauchetière West
4th Floor
Montreal QC H3B 2M9

Telephone #: (514) 399-3848
Fax #: (514) 399-0949

For pension income:

Canadian National Railway Company
Attention: Carmen Lemire
William M. Mercier Ltd.
600 Maisonneuve Blvd West, Suite 660
Montreal QC H3A 3J4

Refer to **Issuing a Requirement to Pay** for further details.

Garnishing Canadian Wheat Board Payments

To garnish Canadian Wheat Board Payments:

- Issue Enhanced Requirements to Pay for GST/HST and Payroll Deductions debts
- Issue regular Requirements to Pay for all other revenue types, for example: income tax, corporate tax, etc.
- Issue all Requirements to Pay to:

  The Canadian Wheat Board
  423 Main Street
  P.O. Box 816, Station Main
  Winnipeg MB R3C 2P5

For further details refer to Memorandum 03-03, **Garnishment of Monies Payable By The Canadian Wheat Board**.

Garnishing House of Commons Employees

To garnish any income of an employee or former employee of the House of Commons, Senator and Member of Parliament:

Digitized by Google

appropriate entry in the ACSES diary. This is mandatory for the garnishee to be issued.

3. Contact Diane Baker by email or telephone and request the issuance of a RTP providing the following information:

   - name of client (including legal entity, if applicable)
   - address of client
   - account number
   - collectible balance
   - percentage rate to be used

     Note: Unless otherwise indicated, the rate for all PAYDAC and GST accounts will be set at 100%.

Related Topics:

- OLAP Account Maintenance
- OLAP Client Enquiries
- Withdrawal of a Requirement to Pay Issued to Ontario Legal Aid Plan
- Renewal of a Requirement to Pay Issued to Ontario Legal Aid Plan

OLAP Account Maintenance

It is important the Collections Officer responsible for the account monitor the garnishee payments received to ensure they are properly applied and the RTP is withdrawn once the collectible balance is paid in full. If an overpayment results, it is the responsibility of the Collections Officer assigned to the account to contact the applicable Tax Centre and request a refund.

OLAP Client Enquiries

All client enquiries received by the TCTSO Liaison Officer will be referred to the responsible Collections Officer for resolution. At no time will the Liaison Officer negotiate arrangements or discuss details of an account with the client.

Withdrawal of a Requirement to Pay Issued to Ontario Legal Aid Plan

To withdraw a RTP issued to Ontario Legal Aid contact Diane Baker by email or telephone and request the withdrawal of the RTP providing the following information:

1. Name of client (including legal entity, if applicable)
2. Address of client

Digitized by Google

3. Account number

Renewal of a Requirement to Pay Issued to Ontario Legal Aid Plan

The TCTSO Collections-OLAP Liaison Officer will automatically renew Requirements to Pay immediately prior to the one year expiry date if any collectible balance remains outstanding.

If the Requirement to Pay is not withdrawn and an overpayment results, it is the responsibility of the collections officer responsible for the account to request a refund of the overpayment from the applicable Tax Centre.

Garnishee Summons in Alberta

Provincial legislation in Alberta allows for the use of Garnishee Summons. This action could be considered if all avenues to collect the liability, with the use of Requirements to Pay, had been exhausted, without success.

The Courts issue Garnishee Summons. In order to obtain a Garnishee Summons, the tax debt must be certified in Federal Court and a Writ of Seizure and Sale is required to be filed in the applicable region or municipality. In Alberta, the Writ must also be filed with the applicable Personal Property Registry.

The Garnishee Summons is especially useful in situations where the tax debtor has a joint bank account and the other party to the joint bank account does not have a liability with CRA. If a Garnishee Summons is obtained and issued to the bank in this scenario, the bank is required to pay, from the joint account, that portion which is considered to be the tax debtor's. The amount would then be paid into Court.

It is suggested that Collection Officers in Alberta refer to their local Tax Services Office for specific procedures.

Collecting a Tax Debt under Bankruptcy and Proposals in Bankruptcy Situations

The collection of a tax debt is affected when an individual files for bankruptcy or makes a proposal in bankruptcy:

Related Topics:

- Collecting When an Individual Files for Bankruptcy
- Collecting When a Notice of Intention to File a Proposal is Filed
- Collecting When a Proposal in Bankruptcy is Filed
- Collecting When a Receiver is Appointed Pursuant to a Security Instrument

Collecting When an Individual Files for Bankruptcy

When an individual files for bankruptcy no further collection action is taken except for issuing enhanced requirements to pay, and/or any memorandum assessment, if applicable.

Digitized by Google

- **Determining if Funds May be Payable to the Receiver**

Determining if Funds are Eligible to Crown

To determine if the funds are eligible to the Crown when an enhanced requirement to pay was issued:

1. Confirm that the enhanced requirement to pay was issued in one of the following situations:

   a) the accounts receivable were generated by the debtor prior to the appointment of the receiver

   b) the existing inventory was manufactured or converted into a finished product prior to the appointment of the receiver to meet the requirements of an order from a specific customer, but the receiver delivered the goods

   c) the existing inventory was manufactured or converted by the debtor into a finished product prior to the appointment of the receiver, but the receiver generated the subsequent sale which resulted in the account receivable

2. If situation a, b or c exists, enforce the enhanced requirement to pay regardless of whether it was issued prior or subsequent to the appointment of a receiver.

   If situation a, b or c do not exist, refer to **Determining if Funds May be Shared with Receiver** and **Determining if Funds May be Payable to the Receiver** for further investigation.

   Note: Where it is unclear whether the receiver is entitled to a specific account receivable, seek the advice of the Department of Justice. Ensure all facts relevant to the case are available for review by the Department of Justice.

Determining if Funds May be Shared with Receiver

To determine if funds may be shared with the receiver when an enhanced requirement to pay was issued:

Note: These procedures are also applicable to service industries such as hotels, convention centres, etc., insofar as they relate to the sale of rooms and convention facilities.

1. Confirm that the enhanced requirement to pay was issued when the existing inventory was:

   a) only partially manufactured or converted into a finished product prior to the appointment of the receiver to meet the requirements of an order placed by a specific customer, but the receiver finished the work in process and delivered the goods

   b) only partially manufactured or converted into a finished product prior to the appointment of the receiver, but the receiver finished the work in process and generated the subsequent sale which resulted in the account receivable

Digitized by Google

c) manufactured or converted into a finished product by the receiver, who generated the subsequent sale, which resulted in the account receivable

2. If situation a, b, or c exists, the enhanced requirement to pay will remain in place.

   If situation a, b, or c do not exist, refer to **Determining if Funds May be Payable to the Receiver** and **Determining if Funds are Eligible to the Crown** for further investigation.

3. Make arrangements with the receiver and third party to have the garnished amounts remitted to the receiver.

   Note: The receiver may deduct from each receivable realized the related expenditures pertaining to the completion, delivery, sale of the corresponding finished product or sales expense.

4. Determine the amount of excess funds from an analysis of all pertinent details associated with individual cases.

5. Monitor for the remittance of all excess funds.

Determining if Funds May be Payable to the Receiver

To determine if funds may be payable to the receiver when an enhanced requirement to pay was issued:

1. Confirm that the enhanced requirement to pay was issued when the receiver purchased new inventory, manufactured or converted it into a finished product, and generated the subsequent sale, which resulted in the account receivable.

2. If step 1 applies, the enhanced requirement to pay will remain in place to maintain the Crown's priority over other accounts receivable; however, the funds attributed to that specific receivable are paid to the receiver.

   If step 1 does not apply, refer to **Determining if Funds are Eligible to the Crown** or **Determining if Funds May be Shared with Receiver** for further investigation.

3. Advise the specific third party in writing to direct payments to the receiver.

4. Confirm which funds or expenditures are directly attributable to:

   - the account receivable generated whether prior or after the appointment
   - the cost of completion including labour, sale or delivery of the finished product
   - the purchase of new inventory
   - the manufacturing or converting of raw materials into a finished product

Delivering a Requirement to Pay

Digitized by Google

Deliver a requirement to pay by:

- registered mail
  - when the liability is substantial (as defined by local TSO parameters)
  - a potential danger of loss exists due to actions by other creditors
  - non-compliance may occur
  - litigation is in process or contemplated
- hand delivery

  Refer to **Hand Delivering a Requirement to Pay** for further detail.
- certified mail
- regular mail

  Note: Mail the tax debtor's copy the same day the requirement to pay is mailed/served to the third party.

Related Topic:

- **Hand Delivering a Requirement to Pay**

Hand Delivering a Requirement to Pay

To hand deliver a Requirement to Pay:

1. Deliver the Requirement to Pay on the company's premises, and on an officer, director or employee of the company who is 18 years of age or over.
2. Verify the identity of the individual acknowledging receipt.
3. Request the individual complete the certification on the reverse side of the office copy of the Requirement to Pay.
4. Return the office copy to the Tax Services Office (TSO).
5. Complete the Affidavit of Personal Service.
6. Contact the tax debtor and advise the tax debtor of the action taken.
7. Mail the tax debtor the appropriate copy of the Requirement to Pay.
8. Record the above actions taken within the ACSES diary, making sure to note that the Requirement to Pay was hand delivered; the date, time, and location of delivery; the name of the person who signed receipt of the Requirement to Pay; and a description of the person who accepted service.

If upon service of the requirement to pay, you are faced with the prospect of someone refusing to sign or accept service of the document, leave the document at the premises and complete the

Digitized by Google

Affidavit of Personal Service on the back of the office copy of the Requirement to Pay and complete the steps outlined within Step 8.

Refer to Non-compliance with a Requirement to Pay for further detail.

Completing a Requirement to Pay when Serving a Designated Branch

When serving a Requirement to Pay to a designated branch, you must insert "Designated Branch" on the Attention line on the "third party address" screen. This distinction will let the Bank know that they are to search all data bases for information and assets. It is critically important to ensure that you have indicated the proper legal entity of the Bank to reduce the exposure of non-compliance.

To ensure the best search results from the Designated Branch, please be as specific as is possible when identifying the taxpayer. Additional information about the taxpayer could be inserted in the field usually reserved to describe the asset to be garnisheed.

Issuing an Amended Requirement to Pay

Issue an amended requirement to pay with an appropriate letter five to ten days prior to the expiry date of the existing requirement to pay if the following circumstances exist:

- it is doubtful that the remaining operative period of the requirement to pay is sufficient to clear the liability
- there is a change in the terms
- there is a change in the amount of the liability

Related Topics:

- Issuing a Letter to Amend the Requirement to Pay
- Delivering a Letter Amending a Requirement to Pay

Issuing a Letter to Amend the Requirement to Pay

Issue a letter to amend a requirement to pay, if the following circumstances exist:

- there is a reduction in the liability through a reassessment, multiple requirement to pay payment from another source, a non-requirement to pay payment, a refund or an offset
- the existing terms are decreased as they are proving too harsh
- decreasing the existing terms on an ongoing requirement to pay which attaches periodic payments

Delivering a Letter Amending a Requirement to Pay

Deliver a letter amending a requirement to pay by:

Digitized by Google

- hand
- registered mail
- regular mail

Delivering a Requirement to Pay Withdrawal

Deliver a Requirement to Pay withdrawal by:

- certified mail
- registered mail
- fax(*)
- phone
- hand delivery

In the case of multiple requirements to pay contact all parties involved.

*The confidentiality provisions of the *Income Tax Act* (*ITA*), paragraph 241(4)(a) and 241(4)(b) and the *Excise Tax Act* (*ETA*), paragraph 295(5)(a) and 295(5)(b), allow for the communication of taxpayer information to a third party if the information is reasonably regarded as necessary to administer and enforce the *ITA*, *ETA*, *Canada Pension Plan*, *Unemployment Insurance Act* and *Employment Insurance Act*. However, officers should provide only that information which is regarded as necessary for the particular situation, that is: account name, date of Requirement to Pay; and, outstanding balance as noted on the Requirement to Pay.

It is permissible to send confidential information such as faxing a release of a Requirement to Pay to a third party, so long as the taxpayer has authorized CRA to do so. It would be best to have written authority; however, in the event that this is not possible, verbal authorization will suffice. For more information, officers should refer to **TOM 3990**. The taxpayer should be cautioned that sending the release by fax is not the most secure method of delivery. Officers must ensure that all particulars are noted in the ACSES diary.

Non-Compliance with a Requirement to Pay

Non-compliance occurs when the recipient of a requirement to pay refuses or fails to honour the terms of the requirement to pay. When forwarding Requirements to Pay or Requirements for Information to Provincial Ministries or Agencies, please note that if any non-compliance issues arise you should immediately contact your respective **HQ Field Support Officer** for his/her review and approval of any proposed non-compliance proceedings. It is recommended that you consult HQ prior to obtaining a legal opinion from the Department of Justice.

Related Topics:

- **Ways in Which Non-Compliance Can Occur**
- **Obtaining Evidence of Non-Compliance from a Third Party**
- **Obtaining Evidence of Non-Compliance from a Financial Institution**

Digitized by Google

- **Requesting Payment**
- **Requesting an Opinion on Non-Compliance**
- **Obtaining Approval for a Non-Compliance Assessment**
- **Crediting Amounts Deducted but Not Remitted**

Ways In Which Non-Compliance Can Occur

The ways in which non-compliance of a garnishment can occur are:

Note: These procedures also apply to the non-compliance of a requirement to pay of joint bank accounts where joint bank account holders are both indebted to CRA, but for different debts.

1. Non-payment of moneys which are payable to the tax debtor within the effective period of the requirement to pay.

2. Payment of moneys to the tax debtor within the effective period of the requirement to pay.

Obtaining Evidence of Non-Compliance from a Third Party

To obtain evidence of non-compliance from a third party:

1. Contact the third party promptly to determine:

   - the date the requirement to pay was received
   - the reason for non-compliance

   If a satisfactory explanation is received at this point no further non-compliance action is required.

2. If non-payment is still suspected, arrange a meeting with the third party, to conduct an examination of the books and records to confirm the total amount payable to the tax debtor.

   If the third party refuses to provide access to the requested documents complete, where applicable, a Request for Information or a Formal Requirement for Information available on the Electronic Letter Creation System (ELCS) verse 19647.

   Refer to the chapter **Requirement for Information** for further detail.

3. Photocopy the relevant documents:

   - cancelled cheques
   - bank statements

Digitized by Google

- cash vouchers
- cash disbursement ledger
- abstract of the accounts payable ledger
- any other document that could prove position of non-compliance

4. Verify that no amounts were paid to the tax debtor since the requirement to pay became operative.
5. Assess third party's ability to pay.
6. If necessary, obtain information from the Post Office to prove service of the requirement to pay.
7. If non-compliance continues, issue another requirement to pay prior to the expiration of the first requirement to pay to ensure continuity with the action.

Obtaining Evidence of Non-Compliance from a Financial Institution

To obtain evidence from a financial institution:

1. Contact the institution's manager by telephone or in person to determine the reason for non-payment.
2. If further investigation is required, obtain a voluntary authorization from the tax debtor or a Requirement to Provide Information on Documents available on the Electronic Letter Creation System (ELCS), verse 19648 to examine the records of the financial institution.

   Refer to the chapter **Requirement for Information** for further information.
3. If necessary, obtain information from the Post Office to prove service of the requirement to pay.

Requesting Payment

To request payment:

1. Obtain the evidence of non-compliance.
2. Ensure that the third party has not remitted the required amount in compliance with the requirement to pay.
3. Prepare a formal written request for payment ELCS 19629 or 19630.
4. If the third party fails to pay the amount requested or does not provide a satisfactory explanation. Refer to **Requesting an Opinion on Non-Compliance**.

Digitized by Google

Requesting an Opinion on Non-Compliance

To request an opinion on non-compliance:

1. Prepare a memorandum to the Department of Justice:

   a) Identify the tax debtor, including:

      - account number
      - amount of debt
      - name

   b) Provide a summary of the facts of non-compliance, including:

      - details of the requirement to pay (provide a copy if available)
      - particulars of any payment received pursuant to the requirement to pay in question

   c) Provide a summary of the results of the investigation including:

      - date the requirement to pay was received
      - details of the relationship between the tax debtor and third party
      - examination of the tax debtor's records
      - potential for recovery
      - third party's financial position

2. Attach copies of relevant documents, including:

   - the third party's records
   - proof of service of the requirement to pay
   - requirement to pay
   - other relevant information

This is an example of case that would justify a request for an opinion directly to the Department of Justice.

> Subsection 70(1) of the Bankruptcy and Insolvency Act makes provision for precedence of receiving orders and assignments on a garnishment that has not been completely executed by payment to its creditor. Cases where it is suspected that the third party should have had more than sufficient time to comply but failed to do so prior to the Bankruptcy, should be referred to the Department of Justice for an opinion on non-compliance.

These are examples of cases, where you could consult HQ Field Support before you request an opinion from the Department of Justice:

Digitized by Google

- cases such as above, where it is suspected that the third party should have had more than sufficient time to comply but failed to do so prior to the debtor's bankruptcy

- where a financial institution appears to be in default, after established HQ liaisons with financial institutions have been utilized

This is an example of a case that you must consult and get approval from HQ Field Support before you request an opinion from the Department of Justice:

- In circumstances where a Provincial government or Agencies refuse to comply with a Requirement to Pay

Obtaining Approval for a Non-Compliance Assessment

To obtain approval for a non-compliance assessment:

1. Prepare a memorandum outlining the details of the case.

2. Attach any relevant documentation, for example, Justice opinion.

3. Upon receipt of the appropriate approval, issue a Notice of Assessment. Refer to the chapter **Memorandum Assessments** for further detail.

Refer to Memoranda 01-21 **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act*** for the approval authority

Crediting Amounts Deducted But Not Remitted

When deductions are made under a requirement to pay but not remitted, or when the remittance cheques are not honoured by the bank, the tax debtor is given credit for the deductions in the certain situations.

To credit amounts deducted but not remitted follow these steps:

1. Confirm that one of the following situation applies:

   - the tax debtor did not cooperate with the third party and evidence of deductions and non-remittance are received from the third party

   Note: This information is determined after a formal representation.

   - the third party's records are unavailable and the tax debtor provides paycheque stubs, along with a signed statement

2. Prepare a memorandum:

   a) Requesting approval to credit the tax debtor's account and debit Headquarters' account.

   b) Providing a summary of all relevant details.

Digitized by Google

3. Attach all supporting documentation.

4. Obtain the signature of the Tax Services Office (TSO), Assistant Director, Revenue Collections.

5. Send the memorandum to:

   Headquarters
   Accounts Receivable Division
   Field Support Section

   Note: After the request has been reviewed and approved by the Field Support section it will be forwarded, for processing, to the Clerk/Officer responsible for the Uncollectible workload at Headquarters.

Resource Material

"Requirement to Pay and Statutory Set-Off Notices", TD8270-000-L (November 1999), issued by the Training and Learning Directorate.

Directive RCD-95-01, "Garnishment of Joint Accounts", issued September 13, 1995.

Directive RCD-95-05, "The Use of Enhanced Garnishment in Receivership", issued October 27, 1995.

Directive RCD-00-31, "Mortgagee in Possession and Attornment of Rent", issued November 22, 2000.

Directive RCD-01-05, "The Status of Source Deductions in a Consumer Proposal", issued February 8, 2001.

Directive RCD-01-06, "Liquidation Proposals", issued February 9, 2001.

Directive ARD-02-04, "Garnishment - Calculation of Deductions", issued August 27, 2002.

Directive ARD-01-02, "The Companies' Creditors Arrangement Act", issued May 28, 2001 (revised January 11, 2002).

Directive ARD-03-06, "Assessment For Failure To Deduct - Collections Restrictions No Longer Apply", issued August 12, 2003.

Memorandum 00-03, "Garnishment of Bank Accounts Located on a Reserve", issued March 2000.

Memorandum 01-07, "Directive CO-88-13 and Memorandum CO-92-13 Construction Lien Claims and Double Jeopardy", issued June 27, 2001

Memorandum 01-21, "Delegation of the Minister's Powers under the *Income Tax Act, Excise Tax Act* and *Customs Act*", issued December 18, 2001.

Memorandum 02-09, "Requirements To Pay Naming Conventions TD Canada Trust", issued July 4, 2002.

Digitized by Google

Memorandum 03-05, **"Liability of Partnerships and Partners for GST/HST"**, issued April 14, 2003.

Memorandum 03-03, **"Garnishment Of Monies Payable By The Canadian Wheat Board"**, issued March 18, 2003.

Memorandum 03-09, **"Validating *Bank Act* Security (S427 *Bank Act*)"**, issued May 13, 2003.

Communication ARD-2003-004, **"Funds Held in RRSPs"**, issued October 21, 2003.

Communication ARD-2004-006, **"Collections Policy for Integrated Proceeds of Crime (IPOC) Cases"**, issued February 20, 2004.

Communication ARD-2004-009, **"Deemed Trusts and Enhanced Requirements To Pay - Non-Construction Sector"**, issued March 3, 2004.

Communication ARD-2004-011, **"Changes to Requirements to Pay Issued to Tenants where the Landlord Debtor is an Individual"**, issued March 16, 2004.

Communication 2004-016, **"Requirements to Pay Issued to the Workers' Compensation Board of Alberta"**, issued April 14, 2004.

Communication ARD-2004-017, **"Instructions in the preparation and withdrawal of Requirement to Pay issued to Royal Bank of Canada"**, issued April 20, 2004.

Communication ARD-2005-022, **"Collection Restrictions following Reassessments Under the *Income Tax Act*, *Excise Act 2001* and *Excise Tax Act – Non-GST*"**, issued July 6, 2005.

Communication TSDMB-2006-020 (ARD), **Changes to the *Bank Act* allowing a Designated Branch for the point of Service for Requirements to Pay and Requirements for Information**, issued February 27, 2006.

Communication TSDMB-2008-017 (ARD), **Correct Signatures for Requirement for Information (RFI) and Requirement to Pay (RTP)**

Glossary

Appropriate Agency

Means:

a) the agency for the province in which is located the place of business of the person by whom or on whose behalf a Notice of Intention is signed

b) if that person has more than one place of business in Canada and the places of business are not in the same province, the agency for the province in which is located the principal place of business of that person, or

c) if that person has no place of business, the agency for the province in which the person resides

Security

Digitized by Google

Rights provided to the secured party for a breach of performance of the debtor. These rights secure the repayment of credit extended to such a party.

Negotiable Instruments

These apply to cheques, money orders, bank drafts and irrevocable letters of credit issued by the financial institution after receipt of a garnishment.

Liable to Make a Payment

That instance in time when the third party can be sued for non-payment.

Order of Restoration

A document issued by a magistrate, which restores items, for example: monies jewellery, etc. to the applicant of the Order.

Order of Disposition

A document issued by a magistrate identifying the disposition of items.

Periodic Payments

Periodic payments can occur at regular intervals or predetermined periods, for example, principal and interest payments under a mortgage, piece work, bonuses, etc. Periodic payments are also defined as payments which recur from time to time but not necessarily at precise or regular intervals. (*Callwood v. Her Majesty the Queen*, 2006 FCA 188).

General Assignment of Book Debts

The assignor pledges all present and future accounts receivable as security for a loan. There is no mention of a fixed or floating charge, and the assignor is said to be trustee or agent to the bank.

Secured Creditor

A person who has a security interest in the property of another person or who acts for or on behalf of that person with respect to the security interest and includes:

- a trustee appointed under a trust deed relating to a security interest
- a receiver or receiver-manager appointed by a secured creditor
- a receiver or receiver-manager appointed by a court
- a sequestrator, or
- any other person performing a similar function.

Digitized by Google

Digitized by Google

Digitized by Google

Digitized by Google

60

Jeopardy Orders

Subsection 225.2(2) details the statutory basis by which the Minister may act to realize any amount merely assessed under the ITA. Subsection 225.2(3) further provides that this process can be pursued regardless of whether an actual assessment has been forwarded to the taxpayer if the mailing would reasonably further jeopardize the realization, in the judge's opinion. The acts that the judge may grant the Minister to do are limited to those in s. 225.1(1) which are:

- commence legal proceedings in a court,
- certify the amount under section 223 against a property of the taxpayer preventing her from dealing with a clear title to it,
- require a person to make a payment under subsection 224(1) under a Requirement to Pay (RTP) to a party who will soon be making a payment to the tax-debtor,
- require an institution or a person to make a payment under subsection 224(1.1) in the form of a RTP to a financial institution,
- require a person to turn over moneys under subsection 224.3(1) where money has been seized pursuant to a police action in respect of a criminal law, or
- give a notice, issue a certificate or make a direction under subsection 225(1) seizing the taxpayer's property.

The ex parte application by the Minister must adhere to the principles of full and frank disclosure of

---

60 "Sun Lion", 2011, Patricia Vertes, Howick, Quebec

Digitized by Google

all the relevant facts since the taxpayer party is not present and cannot make representations as to the validity of the assertions. This has been one the subject of numerous cases whereby the taxpayer has attempted, in some instances successfully, to bring to the court's attention additional factors not revealed that have either upheld or quashed the ex parte order.

Notwithstanding section 225.1, where, on *ex parte* application by the Minister, a judge is satisfied that there are reasonable grounds to believe that the collection of all or any part of an amount assessed in respect of a taxpayer would be jeopardized by a delay in the collection of that amount, the judge shall, on such terms as the judge considers reasonable in the circumstances, authorize the Minister to take forthwith any of the actions described in paragraphs 225.1(1)(a) to 225.1(1)(g) with respect to the amount.[61]

Definition of "judge" - S. 225.2
225.2 (1) In this section, "judge" means a judge or a local judge of a superior court of a province or a judge of the Federal Court.

Authorization to proceed forthwith
(2) Notwithstanding section 225.1, where, on *ex parte* application by the Minister, a judge is satisfied that there are reasonable grounds to believe that the collection of all or any part of an amount assessed in respect of a taxpayer would be jeopardized by a delay in the collection of that amount, the judge shall, on such terms as the judge considers reasonable in the circumstances, authorize the Minister to take forthwith any of the actions described in paragraphs 225.1(1)(*a*) to 225.1(1)(*g*) with respect to the amount.

Notice of assessment not sent
(3) An authorization under subsection 225.2(2) in respect of an amount assessed in respect of a taxpayer may be granted by a judge notwithstanding that a notice of assessment in respect of that amount has not been sent to the taxpayer at or before the time the application is made where the judge is satisfied that the receipt of the notice of assessment by the taxpayer would likely further jeopardize the collection of the amount, and for the purposes of sections 222, 223, 224, 224.1, 224.3 and 225, the amount in respect of which an authorization is so granted shall be deemed to be an amount payable under this Act.

Affidavits
(4) Statements contained in an affidavit filed in the context of an application under this section may be based on belief with the grounds therefor.

Service of authorization and of notice of assessment
(5) An authorization granted under this section in respect of a taxpayer shall be served by the Minister on the taxpayer within 72 hours after it is granted, except where the judge orders the authorization to be served at some other time specified in the authorization, and, where a notice of assessment has not been sent to the taxpayer at or before the time of the

---

[61] See such cases as MNR v. Rochelle Moss, T-166-97, In re the Income Tax Act ... v. Fabrication Gmca Inc., 2002 FCT 1260, In the matter of the Income Tax Act ...v. Jean Gravel, 2005 FC 1252, Harpreet Mann v. MNR, 2006 FC 1358, In the matter of the Income Tax Act ... and Tony Papa And Micheline Gallo, 2009 FC 49, The Queen v. Alexander Tran, 2008 FC 297, In The Matter Of The Income Tax Act And Raynald Douville, 2009 FC 986 for just a SAMPLING of numerous issues regarding extensions of time to file applications, frank disclosure, property subject to possible seizure. And please review case citations: 2008 FC 1106, 2009 FC 499, 2008 FC 1105, 2008 FC 902, 2008 FC 589, 2007 FC 1254, 2007 FC 636, 2006 FC 1548, 2004 FC
1630, 2003 FCT 730, T-2119-02, 2003 FCT 148, etc

Digitized by Google

application, the notice of assessment shall be served together with the authorization.

How service effected
(6) For the purposes of subsection 225.2(5), service on a taxpayer shall be effected by
(*a*) personal service on the taxpayer; or
(*b*) service in accordance with directions, if any, of a judge.

Application to judge for direction
(7) Where service on a taxpayer cannot reasonably otherwise be effected as and when required under this section, the Minister may, as soon as practicable, apply to a judge for further direction.

Review of authorization
(8) Where a judge of a court has granted an authorization under this section in respect of a taxpayer, the taxpayer may, on 6 clear days notice to the Deputy Attorney General of Canada, apply to a judge of the court to review the authorization.

Limitation period for review application
(9) An application under subsection 225.2(8) shall be made
(*a*) within 30 days from the day on which the authorization was served on the taxpayer in accordance with this section; or
(*b*) within such further time as a judge may allow, on being satisfied that the application was made as soon as practicable.

Hearing *in camera*
***(*10) An application under subsection 225.2(8) may, on the application of the taxpayer, be heard *in camera*, if the taxpayer establishes to the satisfaction of the judge that the circumstances of the case justify *in camera* proceedings.**

Disposition of application
(11) On an application under subsection 225.2(8), the judge shall determine the question summarily and may confirm, set aside or vary the authorization and make such other order as the judge considers appropriate.

Directions
(12) Where any question arises as to the course to be followed in connection with anything done or being done under this section and there is no direction in this section with respect thereto, a judge may give such direction with regard thereto as, in the opinion of the judge, is appropriate.

No appeal from review order
(13) No appeal lies from an order of a judge made pursuant to subsection 225.2(11).
.

Digitized by Google

within such further time as a judge may allow, on being satisfied that the application was made as soon as practicable.

In The Matter Of Brent Robarts, 2010 FC 875, a Review of a Jeopardy Order

REASONS FOR ORDER AND ORDER

[1] This is a review of a jeopardy order issued under subsection 225.2(2) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act) by a judge of this Court on April 12, 2010 (the Order). For the reasons indicated below, the Order should be set aside.

– LEGAL FRAMEWORK

[2] The general rule, pursuant to subsection 225.1(1) of the Act, is that the Minister of National Revenue (the Minister) is restricted from collecting amounts owing by a taxpayer until 90 days after the day on which the notice of assessment is mailed.

[3] Nevertheless, where a judge upon an *ex parte* application by the Minister is satisfied that there are reasonable grounds to believe that the collection of all or any part of the amount assessed in respect of the taxpayer would be jeopardized by a delay in the collection of that amount, the judge shall authorize the Minister to take forthwith any of the actions described in paragraphs 225.1(1)(*a*) to 225.1(1)(*g*) of the Act (the collection actions).

[4] That being said, the taxpayer may apply to a judge of the Court to review the authorization. The judge shall determine the question summarily and may confirm, set aside or vary the authorization and make such other order as the judge considers appropriate. No appeal lies from such an order. See paragraphs 225.2(8), (9), (11) and (13) of the Act.

[5] There is no dispute concerning the guiding factors which are well known relating to the review of a jeopardy order (see *Minister of National Revenue v. Services M.L. Marengère Inc.*, [2000] 1 C.T.C. 229, 2000 D.T.C. 6032 at paragraph 63 (*Services M.L. Marengère*)). A two-stage test governs the review which involves aspects of an appeal and a hearing *de novo*.

[6] First, the taxpayer must provide evidence that there are reasonable grounds to doubt that the collection of all or any part of the amount assessed against him would be jeopardized by a delay in the collection of that amount. However, even where a taxpayer fails to meet their initial evidentiary burden, it remains open to the reviewing judge to set aside a jeopardy order where the Minister has not met the obligation to make a full and frank disclosure.

[7] Where the taxpayer has met this initial threshold, the Minister then has the ultimate burden to show that the jeopardy order was justified. At that latter stage, the Court will review all the evidence on record and ask itself whether, on the whole of the evidence submitted by the parties, there are reasonable grounds to believe that the collection of any part of the assessed amount would be jeopardized by delay.

– *EX PARTE* APPLICATION MADE BY THE MINISTER

[8] The named respondent, Mr. Brent Robarts, who is 64-years-old, is a businessman of the city of Kelowna, British Columbia.

[9] On February 1, 2010, the respondent was reassessed for taxes owing in the amount of **$1,265,953.57 (the Tax Debt) for his 2005, 2006 and 2008 tax years as appears from the notices of reassessments (the Reassessments) mailed at that time by the Canada Revenue Agency (the CRA).** [10] On April 6, 2010, the Minister applied

Digitized by Google

for a jeopardy order with respect to the Tax Debt.

[11] A first affidavit by Ms. Amy Walterhouse, sworn April 7, 2010 (the April affidavit) containing the main allegations against the respondent, was made in support of the Minister's application. There is also a second affidavit by Ms. Walterhouse, also sworn April 7, 2010, but its relevance for the purpose of this review is limited (its only object concerns the production of the Reassessments).

[12] Ms. Walterhouse is the CRA officer assigned to Mr. Robarts' collection file.

[13] The Minister's view, based on the affidavits of Ms. Walterhouse, is that there were (and continue to be) reasonable grounds to believe that the collection of the Tax Debt would be jeopardized if delayed.

[14] Five grounds were alleged at paragraph 36 of the April affidavit:

The funds in the respondent's known bank accounts, which totalled approximately $687,706.62, were the only known significant asset of the respondent that was sufficient to pay all or part of the Tax Debt.

The respondent was in the position to withdraw the funds before the CRA was otherwise able to certify the debt and garnish his bank accounts.

The respondent had significantly under-reported his income. He had failed to accurately report business income and rental income in respect to his tax matters in the past.

The 90-day statutory stay relating to the Reassessments was still in effect. Thus, the respondent could file notices of objection to the Reassessments; the Minister would be unable to collect until the conclusion of any objection or appeal period.

The respondent had been conducting his tax affairs in an unorthodox manner. He appeared to have dissipated two substantial assets immediately after being notified of the Reassessments.

[15] As Ms. Walterhouse explained in her April affidavit, on March 23, 2010, she conducted searches of various registries in British Columbia and of the respondent's known financial accounts held with CIBC, ING Direct and Scotiabank iTrade in an effort to locate any assets belonging to the respondent. She found out on this occasion that earlier on, that is, on January 27, 2010, the respondent had withdrawn $109,000 from one of his Scotiabank iTrade accounts and that on January 28, 2010 he had transferred his half interest in a property located in Arizona to Ms. Voll (the Arizona property). <u>This occurred just days after she had spoken with the respondent about the Reassessments.</u>

[16] Mr. Justice Zinn was satisfied that the evidence the Minister put forward in support of the application showed that there were reasonable grounds to believe that the collection of the Tax Debt would be jeopardized if delayed, and as such, granted the Order on April 12, 2010.

[17] Following the issuance of the Order, the CRA froze and seized all the respondent's bank accounts and assets. Indeed the CRA has seized $147,178.67 from accounts held with CIBC and ING Direct and has placed a freeze on the Scotiabank iTrade accounts and the $250,000 RRSP held with the CIBC (collectively the Funds).

– THE PRESENT MOTION IN REVIEW

[18] The respondent asks this Court to set aside the Order and to order the Minister to lift the seizure and freeze of the Funds.

[19] The respondent has no assets in his name in Canada other than the Funds. Denying that he had any intention to dissipate his assets or put them out of reach of the Minister, the respondent submits to the Court that his bank accounts already included registered plans and guaranteed investment certificates, which are long-term investments.

Digitized by Google

Indeed, any income that the respondent has earned recently is from trading securities through his Scotiabank iTrade account. Otherwise, he is not able to earn income to support himself.

[20] The respondent also stresses that nothing allowed the Minister to conclude that he had failed to accurately report income and invokes his good faith. Notices of objection to the Reassessments have been filed. Indeed, whether the respondent has "significantly under-reported his income" is the very issue for the determination by the appeals division of the CRA and the Tax Court of Canada. There were a number of reasons for his belief that such income did not need to be reported. Moreover, he also points out that he never earned rental income and that the Minister exaggerated his request for the issuance of a jeopardy order with unsubstantiated claims.

[21] The respondent also challenges the suggestion made by the Minister that he has been "conducting his tax affairs in an unorthodox manner as he appears to have dissipated two substantial assets." Indeed, the Minister has failed to present relevant evidence with respect to the withdrawal of
$109,000 in January 2010.

[22] In a nutshell, the respondent submits that the Order was made:

1. **without the benefit of complete information, which information was readily available to the Minister;**
2. **based on an incomplete summary of the relevant law;**
3. **based on unsubstantiated facts which were presented in an effort to taint the respondent's character; and**
4. **based on misrepresentations with respect to relevant caselaw crucial to the Minister's submissions.**

[23] To support his grounds of attack, the respondent has provided an affidavit and has also produced an affidavit by Ms. Corina Voll, both sworn on May 5, 2010. Since 1993, Ms. Voll has lived on and off with the respondent. This evidence, which was not before Mr. Justice Zinn, explains the taxpayer's basis for challenging the Reassessments and also clarifies the circumstances and intentions of the taxpayers with respect to the two transactions which Ms. Walterhouse qualified in her April affidavit as "unorthodox behaviour" and a "dissipation of assets".

[24] On the other hand, the Minister submits the Order should be upheld on the basis that:

1. The respondent has failed to provide reasonable grounds to doubt that the test for granting the Order has been met;
2. The evidence put forward by the respondent is insufficient to disturb the findings of Mr. Justice Zinn;
3. The Minister made full and frank disclosure to this Court with respect to all information relevant to the application for the Order known at that time.

[25] Thus, the Minister submits that it was reasonable to conclude here that, if the Order was not granted, the collection of all or any part of the amount assessed would be jeopardized by a delay in the collection of that amount. In this regard, the Minister submits that the evidence already produced and the explanations of the respondent are insufficient to reasonably doubt that the collection of the Tax Debt would be jeopardized by the granting of a delay.

[26] In addition to relying on the April affidavit, the Minister also relies on the third affidavit of Ms. Walterhouse sworn on July 15, 2010 and appended material (the July affidavit). The main purpose of the July affidavit is to respond to the allegations made by the respondent that there was no prompt and frank disclosure at the time of the making of the application.

Digitized by Google

[27] In her July affidavit, Ms. Walterhouse explains that she provided all relevant information in the possession of CRA at the time the jeopardy application was made. First, she did not know that the respondent had deposited $109,000 back in his Scotiabank iTrade account despite making requests for the most current information. Second, none of the information proffered to the Court with respect to the transfer of the half interest of the Arizona property was known to the CRA and, at the time the application was made, the Minister fully disclosed that the CRA was intending to raise assessments against Ms. Voll pursuant to section 160 of the Act.

– DETERMINATION AND FINDINGS BY THE REVIEWING JUDGE

[28] The present motion made by the respondent to set aside the Order should be allowed.

[29] First, I am not satisfied that the obligation to make a full and frank disclosure has been met by the Minister.

[30] Second, I find the respondent has provided cogent evidence that there are reasonable grounds to doubt that the collection of all or any part of the Tax Debt would be jeopardized by a delay.

[31] Third, on the whole of the evidence submitted by the parties, the Minister has not shown to the satisfaction of the Court that the Order and collection actions taken as a result are justified considering the particular circumstances of this case.

[32] Four, provided that there is not a change of situation and that the respondent respects all the undertakings mentioned in his affidavit, there is no reason to maintain the seizure and freeze of the Funds.

– OBLIGATION TO MAKE A FULL AND FRANK DISCLOSURE NOT FULFILLED BY THE MINISTER

[33] The Minister had the duty to exercise utmost good faith and to insure full and frank disclosure (*Minister of National Revenue v. Services M.L. Marengère Inc.*, [2000] 1 C.T.C. 229, 2000 D.T.C. 6032 at paragraph 63). **This duty stems directly from the fact that the hearings for the issuing of jeopardy orders are necessarily *ex parte*, and thus the Minister must fairly present the situation in its entirety, in the respondent's absence.**

[34] This duty of disclosure has been described and defined in various ways by the jurisprudence.

[35] In all *ex parte* matters the applicant is obliged to draw to the attention of the Court all facts in issue, even those which it considers unhelpful or inconvenient, and all relevant case law. (*Minister of National Revenue v. Arab*, 2005 FC 264, [2005] 2 C.T.C. 107 at paragraph 11). Indeed, full and frank disclosure requires that the Minister disclose "what might reasonably be regarded as [known] weaknesses". (*Minister of National Revenue v. 159890 Canada Inc.*, [1997] 3 C.T.C. 284, 97 D.T.C. 5495 at paragraph 10). Overall, the disclosure must be "adequate" or "reasonable" as determined by the circumstances (*R. v. Chamas*, 2006 FC 1548, [2007] 2 C.T.C. 16 at paragraph 37).

[36] First, it now appears from the new evidence brought to the attention of the Court that the inquiry made by Ms. Walterhouse on March 23, 2010, was incomplete and that important material facts (apparently these facts were not known to the Minister, as explained by Ms. Walterhouse in her July affidavit) were omitted from the April affidavit and the presentation made by counsel to the Court in April 2010.

[37] The alleged omission to make a full and frank disclosure concerns the withdrawal of $109,000 on January 27, 2010 from one of the respondent's Scotia iTrade accounts two days after he was notified of the Reassessments. In her April affidavit, Ms. Walterhouse

Digitized by Google

states that she had been unable to further trace the
$109,000. Thus, she believed that the respondent was dissipating his only remaining assets, which were the Funds that would satisfy the Tax Debt. However, the respondent's Scotia iTrade account for March 2010 clearly demonstrates that the Minister's representative assumption was based on erroneous information since the amount of $109,000 was re-deposited on March 10, 2010.

[38] The respondent argues that the Minister's failure to report to the Court that the $109,000 had been credited back to his bank account on March 10, 2010, amounts to a violation of the Minister's duty of full and frank disclosure. He contends that the erroneous information that the $109,000 was untraceable was the central piece of information that the Minister relied on to request the jeopardy order. Thus, given that the correct information was available to Ms. Walterhouse prior to signing her April affidavit, the Minister's omission directly affected the outcome of the Court's decision.

[39] I agree with the respondent. In my opinion, the Minister's failure to report the reappearance of the $109,000 in the respondent's bank account on March 10, 2010 falls squarely in the category of an omission that was directly relevant to the authorization of the jeopardy order obtained a month afterwards. Indeed, apart from the allegation made by Ms. Walterhouse that the respondent had also transferred his half-interest in the Arizona property to Ms. Voll, the disappearance of the $109,000 from the Scotia iTrade account, was the Minister's only proof that the respondent was dissipating his sole Canadian assets, i.e. the Funds.

[40] Upon signing the April affidavit, Ms. Walterhouse should have assured herself that all relevant inquiries had been made with respect to transactions made in March 2010 and that up-to-date information was readily available from the financial institution or made available by the taxpayer. On March 11, 2010, Ms. Walterhouse was advised by Mr. John De Pompa, Director of Compliance at Scotia iTrade, that the March statements would be prepared at the beginning of April 2010, yet she did not subsequently ask that these statements be provided by the financial institution.

[41] While the omission to report the March 10, 2010 deposit of $109,000 was apparently made with no malicious intent, it severely undermines the *ex parte* application that was made by the Minister on April 6, 2010. The jeopardy order issued on the basis of these misleading, incomplete or incorrect facts cannot stand in the circumstances. (*Papa, re,* 2009 FC 49, [2009] 4 C.T.C. 93 at paragraphs 21 to 23; *Canada (Commissioner of Competition) v. Air Canada* (2000), [2001] 1 F.C. 219 (Fed. T.D.) at paragraph 13).

[42] While the omission mentioned above is determinative, the respondent also argues that there were misrepresentations with respect to relevant caselaw crucial to the Minister's submissions.

[43] The Minister relied heavily on the *Minister of National Revenue v. Cormier-Imbeault*, 2009 FC 499, [2009] 6 C.T.C. 45 (*Cormier-Imbeault*), as justification for the jeopardy order, suggesting to the Court that the facts were very similar.

[44] At paragraph 22 of the Minister's written submissions, counsel states that in *Cormier-Imbeault*:

The Minister made an application for a jeopardy order on the basis that the taxpayer's only remaining asset was money in a bank account. As well, the taxpayer had transferred his half-interest in a house in which he jointly owned with his wife upon learning that the CRA was in a position to undertake collection measures. Shore J. granted the Minister's application for a jeopardy order and stated in his reasons that the taxpayer was in a position to withdraw all or part of the amounts held in the bank account at any moment.

[45] The respondent now submits that the above recital of the facts in *Cormier-Imbeault*

Digitized by Google

is incomplete and that the Minister's failure to accurately set out the reasoning of Justice Shore is not in keeping with the standard of the outmost good faith and disclosure.

[46] Justice Shore states in *Cormier-Imbeault*, at paragraph 7, a number of factors established by case law that can justify a jeopardy order:

1. there are reasonable grounds to believe that the taxpayer has acted fraudulently;
2. the taxpayer has proceeded to liquidate or transfer his or her assets;
3. the taxpayer is evading his or her tax liabilities; and
4. the taxpayer has assets that could potentially lessen in value over time, deteriorate or perish.

[47] From a reading of Justice Shore's analysis found at paragraph 8, we can see that Ms. Cormier- Imbeault's only assets having a realizable value were the amounts held in a bank account and half of her undivided ownership of the family residence. In addition, Justice Shore noted that in fact, in the past, there had been many withdrawals made in the bank account. Furthermore, Mr. Imbeault's previous conduct indicated that "he is not trustworthy", namely the taxpayer:

had already pleaded guilty to tax evasion;

had transferred his half of the family residence to Ms. Cormier-Imbeault upon learning that the CRA was in a position to undertake collection measures; and

had hidden the existence of the bank account and the amount of almost $600,000 from the CRA.

[48] Noting that the money in the bank could be withdrawn at any time, Justice Shore concluded that it was urgent and imperative that the CRA be in a position to seize the bank account. Besides authorizing the applicant to take forthwith collection actions, furthermore, in accordance with subsection 225.2(3) of the Act, Justice Shore also authorized the applicant to serve to the taxpayers the notices of assessment at the same time as the jeopardy order. It must be remembered that subsection 225.2(3) of the Act further requires that the judge be satisfied that "the notice of assessment by the taxpayer would likely further jeopardize the collection of the amount".

[49] Given the above, questions could legitimately be raised of whether the Minister acted in accordance with its duty of utmost good faith in not bringing to the attention of Justice Zinn that the decision made by Justice Shore in *Cormier-Imbeault* and relied upon by the applicant in paragraph 22 of their written submissions, was rendered *ex parte*, both under subsections 225.2(2) and (3) of the Act. We can see that very important factual elements and salient features of the reasoning are omitted by counsel.

[50] Although good faith must be presumed, again, this oversimplification in the Minister's presentation leaves a sour taste. It is true that the decision rendered in *Cormier-Imbeault* is included in the applicant's book of authorities. However, in view of the urgency of the matter, it is not generally expected that, at this stage, the Judge will go beyond the Minister's presentation. Considering that the application for a jeopardy order is made *ex parte*, such important omissions on relevant case law from the Minister's written submissions, are certainly not compliant with the spirit of these extraordinary procedures.

[51] Be that as it may, there are further reasons to set aside the Order as discussed below.

– INITIAL BURDEN OF PROOF MET BY THE RESPONDENT

[52] The evidence on record consists of the sworn affidavits of Ms. Walterhouse, Mr. Robarts and Ms. Voll, who have not been cross-examined on their affidavits. There is no reason to find any one of them not credible.

[53] At the hearing of this motion, both counsels indicated to the Court that the veracity

Digitized by Google

of facts recited in these affidavits was not in issue. What is challenged by the parties is the weight to be given by the Court to the evidence respectively filed by the Minister and the respondent, each party submitting that they have discharged themselves of their burden of proof.

[54] Having analyzed the evidence and closely read the parties' materials in light of their respective submissions and the principles earlier exposed at paragraphs 5 to 7 of the present reasons for order, the respondent has met the initial burden of satisfying the reviewing Judge that there are reasonable grounds to doubt that the collection of all or any part of the amount assessed against him would be jeopardized by a delay in the collection of that amount.

[55] As aforementioned, five grounds were alleged by the Minister in support of its application to obtain a jeopardy order:

The funds in the respondent's known bank accounts, which totalled approximately $687,706.62, were the only known significant asset of the respondent that was sufficient to pay all or part of the Tax Debt;

The respondent was in the position to withdraw the funds before the CRA was otherwise able to certify the debt and garnish his bank accounts;

The respondent had significantly under-reported his income. He had failed to accurately report business income and rental income in respect to his tax matters in the past;

The 90-day statutory stay relating to the Reassessments was still in effect. Thus, the respondent could file notices of objection to the Reassessments; the Minister would be unable to collect until the conclusion of any objection or appeal period; and

The respondent had been conducting his tax affairs in an unorthodox manner. He appeared to have dissipated two substantial assets immediately after being notified of the Reassessments.

[56] At the hearing of the present motion, counsel for the Minister was ready to concede that taken alone or cumulatively, the four grounds listed at subparagraphs (i) to (v) of paragraph 36 of the April affidavit of Ms. Walterhouse may not have been sufficient to allow the issuance of a jeopardy order. However, the fifth ground listed at paragraph (v) above was determinative. It concerns the two actions taken by the respondent after he learned late January 2010 that the Reassessments were coming.

[57] As aforesaid, the Minister based himself on the following facts:

On January 27, 2010, the respondent had withdrawn $109,000 from one of his Scotiabank iTrade accounts; and

On January 28, 2010 he had transferred his half-interest in the Arizona property to Ms. Voll.

[58] In the case at bar, the Minister has submitted that the above actions constitute unorthodox behaviour which raises a reasonable apprehension that it would be difficult to trace funds or recover them for the Tax Debt. Having considered the explanations given by the respondent and Ms. Voll (with respect to the Arizona property), there are no reasonable grounds to believe that the collection of the Tax Debt would be jeopardized by delay in view of these two isolated actions. Their explanations are plausible and are not contradicted by other evidence on record. This evidence shed a new light on the Minister's fear that the respondent was about to liquidate the Funds.

[59] First, with respect to the withdrawal of $109,000 from his Scotiabank iTrade account on January 27, 2010, the respondent explains in his affidavit that he intended on combining that amount with $101,000 in his CIBC account and purchasing a CIBC money market certificate for $210,000. Market conditions at that time suggested that a money market certificate could be had at an interest rate of nearly 3%. However, the rates stayed low (near 1.25%) so he decided not to purchase the money market certificate and sent the cheque for $109,000 back to Scotia iTrade to redeposit in his account, which was done

Digitized by Google

on March 10, 2010, as appears from the March statement produced with the respondent's affidavit. I find the respondent's explanations entirely plausible.

[60] Second, with respect to the transfer of his half interest in a property in Arizona on January 28, 2010 to Ms. Voll, the respondent explains that the Arizona property was purchased with funds that both he and Ms. Voll considered to belong to the latter. The property was put into both their names on agreement that the respondent would purchase a condominium in Kelowna in both their names. As he was unable to fulfill his end of that bargain, he was only ensuring that the title to the property reflected the true ownership of the property. Besides, the property was transferred into Ms. Voll's name after she made a demand for repayment of debt. Again, while the timing of this transfer may look suspicious, the explanations provided by the taxpayers are plausible and should not be discarded by the Court.

[61] The jurisprudence has not given a definition to the phrase "unorthodox behaviour", although it has given many examples of what it considers to be unorthodox behaviour. A few examples are as follows:

Keeping large amounts of cash in places such as one's apartment, safety deposit boxes and a cold storage depot locker (*Minister of National Revenue v. Rouleau*, [1995] 2 C.T.C. 442, 101 F.T.R. 57 at para. 6);

Keeping large amounts of cash, untraceable through normal banking records, in the trunk of an automobile (*Minister of National Revenue v. Arab*, 2005 FC 264, [2005] 2 C.T.C. 107 at para. 20);

Keeping double accounts for a restaurant, with one being for entries in the sales journal, the general ledger and income tax returns, and the other being for additional sales not reported by the holding company of the restaurant (*Delaunière, re*, 2007 FC 636, 2008 D.T.C. 6274 (Eng.) at para. 4);

Keeping large amounts of cash in a safety deposit box, a filing cabinet in one's house and in the pocket of a housecoat (*Mann v. Minister of National Revenue*, 2006 FC 1358, [2007] 1 C.T.C. 243 at para. 43); and

Advancing funds to a company about to be dissolved in order to avoid paying income tax (*Laquerre, re*, 2008 FC 459, 2009 D.T.C. 5596 (Eng.) at para. 11).

[62] The respondent's behaviour is clearly not in the same category as the above examples. The Minister flagged two suspicious incidents, namely the transfer of the half ownership in the Arizona property to Ms. Voll and the withdrawal of the $109,000, and the respondent has provided a reasonable explanation for each incident. Therefore, there are reasonable grounds to doubt that the collection of all or any part of the amount assessed against the respondent would be jeopardized by a delay in the collection of that amount. [63] I will now examine the rest of the evidence pertaining to the other grounds raised by the Minister to sustain their allegation that there were (and continue to be) reasonable grounds to believe that the collection of the Tax Debt would be jeopardized if delayed.

– TEST ESTABLISHED BY SUBSECTION 225.2(2) OF THE ACT NOT MET BY THE MINISTER

[64] **Subsection 225.2(2) of the Act requires the Minister to show "that there are *reasonable grounds to believe* that the collection of all or any part of an amount assessed in respect of a taxpayer would be jeopardized by a delay in the collection of that amount …" (emphasis mine). Reasonable grounds to believe in the context of subsection 225.2(2) of the Act has been held to constitute a standard of proof that "while falling short of a balance of probabilities, nevertheless connotes a bona fide belief in a serious possibility based on credible evidence." (see *Canada (Minister of National Revenue - M.N.R.*) v. 514659**

Digitized by Google

B.C. Ltd., 2003 FCT 148, at para. 6; *Qu v. Canada (Minister of Citizenship and Immigration)*, 2001 FCA 399, at para. 24; *Papa, re*, 2009 FC 49, [2009] 4 93 at para. 16 (*Papa*).

[65] I have already dismissed the allegation made by the Minister that the respondent had been conducting his tax affairs in an unorthodox manner because he appeared to have dissipated two substantial assets immediately after being notified of the Reassessments. This leaves the other allegations made by the Minister to the effect that the Funds were the only known significant asset of the respondent, that he was in the position to withdraw the Funds before the CRA was otherwise able to certify the Tax Debt and garnish his bank accounts, that he had failed to accurately report business income and rental income regarding these tax matters in the past, and that the 90-day statutory stay relating to the Reassessments was still in effect when the Minister applied for a jeopardy order.

[66] Ms. Walterhouse's April affidavit first explains the basis of the Reassessments. Following the completion on January 4, 2010 of the internal audit conducted by the CRA, the Minister considered that the respondent had not accurately reported business income regarding two properties located in Surrey, as well as capital gains regarding a third property in Kelowna. These sale transactions occurred on October 31, 2005, August 31, 2006 and April 29, 2008 respectively. Thus, the respondent was reassessed for taxes owing in the amount of $1,265,953.57. Notices of opposition have been filed by the respondent.

[67] The respective positions taken by the Minister and the respondent with respect to the merit of the Reassessments are highly debatable. The general rule established by the jurisprudence is that the correctness of an assessment is determined in a different forum from that where the jeopardy order is challenged. At the stage of challenging the jeopardy order, the validity of the assessments must simply be accepted by the Court (*Services M.L. Marengère Inc.*, at paras 64 and 73; *Minister of National Revenue v. Reddy*, 2008 FC 208, [2008] 3 C.T.C. 10 at para. 30). However, this does not necessarily mean that the Court should not examine the evidence submitted contesting the assessment, when evaluating whether or not a jeopardy order is warranted.

[68] If the record shows that a good portion of the evidence used by the Minister to justify the jeopardy order is seriously challenged by the taxpayer, the Court cannot simply ignore these submissions when determining whether the jeopardy order should stand. The Minister's assertions must necessarily be called into question (see *Minister of National Revenue v. Douville*, 2009 FC 986, 357 F.T.R. 316 at paras 16 and 20).

[69] In the case at bar, Ms. Walterhouse herself, in her April affidavit, has made a number of factual allegations that go beyond the mere fact that Reassessments were issued on February 1, 2010. These allegations were made in an effort to taint the taxpayer's character and form the basis for the issuance of the Order. Ms. Walterhouse alleges that the respondent had significantly under-reported his income and that he had failed to accurately report business income and rental income in respect to his tax matters in the past. [70] It is not challenged that on February 25, 2010, the respondent informed Ms. Walterhouse that he had retained a tax lawyer to assist him in his objections to the Reassessments and had asked that all future correspondence regarding these issues be directed to his lawyer. Ms. Waltherhouse confirms in her April affidavit that she was aware of the fact that the respondent had discussed with his lawyer the possibility of making payments in order to reduce the interest accruing on his Tax Debt. That being said, on March 8, 2010, respondent's counsel confirmed to the CRA's representative in charge of collection that he would be filing notices of objection to the Reassessments.

[71] I can say at this point that the Minister's evidence, which is contradicted in many regards by the respondent's evidence, does not allow me to conclude, as pressed in Ms.

Digitized by Google

Walterhouse's affidavit, that the respondent has "significantly under reported his income" and that he has "failed to accurately report business income and rental income." First, the respondent vehemently denies having ever earned rental income. Second, the respondent may have been mistaken in reporting some gains and may not have been justified in not reporting others, but the proper tax treatment of those gains will be determined in due course. Third, at the hearing, counsel for the respondent agreed that the Court could not draw a negative inference out of the respondent's omissions to report these gains because this litigious question has not been settled yet.

[72] From a reading of Ms. Walterhouse's affidavit, it also appears that the only assets in Canada belonging to the respondent have been constituted of sums of money deposited in various financial institutions, notably the accounts held with CIBC, ING Direct and Scotiabank iTrade. On the other hand, as corroborated by the respondent in his affidavit, this situation has been in existence for a number of years. In the past three years, he has been trading securities and conducting his trades through his Scotia iTrade account. By their very nature, liquid assets may be easily dissipated or put beyond the reach of the Minister, but this is not, by itself, a reasonable ground for believing the taxpayer will waste, liquidate or otherwise transfer such assets so as to make it unavailable to the Minister. (*Minister of National Revenue v. Rouleau*, [1995] 2 C.T.C. 442, 101 F.T.R. 57 at para. 9; *Mann v. Minister of National Revenue*, 2006 FC 1358, [2007] 1 C.T.C. 243 at para. 39; *R. v. Paryniuk*, 2003 FC 1505, 2004 D.T.C. 6023 at para. 14)

[73] The question of whether the assets seized are sufficient to satisfy the alleged Tax Debt is not definitive when evaluating whether a jeopardy order should be granted. The fact that the taxpayer was unable to pay the amount assessed at the time of the assessment is not, by itself, conclusive or determinative (see *Danielson v. Canada (Deputy Attorney General)*, [1986] 2 C.T.C. 380, 7 F.T.R. 42 at paras 7 and 15 (*Danielson*). Evidence that the taxpayer was dissipating his assets or moving his assets out of the jurisdiction would be required (*Danielson*, above, at para. 8). Other factors such as lying about one's assets, the disposition made of one's assets and involvement in nefarious activities would also be considered (*Minister of National Revenue v. Ament*, 97 D.T.C. 5033, 124 F.T.R. 135 at para. 23).

[74] I agree with the respondent that the totality of the actions taken between the date he learned that the Reassessments were coming (i.e. January 25, 2010) and the date the Minister applied for a jeopardy order (i.e. April 6, 2010) must be considered by the Court. Furthermore, several of the respondent's financial characteristics and actions could easily be misinterpreted, when in fact, they appear to be reasonable where the totality of the evidence is considered. In the case at bar, the respondent has only had liquid assets for several years and has not made many withdrawals over the years. In fact, he undertook in his affidavit to be conservative with his stock activities and to not withdraw any sums of money until the Tax Debt has been evaluated and finalized.

[75] Ms. Walterhouse volunteered to call the respondent on January 25, 2010, to tell him that the Reassessments were coming. This was apparently not a case where the Minister felt that a jeopardy order should be issued before the notice of assessment was received by the taxpayer because this would likely further jeopardize the collection of the amount (see paragraph 225.2(3) of the Act).

[76] The withdrawal of the $109,000 on January 27, 2010 was the single most important fact the Minister relied upon when he made an application for a jeopardy order on April 6, 2010. That fact was incorrect as the money was re-deposited on March 10, 2010. During the months of February and March 2010, the Funds were untouched by the respondent who would have had ample time to dispose of said funds prior to the making of the Minister's application.

Digitized by Google

[77] Mere suspicion or concern is not sufficient to establish reasonable grounds. The respondent's explanation that he transferred his half of the Arizona property to Ms. Voll in late January 2010 to better reflect the true ownership of the property is plausible, in light of the loans made between the parties and the state of their relationship at the time. In any event, as stated at paragraph 31 of Ms. Walterhouse's April affidavit, Ms. Voll will be assessed pursuant to section 160 of the Act for the respondent's Tax Debt. Thus, the amount assessed, therefore, is not put beyond the reach of the Minister nor is it jeopardized by delay, further considering that the Arizona property had been bought a long time before the Reassessments and was always out of the reach of the Minister.

[78] In view of this evidence, as of April 6, 2010, there were certainly no reasonable grounds for believing the respondent would waste, liquidate or otherwise transfer property so as to make it unavailable to the Minister. The same conclusion holds today in view of the totality of the evidence submitted by the parties. [79] In this regard, at paragraphs 62 to 64 of his sworn affidavit dated May 5, 2010, , the respondent has made a series of undertakings in an effort to prove to the Court his good faith and his willingness to comply with the reassessment process, in the absence of a jeopardy order. Indeed, the respondent has undertaken:

Not to waste, liquidate or transfer out of Canada any of his assets until the resolution of the outstanding tax dispute with the CRA.

Not to deplete the capital of any of his investments until the resolution of the outstanding tax dispute with the CRA.

To conduct his financial affairs in a conservative manner until the resolution of the outstanding tax dispute with the CRA.

[80] The undertakings above constitute a relevant factor in deciding whether or not it is appropriate in the circumstances to confirm, set aside or vary the Order previously made by Justice Zinn on April 12, 2010 (see *Danielson*, above; *1853-9049 Qué. Inc. c. R,* [1987] 1 C.T.C. 137, 9 F.T.R. 63; *Sagman, re*, 2004 FC 1630, [2005] 1 C.T.C. 165; *Minister of National Revenue v. Douville*, 2009 FC 986, 357 F.T.R. 316).

[81] Good faith must be presumed. Acknowledging the undertakings made by the respondent, I have no indication today that the respondent will not respect his undertakings or that he is otherwise untrustworthy. Although certain actions taken by the respondent appeared suspicious to the tax authorities, I am ready to give him the benefit of the doubt.

[82] Having thoroughly reviewed the evidence and relevant case law and applicable legal principles, overall, I am not satisfied that there are reasonable grounds to believe that the collection of the Tax Debt would be jeopardized by delay.

VII – CONCLUSION

[83] In view of the foregoing, the present motion made by the respondent shall be allowed.

[84] Consequently, the Order shall be set aside and the Minister shall be ordered to forthwith withdraw from taking or pursuing collection actions with respect to the Tax Debt, including the seizure and freeze of the Funds which must be promptly lifted by the CRA. This is without prejudice to the Minister's right to make a new application if there is a change of situation or if the respondent fails to comply with the undertakings made to the Court.

[85] Considering the result, costs shall be in favour of the respondent.

ORDER

THIS COURT ORDERS that:

Digitized by Google

The motion made by the respondent is allowed;
The Order rendered on April 12, 2010 is set aside;
The Minister shall forthwith withdraw from taking or pursuing collection actions with respect to the Tax Debt, including the seizure and freeze of the Funds which must be promptly lifted by the CRA;
The present Order is made without prejudice to the Minister's right to make a new application if there is a change of situation or if the respondent fails to comply with the undertakings made to the Court; and
Costs are in favour of the respondent.

"Luc Martineau" Judge

Hearing *in camera* – 225.2(10)
An application under subsection 225.2(8) may, on the application of the taxpayer, be heard *in camera*, if the taxpayer establishes to the satisfaction of the judge that the circumstances of the case justify *in camera* proceedings.

Doreen Tennina et al v. Minister of National Revenue, 2010 FCA 25

REASONS FOR JUDGMENT LAYDEN-STEVENSON J.A.
[1] The Minister of National Revenue (the Minister) seeks to quash the appellants' notice of appeal filed on September 29, 2009 appealing Federal Court orders dated September 1, 2009 rendered pursuant to subsections 225.2(1) and 225.2(2) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act). The orders in question are commonly known as jeopardy orders. The appellants also filed a notice of application for review pursuant to subsection 225.2(8) of the Act in the Federal Court with respect to the same jeopardy orders.

Relevant Statutory Provisions
[2] The text of section 225.2 of the Act is attached to these reasons as Schedule "A". Briefly, for context, section 225.1 of the Act prohibits the Minister, while an amount assessed under the Act is in dispute, from taking any of the collection actions that are delineated in paragraphs 225.1(a) to (g). The effect of this restriction is to prevent the Minister from taking collection action on the account until such time as the objection and/or appeal from the assessment has been determined or the relevant time period within which to file such objection and/or appeal has expired.

Digitized by Google

[3] Subsection 225.2(2) constitutes an exception to the prohibition in section 225.1. Where, on *ex parte* application by the Minister, a judge is satisfied that there are reasonable grounds to believe that the collection of all or any part of an amount assessed in respect of a taxpayer would be jeopardized by a delay in collection of that amount, the judge shall authorize the Minister to proceed with collection. The taxpayer, subsequently, may seek a review of the authorization under paragraph 225.2(8) of the Act. The judge who hears the review may confirm, set aside or vary the authorization and make such other order as the judge considers appropriate**. Pursuant to subsection 225.2(13), the review order is final and may not be appealed.**

The Appellants' Notice of Appeal

[4] In their notice of appeal, the appellants request that the jeopardy order(s) be set aside, that the collection action(s) taken pursuant to the order(s) be set aside or quashed and that the normal procedure pursuant to section 225.1 of the Act resume on the ground that "the *ex parte* provision(s) in s. 225.2 of the *Income Tax Act* are of no force and effect and unconstitutional." Various breaches of the *Canadian Charter of Rights and Freedoms* are alleged.

The Arguments

[5] The Minister submits that section 225.2 of the Act provides a complete and exhaustive process to challenge the jeopardy order. The appellants must follow that process (subsection 225.8 of the Act) and are expressly precluded from appealing to this Court by section 225.2(13).

[6] The appellants argue that subsection 225.2(13) does nothing other than "specifically and strictly" bar an appeal from an application under subsections 225.2(8) and 225.2(11) of the Act. It does not bar an appeal from the initial order itself, "particularly when the appeal challenges, on constitutional grounds, the jurisdiction of the Federal Court to make the order under subsection 225.2(2) in the first place." Apparently, identical grounds are contained in the review application before the Federal Court.

Analysis

[7] For the reasons that follow, I conclude that the appellants' notice of appeal must be struck.

[8] First, it is inappropriate for the identical point to be raised by the identical parties in the identical file, simultaneously, in two courts. Such an approach has the potential to give rise to contradictory decisions and draw the administration of justice into disrepute: *Del Zotto v. Canada (Minister of National Revenue)* (2000), 181 F.T.R. 168 (F.C.).

[9] Second, the Supreme Court of Canada has repeatedly stated, as a matter of statutory interpretation, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament. While Canadian tax legislation has been strictly interpreted in an era of more literal statutory interpretation, today, all statutes, including the *Income Tax Act*, must be interpreted in a textual, contextual and purposive way: *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601. The Act's provisions are to be interpreted in order to achieve consistency, predictability and fairness:

Digitized by Google

***Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622.**

[10] Section 225.2 of the Act provides a comprehensive scheme with respect to jeopardy orders. Parliament provided a remedy for taxpayers aggrieved by *ex parte* jeopardy orders. Upon application by the taxpayer, subsection 225.2(8) provides for a review of the order by a judge of the same court that granted the authorization under subsection 225.2(2). Subsection 225.2(11) grants broad powers to the reviewing judge who may set aside or vary the authorization and may make such other order as the judge considers appropriate. In short, the legislative scheme contemplates and incorporates a review mechanism for *ex parte* orders. The mechanism chosen and legislated by Parliament is the one set out in subsection 225.2(8), no more and no less.

[11] It is settled law that, by virtue of subsection 225.2(13), no appeal lies from an order made pursuant to subsection 225.2(11): *Papa v. Her Majesty the Queen*, 2009 FCA 112, 2009 DTC 5090; *Dauphin c. Canada*, 2009 CAF 257, 2009 DTC 5164. **It is also settled law that there is no right of appeal from a decision unless expressly granted by statute; the *Charter* does not provide such a right. The provisions of section 27 of the *Federal Courts Act*, R.S.C. 1985, c. F-7, which grant a right of appeal, may be overridden by other statutes: *Luitjens v. Canada (Secretary of State)* (1992), 142 N.R. 173 (F.C.A.); leave to appeal refused (1992), 143 N.R. 316n. The appellants, in relying on section 27 of the *Federal Courts Act*, seek to do indirectly what they cannot do directly.**

[12] Third, while it is unquestionably open to litigants to challenge the constitutionality of a statute or the provisions of a particular enactment, characterizing an argument as one of constitutional invalidity does not create a right of appeal, where none otherwise exists.

[13] In summary, there is no right of appeal from an order made pursuant to subsection 225.2(2) of the Act. The appellants' remedy is the review provision provided by Parliament in subsection 225.2(8).

[14] I would therefore strike the notice of appeal with costs to the respondent.

"Carolyn Layden-Stevenson" J.A

"I agree.
M.N. J.A"

"I agree
J.M.E. J.A."

CRA Internal Operations Manual - Jeopardy

(See below image pages)

Digitized by Google

COLLECTION IN JEOPARDY 1

Overview 1

Legislation 1

Background Information 1
What Constitutes Jeopardy? 1
Jeopardy Case Law 2
Tax Debtor May Leave Canada 2
Role of the Department of Justice 3

Policy 3
Elements of a Jeopardy 3
Types of Accounts to Review for Danger of Loss 4
Jeopardy Indicators 4
Counter Indicators 5
Tax Debtor Leaving Canada 6
Collection Restrictions on Reassessments 6
Authority Approval – Approval Process 7

Procedures 7
Proceeding with an Investigation 8
Comprehensive Investigation 8
Completing a Statement of Facts 9
Risk Analysis 10
Application for Court Order 10
Tax Assessments / Court Order 10
Service of Court Documents 11
Collection Action 11
Judicial Review 11
Basic Steps 12
Steps to follow if a Hearing has Been Ordered 12
Affidavits 12
Examining Affiants 13
Jeopardy Process Summary 13
Refund or Release of Security Pursuant to Subsection 164(1.1) ITA 14
Conditions Required to Satisfy Subsection 164(1.1) ITA 14
What Constitutes a "An Amount Paid on Account" or a "Security" 15
Processing T420 Requests 16
Taxpayer Leaving the Country – Demand for Payment 226(1) 17

Resource Material 18

Digitized by Google

Collection in Jeopardy

Collections Manual Updates

Overview

Collection in Jeopardy, also referred to as "Jeopardy", is defined as a situation where the collection of an account is put at risk due to the collection restrictions imposed by legislation i.e. Subsections 225.1(1)a) to g) of the Income Tax Act.

When a jeopardy situation is recognized, there are provisions under the various acts that, in certain circumstances, set aside collection restrictions and allow immediate collection.

In order to invoke the jeopardy provisions and proceed with immediate collection action, the CRA must make an *ex parte* application to the courts. A judge evaluates the evidence presented and, if satisfied that a delay would jeopardize the collection of the account, grants a jeopardy court order. Once the order is obtained, the CRA proceeds with immediate collection action.

The tax debtor has the right to a judicial review of the court order. Upon review, the Court may confirm, set aside or vary the jeopardy court order. However, a request for judicial review does not delay, or hold in abeyance enforcement of the jeopardy court order.

Legislation

This section identifies legislation relating to collection in jeopardy.

- Excise Tax Act *(ETA)*, s 322, and 322.1(2)
- Income Tax Act (*ITA*), s 164(1.2), s 225.2 and s 226(1)
- Excise Act 2001 (*EA*) s 287(1)
- Customs Act *(CA)* s 97.35 (1)
- Softwood Lumber Products Export Charge Act, 2006 (*SLPECA*) s 87 (1)

Background Information

This section provides background information related to collection in jeopardy:

- **What Constitutes Jeopardy?**
- **Tax Debtor May Leave Canada**
- **Role of the Department of Justice**

What Constitutes Jeopardy?

- A jeopardy situation exists when a delay in collection action, due to legislated collection restrictions, may result in a loss to the Crown.
- GST/HST jeopardy situations arise when a debit is forthcoming, and a delay, resulting from reporting/filing requirements, would cause the collection of that amount to be in jeopardy. In these circumstances the CRA can make *ex-parte* application to the Court to assess and proceed immediately.

Digitized by Google

- The test is whether the evidence, on balance of probability, is sufficient to lead a right-thinking person to conclude that it is more likely than not that collection of the account would be jeopardized by the delays imposed by the legislation.

Note: The jeopardy provisions of the various Acts are not invoked unless there is reasonable potential for recovery

Related Topic:

- Jeopardy Case Law

Jeopardy Case Law

The following is a link to case law pertaining to the jeopardy provisions within Subsection 225.2(2) of the ITA.

Case Law

The following citations are in addition to case law contained in the link

Services M.L. Marengère Inc FCT Docket T-460-99

MNR c. Caib 97 DTC 5430 (FCTD)

O'Brien, re [1999] 1 C.T.C. 72, 2001

Minister of National Revenue v. Thérlault-Sabourin 2003 FCT 124

M.R.N. c. Blouin 2003 DTC 5174, 2003 FCT 178

Minshull v. Minister of National Revenue [1987] 2 C.T.C. 233

Deputy Minister of National Revenue v. Iura 42 [2001] B.C.J. No.68

MNR v Quesnel [2001] 2 CTC 75, 2001

Goldbeck –vs- Canada [1990] 2 CTC 438
Ministre du Revenu National c. Fabrication GMCA inc. 2003 DTC 5026

Canada (Minister of National Revenue) v. MacIver (1999) 172 FTR 273

Tax Debtor May Leave Canada

Evidence that a tax debtor has or is about to leave Canada is a primary indicator of possible jeopardy in collection.

Section 226 of the ITA, Section 322 of the ETA, and Section 94(1) of the SLPECA provide specific collection remedies applicable to situations involving tax debtors leaving Canada.

For further details, refer to Taxpayer Leaving the Country - Demand for Payment 226(1) and Directive RCD 00-32, Jeopardy Assessments and Collection under Section 322.1 of the *Excise Tax Act*

Digitized by Google

Role of the Department of Justice

The Department of Justice is responsible for ensuring the *ex parte* application meets the criteria for successful application to the Court. The Department of Justice will:

- review and provide an opinion on the information submitted by Collections with respect to obtaining a jeopardy court order
- assist in the preparation of all affidavits, and counsel affiants as required
- apply to the Court to have a judge hear the *ex parte* application and appear on behalf of the CRA
- represent the CRA should the tax debtor seek remedy through a judicial review

For further details, refer to TSDMB 2008-021 **Making referrals to the Department of Justice**

Policy

This section provides policy pertaining to collection in jeopardy. For a legal opinion on a particular jeopardy collection matter, please consult with the Department of Justice.

Note: Refer to **Resource Material** to view available additional information.

- **Elements of a Jeopardy**
- **Types of Accounts to Review for Danger of Loss**
- **Jeopardy Indicators**
- **Counter Indicators**
- **Tax Debtor Leaving Canada**
- **Collection Restrictions on Reassessments**
- **Approval Authority – Approval Process**

Elements of a Jeopardy

The following are the basic elements necessary for a jeopardy application. All elements must be in existence before making the *ex-parte* jeopardy court order application:

- Liability
  - a substantial tax liability assessed or about to be assessed

  Note: All debts relating to the application must be assessed prior to the service of the jeopardy court order, on the tax debtor

- Danger of Loss
  - sufficient evidence to prove an imminent danger of loss

  Refer to **Jeopardy Indicators** for further details.

Digitized by Google

- Collectability
  - there must be reasonable potential for recovery

  Note: The Minister must show that at the time of making the application sufficient assets exist to which the Crown would look for payment

- Evidence – the Minister must have evidence supporting the following assertion(s):
  - a delay in collection will result in a loss to the Crown
  - sufficient assets exist to which the Crown could look for payment and if collection is delayed the assets would no longer be available for payment of the debt

An order to proceed with immediate collection is necessary to protect the Crown's interest.

Types of Accounts to Review for Danger of Loss

Collection officers are responsible for screening and identifying accounts where a danger of loss may exist and, if appropriate, make a recommendation for a jeopardy application. Any detrimental changes in the tax debtor's financial situations should be considered. The following are types of accounts that must be reviewed for danger of loss on a regular basis:

PROTECTED

Jeopardy Indicators

Factors or indicators, that should be considered when evaluating a potential jeopardy situation, include:

Prior history - of the tax debtor individually, or as a corporate director, with respect to:

- compliance, remittances, and other statutory requirements
- the use of complex corporate structures and nominees to shield assets/income
- evasiveness and uncooperativeness when dealing with the CRA

Canadian residential instability – as evidenced by:

- prolonged stays outside the country and/ or Canadian property/assets for sale
- banking or business transactions outside the country
- employment and/or the purchase of assets outside the country

Digitized by Google

Dealing with assets to the detriment of creditors

- encumbering assets up to or beyond fair market value (FMV)
- selling or transferring assets at less than FMV, and the timing of these sales or transfers following contact by CRA
- non-arm's length transactions and lending monies without security
- assets moved out of the country
- unusual corporate transactions involving dividends or shareholder loans
- any asset activity uncharacteristic of the tax debtor

Legal actions by other creditors

- any collection enforcement activity by other creditors

Nature of assessment / involvement in criminal activities

- tax evasion, initial assessment, audit reassessment, non-filer etc...
- tax debtors involvement in criminal activities such as narcotics, theft or fraud

> Note: Although relevant in making a determination as to whether there may be jeopardy involved in a particular matter, caution must be exercised when relying on this element. A jeopardy application hearing is not the proper forum to discuss the validity of underlying assessments or affidavits. The Department of Justice has advised of potential pitfalls in this regard and will act accordingly.

For further details, refer to Communication **ARD-2004-006 Collections Policy for Integrated Proceeds of Crime (IPOC) Cases**.

Counter indicators

Counter indicators are any relevant factors of the tax debtor's situation that suggest that the collection of the account is not in jeopardy. As jeopardy court orders are of an *ex parte* nature, it is the responsibility of the Agency to ensure all relevant factors representative of the tax debtor's situation be disclosed in the application and brought to the attention of the judge. Failure to disclose any relevant counter indicators may result in dismissal at the application stage or upon judicial review.

Counter indicators may include the following:

- promises to pay and/or offers of PDC arrangements
- explanations and/or intended plans to repay the debt
- previous payment arrangements to resolve prior tax debts that were acceptable to the Agency
- circumstances that tie the tax debtor to Canada
- payments made to the primary and any related accounts

Digitized by Google

Tax Debtor Leaving Canada

Factors indicating that a tax debtor is in the process of leaving the country include:

- tax debtor's assets and/or principle residence have been sold or are for sale
- tax debtor is dealing with financial institutions, investments, and the purchase of assets located in another country
- children's educational files have been transferred
- statements made by the tax debtor indicate that there is reluctance to resolve issues pertaining to present or future liabilities
- substantial dollar amounts have not been reported
- there has been a request for Clearance Certificates
- ITA s 226, ETA s 322, and SLPECA s 94(1) are applicable to situations where there is evidence that the tax debtor has left, or is about to leave the country. Specifically, a Demand for Payment must be used by the Minister to demand the payment of all taxes, interest and penalties owed for the current tax year and/or the previous year in addition to any unassessed tax years and years where collection restrictions are in effect at the time of service of the notice. Previous assessed years should not be included in the Demand for Payment, as the Minister is able to take all necessary collection actions to collect these debits.
- as a matter of policy after issuance of the Demand for Payment, a Notice of Assessment will be mailed to the tax debtor

If a tax debtor fails to pay the amounts requested under ITA s 226, and SLPECA s 94(1) and the danger of loss is so imminent it leaves no available time to make application for a jeopardy court order, ITA Subsection 226(2) and SLPECA Subsection 94(2) permits the seizure and sale of assets in accordance with, Subsections ITA 225(2) thru (5), and SLPECA 93(2) through (4), the seizure of chattel provisions. Such a situation might exist where a tax debtor has been held at a border crossing and Customs has contacted Collections for immediate actioning of the current or impending tax debt. These provisions are a significant departure from ITA Subsection 223(2), which authorizes debt certification etc. ITA Subsections 225(2) to (5) only provide for the seizure of chattels, not real property nor the issuance of Requirements to Pay.

If on the other hand there is time to file a jeopardy application, serious consideration should be given to initiating the action. If not, the ability of the Minister to seize assets may, as explained above, be very limited.

Collection Restrictions on Reassessments

It is important to know that a particular reassessment is in respect of the tax year, and is not limited to the increased or decreased amount. Therefore, once there is a reassessment, collection restrictions apply to the entire year. If jeopardy collection action is undertaken, it will apply to the entire year, and not just to the incremental amount.

For further details refer to Communication ARD-2005-022 **Collection Restrictions following Reassessments under the *Income Tax Act, Excise Act 2001* and *Excise Tax Act – Non GST***.

Digitized by Google

Authority Approval – Approval Process

When there is evidence that warrants jeopardy collection action, the file should be forwarded to the Collection Team Leader for review and approval for further action. With the concurrence of the Collections Team Leader, the Department of Justice is to be contacted to determine whether sufficient facts are present to warrant a jeopardy application.

Once an affirmative opinion is received from the Department of Justice, collection officers forward a package, including:

- the Statement of Facts,
- copies of all relevant documentation
- notice(s) of assessments or reassessments
- notes from Audit or Investigations
- evidence of tax debtor's conduct etc. and
- copies of correspondence with the Department of Justice,

to the TSO Director for approval to proceed with a jeopardy application. It is recommended that the package be referred to the TSO Director using the T2001 Memorandum Form as a cover sheet, so that the written concurrence of all applicable authority levels required can be documented.

For details concerning authority and approval levels relating to jeopardy in collections, refer to **Memorandum 01-21, Delegation of the Minister's Powers Under the *Income Tax Act*, *Excise Tax Act and Customs Act***, and TSDMB 2008-021 **Making referrals to the Department of Justice**

Procedures

This section provides procedures relating to Collection in Jeopardy.

- **Proceeding with an Investigation**
- **Comprehensive Investigation**
- **Completing a Statement of Facts**
- **Risk Analysis**
- **Application for Court Order**
- **Tax Assessments/Court Order**
- **Service of Court Documents**
- **Collection Action**
- **Judicial Review**
- **Jeopardy Process Summary**

Digitized by Google

- **Refund or Release of Security Pursuant to Subsection 164(1.1) ITA**
- **Taxpayer Leaving the Country – Demand for Payment 226(1)**

Note: Refer to **Resource Material** to view the list of publications in which additional information is available.

Proceeding with an Investigation

To avoid time consuming investigations:

- screen each referral to determine if a detailed jeopardy investigation is required
- ensure the information obtained is complete, accurate and recorded chronologically in the docket and in the online diary.

Comprehensive Investigation

A comprehensive investigation includes confirming the following factors:

- legal name of the tax debtor including trade styles and aliases
- the basis for suspicion that the tax debtor is about to leave Canada (if applicable)
- the basis for the belief that the tax debtor will not pay voluntarily
- the amount of the liability
- details of assets available for seizure (if applicable)
- the type of legal action necessary to recover amounts owing

Once the elements listed above have been confirmed, determine the following:

- the degree of danger of loss
- the collection potential (is the full liability recoverable?) including property and asset searches and any additional sources of recovery
- the extent of investigation necessary
- the number of persons required to conduct the investigation

Provide all documents substantiating the claim.

Obtain assistance, as required, from Audit and Enforcement regarding current financial information such as:

- present bank account(s)
- financial statements, particularly the balance sheet
- the security interests of other creditors
- statement of income and expenses

Digitized by Google

Completing a Statement of Facts

The Statement of Facts is intended to provide the TSO Director and the Department of Justice with sufficient information and evidence to authorize and proceed with a Notice of Motion. It must also provide the Department of Justice with a summary of the key evidence for the preparation of affidavits and the *ex parte* application. The Statement of Facts may also serve as an exhibit to the affidavit(s) should there be a judicial review.

Format

List, in chronological order, only facts supported by admissible evidence.

> Note: Subsection 225.2(4) of the ITA provides that statements contained in an affidavit filed in the context of an application under Section 225 ITA may be based on belief with sufficient grounds therefore.

Headings:

BACKGROUND

- Name
- Address
- Date of birth
- Marital/Family status
- Occupation

TAX LIABILITY

- Amounts and tax years involved
- Basis of liability

ASSETS FROM WHICH RECOVERY MAY BE EFFECTED

- List: property, bank accounts, investments, etc.

SEQUENCE OF RELATED EVENTS

- This is a chronological summary of the account history leading to the request for a jeopardy application
- It must clearly describe the jeopardy **elements**, **indicators** and **counter indicators**

For clarity, categorize and place the facts in the appropriate sections of the Statement of Facts. Background information should not be intermixed with the direct jeopardy facts.

There are some general rules required in the preparation of a Statement of Facts:

- It need not be signed

Digitized by Google

- the pages are not numbered
- the entries must be in chronological order
- it is written on plain paper, not letterhead
- It must identify each person involved, including first/last name
- it must stick to the relevant facts, WITHOUT amplification

To review a sample of a completed Statement of Facts, please refer to Section 3.1 of the Jeopardy Overview Learner's Guide (TD8700-000-L), pp. 3.5-3.8.

Risk Analysis

Once the Statement of Facts has been completed, prepare a Risk Analysis to summarize conclusions based on the balance of probability.

Purpose

The Risk Analysis contains conclusions, inferences or observations consistent with those that would be reached by a reasonable person given the same set of facts. The Risk Analysis should show that, based upon a "balance of probabilities", a delay would jeopardize the collection of the amount outstanding.

The Risk Analysis is based upon facts as summarized within the Statement of Facts.

Format

The Risk Analysis is the conclusion of the Statement of Facts, which summarizes the danger of loss aspect of the account.

The Risk Analysis should address all relevant factors highlighted in the Statement of Facts as well as consider any counter-indicators.

Note: It is acceptable to draw conclusions as to what might happen at a future date, provided that reasonable consideration be given to the facts contained in the Statement of Facts in support of your conclusions.

To review a sample of a completed Risk Analysis, please refer to Section 3.2 of the Jeopardy Overview Learner's Guide (TD8700-000-L) p. 3.10..

Application for Court Order

The Department of Justice will make application via a Notice of Motion and appear on behalf of the Minister. The judge will review the evidence and render a decision.

Tax Assessments / Court Order

An authorization to proceed with immediate collection activity may be granted even though the Notice of Assessment has not been sent to the tax debtor. This authorization is granted when the Court is satisfied that sending the notice to the tax debtor would be detrimental to our collection actions. When the jeopardy authorization is granted, the amount assessed will immediately become due and payable. Otherwise, the assessment must be sent prior to the hearing date.

Digitized by Google

Service of Court Documents

Once a court order is obtained, the client must be served within a prescribed amount of time, pursuant to the applicable Act. The Department of Justice may seek an extension if the prescribed time is insufficient.

A letter, called a Letter of Introduction, signed by the TSO Director will accompany the documents and address the following points:

- an introduction to the documents (for example: Court order and, if applicable, the Notice of Assessment)
- a brief summary of the Court's direction (i.e. which court granted what and when etc)
- the authority for the actions taken
- the client's appeal rights pertaining to the jeopardy action and the name and telephone number of the Assistant Director sponsoring the assessment in case further clarification of the assessment is required

Upon service of the court order, the client must be given the opportunity to pay the amount owing.

To review a sample of a Letter of Introduction, please refer to Section 3.4 of the **Jeopardy Overview Learner's Guide TD8700-000-L) p.3.21.**

Collection Action

Immediate legal action can proceed once the client has been served with the court order and a request for payment has been made (service is effected by personal service or in accordance with directions of a judge). Where a tax debtor has applied or intends to apply for a judicial review, collection action should not be postponed. By law, collection action granted by the jeopardy provisions is not stayed pending a judicial review.

Headquarters policy, however, recommends that liquidation of seized assets be postponed until the 30-day review period has expired and, ultimately, until the judge renders a review decision.

Also, collection action will be stayed should a tax debtor seek remedy under the *Farm Debt Mediation Act*. If such an instance should occur, Head Office policy states that no jeopardy action will be undertaken.

For details regarding the application of the *Farm Debt Mediation Act* to jeopardy in collections, refer to **Directive RCD-00-27, The Effect of the Farm Debt Mediation Act on Revenue Collection.**

Judicial Review

Pursuant to the provisions of the various Acts, tax debtors may challenge a jeopardy authorization in court. The burden to justify the jeopardy authorization rests with the Minister.

The Minister must, in the context of such a review, demonstrate that the authorization to proceed was warranted in the circumstances.
The scope of the review is limited to the facts relating to the question of whether there are reasonable grounds to believe collection would be jeopardized by granting a delay in collection

Digitized by Google

action. The validity of an outstanding notice of objection or appeal is irrelevant in the context of this type of review.

Related Topics:

- **Basic Steps**
- **Steps to follow if a Hearing has been ordered**
- **Affidavits**
- **Examining Affiants**

Basic Steps

The following are the basic steps of a judicial review:

- the tax debtor files a notice of motion to have the jeopardy authorization vacated
- an application will be made fixing the time and place for the hearing
- a copy of the Motion is served on the Deputy Attorney General
- the hearing is heard in public (usually) or behind closed doors (exceptionally)
- a decision is rendered by the Court

Steps to follow if a Hearing has Been Ordered

Good planning and organization is essential when dealing with the short time frames required for a judicial review. Therefore, upon being advised that a hearing has been ordered, the Collection Officer must:

- inform the Tax Services Office management of the hearing
- list all the departmental staff who were involved in the investigation who will likely be called upon to testify for the Crown, and inform them of the upcoming hearing (Note: The info should be readily available from the Statement of Facts)
- contact the Regional Office of the Department of Justice to arrange for the preparation of affidavits, court briefs, etc.
- should a different attorney be representing us for the judicial review, ensure he has all relevant documentation including the Statement of Facts, recent communication, etc.

Affidavits

Affidavits are used to introduce evidence. The Department of Justice reviews the evidence to assist in preparing the affidavit.

It is the responsibility of the Department of Justice to help prepare all affidavits necessary for the initial application and judicial review, when applicable.

The affiant must carefully review every part of an affidavit before signing it. The swearing of an affidavit is a solemn oath to the effect that its contents are true.

Digitized by Google

8. Notice of Assessment prepared in anticipation of court order

9. Department of Justice makes an *ex parte* application

10. Obtain additional court order(s) as necessary i.e. an order for opening doors may be required if there are reasonable grounds to believe in the existence of a safe or safe deposit box.

11. Prepare the Letter of Introduction, certify the debt, obtain writs, prepare T1118s, legal hypothecs, any documents relevant to anticipated collection measures.

12. Service of court order, Assessment Notice (within 72 hours of order if no extension of time sought in jeopardy order), Letter of Introduction, and other documents, where applicable, for legal hypothec, certificate, garnishee orders, etc.

13. Implement Collection Plan

Refund or Release of Security Pursuant to Subsection 164(1.1) ITA

Subsection 164(1.1) of the ITA authorizes the Minister, upon application by the tax debtor, to repay amounts paid or surrender security accepted for amounts in dispute.

This type of request is usually submitted to Appeals who in turn complete and forward Form T420 to Collections for consideration.

Related Topics:

- **Conditions Required to Satisfy Subsection 164(1.1) ITA**
- **What Constitutes a "An Amount Paid on Account" or a "Security"**
- **Processing T420 Requests**

Conditions Required to Satisfy Subsection 164(1.1) ITA

The following three conditions must be met to satisfy Subsection 164(1.1) ITA:

- the first condition is that the tax debtor must have either filed a notice of objection that the Minister, after 120 days, has not confirmed, varied or issued a reassessment in respect thereof, or the tax debtor has appealed to the Tax Court of Canada
- the second condition is that the tax debtor must have paid amounts on account of the amounts in dispute and/or the Minister must have accepted security for the amounts in dispute
- the third condition is that the tax debtor must have made a written application to the Minister for payment of the amounts or surrender of the security

When all three above-noted conditions have been met, the Minister will subsequently determine the amount of the repayment or the amount of the security to be surrendered in accordance with the provisions of Paragraphs 164 (1.1)(c) and (d) of the ITA or may invoke jeopardy provisions under 164(1.2) ITA.

Digitized by Google

It should be noted that a court order pursuant to 164(1.2) ITA allows the Agency to withhold a refund or the release of security and that, where other collection measures are sought, consideration should be given to jeopardy provisions pursuant to 225.2(2) ITA.

Jeopardy indicators under 225.2(2) ITA are applicable to Subsection 164(1.2) ITA with such modifications as circumstances require. Please refer to the Section **Jeopardy Indicators**.

When jeopardy action is undertaken pursuant to 164(1.2) of the ITA, the role of the Department of Justice is the same as its role in jeopardy actions pursuant to 225.2(2). Please refer to the Section **Role of the Department of Justice**.

Contrary to jeopardy actions pursuant to 225.2(2) ITA, an application under 164(1.2) is not *ex parte*. The tax debtor is notified of our intent to invoke jeopardy provisions and he may both attend the hearing and/or make representations.

For details concerning authority and approval levels relating to actions pursuant to 164 (1.2) ITA, refer to Memorandum 01-21, **Delegation of the Minister's Powers under the Income Tax Act, Excise Tax Act and Customs Act**.

When the Minister's denial of a request rests on the fact that the three conditions are not met, no appeal of this decision is provided for in the Income Tax Act. In ***Topol v Canada* 2003 FCT 658 (T-801-02, May 27 2003)** the Court addressed the standard of review applicable to the Minister's decision. In his decision, the judge held that "*I agree with the applicant that the Trial Division of the Federal Court has jurisdiction pursuant to Section 18.1 of the* **Federal Court Act** *and that the appropriate and indeed the only avenue available to the applicant to challenge the Minister's denial of the applicant's requests under Subsection 164(1.1) of the Act is by way of judicial review*".

What Constitutes a "An Amount Paid on Account" or a "Security"

In *Topol v Canada* 2003 FCT 658 (T-801-02, May 27 2003) the Court held that a non-capital loss carried back from a subsequent taxation year was not "an amount paid on account" of the amount in dispute and therefore could not satisfy the second condition under 164(1.1) ITA.

In *Topol* the Court also determined that payments received in the form of deductions at source did not qualify as "an amount paid on account of the amounts in dispute" therefore denying the second condition.

Another issue of significance in *Topol* was the fact that the tax debtor, through the judicial review, sought to have removed a writ of seizure and sale obtained by the Minister, with respect to a taxation year that was later under appeal. The tax debtor argued that the Minister's writ should fall under the meaning of "accepted security" captured by the second precedent condition. These are the Court's conclusions in regard to the writ:

"A writ of seizure and sale, as I understand it, is an enforcement procedure. It is an order to a sheriff to enforce a judgment or order of the court. The writ in issue is the Minister's writ, not that of the tax debtor, although its effect is to afford some type of security to the Minister in the broad sense. In my view, the "security" referred to in Subsection 164(1.1) is security provided by the tax debtor to the Minister. The specific wording of the provision refers to "security accepted". Of necessity, to be accepted, it must have been offered or provided. A writ of seizure and sale, sought and obtained by the Minister, cannot be regarded as security provided by the tax debtor"

The Court found that a writ of seizure and sale, sought and obtained by the Minister, could not be regarded as security provided by the taxpayer.

Digitized by Google

- Return all signed and authorized copies of the T420 to Appeals, if Collections does not agree with the client's request.
- When in agreement with the request, Collections will send copies #1 and #2 (signed and authorized) to Revenue Accounting, if a refund is to be issued. Once completed, Revenue Accounting will return copy # 1 to Appeals, confirming that the process has been completed.
- If only security is to be returned to the client, follow the guidelines in the Security Chapter of the Collections Manual to effect the release, returning copies #1 and #2 (signed and authorized) to Appeals, and entering a detailed notation in the diary.
- Retain copy #3.

Note: Subsection 164(1.1) gives the Agency the discretion to either withhold a credit that is being considered for refund, or release any qualified security that may be held (the reason for the T420), if it can be reasonably considered that eventual collection of the account is in jeopardy and a subsequent court order would have to be obtained pursuant to the jeopardy of ITA 164(1.2).

A copy of the T420 is available via **InfoZone**.

For further details, refer to Communication TSDMB-2005-028(ARD), **Appeals Referral to Collections – Form T420**.

Taxpayer Leaving the Country – Demand for Payment 226(1)

1. Collections will confirm with the necessary assistance from Compliance Programs Branch or Enforcement Divisions:
   - tax debtors name
   - the basis for the suspicion that the taxpayer has left or is about to leave the country
   - the amounts of the proposed assessment(s) for all taxation years
   - the proposed date of assessment
   - details of assets available for seizure
   - what legal action is contemplated to recover the amount owing
2. When the Assistant Director, Revenue Collections concurs with the recommendation to invoke Subsection 226(1), full particulars, together with the recommendation will be submitted under the Assistant Director's signature to the TSO Director for approval to proceed.
3. A Demand for Payment letter will be prepared for the Director's signature. The letter will include the following information:

Digitized by Google

- statement to the effect the Minister of National Revenue suspects the tax debtor has left or is about to leave Canada and thereby give notice and demand immediate payment
- the dollar amount being demanded and what tax, contributions, benefits repayments, interests, etc it comprises
- the applicable statutory authorities for demanding payment (ITA, ETA, Province, CP, EI)

5. On receipt of the Demand for Payment letter from the director:

   - effect personal service of the letter. Have the taxpayer acknowledge receipt by signing a copy, ensuring that both the time and date of receipt are recorded on the copy. If the taxpayer refuses to acknowledge, leave the letter and complete an affidavit of service
   - request payment immediately, or realizable security, from the taxpayer. Payment other than cash, money order or certified cheque will not normally be accepted
   - send the demand for payment by registered mail if personal service is impossible. Obtain written confirmation from the Post Office of the date and time of mailing of letter, assessments, etc.
   - prepare an affidavit of service by registered mail using the Post Office document of confirmation as proof of delivery

   Note: As a matter of policy, after issuance of the Demand for Payment letter, a Notice of Assessment will be mailed to the taxpayer.

5. If the taxpayer is suspected of leaving Canada and jeopardy action is required, the timing of the Demand for Payment letter under 226(1) and assessment notice must be coordinated with the actions under 225.2.

Resource Material

Jeopardy Overview Learners Guide # TD8700 available from Training and Development Directorate.

Directive RCD-00-32, Jeopardy Assessments and Collection under section 322.1 of the *Excise Tax Act*, issued December 29, 2000.

Directive RCD-00-27, The Effect of Farm Debt Mediation Act on Revenue Collection, issued October 19, 2000.

Communication ARD-2004-006, Collections Policy for Integrated Proceeds of Crime (IPOC) Cases, issued February 20, 2004.

Communication ARD-2005-028, Appeals Referral to Collections – Form T420, issued July 28, 2006.

Memorandum 01-21, Delegation of the Minister's Powers Under the *Income Tax Act*, *Excise Tax Act and Customs Act*, issued December 10, 2001.

Digitized by Google

Digitized by Google

Digitized by Google

Withholding Taxes and Liability to Withhold

Withholding taxes - S. 227
227. (1) No action lies against any person for deducting or withholding any sum of money in compliance or intended compliance with this Act.

Return filed with person withholding
(2) Where a person (in this subsection referred to as the "payer") is required by regulations made under subsection 153(1) to deduct or withhold from a payment to another person an amount on account of that other person's tax for the year, that other person shall, from time to time as prescribed, file a return with the payer in prescribed form.

Failure to file return
(3) Every person who fails to file a return as required by subsection (2) is liable to have the deduction or withholding under section 153 on account of the person's tax made as though the person were a person who is neither married nor in a common-law partnership and is without dependants.

Trust for moneys deducted
(4) Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act.

Extension of trust
(4.1) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act (*except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person and property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for a security interest (as defined in subsection 224(1.3)) would be property of the person, equal in value to the amount so deemed to be held in trust is deemed

> **(*a*) to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, and**
> **(*b*) to form no part of the estate or property of the person from the time the amount was so deducted or withheld, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to such a security interest and is property**

Digitized by Google

beneficially owned by Her Majesty notwithstanding any security interest in such property and in the proceeds thereof, and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

Meaning of security interest
(4.2) For the purposes of subsections 227(4) and 227(4.1), a security interest does not include a prescribed security interest.

Application to Crown
(4.3) For greater certainty, subsections (4) to (4.2) apply to Her Majesty in right of Canada or a province where Her Majesty in right of Canada or a province is a secured creditor (within the meaning assigned by subsection 224(1.3)) or holds a security interest (within the meaning assigned by that subsection).

Payments by trustees, etc.
(5) Where a specified person in relation to a particular person (in this subsection referred to as the "payer") has any direct or indirect influence over the disbursements, property, business or estate of the payer and the specified person, alone or together with another person, authorizes or otherwise causes a payment referred to in subsection 135(3), 135.1(7) or 153(1), or on or in respect of which tax is payable under Part XII.5 or XIII, to be made by or on behalf of the payer, the specified person

(*a*) is, for the purposes of subsections 135(3) and 153(1), section 215 and this section, deemed to be a person who made the payment;

(*a.1*) is, for the purposes of subsections 135.1(7) and 211.8(2), deemed to be a person who redeemed, acquired or cancelled a share and made the payment as a consequence of the redemption, acquisition or cancellation;

(*b*) is jointly and severally, or solidarily, liable with the payer to pay to the Receiver General

(i) all amounts payable by the payer because of any of subsections 135(3), 135.1(7), 153(1) and 211.8(2) and section 215 in respect of the payment, and

(ii) all amounts payable under this Act by the payer because of any failure to comply with any of those provisions in respect of the payment; and

(*c*) is entitled to deduct or withhold from any amount paid or credited by the specified person to the payer or otherwise recover from the payer any amount paid under this subsection by the specified person in respect of the payment.

Definition of "specified person"
(5.1) In subsection 227(5), a "specified person" in relation to a particular person means a person who is, in relation to the particular person or the disbursements, property, business or estate of the particular person,

(*a*) a trustee;
(*b*) a liquidator;
(*c*) a receiver;
(*d*) an interim receiver;
(*e*) a receiver-manager;
(*f*) a trustee in bankruptcy or other person appointed under the *Bankruptcy and Insolvency Act*;
(*g*) an assignee;
(*h*) a secured creditor (as defined in subsection 224(1.3));

Digitized by Google

(*i*) an executor, a liquidator of a succession or an administrator;
(*j*) any person acting in a capacity similar to that of a person referred to in any of paragraphs 227(5.1)(*a*) to 227(5.1)(*i*);
(*k*) a person appointed (otherwise than as an employee of the creditor) at the request of, or on the advice of, a secured creditor in relation to the particular person to monitor, or provide advice in respect of, the disbursements, property, business or estate of the particular person under circumstances such that it is reasonable to conclude that the person is appointed to protect or advance the interests of the creditor; or
(*l*) an agent of a specified person referred to in any of paragraphs 227(5.1)(*a*) to 227(5.1)(*k*).

"Person" includes partnership
(5.2) For the purposes of this section, references in subsections 227(5) and 227(5.1) to persons include partnerships.

Excess withheld, returned or applied
(6) Where a person on whose behalf an amount has been paid under Part XII.5 or XIII to the Receiver General was not liable to pay tax under that Part or where the amount so paid is in excess of the amount that the person was liable to pay, the Minister shall, on written application made no later than 2 years after the end of the calendar year in which the amount was paid, pay to the person the amount so paid or such part of it as the person was not liable to pay, unless the person is or is about to become liable to make a payment to Her Majesty in right of Canada, in which case the Minister may apply the amount otherwise payable under this subsection to that liability and notify the person of that action.

First Vancouver Finance v. M.N.R., [2002] 2 S.C.R. 720, 2002 SCC 49

.

Present: McLachlin C.J. and Gonthier, Iacobucci, Major, Bastarache, Binnie and LeBel JJ. on appeal from the court of appeal for saskatchewan

Income tax — Administration and enforcement —Collection — Source deductions — Trust for moneys deducted — Employer failing to remit payroll deductions — Accounts receivable sold to third party
— Whether property acquired by tax debtor after statutory deemed trust arises subject to trust — If so, whether sale of trust property to third party releases property from trust — Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 227(4), (4.1).
The respondent, First Vancouver Finance, entered into a factoring agreement with Great West Transport whereby it would purchase Great West's accounts receivable at a discount. After purchase, the Great West invoices were forwarded to Great West's debtors, along with notification that the accounts had been sold and that subsequent payments should be made directly to First Vancouver. Among the accounts purchased were several owing by Canada Safeway Limited. As of the date of the factoring agreement, Great West owed money to the Minister of National Revenue because of unremitted payroll deductions. First Vancouver had made arrangements with the Minister to forward part of the purchase price of the accounts to be applied to Great West's arrears. The Minister served Canada Safeway with Enhanced Requirement to Pay Notices ("RTPs") as authorized by the *Income Tax Act* ("*ITA*"). In response, Canada Safeway made payments to the

Digitized by Google

Minister relating to accounts which Great West had assigned to First Vancouver. First Vancouver brought an application to recover the amounts paid by Canada Safeway to the Minister pursuant to the RTPs. The Court of Queen's Bench granted the application in part, holding that First Vancouver was entitled to the moneys owing on accounts factored before the RTPs were issued. The Court of Appeal upheld that decision.

Held: The appeal should be dismissed.

The *ITA* requires employers to deduct and withhold amounts from their employees' wages ("source deductions") and remit these amounts to the Receiver General by a specified due date. Under s. 227(4), when source deductions are made, they are deemed to be held separate and apart from the property of the employer in trust for Her Majesty. If the source deductions are not remitted to the Receiver General by the due date, the deemed trust in s. 227(4.1) becomes operative and attaches to property of the employer to the extent of the amount of the unremitted source deductions. The trust is deemed to have existed from the moment the source deductions were made. The s. 227(4.1) deemed trust is similar in principle to a floating charge over all the tax debtor's assets in favour of Her Majesty. As long as the tax debtor continues to be in default, the trust continues to float over the tax debtor's property. At any given point in time, whatever property then belonging to the tax debtor is subject to the deemed trust. As property comes into possession of the tax debtor, it is caught by the trust and becomes subject to Her Majesty's interest. Similarly, property which the tax debtor disposes of is thereby released from the deemed trust. The mutuality of treatment between incoming and outgoing property relating to the deemed trust is supported by both the plain language of the provisions as well as their purpose and intent. Her Majesty's interest in the tax debtor's property is protected because, while property which is sold to third party purchasers is released from the trust, at the same time, the proceeds of disposition of the alienated property are captured by the trust. Commercial certainty is promoted owing to the fact that third party purchasers are free to transact with tax debtors or suspected tax debtors without fearing that Her Majesty may subsequently assert an interest in the property so acquired.

Since the deemed trust created by ss. 227(4) and 227(4.1) encompasses property which comes into the hands of the tax debtor after the trust arises, when Great West came into possession of the Canada Safeway invoices, the deemed trust, which had already arisen as a consequence of Great West's default in remittances, successfully attached to those invoices. However, the deemed trust does not operate over assets which a tax debtor has sold in the ordinary course to third party purchasers. Once the Canada Safeway invoices had been factored to First Vancouver, the Minister was prevented from asserting its interest in these invoices.

Digitized by Google

Cases Cited

Approved: *Royal Bank v. Tuxedo Transport Ltd.* (2000), 79 B.C.L.R. (3d) 1, rev'g (1999), 6 (4th) 285; **referred to:** *Alberta (Treasury Branches) v. M.N.R.*, [1996] 1 S.C.R. 963; *Pembina on the Red Development Corp. v. Triman Industries Ltd.*(1991), 85 D.L.R. (4th) 29; *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411.

Statutes and Regulations Cited

Excise Tax Act, R.S.C. 1985, c. E-15, s. 317(3) [am. 1993, c. 27, s. 133].

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 153(1), 224, 224(1.2), 227(4) [repl. 1998, c. 19, s. 226(1)], (4.1) [en. *idem*].

APPEAL from a judgment of the Saskatchewan Court of Appeal (2000), 199 Sask. R. 9, [2000] 8 W.W.R. 386, [2000] 3 C.T.C. 93, [2001] G.S.T.C. 55, [2000] S.J. No. 330 (QL), 2000 SKCA 58, affirming a decision of the Court of Queen's Bench (1999), 190 Sask. R. 286, [2000] 1 W.W.R. 713, [2000] 1 C.T.C. 99, [2001] G.S.T.C. 54, [1999] S.J. No. 738 (QL), 1999 SKQB 166. Appeal dismissed.

Edward R. Sojonky,Q.C., and *Mark Kindrachuk*, for the appellant.

Joel A. Hesje and *David M. A. Stack*, for the respondent First Vancouver Finance.

The judgment of the Court was delivered by IACOBUCCI J. —

Introduction

This appeal concerns the interpretation of the deemed trust provisions in ss. 227(4) and 227(4.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"). At the hearing of this appeal, the Court dismissed the appeal with reasons to follow. The dispute is over certain property which came into the hands of the tax debtor after a deemed trust under s. 227(4.1) arose. The property was subsequently sold to a third party, after which time the Minister of National Revenue ("Minister") asserted an interest in the property on the basis that it continued to be subject to the deemed trust even after its sale.

As a result, the two specific issues to be resolved on this appeal are, first, whether property which comes into the tax debtor's hands after the deemed trust arises is subject to the trust, and, second, if so, whether the sale of trust property to third parties serves to release this property from the ambit of the trust.

Section 153(1) of the *ITA* requires employers to deduct and withhold amounts from their employees' wages ("source deductions") and remit these amounts to the Receiver General by a specified due date. By virtue of s. 227(4), when source deductions are made, they are deemed to be held separate and apart from the property of the employer in trust for Her Majesty. If the source deductions are not remitted to the Receiver General by the due date, the deemed trust in s. 227(4.1) of the *ITA* becomes operative and attaches to property of the employer to the extent of the amount of the unremitted source deductions. As well, the trust is deemed to have existed from the moment the source deductions were made.

For the reasons set forth below, I find that the s. 227(4.1) deemed trust is similar in principle to a floating charge over all the tax debtor's assets in favour of Her Majesty. The trust arises the moment the tax debtor fails to remit source deductions by the specified due date, but is deemed to have been in existence from the moment the deductions were made. As long as the tax debtor continues to be in default, the trust continues to float over the tax debtor's property. Thus, at any given point in time, whatever property then belonging to the tax debtor is subject to the deemed trust.

Digitized by Google

Viewed in this way, it is clear that, as property comes into possession of the tax debtor, it is caught by the trust and becomes subject to Her Majesty's interest. Similarly, property which the tax debtor disposes of is thereby released from the deemed trust. This mutuality of treatment between incoming and outgoing property relating to the deemed trust is supported by both the plain language of the provisions as well as their purpose and intent. Most importantly, Her Majesty's interest in the tax debtor's property is protected because, while property which is sold to third party purchasers is released from the trust, at the same time, the proceeds of disposition of the alienated property are captured by the trust. Moreover, commercial certainty is promoted owing to the fact that third party purchasers are free to transact with tax debtors or suspected tax debtors without fearing that Her Majesty may subsequently assert an interest in the property so acquired.

Accordingly, I would dismiss the appeal on the basis that, although the property acquired by the tax debtor after the deemed trust arose became subject to the trust, when this property was sold to a third party, it was thereby released from the ambit of the deemed trust. As such, after the sale, Her Majesty could no longer assert an interest in the property.

Facts

The respondent, First Vancouver Finance ("First Vancouver"), is engaged in the business of factoring accounts receivable. Great West Transport Ltd. ("Great West") is in the transportation business. On November 6, 1997, First Vancouver and Great West entered into a factoring agreement providing for the purchase by First Vancouver of Great West's accounts receivable at a discount. Pursuant to the agreement, First Vancouver became the owner of certain debts due to Great West.

Under the terms of the factoring agreement, First Vancouver purchased accounts through assignments entered into from time to time at Great West's option. First Vancouver did not purchase an individual account until it was submitted for approval, and it was not bound to purchase it up to that point. After purchase, the Great West invoices were forwarded to Great West's debtors, along with notification that the accounts had been sold and that subsequent payments should be made directly to First Vancouver. Among the accounts purchased were several owing by Canada Safeway Limited or its associated undertakings ("Canada Safeway").

As of the date of the factoring agreement, Great West owed money to the Minister because of unremitted payroll deductions and goods and services tax ("GST"). First Vancouver was aware from the time it began dealing with Great West in November of 1997 that Great West was in arrears in respect of its payroll deductions and GST accounts. First Vancouver had, as of November 10, 1997, made arrangements with the Minister to forward part of the purchase price of the accounts, in the form of semi-monthly payments of $10,000, to the Minister which were to be applied to the arrears of Great West then outstanding. In addition, Great West remained directly responsible to the Minister for its ongoing payroll deductions and GST remittances as they became due. While First Vancouver regularly made payments pursuant to its arrangement with the Minister, Great West failed to meet its ongoing tax obligations.

In January and February of 1999, Great West made 10 individual assignments to First Vancouver, relating to accounts receivable payable by Canada Safeway and its associated undertakings. On February 10, 1999, the Minister served Canada Safeway with Enhanced Requirement to Pay Notices ("RTPs"), as authorized by s. 224(1.2) of the *ITA* and s. 317(3) of the *Excise Tax Act*, R.S.C. 1985, c. E-15, as amended. In response, Canada Safeway made payments totalling $187,444.66 to the Minister relating to accounts which Great West had assigned to First Vancouver between January 4 and February 17, 1999. Two of the sets of Canada Safeway accounts, totalling $31,086.43, were assigned to First

Digitized by Google

Vancouver on February 11 and February 17, 1999, after the RTPs had been issued. However, the remainder of the accounts had already been assigned to First Vancouver before February 10, 1999 when the RTPs were issued. At no time prior to the payments from Canada Safeway to the Minister did First Vancouver receive any notice that the Minister was claiming an interest in any Great West accounts purchased by First Vancouver.

In response to the Minister's actions, First Vancouver brought an application in the Saskatchewan Court of Queen's Bench to recover the amounts paid by Canada Safeway to the Minister pursuant to the RTPs.

Wimmer J. of the Court of Queen's Bench held that the monies owing on accounts factored prior to February 10, 1999, the date upon which Canada Safeway was served with the RTPs, were not subject to garnishment or to the deemed trust provisions of the *ITA*, or to any claim pursuant to the *Excise Tax Act*, and therefore that First Vancouver was entitled to these amounts. However, he held that the RTPs had captured the two accounts assigned after the RTPs were issued ("post-RTP accounts").

On appeal, the Saskatchewan Court of Appeal dismissed the appeal of the Minister and the cross-appeal of First Vancouver on the issue of the post-RTP accounts.

Relevant Statutory Provisions

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)

227. . . .

[Trust for moneys deducted] Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act.

(4.1) [Extension of trust] Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection (4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person and property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for a security interest (as defined in subsection 224(1.3)) would be property of the person, equal in value to the amount so deemed to be held in trust is deemed to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, and to form no part of the estate or property of the person from the time the amount was so deducted or withheld, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to such a security interest

and is property beneficially owned by Her Majesty notwithstanding any security interest in such property and in the proceeds thereof, and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

Judgments Below

Saskatchewan Court of Queen's Bench, [2000] 1 W.W.R. 713

On the preliminary issue of the ownership of the factored accounts, Wimmer J. relied upon the definition of a factoring agreement from *Alberta (Treasury Branches) v. M.N.R.*, [1996] 1 S.C.R. 963, at paras. 30-31. In that case, Cory J. stated at para. 31 that, "A factoring of accounts receivable is based upon an absolute assignment of them. It is in effect a sale by a

Digitized by Google

company of its accounts receivable at a discounted value to the factoring company for immediate consideration."

Wimmer J. observed that, according to *Alberta (Treasury Branches)*, an absolute and unconditional assignment of book debts is beyond the reach of the Minister under garnishment provisions. He held further that the assignments from Great West to First Vancouver were absolute and unconditional because, upon completion of the assignments, Great West had no residual rights in the property and could not redeem or recover the accounts and, in that circumstance, Canada Safeway had no liability to Great West after there was a completed transfer of accounts. Although the Minister argued that the assignments were not absolute because under the factoring agreement First Vancouver had recourse to Great West if a customer disputed or failed to pay an account, Wimmer J. noted that the definition of factoring approved by Cory J. contemplated that a factor may acquire an absolute interest in book debts with or without recourse (p. 718). 17 As a result, monies owing on accounts factored prior to February 10, 1999, the date upon which Canada Safeway was served with the RTPs, were not subject to garnishment under s. 224 of the *ITA* or s. 317 of the *Excise Tax Act*. However, the two accounts factored after February 10 were effectively intercepted by the RTPs.

With respect to the deemed trust under s. 227(4.1) of the *ITA*, Wimmer J. applied the reasoning of Burnyeat J. of the British Columbia Supreme Court in *Royal Bank v. Tuxedo Transport Ltd.* (1999), 6 C.B.R. (4th) 285. Since the Canada Safeway invoices came into existence after the Great West payroll deduction delinquencies arose and were assessed, the invoices were"after-acquired property" not subject to a s. 227(4.1) deemed trust in favour of Her Majesty. Wimmer J. acknowledged that *Tuxedo Transport* was under appeal. However, he stated that, since the judgment came from a court of comparable jurisdiction, and as he was not satisfied it was wrong, he was prepared to follow that decision.

As a result, Wimmer J. held that amounts owing on accounts factored prior to February 10, 1999, the date upon which the Minister served Canada Safeway with the RTPs, were not subject to garnishment or to a deemed trust pursuant to ss. 224 and 227 of the *ITA*, or to any claim pursuant to s. 317 of the *Excise Tax Act*. Consequently, a declaration was made confirming First Vancouver's entitlement to the funds already paid by Canada Safeway to the Minister, with the exception of the funds covered by the two Canada Safeway accounts factored after February 10, 1999, along with costs.

Saskatchewan Court of Appeal, [2000] 8 W.W.R. 386

In a very brief oral decision, the Saskatchewan Court of Appeal dismissed the Minister's appeal, and First Vancouver's cross-appeal, both with costs, finding that the trial judge had not erred in the interpretation of the relevant statutory provisions or in the application of those provisions to the facts of the case.

Issues

A. Is property acquired by an employer after a default in remitting payroll deductions ("after- acquired property") subject to the deemed trust in s. 227(4.1) of the *ITA*?

B. Does the deemed trust under s. 227(4.1) continue to attach to property which has been sold by the tax debtor to a third party purchaser for value?

Analysis

General Scheme and Background of the Section 227(4.1) Deemed Trust

The collection of source deductions has been recognized as "at the heart" of income tax collection in Canada: see *Pembina on the Red Development Corp. v. Triman Industries Ltd.* (1991), 85 D.L.R. (4th) 29 (Man. C.A.), at p. 51, *per* Lyon J.A. (dissenting), quoted with

Digitized by Google

approval by Gonthier J. (dissenting on another issue) in *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411, at para. 36. Because of the importance of collecting source deductions, the legislation in question gives the Minister the vehicle of the deemed trust to recover employee tax deductions which employers fail to remit to the Minister.

It has also been noted that, in contrast to a tax debtor's bank which is familiar with the tax debtor's business and finances, the Minister does not have the same level of knowledge of the tax debtor or its creditors, and cannot structure its affairs with the tax debtor accordingly. Thus, as an"involuntary creditor", the Minister must rely on its ability to collect source deductions under the *ITA*: *Pembina on the Red Development*, *supra*, at pp. 33-34, *per* Scott C.J.M., approved by Cory J. in *Alberta (Treasury Branches)*, *supra*, at paras. 16-18. For the above reasons, under the terms of the *ITA*, the Minister has been given special priority over other creditors to collect unremitted taxes.

This Court had occasion to interpret the deemed trust provisions in *Sparrow Electric*, *supra*. At that time, the relevant provisions were ss. 227(4) and 227(5) of the *ITA* which read as follows:

227. . . .

Every person who deducts or withholds any amount under this Act shall be deemed to hold the amount so deducted or withheld in trust for Her Majesty.

Notwithstanding any provision of the *Bankruptcy Act*, in the event of any liquidation, assignment, receivership or bankruptcy of or by a person, an amount equal to any amount deemed by subsection (4) to be held in trust for Her Majesty . . .

shall be deemed to be separate from and form no part of the estate in liquidation, assignment, receivership or bankruptcy, whether or not that amount has in fact been kept separate and apart from the person's own moneys or from the assets of the estate.

In *Sparrow Electric*, both Royal Bank and the Minister claimed an interest in the proceeds of inventory of the tax debtor. In characterizing the nature of the deemed trust provisions, Gonthier J. (dissenting, but not on this issue) stated at para. 34 that, even if collateral was subject to a fixed charge at the time of a triggering event such as bankruptcy or liquidation, the deemed trust operated to attach the Minister's interest to such collateral as long as it was not subject to the fixed charge at the time the source deductions were made:

Thus, s. 227(5) [now s. 227(4.1)] alternatively permits Her Majesty's interest to attach retroactively to the disputed collateral if the competing security interest has attached after the deductions giving rise to Her Majesty's claim in fact occurred. Conceptually, the s. 227(5) deemed trust allows Her Majesty's claim to go back in time and attach its outstanding s. 227(4) interest to the collateral before that collateral became subject to a fixed charge. [Emphasis in original.]

Royal Bank's interest was characterized as a fixed and specific charge over the inventory of the tax debtor. This had the effect of making the bank the legal owner of inventory as it came into possession of the tax debtor, subject to the debtor's equitable right of redemption. The majority of the Court concluded that, since the inventory was subject to the bank's security interest before the deductions giving rise to the deemed trust occurred, the bank's interest attached to the inventory in priority to Her Majesty's interest under the deemed trust.

However, in reaching this conclusion, the majority of the Court noted at para. 112 that Parliament was free to grant absolute priority to the deemed trust by adopting the appropriate language:

Finally, I wish to emphasize that it is open to Parliament to step in and assign absolute priority to the deemed trust. A clear illustration of how this might be done is afforded by s. 224(1.2) *ITA*, which vests certain moneys in the Crown "notwithstanding any security interest in those moneys" and provides that they "shall be paid to the Receiver General in priority to

Digitized by Google

any such security interest". All that is needed to effect the desired result is clear language of that kind.

In response to *Sparrow Electric*, the deemed trust provisions were amended in 1998 (retroactively to 1994) to their current form. Most notably, the words "notwithstanding any security interest . . . in the amount so deducted or withheld" were added to s. 227(4). As well, s. 227(4.1) (formerly s. 227(5)) expanded the scope of the deemed trust to include"property held by any secured creditor . . . that but for a security interest . . . would be property of the person". Section 227(4.1) was also amended to remove reference to the triggering events of liquidation, bankruptcy, etc., instead deeming property of the tax debtor and of secured creditors to be held in trust "at any time an amount deemed by subsection (4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act". Finally, s. 227(4.1) now explicitly deems the trust to operate "from the time the amount was deducted or withheld".

It is apparent from these changes that the intent of Parliament when drafting ss. 227(4) and 227(4.1) was to grant priority to the deemed trust in respect of property that is also subject to a security interest regardless of when the security interest arose in relation to the time the source deductions were made or when the deemed trust takes effect. This is clear from the use of the words "notwithstanding any security interest" in both ss. 227(4) and 227(4.1). In other words, Parliament has reacted to the interpretation of the deemed trust provisions in *Sparrow Electric*, and has amended the provisions to grant priority to the deemed trust in situations where the Minister and secured creditors of a tax debtor both claim an interest in the tax debtor's property.

As noted above, Parliament has also amended the deemed trust provisions in regard to the timing of the trust. Reference to events triggering operation of the deemed trust such as liquidation or bankruptcy have been removed. Section 227(4.1) now states that the deemed trust begins to operate "at any time [source deductions are] . . . not paid to Her Majesty in the manner and at the time provided under this Act" (emphasis added). Thus, the deemed trust is now triggered at the moment a default in remitting source deductions occurs. Further, pursuant to s. 227(4.1)(*a*), the trust is deemed to be in effect "from the time the amount was deducted or withheld". Thus, while a default in remitting source deductions triggers the operation of the trust, the trust is deemed to have been in existence retroactively to the time the source deductions were made. It is evident from these changes that Parliament has made a concerted effort to broaden and strengthen the deemed trust in order to facilitate the collection efforts of the Minister.

In light of this overview of the context and operation of the s. 227(4.1) deemed trust, it remains to be determined, first, whether the trust captures property that the tax debtor acquires after the trust is deemed to come into existence, and, second, whether the sale by the tax debtor of trust property effectively releases such property from the purview of the deemed trust.

Does the Deemed Trust Attach to After-Acquired Property of the Tax Debtor?

As noted above, in coming to the conclusion that the deemed trust did not attach to after-acquired property of the tax debtor, the courts below relied on the B.C. Supreme Court decision in *Tuxedo Transport*, *supra*. That decision has since been overturned by the B.C. Court of Appeal: *Royal Bank v. Tuxedo Transport Ltd.* (2000), 79 B.C.L.R. (3d) 1. In that case, Donald J.A., speaking for the court, characterized the trust as follows, at para. 11:

Subsection 227(4) makes the trust operative at the time of the deductions. Subsection 227(4.1) acts to ensure that if deductions are still unpaid when assets come into the hands of the taxpayer, those assets will be deemed to be part of the trust. Beginning with the date the deductions are made the trust continues forward in time and attaches to any property

Digitized by Google

of the debtor as it comes into existence.

The Court of Appeal based this conclusion on the plain meaning of the language used in the statute, and was bolstered by its view that, to hold otherwise, would lead to"unacceptable results" (at para. 15), such as the following:

Take the example of a company that makes a payroll deduction one day and receives a large payment the next. The company could carry on business using the unremitted deductions for its operating expenses and the deemed trust could not attach to the monies received shortly after the payday.

I am in essential agreement with the view taken by the B.C. Court of Appeal in *Tuxedo Transport*. In my view, the plain language of the provisions leads to the inevitable conclusion that the deemed trust attaches to after-acquired property. Most notably, s. 227(4.1) refers expressly to the"proceeds" of property which is subject to the trust and directs that "the proceeds of such property shall be paid to the Receiver General in priority to all . . . security interests [in the property]". In addition, the section states that where, at any time, the debtor is in default to the Minister, that "property of the person . . . equal in value to the amount so deemed to be held in trust is deemed" to be held in trust for Her Majesty (emphasis added). This language implies that Parliament has contemplated a fluidity with respect to the assets of the debtor to which the trust attaches. In particular, reference to the "proceeds" of trust property is an explicit indication that property acquired through the disposition of trust property by the tax debtor after the trust arises is included within the ambit of the trust.

I find additional support for this view in the fact that s. 227(4.1) deems the trust to be in effect "at any time [source deductions are] not paid to Her Majesty in the manner and at the time provided under this Act"(emphasis added). Further, in the event of default, the trust extends back"from the time the amount was deducted or withheld by the person". These words indicate that the intent of the section is to allow the trust to operate in a continuous manner, attaching to any property which comes into the hands of the debtor as long as the debtor continues to be in default, and extending back in time to the moment of the initial deduction. The language Parliament has chosen belies the suggestion that the deemed trust only captures property of the tax debtor in existence at some particular moment in time.

I find no contradiction in coming to the conclusion that after-acquired property can be subject to the trust even though the trust reaches back in time to a point before the acquisition of the property by the tax debtor. This is because the property so acquired will presumably have been taken in exchange for property of equal value which the debtor has disposed of. Thus, the acquired property can simply be viewed as replacing the initial subject matter of the trust. Moreover, since the trust is a deemed statutory trust, it is not governed by common law requirements, and, in this regard, the ongoing acquisition of trust property does not present a conceptual difficulty. I emphasize that it is open to Parliament to characterize the trust in whatever way it chooses; it is not bound by restraints imposed by ordinary principles of trust law.

In addition to being supported by the clear wording of the provisions, this view accords with the purpose of the s. 227(4.1) deemed trust. In this respect, I agree with the B.C. Court of Appeal that Parliament could not have intended an employer who is in default one day and comes into a significant payment the next to thereby largely escape the operation of the deemed trust and continue to use the misappropriated funds in its business dealings. This would not accord with the Parliamentary intention to grant broad powers of collection to the Minister under the deemed trust.

As well, if the deemed trust were limited to property held by the employer at the time of the default, the Minister would have difficulty establishing that any particular part of the employer's property was subject to the deemed trust, and would be forced to engage in a

Digitized by Google

significant degree of tracing. However, as noted by Gonthier J. in *Sparrow Electric*, at para. 37, one of the purposes of the deemed trust is to eliminate the need for tracing:

After considering the matter, it is my view that it is not accurate to describe the mechanism of s. 227(5) as a means of"tracing"; indeed, it would seem that this subsection is antithetical to tracing in the traditional sense, to the extent that it requires no link at all between the subject matter of the trust and the fund or asset which the subject matter is being traced into. . . . [Emphasis added.]

This observation holds true despite the subsequent amendments to the deemed trust provisions. As with the previous enactment of the section, s. 227(4.1) refers to property "equal in value to the amount so deemed to be held in trust" (emphasis added), and states that this property is subject to the trust "whether or not the property has in fact been kept separate and apart". Indeed, if anything, by deeming the trust to be effective "at any time" the debtor is in default, the amendments serve to strengthen the conclusion that the Minister is not required to trace its interest to assets which belonged to the tax debtor at the time the source deductions were made. In this regard, the remarks of Gonthier J. in *Sparrow Electric*, at para. 31, are apposite:

The trust is not in truth a real one, as the subject matter of the trust cannot be identified from the date of creation of the trust. . . . However, s. 227(5) [now s. 227(4.1)] has the effect of revitalizing the trust whose subject matter has lost all identity. This identification of the subject matter of the trust therefore occurs *ex post facto*. In this respect, I agree with the conclusion of Twaddle J.A. in *Roynat*,*supra*, where he states the effect of s. 227(5) as follows, at p. 647: "Her Majesty has a statutory right of access to whatever assets the employer then has, out of which to realize the original trust debt due to Her". [Emphasis added.]

The reasoning adopted by the courts below would require substantial tracing, as the deemed trust would be restricted to include only property held by the tax debtor on the date the source deductions were made. With respect, this is not in accord with the language or purpose of the deemed trust.

In conclusion, based on the plain language of ss. 227(4) and 227(4.1) as supported by the purpose of the provisions and intentions of Parliament, the deemed trust created by these sections encompasses property which comes into the hands of the tax debtor after the trust arises. As a result, when Great West came into possession of the Canada Safeway invoices, the deemed trust, which had already arisen as a consequence of Great West's default in remittances, successfully attached to those invoices.

Does the Deemed Trust Continue to Operate on Property Which Has Been Sold by the Tax Debtor to Third Parties?

As a preliminary matter, I note that the Minister does not take issue with the chambers judge's holding, following *Alberta (Treasury Branches)*,*supra*, that First Vancouver is not a secured creditor of Great West, but a third party purchaser of book debts. Thus, the question of the priority of secured creditors does not arise. The issue here is whether the alienation by Great West of the Canada Safeway invoices, which were subject to the deemed trust under ss. 227(4) and 227(4.1), served to release that property from the scope of the trust.

In my view, the scheme envisioned by Parliament in enacting ss. 227(4) and 227(4.1) is that the deemed trust is in principle similar to a floating charge over all the assets of the tax debtor in the amount of the default. As noted above, the trust has priority from the time the source deductions are made, and remains in existence as long as the default continues. However, the trust does not attach specifically to any particular assets of the tax debtor so as to prevent their sale. As such, the debtor is free to alienate its property in the ordinary

Digitized by Google

course, in which case the trust property is replaced by the proceeds of sale of such property.

This interpretation finds support in both the words used in ss. 227(4) and 227 (4.1) and the purpose of the deemed trust. In my opinion, s. 227(4.1) explicitly restricts the trust to property owned by the tax debtor by stating that the property of the tax debtor held in trust for Her Majesty "is property beneficially owned by Her Majesty . . . and the proceeds of such property shall be paid to the Receiver General" (emphasis added). This reference to the proceeds of trust property is an acknowledgment in the very words of the *ITA* that Parliament contemplated that a tax debtor is free to alienate its property and that, when it does so, the trust releases the disposed-of property and attaches to the proceeds of sale. In addition, as discussed above, the trust does not attach to any specific property. Instead, by s. 227(4.1), the trust attaches to "property of the [tax debtor] . . . equal in value to the amount [of the tax debt]". This language indicates, first, that the subject matter of the trust is focussed solely on the tax debtor's property, and, second, that it is anticipated that the character of the tax debtor's property will change over time.

Indeed, it is the logical corollary to my conclusion on the first issue, namely that the deemed trust attaches to after-acquired property of the tax debtor, that the trust also releases property alienated by the tax debtor. In this way, when an asset is sold by the tax debtor, the deemed trust ceases to operate over that asset; however, the property received by the tax debtor in exchange becomes subject to the deemed trust. As such, the trust is neither depleted nor enhanced; it simply floats over the property belonging to the tax debtor at any given time, for as long as the default in remittances continues.

Although it would be open to Parliament to extend the trust to property alienated by the tax debtor, such an interpretation is simply not supported by the language of the *ITA*. It is significant in this regard that purchasers for value are not included in ss. 227(4) and 227(4.1) whereas secured creditors are. In *Pembina on the Red Development*, *supra*, Twaddle J.A. took note of the "long-established principle of law that, in the absence of clear language to the contrary, a tax on one person cannot be collected out of property belonging to another" (p. 46). In *Sparrow Electric*, *supra*, at para. 39, Gonthier J. also referred to this principle, stating that:

[T]his provision does not permit Her Majesty to attach Her beneficial interest to property which, at the time of liquidation, assignment, receivership or bankruptcy, in law belongs to a party other than the tax debtor. Section 227(4) and (5) are manifestly directed towards the property of the tax debtor, and it would be contrary to well-established authority to stretch the interpretation of s. 227(5) [now s. 227(4.1)] to permit the expropriation of the property of third parties who are not specifically mentioned in the statute. [Emphasis added.]

Thus, in the absence of an express reference to third party purchasers, there is no basis upon which to allow the Minister's interest in the tax debtor's property to continue once such property has been sold to third parties.

Although it is not necessary to resort to policy arguments, in my view it is worthwhile noting that to allow s. 227(4.1) to override the rights of purchasers for value would result in an unprecedented level of uncertainty. In fact, in oral argument, counsel for the Minister conceded that such an interpretation would, in theory, allow the Minister to go so far as to assert an interest in assets sold by tax debtors to ordinary consumers. In my view, it is no exaggeration to say that adopting this interpretation of the deemed trust would have a general chilling effect on commercial transactions.

Furthermore, to allow the deemed trust to attach to property sold to third parties would be more likely to hinder, rather than help, the Minister's collection efforts. For example, in the case at bar, if First Vancouver had thought that it could not purchase Great West's assets free and clear of Her Majesty's claim, it would have been unlikely to have entered into the factoring agreement with Great West. As a result, Her Majesty would not have received the

Digitized by Google

semi-monthly payments of $10,000 from First Vancouver. More generally, the interpretation advocated by the Minister would likely frustrate the ability of a tax debtor to convert hard assets into cash in order to pay "the proceeds of such property . . . to the Receiver General" as contemplated by s. 227(4.1), because prospective purchasers would fear that the Minister would assert an interest in these assets. The practical effect of this would be to freeze the tax debtor's assets and prevent it from carrying on business. In my view, this is clearly not a result intended by Parliament.

In summary, the deemed trust does not operate over assets which a tax debtor has sold in the ordinary course to third party purchasers. As such, once the Canada Safeway invoices had been factored to First Vancouver, the Minister was prevented from asserting its interest in these invoices.

Conclusion

For the foregoing reasons, I would dismiss the appeal with costs.

Century Services Inc. v. Canada (Attorney General), 2010 SCC 60, [2010] 3 S.C.R. 379 – Company's Creditors Arrangement Act Considerations

> ***Bankruptcy and Insolvency — Priorities — Crown applying on eve of bankruptcy of debtor company to have GST monies held in trust paid to Receiver General of Canada — Whether deemed trust in favour of Crown under Excise Tax Act prevails over provisions of Companies' Creditors Arrangement Act purporting to nullify deemed trusts in favour of Crown — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 18.3(1) — Excise Tax Act, R.S.C. 1985, c. E-15, s. 222(3).***
>
> ***Bankruptcy and insolvency — Procedure — Whether chambers judge had authority to make order partially lifting stay of proceedings to allow debtor company to make assignment in bankruptcy and to stay Crown's right to enforce GST deemed trust — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.***
>
> ***Trusts — Express trusts — GST collected but unremitted to Crown — Judge ordering that GST be held by Monitor in trust account — Whether segregation of Crown's GST claim in Monitor's account created an express trust in favour of Crown.***
>
> **The debtor company commenced proceedings under the *Companies' Creditors Arrangement Act* ("*CCAA*"), obtaining a stay of proceedings to allow it time to reorganize its financial affairs. One of the debtor company's outstanding debts at the commencement of the reorganization was an amount of unremitted Goods and Services Tax ("GST") payable to the Crown. Section 222(3) of the *Excise Tax Act* ("*ETA*") created a deemed trust over unremitted GST, which operated despite any other enactment of Canada except the *Bankruptcy and Insolvency Act* ("*BIA*"). However, s. 18.3(1) of the *CCAA* provided that any statutory deemed trusts in favour of the Crown did not operate under the *CCAA*, subject to certain exceptions, none of which mentioned GST.**
>
> **Pursuant to an order of the *CCAA* chambers judge, a payment not exceeding $5 million was approved to the debtor company's major secured creditor, Century Services. However, the chambers judge also ordered the debtor company to hold back and segregate in the Monitor's trust account an amount equal to the unremitted GST pending the outcome of the reorganization. On**

Digitized by Google

concluding that reorganization was not possible, the debtor company sought leave of the court to partially lift the stay of proceedings so it could make an assignment in bankruptcy under the *BIA*. The Crown moved for immediate payment of unremitted GST to the Receiver General. The chambers judge denied the Crown's motion, and allowed the assignment in bankruptcy. The Court of Appeal allowed the appeal on two grounds. First, it reasoned that once reorganization efforts had failed, the chambers judge was bound under the priority scheme provided by the *ETA* to allow payment of unremitted GST to the Crown and had no discretion under s. 11 of the *CCAA* to continue the stay against the Crown's claim. Second, the Court of Appeal concluded that by ordering the GST funds segregated in the Monitor's trust account, the chambers judge had created an express trust in favour of the Crown.

Held **(Abella J. dissenting): The appeal should be allowed.**

Per **McLachlin C.J. and Binnie, LeBel, Deschamps, Charron, Rothstein and Cromwell JJ.: The apparent conflict between s. 222(3) of the *ETA* and s. 18.3(1) of the *CCAA* can be resolved through an interpretation that properly recognizes the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament and the principles for interpreting the *CCAA* that have been recognized in the jurisprudence. The history of the *CCAA* distinguishes it from the *BIA* because although these statutes share the same remedial purpose of avoiding the social and economic costs of liquidating a debtor's assets, the *CCAA* offers more flexibility and greater judicial discretion than the rules-based mechanism under the *BIA*, making the former more responsive to complex reorganizations. Because the *CCAA* is silent on what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily provides the backdrop against which creditors assess their priority in the event of bankruptcy. The contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the *CCAA* and the *BIA*, and one of its important features has been a cutback in Crown priorities. Accordingly, the *CCAA* and the *BIA* both contain provisions nullifying statutory deemed trusts in favour of the Crown, and both contain explicit exceptions exempting source deductions deemed trusts from this general rule. Meanwhile, both Acts are harmonious in treating other Crown claims as unsecured. No such clear and express language exists in those Acts carving out an exception for GST claims. When faced with the apparent conflict between s. 222(3) of the *ETA* and s. 18.3(1) of the *CCAA*, courts have been inclined to follow *Ottawa Senators Hockey Club Corp. (Re)* and resolve the conflict in favour of the *ETA*. *Ottawa Senators* should not be followed. Rather, the *CCAA* provides the rule. Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. Where Parliament has sought to protect certain Crown claims through statutory deemed trusts and intended that these deemed trusts continue in insolvency, it has legislated so expressly and elaborately. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA*. The internal logic of the *CCAA* appears to subject a GST deemed trust to the waiver by Parliament of its priority. A strange asymmetry would result if differing treatments of GST deemed trusts under the *CCAA* and the *BIA* were found to exist, as this would encourage**

Digitized by Google

statute shopping, undermine the *CCAA*'s remedial purpose and invite the very social ills that the statute was enacted to avert. The later in time enactment of the more general s. 222(3) of the *ETA* does not require application of the doctrine of implied repeal to the earlier and more specific s. 18.3(1) of the *CCAA* in the circumstances of this case. In any event, recent amendments to the *CCAA* in 2005 resulted in s. 18.3 of the Act being renumbered and reformulated, making it the later in time provision. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA*. The conflict between the *ETA* and the *CCAA* is more apparent than real.

The exercise of judicial discretion has allowed the *CCAA* to adapt and evolve to meet contemporary business and social needs. As reorganizations become increasingly complex, *CCAA* courts have been called upon to innovate. In determining their jurisdiction to sanction measures in a *CCAA* proceeding, courts should first interpret the provisions of the *CCAA* before turning to their inherent or equitable jurisdiction. Noteworthy in this regard is the expansive interpretation the language of the *CCAA* is capable of supporting. The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. The requirements of appropriateness, good faith and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. The question is whether the order will usefully further efforts to avoid the social and economic losses resulting from liquidation of an insolvent company, which extends to both the purpose of the order and the means it employs. Here, the chambers judge's order staying the Crown's GST claim was in furtherance of the *CCAA*'s objectives because it blunted the impulse of creditors to interfere in an orderly liquidation and fostered a harmonious transition from the *CCAA* to the *BIA*, meeting the objective of a single proceeding that is common to both statutes. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of *BIA* proceedings, but no gap exists between the two statutes because they operate in tandem and creditors in both cases look to the *BIA* scheme of distribution to foreshadow how they will fare if the reorganization is unsuccessful. The breadth of the court's discretion under the *CCAA* is sufficient to construct a bridge to liquidation under the *BIA*. Hence, the chambers judge's order was authorized.

No express trust was created by the chambers judge's order in this case because there is no certainty of object inferrable from his order. Creation of an express trust requires certainty of intention, subject matter and object. At the time the chambers judge accepted the proposal to segregate the monies in the Monitor's trust account there was no certainty that the Crown would be the beneficiary, or object, of the trust because exactly who might take the money in the final result was in doubt. In any event, no dispute over the money would even arise under the interpretation of s. 18.3(1) of the *CCAA* established above, because the Crown's deemed trust priority over GST claims would be lost under the *CCAA* and the Crown would rank as an unsecured creditor for this amount.

***Per* Fish J.: The GST monies collected by the debtor are not subject to a deemed trust or priority in favour of the Crown. In recent years, Parliament has given detailed consideration to the Canadian insolvency scheme but has**

Digitized by Google

declined to amend the provisions at issue in this case, a deliberate exercise of legislative discretion. On the other hand, in upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, courts have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In the context of the Canadian insolvency regime, deemed trusts exist only where there is a statutory provision creating the trust and a *CCAA* or *BIA* provision explicitly confirming its effective operation. The *Income Tax Act*, the *Canada Pension Plan* and the *Employment Insurance Act* all contain deemed trust provisions that are strikingly similar to that in s. 222 of the *ETA* but they are all also confirmed in s. 37 of the *CCAA* and in s. 67(3) of the *BIA* in clear and unmistakeable terms. The same is not true of the deemed trust created under the *ETA*. Although Parliament created a deemed trust in favour of the Crown to hold unremitted GST monies, and although it purports to maintain this trust notwithstanding any contrary federal or provincial legislation, it did not confirm the continued operation of the trust in either the *BIA* or the *CCAA*, reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.

Per* Abella J. (dissenting): Section 222(3) of the *ETA* gives priority during *CCAA* proceedings to the Crown's deemed trust in unremitted GST. This provision unequivocally defines its boundaries in the clearest possible terms and excludes only the *BIA* from its legislative grasp. The language used reflects a clear legislative intention that s. 222(3) would prevail if in conflict with any other law except the *BIA.* This is borne out by the fact that following the enactment of s. 222(3), amendments to the *CCAA* were introduced, and despite requests from various constituencies, s. 18.3(1) was not amended to make the priorities in the *CCAA* consistent with those in the *BIA*. This indicates a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA.

The application of other principles of interpretation reinforces this conclusion. An earlier, specific provision may be overruled by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails. Section 222(3) achieves this through the use of language stating that it prevails despite any law of Canada, of a province, or "any other law" other than the *BIA*. Section 18.3(1) of the *CCAA* is thereby rendered inoperative for purposes of s. 222(3). By operation of s. 44(*f*) of the *Interpretation Act*, the transformation of s. 18.3(1) into s. 37(1) after the enactment of s. 222(3) of the *ETA* has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision. This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act*, that discretion is not liberated from the operation of any other federal statute. Any exercise of discretion is therefore circumscribed by whatever limits are imposed by statutes other than the *BIA* and the *Winding-up Act*. That includes the *ETA*. The chambers judge in this case was, therefore, required to respect the priority regime set out in s. 222(3) of the *ETA*. Neither s. 18.3(1) nor s. 11 of the *CCAA* gave him the authority to ignore it. He could not, as a result, deny the

Digitized by Google

Crown's request for payment of the GST funds during the *CCAA* proceedings.

Cases Cited

By Deschamps J.

Overruled: *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737; **distinguished:** *Doré v. Verdun (City)*, [1997] 2 S.C.R. 862; **referred to:** *Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659; *Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny*, 2009 SCC 49, [2009] 3 S.C.R. 286; *Deputy Minister of Revenue v. Rainville*, [1980] 1 S.C.R. 35; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, 30 Alta. L.R. (4th) 192; *Komunik Corp. (Arrangement relatif à)*, 2009 QCCS 6332 (CanLII), leave to appeal granted, 2010 QCCA 183 (CanLII); *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411; *First Vancouver Finance v. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720; *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4th) 219; *Metcalfe & Mansfield Alternative Investments II Corp. (Re)*, 2008 ONCA 587, 92 O.R. (3d) 513; *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106; *Elan Corp. v. Comiskey* (1990), 41 O.A.C. 282; *Chef Ready Foods Ltd. v. Hongkong Bank of Can.* (1990), 51 B.C.L.R. (2d) 84; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134; *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9; *Air Canada, Re* (2003), 42 C.B.R. (4th) 173; *Air Canada, Re*, 2003 CanLII 49366; *Canadian Red Cross Society/Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4th) 158; *Skydome Corp., Re* (1998), 16 C.B.R. (4th) 118; *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96, aff'g (1999), 12 C.B.R. (4th) 144; *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25; *Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108.

By Fish J.

Referred to: *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737.

By Abella J. (dissenting)

Ottawa Senators Hockey Club Corp. (Re) (2005), 73 O.R. (3d) 737; *Tele-Mobile Co. v. Ontario*, 2008 SCC 12, [2008] 1 S.C.R. 305; *Doré v. Verdun (City)*, [1997] 2 S.C.R. 862; *Attorney General of Canada v. Public Service Staff Relations Board*, [1977] 2 F.C. 663.

Statutes and Regulations Cited

An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts, S.C. 2005, c. 47, ss. 69, 128, 131.

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 67, 81.1, 81.2, 86 [am. 1992, c. 27, s. 39; 1997, c. 12, s. 73; 2000, c. 30, s. 148; 2005, c. 47, s. 69; 2009, c. 33, s. 25].

Canada Pension Plan, R.S.C. 1985, c. C-8, s. 23.

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 11 [am. 2005, c. 47, s. 128], 11.02 [ad. *idem*], 11.09 [ad. *idem*], 11.4 [am. *idem*], 18.3 [ad. 1997, c. 12, s. 125; rep. 2005, c. 47, s. 131], 18.4 [*idem*], 20 [am. 2005, c. 47, s. 131], 21 [ad. 1997, c. 12, s. 126; am. 2005, c. 47, s. 131], s. 37 [ad. 2005, c. 47, s. 131].

Companies' Creditors Arrangement Act, 1933, S.C. 1932-33, c. 36 [am. 1952-53, c. 3].

Digitized by Google

Employment Insurance Act, S.C. 1996, c. 23, ss. 86(2), (2.1).
Excise Tax Act, R.S.C. 1985, c. E-15, s. 222.
Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 227(4), (4.1).
Interpretation Act, R.S.C. 1985, c. I-21, ss. 2 "enactment", 44(*f*).
Winding-up Act, R.S.C. 1985, c. W-11.

Authors Cited

Canada. Advisory Committee on Bankruptcy and Insolvency. *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency*. Ottawa: Minister of Supply and Services Canada, 1986.

Canada. House of Commons. *Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 15, 3rd Sess., 34th Parl., October 3, 1991, 15:15.

Canada. Industry Canada. Marketplace Framework Policy Branch. *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*. Ottawa: Corporate and Insolvency Law Policy Directorate, 2002.

Canada. Senate. *Debates of the Senate*, vol. 142, 1st Sess., 38th Parl., November 23, 2005, p. 2147.

Canada. Senate. Standing Committee on Banking, Trade and Commerce. *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*. Ottawa: Senate of Canada, 2003.

Canada. Study Committee on Bankruptcy and Insolvency Legislation. *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation*. Ottawa: Information Canada, 1970.

Côté, Pierre-André. *The Interpretation of Legislation in Canada*, 3rd ed. Scarborough, Ont.: Carswell, 2000.

Côté, Pierre-André, avec la collaboration de Stéphane Beaulac et Mathieu Devinat. *Interprétation des lois*, 4e éd. Montréal: Thémis, 2009.

Edwards, Stanley E. "Reorganizations Under the Companies' Creditors Arrangement Act" (1947), 25 *Can. Bar Rev.* 587.

Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals. Joint Task Force on Business Insolvency Law Reform. *Report* (2002) (online: http://www.cairp.ca/publications/submissions-to-government/law-reform/index.php).

Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals. Legislative Review Task Force (Commercial). *Report on the Commercial Provisions of Bill C-55* (2005).

Jackson, Georgina R. and Janis Sarra. "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2007*. Toronto: Thomson Carswell, 2008, 41.

Jones, Richard B. "The Evolution of Canadian Restructuring: Challenges for the Rule of Law", in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2005*. Toronto: Thomson Carswell, 2006, 481.

Lamer, Francis L. *Priority of Crown Claims in Insolvency*. Toronto: Carswell, 1996 (loose-leaf updated 2010, release 1).

Morgan, Barbara K. "Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy" (2000), 74 *Am. Bankr. L.J.* 461.

Digitized by Google

Sarra, Janis. *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations*. Toronto: University of Toronto Press, 2003.
Sarra, Janis P. *Rescue! The Companies' Creditors Arrangement Act*. Toronto: Thomson Carswell, 2007.
Sullivan, Ruth. *Sullivan on the Construction of Statutes*, 5th ed. Markham, Ont.: LexisNexis, 2008.
Waters, Donovan W. M., Mark R. Gillen and Lionel D. Smith, eds. *Waters' Law of Trusts in Canada*, 3rd ed. Toronto: Thomson Carswell, 2005.
Wood, Roderick J. *Bankruptcy and Insolvency Law*. Toronto: Irwin Law, 2009.

APPEAL from a judgment of the British Columbia Court of Appeal (Newbury, Tysoe and Smith JJ.A.), 2009 BCCA 205, 98 B.C.L.R. (4th) 242, 270 B.C.A.C. 167, 454 W.A.C. 167, [2009] 12 W.W.R. 684, [2009] G.S.T.C. 79, [2009] B.C.J. No. 918 (QL), 2009 CarswellBC 1195, reversing a judgment of Brenner C.J.S.C., 2008 BCSC 1805, [2008] G.S.T.C. 221, [2008] B.C.J. No. 2611 (QL), 2008 CarswellBC 2895,
dismissing a Crown application for payment of GST monies. Appeal allowed, Abella J. dissenting.

Mary I. A. Buttery, *Owen J. James* and *Matthew J. G. Curtis*, for the appellant.

Gordon Bourgard, *David Jacyk* and Michael J. Lema, for the respondent.

The judgment of McLachlin C.J. and Binnie, LeBel, Deschamps, Charron, Rothstein and Cromwell JJ. was delivered by

[1] DESCHAMPS J. — For the first time this Court is called upon to directly interpret the provisions of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). In that respect, two questions are raised. The first requires reconciliation of provisions of the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), which lower courts have held to be in conflict with one another. The second concerns the scope of a court's discretion when supervising reorganization. The relevant statutory provisions are reproduced in the Appendix. On the first question, having considered the evolution of Crown priorities in the context of insolvency and the wording of the various statutes creating Crown priorities, I conclude that it is the *CCAA* and not the *ETA* that provides the rule. On the second question, I conclude that the broad discretionary jurisdiction conferred on the supervising judge must be interpreted having regard to the remedial nature of the *CCAA* and insolvency legislation generally. Consequently, the court had the discretion to partially lift a stay of proceedings to allow the debtor to make an assignment under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"). I would allow the appeal.

Facts and Decisions of the Courts Below

[2] Ted LeRoy Trucking Ltd. ("LeRoy Trucking") commenced proceedings under the *CCAA* in the Supreme Court of British Columbia on December 13, 2007, obtaining a stay of proceedings with a view to reorganizing its financial affairs. LeRoy Trucking sold certain redundant assets as authorized by the order.

[3] Amongst the debts owed by LeRoy Trucking was an amount for Goods and Services Tax ("GST") collected but unremitted to the Crown. The *ETA* creates a

Digitized by Google

deemed trust in favour of the Crown for amounts collected in respect of GST. The deemed trust extends to any property or proceeds held by the person collecting GST and any property of that person held by a secured creditor, requiring that property to be paid to the Crown in priority to all security interests. The *ETA* provides that the deemed trust operates despite any other enactment of Canada except the *BIA*. However, the *CCAA* also provides that subject to certain exceptions, none of which mentions GST, deemed trusts in favour of the Crown do not operate under the *CCAA*. Accordingly, under the *CCAA* the Crown ranks as an unsecured creditor in respect of GST. Nonetheless, at the time LeRoy Trucking commenced *CCAA* proceedings the leading line of jurisprudence held that the *ETA* took precedence over the *CCAA* such that the Crown enjoyed priority for GST claims under the *CCAA*, even though it would have lost that same priority under the *BIA*. The *CCAA* underwent substantial amendments in 2005 in which some of the provisions at issue in this appeal were renumbered and reformulated (S.C. 2005, c. 47). However, these amendments only came into force on September 18, 2009. I will refer to the amended provisions only where relevant.

[4] On April 29, 2008, Brenner C.J.S.C., in the context of the *CCAA* proceedings, approved a payment not exceeding $5 million, the proceeds of redundant asset sales, to Century Services, the debtor's major secured creditor. LeRoy Trucking proposed to hold back an amount equal to the GST monies collected but unremitted to the Crown and place it in the Monitor's trust account until the outcome of the reorganization was known. In order to maintain the *status quo* while the success of the reorganization was uncertain, Brenner C.J.S.C. agreed to the proposal and ordered that an amount of $305,202.30 be held by the Monitor in its trust account.

[5] On September 3, 2008, having concluded that reorganization was not possible, LeRoy Trucking sought leave to make an assignment in bankruptcy under the *BIA*. The Crown sought an order that the GST monies held by the Monitor be paid to the Receiver General of Canada. Brenner C.J.S.C. dismissed the latter application. Reasoning that the purpose of segregating the funds with the Monitor was "to facilitate an ultimate payment of the GST monies which were owed pre-filing, but only if a viable plan emerged", the failure of such a reorganization, followed by an assignment in bankruptcy, meant the Crown would lose priority under the *BIA* (2008 BCSC 1805, [2008] G.S.T.C. 221).

[6] The Crown's appeal was allowed by the British Columbia Court of Appeal (2009 BCCA 205, 270 B.C.A.C. 167). Tysoe J.A. for a unanimous court found two independent bases for allowing the Crown's appeal.

[7] First, the court's authority under s. 11 of the *CCAA* was held not to extend to staying the Crown's application for immediate payment of the GST funds subject to the deemed trust after it was clear that reorganization efforts had failed and that bankruptcy was inevitable. As restructuring was no longer a possibility, staying the Crown's claim to the GST funds no longer served a purpose under the *CCAA* and the court was bound under the priority scheme provided by the *ETA* to allow payment to the Crown. In so holding, Tysoe J.A. adopted the reasoning in *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737 (C.A.), which found that the *ETA* deemed trust for GST established Crown priority over secured creditors under the *CCAA*.

[8] Second, Tysoe J.A. concluded that by ordering the GST funds segregated in the Monitor's trust account on April 29, 2008, the judge had created an express trust in favour of the Crown from which the monies in question could not be diverted for any other purposes. The Court of Appeal therefore ordered that the money held by

Digitized by Google

the Monitor in trust be paid to the Receiver General.

Issues

[9] This appeal raises three broad issues which are addressed in turn:

Did s. 222(3) of the *ETA* displace s. 18.3(1) of the *CCAA* and give priority to the Crown's *ETA* deemed trust during *CCAA* proceedings as held in *Ottawa Senators*?

Did the court exceed its *CCAA* authority by lifting the stay to allow the debtor to make an assignment in bankruptcy?

Did the court's order of April 29, 2008 requiring segregation of the Crown's GST claim in the Monitor's trust account create an express trust in favour of the Crown in respect of those funds?

Analysis

[10] The first issue concerns Crown priorities in the context of insolvency. As will be seen, the *ETA* provides for a deemed trust in favour of the Crown in respect of GST owed by a debtor "[d]espite . . . any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)" (s. 222(3)), while the *CCAA* stated at the relevant time that "notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be [so] regarded" (s. 18.3(1)). It is difficult to imagine two statutory provisions more apparently in conflict. However, as is often the case, the apparent conflict can be resolved through interpretation.

[11] In order to properly interpret the provisions, it is necessary to examine the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament, and the principles that have been recognized in the jurisprudence. It will be seen that Crown priorities in the insolvency context have been significantly pared down. The resolution of the second issue is also rooted in the context of the *CCAA*, but its purpose and the manner in which it has been interpreted in the case law are also key. After examining the first two issues in this case, I will address Tysoe J.A.'s conclusion that an express trust in favour of the Crown was created by the court's order of April 29, 2008.

Purpose and Scope of Insolvency Law

[12] Insolvency is the factual situation that arises when a debtor is unable to pay creditors (see generally, R. J. Wood, *Bankruptcy and Insolvency Law* (2009), at p. 16). Certain legal proceedings become available upon insolvency, which typically allow a debtor to obtain a court order staying its creditors' enforcement actions and attempt to obtain a binding compromise with creditors to adjust the payment conditions to something more realistic. Alternatively, the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules. The former is usually referred to as reorganization or restructuring while the latter is termed liquidation.

[13] Canadian commercial insolvency law is not codified in one exhaustive statute. Instead, Parliament has enacted multiple insolvency statutes, the main one being the *BIA*. The *BIA* offers a self-contained legal regime providing for both reorganization and liquidation. Although bankruptcy legislation has a long history, the *BIA* itself is a fairly recent statute — it was enacted in 1992. It is characterized by a rules-based approach to proceedings. The *BIA* is available to insolvent debtors owing $1000 or more, regardless of whether they are natural or legal persons. It

Digitized by Google

contains mechanisms for debtors to make proposals to their creditors for the adjustment of debts. If a proposal fails, the *BIA* contains a bridge to bankruptcy whereby the debtor's assets are liquidated and the proceeds paid to creditors in accordance with the statutory scheme of distribution.

[14] Access to the *CCAA* is more restrictive. A debtor must be a company with liabilities in excess of $5 million. Unlike the *BIA*, the *CCAA* contains no provisions for liquidation of a debtor's assets if reorganization fails. There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when the debtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or its creditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or to place the debtor into receivership. As discussed in greater detail below, the key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion, making it more responsive to complex reorganizations.

[15] As I will discuss at greater length below, the purpose of the *CCAA* — Canada's first reorganization statute — is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Proposals to creditors under the *BIA* serve the same remedial purpose, though this is achieved through a rules-based mechanism that offers less flexibility. Where reorganization is impossible, the *BIA* may be employed to provide an orderly mechanism for the distribution of a debtor's assets to satisfy creditor claims according to predetermined priority rules.

[16] Prior to the enactment of the *CCAA* in 1933 (S.C. 1932-33, c. 36), practice under existing commercial insolvency legislation tended heavily towards the liquidation of a debtor company (J. Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (2003), at p. 12). The battering visited upon Canadian businesses by the Great Depression and the absence of an effective mechanism for reaching a compromise between debtors and creditors to avoid liquidation required a legislative response. The *CCAA* was innovative as it allowed the insolvent debtor to attempt reorganization under judicial supervision outside the existing insolvency legislation which, once engaged, almost invariably resulted in liquidation (*Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659, at pp. 660-61; Sarra, *Creditor Rights*, at pp. 12-13).

[17] Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected — notably creditors and employees — and that a workout which allowed the company to survive was optimal (Sarra, *Creditor Rights*, at pp. 13-15).

[18] Early commentary and jurisprudence also endorsed the *CCAA*'s remedial objectives. It recognized that companies retain more value as going concerns while underscoring that intangible losses, such as the evaporation of the companies' goodwill, result from liquidation (S. E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947), 25 *Can. Bar Rev.* 587, at p. 592). Reorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs (*ibid.*, at p. 593). Insolvency could be so widely felt as to impact stakeholders other than creditors and employees. Variants of these views

Digitized by Google

resonate today, with reorganization justified in terms of rehabilitating companies that are key elements in a complex web of interdependent economic relationships in order to avoid the negative consequences of liquidation.

[19] The *CCAA* fell into disuse during the next several decades, likely because amendments to the Act in 1953 restricted its use to companies issuing bonds (S.C. 1952-53, c. 3). During the economic downturn of the early 1980s, insolvency lawyers and courts adapting to the resulting wave of insolvencies resurrected the statute and deployed it in response to new economic challenges. Participants in insolvency proceedings grew to recognize and appreciate the statute's distinguishing feature: a grant of broad and flexible authority to the supervising court to make the orders necessary to facilitate the reorganization of the debtor and achieve the *CCAA*'s objectives. The manner in which courts have used *CCAA* jurisdiction in increasingly creative and flexible ways is explored in greater detail below.

[20] Efforts to evolve insolvency law were not restricted to the courts during this period. In 1970, a government-commissioned panel produced an extensive study recommending sweeping reform but Parliament failed to act (see *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation* (1970)). Another panel of experts produced more limited recommendations in 1986 which eventually resulted in enactment of the *Bankruptcy and Insolvency Act* of 1992 (S.C. 1992, c. 27) (see *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)). Broader provisions for reorganizing insolvent debtors were then included in Canada's bankruptcy statute. Although the 1970 and 1986 reports made no specific recommendations with respect to the *CCAA*, the House of Commons committee studying the *BIA*'s predecessor bill, C-22, seemed to accept expert testimony that the *BIA*'s new reorganization scheme would shortly supplant the *CCAA*, which could then be repealed, with commercial insolvency and bankruptcy being governed by a single statute (*Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 15, 3rd Sess., 34th Parl., October 3, 1991, at 15:15-15:16).

[21] In retrospect, this conclusion by the House of Commons committee was out of step with reality. It overlooked the renewed vitality the *CCAA* enjoyed in contemporary practice and the advantage that a flexible judicially supervised reorganization process presented in the face of increasingly complex reorganizations, when compared to the stricter rules-based scheme contained in the *BIA*. The "flexibility of the *CCAA* [was seen as] a great benefit, allowing for creative and effective decisions" (Industry Canada, Marketplace Framework Policy Branch, *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2002), at p. 41). Over the past three decades, resurrection of the *CCAA* has thus been the mainspring of a process through which, one author concludes, "the legal setting for Canadian insolvency restructuring has evolved from a rather blunt instrument to one of the most sophisticated systems in the developed world" (R. B. Jones, "The Evolution of Canadian Restructuring: Challenges for the Rule of Law", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2005* (2006), 481, at p. 481).

[22] While insolvency proceedings may be governed by different statutory schemes, they share some commonalities. The most prominent of these is the single proceeding model. The nature and purpose of the single proceeding model are described by Professor Wood in *Bankruptcy and Insolvency Law*:

They all provide a collective proceeding that supersedes the usual civil process

Digitized by Google

available to creditors to enforce their claims. The creditors' remedies are collectivized in order to prevent the free-for-all that would otherwise prevail if creditors were permitted to exercise their remedies. In the absence of a collective process, each creditor is armed with the knowledge that if they do not strike hard and swift to seize the debtor's assets, they will be beat out by other creditors. [pp. 2-3]

The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiation with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will realize its claims against the debtor's limited assets while the other creditors attempt a compromise. With a view to achieving that purpose, both the *CCAA* and the *BIA* allow a court to order all actions against a debtor to be stayed while a compromise is sought.

[23] Another point of convergence of the *CCAA* and the *BIA* relates to priorities. Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful. In addition, one of the important features of legislative reform of both statutes since the enactment of the *BIA* in 1992 has been a cutback in Crown priorities (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, ss. 73 and 125; S.C. 2000, c.
30, s. 148; S.C. 2005, c. 47, ss. 69 and 131; S.C. 2009, c. 33, s. 25; see also *Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny*, 2009 SCC 49, [2009] 3 S.C.R. 286; *Deputy Minister of Revenue v. Rainville*, [1980] 1 S.C.R. 35; *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency*).

[24] With parallel *CCAA* and *BIA* restructuring schemes now an accepted feature of the insolvency law landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation (see *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, 30 Alta. L.R. (4th) 192, at para. 19).

[25] Mindful of the historical background of the *CCAA* and *BIA*, I now turn to the first question at issue.

GST Deemed Trust Under the CCAA

[26] The Court of Appeal proceeded on the basis that the *ETA* precluded the court from staying the Crown's enforcement of the GST deemed trust when partially lifting the stay to allow the debtor to enter bankruptcy. In so doing, it adopted the reasoning in a line of cases culminating in *Ottawa Senators*, which held that an *ETA* deemed trust remains enforceable during *CCAA* reorganization despite language in the *CCAA* that suggests otherwise.

[27] The Crown relies heavily on the decision of the Ontario Court of Appeal in *Ottawa Senators* and argues that the later in time provision of the *ETA* creating the GST deemed trust trumps the provision of the *CCAA* purporting to nullify most statutory deemed trusts. The Court of Appeal in this case accepted this reasoning but not all provincial courts follow it (see, e.g., *Komunik Corp. (Arrangement relatif à)*, 2009

Digitized by Google

QCCS 6332 (CanLII), leave to appeal granted, 2010 QCCA 183 (CanLII)). Century Services relied, in its written submissions to this Court, on the argument that the court had authority under the *CCAA* to continue the stay against the Crown's claim for unremitted GST. In oral argument, the question of whether *Ottawa Senators* was correctly decided nonetheless arose. After the hearing, the parties were asked to make further written submissions on this point. As appears evident from the reasons of my colleague Abella J., this issue has become prominent before this Court. In those circumstances, this Court needs to determine the correctness of the reasoning in *Ottawa Senators*.

[28] The policy backdrop to this question involves the Crown's priority as a creditor in insolvency situations which, as I mentioned above, has evolved considerably. Prior to the 1990s, Crown claims largely enjoyed priority in insolvency. This was widely seen as unsatisfactory as shown by both the 1970 and 1986 insolvency reform proposals, which recommended that Crown claims receive no preferential treatment. A closely related matter was whether the *CCAA* was binding at all upon the Crown. Amendments to the *CCAA* in 1997 confirmed that it did indeed bind the Crown (see *CCAA*, s. 21, as added by S.C. 1997, c. 12, s. 126). [29] Claims of priority by the state in insolvency situations receive different treatment across jurisdictions worldwide. For example, in Germany and Australia, the state is given no priority at all, while the state enjoys wide priority in the United States and France (see B. K. Morgan, "Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy" (2000), 74 *Am. Bankr. L.J.* 461, at p. 500). Canada adopted a middle course through legislative reform of Crown priority initiated in 1992. The Crown retained priority for source deductions of income tax, Employment Insurance ("EI") and Canada Pension Plan ("CPP") premiums, but ranks as an ordinary unsecured creditor for most other claims. [30] Parliament has frequently enacted statutory mechanisms to secure Crown claims and permit their enforcement. The two most common are statutory deemed trusts and powers to garnish funds third parties owe the debtor (see F. L. Lamer, *Priority of Crown Claims in Insolvency* (loose-leaf), at §2).

[31] With respect to GST collected, Parliament has enacted a deemed trust. The *ETA* states that every person who collects an amount on account of GST is deemed to hold that amount in trust for the Crown (s. 222(1)). The deemed trust extends to other property of the person collecting the tax equal in value to the amount deemed to be in trust if that amount has not been remitted in accordance with the *ETA*. The deemed trust also extends to property held by a secured creditor that, but for the security interest, would be property of the person collecting the tax (s. 222(3)).

[32] Parliament has created similar deemed trusts using almost identical language in respect of source deductions of income tax, EI premiums and CPP premiums (see s. 227(4) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"), ss. 86(2) and (2.1) of the *Employment Insurance Act*, S.C. 1996, c. 23, and ss. 23(3) and (4) of the *Canada Pension Plan*, R.S.C. 1985, c. C-8). I will refer to income tax, EI and CPP deductions as "source deductions".

[33] In *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411, this Court addressed a priority dispute between a deemed trust for source deductions under the *ITA* and security interests taken under both the *Bank Act*, S.C. 1991, c. 46, and the Alberta *Personal Property Security Act*, S.A. 1988, c. P-4.05 ("*PPSA*"). As then worded, an *ITA* deemed trust over the debtor's property equivalent to the amount owing in respect of income tax became effective at the time of liquidation, receivership, or assignment in bankruptcy. *Sparrow Electric* held that

Digitized by Google

the *ITA* deemed trust could not prevail over the security interests because, being fixed charges, the latter attached as soon as the debtor acquired rights in the property such that the *ITA* deemed trust had no property on which to attach when it subsequently arose. Later, in *First Vancouver Finance v. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720, this Court observed that Parliament had legislated to strengthen the statutory deemed trust in the *ITA* by deeming it to operate from the moment the deductions were not paid to the Crown as required by the *ITA*, and by granting the Crown priority over all security interests (paras. 27-29) (the "*Sparrow Electric* amendment").

[34] The amended text of s. 227(4.1) of the *ITA* and concordant source deductions deemed trusts in the *Canada Pension Plan* and the *Employment Insurance Act* state that the deemed trust operates notwithstanding any other enactment of Canada, except ss. 81.1 and 81.2 of the *BIA*. The *ETA* deemed trust at issue in this case is similarly worded, but it excepts the *BIA* in its entirety. The provision reads as follows:

222. . . .

. . .

(3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed . . . .

[35] The Crown submits that the *Sparrow Electric* amendment, added by Parliament to the *ETA* in 2000, was intended to preserve the Crown's priority over collected GST under the *CCAA* while subordinating the Crown to the status of an unsecured creditor in respect of GST only under the *BIA*. This is because the *ETA* provides that the GST deemed trust is effective "despite" any other enactment except the *BIA*.

[36] The language used in the *ETA* for the GST deemed trust creates an apparent conflict with the *CCAA*, which provides that subject to certain exceptions, property deemed by statute to be held in trust for the Crown shall not be so regarded.

[37] Through a 1997 amendment to the *CCAA* (S.C. 1997, c. 12, s. 125), Parliament appears to have, subject to specific exceptions, nullified deemed trusts in favour of the Crown once reorganization proceedings are commenced under the Act. The relevant provision reads:

18.3 (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

This nullification of deemed trusts was continued in further amendments to the *CCAA* (S.C. 2005, c. 47), where s. 18.3(1) was renumbered and reformulated as s. 37(1):

37. (1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

[38] An analogous provision exists in the *BIA*, which, subject to the same specific

Digitized by Google

exceptions, nullifies statutory deemed trusts and makes property of the bankrupt that would otherwise be subject to a deemed trust part of the debtor's estate and available to creditors (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, s. 73; *BIA*, s. 67(2)). It is noteworthy that in both the *CCAA* and the *BIA*, the exceptions concern source deductions (*CCAA*, s. 18.3(2); *BIA*, s. 67(3)). The relevant provision of the *CCAA* reads:

18.3 . . .

Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* . . . .

Thus, the Crown's deemed trust and corresponding priority in source deductions remain effective both in reorganization and in bankruptcy.

[39] Meanwhile, in both s. 18.4(1) of the *CCAA* and s. 86(1) of the *BIA*, other Crown claims are treated as unsecured. These provisions, establishing the Crown's status as an unsecured creditor, explicitly exempt statutory deemed trusts in source deductions (*CCAA*, s. 18.4(3); *BIA*, s. 86(3)). The *CCAA* provision reads as follows:

18.4 . . .

. . .

Subsection (1) [Crown ranking as unsecured creditor] does not affect the operation of subsections 224(1.2) and (1.3) of the *Income Tax Act*,

any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution . . . .

Therefore, not only does the *CCAA* provide that Crown claims do not enjoy priority over the claims of other creditors (s. 18.3(1)), but the exceptions to this rule (i.e., that Crown priority is maintained for source deductions) are repeatedly stated in the statute.

[40] The apparent conflict in this case is whether the rule in the *CCAA* first enacted as s. 18.3 in 1997, which provides that subject to certain explicit exceptions, statutory deemed trusts are ineffective under the *CCAA*, is overridden by the one in the *ETA* enacted in 2000 stating that GST deemed trusts operate despite any enactment of Canada except the *BIA*. With respect for my colleague Fish J., I do not think the apparent conflict can be resolved by denying it and creating a rule requiring both a statutory provision enacting the deemed trust, and a second statutory provision confirming it. Such a rule is unknown to the law. Courts must recognize conflicts, apparent or real, and resolve them when possible.

[41] A line of jurisprudence across Canada has resolved the apparent conflict in favour of the *ETA*, thereby maintaining GST deemed trusts under the *CCAA*. *Ottawa Senators*, the leading case, decided the matter by invoking the doctrine of implied repeal to hold that the later in time provision of the *ETA* should take precedence over the *CCAA* (see also *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4th) 219 (Alta. Q.B.); *Gauntlet*).

[42] The Ontario Court of Appeal in *Ottawa Senators* rested its conclusion on two considerations. First, it was persuaded that by explicitly mentioning the *BIA* in *ETA* s. 222(3), but not the *CCAA*, Parliament made a deliberate choice. In the words of MacPherson J.A.:

The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the

Digitized by Google

CCAA from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

[43] Second, the Ontario Court of Appeal compared the conflict between the *ETA* and the *CCAA* to that before this Court in *Doré v. Verdun (City)*, [1997] 2 S.C.R. 862, and found them to be "identical" (para. 46). It therefore considered *Doré* binding (para. 49). In *Doré*, a limitations provision in the more general and recently enacted *Civil Code of Québec*, S.Q. 1991, c. 64 ("*C.C.Q.*"), was held to have repealed a more specific provision of the earlier Quebec *Cities and Towns Act*, R.S.Q., c. C-19, with which it conflicted. By analogy, the Ontario Court of Appeal held that the later in time and more general provision, s. 222(3) of the *ETA*, impliedly repealed the more specific and earlier in time provision, s. 18.3(1) of the *CCAA* (paras. 47- 49).

[44] Viewing this issue in its entire context, several considerations lead me to conclude that neither the reasoning nor the result in *Ottawa Senators* can stand. While a conflict may exist at the level of the statutes' wording, a purposive and contextual analysis to determine Parliament's true intent yields the conclusion that Parliament could not have intended to restore the Crown's deemed trust priority in GST claims under the *CCAA* when it amended the *ETA* in 2000 with the *Sparrow Electric* amendment.

[45] I begin by recalling that Parliament has shown its willingness to move away from asserting priority for Crown claims in insolvency law. Section 18.3(1) of the *CCAA* (subject to the s. 18.3(2) exceptions) provides that the Crown's deemed trusts have no effect under the *CCAA*. Where Parliament has sought to protect certain Crown claims through statutory deemed trusts and intended that these deemed trusts continue in insolvency, it has legislated so explicitly and elaborately. For example, s. 18.3(2) of the *CCAA* and s. 67(3) of the *BIA* expressly provide that deemed trusts for source deductions remain effective in insolvency. Parliament has, therefore, clearly carved out exceptions from the general rule that deemed trusts are ineffective in insolvency. The *CCAA* and *BIA* are in harmony, preserving deemed trusts and asserting Crown priority only in respect of source deductions. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA*. Unlike source deductions, which are clearly and expressly dealt with under both these insolvency statutes, no such clear and express language exists in those Acts carving out an exception for GST claims.

[46] The internal logic of the *CCAA* also militates against upholding the *ETA* deemed trust for GST. The *CCAA* imposes limits on a suspension by the court of the Crown's rights in respect of source deductions but does not mention the *ETA* (s. 11.4). Since source deductions deemed trusts are granted explicit protection under the *CCAA*, it would be inconsistent to afford a better protection to the *ETA* deemed trust absent explicit language in the *CCAA*. Thus, the logic of the *CCAA* appears to subject the *ETA* deemed trust to the waiver by Parliament of its priority (s. 18.4).

[47] Moreover, a strange asymmetry would arise if the interpretation giving the *ETA* priority over the *CCAA* urged by the Crown is adopted here: the Crown would retain priority over GST claims during *CCAA* proceedings but not in bankruptcy. As courts have reflected, this can only encourage statute shopping by secured creditors in cases such as this one where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the *BIA*, creditors' incentives would lie overwhelmingly with avoiding proceedings under the *CCAA* and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives

Digitized by Google

against reorganizing under the *CCAA* can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

[48] Arguably, the effect of *Ottawa Senators* is mitigated if restructuring is attempted under the *BIA* instead of the *CCAA*, but it is not cured. If *Ottawa Senators* were to be followed, Crown priority over GST would differ depending on whether restructuring took place under the *CCAA* or the *BIA*. The anomaly of this result is made manifest by the fact that it would deprive companies of the option to restructure under the more flexible and responsive *CCAA* regime, which has been the statute of choice for complex reorganizations.

[49] Evidence that Parliament intended different treatments for GST claims in reorganization and bankruptcy is scant, if it exists at all. Section 222(3) of the *ETA* was enacted as part of a wide-ranging budget implementation bill in 2000. The summary accompanying that bill does not indicate that Parliament intended to elevate Crown priority over GST claims under the *CCAA* to the same or a higher level than source deductions claims. Indeed, the summary for deemed trusts states only that amendments to existing provisions are aimed at "ensuring that employment insurance premiums and Canada Pension Plan contributions that are required to be remitted by an employer are fully recoverable by the Crown in the case of the bankruptcy of the employer" (Summary to S.C. 2000, c. 30, at p. 4a). The wording of GST deemed trusts resembles that of statutory deemed trusts for source deductions and incorporates the same overriding language and reference to the *BIA*. However, as noted above, Parliament's express intent is that only source deductions deemed trusts remain operative. An exception for the *BIA* in the statutory language establishing the source deductions deemed trusts accomplishes very little, because the explicit language of the *BIA* itself (and the *CCAA*) carves out these source deductions deemed trusts and maintains their effect. It is however noteworthy that no equivalent language maintaining GST deemed trusts exists under either the *BIA* or the *CCAA*.

[50] It seems more likely that by adopting the same language for creating GST deemed trusts in the *ETA* as it did for deemed trusts for source deductions, and by overlooking the inclusion of an exception for the *CCAA* alongside the *BIA* in s. 222(3) of the *ETA*, Parliament may have inadvertently succumbed to a drafting anomaly. Because of a statutory lacuna in the *ETA*, the GST deemed trust could be seen as remaining effective in the *CCAA*, while ceasing to have any effect under the *BIA*, thus creating an apparent conflict with the wording of the *CCAA*. However, it should be seen for what it is: a facial conflict only, capable of resolution by looking at the broader approach taken to Crown priorities and by giving precedence to the statutory language of s. 18.3 of the *CCAA* in a manner that does not produce an anomalous outcome.

[51] Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. It merely creates an apparent conflict that must be resolved by statutory interpretation. Parliament's intent when it enacted *ETA* s. 222(3) was therefore far from unambiguous. Had it sought to give the Crown a priority for GST claims, it could have done so explicitly as it did for source deductions. Instead, one is left to infer from the language of *ETA* s. 222(3) that the GST deemed trust was intended to be effective under the *CCAA*.

[52] I am not persuaded that the reasoning in *Doré* requires the application of the doctrine of implied repeal in the circumstances of this case. The main issue in *Doré* concerned the impact of the adoption of the *C.C.Q.* on the administrative law rules with respect to municipalities. While Gonthier J. concluded in that case that

Digitized by Google

the limitation provision in art. 2930 *C.C.Q.* had repealed by implication a limitation provision in the *Cities and Towns Act*, he did so on the basis of more than a textual analysis. The conclusion in *Doré* was reached after thorough contextual analysis of both pieces of legislation, including an extensive review of the relevant legislative history (paras. 31-41). Consequently, the circumstances before this Court in *Doré* are far from "identical" to those in the present case, in terms of text, context and legislative history. Accordingly, *Doré* cannot be said to require the automatic application of the rule of repeal by implication.

[53] A noteworthy indicator of Parliament's overall intent is the fact that in subsequent amendments it has not displaced the rule set out in the *CCAA*. Indeed, as indicated above, the recent amendments to the *CCAA* in 2005 resulted in the rule previously found in s. 18.3 being renumbered and reformulated as s. 37. Thus, to the extent the interpretation allowing the GST deemed trust to remain effective under the *CCAA* depends on *ETA* s. 222(3) having impliedly repealed *CCAA* s. 18.3(1) because it is later in time, we have come full circle. Parliament has renumbered and reformulated the provision of the *CCAA* stating that, subject to exceptions for source deductions, deemed trusts do not survive the *CCAA* proceedings and thus the *CCAA* is now the later in time statute. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA*.

[54] I do not agree with my colleague Abella J. that s. 44(*f*) of the *Interpretation Act*, R.S.C. 1985, c. I-21, can be used to interpret the 2005 amendments as having no effect. The new statute can hardly be said to be a mere re-enactment of the former statute. Indeed, the *CCAA* underwent a substantial review in 2005. Notably, acting consistently with its goal of treating both the *BIA* and the *CCAA* as sharing the same approach to insolvency, Parliament made parallel amendments to both statutes with respect to corporate proposals. In addition, new provisions were introduced regarding the treatment of contracts, collective agreements, interim financing and governance agreements. The appointment and role of the Monitor was also clarified. Noteworthy are the limits imposed by *CCAA* s. 11.09 on the court's discretion to make an order staying the Crown's source deductions deemed trusts, which were formerly found in s. 11.4. No mention whatsoever is made of GST deemed trusts (see Summary to S.C. 2005, c. 47). The review went as far as looking at the very expression used to describe the statutory override of deemed trusts. The comments cited by my colleague only emphasize the clear intent of Parliament to maintain its policy that only source deductions deemed trusts survive in *CCAA* proceedings.

[55] In the case at bar, the legislative context informs the determination of Parliament's legislative intent and supports the conclusion that *ETA* s. 222(3) was not intended to narrow the scope of the *CCAA*'s override provision. Viewed in its entire context, the conflict between the *ETA* and the *CCAA* is more apparent than real. I would therefore not follow the reasoning in *Ottawa Senators* and affirm that *CCAA* s. 18.3 remained effective.

[56] My conclusion is reinforced by the purpose of the *CCAA* as part of Canadian remedial insolvency legislation. As this aspect is particularly relevant to the second issue, I will now discuss how courts have interpreted the scope of their discretionary powers in supervising a *CCAA* reorganization and how Parliament has largely endorsed this interpretation. Indeed, the interpretation courts have given to the *CCAA* helps in understanding how the *CCAA* grew to occupy such a prominent role in Canadian insolvency law.

Digitized by Google

Discretionary Power of a Court Supervising a CCAA Reorganization

[57] Courts frequently observe that "[t]he *CCAA* is skeletal in nature" and does not "contain a comprehensive code that lays out all that is permitted or barred" (*Metcalfe & Mansfield Alternative Investments II Corp. (Re)*, 2008 ONCA 587, 92 O.R. (3d) 513, at para. 44, *per* Blair J.A.). Accordingly, "[t]he history of CCAA law has been an evolution of judicial interpretation" (*Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Ct. (Gen. Div.)), at para. 10, *per* Farley J.).

[58] *CCAA* decisions are often based on discretionary grants of jurisdiction. The incremental exercise of judicial discretion in commercial courts under conditions one practitioner aptly describes as "the hothouse of real-time litigation" has been the primary method by which the *CCAA* has been adapted and has evolved to meet contemporary business and social needs (see Jones, at p. 484).

[59] Judicial discretion must of course be exercised in furtherance of the *CCAA*'s purposes. The remedial purpose I referred to in the historical overview of the Act is recognized over and over again in the jurisprudence. To cite one early example:

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.
> (*Elan Corp. v. Comiskey* (1990), 41 O.A.C. 282, at para. 57, *per* Doherty J.A., dissenting)

[60] Judicial decision making under the *CCAA* takes many forms. A court must first of all provide the conditions under which the debtor can attempt to reorganize. This can be achieved by staying enforcement actions by creditors to allow the debtor's business to continue, preserving the *status quo* while the debtor plans the compromise or arrangement to be presented to creditors, and supervising the process and advancing it to the point where it can be determined whether it will succeed (see, e.g., *Chef Ready Foods Ltd. v. Hongkong Bank of Can.* (1990), 51 B.C.L.R. (2d) 84 (C.A.), at pp. 88-89; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134, at para. 27). In doing so, the court must often be cognizant of the various interests at stake in the reorganization, which can extend beyond those of the debtor and creditors to include employees, directors, shareholders, and even other parties doing business with the insolvent company (see, e.g., *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9, at para. 144, *per* Paperny J. (as she then was); *Air Canada, Re* (2003), 42 C.B.R. (4th) 173 (Ont. S.C.J.), at para. 3; *Air Canada, Re*, 2003 CanLII 49366 (Ont. S.C.J.), at para. 13, *per* Farley J.; Sarra, *Creditor Rights*, at pp. 181-92 and 217-26). In addition, courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed (see, e.g., *Canadian Red Cross Society/Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4th) 158 (Ont. S.C.J.), at para. 2, *per* Blair J. (as he then was); Sarra, *Creditor Rights*, at pp. 195-214).

[61] When large companies encounter difficulty, reorganizations become increasingly complex. *CCAA* courts have been called upon to innovate accordingly in exercising their jurisdiction beyond merely staying proceedings against the debtor to allow breathing room for reorganization. They have been asked to sanction measures for which there is no explicit authority in the *CCAA*. Without exhaustively cataloguing the various measures taken under the authority of the *CCAA*, it is useful to refer briefly to a few examples to illustrate the flexibility the statute affords

Digitized by Google

supervising courts.

[62] Perhaps the most creative use of *CCAA* authority has been the increasing willingness of courts to authorize post-filing security for debtor in possession financing or super-priority charges on the debtor's assets when necessary for the continuation of the debtor's business during the reorganization (see, e.g., *Skydome Corp., Re* (1998), 16 C.B.R. (4th) 118 (Ont. Ct. (Gen. Div.)); *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96, aff'g (1999), 12 C.B.R. (4th) 144 (S.C.); and generally, J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at pp. 93-115). The *CCAA* has also been used to release claims against third parties as part of approving a comprehensive plan of arrangement and compromise, even over the objections of some dissenting creditors (see *Metcalfe & Mansfield*). As well, the appointment of a Monitor to oversee the reorganization was originally a measure taken pursuant to the *CCAA*'s supervisory authority; Parliament responded, making the mechanism mandatory by legislative amendment.

[63] Judicial innovation during *CCAA* proceedings has not been without controversy. At least two questions it raises are directly relevant to the case at bar: (1) What are the sources of a court's authority during *CCAA* proceedings? (2) What are the limits of this authority?

[64] The first question concerns the boundary between a court's statutory authority under the *CCAA* and a court's residual authority under its inherent and equitable jurisdiction when supervising a reorganization. In authorizing measures during *CCAA* proceedings, courts have on occasion purported to rely upon their equitable jurisdiction to advance the purposes of the Act or their inherent jurisdiction to fill gaps in the statute. Recent appellate decisions have counselled against purporting to rely on inherent jurisdiction, holding that the better view is that courts are in most cases simply construing the authority supplied by the *CCAA* itself (see, e.g., *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236, at paras. 45-47, *per* Newbury J.A.; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (C.A.), at paras. 31-33, *per* Blair J.A.).

[65] I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).

[66] Having examined the pertinent parts of the *CCAA* and the recent history of the legislation, I accept that in most instances the issuance of an order during *CCAA* proceedings should be considered an exercise in statutory interpretation. Particularly noteworthy in this regard is the expansive interpretation the language of the statute at issue is capable of supporting.

[67] The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company . . . on the application of any person interested in the matter, . . . subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.

[68] In this regard, though not strictly applicable to the case at bar, I note that

Digitized by Google

Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus, in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, . . . make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence.

[69] The *CCAA* also explicitly provides for certain orders. Both an order made on an initial application and an order on subsequent applications may stay, restrain, or prohibit existing or new proceedings against the debtor. The burden is on the applicant to satisfy the court that the order is appropriate in the circumstances and that the applicant has been acting in good faith and with due diligence (*CCAA*, ss. 11(3), (4) and (6)). [70] The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.

[71] It is well established that efforts to reorganize under the *CCAA* can be terminated and the stay of proceedings against the debtor lifted if the reorganization is "doomed to failure" (see *Chef Ready*, at p. 88; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25 (B.C.C.A.), at paras. 6-7). However, when an order is sought that does realistically advance the *CCAA*'s purposes, the ability to make it is within the discretion of a *CCAA* court.

[72] The preceding discussion assists in determining whether the court had authority under the *CCAA* to continue the stay of proceedings against the Crown once it was apparent that reorganization would fail and bankruptcy was the inevitable next step.

[73] In the Court of Appeal, Tysoe J.A. held that no authority existed under the *CCAA* to continue staying the Crown's enforcement of the GST deemed trust once efforts at reorganization had come to an end. The appellant submits that in so holding, Tysoe J.A. failed to consider the underlying purpose of the *CCAA* and give the statute an appropriately purposive and liberal interpretation under which the order was permissible. The Crown submits that Tysoe J.A. correctly held that the mandatory language of the *ETA* gave the court no option but to permit enforcement of the GST deemed trust when lifting the *CCAA* stay to permit the debtor to make an assignment under the *BIA*. Whether the *ETA* has a mandatory effect in the context of a *CCAA* proceeding has already been discussed. I will now address the question of whether the order was authorized by the *CCAA*.

[74] It is beyond dispute that the *CCAA* imposes no explicit temporal limitations upon proceedings commenced under the Act that would prohibit ordering a continuation of the stay of the Crown's GST claims while lifting the general stay of proceedings temporarily to allow the debtor to make an assignment in bankruptcy.

[75] The question remains whether the order advanced the underlying purpose of the *CCAA*. The Court of Appeal held that it did not because the reorganization efforts

Digitized by Google

had come to an end and the *CCAA* was accordingly spent. I disagree.

[76] There is no doubt that had reorganization been commenced under the *BIA* instead of the *CCAA*, the Crown's deemed trust priority for the GST funds would have been lost. Similarly, the Crown does not dispute that under the scheme of distribution in bankruptcy under the *BIA* the deemed trust for GST ceases to have effect. Thus, after reorganization under the *CCAA* failed, creditors would have had a strong incentive to seek immediate bankruptcy and distribution of the debtor's assets under the *BIA*. In order to conclude that the discretion does not extend to partially lifting the stay in order to allow for an assignment in bankruptcy, one would have to assume a gap between the *CCAA* and the *BIA* proceedings. Brenner C.J.S.C.'s order staying Crown enforcement of the GST claim ensured that creditors would not be disadvantaged by the attempted reorganization under the *CCAA*. The effect of his order was to blunt any impulse of creditors to interfere in an orderly liquidation. His order was thus in furtherance of the *CCAA*'s objectives to the extent that it allowed a bridge between the *CCAA* and *BIA* proceedings. This interpretation of the tribunal's discretionary power is buttressed by s. 20 of the *CCAA*. That section provides that the *CCAA* "may be applied together with the provisions of any Act of Parliament . . . that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them", such as the *BIA*. Section 20 clearly indicates the intention of Parliament for the *CCAA* to operate *in tandem* with other insolvency legislation, such as the *BIA*.

[77] The *CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all. Because the alternative to reorganization is often bankruptcy, participants will measure the impact of a reorganization against the position they would enjoy in liquidation. In the case at bar, the order fostered a harmonious transition between reorganization and liquidation while meeting the objective of a single collective proceeding that is common to both statutes. [78] Tysoe J.A. therefore erred in my view by treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law. Parliament's decision to maintain two statutory schemes for reorganization, the *BIA* and the *CCAA*, reflects the reality that reorganizations of differing complexity require different legal mechanisms. By contrast, only one statutory scheme has been found to be needed to liquidate a bankrupt debtor's estate. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of the *BIA* proceedings. However, as Laskin J.A. for the Ontario Court of Appeal noted in a similar competition between secured creditors and the Ontario Superintendent of Financial Services seeking to enforce a deemed trust, "[t]he two statutes are related" and no "gap" exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy (*Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108, at paras. 62-63).

[79] The Crown's priority in claims pursuant to source deductions deemed trusts does not undermine this conclusion. Source deductions deemed trusts survive under both the *CCAA* and the *BIA*. Accordingly, creditors' incentives to prefer one Act over another will not be affected. While a court has a broad discretion to stay source deductions deemed trusts in the *CCAA* context, this discretion is nevertheless subject to specific limitations applicable only to source deductions deemed trusts (*CCAA*, s. 11.4). Thus, if *CCAA* reorganization fails (e.g., either the creditors or the court refuse a proposed reorganization), the Crown can immediately

Digitized by Google

assert its claim in unremitted source deductions. But this should not be understood to affect a seamless transition into bankruptcy or create any "gap" between the *CCAA* and the *BIA* for the simple reason that, regardless of what statute the reorganization had been commenced under, creditors' claim s in both instances would have been subject to the priority of the Crown's source deductions deemed trust.

[80] Source deductions deemed trusts aside, the comprehensive and exhaustive mechanism under the *BIA* must control the distribution of the debtor's assets once liquidation is inevitable. Indeed, an orderly transition to liquidation is mandatory under the *BIA* where a proposal is rejected by creditors. The *CCAA* is silent on the transition into liquidation but the breadth of the court's discretion under the Act is sufficient to construct a bridge to liquidation under the *BIA.* The court must do so in a manner that does not subvert the scheme of distribution under the *BIA*. Transition to liquidation requires partially lifting the *CCAA* stay to commence proceedings under the *BIA*. This necessary partial lifting of the stay should not trigger a race to the courthouse in an effort to obtain priority unavailable under the *BIA*.

[81] I therefore conclude that Brenner C.J.S.C. had the authority under the *CCAA* to lift the stay to allow entry into liquidation.

Express Trust

[82] The last issue in this case is whether Brenner C.J.S.C. created an express trust in favour of the Crown when he ordered on April 29, 2008, that proceeds from the sale of LeRoy Trucking's assets equal to the amount of unremitted GST be held back in the Monitor's trust account until the results of the reorganization were known. Tysoe J.A. in the Court of Appeal concluded as an alternative ground for allowing the Crown's appeal that it was the beneficiary of an express trust. I disagree.

[83] Creation of an express trust requires the presence of three certainties: intention, subject matter, and object. Express or "true trusts" arise from the acts and intentions of the settlor and are distinguishable from other trusts arising by operation of law (see D. W. M. Waters, M. R. Gillen and L. D. Smith, eds., *Waters' Law of Trusts in Canada* (3rd ed. 2005), at pp. 28-29, especially fn. 42).

[84] Here, there is no certainty to the object (i.e. the beneficiary) inferrable from the court's order of April 29, 2008 sufficient to support an express trust.

[85] At the time of the order, there was a dispute between Century Services and the Crown over part of the proceeds from the sale of the debtor's assets. The court's solution was to accept LeRoy Trucking's proposal to segregate those monies until that dispute could be resolved. Thus, there was no certainty that the Crown would actually be the beneficiary, or object, of the trust.

[86] The fact that the location chosen to segregate those monies was the Monitor's trust account has no independent effect such that it would overcome the lack of a clear beneficiary. In any event, under the interpretation of *CCAA* s. 18.3(1) established above, no such priority dispute would even arise because the Crown's deemed trust priority over GST claims would be lost under the *CCAA* and the Crown would rank as an unsecured creditor for this amount. However, Brenner C.J.S.C. may well have been proceeding on the basis that, in accordance with *Ottawa Senators*, the Crown's GST claim would remain effective if reorganization was successful, which would not be the case if transition to the liquidation process of the *BIA* was allowed. An amount equivalent to that claim would accordingly be set aside pending the outcome of reorganization.

[87] Thus, uncertainty surrounding the outcome of the *CCAA* restructuring eliminates the existence of any certainty to permanently vest in the Crown a beneficial interest

Digitized by Google

in the funds. That much is clear from the oral reasons of Brenner C.J.S.C. on April 29, 2008, when he said: "Given the fact that [*CCAA* proceedings] are known to fail and filings in bankruptcy result, it seems to me that maintaining the status quo in the case at bar supports the proposal to have the monitor hold these funds in trust." Exactly who might take the money in the final result was therefore evidently in doubt. Brenner C.J.S.C.'s subsequent order of September 3, 2008 denying the Crown's application to enforce the trust once it was clear that bankruptcy was inevitable, confirms the absence of a clear beneficiary required to ground an express trust.

Conclusion

[88] I conclude that Brenner C.J.S.C. had the discretion under the *CCAA* to continue the stay of the Crown's claim for enforcement of the GST deemed trust while otherwise lifting it to permit LeRoy Trucking to make an assignment in bankruptcy. My conclusion that s. 18.3(1) of the *CCAA* nullified the GST deemed trust while proceedings under that Act were pending confirms that the discretionary jurisdiction under s. 11 utilized by the court was not limited by the Crown's asserted GST priority, because there is no such priority under the *CCAA*.

[89] For these reasons, I would allow the appeal and declare that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada is not subject to deemed trust or priority in favour of the Crown. Nor is this amount subject to an express trust. Costs are awarded for this appeal and the appeal in the court below.

The following are the reasons delivered by FISH J. —

I

[90] I am in general agreement with the reasons of Justice Deschamps and would dispose of the appeal as she suggests.

[91] More particularly, I share my colleague's interpretation of the scope of the judge's discretion under s. 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). And I share my colleague's conclusion that Brenner C.J.S.C. did not create an express trust in favour of the Crown when he segregated GST funds into the Monitor's trust account (2008 BCSC 1805, [2008] G.S.T.C. 221).

[92] I nonetheless feel bound to add brief reasons of my own regarding the interaction between the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*").

[93] In upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737 (C.A.), and its progeny have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In my respectful view, a clearly marked departure from that jurisprudential approach is warranted in this case.

[94] Justice Deschamps develops important historical and policy reasons in support of this position and I have nothing to add in that regard. I do wish, however, to explain why a comparative analysis of related statutory provisions adds support to our shared conclusion.

[95] Parliament has in recent years given detailed consideration to the Canadian insolvency scheme. It has declined to amend the provisions at issue in this case. Ours is not to wonder why, but rather to treat Parliament's preservation of the relevant provisions as a deliberate exercise of the legislative discretion that is Parliament's alone. With respect, I reject any suggestion that we should instead characterize the apparent conflict between s. 18.3(1) (now s. 37(1)) of the *CCAA*

Digitized by Google

and s. 222 of the *ETA* as a drafting anomaly or statutory lacuna properly subject to judicial correction or repair.

II

[96] In the context of the Canadian insolvency regime, a deemed trust will be found to exist only where two complementary elements co-exist: first, a statutory provision *creating* the trust; and second, a *CCAA* or *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") provision *confirming* — or explicitly preserving — its effective operation.

[97] This interpretation is reflected in three federal statutes. Each contains a deemed trust provision framed in terms strikingly similar to the wording of s. 222 of the *ETA*.

[98] The first is the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"), where s. 227(4) *creates* a deemed trust:

Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act. [Here and below, the emphasis is of course my own.]

[99] In the next subsection, Parliament has taken care to make clear that this trust is unaffected by federal or provincial legislation to the contrary:

(4.1) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person . . . equal in value to the amount so deemed to be held in trust is deemed

(*a*) to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, . . .

. . .

. . . and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

[100]The continued operation of this deemed trust is expressly *confirmed* in s. 18.3 of the *CCAA*:

18.3 (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* . . . .

[101]The operation of the *ITA* deemed trust is also confirmed in s. 67 of the *BIA*:

Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her

Digitized by Google

Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.
Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* . . . .
[102]Thus, Parliament has first *created* and then *confirmed the continued operation of* the Crown's *ITA*
deemed trust under *both* the *CCAA* and the *BIA* regimes.
[103]The second federal statute for which this scheme holds true is the *Canada Pension Plan*, R.S.C. 1985, c. C-8 ("*CPP*"). At s. 23, Parliament creates a deemed trust in favour of the Crown and specifies that it exists despite all contrary provisions in any other Canadian statute. Finally, and in almost identical terms, the *Employment Insurance Act*, S.C. 1996, c. 23 ("*EIA*"), creates a deemed trust in favour of the Crown: see ss. 86(2) and (2.1).
[104]As we have seen, the survival of the deemed trusts created under these provisions of the *ITA*, the *CPP* and the *EIA* is confirmed in s. 18.3(2) of the *CCAA* and in s. 67(3) of the *BIA*. In all three cases, Parliament's intent to enforce the Crown's deemed trust through insolvency proceedings is expressed in clear and unmistakable terms.
[105]The same is not true with regard to the deemed trust created under the *ETA*. Although Parliament creates a deemed trust in favour of the Crown to hold unremitted GST monies, and although it purports to maintain this trust notwithstanding any contrary federal or provincial legislation, it does not *confirm* the trust
— or expressly provide for its continued operation — in either the *BIA* or the *CCAA*. The second of the two mandatory elements I have mentioned is thus absent reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.
[106]The language of the relevant *ETA* provisions is identical in substance to that of the *ITA*, *CPP*, and *EIA* provisions:
222. (1) Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).
. . .
(3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed
(*a*) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, . . .

Digitized by Google

. . .
. . . and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.
[107]Yet no provision of the *CCAA* provides for the continuation of this deemed trust after the *CCAA* is brought into play.
[108]In short, Parliament has imposed *two* explicit conditions, or "building blocks", for survival under the *CCAA* of deemed trusts created by the *ITA*, *CPP*, and *EIA*. Had Parliament intended to likewise preserve under the *CCAA* deemed trusts created by the *ETA*, it would have included in the *CCAA* the sort of confirmatory provision that explicitly preserves other deemed trusts.
[109]With respect, unlike Tysoe J.A., I do not find it "inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception" (2009 BCCA 205, 98 B.C.L.R. (4th) 242, at para. 37). *All* of the deemed trust provisions excerpted above make explicit reference to the *BIA*. Section 222 of the *ETA* does not break the pattern. Given the near-identical wording of the four deemed trust provisions, it would have been surprising indeed had Parliament not addressed the *BIA* at all in the *ETA*.
[110]Parliament's evident intent was to render GST deemed trusts inoperative upon the institution of insolvency proceedings. Accordingly, s. 222 mentions the *BIA* so as to *exclude* it from its ambit — rather than to *include* it, as do the *ITA*, the *CPP*, and the *EIA*.
[111]Conversely, I note that *none* of these statutes mentions the *CCAA* expressly. Their specific reference to the *BIA* has no bearing on their interaction with the *CCAA*. Again, it is the confirmatory provisions *in the insolvency statutes* that determine whether a given deemed trust will subsist during insolvency proceedings.
[112]Finally, I believe that chambers judges should not segregate GST monies into the Monitor's trust account during *CCAA* proceedings, as was done in this case. The result of Justice Deschamps's reasoning is that GST claims become unsecured under the *CCAA*. Parliament has deliberately chosen to nullify certain Crown super-priorities during insolvency; this is one such instance.
III
[113]For these reasons, like Justice Deschamps, I would allow the appeal with costs in this Court and in the courts below and order that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada be subject to no deemed trust or priority in favour of the Crown.

The following are the reasons delivered by
[114] ABELLA J. (dissenting) — The central issue in this appeal is whether s. 222 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), and specifically s. 222(3), gives priority during *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), proceedings to the Crown's deemed trust in unremitted GST. I agree with Tysoe J.A. that it does. It follows, in my respectful view, that a court's discretion under s. 11 of the *CCAA* is circumscribed accordingly.
[115]Section 11[62] of the *CCAA* stated:

---

62 Section 11 was amended, effective September 18, 2009, and now states:
11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

Digitized by Google

11. (1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

To decide the scope of the court's discretion under s. 11, it is necessary to first determine the priority issue. Section 222(3), the provision of the *ETA* at issue in this case, states:

(3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(*a*) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and

(*b*) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

[116]Century Services argued that the *CCAA*'s general override provision, s. 18.3(1), prevailed, and that the deeming provisions in s. 222 of the *ETA* were, accordingly, inapplicable during *CCAA* proceedings. Section 18.3(1) states:

18.3 (1) . . . [N]otwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

[117]As MacPherson J.A. correctly observed in *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737 (C.A.), s. 222(3) of the *ETA* is in "clear conflict" with s. 18.3(1) of the *CCAA* (para. 31). Resolving the conflict between the two provisions is, essentially, what seems to me to be a relatively uncomplicated exercise in statutory interpretation: Does the language reflect a clear legislative intention? In my view it does. The deemed trust provision, s. 222(3) of the *ETA*, has unambiguous language stating that it operates notwithstanding any law except the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

[118]By expressly excluding only one statute from its legislative grasp, and by unequivocally stating that it applies despite any other law anywhere in Canada *except* the *BIA*, s. 222(3) has defined its boundaries in the clearest possible terms. I am in complete agreement with the following comments of MacPherson J.A. in *Ottawa Senators*:

The legislative intent of s. 222(3) of the *ETA* is clear. If there is a conflict with "any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)", s. 222(3) prevails. In these words Parliament did two things: it decided that s. 222(3) should trump all other federal laws and, importantly, it addressed the topic of exceptions to

Digitized by Google

its trumping decision and identified a single exception, the *Bankruptcy and Insolvency Act* . . . . The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

[119]MacPherson J.A.'s view that the failure to exempt the *CCAA* from the operation of the *ETA* is a reflection of a clear legislative intention, is borne out by how the *CCAA* was subsequently changed after s. 18.3(1) was enacted in 1997. In 2000, when s. 222(3) of the *ETA* came into force, amendments were also introduced to the *CCAA*. Section 18.3(1) was not amended.

[120]The failure to amend s. 18.3(1) is notable because its effect was to protect the legislative *status quo*, notwithstanding repeated requests from various constituencies that s. 18.3(1) be amended to make the priorities in the *CCAA* consistent with those in the *BIA*. In 2002, for example, when Industry Canada conducted a review of the *BIA* and the *CCAA*, the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals recommended that the priority regime under the *BIA* be extended to the *CCAA* (Joint Task Force on Business Insolvency Law Reform, *Report* (March 15, 2002), Sch. B, proposal 71). The same recommendations were made by the Standing Senate Committee on Banking, Trade and Commerce in its 2003 report, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*; by the Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals in its 2005 *Report on the Commercial Provisions of Bill C-55*; and in 2007 by the Insolvency Institute of Canada in a submission to the Standing Senate Committee on Banking, Trade and Commerce commenting on reforms then under consideration.

[121]Yet the *BIA* remains the only exempted statute under s. 222(3) of the *ETA*. Even after the 2005 decision in *Ottawa Senators* which confirmed that the *ETA* took precedence over the *CCAA*, there was no responsive legislative revision. I see this lack of response as relevant in this case, as it was in *Tele-Mobile Co. v. Ontario*, 2008 SCC 12, [2008] 1 S.C.R. 305, where this Court stated:

While it cannot be said that legislative silence is necessarily determinative of legislative intention, in this case the silence is Parliament's answer to the consistent urging of Telus and other affected businesses and organizations that there be express language in the legislation to ensure that businesses can be reimbursed for the reasonable costs of complying with evidence- gathering orders. I see the legislative history as reflecting Parliament's intention that compensation not be paid for compliance with production orders. [para. 42]

[122]All this leads to a clear inference of a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA*.

[123]Nor do I see any "policy" justification for interfering, through interpretation, with this clarity of legislative intention. I can do no better by way of explaining why I think the policy argument cannot succeed in this case, than to repeat the words of Tysoe J.A. who said:

I do not dispute that there are valid policy reasons for encouraging insolvent companies to attempt to restructure their affairs so that their business can continue with as little disruption to employees and other stakeholders as possible. It is appropriate for the courts to take such policy considerations into account, but only if

Digitized by Google

it is in connection with a matter that has not been considered by Parliament. Here, Parliament must be taken to have weighed policy considerations when it enacted the amendments to the *CCAA* and *ETA* described above. As Mr. Justice MacPherson observed at para. 43 of *Ottawa Senators*, it is inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception. I also make the observation that the 1992 set of amendments to the *BIA* enabled proposals to be binding on secured creditors and, while there is more flexibility under the *CCAA*, it is possible for an insolvent company to attempt to restructure under the auspices of the *BIA*. [para. 37]

[124]Despite my view that the clarity of the language in s. 222(3) is dispositive, it is also my view that even the application of other principles of interpretation reinforces this conclusion. In their submissions, the parties raised the following as being particularly relevant: the Crown relied on the principle that the statute which is "later in time" prevails; and Century Services based its argument on the principle that the general provision gives way to the specific (*generalia specialibus non derogant*).

[125]The "later in time" principle gives priority to a more recent statute, based on the theory that the legislature is presumed to be aware of the content of existing legislation. If a new enactment is inconsistent with a prior one, therefore, the legislature is presumed to have intended to derogate from the earlier provisions (Ruth Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 346-47; Pierre- André Côté, *The Interpretation of Legislation in Canada* (3rd ed. 2000), at p. 358).

[126]The exception to this presumptive displacement of pre-existing inconsistent legislation, is the *generalia specialibus non derogant* principle that "[a] more recent, general provision will not be construed as affecting an earlier, special provision" (Côté, at p. 359). Like a Russian Doll, there is also an exception within this exception, namely, that an earlier, specific provision may in fact be "overruled" by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails (*Doré v. Verdun (City)*, [1997] 2 S.C.R. 862).

[127]The primary purpose of these interpretive principles is to assist in the performance of the task of determining the intention of the legislature. This was confirmed by MacPherson J.A. in *Ottawa Senators*, at para. 42:

. . . the overarching rule of statutory interpretation is that statutory provisions should be interpreted to give effect to the intention of the legislature in enacting the law. This primary rule takes precedence over all maxims or canons or aids relating to statutory interpretation, including the maxim that the specific prevails over the general (*generalia specialibus non derogant*). As expressed by Hudson J. in *Canada v. Williams*, [1944] S.C.R. 226, . . . at p. 239 .

. . :

The maxim *generalia specialibus non derogant* is relied on as a rule which should dispose of the question, but the maxim is not a rule of law but a rule of construction and bows to the intention of the legislature, if such intention can reasonably be gathered from all of the relevant legislation.

(See also Côté, at p. 358, and Pierre-Andre Côté, with the collaboration of S. Beaulac and M. Devinat,

Interprétation des lois (4th ed. 2009), at para. 1335.)

[128]I accept the Crown's argument that the "later in time" principle is conclusive in this

Digitized by Google

case. Since s. 222(3) of the *ETA* was enacted in 2000 and s. 18.3(1) of the *CCAA* was introduced in 1997, s. 222(3) is, on its face, the later provision. This chronological victory can be displaced, as Century Services argues, if it is shown that the more recent provision, s. 222(3) of the *ETA*, is a general one, in which case the earlier, specific provision, s. 18.3(1), prevails (*generalia specialibus non derogant*). But, as previously explained, the prior specific provision does not take precedence if the subsequent general provision appears to "overrule" it. This, it seems to me, is precisely what s. 222(3) achieves through the use of language stating that it prevails despite any law of Canada, of a province, or "any other law" *other than the BIA*. Section 18.3(1) of the *CCAA* is thereby rendered inoperative for purposes of s. 222(3).

[129]It is true that when the *CCAA* was amended in 2005,[79] s. 18.3(1) was re-enacted as s. 37(1) (S.C. 2005,
c. 47, s. 131). Deschamps J. suggests that this makes s. 37(1) the new, "later in time" provision. With respect, her observation is refuted by the operation of s. 44(*f*) of the *Interpretation Act*, R.S.C. 1985, c. I-21, which expressly deals with the (non) effect of re-enacting, without significant substantive changes, a repealed provision (see *Attorney General of Canada v. Public Service Staff Relations Board*, [1977] 2 F.C. 663, dealing with the predecessor provision to s. 44(*f*)). It directs that new enactments not be construed as "new law" unless they differ in substance from the repealed provision:

44. Where an enactment, in this section called the "former enactment", is repealed and another enactment, in this section called the "new enactment", is substituted therefor,

. . .

(*f*) except to the extent that the provisions of the new enactment are not in substance the same as those of the former enactment, the new enactment shall not be held to operate as new law, but shall be construed and have effect as a consolidation and as declaratory of the law as contained in the former enactment;

Section 2 of the *Interpretation Act* defines an "enactment" as "an Act or regulation or any portion of an Act or regulation".

[130]Section 37(1) of the current *CCAA* is almost identical to s. 18.3(1). These provisions are set out for ease of comparison, with the differences between them underlined:

37. (1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

18.3 (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

[131]The application of s. 44(*f*) of the *Interpretation Act* simply confirms the government's clearly expressed intent, found in Industry Canada's clause-by-clause review of Bill C-55, where s. 37(1) was identified as "a technical amendment to re-order the provisions of this Act". During second reading, the Hon. Bill Rompkey, then the Deputy Leader of the Government in the Senate, confirmed that s. 37(1) represented only a technical change:

On a technical note relating to the treatment of deemed trusts for taxes, the bill [*sic*]

Digitized by Google

makes no changes to the underlying policy intent, despite the fact that in the case of a restructuring under the CCAA, sections of the act [*sic*] were repealed and substituted with renumbered versions due to the extensive reworking of the CCAA. (*Debates of the Senate*, vol. 142, 1st Sess., 38th Parl., November 23, 2005, at p. 2147)

[132]Had the substance of s. 18.3(1) altered in any material way when it was replaced by s. 37(1), I would share Deschamps J.'s view that it should be considered a new provision. But since s. 18.3(1) and s. 37(1) are the same in substance, the transformation of s. 18.3(1) into s. 37(1) has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision (Sullivan, at p. 347).

[133]This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. The question then is how that priority affects the discretion of a court under s. 11 of the *CCAA*.

[134] While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act*,
R.S.C. 1985, c. W-11, that discretion is not liberated from the operation of any other federal statute. Any exercise of discretion is therefore circumscribed by whatever limits are imposed by statutes *other* than the *BIA* and the *Winding-up Act*. That includes the *ETA*. The chambers judge in this case was, therefore, required to respect the priority regime set out in s. 222(3) of the *ETA*. Neither s. 18.3(1) nor s. 11 of the *CCAA* gave him the authority to ignore it. He could not, as a result, deny the Crown's request for payment of the GST funds during the *CCAA* proceedings.

[135]Given this conclusion, it is unnecessary to consider whether there was an express trust. [136]I would dismiss the appeal.

APPENDIX

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (as at December 13, 2007)

11. (1) [Powers of court] Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

. . .

(3) [Initial application court orders] A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,

(*a*) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

(4) [Other than initial application court orders] A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,

(*a*) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);

Digitized by Google

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

. . .

(6) [Burden of proof on application] The court shall not make an order under subsection (3) or (4) unless

(*a*) the applicant satisfies the court that circumstances exist that make such an order appropriate; and

(*b*) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

11.4 (1) [Her Majesty affected] An order made under section 11 may provide that

(*a*) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for such period as the court considers appropriate but ending not later than

(i) the expiration of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or arrangement,

(iv) the default by the company on any term of a compromise or arrangement, or

(v) the performance of a compromise or arrangement in respect of the company; and

(*b*) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company where the company is a debtor under that legislation and the provision has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for such period as the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) may apply.

(2) [When order ceases to be in effect] An order referred to in subsection (1) ceases to be in effect if

(*a*) the company defaults on payment of any amount that becomes due to Her

Digitized by Google

Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) under any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(*b*) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) [Operation of similar legislation] An order made under section 11, other than an order referred to in subsection (1) of this section, does not affect the operation of

(*a*) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(*c*) any provision of provincial legislation that has a similar purpose to subsection

Digitized by Google

224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

18.3 (1) [Deemed trusts] Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) [Exceptions] Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(*a*) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(*b*) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

18.4 (1) [Status of Crown claims] In relation to a proceeding under this Act, all claims, including secured claims, of Her Majesty in right of Canada or a province or any body under an enactment respecting workers' compensation, in this section and in section 18.5 called a "workers' compensation body", rank as unsecured claims.

. . .

(3) [Operation of similar legislation] Subsection (1) does not affect the operation of

Digitized by Google

(*a*) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(*c*) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

20. [Act to be applied conjointly with other Acts] The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province, that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (as at September 18, 2009)

11. [General power of court] Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

11.02 (1) [Stays, etc. — initial application] A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(*a*) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

(2) [Stays, etc. — other than initial application] A court may, on an application in respect of a debtor company other than an initial application, make an order, on any

Digitized by Google

terms that it may impose,

(*a*) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(*a*);

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

(3) [Burden of proof on application] The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

. . .

11.09 (1) [Stay — Her Majesty] An order made under section 11.02 may provide that

(*a*) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for the period that the court considers appropriate but ending not later than

(i) the expiry of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or an arrangement,

(iv) the default by the company on any term of a compromise or an arrangement, or

(v) the performance of a compromise or an arrangement in respect of the company; and

(*b*) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company if the company is a debtor under that legislation and the provision has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for the period that the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) that may

Digitized by Google

apply.

(2) [When order ceases to be in effect] The portions of an order made under section 11.02 that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*) cease to be in effect if

(*a*) the company defaults on the payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(*b*) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) [Operation of similar legislation] An order made under section 11.02, other than the portions of that order that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*), does not affect the operation of

(*a*) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

Digitized by Google

(*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(*c*) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

37. (1) [Deemed trusts] Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) [Exceptions] Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision"), nor does it apply in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province if

(*a*) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(*b*) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

Digitized by Google

Excise Tax Act, R.S.C. 1985, c. E-15 (as at December 13, 2007)

222. (1) [Trust for amounts collected] Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

(1.1) [Amounts collected before bankruptcy] Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act*), to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.

. . .

(3) [Extension of trust] Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(*a*) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and

(*b*) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 (as at December 13, 2007)

67. (1) [Property of bankrupt] The property of a bankrupt divisible among his creditors shall not comprise

(*a*) property held by the bankrupt in trust for any other person,

(*b*) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides, or

(*b*.1) such goods and services tax credit payments and prescribed payments relating to the essential needs of an individual as are made in prescribed circumstances and are not property referred to in paragraph (*a*) or (*b*),

but it shall comprise

(*c*) all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge, and

(*d*) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

(2) [Deemed trusts] Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in

Digitized by Google

trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.

(3) [Exceptions] Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(*a*) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(*b*) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

86. (1) [Status of Crown claims] In relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, in this section and in section 87 called a "workers' compensation body", rank as unsecured claims.

. . .

(3) [Exceptions] Subsection (1) does not affect the operation of

(*a*) subsections 224(1.2) and (1.3) of the *Income Tax Act*;

(*b*) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts; or

(*c*) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

Digitized by Google

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

Appeal allowed with costs, ABELLA J. *dissenting.*

Solicitors for the appellant: Fraser Milner Casgrain, Vancouver.

Solicitor for the respondent: Attorney General of Canada, Vancouver.

Royal Bank of Canada *v.* Sparrow Electric Corp., [1997] 1 S.C.R. 411, Crown's Rank vs-a-vs Bank's Security on Corporate Assets

Her Majesty The Queen *Appellant*

v.

Royal Bank of Canada *Respondent*

Indexed as: Royal Bank of Canada *v.* Sparrow Electric Corp.

File No.: 24713.

1996: June 19; 1997: February 27.

Present: La Forest, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

on appeal from the court of appeal for alberta

Crown -- Priority -- Employee source deductions not paid by company in receivership -- Company's inventory subject to fixed charge and to Bank Act security -- Whether bank had priority to proceeds of sale of inventory over statutory trust in favour of Her Majesty -- Bank Act, S.C. 1991, c. 46, s. 427 -- Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.), ss. 153, 227(4), (5) -- Personal Property Security Act, S.A. 1988, c. P-4.05, s. 28(1).

Banks and banking operations -- Security -- Company's inventory subject to fixed charge and to Bank Act security -- Employee source deductions not paid by company in receivership -- Whether bank had priority to proceeds of sale of inventory over statutory trust in favour of Her Majesty -- Bank Act, S.C. 1991, c. 46, s. 427 -- Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.), ss. 153, 227(4), (5) -- Personal Property Security Act, S.A. 1988, c. P-4.05, s. 28(1).

The Royal Bank secured a loan made to Sparrow Electric with a general security agreement (GSA) covering Sparrow's present and after-acquired property and with *Bank Act* security (BAS) created by an assignment of inventory under s. 427 of the *Bank Act*. When Sparrow experienced financial difficulties, a standstill agreement was executed. This agreement allowed Sparrow to continue its business but permitted the bank, on default, to appoint a receiver and enforce its security. A receiver was appointed in November 1992 at which time it was discovered that Sparrow had not been remitting its payroll deductions as required by s. 153 of the *Income Tax Act* (*ITA*). It is probable that these defaults had occurred in 1992. In January 1993, the receiver received court permission to sell Sparrow's assets. An amount from the proceeds of sale equivalent to that owing the federal government was ordered to be held in trust pending resolution as to entitlement. The bank claimed priority based on its GSA and its BAS, which entitled it to inventory proceeds. The federal government's claim was based on the s. 227 *ITA* deemed trust provisions, which created a deemed statutory trust in the moneys deducted from wages but not remitted to Her Majesty.

Digitized by Google

On the first application to determine priority, the deemed trust was held to take priority over the GSA. On a subsequent application by the bank for a determination of whether its BAS took priority over the deemed trust, the Court of Queen's Bench found that the deemed trust took priority. The Court of Appeal found that the BAS took priority over the deemed trust. At issue here is whether the s. 227(5) *ITA* deemed trust takes priority over a previously executed GSA and a previously executed BAS with respect to the proceeds of the sale of the inventory.

Held (La Forest, Gonthier and Cory JJ. dissenting): The appeal should be dismissed.

(1) *Section 227(4) and (5) of the Income Tax Act*

Although the employer, at the point of withholding, becomes the trustee of a fund which is in law the property of its employee, s. 227(4) *ITA* has the effect of making Her Majesty the beneficiary under that trust. A conceptual difficulty arises when the tax debtor fails to set aside moneys which are to be remitted. The subject of Her Majesty's beneficial interest at that point becomes intermingled with the general assets of the tax debtor and Her Majesty's claim then becomes that of a beneficiary under a non-existent trust. Subsections (4) and (5) of s. 227 resolve this conceptual dilemma by clearly and unambiguously rendering amounts unremitted as held in trust for Her Majesty. In particular, s. 227(5) is designed to, upon liquidation, assignment, receivership or bankruptcy, seek out and attach Her Majesty's beneficial interest to property of the debtor which is in existence at that time. The trust is not a real trust, as its subject matter cannot be identified from the date of the trust's creation. However, s. 227(5) has the effect of revitalizing the trust whose subject matter has lost all identity. This identification of the subject matter of the trust therefore occurs *ex post facto*. Her Majesty has a statutory right to access whatever assets the employer then has, and may realize from those assets the original trust debt. This interpretation is consistent with the scheme of distribution under the *Bankruptcy and Insolvency Act*.

The s. 227(5) deemed trust operates to Her Majesty's benefit in a secondary manner. Under it, Her Majesty's interest can attach retroactively to disputed collateral if the competing security interest has attached after the deductions giving rise to Her Majesty's claim in fact occurred. Conceptually, the s. 227(5) deemed trust allows that claim to go back in time and attach its outstanding s. 227(4) interest to the collateral before that collateral became subject to a fixed charge. The same result occurs when a statutory lien attaches prior to the mortgaging of disputed collateral. Here, the deductions of tax from the employees' pay cheques occurred after the attachment of the bank's fixed charge to the inventory, so this second aspect of s. 227(5)'s operation did not arise.

The mechanism of s. 227(5) cannot accurately be described as a means of "tracing"; indeed, this subsection is antithetical to tracing in the traditional sense in that it requires no link at all between the subject matter of the trust and the fund or asset into which the subject matter is being traced. Section 227(5) is more accurately described as a "relaxation of the equitable tracing rules".

Section 227(5) does not permit Her Majesty to attach Her beneficial interest to property which, at the time of liquidation, assignment, receivership or bankruptcy, in law belongs to a party other than the tax debtor. Subsections (4) and (5) of s. 227 are manifestly directed towards the property of the tax debtor, and it would be contrary to well-established authority to stretch the interpretation of s. 227(5) to permit the expropriation of the property of third parties who are not specifically mentioned in the

Digitized by Google

statute.

Therefore, the proper analysis in determining whether Her Majesty is entitled to priority pursuant to these subsections must utilize principles of property law. The nature of the interests competing with those of Her Majesty must be scrutinized in order to determine whether and to what extent such interests have title in the disputed fund. If it is found that legal title in the collateral is in the bank, and not Sparrow, Her Majesty's deemed trust could only attach to Sparrow's equity of redemption.

The "statutory trust" approach can be distinguished from other legislative methods, such as an explicit "Crown priority" provision, used to secure an interest to unremitted payroll deductions. The application of such a provision to a priority competition can proceed without regard to the quality of the "security interest" which competes with Her Majesty's claim. Such a provision simply transfers title in the collateral to Her Majesty regardless of whose interest may compete with it, so long as its requirements are met.

(2) *Characterization of the Bank's Interests*

The bank's interest in Sparrow's inventory must be characterized as either a floating charge or a fixed and specific charge. A specific charge is one that, without more, fastens on ascertained and definite property or property capable of being ascertained and defined. A floating charge floats with the property which it is intended to affect until it crystallizes. Crystallization occurs upon the default of the debtor and transforms the interest into a fixed and specific charge over the inventory. The critical significance of the characterizing of an interest as being fixed or floating is that it describes the extent to which a creditor can be said to have a proprietary interest in the collateral. During the period in which a charge over inventory is floating, the creditor possesses no legal title to that collateral and a statutory trust or lien attaching during this time will attach to the debtor's interest and take priority over a subsequently crystallized floating charge. A security interest characterized as a fixed and specific charge, however, will take priority over a subsequent statutory lien or charge because all that the lien can attach to is the debtor's equity of redemption in the collateral.

Common law principles did not alter the effect that legislation may have on the characterization of security interests. Here, the Alberta *Personal Property Security Act* (*PPSA*) and the *Bank Act* are determinative of the characterization of the bank's GSA and BAS, respectively. The *PPSA* explicitly removes statutory trusts from its operation and accordingly does not govern the priority competition between a statutory trust and a security interest. The Act's effect, however, fundamentally changes the characterization of security interests. Generally speaking, absent an express intention to the contrary, a security interest in all present and after-acquired personal property will attach when that agreement is executed by the parties. Once attachment has occurred, the GSA becomes in law a fixed and specific charge over the collateral. For these reasons, the GSA held by the respondent bank must be characterized as a fixed and specific charge with a licence to deal with the inventory that arose because of the bank's granting Sparrow permission to sell the encumbered inventory. The fixed charge attached on the agreement's execution.

Similarly, security taken under the *Bank Act* is in the nature of a fixed and specific charge. The concept of the fixed charge is correlative to the notion of a

Digitized by Google

creditor's having legal proprietary rights in the collateral. It is misleading to suggest that s. 427 security is in the nature of a floating charge because the bank effectively acquires legal title. Unlike a floating charge which may apply to all property of a specified kind held by the borrower from time to time but does not affix itself specifically upon any particular item of property until it crystallizes upon default by the borrower, s. 427 security is a fixed charge on each item of assigned property held from time to time whether or not the loan is in default. This gives a bank significantly greater rights than it would hold under a floating charge debenture on inventory. For this reason, the security interest of the bank in the form of BAS should be characterized as a fixed and specific charge with a licence to sell the inventory.

The traditional concept of the fixed charge seems to be at odds with the notion of having a proprietary right over collateral such as after-acquired inventory which is not yet in existence at the time the security agreement is executed. A fixed charge over all present and future inventory represents a proprietary interest over a dynamic collective of present and future assets. The conception of this form of charge must change to meet the modern realities of commercial law and in particular the legislative provisions which have been brought to bear in this appeal. In effect, the fixed and specific charge gives to the secured creditor the title (subject to the debtor's equitable right of redemption) to the present inventory of the debtor, as well as the after-acquired inventory of the debtor. In this way, the secured creditor becomes the legal owner of inventory as it comes into possession of the debtor.

Where a secured creditor holds a fixed charge over a debtor's inventory, that charge will have the effect of ensuring the creditor has legal title to any and all inventory subject to the charge at any given time, subject to the caveat (not operative here) that no outstanding statutory payroll deductions had in fact been made prior to the attachment of the fixed charge. Here, the inventory which was subject to the liquidation sale belonged in law to the respondent bank: both under its GSA and its BAS the bank held a fixed charge over Sparrow's inventory. Her Majesty's beneficial interest accordingly could only attach, before its sale, to Sparrow's equity of redemption in the property.

(3) *Licence Theory*

Per Sopinka, McLachlin, Iacobucci and Major JJ.: The security interests that the respondent has under the *Bank Act* and the *PPSA* take priority over the deemed trust that arises in favour of Her Majesty by operation of s. 227(4) *ITA.* While the former interests are subject to a licence to sell, that licence is not nearly so broad as to encompass the satisfaction of income tax obligations. A licence to sell inventory authorizes at most only the satisfaction of obligations that are immediately incidental to an actual sale of the inventory.

The licence theory holds that a bank's security interest in a debtor's inventory, whether fixed and specific, is subject to a licence in the debtor to deal with that inventory in the ordinary course of business. The point is that the bank's claim to the inventory must as a consequence give way to any debts incurred in the ordinary course of business. In theory, a creditor who has granted a licence to sell inventory has thereby consented to his security interest's being subject to other obligations that may arise "in the ordinary course of business". The licence is thus supposed to afford evidence of the respondent's intention to take less than an entire security interest in the inventory.

The licence affords no such evidence. The potential sale of the inventory

Digitized by Google

does not amount to an actual limitation of the security interest. A great difference exists between saying, on the one hand, that if a debtor sells inventory and applies the proceeds to a debt to a third party, then the third party takes the proceeds free of any security interest and saying, on the other hand, that because a third party could take the proceeds free of any security interest, no security interest exists in the proceeds as against that third party. A licence to sell inventory in the ordinary course of business is a condition of the former kind. The consequent (defeasance of the security interest) follows only if the antecedent (sale of the inventory and application of proceeds to an obligation to a third party) is satisfied. The security interest in the inventory disappears only if the debtor actually sells the inventory and applies the proceeds to a debt to a third party.

In accordance with s. 28(1) *PPSA*, the result of a sale of inventory is to give the purchaser an unencumbered interest in the inventory and the licensor a continuing security interest in the proceeds of the sale. Only if the debtor subsequently uses the proceeds to satisfy an obligation to a third party will the proceeds be removed from the scope of the licensor's security interest in them. Accordingly, a security agreement with a licence to sell creates a defeasible interest; but the event of defeasance is the actual sale of the inventory and the actual application of the proceeds against an obligation to a third party.

By itself, s. 28(1) *PPSA* does not necessarily compel rejection of the broad interpretation of the licence to sell. However, the maxim *expressio unius est exclusio alterius* is appropriately invoked here to complete the argument. The statute prescribes certain consequences for the security interest that follow a dealing with inventory, and in particular, it prescribes the defeasance of the interest if the debtor actually sells the inventory and applies the proceeds to an obligation to a third party. Significantly, the statute does not contemplate a defeasance on the happening of any other event. The statute occupies the field and crowds out other possible interpretations of the licence.

Because the inventory in question was not sold pursuant to the licence, here the licence can have had no effect on the respondent's security interest. What the debtor might have done with the licence does not matter. If it were otherwise, the licence to sell inventory would entirely eviscerate the respondent's GSA.

The argument might be made that the deemed trust works by deeming an actual sale of the inventory to have been made. It this were correct, then it would not matter that the inventory was not actually sold pursuant to the licence. However, the deeming is not a mechanism for undoing an existing security interest, but rather a device for going back in time and seeking out an asset that was not, at the moment the income taxes came due, subject to any competing security interest. The deemed trust provision cannot be effective unless it is first determined that there is some unencumbered asset out of which the trust may be deemed. In this case the inventory was encumbered by the GSA.

The debtor's covenant in the GSA to pay all taxes was not part of the licence and was merely a covenant to obey the law. It adds nothing to s. 153(1) *ITA* and does not prescribe the outcome of a priority contest.

A number of policy considerations support this conclusion. Judicial innovation in this field risks legal uncertainty. Inventory financiers would have to provide against the risk that their security interest might be defeated by some rival claim. There is also a real possibility that recognition of a broad licence theory would obliterate the *PPSA* charge against inventory. If Parliament wishes to do so, it may

Digitized by Google

step in and assign absolute priority to the deemed trust. But in the absence of clear statutory language to that effect, the bank's GSA must prevail.

Per La Forest, Gonthier and Cory JJ. (dissenting): The critical issue here was the scope of the contractual licence. In particular, if the bank's consent included the right to sell the inventory in order to pay wages, then that consent by necessity included the right to sell inventory to remit payroll deductions. In such a situation, Her Majesty's interest would be able to attach to the proceeds of the inventory and so take priority over the bank's interest.

The licence theory operates, in the context of the statutory scheme at issue here, as an exception to the general rule that at the time of "liquidation, assignment, receivership or bankruptcy" Her Majesty's interest cannot attach to property which is at that time the property of a secured creditor. Where a secured creditor has consented to the use of its collateral when deductions are made in order to pay the statutory deductions which are the object of a deemed trust, that creditor has bound itself by the statutory requirements relating to those deductions. Here, therefore, the wage deductions at issue were made at a time when the bank had permitted the sale of inventory in order to pay wages (and thus wage deductions), and the bank's inventory existent at the time of receivership can accordingly be attached under s. 227(5).

The critical factor in the "licence to sell" argument is the permission which must be found to have been granted with respect to the usage of the proceeds of the disputed collateral. While licences are often expressed in terms of a "right to sell in the ordinary course of business", this permission is made with respect to the usage of proceeds, which is the proper focus of the inquiry, and not necessarily the circumstances of sale. Here, Sparrow was permitted to sell its inventory in the ordinary course of its business and "use" the proceeds generated therefrom.

The licence to sell inventory in the ordinary course of business in this case necessarily included a licence to sell inventory to pay wages, and remit wage deductions, in the course of Sparrow's business. Where, as here, the secured party has security over the majority of the assets of the debtor, the security interest over the inventory must permit the debtor to sell the inventory and put it to the general use of its business, including towards the payment of wages. The scope of the licence can be ascertained either from the express terms of the security agreement or from the nature of the agreement and the conduct of the parties. The licence here was to sell inventory in the "ordinary course of [Sparrow's] business . . . and use [the proceeds]" which renders it of such a quality as to include a right to use the proceeds to pay wages. A licence to sell inventory may in certain circumstances be circumscribed so as not to include a right to use the proceeds to pay wages.

The true test of whether the licence to sell inventory includes the right to pay wages is a matter of interpreting the contractual arrangement between the parties. The focus is not so much on the circumstances of the selling of inventory, but rather the permitted usage of the proceeds of inventory. Where the licence has a limited scope, that licence may not include the right to use proceeds to pay wages. However, the expression of a limited use for proceeds of inventory cannot prevail if the arrangement between the parties is such as to allow, in practice, the debtor to use the inventory proceeds in the course of its business. The test should be whether the debtor had the freedom to use these funds in the ordinary course of business as opposed to being under an obligation to remit them to the secured party.

Digitized by Google

The GSA contained an express licence permitting Sparrow to sell inventory in the course of its business and use the proceeds available; the BAS contained an implied licence to this effect. While it is true that the GSA contained a trust proceeds clause, this clause cannot have the effect of limiting the scope of the licence where the real arrangement between the parties was, as expressly stated, that Sparrow could use the proceeds of inventory in the course of its business. The bank in this case was not a small inventory financier who required Sparrow to remit proceeds of inventory to it immediately. To the contrary, the bank was a large scale lender who permitted Sparrow to use inventory sales to maintain the viability of its enterprise. Under the licence at issue here, the bank permitted Sparrow to sell inventory to pay wages and, necessarily, payroll deduction obligations.

The appellant's s. 227(5) deemed trust must take priority over the bank's security interests in the disputed collateral. The trust fund representing the deducted amounts, while without identified subject matter from the date of its inception, is capable of identifying property subject to that trust *ex post facto*. This result is not precluded with respect to the BAS by virtue of s. 428(1) of the *Bank Act*. Although s. 428(1) secures the respondent bank's proprietary right to the disputed collateral, the bank nevertheless consented to the divestment of this interest. Such a waiver of priority renders s. 428(1) of no assistance to the bank.

The licence theory, in addition to providing certainty in disputes between consensual and non-consensual security interests, achieves fairness in commercial law. In essence, the bank is willing to accept the benefits of Sparrow's non-payment of statutory deductions and has permitted the use of its collateral to pay these deductions, but refuses to accept the burden of Sparrow's unlawful action at the time of its receivership. It should be the policy of the law that the respondent bank be held accountable for Sparrow's outstanding statutory obligations. The licence theory ensures that in appropriate circumstances this result will obtain.

The licence theory does not go so far as to mean that every subsequent claim should prevail over the GSA because every rival claim might have to be satisfied out of the proceeds of a hypothetical sale of the inventory. The consent to pay wages is a necessary but not sufficient condition. It did not *simpliciter* lead to the conclusion that Her Majesty's interest must prevail. What is significant is that the bank consented to payment of wages, including deductions, out of inventory which, at the time of the deductions and upon actual payment of wages, were deemed by statute to be taken out of the estate of the debtor. The unique nature of the statutory provisions applicable to wage deductions, and the bank's consent thereto, are integral to the success of the s. 227(5) claim in the case at bar. In this way, the licence theory is circumscribed in its ability to defeat prior secured interests.

In addition, the licence theory as applied here is not inimical to the integrity of commercial law. It operates narrowly, in conjunction with unique statutory provisions, so as to actualize legally performed obligations. It does not create uncertainty in commercial transactions.

Cases Cited

By Iacobucci J.

Referred to: *R. in Right of B.C. v. F.B.D.B.*, 1987 CanLII 156 (BC CA), [1988] 1 W.W.R. 1; *Alberta (Treasury Branches) v. M.N.R.; Toronto-Dominion Bank v. M.N.R.*, 1996 CanLII 244 (SCC), [1996] 1 S.C.R. 963.

By Gonthier J. (dissenting)

Digitized by Google

Royal Bank v. Sparrow Electric Corp., Alberta Court of Queen's Bench, Edmonton, November 24, 1993, unreported; *R. in Right of B.C. v. F.B.D.B.*, 1987 CanLII 156 (BC CA), [1988] 1 W.W.R. 1; *Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd.*, 1980 CanLII 186 (SCC), [1980] 1 S.C.R. 1182; *Bank of Montreal v. Hall*, 1990 CanLII 157 (SCC), [1990] 1 S.C.R. 121; *Board of Industrial Relations v. Avco Financial Services Realty Ltd.*, 1979 CanLII 230 (SCC), [1979] 2 S.C.R. 699; *Royal Bank of Canada v. G.M. Homes Inc.* (1984), 52 C.B.R. (N.S.) 244; *Roynat Inc. v. Ja-Sha Trucking & Leasing Ltd.*, 1992 CanLII 2767 (MB CA), [1992] 2 W.W.R. 641; *Ford Motor Co. of Canada Ltd. v. Manning Mercury Sales Ltd. (Trustee of)*, 1994 CanLII 4852 (SK QB), [1994] 6 W.W.R. 372; *National Bank of Canada v. Director of Employment Standards* (1986), 5 P.P.S.A.C. 326; *Abraham v. Coopers & Lybrand Ltd.* reflex, (1993), 13 O.R. (3d) 649; *Armstrong v. Coopers & Lybrand Ltd.* reflex, (1986), 53 O.R. (2d) 468, aff'd reflex, (1987), 61 O.R. (2d) 129, leave to appeal refused, *sub nom. National Bank of Canada v. Armstrong*, [1988] 1 S.C.R. xii; *Manitoba (Minister of Labour) v. Omega Autobody Ltd. (Receiver of)* 1989 CanLII 178 (MB CA), (1989), 59 D.L.R. (4th) 34; *Re Deslauriers Construction Products Ltd.*, [1970] 3 O.R. 599; *Pembina on the Red Development Corp. Ltd. v. Triman Industries Ltd.* 1991 CanLII 2699 (MB CA), (1991), 85 D.L.R. (4th) 29; *Alberta (Treasury Branches) v. M.N.R.; Toronto-Dominion Bank v. M.N.R.*, 1996 CanLII 244 (SCC), [1996] 1 S.C.R. 963; *Friesen v. Canada*, 1995 CanLII 62 (SCC), [1995] 3 S.C.R. 103; *Illingworth v. Houldsworth*, [1904] A.C. 355; *Re Urman* (1983), 44 O.R. (2d) 248; *North Sky Trading Inc. (Bankrupt), Re* 1994 CanLII 8986 (AB QB), (1994), 158 A.R. 117; *Royal Bank of Canada v. Workmen's Compensation Board of Nova Scotia*, 1936 CanLII 39 (SCC), [1936] S.C.R. 560; *C.I.B.C. v. Klymchuk* reflex, (1990), 74 Alta. L.R. (2d) 232.

Statutes and Regulations Cited

Bank Act, R.S.C. 1927, c. 12, s. 88.
Bank Act, R.S.C., 1985, c. B-1, ss. 2(1), 178, 179(1), 185(2), 186(2).
Bank Act, S.C. 1991, c. 46, ss. 425(1) "goods, wares and merchandise", 427(1), (2), 428(1), 434(2), 435(2).
Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3, s. 67 [am. 1992, c. 27, s. 33].
Canada Pension Plan, R.S.C. 1970, c. C-5.
Canada Pension Plan, R.S.C., 1985, c. C-8, s. 23(3), (4).

Canada Pension Plan, S.C. 1964-65, c. 51, s. 24(3), (4).
Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.), ss. 153(1)(*a*), (3), 224(1.2) [ad. 1987, c. 46, s. 66; am. 1990 c. 34, s.1], (1.3) [ad. 1987, c. 46, s.66], 227(4), (5).
Personal Property Security Act, S.A. 1988, c. P-4.05, ss. 4(a), 10(1), 12(1), 13(1), 28(1).
Personal Property Security Act, S.B.C. 1989, c. 36.
Personal Property Security Act, R.S.O. 1990, c. P.10.

Unemployment Insurance Act, 1971, S.C. 1970-71-72, c. 48.
Unemployment Insurance Act, R.S.C., 1985, c. U-1, s. 57(2), (3).
Workmen's Compensation Act, R.S.N.S. 1923, c. 129, s. 79(2).

Authors Cited

Cuming, Ronald C. C. "Commercial Law -- Floating Charges and Fixed Charges of After-Acquired Property: *The Queen in the Right of British Columbia* v. *Federal Business Development Bank*" (1988), 67 *Can. Bar Rev.* 506.

Digitized by Google

Cuming, Ronald C. C., and Roderick J. Wood. *Alberta Personal Property Security Act Handbook*, 2nd ed. Toronto: Carswell, 1993.
Cuming, Ronald C. C., and Roderick J. Wood. *British Columbia Personal Property Security Handbook*, 2nd ed. Toronto: Carswell, 1993.
Moull, William D. "Security Under Sections 177 and 178 of the Bank Act" (1986), 65 *Can. Bar Rev.* 242.
Waters, D. W. M. *Law of Trusts in Canada*, 2nd ed. Toronto: Carswell, 1984.
Wood, Roderick J. "The Floating Charge in Canada" (1989), 27 *Alta. L. Rev.* 191.
Wood, Roderick J. "Revenue Canada's Deemed Trust Extends Its Tentacles: *Royal Bank of Canada v. Sparrow Electric Corp.*" (1995), 10 *B.F.L.R.* 429.
Wood, Roderick J., and Michael I. Wylie. "Non-Consensual Security Interests in Personal Property" (1992), 30 *Alta. L. Rev.* 1055.
Ziegel, Jacob S. "Symposium: Recent and Prospective Developments in the Personal Property Security Law Area" (1985), 10 *Can. Bus. L.J.* 131.
Ziegel, Jacob S., Benjamin Geva and R. C. C. Cuming. *Commercial and Consumer Transactions*, Rev. 2nd ed. Toronto: Emond Montgomery, 1990.

APPEAL from a judgment of the Alberta Court of Appeal reflex, (1995), 28 Alta. L.R. (3d) 153, 165 A.R. 132, 89 W.A.C. 132, [1995] 6 W.W.R. 718, 33 C.B.R. (3d) 34, 10 P.P.S.A.C. (2d) 1, allowing an appeal from judgments of Agrios J. 1993 CanLII 7257 (AB QB), (1993), 19 Alta. L.R. (3d) 183, 10 P.P.S.A.C. (2d) 1, at p. 3, [1995] 1 C.T.C. 101, and 1994 CanLII 8992 (AB QB), (1994), 21 Alta. L. R. (3d) 275, 156 A.R. 187, [1994] 9 W.W.R. 338. Appeal dismissed, La Forest, Gonthier and Cory JJ. dissenting.

Edward R. Sojonky, *Q.C.*, and *Michael J. Lema*, for the appellant.

Ray C. Rutman, for the respondent.

The reasons of La Forest, Gonthier and Cory JJ. were delivered by

1 GONTHIER J. (dissenting) -- This case involves a determination of priority between a deemed statutory trust and various security instruments in regard to the proceeds of a liquidation sale of inventory. In particular, the appeal requires a determination of the priority status of Her Majesty's deemed trust under s. 227(4) and (5) of the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) (hereinafter "*ITA*"), these provisions becoming operative in this case because of the misappropriation of unremitted payroll deductions lawfully belonging to Her Majesty. In competition to this claim, the Royal Bank of Canada asserts priority under both a general security agreement and an assignment of inventory under s. 427 of the *Bank Act*, S.C. 1991, c. 46.

I - Facts

2 The debtor, Sparrow Electric Corporation (hereinafter "Sparrow"), carried on business as an electrical contractor in Alberta. The enterprise was of a substantial size, employing 200 to 300 employees in its business operations. To finance these operations, Sparrow borrowed heavily from the respondent Royal Bank of Canada (hereinafter the "bank"). The bank secured Sparrow's borrowing with various forms of security, covering most of the assets utilized in Sparrow's business. Of particular relevance to this appeal, however, the bank held a general security agreement over all of Sparrow's present and after-acquired personal property, as well as an assignment of inventory under s. 178 (now s. 427) of the *Bank Act*, R.S.C., 1985, c. B-1.

3 In 1992, it became apparent to the bank that Sparrow was having financial

Digitized by Google

difficulties. On two occasions, August 5, 1992 and September 30, 1992, the bank wrote to Sparrow advising its management that Sparrow was in default on its loan obligations. On October 16, 1992, in order to give Sparrow some time to correct its default situation, the bank and Sparrow entered into a "Standstill Agreement". This agreement permitted Sparrow to continue carrying on business under the proviso that, should Sparrow's position fail to improve, the bank would be entitled to appoint a receiver and enforce its security.

4 Sparrow's financial position did not improve. For this reason, on November 19, 1992, the bank appointed a receiver to take over Sparrow's business, and on December 8, 1992, the bank successfully petitioned Sparrow into bankruptcy. The order appointing the receiver empowered the receiver to, among other things, carry on Sparrow's business as it deemed necessary. The receiver did in fact carry on Sparrow's business for some time, employing approximately 200 employees in order to fulfil Sparrow's outstanding contractual obligations. These employees were terminated effective January 15, 1993.

5 In addition to the failure to pay the loan obligations which inevitably led to its bankruptcy and receivership, Sparrow had failed to honour other obligations in its attempt to remain in business. In particular, Sparrow failed to remit payroll deductions as required by s. 153 *ITA*. While the record does not disclose the exact date of these failures, it appears that the first instance of non-remittance could have occurred no later than August 7, 1992. Having regard to the amount of payroll deductions outstanding as of August 7, and to the average number of Sparrow's employees on the payroll, we can conclude that the actual payroll deductions which give rise to Her Majesty's claim in all likelihood occurred some time in the year 1992. In any event, by the time of its receivership, in addition to substantial amounts outstanding to the bank, Sparrow was indebted to the appellant ("Her Majesty") in the amount of $625,990.86 for unremitted income tax payroll deductions.

6 On January 12, 1993, the receiver applied to the Alberta Court of Queen's Bench for authorization to sell various Sparrow assets. Part of the pool of assets to be sold included Sparrow's inventory which is the subject of this appeal. On January 15, 1993, Wilson J. authorized both the sale of the assets and remittance of its proceeds to the bank in partial repayment of its claims, but ordered that an amount equal to Her Majesty's claim for unremitted payroll deductions be held in trust pending a resolution as to the entitlement to this portion of the proceeds. At some later date, the assets were in fact sold, and the amount of $625,990.86 set aside. It has been held in judicial proceedings that the amount held is constituted entirely of proceeds from inventory (*Royal Bank v. Sparrow Electric Corp.*, Alberta Court of Queen's Bench, Edmonton, November 24, 1993, unreported). That ruling is not at issue in this appeal.

7 At present, the fund being held and constituting the proceeds of inventory is sufficient to satisfy either Her Majesty's claim, or part of the outstanding claims owing to the bank. The determination of priority in this appeal will therefore be determinative as to which party is entitled to the entirety of the disputed fund.

II - <u>The Competing Interests</u>

8 For convenience, I will at the outset outline the claims of the bank and of

Digitized by Google

Her Majesty which are advanced as being entitled to the proceeds of the inventory.

(A) *The Bank*

9 The respondent bank advances two distinct security instruments in order to establish its claim to the disputed fund. First, the bank argues that its general security agreement ("GSA"), executed on February 25, 1992, and perfected pursuant to the Alberta *Personal Property Security Act*, S.A. 1988, c. P-4.05 ("*PPSA*"), is entitled to priority. By this agreement, Sparrow assigned to the bank a security interest in all of its present and after-acquired personal property, including "all inventory of whatever kind and wherever situate" (para. 1(a)(i)). In addition, para. 7 of that agreement provided that proceeds of the collateral received by Sparrow would be received and held in trust for the bank. Of significance to this appeal, however, para. 4 of the GSA contained two express covenants, providing:

> So long as this Security Agreement remains in effect Debtor covenants and agrees:
>
> (a) to defend the Collateral against the claims and demands of all other parties claiming the same or an interest therein; to keep the Collateral free from all Encumbrances ...; provided always that, until default, Debtor may, in the ordinary course of Debtor's business, sell or lease inventory and, subject to Clause 7 hereof, use Money available to Debtor,
>
> ...
>
> (e) to pay all taxes, rates, levies, assessments and other charges of every nature which may be lawfully levied, assessed or imposed against or in respect of Debtor or Collateral as and when the same become due and payable; [Emphasis added.]

Additionally, under the credit facilities agreement between Sparrow and the bank, dated January 22, 1992, Sparrow covenanted as follows:

> (3) it will promptly pay when due all business, income and other taxes properly levied on its operations and property and remit all statutory employee deductions when due; [Emphasis added.]

10 The bank's second claim is that its *Bank Act* security ("BAS") entitles it to priority to the inventory proceeds. That security instrument was executed on two occasions, January 29, 1990 and December 12, 1990. Under the General Assignment, Sparrow assigned to the bank, *inter alia*, "all goods inventory, [and] stock-in-trade" as continuing security for the payment of loans to the bank. In addition, as part of the Agreement as to Loans and Advances, Sparrow granted security in both its inventory and its proceeds. At the time these instruments were executed, s. 178 of the *Bank Act*, R.S.C., 1985, c. B-1, was in effect. However, on June 1, 1992, that Act was replaced with the *Bank Act*, S.C. 1991, c. 46. The relevant portions of these two acts are identical. However, as the facts giving rise to this case occurred while the latter Act was in force, I will refer to the provisions of this new Act for the purposes of this appeal. As such, the bank's claim for security under its BAS is grounded in s. 427 (formerly s. 178) of the *Bank Act*, which provides:

> **427.** (1) A bank may lend money and make advances
>
> (*a*) to any wholesale or retail purchaser or shipper of, or dealer in, products of agriculture, products of aquaculture, products of the forest, products of the quarry and mine, products of the sea, lakes and rivers or goods, wares

Digitized by Google

and merchandise, manufactured or otherwise, on the security of such products or goods, wares and merchandise and of goods, wares and merchandise used in or procured for the packing of such products or goods, wares and merchandise,

...

(2) Delivery of a document giving security on property to a bank under the authority of this section vests in the bank in respect of the property therein described

(*a*) of which the person giving security is the owner at the time of the delivery of the document, or

(*b*) of which that person becomes the owner at any time thereafter before the release of the security by the bank, whether or not the property is in existence at the time of the delivery,

the following rights and powers, namely,

(*c*) if the property is property on which security is given under paragraph (1)(*a*), (*b*), (*g*), (*h*), (i), (*j*) or (*o*), under paragraph (1)(*c*) or (*m*) consisting of aquacultural implements, under paragraph (1)(*d*) or (*n*) consisting of agricultural implements or under paragraph (1)(*p*) consisting of forestry implements, the same rights and powers as if the bank had acquired a warehouse receipt or bill of lading in which that property was described, ...

...

and all such property in respect of which such rights and powers are vested in the bank under this section is for the purposes of this Act property covered by the security. [Emphasis added.]

Section 425(1) (formerly contained within s. 2(1)) provides that:

425. (1) ...

"goods, wares and merchandise" includes products of agriculture, products of aquaculture, products of the forest, products of the quarry and mine, products of the sea, lakes and rivers, and all other articles of commerce; [Emphasis added.]

And s. 435(2) (formerly s. 186(2)) provides:

435. ...

(2) Any warehouse receipt or bill of lading acquired by a bank under subsection (1) vests in the bank, from the date of the acquisition thereof,

(*a*) all the right and title to the warehouse receipt or bill of lading and to the goods, wares and merchandise covered thereby of the previous holder or owner thereof; and

(*b*) all the right and title to the goods, wares and merchandise mentioned therein of the person from whom the goods, wares and merchandise were received or acquired by the bank, if the warehouse receipt or bill of lading is made directly in favour of the bank, instead of to the previous holder or owner of the goods, wares and merchandise.

11 In addition, the respondent directed this Court's attention to s. 428(1) (formerly s. 179(1)), which it was submitted affected the priority position of the bank's BAS:

428. (1) All the rights and powers of a bank in respect of the property mentioned in or covered by a warehouse receipt or bill of lading acquired and held by the bank, and the rights and powers of the bank in respect of the

Digitized by Google

property covered by a security given to the bank under section 427 that are the same as if the bank had acquired a warehouse receipt or bill of lading in which that property was described, have, subject to subsection 427(4) and subsections (3) to (6) of this section, priority over all rights subsequently acquired in, on or in respect of that property, and also over the claim of any unpaid vendor. [Emphasis added.]

Finally, s. 434(2) (formerly s. 185(2)) provides:

434. ...

(2) Nothing in any charter, Act or law shall be construed as ever having been intended to prevent or as preventing a bank from acquiring and holding an absolute title to and in any mortgaged or hypothecated real property, whatever the value thereof, or from exercising or acting on any power of sale contained in any mortgage given to or held by the bank, authorizing or enabling it to sell or convey any property so mortgaged. [Emphasis added.]

12 While no provision in the BAS explicitly permitted Sparrow to sell its inventory, the respondent bank has conceded that such a licence existed, as a practical matter, as between the parties. In any event, I would have thought that once a licence to sell inventory had been granted under the GSA, it would be impossible to grant a more restricted licence to deal with the same collateral under the provisions of the BAS.

(B) *Her Majesty's Interest*

13 Her Majesty's claim arises under the s. 227 deemed trust provisions of the *ITA*. Section 153(1)(*a*) of that Act requires employers to withhold from the pay cheques of its employees and remit to the Receiver General amounts on account of the payee's tax for the year:

153. (1) Every person paying at any time in a taxation year

(*a*) salary or wages or other remuneration,

...

shall deduct or withhold therefrom such amount as may be determined in accordance with prescribed rules and shall, at such time as may be prescribed, remit that amount to the Receiver General on account of the payee's tax for the year.... [Emphasis added.]

Such amounts are deemed to be held in trust for Her Majesty by virtue of s. 227(4) and (5) *ITA*, which provide:

227. ...

(4) Every person who deducts or withholds any amount under this Act shall be deemed to hold the amount so deducted or withheld in trust for Her Majesty.

(5) Notwithstanding any provision of the *Bankruptcy Act*, in the event of any liquidation, assignment, receivership or bankruptcy of or by a person, an amount equal to any amount

(*a*) deemed by subsection (4) to be held in trust for Her Majesty, ...

...

shall be deemed to be separate from and form no part of the estate in liquidation, assignment, receivership or bankruptcy, whether or not that amount has in fact been kept separate and apart from the person's own moneys or from the assets of the estate.

As of June 15, 1994, these provisions have been repealed and replaced by a revised

Digitized by Google

s. 227(4): S.C. 1994, c. 21, s. 104(1). However, as this amendment was not effective at the time the facts of this appeal arose, I decline to comment on the application of the new s. 227(4) to this case.

III - Judgments of the Courts Below

Alberta Court of Queen's Bench 1993 CanLII 7257 (AB QB), (1993), 19 Alta. L.R. (3d) 183

14 The first application brought to determine the priority over the inventory proceeds involved the competing claims under the GSA advanced by the bank, and Her Majesty's deemed trust. Agrios J. held that the deemed trust took priority over the GSA. In characterizing the statutory trust, Agrios J. concluded at p. 189 that the trust attaches to "whatever assets are left" upon bankruptcy. With regard to the GSA security interest, Agrios J. was of the view that it took the form of a fixed charge on the inventory with a licence to sell in the ordinary course of business. However, this latter characterization was not necessary to reach his decision, as the learned chambers judge ultimately reasoned, at p. 188, "[w]hether the charge is floating or fixed, if there is an ability to deal with an asset such as inventory, the asset becomes exposed to the normal market incidents of carrying on business". Relying on the decision of McLachlin J.A. (as she then was) in *R. in Right of B.C. v. F.B.D.B.*, 1987 CanLII 156 (BC CA), [1988] 1 W.W.R. 1 (B.C.C.A.) (hereinafter "*FBDB*"), Agrios J. found that a normal incident of selling inventory was the payment of statutory liens. The sale of the inventory therefore permitted the statutory trust to attach.

Alberta Court of Queen's Bench 1994 CanLII 8992 (AB QB), (1994), 21 Alta. L.R. (3d) 275

15 The bank subsequently applied for a determination of whether their BAS over Sparrow's inventory took priority over Her Majesty's deemed trust. For substantially similar reasons, Agrios J. held that the deemed trust once again took priority. Whether the BAS could be characterized as a fixed charge with a licence to sell, or a floating charge, the sale of the inventory subjected the bank's interest in it to the "normal incidents of business" (at p. 283). And, in Agrios J.'s view, one of these incidents was the paying of wages and withholdings. As these proceeds were impressed with the deemed trust, whatever interest the bank had could not attach to them, as they were no longer the property of Sparrow.

Alberta Court of Appeal reflex, (1995), 28 Alta. L.R. (3d) 153

16 Both the decisions of Agrios J. were appealed to the Alberta Court of Appeal. As such, the priority of both the GSA and the BAS were at issue before that court. However, the Court of Appeal, unanimously deciding to dispose of the appeal solely on the grounds that the BAS took priority over the statutory trust, neither heard oral argument nor ruled with regard to the priority of the GSA.

17 The Court of Appeal began with the premise that BAS was a fixed and specific charge transferring legal title to the bank and not a floating charge over inventory. For this proposition, the court relied upon two judgments of this Court, *Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd.*, 1980 CanLII 186 (SCC), [1980] 1 S.C.R. 1182, and *Bank of Montreal v. Hall*, 1990 CanLII 157 (SCC), [1990] 1 S.C.R. 121, both decisions which the court considered binding upon it. As the claim of Her Majesty arose subsequent to the execution

Digitized by Google

of the BAS, in the court's opinion, the deemed trust could have nothing to attach to. In addition, the court rejected the argument that the inventory was subject to a licence to sell which would provide Her Majesty with an opportunity to attach its interest. The Court of Appeal found *FBDB*, *supra*, relied upon by Agrios J. to be distinguishable on the basis that the intimacy in that case between the sale of inventory and the statutory trust was not present in the case before it. In contrast, in the present case, the court found no conceptual or evidentiary link between the sale of inventory and the withholding of payroll deductions. In any event, the court found that any licence to sell inventory only lasted until default, and as the sale in this case occurred well after any default by Sparrow, the licence must therefore have been extinguished at the relevant time. For these reasons, the Court of Appeal found that the BAS took priority over Her Majesty's deemed trust.

IV - Issues

18 There are two issues to be resolved in this appeal: (1) whether, on the facts of this case, Her Majesty's s. 227(5) *ITA* deemed trust takes priority over a previously executed GSA with respect to the proceeds of the sale of inventory; and (2) whether, on the facts of this case, Her Majesty's s. 227(5) *ITA* deemed trust takes priority over a previously executed BAS with respect to the proceeds of the sale of inventory?

V - Analysis

(A) *Introduction*

19 The law reports are replete with cases involving competing claims between statutory liens and deemed trusts, such as the one found in s. 227 *ITA*, and other previously executed consensual security interests: *Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd.*, *supra*; *Board of Industrial Relations v. Avco Financial Services Realty Ltd.*, 1979 CanLII 230 (SCC), [1979] 2 S.C.R. 699; *Royal Bank of Canada v. G. M. Homes Inc.* (1984), 52 C.B.R. (N.S.) 244 (Sask. C.A.); *Roynat Inc. v. Ja-Sha Trucking & Leasing Ltd.*, 1992 CanLII 2767 (MB CA), [1992] 2 W.W.R. 641 (Man. C.A.); *FBDB, supra*; *Ford Motor Co. of Canada Ltd. v. Manning Mercury Sales Ltd. (Trustee of)*, 1994 CanLII 4852 (SK QB), [1994] 6 W.W.R. 372 (Sask. Q.B.); *National Bank of Canada v. Director of Employment Standards* (1986), 5 P.P.S.A.C. 326 (Ont. Div. Ct.); *Abraham v. Coopers & Lybrand Ltd.* reflex, (1993), 13 O.R. (3d) 649 (Gen. Div.) (under appeal); *Armstrong v. Coopers & Lybrand Ltd.* reflex, (1986), 53 O.R. (2d) 468 (H.C.), aff'd reflex, (1987), 61 O.R. (2d) 129 (C.A.), leave refused, *sub nom. National Bank of Canada v. Armstrong*, [1988] 1 S.C.R. xii. The ubiquitousness of this legal dilemma in our courts speaks no doubt, at least in part, to the prevalence of the unfortunate factual situation which such statutory trusts and liens were meant to counter. Namely, such deemed trusts or liens are devices which legislators often employ in order to recover moneys which ought to have lawfully been paid to them but have been unlawfully misappropriated by a debtor who subsequently encounters financial difficulty and is forced into winding up its business, e.g., *Canada Pension Plan*, R.S.C., 1985, c. C-8, s. 23(3) and (4); *Unemployment Insurance Act*, R.S.C., 1985, c. U-1, s. 57(2) and (3); and the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.), s. 227(4) and (5). Indeed, it is perhaps more accurate to speculate that this sort of misappropriation of public funds is often a manifestation of an already-existing financial difficulty in a debtor's business, as a debtor foregoes statutory

Digitized by Google

payments as required of it in order to increase artificially its supply of working capital.

20 At the same time that legislators have sought to protect the fiscal integrity of public institutions through the devices of statutory trusts and liens, however, they have also endeavoured to protect the security interests of those private institutions who are involved in providing credit to Canadian businesses. For example, the *Bank Act* has historically provided for the protection of the collateral of banking institutions. The current provision of the *Bank Act* granting a security interest in a debtor's inventory, s. 427, can be traced back over one hundred years to the enactment of its predecessor section, s. 74, in 1890 (S.C. 1890, c. 31). The historical and societal importance of this form of security was observed by this Court in *Hall*, *supra*, where, at p. 139, La Forest J. commented that "[i]n a word, the creation of the *Bank Act* security interest has been a key factor in the evolution of banking in this country". Later, at p. 140, La Forest J. concluded:

> The above considerations establish, to my satisfaction, that the s. 178 security interest, which originated as a policy response to structural deficiencies in the lending regimes of the nascent Canadian economy, has, since its inception, played a primordial role in facilitating access to capital by several groups that play a key role in the national economy. [Emphasis added.]

21 More recently, provincial legislatures have moved to protect secured creditors generally through the enactment of personal property security legislation: e.g. *Personal Property Security Act*, R.S.O. 1990, c. P.10; *Personal Property Security Act*, S.B.C. 1989, c. 36; and the *PPSA*. These statutory regimes have been implemented to increase certainty and predictability in secured transactions through the creation of a coherent system of priorities: Ronald C. C. Cuming and Roderick J. Wood, *British Columbia Personal Property Security Act Handbook* (2nd ed. 1993), at pp. 4-5; *G.M. Homes Inc.*, *supra*, at p. 252. The benefits of such certainty in commercial transactions, on basic economic principles, are intended to accrue to the health of the economy in general.

22 It can be seen from the foregoing, therefore, that the priority competition between statutory trusts and consensual security interests represents, in a broad sense, a clash between conflicting legislative objectives. To this extent, then, a resolution of the priority competition in the present case requires a sensitivity to the differing legislative objectives here at play. In particular, however, to the extent that the aim of personal property security regimes is to effect certainty in commercial transactions, the interpretation by the courts of such legislation and the development of the jurisprudence generally in this area must, to every extent possible, seek to achieve predictable results.

23 It has been unfortunate that the development of the case law, to this point, has not inspired the degree of certainty which is so manifestly desirable in this area of commercial law. Indeed, the jurisprudence has been referred to as a "troubled area of the law" (*Manitoba (Minister of Labour) v. Omega Autobody Ltd. (Receiver of)* 1989 CanLII 178 (MB CA), (1989), 59 D.L.R. (4th) 34 (Man. C.A.), at p. 36), and has been the subject of, at times, scathing academic criticism (Roderick J. Wood, "Revenue Canada's Deemed Trust Extends Its Tentacles: *Royal Bank of Canada v. Sparrow Electric Corp.*" (1995), 10

Digitized by Google

B.F.L.R. 429, and Roderick J. Wood and Michael I. Wylie, "Non-Consensual Security Interests in Personal Property" (1992), 30 *Alta. L. Rev.* 1055). The general view, I believe, has been summarized by Professor Wood in his most helpful case commentary, "Revenue Canada's Deemed Trust Extends Its Tentacles: *Royal Bank of Canada v. Sparrow Electric Corp.*", *supra*, at p. 430: "[i]t is somewhat of an embarrassment that after more than two decades we still cannot confidently predict the outcome of a priority dispute between a deemed trust and a security interest". The above judicial and academic commentary, I believe, invites this Court to proceed steadfastly towards the pronouncement of clear principles to be applied in determining the priority between statutory trusts and consensual security interests.

24 With these general observations in mind, I will now proceed to analyze the specific aspects of the competing claims advanced by the parties in the present case.

(B) *The Nature of Section 227(4) and (5) Statutory Trusts*

25 Section 153(1)(*a*) *ITA* places an affirmative duty upon employers to deduct and withhold amounts from their employees' pay cheques, and remit those withholdings to the Receiver General on account of the employees' tax payable. By virtue of s. 153(3) *ITA*, these withholdings are deemed to become the property of the employee:

> **153.** ...
>
> (3) When an amount has been deducted or withheld under subsection (1), it shall, for all the purposes of this Act, be deemed to have been received at that time by the person to whom the remuneration, benefit, payment, fees, commissions or other amounts were paid.

In a perfect world, these deductions would be made, a cash fund would be set aside by the employer, and the withheld amounts would be promptly remitted to the Receiver General when due. The deducted amounts, lawfully the property of the employee, would in this way be transferred to Her Majesty to be set against his overall tax payable.

26 As a practical reality, however, these deductions are often not remitted as required under the *ITA*. Instead, the withholdings are commonly made solely as a book entry, and therefore the deduction of taxes from wages becomes merely a notional transaction; no cash is actually set aside for remittance and, often, the deductions are not transferred to the Receiver General: see, e.g., *Re Deslauriers Construction Products Ltd.*, [1970] 3 O.R. 599 (C.A.), at p. 601. It is at this point which a business becomes indebted to Her Majesty for the amount of moneys only fictionally deducted. I hasten to add, however, that while it can be said Her Majesty at this point becomes *de facto*, if not *de jure*, a creditor of the non-remitting employer, the arrangement is dissimilar to an ordinary debtor-creditor situation in two fundamental respects. First, in contrast to usual negotiated credit arrangements, this transaction is of manifestly a non-consensual nature. Second, by virtue of s. 153(3), the debtor can in law be considered to be utilizing an asset which is the property of its employees. In this sense, it is not inaccurate to characterize the non-remittance of payroll deductions as a "misappropriation" of the property of another. Indeed, the authorities, correctly in my view, commonly refer to the conduct of the tax debtor in this manner: *Roynat*, *supra*, at p. 646, *per* Twaddle J.A.; and

Digitized by Google

Pembina on the Red Development Corp. Ltd. v. Triman Industries Ltd. 1991 CanLII 2699 (MB CA), (1991), 85 D.L.R. (4th) 29 (Man. C.A.), at p. 48, *per* Lyon J.A. dissenting.

27 The economic reality of this sort of misappropriation of statutory deductions is artificially to increase the working capital of the tax debtor. By foregoing a cash payment to Her Majesty in the amount of the payroll deductions, the tax debtor is able to utilize the freed resources elsewhere in its business. The effect of non-remittance was summarized by Lyon J.A. in his dissenting reasons in *Pembina on the Red Development*, *supra*, at p. 48:

> ... either the tax debtor used the misappropriated deductions for its own purposes or the pool of moneys available for distribution to the tax debtor's creditors ... has been increased by the amount which the tax debtor failed to remit to the Receiver-General.

28 It is against the backdrop of this unfortunate factual scenario that the provisions of s. 227(4) and (5) can be seen to have been enacted. While it can be said that at the point of withholding the employer becomes the trustee of a fund which is in law the property of its employee, s. 227(4) has the effect of making Her Majesty the beneficiary under that trust. I agree with the observation of the mechanics of s. 227(4) made by Twaddle J.A. in *Roynat*, *supra*, at p. 646, where he states:

> Although [s. 227(4)] calls the trust created by it a deemed one, the trust is in truth a real one. The employer is required to deduct from his employees' wages the amounts due by the employees under the statute. This money does not belong to the employer anymore. It belongs to the employees. The employer holds it in a statutory trust to satisfy their obligations.

The conceptual difficulty arises, of course, when the tax debtor fails to set aside moneys which are to be remitted. At this point, the subject of Her Majesty's beneficial interest becomes intermingled with the general assets of the tax debtor. As Twaddle J.A. rightly observed in *Roynat*, *supra*, at p. 646, "Her Majesty's claim ... then be[comes] that of a beneficiary under a non-existent trust". In short, the misappropriation of statutory deductions conceptually problematizes the legal vehicle -- the concept of the trust -- which Parliament has invoked in order to regain the moneys lawfully owed to Her Majesty.

29 This conceptual dilemma is resolved by s. 227(5). That provision states that:

> **227.** ...
>
> (5) Notwithstanding any provision of the *Bankruptcy Act*, in the event of any liquidation, assignment, receivership or bankruptcy of or by a person, an amount equal to any amount
>
> (*a*) deemed by subsection (4) to be held in trust for Her Majesty, ...
>
> ...
>
> shall be deemed to be separate from and form no part of the estate in liquidation, assignment, receivership or bankruptcy, whether or not that amount has in fact been kept separate and apart from the person's own moneys or from the assets of the estate.

The effect of s. 227(5) naturally falls to be determined through a proper interpretation of the language contained in that subsection.

30 This Court recently had occasion to review the principles of law to be

Digitized by Google

applied to the interpretation of tax legislation. In *Alberta (Treasury Branches) v. M.N.R.; Toronto-Dominion Bank v. M.N.R.*, 1996 CanLII 244 (SCC), [1996] 1 S.C.R. 963, at pp. 975-76, Cory J. quoted this Court's decision in *Friesen v. Canada*, 1995 CanLII 62 (SCC), [1995] 3 S.C.R. 103, at pp. 112-14, where the relevant principles were summarized as follows:

> In interpreting sections of the *Income Tax Act*, the correct approach, as set out by Estey J. in *Stubart Investments Ltd. v. The Queen*, 1984 CanLII 20 (SCC), [1984] 1 S.C.R. 536, is to apply the plain meaning rule. Estey J. at p. 578 relied on the following passage from E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87:
>
> > Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.
>
> The principle that the plain meaning of the relevant sections of the *Income Tax Act* is to prevail unless the transaction is a sham has recently been affirmed by this Court in *Canada v. Antosko*, 1994 CanLII 88 (SCC), [1994] 2 S.C.R. 312. Iacobucci J., writing for the Court, held at pp. 326-27 that:
>
> > While it is true that the courts must view discrete sections of the *Income Tax Act* in light of the other provisions of the Act and of the purpose of the legislation, and that they must analyze a given transaction in the context of economic and commercial reality, such techniques cannot alter the result where the words of the statute are clear and plain and where the legal and practical effect of the transaction is undisputed: *Mattabi Mines Ltd. v. Ontario (Minister of Revenue)*, 1988 CanLII 58 (SCC), [1988] 2 S.C.R. 175, at p. 194; see also *Symes v. Canada*, 1993 CanLII 55 (SCC), [1993] 4 S.C.R. 695.
>
> I accept the following comments on the *Antosko* case in P. W. Hogg and J. E. Magee, *Principles of Canadian Income Tax Law* (1995), Section 22.3© "Strict and purposive interpretation", at pp. 453-54:
>
> > It would introduce intolerable uncertainty into the Income Tax Act if clear language in a detailed provision of the Act were to be qualified by unexpressed exceptions derived from a court's view of the object and purpose of the provision.... (The *Antosko* case) is simply a recognition that "object and purpose" can play only a limited role in the interpretation of a statute that is as precise and detailed as the Income Tax Act. When a provision is couched in specific language that admits of no doubt or ambiguity in its application to the facts, then the provision must be applied regardless of its object and purpose. Only when the statutory language admits of some doubt or ambiguity in its application to the facts is it useful to resort to the object and purpose of the provision.

At pp. 976-77 of *Alberta (Treasury Branches)*, *supra*, Cory J. concluded:

> Thus, when there is neither any doubt as to the meaning of the legislation nor any ambiguity in its application to the facts then the statutory provision must be applied regardless of its object or purpose. I recognize that agile legal minds could probably find an ambiguity in as simple a request as "close the door please" and most certainly in even the shortest and clearest of the ten commandments. However, the very history of this case with the clear differences of opinion expressed as between the trial judges and the Court of Appeal of

Digitized by Google

Alberta indicates that for able and experienced legal minds, neither the meaning of the legislation nor its application to the facts is clear. It would therefore seem to be appropriate to consider the object and purpose of the legislation. Even if the ambiguity were not apparent, it is significant that in order to determine the clear and plain meaning of the statute it is always appropriate to consider the "scheme of the Act, the object of the Act, and the intention of Parliament".

31 In the present case, I find the language in s. 227(5) to be clear and unambiguous, especially when viewed as a provision directly following s. 227(4), which renders amounts unremitted as held in trust for Her Majesty. In my view, this section is designed to, upon liquidation, assignment, receivership or bankruptcy, seek out and attach Her Majesty's beneficial interest to property of the debtor which at that time is in existence. The trust is not in truth a real one, as the subject matter of the trust cannot be identified from the date of creation of the trust: D. W. M. Waters, *Law of Trusts in Canada* (2nd ed. 1984), at p. 117. However, s. 227(5) has the effect of revitalizing the trust whose subject matter has lost all identity. This identification of the subject matter of the trust therefore occurs *ex post facto*. In this respect, I agree with the conclusion of Twaddle J.A. in *Roynat*, *supra*, where he states the effect of s. 227(5) as follows, at p. 647: "Her Majesty has a statutory right of access to whatever assets the employer then has, out of which to realize the original trust debt due to Her".

32 I add that this approach was taken to a provision substantially similar to s. 227(5) by Gale C.J. in *Re Deslauriers Construction Products Ltd.*, *supra*, at p. 601, whose reasoning was affirmed by this Court in *Dauphin Plains*, *supra*. The *Deslauriers* case, *supra*, involved a priority competition between a trustee-in-bankruptcy and a statutory deemed trust provision created under the *Canada Pension Plan*, S.C. 1964-65, c. 51. Section 24(3) and (4) of that Act stated:

> **24.** ...
>
> (3) Where an employer has deducted an amount from the remuneration of an employee as or on account of any contribution required to be made by the employee but has not remitted such amount to the Receiver General of Canada, the employer shall keep such amount separate and apart from his own moneys and shall be deemed to hold the amount so deducted in trust for Her Majesty.
>
> (4) In the event of any liquidation, assignment or bankruptcy of an employer, an amount equal to the amount that by subsection (3) is deemed to be held in trust for Her Majesty shall be deemed to be separate from and form no part of the estate in liquidation, assignment or bankruptcy, whether or not that amount has in fact been kept separate and apart from the employer's own moneys or from the assets of the estate.

This Court in *Dauphin Plains*, *supra*, at p. 1198, approved of Gale C.J.'s conclusion as to the interpretation of s. 24(4) (at p. 601 of *Deslauriers*, *supra*):

> It seems to us that s-s. (4), and particularly the concluding six words thereof, were inserted in the Act specifically for the purpose of taking the moneys equivalent to the deductions out of the estate of the bankrupt by the creation of a trust and making those moneys the property of the Minister.

33 This interpretation of s. 227(5) also has the virtue of being consistent with the scheme of distribution under the *Bankruptcy and Insolvency Act*, R.S.C.,

Digitized by Google

1985, c. B-3. Section 67 of that Act expressly removes claims for unremitted payroll deductions, which are held in trust (*inter alia*) pursuant to s. 227 *ITA*, from the bankrupt's estate:

> **67.** (1) The property of a bankrupt divisible among his creditors shall not comprise
>
> (*a*) property held by the bankrupt in trust for any other person,
>
> ...
>
> (2) Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.
>
> (3) Subsection (2) does not apply in respect of subsections 227(4) and (5) of the *Income Tax Act*, subsections 23(3) and (4) of the *Canada Pension Plan* or subsections 57(2) and (3) of the *Unemployment Insurance Act*....

34 It is to be observed that in addition to attaching Her Majesty's interest to the debtor's property upon the triggering of any of the events mentioned in s. 227(5), the deemed trust operates to the benefit of Her Majesty in a secondary manner. Namely, s. 227(5) permits Her Majesty's interest to attach to collateral which is subject to a fixed charge if the deductions giving rise to Her Majesty's claim arose before that charge attached to that collateral. This proposition flows from the decision of this Court in *Dauphin Plains*, *supra*. *Dauphin Plains* involved a determination as to priority in respect of the proceeds of a liquidation sale of a receiver-manager. In that case, the claims of Her Majesty (*inter alia*) arose by virtue of the non-remittance of payroll deductions in regard to payments under the *Canada Pension Plan*, R.S.C. 1970, c. C-5, and the *Unemployment Insurance Act*, *1971*, S.C. 1970-71-72, c. 48. Those Acts provided Her Majesty with claims pursuant to deemed trusts whose language is substantially similar to the version of s. 227(4) and (5) at issue in this appeal. In finding that these claims took precedence over a floating charge which had crystallized after the deductions at issue were actually made, Pigeon J. stated at p. 1199:

> It should first be observed that, for reasons similar to those on which the decision in the *Avco* case, *supra*, was based, the claim for Pension Plan and Unemployment Insurance deductions cannot affect the proceeds of realization of property subject to a fixed and specific charge. From the moment such charge was created, the assets subject thereto, were no longer the property of the debtor except subject to that charge. The claim for the deductions arose subsequently and thus cannot affect this charge in the absence of a statute specifically so providing. However, the floating charge did not crystallize prior to the issue of the writ and the appointment of the receiver. In the present case it makes no difference which of the two dates is selected, both are subsequent to the deductions. [Emphasis added.]

Thus, s. 227(5) alternatively permits Her Majesty's interest to attach retroactively to the disputed collateral if the competing security interest has attached after the deductions giving rise to Her Majesty's claim in fact occurred. Conceptually, the s. 227(5) deemed trust allows Her Majesty's claim to go back in time and attach its outstanding s. 227(4) interest to the collateral before that collateral became subject to a fixed charge. The same result occurs when a statutory lien attaches prior to the

Digitized by Google

mortgaging of disputed collateral. In *Avco*, *supra*, this Court *per* Martland J. commented upon just such a scenario, at p. 706:

> From that date, the lien attaches to the employer's property and, as provided in subs. (1), it will take priority over any other claim, including an assignment or mortgage. In other words, after the lien attaches, its priority is unaffected by a disposition of his property made by the employer. Where a mortgage has been made prior to the lien attaching, it is not affected. The lien will only attach to the employer's equity in that property. [Emphasis added.]

See also *G.M. Homes Inc.*, *supra*, at p. 250.

35 In this appeal, however, the deductions of tax from the employees' pay cheques occurred after the attachment of the bank's fixed charge to the inventory. As such, this second aspect of s. 227(5)'s operation is not at issue in this case.

36 I find support for the interpretation of s. 227(5) that I have taken in as much as it is consistent with the overall purpose of s. 227(4) and (5). In *Pembina on the Red Development*, *supra*, Lyon J.A. (dissenting) had occasion to comment upon the purpose of the predecessor section to the current s. 224(1.2) *ITA*, namely s. 224(1.2) and (1.3) of the *Income Tax Act*, S.C. 1970-71-72, c. 63, which were added by S.C. 1987, c. 46, s. 66. I find that Lyon J.A.'s comments in this respect to be fully applicable to the articulation of the purpose of s. 227(5). At p. 51, Lyon J.A. stated:

> One must always remember that the withholding tax or source deduction to which s. 224 applies is at the heart of the collection procedures for personal income taxation in Canada. Indeed, if one makes a calculation from the statistics reported in "Taxation Statistics, 1987", a publication of Revenue Canada Taxation, Catalogue No. RV-1987, one finds that 87% of all personal income taxes paid in Canada are collected by source deductions. It can thus be seen that Parliament in passing s. 224(1.2) made it as all-encompassing as it is in order to ensure its continued viability. No other system is so crucial to the overall collection procedure adopted by the Crown. Parliament clearly meant to protect this system. Using the employer as a tax collector requires such extra protection in cases such as the one at bar where the employer converts the withheld tax money to its own purposes. Understandably, that conversion cannot be countenanced if the integrity of that system is to be preserved. Parliament, therefore, acting within its constitutional authority, has taken this extraordinary remedy to protect a major collection source.

Similarly, Parliament has clearly sought to protect the collection of unremitted payroll deductions through the device of the statutory deemed trust. Accordingly, s. 227(5) must be interpreted in light of this purpose. To summarize, it operates in a twofold manner: upon the triggering of an event specified in s. 227(5), Her Majesty's beneficial interest (i) attaches to the tax debtor's property then in existence; or (ii) attaches to collateral subject either to a fixed charge, or a crystallized floating charge, if the actual deductions giving rise to Her Majesty's claim occurred before the fixed charge attached, or the floating charge crystallized, respectively.

37 One further point with respect to terminology is necessary before leaving the present discussion. The method of attachment of Her Majesty's beneficial interest pursuant to s. 227(5) has been referred to at times as a "mechanism for tracing": *Roynat*, *supra*, at p. 647. This was indeed how it was presented

Digitized by Google

by counsel for Her Majesty in his submissions before this Court. During the hearing of this case, it was questioned whether this was not an awkward usage of the word "tracing". After considering the matter, it is my view that it is not accurate to describe the mechanism of s. 227(5) as a means of "tracing"; indeed, it would seem that this subsection is antithetical to tracing in the traditional sense, to the extent that it requires no link at all between the subject matter of the trust and the fund or asset which the subject matter is being traced into: D. W. M. Waters, *Law of Trusts in Canada*, *supra*, at pp. 1037-53. For this reason, I find Professor Wood's description of the operation of s. 227(5), namely, a "relaxation of the equitable tracing rules", to be most accurate: Roderick J. Wood, "The Floating Charge in Canada" (1989), 27 *Alta. L. Rev.* 191, at p. 221; see also *Omega*, *supra*, at p. 43; and *Re Deslauriers Construction Products Ltd.*, *supra*, at p. 603.

38 In conclusion, s. 227(5) is a provision designed to minimize the adverse effect upon Her Majesty from the misappropriation of trust funds held by tax debtors on account of their employees' tax payable. The provision contemplates an intermingling of Her Majesty's property with that of a tax debtor's, such that the subject matter of the trust cannot be (or indeed never was) identifiable. To address this conceptual problem, s. 227(5) allows Her Majesty to attach its interest to any property which lawfully belongs to the debtor at the time of liquidation, assignment, receivership or bankruptcy; this property is then deemed to exist "separate" and apart from the tax debtor's estate. The *ITA* thus permits Her Majesty to transfer title in the property from the tax debtor to Herself in order to satisfy the tax debtor's outstanding unremitted payroll obligations.

39 I would hasten to add to this, however, that this provision does not permit Her Majesty to attach Her beneficial interest to property which, at the time of liquidation, assignment, receivership or bankruptcy, in law belongs to a party other than the tax debtor. Section 227(4) and (5) are manifestly directed towards the property of the tax debtor, and it would be contrary to well-established authority to stretch the interpretation of s. 227(5) to permit the expropriation of the property of third parties who are not specifically mentioned in the statute. As Martland J. stated in *Avco*, *supra*, at p. 706:

> The property to which a s. 5A lien attaches is not defined nor identified. In the absence of a specific statutory provision to that effect, in my view it should not be construed in a manner which could deprive third parties of their pre-existing property rights.

Similarly, in *Pembina on the Red Development*, *supra*, Scott C.J. stated the presumption against expropriation of property, at p. 38:

> In Cross, *Statutory Interpretation* (London: Butterworths, 1987), the author writes at p. 180:
>
> > There is a general presumption that Parliament does not intend to take away private property rights unless the contrary is clearly indicated. Lord Atkinson stated that there is a canon of interpretation "that an intention to take away the property of a subject without giving to him a legal right to compensation for the loss of it is not to be imputed to the legislature unless that intention is expressed in unequivocal terms." After all, the protection of property is generally regarded as one of the fundamental values of a liberal society. [Emphasis added.]

Digitized by Google

Later in that same case, Twaddle J.A., in separate concurring reasons, articulated this same principle as follows, at p. 46, "[i]t is a long-established principle of law that, in the absence of clear language to the contrary, a tax on one person cannot be collected out of property belonging to another".

40 Thus, while s. 227(5) can be seen as a provision enacted to solve the conceptual dilemma precipitated by an intermingling of unremitted payroll deductions with a tax debtor's general assets, it is a legal vehicle not without its own conceptual limitations. Namely, while the s. 227(5) deemed trust permits Her Majesty to attach Her beneficial interest to property of the tax debtor upon liquidation (assignment, receivership or bankruptcy), it does not permit the expropriation of property which may belong to a third party creditor at the time the subsection becomes engaged.

41 However, as will be discussed in further detail, *infra*, it is my opinion that the licence theory may, in certain cases, create an exception to this general principle. In particular, where a secured creditor consents to the disposition of his collateral in order to pay wage deductions, that consent, coupled with the statutory trust provisions here at issue, may act to divest that creditor of its proprietary interest in that collateral at the time of liquidation, assignment, receivership or bankruptcy. Indeed, it is my view that this exception is engaged in the present case such that the s. 227(5) claim of Her Majesty must prevail.

(C) *The Nature of the Bank's Security Interests*

42 I begin from the observation that Parliament, in enacting s. 227(4) and (5), has chosen to secure Her Majesty's claims to unremitted payroll deductions through employing the concept of a deemed trust. Therefore, the proper analysis to follow in determining whether Her Majesty is entitled to priority pursuant to these subsections must utilize principles of property law. For this reason, it becomes relevant and indeed essential to scrutinize the nature of the interests which compete with Her Majesty's trust in order to determine whether and to what extent such interests have title in the disputed fund. As I mentioned previously, Her Majesty's trust can attach to the disputed collateral only to the extent that that collateral is not in law the property of a party other than the tax debtor at the time the deemed trust is engaged. More specifically, subject to the application of the licence theory, if it is found that legal title in the collateral is in the bank, and not Sparrow, Her Majesty's deemed trust could only attach to Sparrow's equity of redemption: see *Avco*, *supra*, at p. 706.

43 This "statutory trust" approach can be distinguished from other legislative methods which are used to secure an interest to unremitted payroll deductions, namely, through employing an explicit "Crown priority" provision. An example of such a provision can be found in s. 224(1.2) *ITA*, a subsection which was recently the subject of consideration of this Court in *Alberta (Treasury Branches)*, *supra*. That provision reads:

> **224.** ...
>
> (1.2) Notwithstanding any other provision of this Act, the *Bankruptcy Act*, any other enactment of Canada, any enactment of a province or any law, where the Minister has knowledge or suspects that a particular person is or will become, within 90 days, liable to make a payment
>
> (*a*) to another person ... who is liable to pay an amount assessed under subsection 227(10.1) or a similar provision, or

Digitized by Google

(*b*) to a secured creditor who has a right to receive the payment that, but for a security interest in favour of the secured creditor, would be payable to the tax debtor,

the Minister may, by registered letter or by a letter served personally, require the particular person to pay forthwith, where the moneys are immediately payable, and in any other case, as and when the moneys become payable, the moneys otherwise payable to the tax debtor or the secured creditor in whole or in part to the Receiver General on account of the tax debtor's liability under subsection 227(10.1) or a similar provision, and on receipt of that letter by the particular person, the amount of those moneys that is required by that letter to be paid to the Receiver General shall, notwithstanding any security interest in those moneys, become the property of Her Majesty and shall be paid to the Receiver General in priority to any such security interest. [Emphasis added.]

In contrast to the "deemed trust" approach, the application of this section to a priority competition can proceed without regard to the quality of the "security interest" which competes with Her Majesty's claim. Indeed, s. 224(1.2) simply transfers title in the collateral to Her Majesty regardless of whose interest may compete with it, so long as the requirements of s. 224(1.2) are met: see, e.g., *Alberta (Treasury Branches)*, *supra*. For a general discussion of these two distinct analytical methods of determining priority between non-consensual security interests (such as statutory trusts) and consensual security interests, see Wood and Wylie, "Non-Consensual Security Interests in Personal Property", *supra*, at pp. 1072-83.

44 In the present case, it therefore becomes necessary to characterize the bank's interest in Sparrow's inventory as either a floating, or a fixed and specific charge.

45 The basic distinction between fixed and floating charges was articulated by Lord Macnaghten in *Illingworth v. Houldsworth*, [1904] A.C. 355 (H.L.), at p. 358:

A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.

The "event ... or ... act" to which Lord Macnaghten refers to as causing the floating interest to "settle and fasten" is described in the modern authorities as "crystallization". Generally speaking, crystallization occurs upon the default of the debtor. Once the floating interest has been said to crystallize, that interest is transformed into a fixed and specific charge over the inventory. See Wood, "The Floating Charge in Canada", *supra*, at pp. 204-8.

46 The critical significance of the characterization of an interest as being fixed or floating, of course, is that it describes the extent to which a creditor can be said to have a proprietary interest in the collateral. In particular, during the period in which a charge over inventory is floating, the creditor possesses no legal title to that collateral. For this reason, if a statutory trust or lien attaches during this time, it will attach to the debtor's interest and take priority over a subsequently crystallized floating charge. However, if a security interest can be characterized as a fixed and specific charge, it will take priority over a

Digitized by Google

subsequent statutory lien or charge; in such a case, all that the lien can attach to is the debtor's equity of redemption in the collateral: *Avco*, *supra*, at p. 706. This correlative relationship between fixed charges and legal ownership was articulated by this Court in *Dauphin Plains*, *supra*, at p. 1199, where Pigeon J. stated:

> It should first be observed that, for reasons similar to those on which the decision in the *Avco* case, *supra*, was based, the claim for Pension Plan and Unemployment Insurance deductions cannot affect the proceeds of realization of property subject to a fixed and specific charge. From the moment such charge was created, the assets subject thereto, were no longer the property of the debtor except subject to that charge. [Emphasis added.]

See also *Avco*, *supra*.

47 There has been much debate as to whether it is appropriate to characterize a security interest over inventory which permits the debtor to sell that inventory in the ordinary course of business as a floating charge. The debate centres around the ability to characterize a security interest as fixed, in the presence of a licence given to the debtor to sell the collateral, where such an arrangement involves "no final and irrevocable appropriation of property to the creditor": *FBDB*, *supra*, at p. 33. McLachlin J.A. (as she then was) in *FBDB*, *supra*, fully considered the conflicting authorities on this point and concluded at pp. 37-38 and 40:

> In short, the answer to the question of whether the courts have recognized a fixed charge subject to a licence to sell in the ordinary course of business is no, with the exception of the line of cases confirming the right of a chattel mortgagor to sell mortgaged stock in the ordinary course of business.
>
> ...
>
> If a charge conferred on the debtor the right to deal with the goods in the ordinary course of business then, regardless of what the parties chose to call it, it was regarded as floating, with the result that third party interests acquired prior to crystallization of the charge had priority over the chargeholder.

Adopting this "either-or" doctrine, McLachlin J.A. chose to characterize the security agreement in *FBDB*, which permitted the debtor to sell the secured collateral in the ordinary course of the debtor's business, as a floating charge.

48 I note also that this Court very recently referred to the decision of McLachlin J.A. in *FBDB*, *supra*, with approval: *Alberta (Treasury Branches)*, *supra*. While the issue in that case was different from that in *FBDB*, the comments of Cory J. can, I think, be taken as affirming the "either-or" doctrine as applied in *FBDB*.

49 The relevance of the "either-or" doctrine to the present case, of course, lies in the fact that Sparrow had been granted by the bank, both expressly and impliedly, a licence to sell the inventory over which the bank held a security interest. It therefore could be argued that such a licence renders the interest of the bank in the nature of a floating charge, an interest which must yield to a statutory trust which attaches prior to the charge's crystallization.

50 I do not find it necessary to comment on *FBDB* to the extent that that decision suggests that in the present case the interests of the bank should be characterized as a floating charge. It should be noted that the decision of McLachlin J.A. in the *FBDB* case predated the enactment of personal property

Digitized by Google

security legislation in British Columbia, and so does not speak to the state of the law in a *PPSA* jurisdiction. Nor did that case deal with any other statutory enactment, such as the *Bank Act*, which could affect the characterization of the security agreement there at issue. For these reasons, I consider the comments of McLachlin J.A. in *FBDB* to be directed to the common law position with regard to the characterization of fixed and floating charges. Whatever those common law principles may be, they cannot be taken to alter the effect that legislation may have on the characterization of security interests. As it is my view that the Alberta *PPSA* and the *Bank Act* are determinative of the characterization of the bank's GSA and BAS, respectively, I do not need to address the common law view articulated in *FBDB*.

51 I turn now to consider each of the bank's security interests.

(i) The General Security Agreement (GSA)

52 Counsel for the appellant, Her Majesty, argued in his factum that the bank's GSA is to be considered in the nature of a floating charge. In support of this proposition, counsel advances the decision of the Ontario Court of Appeal in *Re Urman* (1983), 44 O.R. (2d) 248. In that case, involving a general assignment of book debts perfected under the Ontario *Personal Property Security Act*, the security interest was characterized as a floating charge.

53 For the reasons which follow, I cannot accept this submission. In my view, the general security agreement in this case, which was subject to the Alberta personal property security legislation, must be characterized as a fixed and specific charge subject to a licence to sell the inventory.

54 It is of course true that the *PPSA* does not govern the priority competition between a statutory trust and a security interest. Subsection 4(a) explicitly removes statutory trusts such as the one created by s. 227 *ITA* from the province of the Alberta *PPSA*:

> **4** Except as otherwise provided in this Act, this Act does not apply to the following:
>
> (a) a lien, charge or other interest given by an Act or rule of law in force in Alberta;

However, this does not mean that the *PPSA* does not affect the characterization of a charge executed in a jurisdiction which is subject to such an Act. To the contrary, the effect of personal property security legislation has been said to have "fundamentally changed the characterization of security interests": Wood and Wylie, "Non-Consensual Security Interests in Personal Property", *supra*, at p. 1082. In particular, while pre-*PPSA*, a security agreement purporting to create a floating charge could be said to remain unattached to the collateral until crystallization, s. 12(1) of the Alberta *PPSA* manifestly alters this situation. That subsection reads:

> **12**(1) A security interest, including a security interest in the nature of a floating charge, attaches when
>
> (a) value is given,
>
> (b) the debtor has rights in the collateral, and
>
> (c) except for the purpose of enforcing rights between the parties to the security agreement, the security interest becomes enforceable within the meaning of section 10,
>
> unless the parties specifically agree in writing to postpone the time for attachment, in which case the security interest attaches at the time specified in

Digitized by Google

the agreement.

The relevant portion of s. 10 for our purposes states:

> **10**(1) Subject to subsection (2), a security interest is enforceable against a third party only where
>
> (a) the collateral is in the possession of the secured party, or
>
> (b) the debtor has signed a security agreement that contains
>
> ...
>
> (ii) a statement that a security interest is taken in all of the debtor's present and after-acquired personal property ....

Generally speaking, therefore, absent an express intention to the contrary, a security interest in all present and after-acquired personal property will attach when that agreement is executed by the parties. Once attachment has occurred, in my view, the GSA then becomes in law a fixed and specific charge over the collateral.

55 I find support in this conclusion as to the effect of personal property security legislation upon security interests from the fact that the academic literature is unanimous on this point. For example, Professor Jacob S. Ziegel in his article "Symposium: Recent and Prospective Developments in the Personal Property Security Law Area" (1985), 10 *Can. Bus. L.J.* 131, commented as follows, at p. 152:

> It is of the first importance to determine whether a security interest under the PPSA retains any of the common law characteristics of a floating charge and if so which. My own view is that once a security interest has attached under the PPSA it has no "floating" attributes even though the security agreement, expressly or impliedly, gives the debtor considerable powers to dispose of the collateral in the course of his business. In brief, the PPSA only recognizes specific or fixed security interests although admittedly the collateral itself may often change its character because of the express or implied powers of disposition given the debtor. [Emphasis added.]

This opinion is echoed by Professor Wood in his recent article "Revenue Canada's Deemed Trust Extends Its Tentacles: *Royal Bank of Canada v. Sparrow Electric Corp.*", *supra*, at p. 433:

> Under pre-PPSA law, a plausible argument could be made that a security interest in the form of a fixed charge combined with a licence to deal is, in effect nothing more than a floating charge. However, this argument [is] untenable in the cases involving PPSA security interests....

Similarly, Professor Ronald C. C. Cuming, in "Commercial Law -- Floating Charges and Fixed Charges of After-Acquired Property: *The Queen in the Right of British Columbia* v. *Federal Business Development Bank*" (1988), 67 *Can. Bar Rev.* 506, at pp. 510-11, opined:

> In effect, [PPS] legislation treats all charges, including floating securities, as fixed charges. The legislatures that have enacted Personal Property Security Acts have implicitly declared that, as a matter of public policy, there is nothing objectionable to having a fixed charge on stock-in-trade of a debtor coupled with a licence to deal with the collateral in the ordinary course of business. [Emphasis added.]

At p. 519, the learned author concludes "there can be no such thing as a floating charge under a Personal Property Security Act".

56 Applying this principle to the case at bar, the GSA held by the respondent

Digitized by Google

bank must certainly be characterized as a fixed and specific charge. It attached at the time the agreement was executed, February 25, 1992. More specifically, however, because of the permission granted by the bank which allowed Sparrow to sell the encumbered inventory, the GSA is in the nature of a fixed charge with a licence to deal with the inventory.

(ii) Bank Act Security (BAS)

57 The appellant has further submitted that the respondent bank's BAS is in the nature of a floating charge over the inventory. Several lower court decisions have been relied upon in support of this proposition: *Abraham*, *supra* (under appeal); *Armstrong*, *supra*; and *North Sky Trading Inc. (Bankrupt), Re* 1994 CanLII 8986 (AB QB), (1994), 158 A.R. 117 (Q.B.) (under appeal).

58 The earliest authority to comment upon the nature of BAS is the decision of this Court in *Royal Bank of Canada v. Workmen's Compensation Board of Nova Scotia*, 1936 CanLII 39 (SCC), [1936] S.C.R. 560. That case involved a priority competition between security under s. 88 of the *Bank Act*, R.S.C. 1927, c. 12, the predecessor of s. 427, and a lien created by s. 79(2) of *The Workmen's Compensation Act*, R.S.N.S. 1923, c. 129. In his concurring judgment, Davis J. observed the effect of s. 88 security as follows, at p. 567:

> . . . the security [does] not operate to transfer absolutely the ownership in the goods but ... the transaction [is] essentially a mortgage transaction and subject to the general law of mortgages except where the statute has otherwise expressly provided.... Section 88 set up by the *Bank Act* enables manufacturers, who desire to obtain large loans from their bankers in order to carry on their industrial activities, to give to the bank a special and convenient form of security for the bank's protection in the large banking transactions necessary in the carrying on of industry throughout the country. Until the moneys are repaid, the bank is the legal owner of the goods but sale before default is prohibited and provision is made for the manufacturer regaining title upon repayment. To say that Parliament did not use language to expressly provide that the bank shall have a first lien on the goods is beside the mark. The bank acquires ownership in the goods by the statute. [Emphasis added.]

59 More recently, this Court had occasion to consider the attributes of *Bank Act* security in *Hall*, *supra*. In that case, La Forest J. underlined this Court's previous ruling in *Workmen's Compensation Board of Nova Scotia*, *supra*, that BAS gives to the lender legal title in the collateral. At pp. 133-34, La Forest J. stated:

> By section 178(2) [now s. 427(2)], a bank may take security in property owned by the borrower at the time of the loan transaction, and any property acquired during the pendency of the security agreement. The rights and powers of the bank with respect to the secured property are set out in s. 178(2)(*c*). By the terms of s. 178(2)(*c*), these rights and powers are stated to be "the same rights and powers as if the bank had acquired a warehouse receipt or bill of lading in which such property was described". These powers are defined, in turn, in s. 186 [now s. 435] of the Act where it is specified that any warehouse receipt or bill acquired by a bank as security for the payment of a debt, vests in the bank all the right and title to goods, wares and merchandise covered by the holder or owner thereof.
>
> The nature of the rights and powers vested in the bank by the delivery of the document giving the security interest has been the object of some debate.

Digitized by Google

Argument has centred on whether the security interest should be likened to a pledge or bailment, or whether it is more in the nature of a chattel mortgage. I find the most precise description of this interest to be that given by Professor Moull in his article "Security Under Sections 177 and 178 of the Bank Act" (1986), 65 *Can. Bar Rev.* 242, at p. 251. Professor Moull, correctly in my view, stresses that the effect of the interest is to vest title to the property in question in the bank when the security interest is taken out. He states, at p. 251:

> The result, then, is that a bank taking security under section 178 effectively acquires legal title to the borrower's interest in the present and after-acquired property assigned to it by the borrower. The bank's interest attaches to the assigned property when the security is given or the property is acquired by the borrower and remains attached until released by the bank, despite changes in the attributes or composition of the assigned property. The borrower retains an equitable right of redemption, of course, but the bank effectively acquires legal title to whatever rights the borrower holds in the assigned property from time to time. [Emphasis added.]

60 It follows from the comments of this Court regarding the ownership rights in inventory conferred by the *Bank Act* that security taken under that Act must be considered to be in the nature of a fixed and specific charge. As stated above, the concept of the fixed charge is correlative to the notion of a creditor's having legal proprietary rights in the collateral. I add that this view has been adopted by academic literature in this area: R. J. Wood, "Revenue Canada's Deemed Trust Extends Its Tentacles: *Royal Bank of Canada v. Sparrow Electric Corp.*", *supra*, at p. 433; and William D. Moull, "Security Under Sections 177 and 178 of the Bank Act" (1986), 65 *Can. Bar Rev.* 242. I find this following passage, at p. 251, from the article written by Professor Moull which was cited with approval by this Court in *Hall*, *supra*, particularly persuasive:

Because of its scope and flexibility, some commentators have suggested that section 178 [now 427] security is in the nature of a floating charge. This can be misleading, however. Because the bank effectively acquires legal title, section 178 security is really in the nature of a fixed charge on the present and after-acquired property of the borrower assigned to the bank. One attribute that section 178 security may be said to share with a floating charge is its application to all property of a specified class held by the borrower from time to time. But while a floating charge may apply to all property of a specified kind held by the borrower from time to time, it does not affix itself specifically upon any particular item of property until it crystallizes upon default by the borrower. Conversely, a section 178 security is a fixed charge on each item of assigned property held from time to time whether or not the loan is in default. This gives a bank significantly greater rights than it would hold under a floating charge debenture on inventory.

61 For these reasons, I consider the security interest of the bank in the form of BAS to be in the nature of a fixed and specific charge with a licence to sell the inventory.

(iii) Summary -- Fixed and Specific Charge Over Inventory

62 It would seem appropriate at this point, before leaving the present discussion, to comment briefly upon this novel and perhaps abstract notion of possessing a fixed charge over all of the present and future inventory of a

Digitized by Google

debtor. To begin with, I note that traditional definitions of the fixed charge, as for example the one I previously quoted above from *Illingworth*, *supra*, emphasize the ability to "settle and fasten" upon ascertainable and defined property as being an integral attribute to this particular form of charge. This type of attachment to tangible and ascertainable property, of course, is impossible to achieve in the case of an assignment of inventory, where that collateral is changing constantly. In short, the traditional concept of the fixed charge seems to be at odds with the notion of having a proprietary right over collateral such as after-acquired inventory which, by definition, is not yet in existence at the time the security agreement is executed.

63 In my view, however, a fixed charge over all present and future inventory represents a proprietary interest over a dynamic collective of present and future assets. To this extent, as stated above, this form of security interest challenges our traditional conception of a fixed charge; to the same extent, in my opinion, our conception of this form of charge must change to meet the modern realities of commercial law, and in particular the legislative provisions which have been brought to bear in this appeal.

64 In effect, the fixed and specific charge gives to the secured creditor the title (subject, of course, to the debtor's equitable right of redemption) to the present inventory of the debtor, as well as the after-acquired inventory of the debtor. In this way, the secured creditor becomes the legal owner of inventory as it comes into possession of the debtor. I note that the Alberta *PPSA* contains a specific provision securing a creditor's proprietary right to after-acquired property in this way:

> **13**(1) Except as provided in subsection (2), where a security agreement provides for a security interest in after-acquired property, the security interest attaches in accordance with section 12, without the need for specific appropriation. [Emphasis added.]

Professors Cuming and Wood, in their published annotation of the Alberta *PPSA*, observe that by virtue of this subsection "the security interest in after-acquired property has equal status with a security interest in collateral in existence at the time the security agreement is executed": Cuming and Wood, *Alberta Personal Property Security Act Handbook* (2nd ed. 1993), at p. 121 (emphasis added). Similarly, the BAS has the effect of presently attaching the secured creditor's interest to the after-acquired inventory of the debtor. In *Hall*, *supra*, La Forest J. approved of Professor Moull's description of the effect of the relevant provisions of the *Bank Act*, at p. 134, which is particularly apposite to the present discussion:

> The result, then, is that a bank taking security under section 178 [now s. 427] effectively acquires legal title to the borrower's interest in the present and after-acquired property assigned to it by the borrower. The bank's interest attaches to the assigned property when the security is given or the property is acquired by the borrower and remains attached until released by the bank, despite changes in the attributes or composition of the assigned property. The borrower retains an equitable right of redemption, of course, but the bank effectively acquires legal title to whatever rights the borrower holds in the assigned property from time to time. [Emphasis added.]

65 It follows from these observations that where, as here, a secured creditor holds a fixed charge over a debtor's inventory, that charge will have the effect

Digitized by Google

of ensuring the creditor has legal title to any and all inventory subject to the charge at any given point in time. This, of course, is subject to the caveat (not operative in this case) that no outstanding statutory payroll deductions had in fact been made prior to the attachment of the fixed charge. Thus, in the present case, the inventory which was subject to the liquidation sale belonged in law to the respondent bank: both under its GSA and its BAS the bank held a fixed charge over Sparrow's inventory. As such, all that Her Majesty's beneficial interest could attach to, before its sale, was Sparrow's equity of redemption in the property: *Avco*, *supra*; *C.I.B.C. v. Klymchuk* reflex, (1990), 74 Alta. L.R. (2d) 232 (C.A.), at p. 240.

66 But this of course does not end the matter. While it is true that the bank held legal title in the inventory which is the subject of the dispute in this case, it is also true that at the time the deductions were made the bank had given its permission to Sparrow to sell this inventory in the course of its business. The GSA contained an express licence to this effect; and the BAS impliedly contained such a licence. In this way, the bank had consented, contractually, to the divestment of their interest in the collateral taken in inventory and the usage of the proceeds of that collateral for certain purposes. The critical issue which falls to be decided is, then, what is the scope of this contractual licence? In particular, if this bank's consent included the right to sell the inventory in order to pay wages, then that consent by necessity included the right to sell inventory to remit payroll deductions. In such a situation, for the following reasons, Her Majesty's interest would be able to attach to the proceeds of the inventory, and in this way take priority over the bank's interest.

67 As stated previously, at para. 41, it is my opinion that the licence theory may operate, in the context of the statutory scheme at issue in the present appeal, as an exception to the general rule that at the time of “liquidation, assignment, receivership or bankruptcy” Her Majesty’s interest cannot attach to property which is at that time the property of a secured creditor. More specifically, where it can be said that at the time the deductions were made a secured creditor had consented to the use of its collateral in order to pay the statutory deductions which are the object of a deemed trust, it may also be said that that creditor has bound itself by the statutory requirements relating to those deductions. Here, therefore, if it can be said that at the time the wage deductions at issue were made the bank had permitted the sale of inventory in order to pay wages, and thus wage deductions, it will be possible for s. 227(5) to attach to the bank’s inventory existent at the time of receivership. With regard to this approach to the licence theory, see *FBDB*, *supra*, at pp. 40-41, *Roynat*, *supra*, at pp. 649-50, and *G.M. Homes Inc.*, *supra*, at pp. 252-54.

68 In short, where the bank has consented to the reduction in the value of its security in order to pay statutory deductions at the time those deductions are made, they have to the same extent, by virtue of s. 227(5), consented to the reduction in their security at the time of receivership. The critical question which falls to be decided in this case, then, is what was the scope of the bank’s consent to sell inventory at the time the deductions were made?

(D) *Whether on the Facts the Licence to Sell Included the Right to Use the Proceeds to Pay Wages*?

69 I underline at the outset that the critical factor in the “licence to sell” argument is the permission which must be found to have been granted with

Digitized by Google

respect to the usage of the proceeds of the disputed collateral. Thus, while licences may often be mouthed in terms of a "right to sell in the ordinary course of business", it must not be forgotten that it is permission with respect to the usage of proceeds, and not necessarily the circumstances of sale, which is the proper focus of the inquiry.

70 When interpreting the contractual provisions which gave Sparrow the right to sell the encumbered inventory, it is necessary to look at the words of the contract, the nature of the transaction which the parties entered into, and all of the surrounding circumstances.

71 The express provisions of the GSA establishes that Sparrow was granted a licence to sell the encumbered inventory. In particular, the licence stated that:

> . . . until default, Debtor may, in the ordinary course of Debtor's business, sell or lease inventory and, subject to Clause 7 hereof, use Money available to Debtor. [Emphasis added.]

Therefore, Sparrow was permitted to sell its inventory in the ordinary course of its business and "use" the proceeds generated therefrom. The critical question is what "us[age]" this licence to sell in the "ordinary course of ... business" contemplated. In this connection, I find two of the express covenants in Sparrow's contractual arrangements to be salient. Paragraph 4(e) of the GSA required Sparrow:

> (e) to pay all taxes, rates, levies, assessments and other charges of every nature which may be lawfully levied, assessed or imposed against or in respect of Debtor or Collateral as and when the same become due and payable; [Emphasis added.]

In addition, in the Credit Facilities Agreement, Sparrow covenanted to the bank as follows:

> (3) it will promptly pay when due all business, income and other taxes properly levied on its operations and property and remit all statutory employee deductions when due; [Emphasis added.]

72 Looking at these express provisions of the contractual arrangements between Sparrow and the bank, I conclude that the payment of payroll deductions would be a usage to which the bank contemplated Sparrow would use the proceeds of inventory sold in the "ordinary course of ... business". My conclusion in this respect is buttressed when the nature of the dealings between Sparrow and the bank, and all the surrounding circumstances, are observed.

73 The bank was Sparrow's primary lender; it held a security interest in most, if not all, of Sparrow's assets. In particular, the bank held various security interests in Sparrow's inventory. It was of course in the bank's best interest that Sparrow function as a viable economic unit. To do so, Sparrow was required to sell its services as an electrical contractor and, necessarily, sell its inventory. From the sales of the inventory, Sparrow could generate revenues to, *inter alia*, pay its outstanding operating debts. If it failed to do so, Sparrow could be petitioned into bankruptcy, with the result that Sparrow could no longer generate the profits necessary to pay its loan obligations to the bank in the long term. One of Sparrow's ongoing obligations, its costs of doing business, was the paying of wages. In order to stay in business, and operate as a profitable business enterprise, Sparrow would have to pay its employees.

Digitized by Google

This is a necessary requirement of continuing in business. It would be reasonable that the bank expect, taking into consideration all the circumstances of this arrangement, that revenue from the sale of inventory would be used to pay wages.

74 From these observations, I consider the licence to sell inventory in the ordinary course of business in this case necessarily included a licence to sell inventory to pay wages, and remit wage deductions, in the course of its business. Where, as here, the secured party has security over the majority of the assets of the debtor, the security interest over the inventory must permit the debtor to sell the inventory and put it to the general use of its business, including towards the payment of wages. Indeed, the express terms of the licence intimates this, providing Sparrow could, "in the ordinary course of ... business, ... use Money available". The scope of the licence can thus be ascertained either from the express terms of the security agreement, or from the nature of the agreement and the conduct of the parties. To be clear, however, the scope of the licence in this case flows not merely from a right to sell inventory *per se*. Instead, it is the licence to sell inventory in the "ordinary course of [Sparrow's] business ... and use [the proceeds]" which renders it of such a quality as to include a right to use the proceeds to pay wages. As Professor Wood has correctly observed in "Revenue Canada's Deemed Trust Extends Its Tentacles: *Royal Bank of Canada v. Sparrow Electric Corp.*", *supra*, at p. 435, a licence to sell inventory may in certain circumstances be circumscribed so as to not include a right to use the proceeds to pay wages:

> The fact that the secured party permits the debtor to sell the inventory does not in itself imply that the secured party permits the debtor to use these proceeds to pay employees. In some cases the secured party will not restrict the debtor's ability to use the proceeds in the ordinary course of business, but this depends entirely on the security arrangement negotiated between the debtor and the secured party. Consider the following scenario:
>
> > SP finances the acquisition of inventory by an automobile dealer (D), and is granted a security interest in the inventory. The wholesale security agreement provides that D may sell the inventory in the ordinary course of business and that upon doing so D must immediately remit the wholesale purchase price of the automobile to SP.
>
> In this scenario, SP clearly does not permit the debtor to use the proceeds of inventory to pay its employees. Indeed, it is common for SP to regularly monitor the debtor to ensure that the debtor is not "out of trust" by failing to remit the proceeds of sale.

75 In summary, the true test of whether the licence to sell inventory includes the right to pay wages must therefore be a matter of interpreting the contractual arrangement between the parties. The focus is not so much on the circumstances of the selling of inventory, but rather the permitted usage of the proceeds of inventory. As in Professor Wood's example, where the licence has a limited scope, that licence may not include the right to use proceeds to pay wages. However, the expression of a limited use for proceeds of inventory cannot prevail if the arrangement between the parties is such as to allow, in practice, the debtor to use the inventory proceeds in the course of its business. In this respect, I agree with Professor Wood's comments regarding the

Digitized by Google

appropriate test for determining whether a licence to sell inventory includes permission to pay wages with the proceeds ("Revenue Canada's Deemed Trust Extends Its Tentacles: *Royal Bank of Canada v. Sparrow Electric Corp.*", *supra*, at pp. 435-36):

> This is not to say that the analysis should hinge on the existence of a trust proceeds clause or other contractual provision requiring the debtor to remit proceeds. A contractual provision of this type should not govern if the real arrangement between the parties is such that the debtor has the freedom to use the proceeds of inventory in the ordinary course of business.
>
> ...
>
> To make any sense at all, the licence theory must, at the very least, be restricted to cases where the secured party permits the debtor to pay employees either out of its collateral or out of the proceeds of its collateral. This permission cannot be derived merely from the existence of a licence to sell inventory. The test should be whether the debtor had the freedom to use these funds in the ordinary course of business as opposed to being under an obligation to remit them to the secured party. [Emphasis added.]

76 In the case at bar, the GSA contained an express licence permitting Sparrow to sell inventory in the course of its business and use the proceeds available; the BAS contained an implied licence to this effect. While it is true that the GSA contained a trust proceeds clause, I find that this cannot have the effect of limiting the scope of the licence where the real arrangement between the parties was, as expressly stated, that Sparrow could use the proceeds of inventory in the course of its business. The bank in this case was not a small inventory financier who required Sparrow to immediately remit proceeds of inventory to it. To the contrary, the bank was a large scale lender who permitted Sparrow to use inventory sales to maintain the viability of its enterprise. For these reasons, applying Professor Wood's test, I find that under the licence to "sell ... inventory" "in the ordinary course of ... business" and "use [the] [m]oneys available" the bank permitted Sparrow to sell inventory to pay wages and, necessarily, payroll deduction obligations.

77 For all these reasons, through the application of the licence theory, it is my conclusion that the appellant's s. 227(5) deemed trust must take priority over the bank's security interests in the disputed collateral. The trust fund representing the deducted amounts, while without identified subject matter from the date of its inception, is capable of identifying property subject to that trust *ex post facto*. To reiterate, the bank consented to the reduction in its security in inventory in order to pay wage deductions at the time those deductions were made, and s. 227(5) *ITA* has the effect of carrying forward that consent to the time of receivership. By consenting to the payment of wages out of the proceeds of inventory during the course of Sparrow's business, the bank *ipso facto* consented to the statutory scheme under the *ITA* designed to cover unpaid wage deductions. In short, in the present case the licence to deal with inventory proceeds coupled with the statutory scheme in s. 227(4) and (5) *ITA* gives priority to Her Majesty's claims for statutory wage deductions. This result is obtained both in regard to the bank's GSA, and its BAS.

78 The respondent bank has submitted that this result is necessarily precluded with regard to their BAS by virtue of s. 428(1) of the *Bank Act*, which provides as follows:

Digitized by Google

> **428.** (1) All the rights and powers of a bank in respect of the property mentioned in or covered by a warehouse receipt or bill of lading acquired and held by the bank, and the rights and powers of the bank in respect of the property covered by a security given to the bank under section 427 that are the same as if the bank had acquired a warehouse receipt or bill of lading in which that property was described, have, subject to subsection 427(4) and subsections (3) to (6) of this section, priority over all rights subsequently acquired in, on or in respect of that property, and also over the claim of any unpaid vendor. [Emphasis added.]

I cannot agree with this submission. It is true that s. 428(1) secures the respondent bank's proprietary right to the disputed collateral. However, for the reasons I have expressed, the fact remains that the bank has consented to the divestment of this interest. Such a waiver of priority, in my view, renders s. 428(1) of no assistance to the respondent bank.

79 I add as a final matter that in addition to providing certainty in disputes between consensual and non-consensual security interests, the licence theory has the virtue of achieving fairness in commercial law. Here, the respondent bank had permitted Sparrow to sell its inventory in the course of its business in order to, among other things, pay wages and wage deductions. To this extent, therefore, the bank permitted the reduction in the value of its security interest in Sparrow's inventory, during the ordinary course of Sparrow's business. Implicit in the bank's consent is the assumption that in so doing, Sparrow would generate profits from the conversion of inventory into revenues; this economic process, as I noted above, ensures that interest payments owing to the bank would be paid to them on a sustainable basis. In short, the bank benefitted in a general sense from Sparrow's carrying on its business operations, an endeavour which required Sparrow to pay wages and wage deductions. More specifically, however, when Sparrow stopped paying its wage deductions, as required, the bank could be said to benefit from the artificial increase in Sparrow's working capital, allowing an extension of the life of Sparrow's business.

80 Now, when Sparrow's business is no longer a viable enterprise, the bank says that it is entitled to the very payments which allowed Sparrow, in part at least, to stay in business longer than was legally economical. In essence, the bank is willing to accept the benefits of Sparrow's non-payment of statutory deductions, and can be said to have reasonably permitted the use of its collateral to pay these deductions at the time they should have lawfully been paid, but refuses to accept the burden of Sparrow's unlawful action at the time of its receivership. In my view, it should be the policy of the law that the respondent bank be held accountable for Sparrow's outstanding statutory obligations. The licence theory, as I have developed it, ensures that in appropriate circumstances this result will obtain. In this way, in my opinion the licence theory is grounded not only in legal principles, but also in sound policy.

81 Since writing the foregoing, I have had the benefit of reading the careful reasons of my colleague, Mr. Justice Iacobucci. With deference however, I do not share his views or his concerns.

82 I note that Iacobucci J., in his reasons, has taken me to have adopted the licence theory in extremely broad terms. Specifically, when summarizing the

Digitized by Google

conceptual basis of my reasoning, he states at para. 91:

> Consequently, says the [licence] theory, the bank's claim to the inventory must give way to any debts incurred in the ordinary course of business. [Emphasis added.]

Similarly, Iacobucci J. writes at para. 97:

> The satisfaction of any legitimate debt or obligation, whenever incurred, is arguably "in the ordinary course of business". Certainly, the payment of creditors is a permissible "use" of the proceeds of a sale of inventory. Following my colleague's reasoning, this would mean that every subsequent claim should prevail over the respondent's general security agreement, because every rival claim might have been satisfied out of the proceeds of a hypothetical sale of the inventory. [Emphasis added.]

83 With respect, as he acknowledges, my reasons do not go this far. It is not the consent to payment of wage deductions from the proceeds of inventory *simpliciter* which drives me to the conclusion that Her Majesty's interest must prevail. This is a necessary, but not sufficient, condition. In addition, however, what is significant to the outcome of this case is that the bank has consented to payment of wages including deductions, out of inventory which, at the time of the deductions, are by statute deemed to be taken out of the estate of the debtor (see ss. 153(3) and 227(4) *ITA*). Section 227(5) carries that consent forward to the time of liquidation, assignment, receivership or bankruptcy, to realize Her Majesty's claim out of the bank's inventory.

84 Therefore, the unique nature of the statutory provisions applicable to wage deductions, and the bank's consent thereto, are integral to the success of the s. 227(5) claim in the case at bar. In this way, the licence theory, as I have employed it, is circumscribed.

85 It must be stressed that the issue relates to wages actually paid to employees -- not a simple obligation to pay wages -- a portion of which has been deducted from the amount remitted to the employee and must be remitted to Her Majesty. Pending such remittance, the amount deducted is deemed under s. 227(4) to be held in trust for Her Majesty. By virtue of these *ITA* provisions, and unlike ordinary debts and obligations, unpaid wage deductions are, in law, performed obligations. The consent by the bank to the payment of wages out of the proceeds of the sale of inventory must be taken to cover the wages paid according to law including that portion which has been deducted from the remittance to the employee, pursuant to the *ITA*, in order that it be remitted to Her Majesty. While the value of the bank's security in the inventory may be thereby reduced, this is by virtue of specific statutory requirements under well-defined rules limited in their application to actual payment of wages. These requirements are well known and are encompassed by the bank's consent to the payment of wages in the ordinary course of business and do not open the door to uncertainty as to the value of security. Any risk to the bank's security is part of the very risk involved in consenting to the payment of wages. This does not open the door to any uncertainty as to the value of the bank's security arising from unperformed obligations incurred by the debtor in the ordinary course of business.

86 For these reasons, I cannot agree with the premise underlying Iacobucci J.'s reasons, namely, that the licence theory as I have employed it is

Digitized by Google

inimical to the integrity of commercial law. It does not have the extensive application suggested by my colleague; it does not create uncertainty in commercial transactions. Instead, the licence theory operates narrowly, in conjunction with unique statutory provisions, so as to actualize legally performed obligations when they, in fact, exist.

VI - Conclusion

87 It is possible to summarize my conclusions in this case into the following five propositions:

1. Priorities between statutory trusts and consensual security interests are resolved by determining which interest has an attached interest in the disputed collateral at the time the statutory trust becomes operative.

2. The s. 227(5) *ITA* deemed trust attaches to any property of the debtor which exists upon liquidation, assignment, bankruptcy or receivership.

3. For example, if deductions are made prior to the attachment of a fixed charge over collateral, the s. 227(5) deemed trust will engage to retroactively attach Her Majesty's beneficial interest to that collateral. The fixed charge over that collateral will thereafter be subject to Her Majesty's pre-existing claims for unremitted payroll deductions.

4. Otherwise, if a security interest is in the nature of a fixed and specific charge, that interest gives the holder legal title to the collateral, such that a subsequent competing statutory trust will not be able to attach its interest. In such a case, all the statutory trust can attach to is the equity of redemption in the collateral.

5. However, as an exception to propositions 2 and 4, where the holder of a fixed security interest permits the debtor to sell the collateral, this may provide an opportunity for the statutory trust to attach. Whether this actually occurs depends entirely on the facts of each case. The test is whether, at the time the deductions occurred, the debtor had the right to sell the collateral and use the proceeds to pay the obligation to which the statutory trust is related.

88 I have found that, on the facts of this case, the licence invoked to sell inventory included the permission to use its proceeds to pay wages or wage deductions. The test in proposition 5 has therefore been made out. Accordingly, I would allow the appeal with costs.

The judgment of Sopinka, McLachlin, Iacobucci and Major JJ. was delivered by

89 IACOBUCCI J. -- I have read the lucid reasons of my colleague, Justice Gonthier, and although I agree with much of his reasoning, I cannot, with respect, accept the conclusion that he reaches. In particular, I do not accept that the deemed trust that arises in favour of the Crown by operation of s. 227(4) of the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) (hereinafter "*ITA*"), takes priority over the security interests that the respondent has under the *Bank Act*, S.C. 1991, c. 46, and the *Personal Property Security Act*, S.A. 1988, c. P-4.05 (hereinafter "*PPSA*"). Even conceding that the latter interests are subject to a licence to sell, the licence is not nearly so broad as to encompass the satisfaction of income tax obligations. As I will discuss below, a licence to sell inventory authorizes at most only the satisfaction of obligations that are immediately incidental to an actual sale of the inventory.

90 Because my only disagreement with my colleague is in his application of the licence-to-sell approach to this case, I do not propose to discuss the facts or background that he has so ably described or to dwell on any other part

Digitized by Google

of his reasons. I need not say anything more about the character of the respondent's security interests than that they are fixed and specific.

91 My colleague disposes of this appeal on the basis of the so-called "licence theory". Briefly, the licence theory holds that a bank's security interest in a debtor's inventory, though it be fixed and specific, is subject nevertheless to a licence in the debtor to deal with that inventory in the ordinary course of business. Consequently, says the theory, the bank's claim to the inventory must give way to any debts incurred in the ordinary course of business. The leading articulation of the licence theory appears in McLachlin J.A.'s (as she then was) reasons in *R. in Right of B.C. v. F.B.D.B.*, 1987 CanLII 156 (BC CA), [1988] 1 W.W.R. 1 (B.C.C.A.) (hereinafter "*FBDB*"), at p. 40.

92 The theoretical basis of the licence theory seems to be that a creditor who has granted a licence to sell inventory has thereby consented to the subjection of his security interest to other obligations that may arise "in the ordinary course of business". My colleague says this in his reasons, at para. 68:

> In short, where the bank has consented to the reduction in the value of its security in order to pay statutory deductions at the time those deductions are made, they have to the same extent, by virtue of s. 227(5) [*ITA*], consented to the reduction in their security at the time of receivership.

This is sensible, because it is only if the licence is understood as a kind of tacit lessening of the creditor's security interest that the appellant's cause is advanced. Certainly the actual operation of the licence is not relevant, because in this case the inventory in question was never actually sold pursuant to the licence. Rather, the receiver sold it by court order. If the licence is to have anything to do with the disposition of this appeal, it must be by virtue of the evidence it affords of the respondent's intention to take less than an entire security interest in the inventory.

93 In my view, the licence affords no such evidence. My colleague seems to think that the potential sale of the inventory amounts to an actual limitation of the security interest. For my part, I do not see what the one thing has to do with the other. There is a great difference between saying, on the one hand, that <u>if</u> a debtor sells inventory and applies the proceeds to a debt to a third party, <u>then</u> the third party takes the proceeds free of any security interest and saying, on the other hand, that because a third party <u>could</u> take the proceeds free of any security interest, no security interest exists in the proceeds as against that third party. A licence to sell inventory in the ordinary course of business is a condition of the former kind. The consequent (defeasance of the security interest) follows only if the antecedent (sale of the inventory and application of proceeds to an obligation to a third party) is satisfied. In other words, the security interest in the inventory disappears <u>only if</u> the debtor actually sells the inventory and applies the proceeds to a debt to a third party.

94 That this is so is suggested by s. 28(1) *PPSA*, which provides:

> **28**(1) Subject to this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest
>
> (a) continues in the collateral, unless the secured party expressly or impliedly authorized the dealing, and
>
> (b) extends to the proceeds,

Digitized by Google

but where the secured party enforces a security interest against both the collateral and the proceeds, the amount secured by the security interest in the collateral and the proceeds is limited to the market value of the collateral at the date of the dealing.

In accordance with this provision, the result of a sale of inventory is to give the purchaser an unencumbered interest in the inventory and the licensor a continuing security interest in the proceeds of the sale. It is only if the debtor subsequently uses the proceeds to satisfy an obligation to a third party that the proceeds will be removed from the scope of the licensor's security interest in them. Accordingly, what a security agreement with a licence to sell creates is a defeasible interest; but the event of defeasance is the actual sale of the inventory and the actual application of the proceeds against an obligation to a third party.

95 I recognize that the operation of s. 28(1) *PPSA* is not necessarily inconsistent with the broad interpretation of the licence to sell that my colleague advances. However, it seems to me that this is an appropriate case for the invocation of the maxim *expressio unius est exclusio alterius*. The statute prescribes certain consequences for the security interest that follow a dealing with inventory. In particular, the statute contemplates defeasance of the interest if the debtor actually sells the inventory and applies the proceeds to an obligation to a third party. Significantly, the statute does not contemplate a defeasance on the happening of any other event. In my view, the statute occupies the field and crowds out other possible interpretations of the licence, including the one that Gonthier J. favours.

96 Because in this case there was no actual sale of the inventory in question, let alone any disposition of the proceeds, the licence can have had no effect on the respondent's security interest. What the debtor might have done with the licence does not matter.

97 If it were otherwise, the licence to sell inventory would entirely eviscercate the respondent's general security agreement. The satisfaction of any legitimate debt or obligation, whenever incurred, is arguably "in the ordinary course of business". Certainly the payment of creditors is a permissible "use" of the proceeds of a sale of inventory. Following my colleague's reasoning, this would mean that every subsequent claim should prevail over the respondent's general security agreement, because every rival claim might have been satisfied out of the proceeds of a hypothetical sale of the inventory. Moreover, the priority rules of the *PPSA*, whose general policy is to assign priority to the earliest registered security interest, would be turned on their head. Presuming that every charge against inventory is subject to a licence to sell -- a presumption that accords with the interest of creditors in ensuring the debtor's continued vitality -- the last security interest would take priority over all earlier ones, because only the last interest would not be subject to some charge arising in the ordinary course of business. In answer to this objection, it might be said that as between two *PPSA* securities, the rules in the Act should be applied to determine priority. However, such an answer would not be consistent with the licence theory, which supposes that the original security interest in the inventory ends where obligations incurred in the ordinary course of business begin. The subsequent interest would prevail because the earlier interest would disappear before it.

Digitized by Google

98 It is open to my colleague to distinguish the fact situation in this appeal from the hypothetical priority contests I have mentioned on the ground that the Crown's interest in the inventory is unlike other charges against inventory in that it depends on the fictional device of deeming. What makes this case different, it might be said, is that the *ITA* deems to have been done what could have been done. On this understanding, it does not matter that the inventory was not actually sold and the proceeds were not actually remitted to the Receiver General, because s. 227(4) and (5) *ITA* deem these things to have been done. But in my view, this answer cannot succeed because the inventory was not an unencumbered asset at the moment the taxes came due. It was subject to the respondent's security interest and therefore was legally the respondent's and not attachable by the deemed trust. As Gonthier J. himself says (at para. 39):

> . . . [s. 227(4)] does not permit Her Majesty to attach Her beneficial interest to property which, at the time of liquidation, assignment, receivership or bankruptcy, in law belongs to a party other than the tax debtor.

99 The deeming is thus not a mechanism for undoing an existing security interest, but rather a device for going back in time and seeking out an asset that was not, at the moment the income taxes came due, subject to any competing security interest. In short, the deemed trust provision cannot be effective unless it is first determined that there is some unencumbered asset out of which the trust may be deemed. The deeming follows the answering of the chattel security question; it does not determine the answer.

100 Indeed, Gonthier J. does seize on the peculiar nature of the deemed trust as a possible ground for distinguishing the Crown's interest from rival interests. However, his argument differs from the one I have outlined to the extent that it emphasizes the deemed performance of the obligation to the Crown. It appears to be my colleague's position that the licence to sell represents a reduction in the value of the security interest only with respect to performed obligations but not with respect to unperformed ones. In his view, this represents a sufficient check on the licence theory. I agree that, if the distinction between performed and unperformed obligations were maintainable, then the likelihood of the licence consuming the security interest would be greatly reduced. However, in my view, the distinction cannot be maintained. As Gonthier J. says more than once in his reasons, the licence theory rests on the consent of the parties. But the parties to this case consented to the sale of inventory "in the ordinary course of Debtor's business". The language is unqualified. No distinction is drawn between performed and unperformed obligations. The only performance that is contemplated in the licence is the actual sale of the inventory and the application of the proceeds to a debt. And, as I have already argued, the deeming mechanism does not furnish the needed actual sale. Accordingly, I conclude that if the words of the licence are to be given their due as an *indicium* of the parties' intent, then there can be no distinction between performed and unperformed obligations.

101 My colleague places great emphasis on the fact that the debtor covenanted, in the general security agreement, "to pay all taxes, rates, levies, assessments and other charges of every nature which may be lawfully levied, assessed or imposed against or in respect of Debtor or Collateral as and when

Digitized by Google

the same become due and payable". But this covenant is not part of the licence. And in any event, it is merely a covenant to obey the law. It adds nothing to s. 153(1) *ITA*. Furthermore, it does not prescribe the outcome of a priority contest. What is more, the covenant to pay taxes is only one of several in the agreement. Another covenant provides that the debtor shall "carry on and conduct the business of Debtor in a proper and efficient manner". Presumably the debtor might incur subsequent debts in the course of carrying on and conducting its business. Gonthier J. advances no principle that might permit the settlement of priority disputes as between the Crown and subsequent lenders. In the event of a dispute, both would have the benefit of the licence to sell inventory and of express covenants, so that some other criterion would have to be found to determine which takes priority. Here, as before, the prospect of a reversal of the ordinary priority rules is immediate and troubling.

102 My colleague also relies on comments made in *FBDB*. In that case, the British Columbia Court of Appeal said, after having disposed of the appeal on another ground, that a licence to sell inventory carries with it a requirement that the licencee should satisfy obligations incurred in "dealing with the stock in the ordinary course of business": *FBDB*, *supra*, at p. 40. Because the obligation to set aside provincial sales taxes is a "legal incident" of the sale of inventory, a lien for unpaid sales taxes comes within the scope of the licence and so is excepted from any security interest that is subject to it: *idem*.

103 As I understand the comments in *FBDB*, a licence to sell inventory permits the satisfaction of obligations out of the proceeds only to the extent of the "legal incidents" of the sale. In itself, this greatly limits the scope of the theory. Because the payment of wages, except perhaps to the sales agent, is not a "legal incident" of the sale of inventory, deduction of income taxes from wages does not come within the scope of the licence. This alone would appear sufficient to distinguish *FBDB* from the instant appeal.

104 However, I think that on closer examination it turns out that *FBDB* does not even depend on a licence theory, or at least does not depend on a licence theory of the kind advanced by my colleague. I say this because his reasons posit a charge that arises against the value of the inventory as a result of the operation of the licence. But the sales taxes that were at issue in *FBDB* were not against the value of the inventory. Rather, they were superadded to the underlying value, which is to say that they were calculated on the basis of the sale price of the inventory. Thus, the sales taxes that attend a sale of inventory represent something over and above the value of the inventory. Because a bank's charge is against the inventory, it does not extend so far as the sales taxes generated by a sale of inventory. But income taxes are not like sales taxes in that they are not as directly related to sales of inventory as sales taxes are. To the extent that income taxes have anything to do with the proceeds of a sale of inventory, they are payable out of the monies received for the value of the inventory. A bank's charge against the inventory is therefore adequate to defeat subsequent claims for the payment of income taxes. For this reason, McLachlin J.'s reasoning in *FBDB* is not contrary to what I am advancing herein.

105 I should also mention that in 1988, when the *FBDB* case was

Digitized by Google

decided, British Columbia's *Personal Property Security Act*, S.B.C. 1989, c. 36, was not in force. As a consequence, the British Columbia Court of Appeal did not have to contend with the legislative considerations that we face in this appeal. In particular, there was at the time no equivalent in British Columbia law to s. 28(1) of Alberta's *PPSA*. The Court of Appeal therefore had greater latitude than we have to interpret a licence to sell as a tacit consent to a reduction of the security interest in the inventory. It seems to me that as a result of the enactment of the *PPSA*, something more than an unadorned licence to sell is needed to justify the conclusion that a creditor intended to abridge considerably its security interest in inventory.

106 And so I conclude that the licence to sell inventory is not an exception to the respondent's fixed and specific charge against the debtor's inventory. To hold otherwise would be to eviscerate the respondent's security interest. This is not to say, however, that Parliament could not legislate otherwise. Parliament has shown that it knows how to assert priority over rival security interests. See *Alberta (Treasury Branches) v. M.N.R.; Toronto-Dominion Bank v. M.N.R.*, 1996 CanLII 244 (SCC), [1996] 1 S.C.R. 963, at p. 975. All that is needed to overtake a fixed and specific charge is clear language to that effect.

107 Though I consider the above legal arguments sufficient to dispose of this appeal, I observe that policy considerations also tell in favour of the conclusion I have reached.

108 In this respect, the first thing to notice is that the security agreement that the debtor and the respondent had in this case is an example of a very common and important financing device. To a considerable extent, commerce in our country depends on the vitality of such agreements. As several leading academics have observed, the amounts at stake run into the billions of dollars each year. And though not every creditor seeks security, the incentives to do so are powerful. See Jacob S. Ziegel, Benjamin Geva and R. C. C. Cuming, *Commercial and Consumer Transactions* (Rev. 2nd ed. 1990), at pp. 957-60. Accordingly, tinkering with security interests is a dangerous business. The risks of judicial innovation in this neighbourhood of the law are considerable.

109 Chief among these is the risk that attends legal uncertainty. If the legal rule is not clear, then inventory financiers will have to provide against the risk that their security interest might be defeated by some rival claim. The danger is particularly acute where as here, the language is as broad as "in the ordinary course of business". In this regard, I agree with what Professor Roderick J. Wood said in his article ("Revenue Canada's Deemed Trust Extends Its Tentacles: *Royal Bank of Canada v. Sparrow Electric Corp.*" (1995), 10 *B.F.L.R.* 429, at p. 429) that my colleague cites:

> . . . there is little controversy with the proposition that a priority rule should be capable of producing reasonably predictable results. An unclear priority rule imposes a number of social costs. It means that creditors must plan their affairs against less certain outcomes. Uncertain rules generate more litigation than clear rules. Over time an uncertain rule is sometimes transformed into a clear rule through the process of judicial interpretation. However, this is a piecemeal approach which often occurs at a glacial pace.

110 Indeed, the consequences of my colleague's approach might be more dire than even Professor Wood supposes. For, as I have observed, almost any subsequent financial arrangement might be in the ordinary course of business.

Digitized by Google

Accordingly, the possibility is real that my colleague's proposed rule would effectively obliterate the *PPSA* charge against inventory. As insurance against this outcome, the costs of financing would presumably increase. I agree that if Parliament mandated this outcome, the courts must perforce accept it. However, judges should not rush to embrace such a weighty consequence unless the statutory language requiring them to do so is unequivocal.

111 Moreover, and for reasons I have already given, there is every likelihood that a broad interpretation of the licence theory would do violence to the *PPSA*. The Act clearly contemplates that inventory financing will be an important commercial device. But allowing the mere potential operation of a licence to sell to defeat a security interest in inventory would deprive the interest of all efficacy. It would not be any sort of security against subsequent obligations.

112 Finally, I wish to emphasize that it is open to Parliament to step in and assign absolute priority to the deemed trust. A clear illustration of how this might be done is afforded by s. 224(1.2) *ITA*, which vests certain moneys in the Crown "notwithstanding any security interest in those moneys" and provides that they "shall be paid to the Receiver General in priority to any such security interest". All that is needed to effect the desired result is clear language of that kind. In the absence of such clear language, judicial innovation is undesirable, both because the issue is policy charged and because a legislative mandate is apt to be clearer than a rule whose precise bounds will become fixed only as a result of expensive and lengthy litigation.

113 It remains to make a few remarks by way of conclusion. Because I believe that the respondent's general security agreement gave it a fixed and specific charge against the debtor's inventory, and because I conclude that the licence to sell that inventory does not derogate from the respondent's security interest, I conclude that this appeal should be dismissed. I do not need to decide whether the *Bank Act* security would have priority over the deemed trust as well; though given that the licence to sell inventory under the *Bank Act* security is only implied, I do not see how the Crown could have a greater claim under the *Bank Act* than it has under the *PPSA*.

114 Therefore I would dismiss the appeal with costs.

Appeal dismissed with costs, LA FOREST, GONTHIER *and* CORY JJ. *dissenting*.

Solicitor for the appellant: The Attorney General of Canada, Ottawa.

Solicitors for the respondent: Milner, Fenerty, Edmonton.

Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny, 2009 SCC 49, [2009] 3 S.C.R. 286 – Bankruptcy and Insolvency Act Considerations on ETA Deemed Trusts ceasing to apply

Bankruptcy and insolvency — Crown claims — Goods and services tax —Provincial sales tax
Tax amounts that have been collected but not remitted, or are collectible, at time of bankruptcy of supplier

Digitized by Google

Legal characterization of Crown's rights in amounts of such taxes — Whether federal or provincial Crown is ordinary creditor or owner of tax amounts — Excise Tax Act, R.S.C. 1985, c. E-15, s. 222(1), (1.1) — Act respecting the Ministère du Revenu, R.S.Q., c. M-31, s. 20 — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 67(2).

The GST imposed under the *Excise Tax Act* ("*ETA*") and the QST payable under the *Act respecting the Québec Sales Tax* are taxes that are collected, and in respect of which credits are available, at each step of the manufacturing and marketing of taxable goods and services. They are payable by the recipient, who is regarded as the debtor in respect of the tax liability to the Crown. In principle, the supplier acts only as a mandatary of the Crown in collecting and remitting these taxes and is deemed to hold the amounts so collected in trust for Her Majesty.

A number of businesses went bankrupt. The Canadian and Quebec tax authorities (the "tax authorities") claimed from the trustees the GST and QST amounts that had been collected but not remitted, or were collectible, by those businesses as of the dates of their bankruptcies. The tax authorities submitted that they were entitled to the amounts in issue as the owners thereof. Financial institutions that held various security interests in the property of the bankrupts contended that, under the law applicable in bankruptcy matters, the federal or provincial Crown is only an ordinary creditor and must be ranked as such with the debtors' other creditors, and that their security interests could therefore be set up against the Crown. The Quebec Superior Court found for the tax authorities on the basis that the GST and QST amounts were not part of the bankrupts' patrimonies. The Quebec Court of Appeal set aside the judgments.

Held: The appeals should be dismissed.

When a supplier goes bankrupt, the tax authorities do not own GST and QST amounts that have been collected but not remitted or are collectible at the time of the bankruptcy. Instead, they have an unsecured claim against the supplier. The legal characterization of the relationships between the tax authorities and the suppliers and recipients of goods and services cannot be considered in isolation from the overall context of the system for the collection and remittance of these taxes and from the provisions of the *Bankruptcy and Insolvency Act* ("*BIA*"). The tax authorities' position amounts to maintaining that the deemed trusts established by s. 222 *ETA* and s. 20 of the *Act respecting the Ministère du Revenu* ("*AMR*")continue to exist after a bankruptcy, which conflicts with both the words and the intent of the statutory provisions in question, and is inconsistent with the nature of the tax authorities' rights under the system for the collection and remittance of the GST and QST. [7] [21] [28-29]

In light of the 1992 amendments to s. 67 *BIA*, the deemed trusts established by ss. 222 *ETA* and 20 *AMR* are terminated at the time of the bankruptcy. Parliament also enacted concordance amendments to the *ETA* by adding subs. (1.1) to s. 222. As a result of this provision, deemed trusts intended to secure GST claims are ineffective in bankruptcy situations. Although the Quebec legislation does not contain a provision similar to s. 222(1.1) *ETA*, Parliament's legislative authority over bankruptcy prevents the provincial legislatures from modifying the order of priority established in the *BIA*. Thus, the trustee is responsible for liquidating patrimonies that include the GST and QST amounts in issue. The mandate the supplier or the trustee is deemed to have been given with respect to the two taxes involves the performance of

Digitized by Google

obligations to collect and then to remit, not the amounts collected, but a balance resulting from offsetting claims of the Crown and the supplier. [7-8] [16-17] [23] [27-28]

Cases Cited

Referred to: *Reference re Quebec Sales Tax*, [1994] 2 S.C.R. 715; *Reference re Goods and Services Tax*, [1992] 2 S.C.R. 445; *D.I.M.S. Construction inc. (Trustee of) v. Quebec (Attorney General)*, 2005 SCC 52, [2005] 2 S.C.R. 564; *Victuni AG v. Minister of Revenue of Quebec*, [1980] 1 S.C.R. 580; *Lefebvre (Trustee of)*, 2004 SCC 63, [2004] 3 S.C.R. 326; *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24; *Caisse populaire Desjardins de l'Est de Drummond v. Canada*, 2009 SCC 29, [2009] 2
S.C.R. 94.

Statutes and Regulations Cited

Act respecting the Ministère du Revenu, R.S.Q., c. M-31, ss. 20, 23, 24.
Act respecting the Québec sales tax, R.S.Q., c. T-0.1, ss. 16, 82, 302.1, 422, 425, 427, 437.
Act respecting the Québec sales tax and amending various fiscal legislation, S.Q. 1991, c. 67.
Act to amend the Bankruptcy Act and to amend the Income Tax Act in consequence thereof, S.C. 1992, c. 7.
Bank Act, S.C. 1991, c. 46, s. 427.
Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 67, 86(1), 87(1).
Constitution Act, 1867, s. 92(2).
Excise Tax Act, R.S.C. 1985, c. E-15, ss. 141.01, 165, 169(1), 221(1), 222(1), (1.1), (3), 223, 224, 228,
265, 296(1)(*b*).

Authors Cited

Canada. House of Commons. *House of Commons Debates*, vol. II, 3rd Sess., 34th Parl., June 19, 1991, p.
2106.
Canada. House of Commons. *House of Commons Debates*, vol. IV, 3rd Sess., 34th Parl., November 1, 1991, p. 4354.
Canada. House of Commons. *Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 9, September 5, 1991, p. 9:5.
Canada. House of Commons. *Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 10, September 5, 1991, p. 10:18.
Robert Brakel & Associates Ltd. *Value-Added Taxation in Canada: GST, HST, and QST*, 2nd ed. Toronto: CCH Canadian, 2003.
Sullivan, Ruth. *Sullivan on the Construction of Statutes*, 5th ed. Markham, Ont.: Lexis-Nexis, 2008.

APPEAL from a judgment of the Quebec Court of Appeal (Forget, Doyon and Duval Hesler JJ.A.), 2007 QCCA 1837, [2008] R.J.Q. 39, 40 C.B.R. (5th) 18, [2008] G.S.T.C. 3, SOQUIJ AZ-50464769,

[2007] J.Q. n^{o} 14712 (QL), 2007 CarswellQue 12231, setting aside a decision of Boisvert J., 2006 QCCS 2108, 34 C.B.R. (5th) 245, [2007] G.S.T.C. 185, SOQUIJ AZ-50368833, [2006] J.Q. n^{o} 3613 (QL), 2006
CarswellQue 3427. Appeal dismissed.

Digitized by Google

APPEAL from a judgment of the Quebec Court of Appeal (Forget, Doyon and Duval Hesler JJ.A.), 2007 QCCA 1835, 40 C.B.R. (5th) 18, [2008] G.S.T.C. 3, SOQUIJ AZ-50464328, [2007] J.Q. n° 14713 (QL), 2007 CarswellQue 12231, setting aside a decision of St-Julien J., 2006 QCCS 6370, SOQUIJ AZ-50412620, [2006] J.Q. n° 15239 (QL), 2006 CarswellQue 11998. Appeal dismissed.

APPEAL from a judgment of the Quebec Court of Appeal (Forget, Doyon and Duval Hesler JJ.A.), 2007 QCCA 1813, 40 C.B.R. (5th) 18, [2008] G.S.T.C. 3, SOQUIJ AZ-50464770, [2007] J.Q. n° 14564 (QL), 2007 CarswellQue 12231, setting aside a decision of Bouchard J., 2006 QCCS 2656, 21 C.B.R. (5th) 289, [2006] G.S.T.C. 123, SOQUIJ AZ-50373960, [2006] J.Q. n° 11028 (QL), 2006 CarswellQue 4759.

Appeal dismissed.

Christian Boutin, *Michel Beauchamp*and *Jean-Yves Bernard*, for the appellant the Deputy Minister of Revenue of Quebec.

Pierre Cossette and *Guy Laperrière*, for the appellant Her Majesty The Queen.

Reynald Auger and *Jean-Patrick Dallaire*, for the respondents Caisse populaire Desjardins de Montmagny and Raymond Chabot Inc., in its capacity as Trustee in bankruptcy of 9083-4185 Québec Inc.

Mason Poplaw and *Miguel Bourbonnais*, for the respondent Raymond Chabot Inc., in its capacity as Trustee for the estate of the debtor, Consortium Promecan Inc.

Marc Germain, for the respondent the National Bank of Canada.

Éric Vallières and *Sidney Elbaz*, for the intervener.

Digitized by Google

English version of the judgment of the Court delivered by LEBEL J. —

Introduction

[1] **In these three cases, the Canadian and Quebec tax authorities, on the one hand, and the trustees in bankruptcy of certain businesses and financial institutions holding various security interests in the property of the bankrupts, on the other, disagree about what should be done with taxes on consumption that had been collected but not remitted, or were collectible, as of the date of the bankruptcy.** The tax authorities submit that they are entitled to the amounts in issue as the owners thereof. The respondents contend that, under the law applicable in bankruptcy matters, the federal or provincial Crown is only an ordinary creditor and must be ranked as such with the debtors' other creditors. The financial institutions submit that their security interests can be set up against the Crown as against any ordinary creditor. **The Quebec Superior Court found for the Crown. The Quebec Court of Appeal set aside the judgments and accepted the arguments of the trustees and financial institutions. In my view, that decision is well founded, and I would uphold it.**

Origins of the Cases

[2] These three cases result from the bankruptcies of a number of businesses and from problems that arose as a result of their insolvency in respect of the administration of the federal goods and services tax ("GST") imposed under the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), and the Quebec sales tax ("QST") payable under the *Act respecting the Québec sales tax*, R.S.Q., c. T-0.1 ("*AQST*"). To begin, I will summarize the facts that must be considered to understand these cases. The relevant statutory provisions are reproduced in the Appendix.

Deputy Minister of Revenue of Quebec and Her Majesty the Queen in Right of Canada v. Caisse populaire Desjardins de Montmagny and Raymond Chabot Inc., in its Capacity as Trustee in Bankruptcy of 9083-4185 Québec Inc.

[3] In this case, a manufacturing company required, as a supplier, to collect the GST and the QST went bankrupt on September 7, 2005. Raymond Chabot Inc. was appointed trustee in bankruptcy. The debtor had hypothecated its claims and accounts receivable in favour of the respondent Caisse populaire Desjardins de Montmagny. Quebec's Deputy Minister of Revenue gave the trustee notice that he considered it to be his mandatary for the recovery of GST and QST amounts that had been collected but not remitted or were collectible. The tax authorities claimed that they owned the amounts in question. Furthermore, the record shows that some of the taxes that had been collected or were collectible at the time of the bankruptcy had been payable for more than 60 days. The Caisse populaire Desjardins de Montmagny claimed to hold valid security interests, which could be set up against the tax authorities, in the tax amounts related to the claims hypothecated in its favour. In view of these conflicting claims, the trustee asked the Superior Court to determine to whom the tax amounts belonged.

Deputy Minister of Revenue of Quebec and Her Majesty the Queen in Right of Canada v. Raymond Chabot Inc. in Its Capacity as Trustee for the Estate of the Debtor, Consortium Promecan Inc.

[4] In this case, Consortium Promecan Inc. went bankrupt on March 20, 2004, and

Digitized by Google

Raymond Chabot Inc. was appointed trustee. The debtor had not filed returns with respect to the GST and the QST since February 1, 2004. Quebec's Deputy Minister of Revenue asked the trustee to remit to him all GST and QST amounts in respect of the period between February 1 and March 20, 2004 that had been collected or were collectible. The trustee replied that, in its view, the Deputy Minister was only an ordinary creditor in the bankruptcy, and it denied his request. The Crown appealed that decision to the Superior Court.

Deputy Minister of Revenue of Quebec and Her Majesty the Queen in Right of Canada v. National Bank of Canada

[5] The tax claims in this case result from the bankruptcies of two companies, Alternative Granite et Marbre inc. and Stone Vogue Ressources inc., on November 5, 2004. The Crown claimed GST and QST amounts related to the accounts receivable of the bankrupt debtors. The National Bank of Canada had obtained, on those accounts, security under s. 427 of the *Bank Act*, S.C. 1991, c. 46, and movable hypothecs. It tried to exercise its rights under these various security interests and claimed the proceeds of the accounts receivable as well as the GST and QST amounts related to these claims. It then applied to the Superior Court to resolve the resulting dispute between itself and the tax authorities. In the meantime, the Bank's mandatary, the trustee and the Crown all collected portions of the disputed taxes and even of the accounts receivable.

Judicial History

Quebec Superior Court

[6] The Superior Court heard the three cases separately. The result was the same in all of them. All three judges concluded that the Crown owned the disputed GST and QST amounts. If the trustee in bankruptcy collected them, it was as a mandatary of the tax authorities. Quebec's Deputy Minister of Revenue and the Minister of National Revenue could not be considered to be mere ordinary creditors. In essence, the Superior Court judges held that the GST and QST amounts were not part of the bankrupt's patrimony: 2006 QCCS 2108, 34 C.B.R. (5th) 245 (*per* Boisvert J.), 2006 QCCS 6370, [2006] J.Q. n^{o} 15239 (QL) (*per* St-Julien J.), 2006 QCCS 2656, 21 C.B.R. (5th) 289 (*per* Bouchard J.). All three judgments were appealed to the Quebec Court of Appeal.

Quebec Court of Appeal, Forget, Doyon and Duval Hesler JJ.A.

[7] Duval Hesler J.A., writing for the Court of Appeal, allowed the appeals and set aside the Superior Court's judgments: 2007 QCCA 1837, 2007 QCCA 1835, 2007 QCCA 1813, [2008] R.J.Q. 39. She acknowledged that the QST and the GST are direct taxes payable by the recipient of the good or service. But in her view, as a result of the 1992 amendments to the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"), the tax authorities must be treated as an ordinary creditor in such a case. They do not own tax amounts payable by purchasers of goods and services that are subject to the GST and QST, but instead have a claim against the supplier. Furthermore, any deemed trust in favour of the tax authorities ended at the time of the bankruptcy. The tax amounts in issue were therefore part of the bankrupt's patrimony but remained subject to any security interests that had been validly granted to creditors like the Caisse populaire Desjardins de Montmagny and the National Bank of Canada. This Court granted leave for three appeals from that judgment.

Digitized by Google

Analysis

Issues and Positions of the Parties

[8] The issue is the nature of the rights of the tax authorities, the trustee in bankruptcy and the secured creditors to GST and QST amounts that have been collected but not remitted or are collectible at the time of the bankruptcy of a supplier within the meaning of the *AQST* and the *ETA*. In sum, the tax authorities submit that they own these amounts. In their opinion, the trustee collects the taxes on their behalf, as their mandatary, and these amounts are not part of the bankrupt's patrimony. The respondents reply that the amounts are part of the bankrupt's patrimony, subject to any validly granted security interests. In their view, the Crown does not have a right of ownership in the tax amounts and enjoys only the rights of an ordinary creditor in a bankruptcy situation. To resolve this issue, it will be necessary to begin by considering the nature of the two taxes in issue, the GST and the QST, and the mechanism for administering them. I will also need, before ruling on the legal characterization of the Crown's rights, to discuss the effect of the 1992 amendments to the *BIA*.

Nature of the GST and the QST

[9] The GST and the QST are similar types of taxes on consumption. The legal framework for imposing them was established almost 20 years ago now. They are considered to be direct taxes, and the ultimate recipient of taxable goods and services is responsible for paying them. However, the taxes are collected, and credits apply, at each step of the manufacturing and marketing chains. In principle, the supplier acts only as a mandatary of the Crown in collecting and remitting these taxes (*Reference re Quebec Sales Tax*, [1994] 2 S.C.R. 715, at pp. 720-22).

[10] The GST, which was implemented in 1990 by legislation that amended the *ETA*(S.C. 1990, 45), replaced the former federal manufacturers' sales tax. The GST can be regarded as a value-added tax. It is collected at every stage of the manufacturing and marketing of goods and services and is payable by the recipient, who is regarded as the debtor in respect of the tax liability to the Crown (s. 165 *ETA*). However, the supplier is responsible for collecting and remitting the tax (s. 221(1) *ETA*). The supplier is deemed to hold the amounts so collected in trust for Her Majesty (s. 222(1) and (3) *ETA*) and must periodically file returns and make remittances. In addition, the Act establishes a system under which input credits can be claimed, at each step of the marketing and supply of the good, in respect of the taxes the supplier has had to pay to his or her own suppliers (ss. 141.01 and 169(1) *ETA*). The ultimate recipient bears the full burden of the tax (R. Brakel & Associates Ltd., *Value-Added Taxation in Canada: GST, HST, and QST* (2nd ed. 2003), at pp. 2-3). This Court has confirmed this as a valid exercise of the Parliament of Canada's taxing power (*Reference re Goods and Services Tax*, [1992] 2 S.C.R. 445).

[11] In parallel with this federal tax reform, an in-depth review of the consumption tax system took place in Quebec. In 1991, the National Assembly enacted new sales tax legislation, the *Act respecting the Québec sales tax and amending various fiscal legislation*, S.Q. 1991, c. 67. The National Assembly's intention in enacting this statute was to achieve extensive harmonization with the GST and to align this aspect of Quebec's tax system with the model chosen by the Parliament of Canada. The legislation came into force on July 1, 1992 (Brakel, at pp. 3-4). Under an agreement with the Government of Canada, the Quebec government is responsible for collecting both the GST and the QST in Quebec (Brakel, at p. 4).

Digitized by Google

Moreover, pursuant to s. 20 of the *Act respecting the Ministère du Revenu*, R.S.Q., c. M-31 ("*AMR*"), amounts collected by suppliers of goods and services are deemed to be held in trust for the State. This Court held that this new sales tax falls within the provincial taxing power under s. 92(2) of the *Constitution Act, 1867* (*Reference re Quebec Sales Tax*).

Effects of the Amendments to the BIA on the Status of Claims of the Crown

[12] In 1992, the Parliament of Canada also made extensive changes to the *BIA*, and those changes are of particular relevance to this issue of the nature and extent of the Crown's rights to recover the GST and QST amounts. The amendments in question were set out in the *Act to amend the Bankruptcy Act and to amend the Income Tax Act in consequence thereof*, S.C. 1992, c. 27. Some of these changes related to the Crown's priority in bankruptcy situations. The federal government seemed at the time to want to respond to criticisms that the system establishing the priority of the Crown's claims often left nothing for a bankrupt's ordinary creditors. A government spokesperson acknowledged these concerns at the time of the introduction of the legislation to revise the Crown priority system:

We also took steps to limit the priority of the Crown, one of the more blatantly unfair aspect[s] of the present Bankruptcy Act.

(*House of Commons Debates*, vol. II, 3rd Sess., 34th Parl., June 19, 1991, at p. 2106)

[13] Felix Holtmann, the Chairman of the Standing Committee on Consumer and Corporate Affairs and Government Operations, also acknowledged the problems and injustices caused by the proliferation of deemed trusts developed to protect the Crown's claims. He stressed the need to reduce the extent of such trusts in order to achieve a better balance among creditors in bankruptcy situations:

One of the main areas is Crown priority. Under the present Bankruptcy Act the Crown has a preferred claim for various types of taxes and ranks ahead of all unsecured creditors. In 1970 a study report made reference to Crown priority; then again in 1986 proposed bankruptcy amendments recommended the abolition of the Crown priority. With the Crown priority, creditors are less likely to participate in an insolvency, in a bankruptcy, and today rarely come out to meetings of creditors because there are no assets. The assets are fully secured to the secured creditors, banks and major lenders as well as to Crowns. As a result there is virtually nothing left for the unsecureds. We recommend that the Crown priority be abolished and that if the Crown wants to contract directly with the debtor, it be entitled to a contractual priority but not a Crown priority.

(*Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 9, September 5, 1991, at p. 9:5)

[14] During the parliamentary debates on Bill C-22 regarding the amendment of the *BIA*, comments by the government spokesperson confirmed that the government intended to reduce the Crown to the rank of an ordinary creditor in bankruptcy situations:

A second very important point in the legislation is that the Government of Canada, the Crown, does not put itself in a priority position. It stands in line with the unsecured creditors in almost all cases except for the deductions of tax and unemployment owed.

(*House of Commons Debates*, vol. IV, 3rd Sess., 34th Parl., November 1, 1991, at p. 4354)

In the course of the discussions in the Standing Committee on Consumer and

Digitized by Google

Corporate Affairs and Government Operations, the government spokesperson had clearly expressed the intention to abolish the deemed trust in respect of the GST in bankruptcy situations:

As far as the GST is concerned, if there is a deemed trust for GST, it will not come under this particular provision so it will not survive. If there is a statutory lien or priority, or a statutory security interest for GST, it will not take priority under this legislation unless it is a registered interest.

(*Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 10, September 5, 1991, at p. 10:18)

[15] The amendments to the bankruptcy legislation appear to be consistent with the legislative intention announced during the parliamentary debates. First of all, s. 67 *BIA* reinforces the principle that all the bankrupt's property is part of the estate of the bankrupt and constitutes the common pledge of the creditors, although with the exception of property held in trust for another person. However, s. 67(2) *BIA* provides that, with certain exceptions, property may not be regarded as held in trust unless it would be so regarded in the absence of a statutory provision. This renders statutory trusts ineffective without affecting trusts resulting from the common law or the civil law or statutory trusts that secure claims of the federal and provincial Crowns related to source deductions for income tax, a comprehensive pension plan or the federal employment insurance program (s. 67(3) *BIA*). No mention is made of trusts related to the GST or to provincial taxes such as the QST. Moreover, s. 86(1) *BIA* confirms that the Crown is only an ordinary creditor in a bankruptcy situation:

86. (1) In relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, in this section and in section 87 called a "workers' compensation body", rank as unsecured claims.

[16] In addition, not long after these changes to the *BIA*, the Parliament of Canada enacted concordance amendments with regard to GST claims (S.C. 1993, c. 27). It added subs. (1.1) to s. 222 *ETA*. As a result of this provision, deemed trusts intended to secure GST claims are ineffective in bankruptcy situations:

222. . . .

(1.1) Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act*), to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.

[17] The Quebec legislation respecting the QST does not contain a provision similar to s. 222(1.1) *ETA* that renders the deemed trust in favour of the tax authorities ineffective in bankruptcy situations. However, according to a settled principle of constitutional law regarding the Parliament of Canada's legislative authority over bankruptcy and insolvency, the provincial legislatures may not modify the order of priority established in the *BIA*. In the event of conflict, the *BIA* will prevail and the provincial statute will be inapplicable regardless of the legislature's intention (*D.I.M.S. Construction inc. (Trustee of) v. Quebec (Attorney General)*, 2005 SCC 52, [2005] 2 S.C.R. 564, at para. 12, *per* Deschamps J.).

[18] The tax authorities do not dispute the clear terms of the statutory provisions. Rather, they argue that those provisions do not apply to the GST and the QST and that the Crown is not a creditor, but the owner of the tax amounts. Thus, the amounts collected or collectible at the time of the bankruptcy in respect of the GST or the QST do not form part of the bankrupt's patrimony. As a result, they are not

Digitized by Google

included in the property that is to be liquidated in accordance with the order of priority established in the *BIA*. It will therefore be necessary to resolve the issue of the legal characterization of the Crown's rights with respect to the GST and QST amounts. The characterization of those rights will essentially resolve the dispute before this Court.

Legal Characterization of the Crown's Rights

[19] In this analysis, it is important to abide by the fundamental rules of contemporary statutory interpretation. Parliament's intent must be ascertained, and to do this, it is often necessary to review the statutory provisions at issue in their overall context (R. Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at p. 276). This approach casts doubt on the validity of the tax authorities' arguments.

[20] The appellants' arguments consist of a few fundamental propositions. They submit, first, that the GST and the QST are direct taxes on consumption. They are imposed on the consumer, and more specifically on the ultimate recipient of a taxable good or service. The legislation establishes a direct link between the Crown and the recipient, as the former may claim the taxes payable directly from the latter if they have not been collected (s. 296(1)(*b*) *ETA*). The appellants contend that where the GST is collected by a trustee in bankruptcy, the trustee, like the bankrupt supplier, collects it as an agent of, and on behalf of, the Crown. And the Crown is in a similar legal situation where the QST is concerned. The recipient owes the sales tax to the Crown pursuant to ss. 16 and 82 *AQST*. The supplier collects the tax on the Crown's behalf and is deemed to be a mandatary of the Crown pursuant to s. 422 *AQST*. Moreover, under s. 23 *AMR*, a person who does not collect a tax he or she was required to collect becomes a debtor of the State for that amount. The appellants further submit that, in the context of the *ETA* and the *AQST*, the supplier, a mandatary of the Crown, is responsible, after supplying a taxable service or good to a consumer, for the recovery of property— a GST or QST amount — that belongs to the Crown and that remains Crown property, until it is remitted to the Crown. The legal situation is the same regardless of whether the tax is collected by the supplier or by a trustee after its bankruptcy. In the appellants' view, when the collected tax is remitted, the mandatary does not settle a claim, but remits to the Crown its own property. Moreover, according to this argument, this Court has established a general principle that, in performing its obligation, the mandatary does not discharge a debt, but delivers over property belonging to the mandator (*Victuni AG*

v. Minister of Revenue of Quebec, [1980] 1 S.C.R. 580, at p. 584, *per* Pigeon J.).

[21] This set of legal propositions disregards the mechanisms for administering the GST and the QST. The legal characterization of the relationships between the tax authorities and the suppliers and recipients of goods and services cannot be considered in isolation from the overall context of the system for the collection and remittance of these taxes and from the provisions of the *BIA*.

[22] An initial comment must be made about the impact of the federal bankruptcy legislation. The appellants are oversimplifying the trustee's role and, in particular, his or her legal situation *vis-à-vis* the bankrupt. This Court has noted the complexity of the trustee's duties in, for example, *Lefebvre (Trustee of)*, 2004 SCC 63, [2004] 3 S.C.R. 326, at paras. 35-37. The trustee's role is not limited to representing the bankrupt. The trustee manages the bankrupt's patrimony and is seized thereof as a result of the bankruptcy, but he or she also represents the creditors and is responsible to them for the liquidation and orderly distribution of the patrimony.

[23] In the cases before the Court, the trustees were responsible for liquidating a

Digitized by Google

patrimony that included the GST and QST amounts in issue, as the Court of Appeal concluded (see paras. 51-55). In her reasons, Duval Hesler J.A. clearly and correctly defined the nature of the trustee's role in this respect. The reason why the supplier was given the status of a mandatary was to ensure that the tax qualified as a direct tax so that the imposition, by the province of Quebec, of the QST in a form compatible with that of the federal GST would be constitutional (para. 50). However, the fact that this tax is ultimately borne by the recipient does not support a finding that the supplier and then the trustee, the bankrupt's representative, merely collect and remit the Crown's "property" or "thing". The nature of the collection mechanism for the two taxes suggests another interpretation of the legal situation.

[24] This mechanism is designed to implement a direct tax that is also a tax on the value added at each stage of the production and marketing of the good or service until it is acquired by its ultimate recipient. In such a system, as Duval Hesler J.A. noted, —TRANSLATION— "[t]he dollar collected is not the dollar remitted"(para. 52).

[25] First of all, the collection mechanism does not require separate invoices for the GST and the QST. These taxes are indicated and included in the invoice or other document given to the recipient (s. 223 *ETA*; s. 425 *AQST*). Next, the tax amounts collected by suppliers are remitted in accordance with the accrual, not cash, method of accounting. At periodic intervals, which vary depending on the individual supplier's sales and sometimes on the nature of the business, suppliers remit to the tax authorities amounts corresponding to the tax amounts that have been billed for and are collectible during the reporting period in question even if these collectible amounts have not in fact been collected from the recipients. When sending remittances, suppliers deduct from the amounts being remitted credits corresponding to their own inputs, that is, to the taxes they have paid to their own suppliers. Thus, they remit net tax amounts based on the difference between the taxes they have collected and the taxes they themselves have paid (s. 228 *ETA*; s. 437 *AQST*). At times, under this system, they can obtain rebates.

[26] Moreover, nothing in the legislation respecting the GST and the QST requires suppliers to keep the taxes they collect separate. Until a bankruptcy occurs, only the deemed trusts established by s. 222 *ETA* and s. 20 *AMR* lead to this legal result by giving the tax authorities a right to equivalent amounts from the suppliers' assets. Finally, while it is true that the recipient owes the tax to the Crown, a supplier who has remitted the tax owed by the recipient but has not collected it has a cause of action against the recipient (s. 224 *ETA*; s. 427 *AQST*).

[27] The statutory mandate imposed on the supplier to collect the GST and the QST differs from the mandate in issue in *Victuni*, which related to the acquisition and development of an immovable. The mandate with respect to the two taxes involves the performance of obligations to collect and then to remit, not the amounts collected, but a balance resulting from offsetting claims of the Crown and the supplier. The existence of these offsetting claims confirms that claims for the amounts collected by suppliers are fungible, as this Court in fact pointed out in *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24, at pp. 34-35.

[28] I note that the appellants' position amounts to maintaining that the deemed trusts established by s. 222 *ETA* and s. 20 *AMR* continue to exist after a bankruptcy. The appellants' argument is inconsistent with the nature of their rights under the system for the collection and remittance of the GST and QST. It also conflicts with Parliament's clear intent and with the very explicit wording of the relevant statutory provisions regarding what is to happen if a supplier goes bankrupt. Before 1992, the Crown held a priority where certain tax claims were concerned. These claims were

Digitized by Google

often protected by an increasingly complex series of statutory deemed trusts. **The 1992 amendments to the *BIA* rendered these trusts ineffective in a bankruptcy situation, although there were exceptions with respect, for example, to claims for income tax source deductions (see, for example, *Caisse populaire Desjardins de l'Est de Drummond v. Canada*, 2009 SCC 29, [2009] 2 S.C.R. 94). Other than where these exceptions apply, when a debtor goes bankrupt, the Crown becomes an ordinary creditor.** The trustee will give it the same priority as other creditors of the same rank. The trustee will be personally responsible for paying the GST or QST in respect of its own activities only (s. 265 *ETA*; s. 302.1 *AQST*).

[29] Canadian tax authorities are bound by the choice of legislative policy now expressed in the *BIA*. The order of priority established in the *BIA*is also binding on the Quebec tax authorities, even though the *AMR* is silent on what happens to the deemed trust established in s. 20 thereof in the event of bankruptcy. The appellants' arguments conflict with both the words of the statutory provisions in question and their underlying legislative intent, and cannot be accepted.

Conclusion

[30] For these reasons, I would affirm the decision of the Quebec Court of Appeal and dismiss the appellants' appeals with costs.

APPENDIX

Excise Tax Act, R.S.C. 1985, c. E---15

165. (1) Subject to this Part, every recipient of a taxable supply made in Canada shall pay to Her Majesty in right of Canada tax in respect of the supply calculated at the rate of 5% on the value of the consideration for the supply.

.

(1) Every person who makes a taxable supply shall, as agent of Her Majesty

. in right of Canada, collect the tax under Division II payable by the recipient in respect of the supply.

.

.

.

.

. . .

Digitized by Google

(1) every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

Subject to

(1.1) Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act*), to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.

to subsection (1.1),

(3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and

to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

An Act respecting the Québec sales tax, R.S.Q., c. T---0.1

16. Every recipient of a taxable supply made in Québec shall pay to the Minister of Revenue a tax in respect of the supply calculated at the rate of 7.5% on the value of the consideration for the supply.

422. Every person who makes a taxable supply shall, as a mandatary of the Minister, collect the tax payable by the recipient under section 16 in respect of the supply.

Digitized by Google

An Act respecting the Ministère du Revenu, R.S.Q., c. M---31

20. Every person who deducts, withholds or collects any amount under a fiscal law is deemed to hold it in trust for the State, separately from the person's patrimony and the person's own funds, for payment to the State in the manner and at the time provided under a fiscal law.

Where at any time an amount deemed by the first paragraph to be held by a person in trust for the State is not paid to the State in the manner and at the time provided under a fiscal law, an amount equal to the amount thus deducted, withheld or collected is deemed, from the time the amount is deducted, withheld or collected, to be held in trust for the State, separately from the person's patrimony and the person's own funds, and to form a separate fund not forming part of

. . the property of that person, whether or not the amount has in fact been held separately from that person's patrimony or that person's own funds.

. Every person who does not collect a duty that he was bound to collect as a . mandatary of the Minister or does not withhold a duty that he was bound to withhold, under a fiscal law or a regulation made under such a law, shall become a debtor of the State for the amount of that duty, with the exception of the withholding provided for in section 1015 of the Taxation Act (chapter I--- 3), unless the withholding concerns a duty that a person was required to withhold from an amount paid to another person who is not resident in Canada for services performed in Québec.

. Every person who deducts, withholds or collects an amount under a fiscal law is bound to pay to the Minister, at the date fixed by such law, or in . accordance with the provision for such payment, an amount equal to that which the person must remit under the said Act.

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B---3

67. (1) The property of a bankrupt divisible among his creditors shall not comprise

(*a*) property held by the bankrupt in trust for any other person,

. . .

Subject to subsection (3), notwithstanding any provision in federal or provincial legislation

Digitized by Google

that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.

Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

(1) In relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, in this section and in section 87 called a "workers' compensation body", rank as unsecured claims.

(1) A security provided for in federal or provincial legislation for the sole or principal purpose of securing a claim of Her Majesty in right of Canada or of a province or of a workers' compensation body is valid in relation to a bankruptcy or proposal only if the security is registered under a prescribed system of registration before the date of the initial bankruptcy event.

Appeals dismissed with costs.

Solicitor for the appellant the Deputy Minister of Revenue of Quebec: Attorney General of Quebec, Montréal.

Solicitor for the appellant Her Majesty The Queen: Attorney General of Canada, Montréal.

Solicitors for the respondents Caisse populaire Desjardins de Montmagny and Raymond Chabot Inc., in its capacity as Trustee in bankruptcy of 9083-4185 Québec Inc.: Langlois Kronström Desjardins, Lévis.

Solicitors for the respondent Raymond Chabot Inc., in its capacity as Trustee for the estate of the debtor, Consortium Promecan Inc.: McCarthy Tétrault, Montréal.

Solicitors for the respondent the National Bank of Canada: Stein Monast, Québec.

Solicitors for the intervener: McMillan, Montréal.

Caisse populaire Desjardins de l'Est de Drummond v. Canada, 2009 SCC 29, [2009] 2 S.C.R. 94 – Bankruptcy and Insolvency Act and "Security Interests"

Digitized by Google

Taxation — Income tax — Trust for moneys deducted —Employer defaulting on line of credit and financial institution exercising right of compensation on employer's term deposit pursuant to agreement
Deemed trust in favour of Crown over property of employer that has deducted income tax and employment insurance premiums at source — Crown seeking to collect amount due by employer for unremitted source deductions from proceeds of term deposit— Whether compensation agreement between financial institution and employer created "security interest" within meaning of s. 224(1.3) of Income Tax Act Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 224(1.3)"security interest", 227(4.1).

On September 18, 2000, the Caisse granted Camvrac a line of credit up to $277,000. A week later, Camvrac deposited $200,000 with the Caisse in accordance with a "Term Savings Agreement". Under the agreement, the deposit was neither negotiable nor transferable. On the same day, the Caisse and Camvrac entered into a "Security Given Through Savings" agreement in which Camvrac agreed to maintain and permit the Caisse to retain the deposit of $200,000 for the duration of its indebtedness to the Caisse. It also agreed that, in the event it defaulted, there would be compensation between the credit agreement and the term deposit. Camvrac defaulted on the loan on November 25, 2000, and later made an assignment in bankruptcy. The Caisse noted on its copy of the "Term Savings Agreement": "To be closed on 21/2/2001 to realize on security". Since Camvrac had failed to remit to the Crown income tax and employment insurance premiums deducted at source, the Crown gave the Caisse notice to pay the amount owing to the Crown from the proceeds of the deposit. Section 227(4.1) of the *Income Tax Act* ("*ITA*") and s. 86(2.1) of the *Employment Insurance Act* ("*EIA*") create a deemed trust in favour of the Crown over property of the employer that has deducted income tax and employment insurance premiums at source. This trust applies to property of an employer and property held by any secured creditor of the employer that, but for its security interest, would be property of the employer. The property is impressed with the deemed trust at the time the unremitted amounts were deducted at source by the employer. The Caisse unsuccessfully challenged the recovery process. The prothonotary, the Federal Court and the Federal Court of Appeal held that the Crown was entitled to recover the amounts due and the interest paid at the rate provided for in ss. 36(2) and 37(2) of the *Federal Courts Act*.

Held (LeBel and Deschamps JJ. dissenting): The appeal should be dismissed.
Per McLachlin C.J. and Binnie, Fish, Charron and Rothstein JJ.: The agreement between the Caisse and Camvrac gave rise to a "security interest" for the purposes of s. 224(1.3) *ITA*. Camvrac's property subject to the security interest is thus deemed to be held in trust for the Crown under s. 227(4.1) *ITA* and s. 86(2.1) *EIA* because Camvrac did not remit to the Crown income tax and employment insurance premiums deducted at source. [1] [2]
The definition of "security interest" in s. 224(1.3) does not require that the agreement between the creditor and debtor take any particular form, nor is any particular form expressly excluded. So long as the creditor's interest in the debtor's property secures payment or performance of an obligation, there is a security interest within the meaning of this section. Parliament has chosen an expansive definition of security interest in s. 224(1.3) in order to enable maximum recovery by the Crown under its deemed trust for unremitted income tax and employment insurance premiums deducted at source by employers. It is open to Parliament to define a term

Digitized by Google

in an area of its own legislative competence in order to ensure that there is a rule of general application across all of the provinces. [12] [14] [15]

Whether a contract providing for a right to compensation (in Quebec) or a right to set-off (in the common law provinces) also gives rise to a security interest within the meaning of s. 224(1.3) requires that the terms of the contract be carefully considered to determine whether the parties intended to confer on one party an interest in the property of the other party that secures payment or performance of an obligation. If the substance of the agreement demonstrates that the parties intended an interest in property to secure an indebtedness, then a security interest exists within the meaning of s. 224(1.3). In this case, it was the five-year term and the maintenance and retention of the $200,000 deposit, as well as Camvrac's agreement not to transfer or negotiate the deposit and that the deposit could only be used as security with the Caisse, that created the Caisse's interest in Camvrac's property for the purposes of s. 224(1.3) *ITA*. In the absence of these encumbrances on Camvrac's deposit, Camvrac could have withdrawn the deposit at any time. Should it have done so and still been indebted to the Caisse, the Caisse's right to compensation would be ineffective because it would not be indebted to Camvrac at the time the Caisse had to resort to the remedy of compensation. [23] [25] [30]

The Caisse is liable to pay to the Crown the amounts for employment insurance premiums and income tax deducted at source by Camvrac up to, and including, any deductions not remitted as of February 21, 2001 — the date on which the Caisse realized on its security. The trust created by s. 227(4.1) *ITA* and s. 86(2.1) *EIA* is deemed to be in effect at any time. It does not matter that the term deposit became the property of Camvrac only after some of the employment insurance premiums and income tax deductions went unremitted since the deemed trust encompasses property which comes into the hands of the tax debtor after the trust arises. The proceeds of Camvrac's term deposit are therefore available to the Crown to discharge all of the outstanding employment insurance premiums and income tax deducted at source by Camvrac, whether the unremitted deductions occurred before or after Camvrac entered into the "Term Savings Agreement" and until February 21, 2001. Interest is calculated in accordance with ss. 36(2) and 37(2) of the *Federal Courts Act* from February 21, 2001, when the Caisse effected compensation, to the date of payment. [59] [61] [63]

Per LeBel and Deschamps JJ. (dissenting): Compensation is not a "security interest" as that term is defined in s. 224(1.3) *ITA*. For the purposes of s. 224(1.3), it is not enough that compensation offers protection similar to that of a security interest: it must also confer a real right. To limit the concept of security interest in s. 224(1.3) to rights that are real in nature is consistent both with the shared meaning of the terms ("security interest" and "*garantie*") used in the two versions of the provision and with Parliament's purpose of giving the deemed trust priority over the security interests referred to in s. 224(1.3). This deemed trust was created to ensure that employers remit income tax deducted from their employees' salaries to the Receiver General for Canada. [65] [98] [101]

Although compensation can be likened to a security interest, it cannot be equated with one in the sense that the term "security interest" must be given in the context of s. 224(1.3) *ITA*. Where compensation may be effected between two debts, the effect is clearly analogous to that of a "security interest" in the broad sense of the term; nevertheless, compensation or set-off is not regarded, in the positive law of either Quebec or the common law provinces, as having the characteristics of a

Digitized by Google

real right. The automatic extinction of mutual debts is an effect of compensation, but it does not constitute the enforcement of a real right in the property in question. Furthermore, a conclusion that compensation is a "security interest"as that term is defined in the federal statute would conflict with the meaning given to the term in provincial personal property security statutes, which exclude set-off. Such an interpretation would also be inconsistent with the common law concept of "set-off", on which numerous business transactions are based. Finally, whether considered in isolation or as a whole, the term for repayment of the deposit amount, the obligation to maintain, the right to withhold and the limits on the right to transfer, hypothecate or negotiate the deposit created only personal obligations. [102] [107] [122] [132]

Insofar as the amounts had not been deducted at the time the agreement was entered into, the Caisse's right to conventional compensation may be set up against Her Majesty because Her Majesty cannot have more rights than Camvrac itself had. In Quebec civil law, as at common law, the rule for asserting contractual rights against third-party assignees is based on the general principles governing obligations. The right to conventional compensation is assessed as of the time the right is granted, not as of the time it is exercised. The protection of third parties, codified in art. 1681 *C.C.Q.*, applies to rights acquired before the compensation agreement was signed. Thus, where the trust applies to a claim, it attaches to a legal relationship that corresponds to an active contractual situation, which explains why the beneficiary of the trust may assert only those rights held by the tax debtor. When Parliament wished to give the deemed trust more teeth, it took care to give Her Majesty priority over secured creditors. It did not alter the general rules governing the rights a debtor can assert against its original creditor. [65] [147] [148] [150] [152]

Camvrac's right to recover its claim was subject to the right to compensation that had been granted to the Caisse in September 2000 in the agreement to give savings as security. In the context of that agreement, the right to compensation was a right held by the Caisse that could not be negated solely by the fact of the deemed trust becoming effective. Her Majesty, as a third party, could not demand that the Caisse discharge its debt to Camvrac if the conditions for repayment had not been met. The Caisse's right had to be respected by third parties who acquired rights after the agreement was signed. Consequently, Her Majesty must abide by the compensation agreement, given that her right is subsequent to it. [153]

Her Majesty may, however, claim from the Caisse the amount owed by Camvrac before the compensation agreement was signed in September 2000. The claims of the Caisse and Camvrac have distinct sources: one is based on the variable credit contract, the other, on the term savings agreement. The Caisse's claim against Camvrac dates from September 18, 2000 and Camvrac's claim, from September 25, 2000. On the latter date, Camvrac undertook, first in the term savings agreement, "to make, on the date of acquisition, a deposit in the amount of $200,000", and then in the agreement to give savings as security, to "maintain" a deposit in the amount of $200,000. For Camvrac to be able to undertake in the agreement to give savings as security to "maintain" the deposited amount, its claim resulting from the term savings agreement had to take on an independent existence, if only at the time the deposit was made. Given that the deposit was made before the right to compensation was granted, the deemed trust could have become effective in respect of Camvrac's claim up to the total of the amounts owed to Her Majesty as of September 25, 2000. This is not a case in which the respective debts have the same source and the claim is subject to a right to compensation. Just as Her Majesty's

Digitized by Google

rights are subordinated to the right to compensation for deductions subsequent to the signing of the agreement, the Caisse's right must give way to Her Majesty's pre-existing right. [154] [156]
On the interest issue, there is no need to vary the decision of the Federal Court of Appeal. [157]

Cases Cited
By Rothstein J.
Referred to: *Saulnier v. Royal Bank of Canada*, 2008 SCC 58, [2008] 3 S.C.R. 166; *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453; *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411; *Dagg v. Canada (Minister of Finance)*, [1997] 2 S.C.R. 403; *Holt v. Telford*, [1987] 2 S.C.R. 193; *DaimlerChrysler Financial Services (debis) Canada Inc. v. Mega Pets Ltd.*, 2002 BCCA 242, 212 D.L.R. (4th) 41; *Caisse populaire Desjardins de Val-Brillant v. Blouin*, 2003 SCC 31, [2003] 1 S.C.R. 666; *First Vancouver Finance v. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720; *Markevich v. Canada*, 2003 SCC 9, [2003] 1 S.C.R. 94.

By Deschamps J. (dissenting)
Markevich v. Canada, 2003 SCC 9, [2003] 1 S.C.R. 94; *Canada (Attorney General) v. Caisse populaire d'Amos*, 2004 FCA 92, 324 N.R. 31; *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411; *Quebec North Shore Paper Co. v. Canadian Pacific Ltd.*, [1977] 2 S.C.R. 1054; *McNamara Construction (Western) Ltd. v. The Queen*, [1977] 2 S.C.R. 654; *R. v. S.A.C.*, 2008 SCC 47, [2008] 2 S.C.R. 675; *Reagan v. Murphy*, 105 So.2d 210 (1958); *Harwood Oil & Mining Co. v. Black*, 124 So.2d 764 (1960); *Alberta (Treasury Branches) v. M.N.R.*, [1996] 1 S.C.R. 963; *First Vancouver Finance v. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720; *Royal Bank of Canada v. First Pioneer Investments Ltd.*, [1984] 2 S.C.R. 125; *518718 Alberta Ltd. v. Canadian Forest Products Ltd.*, 1998 ABQB 619, 63 Alta. L.R. (3d) 371; *Caisse populaire Desjardins de Val-Brillant v. Blouin*, 2003 SCC 31, [2003] 1 S.C.R. 666; *A. L. Green Ltd. v. Michaud*, [1975] C.A. 432; *Banque Royale du Canada v. Béliveau*, [1976] C.A. 539; *Bandera Investment Co. v. Société immobilière du Québec*, J.E. 98-1667, SOQUIJ AZ-98021774; *Seigneur v. Immeubles Beneficial Ltée*, [1994] R.J.Q. 1535; *Banque Nationale du Canada v. Notre-Dame-du-Lac (Ville)* (1990), 31 Q.A.C. 45;*Banque de Montréal v. Walsh & Brais Inc.*, [1990] R.L. 119; *D.I.M.S. Construction inc. (Trustee of) v. Quebec (Attorney General)*, 2005 SCC 52, [2005] 2 S.C.R. 564; *Ching v. Jeffery* (1885), 12 O.A.R. 432; *Canadian Admiral Corp. v. L. F. Dommerich & Co.*, [1964] S.C.R. 238; *Toronto-Dominion Bank v. Block Bros. Contractors Ltd.* (1980), 118 D.L.R. (3d) 311; *Board of Industrial Relations v. Avco Financial Services Realty Ltd.*, [1979] 2 S.C.R. 699; *Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd.*, [1980] 1 S.C.R. 1182; Cass. civ., 13 juillet 1942, J.C.P. 1943.II.2157, note Houin; Cass. com., 3 juin 1997, D. 1998.Jur.61, note François; Cass. com., 9 décembre 1997, *Bull. civ.* IV, n^{o} 327.

Statutes and Regulations Cited
Act respecting the special powers of legal persons, R.S.Q., c. P-16.
Civil Code of Lower Canada.
Civil Code of Québec, S.Q. 1991, c. 64, arts. 875, 974, 1250, 1260, 1261, 1637, 1641, 1643, 1671, 1672, 1673, 1680, 1681, 2111 para. 2, 2123, 2329, 2330, 2543, 2660, 2683, 2702, 2703, 2710, 2714.7.
Code of Civil Procedure, R.S.Q., c. C-25, art. 637.

Digitized by Google

Constitution Act, 1867, s. 91(2A), (3).
Courts of Justice Act, R.S.O. 1990, c. C.43, s. 111.
Employment Insurance Act, S.C. 1996, c. 23, s. 86.
Excise Tax Act, R.S.C. 1985, c. E-15.
Federal Courts Act, R.S.C. 1985, c. F-7, ss. 36, 37.

Digitized by Google

Federal Law — Civil Law Harmonization Act, No. 1, S.C. 2001, c. 4, s. 8.
Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 224(1), (1.3) "security interest", 227(4) [repl. 1998, c. 19, s. 226(1)], (4.1) [ad. *idem*].
Interpretation Act, R.S.C. 1985, c. I-21, ss. 8.1, 8.2.
Personal Property Security Act, C.C.S.M., c. P35, s. 3(1).
Personal Property Security Act, R.S.A. 2000, c. P-7, s. 3(1).
Personal Property Security Act, R.S.B.C. 1996, c. 359, s. 2(1).
Personal Property Security Act, R.S.O. 1990, c. P.10, ss. 1 "security interest", "*sûreté*",2(a) "debenture", 40.
Personal Property Security Act, R.S.P.E.I. 1988, c. P-3.1, s. 3(1).
Personal Property Security Act, R.S.Y. 2002, c. 169, s. 2.
Personal Property Security Act, S.N.B. 1993, c. P-7.1, ss. 1 "security interest", 3(1), 41.
Personal Property Security Act, S.N.L. 1998, c. P-7.1, s. 4(1).
Personal Property Security Act, S.N.S. 1995-96, c. 13, s. 4(1).
Personal Property Security Act, S.N.W.T. 1994, c. 8, s. 2(1).
Personal Property Security Act, 1993, S.S. 1993, c. P-6.2, s. 3(1).
Regulation to amend the Regulation respecting the register of personal and movable real rights, O.C.
30-2009, (2009) 141 G.O. 2A, 17A.

Authors Cited

Austin, John. *Lectures on Jurisprudence, or, The Philosophy of Positive Law*, 5th ed. revised and edited by
R. Campbell. London: J. Murray, 1885.
Bastarache, Michel, et al. *The Law of Bilingual Interpretation*. Markham, Ont.: LexisNexis Canada, 2008. Baudouin, Jean-Louis, et Pierre-Gabriel Jobin. *Les obligations*, 5e éd. Cowansville, Qué.: Yvon Blais, 1998.
Baudouin, Jean-Louis, et Pierre-Gabriel Jobin. *Les obligations*, 6e éd. par Pierre-Gabriel Jobin avec la collaboration de Nathalie Vézina. Cowansville, Qué.: Yvon Blais, 2005.
Bélanger, André. *Essai d'une théorie juridique de la compensation en droit civil québécois*. Cowansville, Qué.: Yvon Blais, 2004.
Black's Law Dictionary, 6th ed. St. Paul, Minn.: West Publishing Co., 1990, "encumbrance". Bonneau, Thierry. *Droit bancaire*, 7eéd. Paris: Montchrestien, 2007.
Brierley, John E. C. "Title Six: Certain Patrimonies by Appropriation — Articles 1256-1298", in *Reform of the Civil Code*, vol. 1-B, *Property*. Texts written for the Barreau du Québec and the Chambre des notaires du Québec. Translated by Susan Altschul. Montréal: Barreau du Québec, 1993.
Ciotola, Pierre, et Antoine Leduc. "Arrêt *Val-Brillant*: évolution ou régression de l'hypothèque mobilière avec dépossession, en droit civil québécois?", dans Sylvio Normand, dir., *Mélanges offerts au professeur François Frenette: études portant sur le droit patrimonial*. Québec: Presses de l'Université Laval, 2006, 361.
Claxton, John B. *Studies on the Quebec Law of Trust*. Toronto: Thomson Carswell, 2005.
Côté, Pierre-André. *The Interpretation of Legislation in Canada*, 3rd ed. Scarborough, Ont.: Carswell, 2000. Crawford, Bradley. *The Law of Banking and Payment in Canada*, vol. 2. Aurora, Ont.: Canada Law Book,
2008 (loose-leaf updated November 2008).

Digitized by Google

Cuerrier, Marc. "The Harmonization of Federal Tax Legislation", in *The Harmonization of Federal Legislation with the Civil Law of the Province of Quebec and Canadian Bijuralism* (Second publication), Booklet 7. Ottawa: Department of Justice, 2001.
Cuming, Ronald C. C., Catherine Walsh and Roderick J. Wood. *Personal Property Security Law*. Toronto: Irwin Law, 2005.
Davies, Paul L. *Gower and Davies' Principles of Modern Company Law*, 7th ed. London: Sweet & Maxwell, 2003.
Denault, Philippe. *La recherche d'unité dans l'interprétation du droit privé fédéral: Cadre juridique et fragments du discours judiciaire*. Montréal: Thémis, 2008.
Derham, S. Rory. *The Law of Set-Off*, 3rd ed. New York: Oxford University Press, 2003.
Deschamps, Michel. "Le nouveau régime québécois des sûretés sur des valeurs mobilières", conférence donnée le 19 mars 2009 à la Chaire du notariat de l'Université de Montréal (en ligne:
www.chairedunotariat.qc.ca/fr/conferences/mois/032009/Deschamps.pdf).
Duboc, Guy. *La compensation et les droits des tiers*. Paris: L.G.D.J., 1989.
Dukelow, Daphne A. *The Dictionary of Canadian Law*, 3rd ed. Scarborough, Ont.: Thomson Carswell, 2004, "debenture", "encumbrance".
Garner, Bryan A. *A Dictionary of Modern Legal Usage*, 2nd ed. New York: Oxford University Press, 1995, "debenture".
Ghestin, Jacques. *Traité de droit civil— Les obligations: les effets du contrat*, avec le concours de Marc Billiau. Paris: L.G.D.J., 1992.
Goode on Legal Problems of Credit and Security, 4th ed. by Louise Gullifer. London: Sweet & Maxwell, 2008.
Grottenthaler, Margaret E., and Philip J. Henderson. *The Law of Financial Derivatives in Canada*. Toronto: Thomson Carswell, 2003 (loose-leaf updated 2008, release 1).
Hohfeld, Wesley Newcomb. "Fundamental Legal Conceptions as Applied in Judicial Reasoning" (1917), 26
Yale L.J. 710.
Holland, Thomas Erskine. *The Elements of Jurisprudence*, 12th ed. Oxford: Clarendon Press, 1916. Honorat, Adrienne. "Redressement et liquidation judiciaires", D. 1998.Somm.325.
Karim, Vincent. *Les obligations*, 2e éd., vol. 2, art. 1497 à 1707 C.c.Q. Montréal: Wilson & Lafleur, 2002. Lafond, Pierre-Claude. *Précis de droit des biens*, 2e éd. Montréal: Thémis, 2007.
Lamontagne, Denys-Claude. *Biens et propriété*, 6e éd. Cowansville, Qué.: Yvon Blais, 2009.
Lamoureux, Martin. "The Income Tax Act, the Excise Tax Act and the Term Interest: An Interesting Case for Harmonization", in *The Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism — Collection of Studies in Tax Law 2001*. Montréal: Fiscal and Financial Planning Association/Department of Justice of Canada, 2002, 7:1.
Lluelles, Didier, et Benoît Moore. *Droit des obligations*. Montréal: Thémis, 2006.
Macdonald, Roderick A. "Reconceiving the Symbols of Property: Universalities, Interests and Other Heresies" (1994), 39 *McGill L.J.* 761.
Macdonald, Roderick A. "The Security Trust: Origins, Principles and Perspectives", in Hélène Jutras and Katia Opalka, eds.,*Contemporary Utilisation of Non-Corporate Vehicles of Commerce*. Meredith Lectures. Montréal: Faculty of Law, McGill

Digitized by Google

University, 1997, 155.
Martel, Paul. *Business Corporations in Canada: Legal and Practical Aspects*. Toronto: Thomson Carswell, 2005 (loose-leaf updated 2008, release 3).
Martin, Didier. "Contrats et obligations", *Juris-classeur civil*, art. 1289 à 1293, fasc. 108 à 111.
France: Éditions Techniques, 1995.
Martin, Didier. "Des techniques d'affectation en garantie des soldes de comptes bancaires", D.
1987.Chron.229.
Morel, André. "La rédaction de lois bilingues harmonisées avec le droit civil", dans *The Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism — Collection of studies*. Ottawa: Department of Justice, 1997, 309.
Palmer, Kelly R. *The Law of Set-Off in Canada*. Aurora, Ont.: Canada Law Book, 1993.
Paton, George Whitecross. *A Text-Book of Jurisprudence*, 2nd ed. Oxford: Clarendon Press, 1951.

Payette, Louis. *Les sûretés réelles dans le Code civil du Québec*, 2e éd. Cowansville, Qué.: Yvon
Blais, 2001.

Pineau, Jean, Danielle Burman et Serge Gaudet. *Théorie des obligations*, 4e éd. par Jean Pineau et Serge Gaudet. Montréal: Thémis, 2001.
Pratte, Denise. "L'hypothèque avec dépossession de créances non représentées par un titre négociable ou le retour à une fiction accommodante", dans Sylvio Normand, dir., *Mélanges offerts au professeur François Frenette: études portant sur le droit patrimonial*. Québec: Presses de l'Université Laval, 2006, 421.

Québec. Assemblée nationale. *Journal des débats*, 1re sess., 38e lég., vol. 40, no 46, 11 juin 2008, Étude détaillée du projet de loi no 47, *Loi sur le transfert de valeurs mobilières et d'autres actifs financiers*,
p. 1.
Quebec Research Centre of Private and Comparative Law. *Private Law Dictionary and Bilingual Lexicons: Obligations*. Cowansville, Que.: Yvon Blais, 2003, "accessory real right".
Reid, Hubert. *Dictionnaire de droit québécois et canadien avec table des abréviations et lexique anglais-français*, 3e éd. Montréal: Wilson & Lafleur, 2004, "*débenture*".

Rives-Lange, Jean-Louis, et Monique Contamine-Raynaud. *Droit bancaire*, 6e éd. Paris: Dalloz, 1995. Salmond, John William. *Jurisprudence*, 10th ed. by Glanville L. Williams. London: Sweet and Maxwell,
1947.
Sullivan, Ruth. *Sullivan on the Construction of Statutes*, 5th ed. Markham, Ont.: LexisNexis, 2008.
Wood, Philip R. *Set-Off and Netting, Derivatives, Clearing Systems*, 2nd ed. London: Sweet & Maxwell, 2007.

APPEAL from a judgment of the Federal Court of Appeal (Desjardins, Létourneau and Pelletier JJ.A.), 2006 FCA 366, 361 N.R. 77 (*sub nom. Minister of National Revenue v. Caisse populaire du Bon*

Digitized by Google

Conseil), [2007] 3 C.T.C. 70, 2007 D.T.C. 5220, [2006] F.C.J. No. 1775 (QL), 2006 CarswellNat 5050,
affirming a decision of Pinard J., 2005 FC 1563, [2007] 2 C.T.C. 44, 2007 D.T.C. 5664, [2005] F.C.J. No.
1933 (QL), affirming a decision by Mireille Tabib, Prothonotary, 2005 FC 731, 293 F.T.R. 166, 2006 D.T.C. 6385, [2005] F.C.J. No. 900 (QL). Appeal dismissed, LeBel and Deschamps JJ. dissenting.
Reynald Auger and *Jean-Patrick Dallaire*, for the appellant.
Pierre Cossette and *Guy Laperrière*, for the respondent.

The judgment of McLachlin C.J. and Binnie, Fish, Charron and Rothstein JJ. was delivered by [1] ROTHSTEIN J. — The primary issue in this appeal is whether the agreements between the Caisse populaire ("Caisse") and its customer, Camvrac Enterprises Inc. ("Camvrac"), give rise to a "security interest" within the meaning of that term in s. 224(1.3) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"). The definition of "security interest" in s. 224(1.3) *ITA* has also been incorporated by reference in s. 86(2.1) of the *Employment Insurance Act*, S.C. 1996, c. 23 ("*EIA*"). If the agreements between the Caisse and Camvrac do fall within the definition of "security interest" in s. 224(1.3) *ITA*, then the property of Camvrac that is subject to the security interest of the Caisse is deemed to be held in trust for the Crown under s. 227(4.1) *ITA* and s. 86(2.1) *EIA* because Camvrac did not remit to the Crown income tax and employment insurance premiums deducted at source by Camvrac.
[2] In my view, the agreements between the Caisse and Camvrac gave rise to a "security interest" for the purposes of s. 224(1.3) *ITA*. Camvrac's property subject to the security interest was property that was subject to the Crown's deemed trust. I would dismiss the appeal.

F s
a [3] On September 18, 2000, the Caisse granted Camvrac a line of credit
ct up to $277,000.
September 25, 2000, Camvrac deposited $200,000 with the Caisse in accordance with a "Term Savings Agreement" providing that the deposit would mature on October 16, 2005. The "Term Savings Agreement" sets out the terms of Camvrac's entitlement to the deposit and the Caisse's obligation to pay Camvrac
$200,000. The relevant portions of the "Term Savings Agreement" stated: [TRANSLATION]
Date of maturity: October 16, 2005

Digitized by Google

. . .
. . .

PROVISIONS GOVERNING THE PRINCIPAL
The member [Camvrac] agrees to make, on the date of acquisition, a deposit in the amount of $200,000 (hereinafter referred to as the "initial amount of deposit").
On the date of issue associated with the applicable term ("date of issue"), the initial amount of deposit and the interest then accrued on that amount shall be reinvested in the form of a deposit maturing on the maturity date associated with the applicable term ("date of maturity").
This deposit may neither be negotiated nor transferred. No amount in principal or interest shall be redeemable or payable before the date of maturity.
This deposit may be hypothecated or given as security only in favor of the issuing Caisse.

[4] The Caisse and Camvrac also entered into a "Security Given Through Savings Agreement"
The most relevant terms read:
[TRANSLATION]
RIGHT TO WITHHOLDING AND COMPENSATION
To secure the repayment of any sum in principal, interest, costs and accessories owed or to be owed the Caisse by:
☒ the Depositor [Camvrac]
. . .
. . .
. . .

under:
☒ (a) a line of credit agreement in the amount of $277,000.00 granted to him (her) on 2000-09-18;

☒ and under any debts or obligations, present or future, direct or indirect held by:
☒ the Depositor

(hereinafter referred to as "the Credit Contract[s]")

the Depositor undertakes to maintain and consents to the withholding by the Caisse, in the account(s) or on the certificate(s) of deposit mentioned below, of the amount of
$200,000.00 distributed as follows:
Account or certificate of deposit Sum withheld by the Caisse identification
(for deposit certificates, state date issued amount and certificate number)
ALTERNATIVE TERM SAVINGS
5 YEARS IN THE AMOUNT OF
$200,000.00 $200,000.00
_____$____
. . .
. . .
. . .
. . .

Digitized by Google

The Caisse may withhold the sums shown above, . . . as long as all the amounts due under the Credit Contract(s) have not been fully repaid and, in the case of a line of credit, as long as it has not been cancelled. In cases of default as provided for below, there shall be compensation between the Credit Contract(s) and the certificate(s) of deposit or the amounts deposited defined above, as provided for in Section 7.

SAFEKEEPING OF CERTIFICATES

For the whole term of this agreement, the above-mentioned certificate(s) of deposit shall be kept by the Caisse.

HYPOTHEC

To further secure the repayment of any sum owed or to be owed under the Credit Contract(s), the Depositor hypothecates and pledges the above-mentioned certificate(s) of deposit and sums deposited, for an amount equal to the total amount of the sums withheld. The parties also agree that the clause shown on the certificate(s) of deposit stipulating that such certificate(s) are neither negotiable nor transferable shall be deemed cancelled, effective from the date of these presents.

DEFAULT

The Depositor shall be in default in any of the following cases:

if any of the commitments under the Credit Contract(s) or these presents is not fulfilled;

if the Depositor or the Borrower becomes insolvent or goes bankrupt, or if he(she) makes a proposal and it is rejected or annulled;

In the event of any default:

any sums owing under the Credit Contracts shall immediately become payable;

the Caisse may use the sums deposited or the certificate(s) of deposit contemplated herein, regardless of its(their) having matured or not, to compensate its claim under the Credit Contract(s);

The consequences of a default are for the exclusive benefit of the Caisse and the latter may waive them expressedly. The Caisse may, among others, without any prejudice to its rights, wait for the maturity date of the certificate(s) of deposit before exercising its rights as provided for in paragraphs (b) and (c) above.

RESERVE OF RECOURSES

. . . Furthermore, failure by the Caisse to avail itself of any of its rights in case of default shall not be interpreted as a waiver of such rights.

[5] Camvrac failed to pay the interest on its line of credit on November 25, 2000 and so was technically in default on that date. However, the Caisse took no steps as a result of the default and, according to the Caisse's account summaries, Camvrac's line of credit continued to accrue interest until January 31, 2001. On February 7, 2001, Camvrac made an assignment in bankruptcy. On February 21, 2001, the Caisse made the following note on its copy of the "Term Savings Agreement" : [TRANSLATION]"To be closed on 21/2/2001 to realize on security." Finally, on June 12, 2001, the Crown gave the Caisse notice to pay the amount owing to the Crown for unremitted employment insurance premiums and income tax deducted at source by Camvrac from the proceeds of the term deposit the Crown said was subject to its deemed trust.

Digitized by Google

[6] Prothonotary Tabib of the Federal Court, Justice Pinard of the Federal Court, and Justice Létourneau writing for the Federal Court of Appeal found in favour of the Crown: 2005 FC 731, 2006 D.T.C. 6385, aff'd 2005 FC 1563, 2007 D.T.C. 5664, aff'd 2006 FCA 366, 361 N.R. 77. The Caisse now appeals to this Court.

The Primary Issue

[7] Under the "Security Given Through Savings" agreement, the Caisse was entitled to effect compensation to reduce or eliminate Camvrac's indebtedness to it if Camvrac defaulted on its line of credit. The Caisse did so. The issue is whether the Crown is the beneficial owner of Camvrac's term deposit to the extent of the unremitted employment insurance premiums and income tax deducted by Camvrac at source as a result of the deemed trust created by s. 227(4.1) *ITA* and s. 86(2.1) *EIA*.

Analysis

The Definition of "Security Interest" in Section 224(1.3) of the Income Tax Act

[8] Parliament has defined "security interest" in s. 224(1.3) *ITA*. This definition provides that: "security interest" means any interest in property that secures payment or performance of an obligation and includes an interest created by or arising out of a debenture, mortgage, hypothec, lien, pledge, charge, deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for;

[9] Section 227(4.1) *ITA* and s. 86(2.1) *EIA* create a deemed trust in favour of the Crown over property of the employer that has deducted income tax and employment insurance premiums at source. The deemed trust applies to property of the employer and property held by any secured creditor of the employer that, but for its security interest, would be property of the employer. The property is impressed with the deemed trust at the time the unremitted amounts were deducted at source by the employer. Section 227(4.1) *ITA* provides:

Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection (4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person and property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for a security interest (as defined in subsection 224(1.3)) would be property of the person, equal in value to the amount so deemed to be held in trust is deemed to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, and to form no part of the estate or property of the person from the time the amount was so deducted or withheld, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to such a security interest and is property beneficially owned by Her Majesty notwithstanding any security interest in such property and in the proceeds thereof, and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

Section 86(2.1) *EIA* is to the same effect with respect to employment insurance

Digitized by Google

premiums deducted by employers at source.
[10]While the definition of "security interest" is similar to legal terminology used in the personal property security and other legislation of the provinces, the definition in s. 224(1.3) *ITA* is the only relevant definition of "security interest" for the purposes of s. 227(4.1) *ITA* and s. 86(2.1) *EIA*. Both s. 227(4.1) *ITA* and s. 86(2.1) *EIA*, which incorporate by reference the definition of "security interest" from s. 224(1.3) *ITA*, apply

> [n]otwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law . . . . [s. 227(4.1) *ITA*]
>
> [n]otwithstanding the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law . . . . [s. 86(2.1) *EIA*]

This is a clear indication that the scope of the deemed trust created by these provisions over property of the tax debtor is to be defined in terms of the statutory definition of "security interest" provided by Parliament in s. 224(1.3) *ITA*and not as the term security interest may be used in provincial legislation.
[11]As Binnie J. recently noted in *Saulnier v. Royal Bank of Canada*, 2008 SCC 58, [2008] 3 S.C.R. 166, at para. 16, "[f]or particular purposes Parliament can and does create its own lexicon." Parliament's authority to define terms without reference to provincial law in areas of federal legislative competency was considered with respect to bankruptcy in *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453. Gonthier J. held for the majority, at para. 32, that the definition of terms such as "secured creditor", if defined under the Bankruptcy Act, must be interpreted in bankruptcy cases as defined by the federal Parliament, not the provincial legislatures. Provinces cannot affect how such terms are defined for purposes of the Bankruptcy Act.
[12]It is therefore open to Parliament to define a term in an area of its own legislative competence (*Constitution Act, 1867*, s. 91(2A)"Unemployment Insurance" and s. 91(3) "The raising of Money by any Mode or System of Taxation"), as it has done here, in order to ensure that there is a rule of general application across all of the provinces. Were provincial law used to define the meaning of "security interest" in s. 224(1.3) *ITA* and, in turn, the scope of the deemed trust created by s. 227(4.1) *ITA* and s. 86(2.1) *EIA*, uniformity could not be achieved. Rather, what constituted a "security interest" for the purposes of s. 224(1.3) *ITA* could be different from province to province. The Minister's ability to recover unremitted source deductions would then vary depending on an employer's location.
[13]Further, if provincial law were used to define the meaning of a"security interest" under s. 224(1.3) *ITA*, a change in the provincial law of property security would affect the scope of the deemed trust created by s. 227(4.1) *ITA* and s. 86(2.1) *EIA* from time to time. This level of uncertainty cannot have been what Parliament intended with the words"any interest in property that secures payment or performance of an obligation"in s. 224(1.3) *ITA*. This definition is incorporated by reference in s. 227(4.1) *ITA* and s. 86(2.1) *EIA* which create the deemed trust in favour of the Crown "[n]otwithstanding . . . any enactment of a province".
[14]In this case, Parliament has chosen an expansive definition of"security interest" in s. 224(1.3) *ITA* in order to enable maximum recovery by the Crown under its deemed trust for unremitted income tax and employment insurance premiums deducted at source by employers. Parliament did so, in part, in response

Digitized by Google

to this Court's decision in *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411, which interpreted the former deemed trust provisions in the *ITA* narrowly.

[15]In order to constitute a security interest for the purposes of s. 227(4.1) *ITA* and s. 86(2.1) *EIA*, the creditor must hold "any interest in property that secures payment or performance of an obligation". The definition of "security interest" in s. 224(1.3) *ITA* does not require that the agreement between the creditor and debtor take any particular form, nor is any particular form expressly excluded. So long as the creditor's interest in the debtor's property secures payment or performance of an obligation, there is a "security interest" within the meaning of this section. While Parliament has provided a list of "included" examples, these examples do not diminish the broad scope of the words "any interest in property": see *Dagg v. Canada (Minister of Finance)*, [1997] 2 S.C.R. 403, at para. 68, and R. Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 61-68.

[16]I agree with my colleague that the common linguistic meaning of the defined term "security interest" in s. 224(1.3) *ITA* is the English term "security interest". A "security interest" is defined as any interest in property or "*droit sur un bien*" (right over property) that secures the performance of an obligation.

[17] For the reasons that follow, I conclude that the definition of"security interest" in s. 224(1.3) *ITA* applies to the facts before this Court.

The Relationship Between Contractual Compensation or Set-Off and a Security Interest

[18]Compensation and set-off are terms of art which I do not purport to define exhaustively in these reasons. Compensation in Quebec is similar to set-off in the common law provinces. There are a number of circumstances giving rise to compensation or set-off. There are also different kinds of compensation and set-off. "Legal compensation" is defined in arts. 1672 ff. of the *Civil Code of Québec*, S.Q. 1991, c. 64 ("*C.C.Q.*"). Articles 1672 and 1673 state in part that:

1672. Where two persons are reciprocally debtor and creditor of each other, the debts for which they are liable are extinguished by compensation, up to the amount of the lesser debt.

1673. Compensation is effected by operation of law upon the coexistence of debts that are certain, liquid and exigible and the object of both of which is a sum of money or a certain quantity of fungible property identical in kind.

[19]In the common law provinces, "legal set-off" is similarly statutorily defined. In the Ontario *Courts of Justice Act*, R.S.O. 1990, c. C.43, for example, "legal set-off" is defined in s. 111:

111. — (1) In an action for payment of a debt, the defendant may, by way of defence, claim the right to set off against the plaintiff's claim a debt owed by the plaintiff to the defendant.

Mutual debts may be set off against each other even if they are of a different nature.

Where, on a defence of set off, a larger sum is found to be due from the plaintiff to the defendant than is found to be due from the defendant to the plaintiff, the defendant is entitled to judgment for the balance.

[20]"Equitable set-off" was compared and contrasted with legal set-off by Wilson J. in *Holt v. Telford*, [1987] 2 S.C.R. 193. Wilson J. said of equitable set-off, at pp. 205-6:

The distinction between set-off at law and set-off in equity was canvassed by the

Digitized by Google

British Columbia Court of Appeal in *C.I.B.C. v. Tuckerr Indust. Inc.*, *supra*, at p. 605:
Such a set-off has its origin in equity and does not rest on the statute of 1728. It can apply where mutuality is lost or never existed. It can apply where the cross obligations are not debts.
Equitable set-off, like legal set-off, is also raised by way of cross-claim (see *Holt*, at pp. 212-13).
[21]There may be some differences between legal compensation (in Quebec) and legal and equitable set-off (in the common law provinces). However, the differences between legal compensation and legal and equitable set-off do not arise in this case because this Court is considering a right to compensation conferred on the Caisse by a contract between the Caisse and Camvrac (i.e. the "Security Given Through Savings" agreement). The Caisse and my colleague use the term "*compensation conventionnelle*". I translate "*compensation conventionnelle*" as "contractual compensation".
[22]Contractual compensation achieves a similar goal to legal compensation or legal or equitable set-off, the discharge of mutual debts. However, contractual compensation achieves this goal through mutual consent. It provides the contracting parties with a self-help remedy that avoids the technical requirements of legal compensation or legal or equitable set-off : see J.-L. Baudouin and P.-G. Jobin, *Les obligations* (5th ed. 1998), at para. 981, and K. R. Palmer, *The Law of Set-Off in Canada* (1993), at pp. 263-
Both a contract providing for a right of compensation in Quebec and a contract providing for a right of set- off in the common law provinces are to be interpreted by a court in a manner that gives effect to the intentions of the parties as reflected in the words of the contract.
[23]I do not think it is correct to make a blanket determination that a contractual right to compensation or a contractual right to set-off can never be associated with a "security interest" or that they are always associated with a "security interest". Whether a contract providing for a right to compensation or a right to set-off also gives rise to a "security interest"within the meaning of s. 224(1.3) *ITA* requires that the terms of the contract be carefully considered to determine whether the parties intended to confer on one party or the other "any interest in property [of the other party] that secures payment or performance of an obligation".
[24]In *The Law of Set-Off* (3rd ed. 2003), Professor S. R. Derham argues, I think persuasively, that some contracts including a right of set-off (or, in this case, contracts including a right of compensation) should be said also to involve security. As an example of a set-off agreement that also contains a security interest, Professor Derham describes a situation very similar to the one before this Court in the following words, at para. 16.82:
. . . a bank as a condition to the grant of a facility requires that a deposit be made with it which the depositor is not permitted to access until all indebtedness under the facility has been paid, and the parties agree that the bank may appropriate the deposit in discharge of the debt in the event of default in payment. The essence of the arrangement is that the depositor's property, in the form of the account in credit, is to function as a security. Indeed, in the case of a charge-back in which express words of charge are used, a contractual set-off is the very remedy that would be contemplated . . . . [Emphasis added.]
[25]The essence of contractual compensation or set-off is that the terms of the contract reflect the mutual intention of the parties: see Derham, at para. 16.86. If their mutual intention is to create a security interest to ensure that the right of

Digitized by Google

compensation or set-off will be an effective remedy, there is no reason to think that a security interest does not exist simply because the parties have chosen one mechanism for realizing on the security, rather than another. What must be considered is the substance of the agreement. If the substance of the agreement demonstrates that the parties intended an interest in property to secure an indebtedness, then a security interest exists within the meaning of s. 224(1.3) *ITA*.

Application of the Deemed Trust Provisions

[26]In this case, the Caisse says that its contractual right to effect compensation with Camvrac is not a "security interest" within the meaning of s. 224(1.3) *ITA*. It says that this contractual right did not confer on it an interest in Camvrac's property with the intention of securing the line of credit that it extended to Camvrac. Rather, the Caisse says that the contractual right allowed it simply to extinguish its own indebtedness to Camvrac.

[27]The Crown submits that the definition of "security interest" in s. 224(1.3) *ITA* is broad enough to include the Caisse's contractual right to effect compensation contained in the "Security Given Through Savings"agreement between the Caisse and Camvrac. It says that the deemed trust created by s. 227(4.1) *ITA* and s. 86(2.1) *EIA* protected its interest in the proceeds of Camvrac's term deposit because the property of Camvrac subject to the Caisse's security interest is beneficially owned by the Crown under its deemed trust to the extent of the unremitted source deductions.

[28]The issue then is whether the Caisse and Camvrac intended the agreements, which included the Caisse's right to effect compensation, to create a "security interest" within the meaning of s. 224(1.3) *ITA*. In my view, they did.

[29]The relevant facts are these. Camvrac made a deposit of $200,000 with the Caisse. Camvrac and the Caisse entered into a "Term Savings Agreement" under which Camvrac and the Caisse agreed that:

Camvrac's deposit would be for a term of five years;

Camvrac could not negotiate or transfer the deposit;

the term deposit could be hypothecated or given as security, but only in favour of the Caisse.

Camvrac and the Caisse also agreed to enter into the "Security Given Through Savings" agreement. Under this agreement, Camvrac and the Caisse agreed that:

"To secure repayment of any sum . . . owed or to be owed the Caisse" by Camvrac under its line of credit that:

Camvrac would maintain a deposit of $200,000;

Camvrac consented to the Caisse withholding repayment of the sum of $200,000; as long as the line of credit was still outstanding.

In the event of default, there would be compensation between the line of credit and the deposit of $200,000.

These agreements expressly conferred on the Caisse an interest in the property of Camvrac (i.e. Camvrac's deposit) to secure repayment of Camvrac's indebtedness to the Caisse.

[30]It was the five-year term and the maintenance and retention of the $200,000 deposit, as well as Camvrac's agreement not to transfer or negotiate the deposit and that the deposit could only be used as security with the Caisse, that created the Caisse's interest in Camvrac's property for the purposes of s. 224(1.3) *ITA*. In the absence of these encumbrances on Camvrac's deposit, Camvrac could have withdrawn the deposit at any time. Should it have done so and still been indebted to

Digitized by Google

the Caisse, the Caisse's right to compensation would be ineffective because it would not be indebted to Camvrac at the time the Caisse had to resort to the remedy of compensation. However, in this case the terms of the agreements provided that Camvrac agreed to the encumbrances on its deposit of $200,000 so that the Caisse would continuously be indebted to Camvrac and that on default there would be effective compensation. It is the fact that the agreements secured the Caisse's right to effective compensation by conferring on the Caisse an interest in Camvrac's property that created a "security interest" for the purposes of s. 224(1.3) *ITA*.

[31]I note here, from the words of the agreements, that the Caisse itself conceived of its agreements with Camvrac as creating "security" for the line of credit. The "Term Savings Agreement" provided that the term deposit"may be hypothecated or given as security only in favor of the issuing Caisse" (emphasis added). In the "Security Given Through Savings" agreement, it was Camvrac's term deposit which was used "[t]o secure the repayment" of the line of credit (emphasis added). The hypothecation provision contained in the "Security Given Through Savings" agreement was "[t]o further secure the repayment" (emphasis added). Thus, even in the absence of hypothecation, the agreements granted the Caisse rights over Camvrac's deposit to ensure an effective compensation remedy. The rights and obligations ensuring an effective compensation remedy were the Caisse's primary security because the hypothecation was viewed as "further" security.

[32] While the mechanism by which the Caisse would realize on its security was compensation, that mechanism in no way detracts from the fact that the deposit was encumbered by the conditions agreed to by Camvrac and imposed by the Caisse in order to ensure that the remedy of compensation would be effective. Nor does the fact that the Caisse could realize on its security by means of a book entry diminish the fact that the deposit secured Camvrac's obligation to the Caisse. In the absence of the restrictions imposed by the Caisse, Camvrac's right to repayment of its deposit of $200,000 could have been encumbered or transferred to a third party as security: see arts. 1637 and 2710*C.C.Q.* and B. Crawford, *The Law of Banking and Payment in Canada*(loose-leaf), vol. 2, at § 9:30.20. Just because a creditor holding a security interest (the Caisse) is also the debtor (the Caisse owes the $200,000 deposited by Camvrac to Camvrac) does not make it any less of a security interest for the purposes of s. 224(1.3) *ITA*.

[33]The situation in this case is in contrast to one in which a bank has what may be a standard term in a deposit agreement that any credit in the customer's account may be appropriated by the bank in discharge of the customer's potential indebtedness to the bank. In that case, there is no obligation on the customer to maintain a specific sum or, indeed, any amount deposited in the account at all as security for a loan that may or may not exist. There is no continuous right in the customer's property to protect the bank against default. The customer may withdraw any or all of the amounts in the account at any time. No specific property secures repayment. In these circumstances, based on this type of deposit agreement, the customer's property— its right to claim a deposit — cannot be said to secure its indebtedness to the bank. Unlike the case before this Court, this is a simple contractual right to set-off or compensation without attendant security.

Responses to Deschamps J.

[34]In my view, the difference in the results reached by Deschamps J. and myself in this case stems from the approaches we have taken. If I understand my colleague's approach correctly, she focusses on the remedy of compensation to conclude it is not a security interest. Under my approach, it is necessary to consider all of the relevant

Digitized by Google

terms of the agreements between Camvrac and the Caisse and not solely the provisions entitling the Caisse to the remedy of compensation. In my view, the issue is not whether compensation alone is viewed as a security interest. It is whether the agreements between the parties — including the Caisse's contractual right to effect compensation —created a "security interest" to ensure that the remedy of compensation would be effective.

[35]Deschamps J. says that a creditor with a right to effect compensation or set-off attains a goal analogous to a security interest. However, in her view, creditors who exercise their right to compensation or set-off are not enforcing a security by realizing on the debtor's property, but are instead just extinguishing mutual obligations.

[36] I agree with her that compensation or set-off is the extinguishment of mutual obligations. However, mutual obligations must exist for compensation to be an effective remedy. If a debtor can, at its own option, eliminate the creditor's liability to it (by withdrawing its deposit), the creditor may have a right of compensation or set-off, but it may not be effective. It is the encumbrances placed on the debtor's claim against the creditor that ensure that the creditor will remain liable to the debtor and, in this way, ensure an effective compensation remedy.

[37]Deschamps J. also notes that compensation is not specifically enumerated in s. 224(1.3) *ITA* and that this is important for two reasons. First, she relies on academic authorities who assert that a contractual right to set-off cannot create a security interest because the right does not confer on the creditor an interest in the debtor's property. Second, she says that compensation would have to be specifically enumerated in s. 224(1.3) *ITA* because compensation and set-off are not included in the provincial statutes respecting personal property security. Legal compensation is not included in the division relating to hypothecs in the *Civil Code of Québec*. She also says that set-off is excluded from the personal property security legislation of the common law provinces which all include definitions of security interest that are similar to that in s. 224(1.3) *ITA*. In light of the exclusion of contractual compensation and contractual set-off from provincial legislation dealing with security interests over property and the fact that contractual compensation does not confer on the creditor an interest in the debtor's property, its absence from the list of examples of security interests provided in s. 224(1.3) *ITA* is evidence that Parliament did not intend to include contractual compensation or contractual set-off within its definition of "security interest".

[38]With respect to my colleague's reliance on academic authorities who say that a contractual right to set-off does not confer on a creditor an interest in property, I understand these authorities differently than my colleague. Professor Derham explains that a contract containing a right to set-off like the one at issue in this case can also confer on a creditor an interest in a debtor's property: see Derham, at para. 16.82. However, the authors upon whom Deschamps J. relies do not address the precise issue before this Court. For example, R. C. C. Cuming, C. Walsh and R. J. Wood say, in *Personal Property Security Law* (2005):

Set-off, whether contractual or procedural, does not involve a security interest because neither party to the set-off acquires a property interest. [p. 87]

And Professor R. M. Goode says, in *Goode on Legal Problems of Credit and Security* (4th ed. 2008):

The party asserting it [the right of set-off] never acquires rights in the other's monetary claim at all; he merely asserts a countervailing claim which operates in pro tanto extinction of his monetary liability. [para. 1-19]

However, in this case, the Caisse has acquired rights in Camvrac's property by the

Digitized by Google

encumbrances placed on Camvrac's deposit. Those rights ensured that Camvrac's claim against the Caisse for its deposit would continuously exist in order to ensure that the compensation remedy would be effective. The P. Wood quote relied upon by Deschamps J. states:

[With respect to set-off] . . . a depositor does not grant a property right over the depositor's ownership of the deposit claim back to the bank to secure a loan owed by the depositor to the bank.

(*Set-Off and Netting, Derivatives, Clearing Systems* (2nd ed. 2007), at para. 1-008)

Yet, in this case, Camvrac did grant the Caisse a continuous interest in its deposit.

[39]It appears these authors were considering a bare right to contractual set-off such as the standard form deposit agreement I have discussed above. I believe these authors are saying that the remedy of set-off results in no property of the debtor coming in the hands of the creditor as the result of a set-off. All that occurs is the extinguishment of mutual debts. These authors are not addressing the period of time before set-off takes place where, as in this case, the creditor has taken steps to place restrictions on the debtor's property to ensure that the creditor continuously remains liable to the debtor so that the set-off remedy will be effective.

[40]I agree with my colleague that legal compensation does not appear grouped with hypothecs in the *Civil Code of Québec*. However, the issue is not whether compensation is a security interest. The fact that the terms"contractual compensation" or "contractual set-off" do not specifically appear as examples of the defined term "security interest" in s. 224(1.3) *ITA*does not mean that an agreement which provides for compensation, but which also conforms to the statutory definition of a "security interest" in s. 224(1.3) *ITA*is to be exempted from the purview of this definition. The list is non-exhaustive. Even when the remedial mechanism is compensation, so long as an agreement confers on a creditor an interest in property that secures the payment or performance of an obligation through compensation, the agreement will constitute a "security interest" within the meaning of s. 224(1.3) *ITA*.

[41]Although it is unnecessary for me to decide this point in order to resolve the issues in this appeal, I would respectfully disagree with my colleague that any agreement that provides for contractual set- off is categorically excluded from the personal property security legislation of the common law provinces. In the common law provinces, the approach to personal property security arrangements is functional, rather than formal. For example, s. 3(1) of Alberta's *Personal Property Security Act*, R.S.A. 2000, c. P-7, states that it applies to

every transaction that in substance creates a security interest, without regard to its form and without regard to the person who has title to the collateral, and

without limiting the generality of clause (a), a chattel mortgage, conditional sale, floating charge, pledge, trust indenture, trust receipt, assignment, consignment, lease, trust and transfer of chattel paper where they secure payment or performance of an obligation.

See also the personal property security acts of the other provinces and territories: s. 3(1) in New Brunswick (S.N.B. 1993, c. P-7.1), Prince Edward Island (R.S.P.E.I. 1988, c. P-3.1), Manitoba (C.C.S.M., c. P35) and Saskatchewan (S.S. 1993, c. P-6.2); s. 2(1) in British Columbia (R.S.B.C. 1996, c. 359), Northwest Territories and Nunavut (both S.N.W.T. 1994, c. 8); s. 4(1) in Nova Scotia (S.N.S. 1995-96, c. 13) and Newfoundland and Labrador (S.N.L. 1998, c. P-7.1); s. 2(a) in Ontario (R.S.O. 1990, c. P.10); and s. 2 in Yukon (R.S.Y. 2002, c. 169).

[42]Given the functional approach to personal property security arrangements in these

Digitized by Google

statutes, it is difficult for me to see how any transaction that confers an interest on a creditor in a debtor's property to secure an obligation could be categorically excluded unless that type of transaction has been defined and expressly excluded by the legislation itself. To my knowledge, an agreement that provides for security together with a right of set-off to realize on that security is not expressly excluded in any of the common law provincial personal property security statutes. What is required by the common law provincial personal property security statutes is a decision about whether a particular contract or agreement in a given case functions as a security interest.

[43]Deschamps J. says the Caisse did not rely on its hypothec. She says the mere obligation of Camvrac to maintain its deposit and the Caisse's right to withhold repayment of the deposit do not create the real right necessary for a "security interest". She distinguishes between "*droit de rétention*", which she says only applies to corporeal property and which has some of the attributes of a real right and a "*droit de retenue*", which applies to retention of amounts of money and which has no attributes of a real right and corresponds to compensation.

[44]At both civil and common law, a claim, like a deposit, may be charged with a real right or become the subject of a creditor's interest in property. For example, accounts receivable are often assigned to lending institutions as security for loans. Indeed, a deposit in a bank or caisse is an account receivable in favour of the customer. In the case of term deposits, in the absence of restrictions imposed by the lending institution, a term deposit may be assigned just like other receivables. An assignee has an interest in or a real right over the account receivable, that is an encumbrance on the claim of the creditor to the proceeds of the receivables whether from debtor customers or from a debtor bank or caisse.

[45]In s. 224(1.3) *ITA*, the word "interest" in English is rendered as "*droit*" or right in French. As Marc Cuerrier notes in "The Harmonization of Federal Tax Legislation" (section 2.3), booklet 7 published in *The Harmonization of Federal Legislation with the Civil Law of the Province of Quebec and Canadian Bijuralism* (2001), this terminological difference in the English and French reflects differences in the two major legal systems of Canada. While in the common law it is possible to speak independently of both rights and interests in property, only rights are recognized in the civil law. As Martin Lamoureux notes in his article "The Income Tax Act, the Excise Tax Act and the Term Interest: An Interesting Case for Harmonization" published in *The Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism — Collection of Studies in Tax Law 2001* (2002), 7.1, the term "*droit*"in civil law corresponds most to the term "interest" in common law.

[46]In this case, the issue is not whether the Caisse's interest in or right over Camvrac's property is one that conforms with the property security legislation of the provinces. This is because the deemed trust created by s. 227(4.1) *ITA* and s. 86(2.1) *EIA*, which incorporate by reference the definition of "security interest" in s. 224(1.3) *ITA*, applies"[n]otwithstanding . . . any enactment of a province" (see also *DaimlerChrysler Financial Services (debis) Canada Inc. v. Mega Pets Ltd.*, 2002 BCCA 242, 212 D.L.R. (4th) 41, at para. 31). However, it is of note that the agreements between the Caisse and Camvrac did conform to the requirements for a movable hypothec with delivery established by this Court in *Caisse populaire Desjardins de Val-Brillant v. Blouin*, 2003 SCC 31, [2003] 1 S.C.R. 666, so as to constitute a real right under the *Civil Code of Québec*.

[47]In the *Civil Code of Québec*, a hypothec is defined as a real right (art. 2660 *C.C.Q.*). As my colleague notes, a claim, like an account receivable, can be

Digitized by Google

hypothecated with or without delivery (art. 2710 *C.C.Q.*). In *Val-Brillant*, Gonthier J., for the majority, considered what was necessary for a movable hypothec with delivery over a non-negotiable claim, like the one at issue in this case. He held at para. 28 that:

A movable hypothec with delivery on a non-negotiable claim is therefore validly granted and published [per arts. 2702 and 2703 C.C.Q.] where (i) the debtor has transferred effective control of the claim to the creditor by giving the creditor the right to collect directly in the event of default, without further authorization by the debtor; (ii) where the claim is evidenced by a non-negotiable title which it is possible to hand over, such title has been handed over to the creditor; and (iii) the necessary steps have been taken so that the hypothec may be set up against the debtor of the claim in accordance with art. 1641 C.C.Q.

[48]In this case, the agreements between the Caisse and Camvrac met these criteria. First, the Caisse had effective control over Camvrac's claim. The five-year term and the conditions in the "Security Given Through Savings" agreement ensured that the Caisse had effective control over Camvrac's deposit and that, in the event of default, the Caisse could effect compensation between the line of credit and Camvrac's deposit without further authorization from Camvrac. Second, it is not clear on the record whether a certificate of deposit was or was not issued in this case. Both clause 2 of the "Security Given Through Savings" agreement and the fact that the Caisse noted on its copy of the "Term Savings Agreement" that it had been [TRANSLATION] "To be closed on 21/2/2001 to realize on security" suggest that, if a certificate of deposit was issued, it was held by the Caisse. However, nothing turns on whether Camvrac's term deposit was evidenced by a certificate of deposit. Gonthier J.'s second criteria for a movable hypothec with delivery over a non-negotiable claim only applies where a non-negotiable title exists. Where it does not, the second criteria is not applicable. Third, a movable hypothec with delivery is set up against the account debtor and all other claimants by taking the necessary steps under art. 1641 *C.C.Q.* Under art. 1641 *C.C.Q.*, the assignment may be set up against the account debtor and other claimants as soon as the account debtor has acquiesced in it. In this case, in respect of Camvrac's deposit, the Caisse is the account debtor as well as the assignee. Obviously, the Caisse as account debtor acquiesced in the assignment of its debt to itself as assignee. In my view, because the agreements between the Caisse and Camvrac met the criteria of a movable hypothec with delivery on a non-negotiable claim and because a hypothec is defined as a real right in the *Civil Code of Québec*, the Caisse must have held a real right over Camvrac's property.

[49]As my colleague notes at para. 129, art. 2702 *C.C.Q.* has been amended and these amendments have come into force since this case was heard. It is not necessary to embark upon an interpretation of these amendments. However, what they point out is that, should provincial law form the basis for defining a "security interest" under s. 224(1.3) *ITA*, the scope of the deemed trust created by s. 227(4.1) *ITA* and s. 86(2.1) *EIA*could change from time to time with changes to provincial property security law. In my view, this result is not contemplated by the words of ss. 224(1.3) and 227(4.1) *ITA*, and s. 86(2.1) *EIA*.

[50]Deschamps J. says that Camvrac's obligation to maintain the deposit and the Caisse's right to withhold repayment "were of residual application" only (para. 120). During the term of the deposit, the Caisse was not required to return the deposit until the term had expired.

[51]Even if the obligation to maintain and the right to retain are residual and apply only after the five-year term of the deposit has expired, they are nonetheless

Digitized by Google

encumbrances that could affect Camvrac's use of its property. Indeed, as Deschamps J. says, they are mechanisms provided "to ensure that legal or conventional compensation could be effected" (para. 120). That is precisely the point. The agreements entered into by Camvrac and the Caisse created rights and obligations, including the Caisse's right of retention and Camvrac's obligation to maintain the deposit, to ensure that the Caisse would remain liable to Camvrac if the Caisse had to resort to compensation as a remedy.

[52]Finally, Deschamps J. says that the Caisse's right of retention of Camvrac's $200,000 deposit does not confer on the Caisse a real right to Camvrac's term deposit. She says at para. 121:

The most important thing to bear in mind is that none of the clauses . . . created a real right or [a] security interest . . . . A term is a deadline for repayment. The right to deduct is simply the right of a creditor not to perform an obligation to pay as long as a debt is owed to him or her. It is, in a way, an extension granted for repayment. As for the obligation to maintain, it is clearly an undertaking by one person to another to perform an obligation. The limit on the right to transfer, hypothecate or negotiate constitutes an obligation "not to do".

[53]She further says, at para. 124, that my approach may conflict with how negative pledges are treated under the functional approach to personal property security in the common law provinces. She quotes Professors Cuming, Walsh and Wood who say, at p. 86:

A "negative pledge" clause or negative covenant in a loan agreement under which the borrower covenants not to encumber or dispose of some or all of her personal property until the loan is repaid does not create a security interest since, standing alone, the covenant does not create an interest in the property of the borrower. A negative pledge clause in a security agreement cannot prevent the covenantor from giving another effective security interest in the collateral. [Emphasis added.]

[54]I believe her paras. 121 and 124 highlight the difference between us. I would agree with my colleague that no security interest has been created if a contractual right to compensation only means that, should the debtor default, the creditor may retain amounts owed to the debtor, if any. I would also agree that a negative pledge "standing alone" does not "prevent the covenantor from giving another effective security interest in collateral".

[55]However, much more was occurring here. From the outset, the Caisse required that Camvrac make a term deposit subject to encumbrances in order to ensure that the Caisse would remain liable to Camvrac, in the event that the Caisse had to resort to the remedy of compensation as a result of default. The right of retention, the obligation to maintain and Camvrac's pledge not to hypothecate or use its term deposit as security in favour of anyone besides the Caisse were three of a series of encumbrances that created the Caisse's interest in or right over Camvrac's property to ensure that compensation would be an effective remedy.

To Which of the Unremitted Source Deductions Did the Deemed Trust Apply?

[56]Having concluded that the agreements between the Caisse and Camvrac created a "security interest" within the meaning of s. 224(1.3) *ITA*, it is now necessary to determine whether the deemed trust covered all unremitted source deductions that the Crown sought from the Caisse.

[57]On the facts of this case, some of the unremitted employment insurance premiums and income tax deducted was owed by Camvrac to the Crown before Camvrac entered into the "Term Savings Agreement" with the Caisse. There is some

Digitized by Google

question, then, in this case, whether the deemed trust provisions in s. 227(4.1) *ITA* and s. 86(2.1) *EIA* can confer beneficial ownership on the Crown over Camvrac's after- acquired property (i.e. the term deposit).

[58]A second issue is at what point the Caisse realized on its security in the term deposit by effecting compensation. The Caisse says that the relevant date was the date of default, November 25, 2000. The Crown says that the relevant date was February 21, 2001. Under s. 227(4.1) *ITA* and s. 86(2.1) *EIA*, Camvrac's property is impressed with the Crown's deemed trust from the time income tax and employment insurance premiums were deducted at source by Camvrac. The date at which the Caisse effected compensation is important because unremitted employment insurance premiums and income tax were deducted by Camvrac until the end of January 2001. If the Caisse is correct, as of November 25, 2000 the Crown would have no entitlement to the proceeds of the term deposit for source deductions that were deducted after November 25, 2000 since the term deposit would no longer have been the property of Camvrac once compensation had been effected and could not be subject to the deemed trust created by s. 227(4.1) *ITA* and s. 86(2.1) *EIA*. If the Crown is correct, then the proceeds would be subject to the deemed trust for the full amount of the unremitted source deductions to February 21, 2001 (as the date when compensation was effected by the Caisse).

[59]With respect to whether the deemed trust provisions apply to after-acquired property, this Court interpreted s. 227(4.1) *ITA* broadly in *First Vancouver Finance v. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720, as applying to both property in the hands of the tax debtor and after-acquired property. In *First Vancouver*, Iacobucci J. held for the Court, at para. 38, that based on the plain language of ss. 227(4) and 227(4.1) as supported by the purpose of the provisions and intentions of Parliament, the deemed trust created by these sections encompasses property which comes into the hands of the tax debtor after the trust arises.

The trust created by s. 227(4.1) *ITA* and s. 86(2.1) *EIA* is deemed to be in effect "at any time". It does not matter that the term deposit became the property of Camvrac only after some of the employment insurance premiums and income tax deductions went unremitted since the deemed trust "encompasses property which comes into the hands of the tax debtor after the trust arises".The proceeds of Camvrac's term deposit are therefore available to the Crown to discharge all of the outstanding employment insurance premiums and income tax deducted at source by Camvrac, whether the unremitted deductions occurred before or after Camvrac entered into the "Term Savings Agreement" and until the date that the Caisse realized on its security.

[60]As to the date on which the Caisse exercised its right to compensation, I agree with the Crown for two reasons. First, February 21, 2001 is the date on which the Caisse itself noted on its copy of the "Term Savings Agreement": [TRANSLATION] "To be closed on 21/2/2001 to realize on security." This is evidence that the Caisse believed that compensation was effected on that date and not earlier. Second, the Caisse, according to its account records, continued to charge interest on the line of credit until January 31, 2001 despite the fact that Camvrac had defaulted on November 25, 2000 by failing to make its interest payment to the Caisse due on that date. The "Security Given Through Savings" agreement stated that:

DEFAULT

. .

.

Digitized by Google

ve benefit of the Caisse and the latter may waive them expressedly. The Caisse may, among others, without any prejudice to its rights, wait for the maturity date of the certificate(s) of deposit before exercising its rights as provided for in paragraphs (b) and (c) above.

RESERVE OF RECOURSES

The consequences of a default are for the exclusi

Digitized by Google

. . . Furthermore, failure by the Caisse to avail itself of any of its rights in case of default shall not be interpreted as a waiver of such rights.

[61]These terms acknowledged that the Caisse had a discretion as to the timing of when compensation would be effected. The Caisse was entitled, as it did here, not to effect compensation immediately upon default, but instead could choose to allow the line of credit to remain open. This is what the Caisse did. It did not effect compensation until February 21, 2001. The Caisse is liable to pay to the Crown the amounts for employment insurance premiums and income tax deducted at source by Camvrac up to, and including, any deductions not remitted as of February 21, 2001.

Interest Calculation

[62]This issue may be disposed of quickly. The Caisse says that if it is liable to the Crown, the law of Quebec with respect to pre-judgment interest rather than ss. 36(2) and 37(2) of the *Federal Courts Act*, R.S.C. 1985, c. F-7, applies. I cannot agree with the Caisse. *Markevich v. Canada*, 2003 SCC 9, [2003] 1 S.C.R. 94, is dispositive of the issue. Indebtedness under the *ITA* and *EIA* gives rise to a cause of action outside of a particular province and so the rules respecting pre-judgment interest in ss. 36(2) and 37(2) of the *Federal Courts Act* apply: see *Markevich*, at paras. 39-40. The cause of action was that of the Crown against the Caisse for unremitted source deductions pursuant to its deemed trust which arose because the Caisse appropriated funds belonging to Camvrac which were impressed with the Crown's deemed trust.

Conclusion

[63]For these reasons, I find that the terms of the "Term Savings Agreement" and the "Security Given Through Savings" agreement between the Caisse and Camvrac created a "security interest" within the meaning of s. 224(1.3) *ITA*. The Caisse was liable to the Crown for the unremitted employment insurance premiums and income tax deducted at source by Camvrac up to and including February 21, 2001. Interest is calculated in accordance with ss. 36(2) and 37(2) of the *Federal Courts Act* from February 21, 2001, when the Caisse effected compensation, to the date of payment.

[64]The appeal should be dismissed with costs in this Court only.

English version of the reasons of LeBel and Deschamps JJ. delivered by

[65]DESCHAMPS J.(dissenting) — The Court is once again being asked to consider the scope of the rights resulting from the deemed trust created by Parliament to ensure that employers remit income tax and employment insurance premiums deducted from their employees' salaries to the Receiver General for Canada. For the reasons that follow, I find that compensation is not a "security interest" within the meaning of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"),and the *Employment Insurance Act*,

1996, c. 23 ("*EIA*"),and that the appellant's contractual right may be set up against the respondent because the respondent cannot have more rights than the employer itself had. I would accordingly allow the appeal and remand the case to the trial judge to establish the amount of the deductions that had not been remitted at the time the compensation agreement was signed.

Iss
ue
s

Digitized by Google

[66]The main issue in this appeal concerns the effect of the deemed trust provided for in the *ITA* and the *EIA* on assets subject to compensation under an agreement between the Caisse populaire Desjardins de Bon Conseil, to whose rights the appellant ("Caisse") has succeeded, and the employer, Camvrac Enterprises Inc. ("Camvrac"). The Caisse raises an additional issue related to the calculation of interest. It submits that as a result of ss. 36(1) and 37(1) of the *Federal Courts Act*, R.S.C. 1985, c. F-7, interest should have been calculated in accordance with the rule that applies in Quebec. The respondent contends that ss. 36(2) and 37(2) of that Act apply instead, because the cause of action arose outside Quebec. I will discuss the issue relating to the deemed trust first before turning to the interest issue.

[67]Between May 2000 and January 2001, Camvrac, an employer doing business in Quebec, failed to remit $26,863.53 in income tax and employment insurance premiums deducted from its employees' salaries to the Receiver General for Canada. Nothing in the evidence specifies the amount owed by Camvrac as of September 25, 2000, but according to the Federal Court prothonotary who heard the matter at trial, the unremitted deductions totalled $5,558.72 in October 2000.

[68]On September 18, 2000, the Caisse and Camvrac signed a variable credit contract under which the Caisse extended $277,000 in credit to Camvrac. A few days later, on September 25, 2000, two additional agreements were signed: a term savings agreement under which Camvrac deposited $200,000 in the Caisse for a term expiring on October 16, 2005, and an agreement to give savings as security for the repayment of any amount owed to the Caisse, in which Camvrac granted the Caisse a "right to withholding and compensation" and a hypothec. Only the right to compensation is in issue in this appeal: neither the hypothec nor the right to withhold was raised, enforced or exercised, or set up against the respondent. Although excerpts from the relevant clauses are also set out in the Appendix, I will reproduce one here that I will be discussing more specifically:

[TRANSLATION]

RIGHT TO WITHHOLDING AND COMPENSATION

To secure the repayment of any sum in principal, interest, costs and accessories owed or to be owed the Caisse by the Depositor under a line of credit agreement in the amount of

$277,000.00 granted to him (her) on 2000-09-18 and under any debts or obligations, present or future, direct or indirect held by the Depositor, the Depositor undertakes to maintain and consents to the withholding by the Caisse, in the account(s) . . . mentioned below, of the amount of $200,000.00 distributed as follows: . . . . Alternative term saving 5 years in the amount of $200,000.00 . . . .

The Caisse may withhold the sums shown above, along with the interest from the certificates of deposit if applicable, as long as all the amounts due under the Credit Contract(s) have not been fully repaid and, in the case of a line of credit, as long as it has not been cancelled. In cases of default as provided for below, there shall be compensation between the Credit Contract(s) and the certificate(s) of deposit or the amounts deposited defined above, as provided for in Section 7.

[69]I note that the parties and the courts below have sometimes referred to the term deposit as a "certificate of deposit". In my opinion, as is indicated in the term savings agreement, it is simply a term deposit. But what it is called is of no consequence in light of the mechanisms that are at issue in this appeal.

[70]On November 25, 2000, Camvrac defaulted on the interest on the borrowed amount. On December 1, 2000, that interest was paid by means of a manual transfer of funds effected by the Caisse. A statement dated December 31, 2000, shows a

Digitized by Google

debt of $277,000 owed by Camvrac to the Caisse; it also indicates that monthly interest on the total amount of the loan was charged to Camvrac. A savings and investment account statement dated January 31, 2001 shows a balance of $200,578 in respect of the deposit. On February 5, 2001, Camvrac made an assignment in bankruptcy. On its copy of the deposit agreement, the Caisse made the following note: [TRANSLATION] "To be closed on 21/2/2001 to realize on security."

[71]On June 12, 2001, the respondent required the Caisse to pay her $26,863.53 owed by Camvrac for payroll deductions. She submits that this amount was protected by the deemed trust resulting from provisions of the *ITA*and the *EIA*. The Caisse counters that the note made on the deposit agreement on February 21, 2001 was merely administrative in nature and that its debt to Camvrac was extinguished by compensation.

Judicial History

[72]Before a prothonotary of the Federal Court, the respondent argued that the deposited amount was property of Camvrac that was subject to the deemed trust, and that in enforcing its security interest on February 21, 2001, the Caisse had realized on that certificate and should have paid her the amount of the deductions Camvrac had failed to remit. The Caisse submitted that under the agreement with Camvrac, the mutual debts —its own and that of Camvrac — became exigible when Camvrac defaulted and that those debts had been extinguished by compensation. In the prothonotary's opinion, there was no doubt that the deposited amount was held as security, that in "cashing it in", the Caisse was enforcing a security interest, and that the deposited amount was subject to the deemed trust. She therefore held that"the value of the benefit conferred on the [Caisse] through the realization on its security interest in the certificate of deposit constitutes the proceeds from the certificate of deposit, and must be paid to the Receiver General"(2005 FC 731, 2006 D.T.C. 6385, at para. 22). According to the prothonotary, legal compensation could not be relied on, because the term of the deposit had not expired. She added that if the Caisse wanted to avail itself of its contracts with Camvrac, it had to manifest its intention to enforce them, which it did not do until February 21, 2001, by which time the respondent's right had priority. The prothonotary therefore ordered the Caisse to pay the amount claimed by the respondent. She awarded interest at the rate provided for in ss. 36(2) and 37(2) of the *Federal Courts Act*.

[73]The Federal Court upheld the prothonotary's judgment (2005 FC 1563, 2007 D.T.C. 5664). In response to the Caisse's argument that the prothonotary had failed to consider the forfeiture of the term clause in the term savings agreement, the court stated that although conventional compensation could have been effected under the terms of the contract before the expiry of the term of the deposit, the Caisse had not exercised its right to do so until February 21, 2001, by which time the deposit amount was subject to the deemed trust. The Federal Court rejected the Caisse's argument that compensation is not a security interest, relying instead on the French version of the definition of "security interest" (*garantie*) in s. 224(1.3) *ITA*to conclude that even if compensation were held to constitute a payment, it would be considered a "security interest" within the meaning of the *ITA*.

[74]The Federal Court of Appeal also concluded that the *ITA*'s definition of "security interest" is sufficiently broad to include the Caisse's right to compensation in respect of Camvrac's deposit, and that the provisions concerning the deemed trust authorized the respondent to recover from the Caisse the amounts owed by Camvrac (2006

Digitized by Google

FCA 366, 361 N.R. 77). On the interest issue, the Court of Appeal relied on *Markevich v. Canada*, 2003 SCC 9, [2003] 1 S.C.R. 94, and *Canada (Attorney General) v. Caisse populaire d'Amos*, 2004 FCA 92, 324 N.R. 31, and upheld the trial judgment.

Parties' Arguments Concerning the Deemed Trust

[75]The Caisse advances three arguments: (1) the courts below erred in finding that the mechanism it relies on is a security interest within the meaning of ss. 224(1.3) and 227(4.1); (2) compensation is not a mechanism for performing obligations; and (3) the time when the debt was extinguished does not depend on whether the compensation is characterized as legal or conventional, but in the alternative, if it must be characterized, it should instead be regarded as a contractual arrangement for compensation in the future. This last argument does not appear to have been raised as forcefully in the courts below, but the facts and legal concepts relied on remain the same.

[76]The respondent contends that the deemed trust creates an absolute priority and that, regardless of whether the compensation is conventional or legal or of whether compensation constitutes a security interest, the proceeds from the "cashing in" of the term deposit must be paid to her up to the amount of the source deductions owed by the employer.

[77]Because the courts below held that compensation constitutes a"security interest" as defined in s. 224(1.3) *ITA*, I will deal with this issue first. I will then consider whether the contractual right to compensation may be set up against the respondent.

"Security Interest" as Defined in Section 224(1.3) *ITA*

[78]Over ten years ago, Gonthier J. observed in *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411, at para. 22, that a clash between conflicting legislative objectives had given rise to a competition of priorities between deemed trusts and consensual security interests. In 1998, Parliament enacted legislation to expand the scope of the deemed trust (S.C. 1998, c. 19, s. 226(1)) and give it priority over every"security interest" as that term is defined in s. 224(1.3). In this context, it is important to clearly delineate the concept of "security interest" as defined in that provision.

[79]Although the provisions in issue in this appeal —ss. 224(1.3), 227(4) and 227(4.1) *ITA* and the corresponding provisions of the *EIA* — are reproduced in the Appendix, I will nevertheless reproduce the more relevant passages here for ease of reference. Section 224(1.3) *ITA* defines "security interest" for the purposes of the deemed trust. The English version of the definition reads as follows:

"security interest" means any interest in property that secures payment or performance of an obligation and includes an interest created by or arising out of a debenture, mortgage, hypothec, lien, pledge, charge, deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for;

[80]The terminology used in the French version is different. On the one hand, the term "security interest" is rendered as "*garantie*". On the other hand, whereas the word "interest" is used in the English expression"interest in property", the word "*droit*" is used instead in the expression "*droit sur un bien*" in French:

« garantie » Droit sur un bien qui garantit l'exécution d'une obligation, notamment un

Digitized by Google

paiement. Sont en particulier des garanties les droits nés ou découlant de débentures, hypothèques, privilèges, nantissements, sûretés, fiducies réputées ou réelles, cessions et charges, quelle qu'en soit la nature, de quelque façon ou à quelque date qu'elles soient créées, réputées exister ou prévues par ailleurs.

[81]The concept of "*garantie*" can vary in scope depending on the context. It is therefore important that the two versions be read together and that the meaning of the terms "security interest" and "*garantie*" be harmonized in the context of s. 224(1.3) *ITA*. It should be noted that there is no distinct federal common law: *Quebec North Shore Paper Co. v. Canadian Pacific Ltd.*, [1977] 2 S.C.R. 1054, *McNamara Construction (Western) Ltd. v. The Queen*, [1977] 2 S.C.R. 654, and P. Denault, *La recherche d'unité dans l'interprétation du droit privé fédéral* (2008), at p. 38. Where the suppletive law must be applied to interpret a concept incorporated into a federal rule, the law of the province is the relevant source: *Federal Law—Civil Law Harmonization Act, No. 1*, S.C. 2001, c. 4, s. 8, amending the *Interpretation Act*, R.S.C. 1985, c. I-21. As a result, absent an express provision to the contrary, federal legislation must be interpreted in a manner consistent with the concepts and institutions of the legal system of the province in which it is to be applied: A. Morel, "La rédaction de lois bilingues harmonisées avec le droit civil", in *The Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism — Collection of studies* (1997), 309, at p. 313.

[82]Furthermore, not only must reference be made — when necessary to interpret federal legislation — to the law of the province in which it is to be applied, but both the English and French versions must be taken into consideration: M. Bastarache et al., *The Law of Bilingual Interpretation*(2008), at pp. 42 *et seq*. I will begin by analysing the English and French versions to determine whether a shared meaning can be established. In the case at bar, this analysis leads to a notion common to the civil law and the common law that makes it possible to harmonize the application of the taxing provision in the two legal systems.

[83]Given that the terms "security interest" in the English version and "*garantie*" in the French version may not have the same scope, it will be necessary to establish the shared meaning of the English and French versions by applying the principles of bilingual interpretation recently reiterated in *R. v. S.A.C.*, 2008 SCC 47, [2008] 2 S.C.R. 675, at paras. 14-16 (see also Bastarache et al. and P.-A. Côté, *The Interpretation of Legislation in Canada* (3rd ed. 2000), at p. 327).

[84]There are two steps to this analysis: identifying the shared meaning and establishing Parliament's intent. At the first step, there are three possibilities (*S.A.C.*, at para. 15):

First, the English and French versions may be irreconcilable. . . . Second, one version may be ambiguous while the other is plain and unequivocal. The shared meaning will then be that of the version that is plain and unambiguous: *Daoust*, at para. 28; Côté, at p. 327. Third, one version may have a broader meaning than the other. According to LeBel J. in *Schreiber*, at para. 56, "where one of the two versions is broader than the other, the common meaning would favour the more restricted or limited meaning".

[85]The first possibility can be ruled out: the two versions are not irreconcilable. In English, the expression "security interest" has a well-established meaning, whereas the French word "*garantie*" is more general. While every security interest is necessarily a *garantie*, the opposite is not necessarily true. For example, a personal surety provides a *garantie*but does not establish a security interest in his or her property. The English term is therefore more specific than the French.

Digitized by Google

However, in light of the broad scope of the "security interest" concept, I do not consider it appropriate to say that the English version is "narrow" and the French version broad. If a choice had to be made between the second and third categories, therefore, the question would have to be placed in the second, that of the unequivocal version/ambiguous version. Here, this choice does not change the outcome, since in either case the shared meaning is that of the term used in the English version: "security interest".

[86]At the second step in the interpretation of bilingual statutes, it must be determined whether the shared meaning of the two versions is consistent with Parliament's intent (*S.A.C.*, at para. 16). It is clear that the successive amendments to the *ITA* and the *EIA* in respect of the deemed trust were intended to give enhanced protection to the tax creditor. Beyond this immediate objective, however, I cannot conclude that Parliament intended that the priority set for the taxing authorities should be vague. Such an interpretation would make it impossible for a tax debtor's creditors to determine their rights in advance. Given that the common law and civil law concepts are compatible, Parliament can only have intended to treat all Canadian taxpayers the same way and to enable both communities to predict how the legal mechanisms they use to organize their affairs will be interpreted. Only the shared meaning makes it possible to attain this objective. Accordingly, I conclude that Parliament's intent is consistent with the well-established concept of "security interest" as opposed to the more ambiguous concept of "*garantie*" (see ss. 8.1 and 8.2 of the *Interpretation Act*, introduced by the *Federal Law — Civil Law Harmonization Act, No. 1*; Denault, at p. 117).

[87]If, in the instant case, the shared meaning corresponds to the unequivocal concept of "security interest", it is because there is a concept common to a "security interest" in the sense of "interest in property" and a "*garantie*"in the sense of "*droit sur un bien*". It is this concept that must be identified. In "The Income Tax Act, the Excise Tax Act and the Term Interest: An Interesting Case for Harmonization", in *The Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism* (2002), published in the *Collection of Studies in Tax Law 2001*, Martin Lamoureux points out that a term like "interest" may be impossible to define without considering the context. In his view, "depending on the context, the expression 'interest in property' appears to be the converse of the notion of absolute ownership"(p. 7:9). According to this interpretation, therefore, the security interest —the right in question in s. 224(1.3) *ITA* — is distinct from a right of absolute ownership.

[88]After analysing how the "interest" concept is used in the *ITA*and in the *Excise Tax Act,*
R.S.C. 1985, c. E-15 ("*ETA*"),Lamoureux proposes the concept of "real right" as a basis for harmonizing those of "interest" and "*droit*". He explains this as follows:

As we stated in part three, we propose to harmonize the notion of "interest" (*intérêt*) with its Quebec equivalent which is"real right" (*droit réel*). This conclusion is based on a comparative analysis which shows a great similarity between the two concepts. In fact, a comparison of the two concepts shows a similarity between several of their general attributes, for example, the right to follow, the right to assert *adversus omnes*, a direct right to the thing and the dismemberment of property over time. [p. 7:22]

[89]This proposal is relevant in the case of s. 224(1.3), because the words "interest" and "*droit*" are used in the English and French versions of that provision. However, Lamoureux mentions some differences between the "interest" and "real right" concepts: for instance, beneficial ownership, equity and future interest can

Digitized by Google

give rise to an interest in property but do not necessarily have equivalents in civil law. He accordingly suggests that Parliament should define "real right" in the *ITA* and the *ETA*, and include common law concepts needed for certain specific purposes in the definition. I agree with using the "real right" concept to harmonize the concept of "interest in property" with that of "*droit sur un bien*" (right in property). In classical civil law, a *droit sur un bien*is a real right, not a personal right. The accessory real right (known in French as a "*droit réel accessoire*" and, often, as a "*droit réel de garantie*") forms an essential component of a security: P.-C. Lafond,*Précis de droit des biens* (2nd ed. 2007), at paras. 422-23 and 440-47;*Private Law Dictionary and Bilingual Lexicons: Obligations* (2003),"accessory real right", at pp. 4-5; D.-C. Lamontagne, *Biens et propriété* (6th ed. 2009), at paras. 103-4.

[90]At common law, the term "real right" and its close cousins "right*in rem*" and "*jus in re*", although less common, are nevertheless established. Professor Royston Miles Goode writes in *Goode on Legal Problems of Credit and Security* (4th ed. 2008), at para. 1-17, that "a security interest is a right in rem". Professors Ronald C. C. Cuming, Catherine Walsh and Roderick J. Wood also refer to the concept of "real right"or "right *in rem*" in *Personal Property Security Law* (2005):

A creditor who is given a security interest in the debtor's property obtains a proprietary right to the collateral. The defining characteristic of a proprietary right (which is also referred to as a real right or a right *in rem*) is that it is a right in a thing that is generally enforceable against the world. [p. 511]

See also R. A. Macdonald, "Reconceiving the Symbols of Property: Universalities, Interests and Other Heresies" (1994), 39 *McGill L.J.* 761; J. Austin, *Lectures on Jurisprudence, or, The Philosophy of Positive Law* (5th ed. 1885), at pp. 381-91; T. E. Holland, *The Elements of Jurisprudence* (12th ed. 1916), at pp. 146-47; W. N. Hohfeld, "Fundamental Legal Conceptions as Applied in Judicial Reasoning" (1917), 26 *Yale*

L.J. 710, at pp. 714-15; J. W. Salmond, *Jurisprudence* (10th ed. 1947), at pp. 252-56; G. W. Paton, *A Text-book of Jurisprudence* (2nd ed. 1951), at pp. 232-36; *Reagan v. Murphy*, 105 So.2d 210 (La. 1958); *Harwood Oil & Mining Co. v. Black*, 124 So.2d 764 (La. 1960).

[91]Moreover, just as an interest in property may be considered to be similar in many respects to a civil law real right, at common law, the notion of a "real right" is considered to be essential to a finding that a security interest exists in the area of personal property security. It is now well established that a functional approach has been adopted in the common law provinces and that form is not determinative of whether a security has been created. The fact remains, however, that the basis for a security interest continues to be a real right. Professors Cuming, Walsh and Wood explain this clearly:

The elimination of form as a determinant of the existence of a security agreement necessitates a close look at some types of transactions that, on the surface, appear to fall outside the scope of a PPSA but that may provide for interests that fall on one side of the line or the other, depending upon the presence or absence of a feature. In each case, it is necessary to determine whether the essential characteristics of a security agreement are present. This involves answering the question: does the transaction involve the contractual recognition or creation of an interest in the personal property of one person that secures an obligation owing to another person? . . . The "interest" involved must be a real right in personal property in the sense that it is exercisable against not only the obligor but also against third parties with subsequent interests in the property. [pp. 85-86]

Digitized by Google

Professor Goode makes a similar comment in this respect (at para. 1-17):

Even where the creditor is to be given rights in respect of an asset, it is necessary to distinguish real rights from personal rights. . . . [A] security interest is a right in rem and in principle the secured creditor is entitled to remove the asset from the general body of creditors.

[92]The common law concept of security interest therefore corresponds, in civil law terms, not to a personal right, but to a real right. In short, although no single expression is used at common law, what can be seen is that the right holder has a right in the property itself, as opposed to a right to compel a person to perform an obligation, which is the essence of a personal right. Thus, the "real right" concept is common to the two legal traditions. This concept is also inherent, and literally so, in the English expression "interest in property" and the French expression "*droit surun bien*" used in s. 224(1.3).

[93]The "real right" concept is also inherent in the mechanisms listed in s. 224(1.3). From the perspective of the civil law, the list in that provision includes forms of security formerly provided for in the *Civil Code of Lower Canada* and certain special statutes, such as the *Act respecting the special powers of legal persons*, R.S.Q., c. P-16, that have been consolidated in the *Civil Code of Québec* in the concept of the hypothec; the forms of security in question conferred real rights on creditors. Some of the mechanisms set out in the list in s. 224(1.3) *ITA* warrant comment.

[94]For instance, the term "assignment" refers to an assignment by way of security, not an absolute assignment (*Alberta (Treasury Branches) v. M.N.R.*, [1996] 1 S.C.R. 963, at para. 22; *First Vancouver Finance v. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720, at para. 39). In the *Civil Code of Québec*, an assignment by way of security takes the form of a movable hypothec (J.-L. Baudouin and P.-G. Jobin, *Les obligations* (6th ed. 2005), by P.-G. Jobin with the collaboration of N. Vézina, at No. 942).

[95]As for the trust, it is true that, in civil law, property is transferred in trust to a patrimony by appropriation (art. 1261 *C.C.Q.*). However, the transferred right is in the "property" (art. 1260 *C.C.Q.*). Moreover, a creditor who is a beneficiary of a security trust is not an ordinary creditor; the beneficiary's right may be characterized as a hybrid or *sui generis* right and has some of the characteristics of a real right (R. A. Macdonald, "The Security Trust: Origins, Principles and Perspectives", in *Contemporary Utilisation of Non-Corporate Vehicles of Commerce* (1997), Meredith Lectures, 155, at pp. 203-4; J. B. Claxton, *Studies on the Quebec Law of Trust* (2005), at pp. 553-55; J. E. C. Brierley, "Title Six: Certain Patrimonies by Appropriation — Articles 1256-1298", in *Reform of the Civil Code* (1993), vol. 1-B, at p. 17). And it should be noted that a legislature may expressly include, in a technical definition of a term, mechanisms that do not fall within the usual definition of the term.

[96]The same reasoning applies to the mechanisms listed in the provision if they are viewed from a common law perspective. Some of them (mortgage, trust, assignment) transfer legal or equitable title to the secured creditor. Others, such as the pledge or the charge, are comparable to the civil law's hypothec, with or without delivery. As for the lien, it may take a number of forms: it is akin sometimes to a pledge, where it includes a right to sell the property (Goode, at para. 1-49), and sometimes to a legal mortgage, where it is non-possessory. Finally, "encumbrance" is a very broad term that is defined in *Black's Law Dictionary* (6th ed. 1990) as"[a]ny right to, or interest in, land which may subsist in another to diminution of its value" (p. 527). Although this term can refer to an easement, it should be noted that where its use to refer to a form of security is concerned, the examples given are

Digitized by Google

usually the mortgage, the lien and the trust (D. A. Dukelow, *The Dictionary of Canadian Law* (3rd ed. 2004), at p. 408). Thus, the mechanisms mentioned above give the creditor a right that can be characterized as a "real right" within the shared meaning of this expression in the two legal traditions.

[97]The debenture is the only item in the list in s. 224(1.3) *ITA*that does not create a real right. However, it is a special case. The debenture has historically been central to secured lending transactions (L. Payette, *Les sûretés réelles dans le Code civil du Québec* (2nd ed. 2001), at pp. 387-89 and 815-20; B. A. Garner, *A Dictionary of Modern Legal Usage* (2nd ed. 1995), at p. 250; *The Dictionary of Canadian Law*, at pp. 318-19; H. Reid, *Dictionnaire de droit québécois et canadien* (3rd ed. 2004), at p. 162). Ordinarily, a debenture is issued and secured in a single instrument. One such instrument was considered by this Court in *Royal Bank of Canada v. First Pioneer Investments Ltd.*, [1984] 2 S.C.R. 125. The following comment by P.

L. Davies helps clarify the scope of the mechanism to which the term "debenture" as used in s. 224(1.3) *ITA* applies: "The expression'debenture' is applied indiscriminately to the instrument creating or evidencing the indebtedness and to the debt itself and the bundle of rights vested in the holder to secure its payment" (*Gower and Davies' Principles of Modern Company Law* (7th ed. 2003), at p. 809). The debenture is also mentioned in s. 2(a) of Ontario's *Personal Property Security Act*, R.S.O. 1990, c. P.10, as an example of a transaction that creates a security interest. Cuming, Walsh and Wood explain this as follows: ". . . it can be assumed that, in this context, the term refers to a corporate obligatio[n] secured by some form of security agreement in personal property"(p. 62, n. 21). In short, even though a debenture can be seen, in a technical sense, as merely a debt obligation (P. Martel, *Business Corporations in Canada* (2005), at pp. 32-14 and 32-15), the term "debenture" must be interpreted in its commercial and historical context, and its inclusion in the list in s. 224(1.3) *ITA* leads to the conclusion that Parliament intended to include the types of security that are most frequently used to grant real rights in property.

[98]In my opinion, since compensation has not been included in the list, the Caisse's right can constitute a security interest only if it entails a real right. To limit the concept of security interest in s. 224(1.3) *ITA*to rights that are real in nature is consistent both with the shared meaning of the terms ("security interest" and "*garantie*") used in the two versions of the provision and with Parliament's purpose of giving the deemed trust priority over the security interests referred to in s. 224(1.3) *ITA*: *First Vancouver Finance*.

[99]It must now be determined whether compensation is a "security interest" as that term is defined in s. 224(1.3) *ITA*.

Right to Compensation and Security Interest

[100] Before determining whether compensation is a "security interest"as that term is defined in

s. 224(1.3) *ITA*, I must mention that many Quebec commentators have characterized compensation as a *form* or *type*of "*garantie*". It is important to note their use of the French term "*garantie*",which, as I mentioned above, has a less precise meaning than "security interest". Thus, Baudouin, Jobin and Vézina state, at No. 1035, that compensation [TRANSLATION] "serves as a *garantie* by making it possible to avert the risks of debtor insolvency". In their view, compensation gives [TRANSLATION] "ordinary creditors a measure of priority in not requiring them to compete with other creditors" (see also: D. Lluelles and B. Moore, *Droit des*

Digitized by Google

obligations (2006), at No. 2672; V. Karim, *Les obligations* (2nd ed. 2002), vol. 2, arts. 1497 à 1707 C.c.Q., at pp. 749-50; J. Pineau, D. Burman and S. Gaudet, *Théorie des obligations* (4th ed. 2001), at p. 612). Moreover, compensation is a mechanism for extinguishing obligations that operates differently depending on the context in which it is effected: A. Bélanger, *Essai d'une théorie juridique de la compensation en droit civil québécois* (2004), at p. 299.

[101] These observations, although relevant to a description of compensation and its effects, do not support a conclusion that compensation is a "security interest" as that term is defined in s. 224(1.3) *ITA*. Although compensation may have the same effect as a security interest, care must be taken not to refer to the flexible sense that can be derived only from the French term "*garantie*". For the purposes of s. 224(1.3) *ITA*, it is not enough that compensation offers protection similar to that of a security interest: it must also confer an "interest in property", that is, a real right.

[102] Although it is true that compensation can be likened to a security interest, it cannot be equated with one in the sense that the term"security interest" must be given in the context of s. 224(1.3) *ITA*. Where compensation may be effected between two debts, the effect is clearly analogous to that of a "security interest" in the broad sense of the term; nevertheless, compensation or set-off is not regarded, in the positive law of either Quebec or the common law provinces, as having the characteristics of a real right. The automatic extinction of mutual debts is an effect of compensation, but it does not constitute the enforcement of a real right in the property in question. Since compensation is not specifically mentioned in the definition of "security interest" in s. 224(1.3) *ITA*, I find that it is not a security interest for the purposes of that provision.

[103] Guy Duboc, a French author, suggests in *La compensation et les droits des tiers* (1989), at pp. 244-47, Nos. 360-64, that compensation agreements should be recognized as pledge agreements that are subject to the same conditions and have the same effects as a pledge. But he is alone in his opinion, and he himself acknowledges that his position is a bold one. In my view, this position cannot be incorporated into Quebec law, especially in light of the consolidation of all forms of security that took place in the course of the reform of the *Civil Code of Québec*. Rather, it must be concluded that the provisions on compensation, located as they are in the chapter on the extinction of obligations, do not support the argument that compensation is a pledge that would be considered a hypothec under the *Civil Code of Québec*. To reach the same conclusion as Duboc would be contrary to the objective pursued by the codifiers in 1991 of consolidating the various forms of security.

[104] There is another reason why I would place compensation, or set-off, outside the ambit of s. 224(1.3) *ITA*. The term "security interest"used in the English version is one that is used extensively in the common law provinces in, specifically, the context of personal property security law. For example, it is defined as follows in the English version of Ontario's *Personal Property Security Act*:

"security interest" means an interest in personal property that secures payment or performance of an obligation, and includes . . . .

As can be seen, this definition is very similar to the one in the English version of s. 224(1.3) *ITA*:

"security interest" means any interest in property that secures payment or performance of an obligation and includes an interest created by or arising out of . . . .

[105] Furthermore, in most of the common law provinces, the French versions of this provision do not raise the same problems as the French version of the federal

Digitized by Google

provision (see, for example, in addition to the Ontario statute, those of New Brunswick (*Personal Property Security Act*, S.N.B. 1993, c. P-7.1) and Manitoba (*Personal Property Security Act*, C.C.S.M., c. P35)). In the Ontario statute, the French version reads as follows:

« sûreté » Intérêt sur des biens meubles qui garantit le paiement ou l'exécution d'une obligation, notamment les intérêts suivants . . . .

Thus, the term"security interest" is rendered as "*sûreté*" in the Ontario statute, as opposed to "*garantie*" — a word that requires interpretation because of its vagueness — in the federal statute.

[106] All the personal property security statutes of the common law provinces include broad, functional definitions of "security interest" (see, for example, s. 1 ("security interest") of Ontario's *Personal Property Security Act* and s. 1 ("security interest") of New Brunswick's *Personal Property Security Act*). Despite this liberal approach, all these statutes— except that of Ontario — give priority to contractual rights that arise before an assignment to another creditor is known. The Ontario statute was to the same effect until 2006; since then, it has provided that the right arises as of the time the debt becomes payable. The new Ontario provision does not appear to have been considered by the courts. However, regardless of when such rights arise, they are always dealt with separately from security interests (e.g., Ontario's *Personal Property Security Act*, s. 40; New Brunswick's *Personal Property Security Act*, s. 41; all other such statutes have virtually identical provisions), which shows that the legislatures did not consider set-off to be included in the concept of"security interest". In the only case in which the most common wording of the provisions creating this type of right has been interpreted, *518718 Alberta Ltd. v. Canadian Forest Products Ltd.*, 1998 ABQB 619, 63 Alta. L.R. (3d) 371, the Alberta Court of Queen's Bench held that a creditor with a contractual right of set-off has priority over an assignee provided that the creditor's right arises before the assignment (paras. 54, 55 and 63) (in that case, the result was altered on the basis of estoppel, but estoppel is not in issue in the case at bar).

[107] A conclusion that compensation is a "security interest" as that term is defined in the federal statute would therefore conflict with the meaning given to the term in the provincial personal property security statutes, which exclude set-off. Such an interpretation would also be inconsistent with the common law concept of "set-off", on which numerous business transactions are based. Cuming, Walsh and Wood express the following opinion (at p. 87):

Set-off, whether contractual or procedural, does not involve a security interest because neither party to the set-off acquires a property interest.

Professor Goode adds the following, at para. 1-19:

A right of set-off, even if given by contract, is a purely personal right to set one claim against another. The party asserting it never acquires rights in the other's monetary claim at all; he merely asserts a countervailing claim which operates in pro tanto extinction of his monetary liability. It follows that a contractual set-off does not create a security interest.

P. Wood expresses the same opinion in *Set-Off and Netting, Derivatives, Clearing Systems* (2nd ed. 2007), at para. 1-008:

Although set-off has a similar commercial effect to a security interest, set-off is not a security interest in that the creditor does not grant the debtor a property interest over the creditor's property in the debt owed to the creditor to secure the cross-claim owed by the creditor to the debtor, eg a depositor does not grant a property right

Digitized by Google

over the depositor's ownership of the deposit claim back to the bank to secure a loan owed by the depositor to the bank. Nor is set-off a right of retention like a lien because the bank does not retain the coins or notes of the depositor: the property in the benefit of the deposit account is held by the depositor and the bank has no property to retain.

Hence a right of set-off would not normally conflict with negative pledges typical of unsecured bank loan agreements whereby the borrower agrees not to create security over its assets. Negative pledges which widen the concept to include transactions similar to security interests should also not prohibit set-offs since a security interest and related title finance transactions (sale and leaseback, factoring, sale and repurchase) usually involve property transfers, but set-off is not a property transfer. A negative pledge which prohibited set-off would effectively prevent the debtor from becoming reciprocally indebted to a counterparty — impracticable in the normal case.

Professor Grant Gilmore, one of the US architects of Article 9 of the Uniform Commercial Code, when requested to exclude set-off from the definition of security interests, remarked, "One might as well exclude fan-dancing". Nevertheless he reluctantly gave in: Article 9 does not apply to "a right of recoupment or set-off": see s. 9-109(d)(10). In New Zealand the equivalent Personal Property Security Act does not apply to a right of set-off, netting or combination of accounts: see s. 23(c).

[108] Although I will be discussing the reasons of Rothstein J. below, I wish at this point to draw attention to one aspect of his reasoning. He relies on an excerpt from S. R. Derham's book *The Law of Set-Off*(3rd ed. 2003) to conclude that if the parties intended to create a security interest, that interest must be covered by the definition in s. 224(1.3) *ITA*. With respect, the following statement by Derham must be borne in mind: ". . .the predominant view is that a set-off agreement is not a charge" (para. 16.80). Thus, it must be understood that the passages cited by my colleague are part of a discussion of arguments in support of an unconventional approach. As with my rejection of Duboc's novel interpretation of French law, I find that it would not really be appropriate to incorporate into federal law a concept that is not recognized at common law and is totally unknown in civil law. In my view, it is very dangerous to assert that a real right in property can result from the parties' intention without basing that assertion on a mechanism known to the law.

[109] This review of the academic commentaries thus leads me to conclude that, under the common law as it now stands, set-off is excluded from the field of personal property security. The fact that a legal mechanism enables a creditor to obtain an effect similar to that of a "security interest"in the generic sense of the term does not make that mechanism a security interest.

[110] Despite the arguments presented in all courts, my colleague Rothstein J. considers that the question to be answered is not whether compensation is a security interest. Rather, in his view, the issue is whether the agreement created a "security interest" as defined in s. 224(1.3) *ITA*. He concludes that such an interest did in fact result from the juxtaposition of certain rights of the Caisse and obligations of Camvrac.

[111] As Rothstein J. sees it, compensation is merely a remedy (para. 30). The undertakings that gave rise to an "interest in property" as defined in s. 224(1.3) *ITA* were those relating to the term for repayment of the deposit amount, the obligation to maintain the deposit, the right to withhold and the limits on transferring, negotiating and hypothecating the deposit (para. 30). Rothstein J. does not concern himself with whether those rights, either individually or collectively, created a real right. Yet even

Digitized by Google

though he does not expressly accept that a security interest entails a real right, he considers that, in the case at bar, the Caisse held a movable hypothec with delivery in accordance with the reasoning of the majority in *Caisse populaire Desjardins de Val-Brillant v. Blouin*, 2003 SCC 31, [2003] 1 S.C.R. 666. For several reasons, I cannot accept my colleague's interpretation of the "security interest" concept or his recourse to the hypothec to conclude that the deemed trust had priority. I will discuss my objections under two heads.

Novel Approach to the "Security Interest" Concept

[112] I must say that Rothstein J.'s approach to the "security interest" concept is a novel one. He states that he agrees that the shared meaning lies in the English version, which implies that the English term corresponds to a legally recognized common concept. As I mentioned above, there is no federal common law. To identify the purpose Parliament was pursuing when it chose the "security interest" concept, it is necessary to refer to the common law, which is provincial law. The analysis cannot therefore disregard provincial law. However, the effect of my colleague's interpretation is to expand the "security interest" concept beyond its accepted scope in Canadian commercial law. Since his approach does not correspond at all to the shared meaning, its effect is to disregard both the principles applicable to the interpretation of bilingual legislation and those applicable to the harmonization of federal law and provincial law.

[113] Rothstein J. concludes on the basis of inchoate accessory rights that an interest in property — or, in other words, a "security interest" as defined in s. 224(1.3) LIR — was created (at para. 30):

It was the five-year term and the maintenance and retention of the $200,000 deposit, as well as Camvrac's agreement not to transfer or negotiate the deposit and that the deposit could only be used as security with the Caisse, that created the Caisse's interest in Camvrac's property for the purposes of s. 224(1.3) *ITA*.

What my colleague overlooks in his analysis is the fact that under s. 224(1.3) *ITA*, the interest in the property must make it possible to realize on the security. To simply find that an interest in property exists without regard for the context is not sufficient.

[114] At common law, a security interest typically entails three fundamental rights: (1) the right to realize on property given as security; (2) a right to priority with respect to the proceeds of realization; and the right to follow the property in the hands of a third party to whom it has been transferred (Cuming, Walsh and Wood, at p. 1). None of the rights mentioned by Rothstein J. enable the person concerned to appropriate the property. Thus, neither the term for repayment, nor the obligation to maintain, nor the right to withhold, nor the limit on the right to transfer, hypothecate or negotiate would enable the Caisse to realize on the deposit or appropriate the deposit amount to ensure performance of the secured obligation. I cannot imagine that Parliament intended the provision to apply to any mechanism other than the one known at common law that makes it possible to appropriate the property to which the security interest relates. What must be done under s. 224(1.3) *ITA*is to identify a *security* interest, not a simple interest.

[115] Although my colleague does not include compensation in the above list in support of his conclusion that an interest in property was created, he does ultimately refer to it, describing it as a remedy. What I conclude from this is that he does not see compensation as an interest in property and that according to his interpretation only the rights he mentions create such an interest. I believe that a few comments about each of these rights will be helpful here.

Digitized by Google

[116] Regardless of what standpoint is taken in reviewing the Caisse's obligation with respect to the term, the clause establishing the term cannot be viewed as stipulating anything other than a deadline for repayment of the deposit. It is well established that in the context of a banking contract, to deposit an amount in a financial institution is to make a loan. The financial institution becomes the owner of the loaned amount and must return it with the interest agreed on (art. 2330 *C.C.Q.*). The transaction is, in a word, a simple loan (art. 2329 *C.C.Q.*). The clause that establishes the term merely fixes the time when the loaned amount is to be returned. Camvrac's relationship with the Caisse with respect to the deposit was merely one of creditor and debtor that entailed only a right to be repaid upon expiry of the term. The establishment of a term did not alter the nature of the legal relationship between the Caisse and Camvrac. The right was not a real right, but a simple personal right.

[117] The same analysis applies to the covenants to which Camvrac agreed, those relating to Camvrac's claim against the Caisse. The undertakings to maintain the deposit and not to transfer, negotiate or hypothecate the claim conferred on the Caisse no right in the claim Camvrac had against it. In the event of default, these rights would be of no assistance unless they were violated, in which case they might give rise to an action for failure to perform the contract. All these rights were personal rights, not real rights. The right to withhold warrants more specific comment.

[118] In considering the meaning to be given to the expressions "*droit de retenue*" and "*droit de rétention*" and the nature of the right that has been created, the context is essential. In civil law, there is one concept known as the "*droit de rétention*" (under, for example, arts. 875, 974, 1250 and 2543 *C.C.Q.*), which is a right to retain corporeal property, and another known as the "*droit de retenue*", or right to deduct (see arts. 2111, para. 2 and 2123 *C.C.Q.*). The right to deduct is different from the right to retain: it applies to an amount of money, not to corporeal property. There is therefore no right to follow. Also, the creditor's claim does not have priority. The right to deduct has none of the characteristics on the basis of which a right to retain can be likened to a real right.

[119] In the instant case, in the agreement to give savings as security, the following appears as the title of clause 1: "*Droit de rétention et de compensation*" ("Right to withholding and compensation" in the English version of the Caisse's standard form contract). Regarding obligations, the agreement provides that the depositor "consents to the withholding by the Caisse, in the account(s) . . . mentioned below, of the amount of . . .", and that "[t]he Caisse may withhold the sums . . . in the case of a line of credit, as long as it has not been cancelled". Despite the use of the expression "*droit de rétention*" in the title of the clause, the purpose of the right is to deduct an amount of money and not to retain corporeal property, which means that it is a "*droit de retenue*", not a "*droit de rétention*" within the meaning of the *Civil Code of Québec*.

[120] This right to deduct could be of no help to the Caisse during the term of the deposit, as the Caisse was not required to return the deposited amount until the term expired, and this stipulation afforded it no additional protection. Since clause 11 of the term savings agreement provided that the term would be renewed automatically in the absence of notice to the contrary, the Caisse would be able to exercise the right to deduct only if Camvrac gave notice that it would not be renewing the term. Such notice could be given not later than seven days after the term expired. If a notice of non-renewal were received, it would then be open to the Caisse to request repayment under clause 5 of the variable credit contract. In such circumstances, compensation could be effected by operation of law upon the expiry of the term, and

Digitized by Google

the right to deduct and the obligation to maintain the deposit would be irrelevant. If, however, the Caisse did not immediately cancel the line of credit when the term of the deposit expired owing to the non-renewal, Camvrac would be precluded from requesting repayment because of its undertaking to maintain the amount in a deposit and the Caisse's right to deduct the amount. The Caisse would then retain the power to cancel the line of credit at any time, at its discretion, in order to effect legal compensation or, in the case of default, conventional compensation. These scenarios show that the Caisse's right to deduct and Camvrac's obligation to maintain were mechanisms provided for in the agreement to ensure that legal or conventional compensation could be effected. They conferred no separate right to realize on the claim and, moreover, were of residual application.

[121] The most important thing to bear in mind is that none of the clauses on which Rothstein J. relies created a real right or an interest in property ("security interest" as defined in s. 224(1.3) *ITA*). A term is a deadline for repayment. The right to deduct is simply the right of a creditor not to perform an obligation to pay as long as a debt is owed to him or her. It is, in a way, an extension granted for repayment. As for the obligation to maintain, it is clearly an undertaking by one person to another to perform an obligation. The limit on the right to transfer, hypothecate or negotiate constitutes an obligation "not to do".

[122] Thus, I cannot see how these rights, whether considered in isolation or as a whole, might constitute a "security interest" as that term is defined in s. 224(1.3) *ITA*. None of them provides a basis for using the property to ensure performance of the obligation, and none of them constitutes an interest in property that secures performance of an obligation.

[123] As Professors Cuming, Walsh and Wood point out, the elimination of form as a determinant of the creation of a security does not mean that every contractual undertaking can be regarded as security on personal property. The limits on which Rothstein J. relies can be compared with those applicable to flawed assets. According to the technique of flawed assets, property such as a bank deposit is subject to limits on withdrawal until the depositor has repaid his or her debt to the bank. It is well established that this technique does not create a security interest. Professor Goode explains this as follows (at para. 1- 21):

[The technique of flawed assets] does not of itself constitute a security, for the bank acquires no rights over the deposit, merely a right to withhold repayment.

[124] Cuming, Walsh and Wood also cite examples of undertakings pursuant to which creditors are given interests in property that cannot be characterized as security interests. One of them, the covenant not to dispose of or encumber property, is of interest, as it is analogous to one of the undertakings on which Rothstein J. relies:

A "negative pledge" clause or negative covenant in a loan agreement under which the borrower covenants not to encumber or dispose of some or all of her personal property until the loan is repaid does not create a security interest since, standing alone, the covenant does not create an interest in the property of the borrower. A negative pledge clause in a security agreement cannot prevent the covenantor from giving another effective security interest in the collateral. [p. 86]

Adding one or more personal rights does not result in the creation of a real right, which, as we saw above, Cuming, Walsh and Wood consider essential to the creation of a security interest. If Rothstein J.'s conclusion that a contractual undertaking creates an interest in the property is based on the functional approach, a further issue that will arise is how the negative pledge — whether or not in combination with another personal right such as the right to compensation — is now to be

Digitized by Google

characterized.

[125] Therefore, in my view, not only is Rothstein J.'s analysis of the expression "interest in property" or "*droit sur un bien*" unacceptable in that it disregards the fact that the principal purpose of a security interest must be to permit the property given as security to be realized, but it cannot be reconciled with the characterization of techniques similar to those adopted in the case at bar that do not create security interests.

Granting of a Movable Hypothec on a Claim With Delivery

[126] I also wish to comment on the argument that a hypothec was granted on the basis of the reasoning followed in *Val-Brillant*. First of all, I would point out that no evidence was adduced concerning a hypothec and that no submissions were made in this respect either before the prothonotary or in the Federal Court or the Federal Court of Appeal. I find this argument somewhat surprising in view of the fact that the parties neither produced evidence nor made submissions with respect to it. It will also be necessary to place *Val-Brillant* in context and to comment briefly on the use of the hypothec to confirm that the Caisse's right is subject to the deemed trust.

[127] In *Val-Brillant*, the issue was whether a non-negotiable certificate of deposit could be the object of a pledge (art. 2702 *C.C.Q.*). There were two opposing theories, of "materialization" or"dematerialization" of the pledge: Payette, at pp. 380-91; P. Ciotola and A. Leduc, "Arrêt *Val-Brillant*: évolution ou régression de l'hypothèque mobilière avec dépossession, en droit civil québécois?", in S. Normand, ed., *Mélanges offerts au professeur François Frenette: études portant sur le droit patrimonial* (2006), at p. 361. The majority accepted the theory of dematerialization and held that there could be a pledge on a non-negotiable instrument. Gonthier J., writing for the majority, concluded that effective control of a non-negotiable instrument for the purposes of arts. 2702 and 2703 *C.C.Q.* could be gained by means of the assignment of claims mechanism referred to in art. 2710 *C.C.Q.*

[128] The commentators have criticized the view that a movable hypothec with delivery can be granted in the manner described in *Val-Brillant*: Ciotola and Leduc; D. Pratte, "L'hypothèque avec dépossession de créances non représentées par un titre négociable ou le retour à une fiction accommodante",in *Mélanges offerts au professeur François Frenette: études portant sur le droit patrimonial*, at p. 421.

[129] Article 2702 *C.C.Q.* was amended on January 1, 2009. The *Civil Code of Québec* now explicitly provides that physical delivery of the property or instrument is essential for a pledge to be granted. This amendment to the *Civil Code of Québec* is a clarification made by the legislature in response to *Val-Brillant* (see: Quebec, National Assembly, *Journal des débats*, June 11, 2008, 1st Sess., 38th Leg., vol. 40, No. 46, at p. 1, Bill 47, *Securities and Other Financial Assets Transfer Act*; M. Deschamps, "Le nouveau régime québécois des sûretés sur des valeurs mobilières", lecture delivered on March 19, 2009 to the Chaire du notariat of the Université de Montréal, at p. 4, note 12 (online:/www.chairedunotariat.qc.ca/fr/conferences/mois/032009/Deschamps.pdf.). It is now clear that the instrument that is delivered must confer effective control over the claim without recourse being had to the assignment of claim mechanism as suggested by Gonthier J. By specifying that *physical* delivery is required, the legislature has indicated that the theory of materialization of the pledge has been accepted: the instrument must therefore be negotiable. The only exception to this requirement that the instrument be negotiable relates to certain securities (art.

Digitized by Google

2714.7 *C.C.Q.*). At the same time, in response to a concern expressed by the majority in *Val-Brillant*, the *Regulation respecting the register of personal and movable real rights* was amended to enable individuals who do not operate enterprises to hypothecate incorporeal property and claims — including claims represented by non-negotiable instruments — without delivery: O.C. 30-2009, (2009) 141 G.O. 2A, at p. 17A; art. 2683 *C.C.Q.* This amounts to a relaxation of the conditions under which an individual can grant a hypothec without delivery. As for a deposit, such as the one in the case at bar, it cannot be the object of a pledge.

[130] Having said this, I have difficulty understanding how the hypothec fits into the reasoning that leads Rothstein J. to conclude that the rights granted to the Caisse created a security interest. Two interpretations are possible. Does my colleague conclude that the respondent's right has priority over the Caisse's right solely because of the control exercised over the claim by means of the term, the obligation to maintain, the right to withhold and the limits on the rights to transfer, hypothecate and negotiate? Or is his conclusion based on the idea that in addition to those rights, Camvrac had granted a right to compensation that resulted in a hypothec? If the first interpretation is correct, the argument based on the hypothec is irrelevant. If the second is correct, the right to compensation becomes determinative even though my colleague does not include it among the sources of an interest in property. If Rothstein J.'s conclusion that the deemed trust has priority is based on the hypothec, his reasoning clashes with the clarification made by the Quebec legislature.

[131] Furthermore, I cannot accept the Court's recourse to an argument that has been raised neither by the Caisse nor by the respondent. As I mentioned above, the agreement to give savings as security provided for the granting of a hypothec, a right to withhold and a right to compensation, but only the right to compensation was raised and argued. The Caisse was not limited in the choice of rights it could exercise. If, for example, in addition to the hypothec and the right to compensation, the claim had been secured by another personal right, such as by suretyship, the respondent could not have claimed from the Caisse the amount received from the surety. It would have been clear that the Caisse was free to choose which right it would exercise. Thus, it could have chosen to exercise its right to compensation, or it could also — independently of the hypothec also provided for in the contract — have availed itself of the suretyship if such a right were provided for in the contract. The *Civil Code of Québec* provides, on the one hand, for compensation and, on the other hand, for hypothecs on claims. These two mechanisms must not, in my opinion, be confused. The reasons for the parties' choice may be based in fact. In my view, the question is not merely one of law. In all fairness to the parties, therefore, I do not consider it appropriate at this point to intervene in the "judicial contract" to alter the bases of the appeal before the Court.

[132] I therefore find, with respect, that as regards the term, the obligation to maintain, the right to withhold and the limits on the right to transfer, hypothecate or negotiate, all that have been created are personal obligations. Furthermore, since the parties did not raise the hypothec in this Court, I do not think that we can base our conclusion on an argument in respect of which no evidence was adduced and that does not correspond to the law. The appellant chose to exercise its right to compensation, and that is the right that must be considered.

[133] As a result, I conclude that the appellant is correct in arguing that compensation is not a "security interest" as that term is defined in s. 224(1.3) *ITA*. To accept the Caisse's first argument is not to dispose of the appeal, however. Despite my finding

Digitized by Google

that the Federal Court of Appeal erred in holding that the respondent had priority on the basis that the Caisse, in effecting compensation, had created a security interest for itself, the case is not yet closed. It must still be determined whether the right to compensation may be set up against the respondent, who, as a result of the deemed trust, not only has a priority over secured creditors — as the term"secured creditor" is defined in s. 224(1.3) *ITA* — but also has a right in the tax debtor's property. To do this, it must be asked whether the respondent may exercise its right in respect of both the amounts that had not been remitted at the time the right to compensation was granted to the Caisse and those that were not remitted after that time. As I mentioned above, by September 25, 2000, the date the compensation agreement was signed, Camvrac had already failed to remit some amounts that had been deducted from its employees' salaries. Those amounts totalled approximately $5,000.

Possibility of Setting up the Compensation Agreement Against the Respondent

[134] I do not think it necessary to explain at length why, prior to the expiry of the term of the deposit, the Caisse's right was not a right to legal compensation. The Caisse's right cannot be dissociated from the contract in which it was granted, if only because one of the conditions for legal compensation was not met: Camvrac's debt was not exigible, because repayment of the deposit amount was not due until October 2005. It will therefore be necessary to refer to the agreements between Camvrac and the Caisse.

[135] The *Civil Code of Québec* does not mention conventional compensation. However, there is nothing that prohibits it. In fact, conventional compensation is merely the arrangement by contract of the mechanism provided for in the Code. Furthermore, commentators have long recognized the validity of compensation agreements (see: Baudouin, Jobin and Vézina, at No. 1057; Lluelles and Moore, at No. 2701). [136] The issue in the case at bar is whether the Caisse may set up its compensation

agreement against the respondent. The respondent's right is provided for in s. 227(4.1) *ITA*. If I exclude the portions relating to the priority over secured claims, which I have already discussed, the respondent's right in Camvrac's property is set out as follows:

227. . . .

Every person who deducts or withholds an amount under this Act is deemed . . . to hold the amount separate and apart from the property of the person . . . in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act.

(4.1) . . . where at any time an amount deemed by subsection (4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person . . . equal in value to the amount so deemed to be held in trust is deemed

to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty . . . and to form no part of the estate or property of the person from the time the amount was so deducted or withheld . . . .

[137] The statutory mechanism transfers the tax debtor's property to a trust. In *First Vancouver Finance*, the Court likened this mechanism to a floating charge over all the tax debtor's assets up to the amount due, in that the trust does not attach to any

Digitized by Google

specific property and allows the tax debtor's business to be carried on as usual.

[138] All forms of security — including what was formerly referred to as a floating charge — are now consolidated in the Civil Code in a single mechanism, the hypothec. The transfer of property into a trust may also be likened to garnishment, since that is the procedure provided for in s. 224(1) *ITA* to enable the respondent to appropriate amounts owed to the tax debtor that are subject to the deemed trust: *Alberta (Treasury Branches)*. Whether the transfer into a trust is likened to a hypothec, to garnishment or to a simple assignment, the rules remain the same. The *Civil Code of Québec* and the *Code of Civil Procedure*, R.S.Q.,

c. C-25, provide that the rules governing the assignment of claims apply. The relevant provisions read as follows:

Civil Code of Québec

1680. A debtor who has acquiesced unconditionally in the assignment or hypothecating of claims by his creditor to a third person may not afterwards set up against the third person any compensation that he could have set up against the original creditor before he acquiesced.

An assignment or hypothec in which a debtor has not acquiesced, but which from a certain time may be set up against him, prevents compensation only for debts of the original creditor which come after that time.

Code of Civil Procedure

637. If the affirmative declaration of the garnishee is not contested and does not show the existence of another seizure by garnishment in his hands, the clerk, upon an inscription by either party, orders the garnishee to pay to the seizing creditor the amounts which he owes to the judgment debtor to the extent of the amount of the judgment in capital, interest and costs. To that extent the order of the clerk effects an assignment, in favour of the seizing creditor, of the judgment debtor's claim, from the date of the seizure. Such order must be served on the garnishee and becomes executory 10 days later.

[139] The ability of the debtor of the assigned claim to set up against the assignee any recourse that the debtor may have against the assignor is based on the general rule that the assignee may not have more rights in the assigned claim than the assignor had. This rule is set down in art. 1637 *C.C.Q.*:

1637. A creditor may assign to a third person all or part of a claim or a right of action which he has against his debtor.

He may not, however, make an assignment that is injurious to the rights of the debtor or that renders his obligation more onerous.

[140] This provision is complemented by art. 1643 *C.C.Q.*, which provides that a debtor may rely on a cause of extinction that occurred before an assignment could be set up against him or her. The first paragraph of that article reads as follows:

1643. A debtor may set up against the assignee any payment made to the assignor before the assignment could be set up against him, as well as any other cause of extinction of the obligation that occurred before that time.

[141] The commentators and the courts have accordingly recognized that any defences and any right to refuse to perform (exception for nonperformance) that arose prior to an assignment may be set up against the assignee by a debtor who has not acquiesced in the assignment. The same is true of the extinction of obligations by compensation: Karim, at p. 773; Baudouin, Jobin and Vézina, at No. 962; Lluelles and Moore, at No. 3176; Bélanger, at p. 189.

[142] Furthermore, where the right to compensation arises from an agreement entered into before the assignment became enforceable against the debtor, the

Digitized by Google

debtor's rights under the agreement may be set up against the assignee: *A. L. Green Ltd. v. Michaud*, [1975] C.A. 432, cited with approval in *Banque Royale du Canada v. Béliveau*, [1976] C.A. 539, and *Bandera Investment Co. v. Société immobilière du Québec*, J.E. 98-1667 (Sup. Ct.), SOQUIJ AZ-98021774. The above cases concerned claims for rent in respect of which the lessees had a right to deduct or a right to compensation. In each case, because the contractual right to compensation predated the assignment, the exercise of the right was authorized in respect of the period after the assignment. In these circumstances, it was held that the agreements could be set up against the third parties because they had acquired their rights after the compensation agreements were signed. Although the judges did not say so explicitly, it seems clear that this conclusion was based on the premise that art. 1681 *C.C.Q.*did not apply in the circumstances because the assignees had acquired no rights as of the time the compensation agreements were signed. Vincent Karim makes the following comment:

[TRANSLATION] However, it will be hard for the creditors of an insolvent party to challenge a compensation agreement entered into at the same time as the contract giving rise to that party's claim, as the creditors will have difficulty proving that the agreement has caused them any prejudice. [p. 750]

[143] The same approach has been adopted for assignments of conditional claims: *Seigneur v. Immeubles Beneficial Ltée*, [1994] R.J.Q. 1535 (C.A.); *Banque Nationale du Canada v. Notre-Dame-du-Lac (Ville)* (1990), 31 Q.A.C. 45; and *Banque de Montréal v. Walsh & Brais Inc.*, [1990] R.L. 119 (C.A.).

[144] Conventional compensation — or contractual set-off — defies categorization, since it may take as many forms as the contract that provides for it will allow: Derham, at para. 16.85. However, there is no denying that the right to compensation has characteristics in common with such concepts as the conditional obligation, the exception for nonperformance, and even the right to deduct or the right to retain. In *D.I.M.S. Construction inc. (Trustee of) v. Quebec (Attorney General)*, 2005 SCC 52, [2005] 2 S.C.R. 564, at paras. 28-29, for example, the Court likened a statutory right to deduct to compensation. Moreover, the right to deduct was one of the very first justifications given in France for holding that the debt actually owed to an assignee was the net amount: Duboc, at p. 169, No. 239, commenting on Ch. civ., May 13, 1833, S. 1833.1.668. While it comes as no surprise that Quebec's rules lead to the same result as the rules of French law, it is interesting to note that common law commentators and courts also acknowledge that the right to set-off may be asserted against third parties.

[145] Where the French rules are concerned, however, it should be noted that allowing compensation to be effected is based on a concept that does not on its own form part of the positive law of Quebec. In France, where there is a sufficient nexus between two debts, compensation may be effected despite the assignment of a claim or a collective recovery procedure: D. R. Martin,"Contrats et obligations", *Juris-classeur civil*, arts. 1289 to 1293, fasc. 108 to 111, No. 75. Since a compensation agreement creates a sufficient nexus, the possibility of setting it up is not in dispute (unless the agreement was entered into during a period where solvency was in doubt): Cass. civ., July 13, 1942, J.C.P. 1943.II.2157 (Annot. Houin); Cass. com., June 3, 1997, D. 1998.Jur.61 (Annot. François). (See, however, Cass. com., Dec. 9, 1997, *Bull. civ.* IV, No. 327, and the critique of that decision by A. Honorat, "Redressement et liquidation judiciaires", D. 1998.Somm.325.) Some authors draw a distinction in the case of garnishment by a third party on the basis that the property would no longer be available after the seizure: Didier Martin, "Des

Digitized by Google

techniques d'affectation en garantie des soldes de comptes bancaires", D. 1987.Chron.229, and Thierry Bonneau, in *Droit bancaire* (7th ed. 2007), at No. 395. Duboc disagrees, however, as do Jean-Louis Rives-Lange and Monique Contamine-Raynaud (*Droit bancaire* (6th ed. 1995)). According to Rives-Lange and Contamine-Raynaud, [TRANSLATION] "[t]here is no reason to decide cases involving collective seizures differently from those involving individual seizures" (p. 183, footnote 6). In Quebec, the French debate over the unavailability of seized property would have to be resolved in favour of the possibility of setting up a compensation agreement entered into before the seizure. As I mentioned above, since art. 637 of the *Code of Civil Procedure* provides that seizure results in assignment of the claim, the principles discussed above concerning the assignment of claims apply to garnishment.

[146] The number of cases in which common law courts have considered contractual set-off is small, but the few reported decisions on this subject have been favourable to the right to rely on set-off agreements. For instance, I have already mentioned *518718 Alberta*, in which the court held that a contractual right of set-off had priority over the assignee's rights. Likewise, the Ontario Court of Appeal held in *Ching v. Jeffery* (1885), 12 O.A.R. 432, that the defences available to the debtor on an assigned promissory note, including the right to reduce his or her debt by an amount owed by the assignor, could be raised against the assignee. In *Canadian Admiral Corp. v. L. F. Dommerich & Co.*, [1964] S.C.R. 238, it was held that the debtor had as against the assignee under a factoring agreement the same defence it would have had as against the assignor. Finally, in *Toronto-Dominion Bank v. Block Bros. Contractors Ltd.* (1980), 118 D.L.R. (3d) 311 (Alta. Q.B.), a contractual right to set-off (referred to by the parties as a right to "future set-off") was available against an assignee of security on the basis of cases in which courts had applied the general rule that an assignee cannot have any greater right than the assignor (p. 318).

[147] In sum, at common law, as in Quebec civil law, the rule for asserting contractual rights against third-party assignees is based on the general principles governing obligations. It can be inferred from the decisions cited above that the right to conventional compensation is assessed as of the time the right is granted, not as of the time it is exercised. The protection of third parties, codified in Quebec law in art. 1681 *C.C.Q.*, applies to rights acquired before the compensation agreement was signed. In *Traité de droit civil — Les obligations: les effets du contrat* (1992), No. 602, at p. 589, Professor Jacques Ghestin gives a clear explanation of the effect of the transfer of a claim. His comment clarifies the legal justification for the possibility of setting up a contractual right to compensation against third parties:

[TRANSLATION] A claim is not only a patrimonial asset, but also a legal relationship. When a claim is alienated, therefore, what is transferred is not just an asset, but also an active contractual situation.

The possibility of setting up a contract whose object is the transfer of a claim thus necessarily has some particularities that are accounted for in positive law on the basis that the contract produces effects in respect of certain third parties.

[148] Thus, where the deemed trust applies to a claim, it attaches to a legal relationship that corresponds to an active contractual situation, which explains why the beneficiary of the trust may assert only those rights held by the tax debtor at the time the trust became effective.

[149] It will also be helpful to refer back to s. 227(4.1) *ITA* and to review the cases in which the scope of the deemed trust has been considered. Before Parliament clarified the respondent's priority over secured creditors, the courts had held that

Digitized by Google

prior rights could be disregarded only to the extent expressly provided for in the relevant provision. For example, in *Board of Industrial Relations v. Avco Financial Services Realty Ltd.*, [1979] 2 S.C.R. 699, Martland J. wrote:

In [s. 5A] the absence of a specific statutory provision to that effect, in my view it should not be construed in a manner which could deprive third parties of their pre-existing property rights. [p. 706]

(See also *Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd.*, [1980] 1 S.C.R. 1182, at p. 1199.)

[150] This suggests that it is necessary to be cautious in assessing the scope of the deemed trust on the tax debtor's property. When Parliament wished to give the deemed trust more teeth, it took care to give the respondent priority over secured creditors. It did not alter the general rules governing the rights a debtor can assert against its original creditor. In assessing the consequences of that decision, particularly with regard to compensation, one can but find support in an interpretation based on the normally applicable legal rules.

[151] Compensation is used in many business transactions and in the asset accounting of many businesses. M. E. Grottenthaler and P. J. Henderson state in *The Law of Financial Derivatives in Canada* (loose-leaf) that "Canada can be described as a 'netting friendly' jurisdiction" both in the context of insolvency and where contractual matters outside that context are concerned (p. 5-3). They explain that netting, which is a form of set-off, is crucial to derivatives transactions that affect the capitalization rules applicable to banks. They say the following about the importance of this mechanism:

It is of the utmost importance to parties that the termination and close-out netting provisions are enforceable against the other party. Unlike the case with many commercial transactions, parties are not willing to accept the risk that these provisions may not be fully enforceable in an insolvency situation. There are several reasons for this. First, many entities that participate in the derivatives market are subject to regulatory requirements that they maintain a certain asset level in relation to their liabilities (i.e. adequate capital). For this purpose, it is desirable to account for their transactions with their various counterparties on a net basis. The Basel Committee on Banking Supervision developed a new framework for regulatory capital and risk management (known as Basel II). The implementing Capital Adequacy Requirements guidelines released by OSFI [the Office of the Superintendent of Financial Institutions] to apply to Canadian incorporated banks allow for the netting of contracts pursuant to contractual netting provisions if the bank can satisfy OSFI that certain conditions are met, including that the institution has a written and reasoned legal opinion that, in the event of any legal challenge, the relevant courts would find the exposure under the netting agreement to be the net amount under the laws of all relevant jurisdictions (which includes the counterparty's home jurisdiction and the governing law of the transactions and the netting agreement). The legal opinions must address the validity and enforceability of the netting agreements in the context of insolvency proceedings.

Secondly, because the marketplace for derivatives transactions is a highly competitive and global marketplace, entities governed by the laws of a jurisdiction that does not recognize the effectiveness of termination and close-out netting in an insolvency situation are put at a serious competitive disadvantage. [pp. 5-2 and 5-3]

[152] This is just one example of the use of compensation in a context that does not involve the "security interest" concept and of the great importance of this mechanism both in Canadian law and in international economic relations.

Digitized by Google

Parliament thus seems to have had reasons for acting as it did in modifying the deemed trust only to give the respondent priority over creditors with security interests. I have concluded that the deemed trust does not give the respondent more rights than the tax debtor had and that, insofar as the amounts had not been deducted at the time the agreement was entered into, the Caisse's right may be set up against the respondent. What this finding means in practice must now be determined.

[153] In the case at bar, Camvrac's right to recover its claim was subject to the right to compensation that had been granted to the Caisse in the agreement to give savings as security. In the context of that agreement, the right to compensation was a right held by the Caisse that could not be negated solely by the fact of the deemed trust becoming effective. The respondent, as a third party, could not demand that the Caisse discharge its debt to Camvrac if the conditions for repayment had not been met. The Caisse's right had to be respected by third parties who acquired rights after the agreement was signed. Consequently, the respondent must abide by the compensation agreement, given that her right is subsequent to it.

[154] As I mentioned above, Camvrac had remitted nothing to the respondent since May 2000. Because the compensation agreement was entered into in September 2000, a question that arises is whether the respondent may claim from the Caisse amounts owed prior to that date. This is the issue that remains to be addressed.

[155] In certain circumstances, the debt itself can consist only of the net balance owed by the debtor. Thus, where, as in *Bandera*, the amount of an assignment of rent is established only after adjustments, the amount of the rent corresponds to the net balance payable to the landlord. In such a situation, regardless of when the assignee's right first arises, his or her claim cannot exceed the actual amount owed by the debtor of the assigned claim, that is, the post-compensation amount. In other cases, such as where the respective claims do not have the same source, the date the creditor's right arises may be relevant. The instant case is one such case.

[156] The claims of the Caisse and Camvrac have distinct sources: one is based on the variable credit contract, the other, on the term savings agreement. The Caisse's claim against Camvrac dates from September 18, 2000 and Camvrac's claim, from September 25, 2000. On the latter date, Camvrac undertook, first in the term savings agreement, [TRANSLATION] "to make, on the date of acquisition, a deposit in the amount of $200,000", and then in the agreement to give savings as security, to "maintain" a deposit in the amount of $200,000. These undertakings show that the respective claims of the Caisse and Camvrac are distinct. For Camvrac to be able to undertake in the agreement to give savings as security to "maintain" the deposited amount, its claim resulting from the term savings agreement had to take on an independent existence, if only at the time the deposit was made. Given that the deposit was made before the right to compensation was granted, the deemed trust could have become effective in respect of Camvrac's claim up to the total of the amounts owed to the respondent as of September 25, 2000. This is not a case in which the respective debts have the same source and the claim is subject to a right to compensation. Just as the respondent's rights are subordinated to the right to compensation for deductions subsequent to the signing of the agreement, the Caisse's right must give way to the respondent's pre-existing right. As I stated at the beginning of these reasons, the evidence in the record is insufficient to establish the amount of the unremitted deductions with any precision; therefore, failing an agreement between the parties, the case must be remanded to the court of original jurisdiction to establish that amount.

Digitized by Google

Interest Issue

[157] Regarding interest, the Court of Appeal correctly endorsed the application of *Markevich*, and there is no need to intervene.

Conclusion

[158] For these reasons, I would allow the appeal, set aside the judgment of the Court of Appeal, authorize compensation for the balance of the amounts deducted as of September 25, 2000 and, failing an agreement between the parties, remand the case to the court of original jurisdiction to establish the amount to be paid by the Caisse to the respondent, with costs throughout.

APPENDIX

Contractual Provisions

Variable Credit Contract

[TRANSLATION]

LINE OF CREDIT

Digitized by Google

The Caisse agrees to extend to the Borrower, who accepts, a line of credit in the amount of $277,000.00. . . .

. At any point in time, the Caisse may notify the Borrower that no advance shall be granted to it thenceforth under this contract.

.

3. INTEREST

.

The interest shall be paid on the twenty-fifth day of each month. It shall be debited automatically from the . . . account . . . .

. The Borrower further undertakes to pay, on any payment due not made, additional interest . . . , any arrears of interest being then

. considered as principal.

. 5. REQUEST FOR REPAYMENT

. The Caisse reserves the right to demand at any time the immediate repayment of any balance owed in principal, interest, costs and

. accessories. The Caisse shall then be entitled to no longer carry out this agreement, subject to all its other rights and recourses.

.

7. DEFAULT

If the Borrower draws a cheque that brings the line of credit balance to an amount higher than the amount authorized hereunder, if it goes bankrupt, if it transfers its property or becomes insolvent or fails to meet any of the conditions and obligations stipulated herein, any balance then

. owing in principal, interest, costs and accessories shall become immediately payable.

.

.

.

.

.

Term Savings Agreement
[TRANSLATION]
Date of maturity: October 16, 2005

. .

.

Digitized by Google

PROVISIONS GOVERNING THE PRINCIPAL

The member agrees to make, on the date of acquisition, a deposit in the amount of

$200,000 (hereinafter referred to as the “initial amount of deposit”).

On the date of issue associated with the applicable term (“date of issue”), the initial amount of deposit and the interest then accrued on that amount shall be reinvested in the form of a deposit maturing on the maturity

. date associated with the applicable term (“date of maturity”).

This deposit may neither be negotiated nor transferred. No amount in

. principal or interest shall be redeemable or payable before the date of maturity.

. This deposit may be hypothecated or given as security only in favor of the issuing Caisse.

Digitized by Google

. . .

Digitized by Google

PROVISIONS GOVERNING DISPOSAL AT MATURITY

11. At maturity date, unless the Caisse is notified to the contrary not later than the seventh day following such date, the principal and interest shall be deposited (to a term savings account) for a term equal to the term of this deposit. The interest rate shall be the rate then in force at the Caisse for such deposit, depending on the applicable term. The interest shall be reckoned daily and capitalized annually.

THIS IS A DEPOSIT WITHIN THE MEANING OF THE DEPOSIT INSURANCE ACT.

Agreement to Give Savings as Security

[TRANSLATION]

RIGHT TO WITHHOLDING AND COMPENSATION

To secure the repayment of any sum in principal, interest, costs and accessories owed or to be owed the Caisse by:

☒ the Depositor

Name of Borrower (if other than Depositor) under:

Digitized by Google

☒ (a) a line of credit agreement in the amount of $277,000.00 granted to him (her) on 2000-09-18;
(b) a (Loan, line of credit, etc.) agreement in the amount of $ granted to him (her) on ;
(c) the following agreements:
. . .
. . .
. . .
. . .
. .
☒ and under any debts or obligations, present or future, direct or indirect held by:
☒ the Depositor
Name of Borrower (if other than Depositor) towards the Caisse, (hereinafter referred to as "the Credit Contract[s]")
the Depositor undertakes to maintain and consents to the withholding by the Caisse, in the account(s) or on the certificate(s) of deposit mentioned below, of the amount of
$200,000.00 distributed as follows:
Account or certificate of deposit Sum withheld by the Caisse identification
(for deposit certificates, state date issued amount and certificate number)
ALTERNATIVE TERM SAVINGS
5 YEARS IN THE AMOUNT OF
$200,000.00 $200,000.00
$
The Caisse may withhold the sums shown above, ☐along with the interest from the
certificates of deposit if applicable, as long as all the amounts due under the Credit Contract(s) have not been fully repaid and, in the case of a line of credit, as long as it has not been cancelled. In cases of default as provided for below, there shall be compensation between the Credit Contract(s) and the certificate(s) of deposit or the amounts deposited defined above, as provided for in Section 7.
SAFEKEEPING OF CERTIFICATES

HYPOTHEC

To further secure the repayment of any sum owed or to be owed under the Credit Contract(s), the Depositor hypothecates and pledges the above-mentioned certificate(s) of deposit and sums deposited, for an amount equal to the total amount of the sums withheld. The parties also agree that the clause shown on the certificate(s) of deposit stipulating that such certificate(s) are neither negotiable nor transferable shall be deemed cancelled, effective from the date of these presents.
WITHDRAWALS AND CHEQUES

REDEMPTION BEFORE MATURITY OF A CERTIFICATE OF DEPOSIT

MATURITY AND RENEWAL OF A CERTIFICATE OF DEPOSIT

DEFAULT
The Depositor shall be in default in any of the following cases:
if any of the commitments under the Credit Contract(s) or these presents is not fulfilled;

Digitized by Google

if the Depositor or the Borrower becomes insolvent or goes bankrupt, or if he (she) makes a proposal and it is rejected or annulled;

In the event of any default:
any sums owing under the Credit Contracts shall immediately become payable;
the Caisse may use the sums deposited or the certificate(s) of deposit contemplated herein, regardless of its (their) having matured or not, to compensate its claim under the Credit Contract(s);. . .
The consequences of a default are for the exclusive benefit of the Caisse and the latter may waive them expressedly. The Caisse may, among others, without any prejudice to its rights, wait for the maturity date of the certificate(s) of deposit before exercising its rights as provided for in paragraphs (b) and (c) above.
RESERVE OF RECOURSES
. . . Furthermore, failure by the Caisse to avail itself of any of its rights in case of default shall not be interpreted as a waiver of such rights.
Statutory Provisions
Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)
224. . . .
(1.3) In subsection (1.2),
.

> "security interest" means any interest in property that secures payment or
> . performance of an obligation and includes an interest created by or arising out of a debenture, mortgage, hypothec, lien, pledge, charge,
> . deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for;
> **227.** . . .
> Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act.

(4.1) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection (4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person and property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for a security interest (as defined in subsection 224(1.3)) would be property of the person, equal in value to the amount so deemed to be held in trust is deemed
to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, and
to form no part of the estate or property of the person from the time the amount was so deducted or withheld, whether or not the property has in fact been kept separate

Digitized by Google

and apart from the estate or property of the person and whether or not the property is subject to such a security interest . . . .

Employment Insurance Act, S.C. 1996, c. 23

86. (1) All premiums, interest, penalties and other amounts payable by an employer under this Act are debts due to Her Majesty and are recoverable in the Federal Court or any other court of competent jurisdiction or in any other manner provided for by this Act.

(2) Where an employer has deducted an amount from the remuneration of an insured person as or on account of any employee's premium required to be paid by the insured person but has not remitted the amount to the Receiver General, the employer is deemed, notwithstanding any security interest (as defined in subsection 224(1.3) of the *Income Tax Act*) in the amount so deducted, to hold the amount separate and apart from the property of the employer and from property held by any secured creditor (as defined in subsection 224(1.3) of the *Income Tax Act*) of that employer that but for the security interest would be property of the employer, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act.

(2.1) Notwithstanding the *Bankruptcy and Insolvency Act*(except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection (2) to be held by an employer in trust for Her Majesty in the manner and at the time provided under this Act, property of the employer

Digitized by Google

and property held by any secured creditor (as defined in subsection 224(1.3) of the *Income Tax Act*) of that employer that but for a security interest (as defined in subsection 224(1.3) of the *Income Tax Act*) would be property of the employer, equal in value to the amount so deemed to be held in trust is deemed

to be held, from the time the amount was deducted by the employer, separate and apart from the property of the employer, in trust for Her Majesty whether or not the property is subject to such a security interest, and

to form no part of the estate or property of the employer from the time the amount was so deducted, whether or not the property has in fact been kept separate and apart from the estate or property of the employer and whether or not the property is subject to such a security interest

and is property beneficially owned by Her Majesty notwithstanding any security interest in such property or in the proceeds thereof, and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

(2.2) For the purposes of subsections (2) and (2.1), a security interest does not include a prescribed security interest.

Civil Code of Québec, S.Q. 1991, c. 64

1637. A creditor may assign to a third person all or part of a claim or a right of action which he has against his debtor.

He may not, however, make an assignment that is injurious to the rights of the debtor or that renders his obligation more onerous.

. . .

. . .

. . .

1643. A debtor may set up against the assignee any payment made to the assignor before the assignment could be set up against him, as well as any other cause of extinction of the obligation that occurred before that time.

1671. Obligations are extinguished not only by the causes of extinction contemplated in other provisions of this Code, such as payment, the expiry of an extinctive term, novation or prescription, but also by compensation, confusion, release, impossibility of performance or discharge of the debtor.

1672. Where two persons are reciprocally debtor and creditor of each other, the debts for which they are liable are extinguished by compensation, up to the amount of the lesser debt.

Compensation may not be claimed from the State, but the State may claim it.

1673. Compensation is effected by operation of law upon the coexistence of debts that are certain, liquid and exigible and the object of both of which is a sum of money or a certain quantity of fungible property identical in kind.

A person may apply for judicial liquidation of a debt in order to set it up for compensation.

1680. A debtor who has acquiesced unconditionally in the assignment or hypothecating of claims by his creditor to a third person may not afterwards set up against the third person any compensation that he could have set up against the original creditor before he acquiesced.

An assignment or hypothec in which a debtor has not acquiesced, but which from a certain time may be set up against him, prevents compensation only for debts of the original creditor which come after that time.

Digitized by Google

1681. Compensation may neither be effected nor be renounced to the prejudice of the acquired rights of a third person.

Code of Civil Procedure, R.S.Q., c. C-25

637. If the affirmative declaration of the garnishee is not contested and does not show the existence of another seizure by garnishment in his hands, the clerk, upon an inscription by either party, orders the garnishee to pay to the seizing creditor the amounts which he owes to the judgment debtor to the extent of the amount of the judgment in capital, interest and costs. To that extent the order of the clerk effects an assignment, in favour of the seizing creditor, of the judgment debtor's claim, from the date of the seizure. Such order must be served on the garnishee and becomes executory 10 days later.

Appeal dismissed with costs, LEBEL*and* DESCHAMPS JJ. *dissenting. Solicitors for the appellant: Langlois Kronström Desjardins, Lévis.*

Solicitor for the respondent: Canada Department of Justice, Montréal.

Digitized by Google

Extension of trust – 227(4.1)

(4.1) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person and property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for a security interest (as defined in subsection 224(1.3)) would be property of the person, equal in value to the amount so deemed to be held in trust is deemed

to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, and

to form no part of the estate or property of the person from the time the amount was so deducted or withheld, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to such a security interest

and is property beneficially owned by Her Majesty notwithstanding any security interest in such property and in the proceeds thereof, and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

Her Majesty the Queen in Right of Canada as represented by the Minister of National Revenue v. HSBC Bank of Canada, 2004 FC 467, Tracing the Interest in The Proceeds of The Trust Into a Subordinate Creditor's Hands

REASONS FOR JUDGMENT AND JUDGMENT

[1] **The plaintiff (hereinafter "the Minister) instituted this action to recover outstanding source deductions owed by Cambridge Colleges Inc. from HSBC Bank of Canada ("HSBC") on the basis that HSBC appropriated assets which were held in trust by Cambridge in favour of the Minister. More particularly, HSBC was Cambridge's banker and it redeemed on July 19, 1999, a guaranteed investment certificate ("G.I.C.") issued by another financial institution to Cambridge on May 26, 1999 for an amount of $300,000.00 pursuant to a security agreement covering this G.I.C.**

[2] All the facts relevant to this action have been included in a statement of agreed facts filed by the parties instead of *viva voce* evidence. Rather than trying to summarize them further, I have included a copy of the said statement (without the annexes) as Appendix I to my reasons for judgment.

THE ISSUES

[3] The Minister relies on subsection 227(4.1) of the *Income Tax Act*, R.S.C. 1985, ch. 1 (5th Supplement) as amended (the "*Act*"), which creates a deemed trust in its favour. The plaintiff submits that this trust came into existence retroactively to the time the source deductions were made by Cambridge that is back in January 1999 and that it attaches assets equal in value to the amounts not remitted by Cambridge which as of June

Digitized by Google

1999 totalled $99,531.28 (see paragraphs 19 to 21 in Appendix 1).

[4] **The Minister claims that on July 19, 1999, when HSBC caused the G.I.C. to be redeemed, and used the proceeds to fulfill its obligations under letters of credit issued by it in favour of another creditor of Cambridge, it did so as a "secured creditor" within the meaning of subsection 224(1.3) of the *Act* (paragraphs 6, 7, 13 and 16 of Appendix 1).**

[5] **Pursuant to subsection 227(4.1) of the *Act,* HSBC was thus bound to remit to the Minister the proceeds of the G.I.C. up to the amount owed by Cambridge.** It failed to do so and must now be condemned to pay $80,915.32 which represents the current outstanding debt owed to the Minister (paragraph 31 of Appendix 1).

[6] HSBC relies on the recent decision of the Supreme Court of Canada in *First Vancouver Finance v. Canada (Minister of National Revenue)*, [2002] 2 S.C.R. 720, to argue that the security provided for in favour of the Minister at subsections 227(4) and (4.1) of the *Act* is akin to a floating charge over all of the tax debtor's assets. **Until it crystallized, Cambridge was free to dispose of its assets. According to the defendant, the floating charge only crystallized on September 2, 1999, when the Minister sent its requirement to pay (paragraph 23 of Appendix 1).**

[7] **HSBC had no notice that Cambridge had not remitted all its source deductions when it redeemed the G.I.C. and used the proceeds to pay other obligations of Cambridge. When the deemed trust provided for at section 227 of the *Act* crystallized, the G.I.C. or the proceeds thereof were no longer subject to the trust and HSBC was no longer a secured creditor in respect of such assets. Thus, HSBC owes nothing to the plaintiff.**

ANALYSIS

[8] Subsections 227(4) and (4.1) read as follows:

227(4) Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act.

227(4.1) Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection (4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person and property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for a security interest (as defined in subsection 224(1.3)) would be property of the person, equal in value to the amount so deemed to be held in trust is deemed to be held; from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, and

Digitized by Google

to form no part of the estate or property of the person from the time the amount was so deducted or withheld, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to such a security interest
and is property beneficially owned by

227(4) Toute personne qui déduit ou retient un montant en vertu de la présente loi est réputée, malgré toute autre garantie au sens du paragraphe 224(1.3) le concernant, le détenir en fiducie pour Sa Majesté, séparé de ses propres biens et des biens détenus par son créancier garanti au sens de ce paragraphe qui, en l'absence de la garantie, seraient ceux de la personne, et en vue de le verser à Sa Majesté selon les modalités et dans le délai prévus par la présente loi.
227(4.1) Malgré les autres dispositions de la présente loi, la Loi sur la faillite et l'insolvabilité (sauf ses articles 81.1 et 81.2), tout autre texte législatif fédéral ou provincial ou toute règle de droit, en cas de non-versement à Sa Majesté, selon les modalités et dans le délai prévus par la présente loi, d'un montant qu'une personne est réputée par le paragraphe (4) détenir en fiducie pour Sa Majesté, les biens de la personne, et les biens détenus par son créancier garanti au sens du paragraphe 224(1.3) qui, en l'absence d'une garantie au sens du même paragraphe, seraient ceux de la personne, d'une valeur égale à ce montant sont réputés:
être détenus en fiducie pour Sa Majesté, à compter du moment où le montant est déduit ou retenu, séparés des propres biens de la personne, qu'ils soient ou non assujettis à une telle garantie;
ne pas faire partie du patrimoine ou des biens de la personne à compter du moment où le montant est déduit ou retenu, que ces biens aient été ou non tenus séparés de ses propres biens ou de son patrimoine et qu'ils soient ou non assujettis à une telle garantie.
Ces biens sont des biens dans lesquels Sa Majesté a un droit de bénéficiaire malgré toute autre garantie sur ces biens ou sur le produit en découlant, et le produit découlant de ces biens est payé au receveur général par priorité

Digitized by Google

Her Majesty notwithstanding any security interest in such property and the proceeds thereof, and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests. [my emphasis]

sur une telle garantie. [mes soulignés]

Digitized by Google

[9] It is not disputed that on July 19, 1999:
the G.I.C. and the $300,000 it represented were the property of Cambridge;
the G.I.C. was covered by the deemed trust in favour of the Minister as well as a security interest in favour of the defendant;
HSBC was a secured creditor holding a security interest in the G.I.C. and in its proceeds.
[10] In *First Vancouver Finance*, supra, the Supreme Court of Canada had to decide whether the deemed trust in favour of the Minister prevented a tax debtor from selling for value some of its assets, more particularly its receivables, to a financial institution under a factoring agreement.
[11] In that case, the financial institution had paid a fair value for the receivables. It purchased those assets and was never a secured creditor within the meaning of the *Act*. It also knew that the tax debtor owed source deductions to the Minister and had agreed to pay a portion of the value of the receivables directly to the Minister.
[12] The Court found that the sale of assets to a third party purchaser for value in the ordinary course of business was not precluded by the existence of the deemed trust. It reached that conclusion because of the absence of a specific reference to third party purchasers in subsections 227(4) and (4.1) of the *Act*. It held that in such a case, there was no basis to allow the Minister's interest in the tax debtor's property to continue, once, such property had been sold to such third parties. It found that this interpretation was in harmony with the purpose of the statute given that the deemed trust would attach automatically to the proceeds or assets received by the debtor in exchange for its assets. This conclusion was also warranted by the plain language of subsection 227(4.1) which specifically refers to proceeds. It was in line with the intention of the legislator which directed its effort to recovery in priority of secured creditors. Even the Minister had not argued that it could be assumed that the legislator wanted to assert priority over ordinary consumers because this would have a general chilling effect on commercial transactions.
[13] **HSBC says that the same reasoning is applicable here and that indeed, it would have a chilling effect on commercial transactions if bankers could not exercise their security in the ordi nary course of business (particularly those given to secure payments under letters of credit), when they have not receive any notice of their client's failure to pay the Minister.**
[14] This position does not take into consideration that the very purpose of subsections 227(4) and (4.1) is to grant the Minister priority over secured creditors such as HSBC. In *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (QL), the Supreme Court of Canada had indicated that strong language would be necessary to give the Minister such priority over secured creditors**. This prompted the latest series of amendments to the *Act* and the current version of subsections 227(4) and 227(4.1) is the result thereof. These subsections no longer refer to specific events triggering the deemed trust. Instead, the *Act* deems property of the taxpayer and of secured creditor to be held in trust at any time an amount is not paid in accordance with the *Act*.**
[15] In *First Vancouver Finance*, supra, the Supreme Court of Canada confirmed that the new wording not only triggered a retroactive trust at the time the deductions were made but also that it extended the trust to all property acquired after it came into existence. **In doing so, the Supreme Court of Canada recognized that the broad power given to the Minister was necessary because in contrast to a tax debtor's bank which is familiar with its debtor's business and finances, the Minister does not have much knowledge and he is in fact, an involuntary creditor. The Minister must thus rely entirely on its ability to collect the source deductions which are, as mentioned in *First Vancouver Finance*, supra, at the very heart of the income tax collection in Canada. The legislator specifically intend ed to avoid the need for the Minister to trace tax**

Digitized by Google

debtor's assets and to prove what property was covered by the trust.

[16] On July 19, 1999 when it cause Cambridge's G.I.C. to be redeemed, HSBC was relying on its security agreement and was acting as a "secured creditor" of Cambridge.

[17] HSBC could have made inquiries on or before July 19, 1999, to determine if any money was owed for source deductions. There is no evidence that they made any attempt in this respect or that they didn't have the capacity to do so. They could have required personal guarantees to balance the risk that such debt would take priority over its security pursuant to the *Act*.

[18] Until the Minister carries out an audit which in this case was done at the end of June 1999, the plaintiff is not in a position to notify any secured creditor that the tax debtor failed to remit all its source deductions.

[19] The *Act* does not require the sending of a notice by the Minister but HSBC states that it has always been a requirement under common law to prevent bankers from exercising their security on assets held in trust (see *Canada v. Phoenix Assurance Co.,* [1976] 2 FC 649 (QL)).

[20] The Supreme Court of Canada in *First Vancouver Finance* above, at paragraph 34, states that the Minister is not bound by any restraint imposed by ordinary principles of trust law and that a statutory trust, such as the one created at subsections 227(4) and (4.1), is not governed by common law requirements.

[21] **In light of the above, it appears to me that the circumstances of this case are very different from those in *First Vancouver Finance*, supra. HSBC is not a third party purchaser for value and its argument runs contrary to the language of the *Act* as well as the purpose and intention of the legislator.**

[22] **In the circumstances, the Court concludes that the proceeds of the G.I.C. should have been paid to the Minister in priority. This was not done and the defendant must therefore repay the amount of outstanding source deductions owed by Cambridge that is, $80,915.32.**

[23] The Court is satisfied that the plaintiff is entitled to prejudgment interests pursuant to subsection 36(1) of the *Federal Courts Act*, R.S. 1985, c. F-7. Having considered the relevant provisions of the *Judgment Interest Act*, R.S.A. 2000, c. J-1, of the province of Alberta and all the circumstances of this case, I find that it would be just to award prejudgment interest from September 2, 1999 at the various rates prescribed by regulation pursuant to the said *Judgment Interest Act*.

JUDGMENT

This Court's judgment is that:

The action is allowed.

Digitized by Google

The defendant shall pay to the plaintiff $80,915.39, plus prejudgment interest from September 2, 1999 at the various rates prescribed by regulation under the *Judgment Interest Act* of the province of Alberta.
Plaintiff shall have its costs assessed as per column III of the Tariff B of the *Federal Court Rules, 1998*.

"Johanne Gauthier"
Judge

CRA Internal Operations Manual - Deemed Trusts

(See below image page)

Digitized by Google

DEEMED TRUST 1

Overview 1

Legislation 1
Legislative Provisions and Their Impact 2
Income Tax Act 2
Deemed Trust and Non-Resident Accounts 2
Excise Tax Act 3
Air Travellers Security Charge Act 3
Legislative Amendments 3
Income Tax Act 3
Excise Tax Act 4
Air Travellers Security Charge Act 4
Canada Pension Plan Act, Employment Insurance Act and Unemployment Insurance Act 5
Bankruptcy and Insolvency Act and Companies' Creditors Arrangement Act 5
Amounts that Make up The Deemed Trust 5
Income Tax Act 6
Excise Tax Act 6
Amounts Collected, Deemed to Have Been Collected, Collectible and Net Tax 7
Air Travellers Security Charge Act 7
Priorities Arising From the Deemed Trust Provisions 7
Income Tax Act 8
Excise Tax Act 8
Air Travellers Security Charge Act 9
General Priority Rule 9

Policy 10
Introduction 10
Exceptions to the General Priority Rule 11
Sections 81.1 and 81.2 of the BIA 11
Prescribed Security Interest 12
Claiming the Net Proceeds of Realization 14
Realization of Property by the CRA 15
A Third Party Refuses to Sell Seized Property 15
Where the Proceeds of Realisation Have Already Been Distributed 16
Distribution Prior to June 18, 1998 17
Distribution as of June 18, 1998 17
Transitional Provisions – GST/HST Deemed Trust 18
Confidentiality 18
Deemed Trust and Enhanced Requirements To Pay 20
Priority of the Deemed Trust Over Provincial Debts 21
Proposal Under the BIA or Plan of Arrangement Under the CCAA 23
More Than One Secured Creditor 23
Application of Payments 24
Merger of Corporations 24

Procedures 25
Situations Where the Debtor is not in an Insolvency Situation 25
When Can a Claim be Issued? 26
Claim Against the Debtor 26
Claim Against a Secured Creditor or a Third Party 27
When an Employer is in an Insolvency Situation 29

Digitized by Google

Collection of the Deemed Trust Amount Within the Bankruptcy Estate (Other Than by Way of Property Encumbered by Security) 30
Rejection of Our Property Claim 30
Collection of our Deemed Trust Amount Using Property Encumbered by Securities 30
Secured Creditor Who Does not Participate in the Bankruptcy Process 31
Secured Creditor Participating in the Bankruptcy Process 31
Secured Creditor Who Disposes of Property Held as Security - Section 130 of the BIA 33
Net Proceeds of Realization Greater Than The Amount of our Deemed Trust 33
Insufficient Net Proceeds of Realization 34
Possible Loss Incurred at Realization 35
Risky Situations With High Potential of Realization or Situations Where the Trustee Does Not Have Sufficient Liquidity 35
Objection to Dividend Sheet 35

Resource Material **36**

Appendix **36**
Appendix 1 - Deemed Trust Claim Where the Employer is not Bankrupt 37
Appendix 2 - Deemed Trust Claim - Sale 38
Appendix 3 - Covering Letter for Property Claim 39
Appendix 4 - Deemed Trust Claim - Bankruptcy - Secured Creditor 40
Appendix 5 - Deemed Trust Claim - Bankruptcy - Other person 40
Appendix 6 - Deemed Trust Claim - Bankruptcy - Redemption of Security Interest 41
Appendix 7 - Preassessment Letter – Under Section 159 of the ITA 42
Appendix 8 - Authorization From an Employer - Disclosure of Confidential Information 43
Appendix 9 - Letter to Third Party - Status of Source Deductions Account 44
Appendix 10 - Deemed Trust Claim – Registrant Other Than Bankrupt 46
Appendix 11 - Deemed Trust Claim – Sale 46
Appendix 12 - Preassessment Notice Letter – Under Section 270 of the ETA 47
Appendix 13 - Registrant Authorization – Disclosure of Confidential Information 48
Appendix 14 - Letter Sent to Third Party– GST/HST Account Status 49
Appendix 15 - Deemed Trust (DT) Calculation Sheet 50
Appendix 16 - Examples of GST/HST Deemed Trust Calculation 51

Digitized by Google

Deemed Trust

Collections Manual Updates

Overview

The present chapter deals with the deemed trust under the *Income Tax Act* ("ITA"), the *Excise Tax Act* ("ETA") and the *Air Travellers Security Charge Act* ("ATSCA"). On the one hand, the chapter examines the effects of the latest legislative amendments that reinforced the deemed trust provisions of the ITA and the ETA and also examines the newer deemed trust provisions under the ATSCA. At the same time, the chapter emphasizes the differences that exist in the deemed trust provisions under these three Acts.

On the other hand, the chapter reviews the policies of the Canada Revenue Agency ("the CRA") relating to the priority given to the CRA under the ITA, the ETA and the ATSCA deemed trust provisions. It also analyses the ways by which the CRA can invoke this priority against tax debtors and their creditors.

Finally, the chapter devotes a section on the procedures to be followed in order to invoke the deemed trust when the tax debtor is not in an insolvency situation and when he has filed a Notice of Intention to file a proposal, a proposal or has become bankrupt.

Legislation

The present section sets out the legislative provisions regarding deemed trusts:

- Income Tax Act, subsections 227(4), (4.1)
- Excise Tax Act, subsections 222(1), (3)
- Air Travellers Security Charge Act, 15
- Canada Pension Plan Act, 23(3), (4), (4.1)
- Employment Insurance Act, 57(2), (3), (3.1)

Related subjects:

- Legislative Provisions and Their Impact
- Legislative Amendments
- Amounts that Make up the Deemed Trust
- Priorities Arising from the Deemed Trust Provisions
- General Priority Rule

Digitized by Google

Legislative Provisions and Their Impact

The present section defines the legislative provisions and their implication concerning deemed trusts:

- **Income Tax Act**
- **Deemed Trust and Non-Resident Accounts**
- **Excise Tax Act**
- **Air Travellers Security Charge Act**

Income Tax Act

Prior to the legislative amendments of June 18, 1998, (retroactive to June 15, 1994), the ITA deemed trust stipulated:

- that the amounts a person deducted or withheld under the ITA were deemed to be held in trust for Her Majesty and kept separate and apart from the funds of the person who deducted and withheld them
- that Her Majesty had a lien and charge on the property of that person from the time the amounts were deducted, irrespective of whether that person kept the amounts separate from his own property or was in receivership, bankruptcy or liquidation

On February 27, 1997, the Supreme Court of Canada handed down a decision unfavourable to the CRA in the matter of *The Queen v. Royal Bank of Canada, 97DTC 5089 (C.S.C.)*, also known under the name of *Sparrow Electric*.

In a 4:3 decision, the Supreme Court ruled that the ITA deemed trust did not have priority over the security interest held by the Royal Bank. It commented on the priority of the deemed trust in these terms:

> ... I wish to emphasize that it is open to Parliament to step in and assign absolute priority to the deemed trust. A clear illustration of how this might be done is afforded by section 224(1.2) of the ITA, which vests certain moneys in the Crown "notwithstanding any security interest in those moneys" and provides that they "shall be paid to the Receiver General in priority to any such security interest". All that is needed to effect the desired result is clear language of that kind. [Free Translation]

Deemed Trust and Non-Resident Accounts

The previous wording as well as the current wording of the deemed trust provisions applies to other amounts in addition to amounts deducted from wages. The deemed trust provisions of the ITA also apply to withholdings that a payer must make when it pays amounts to a non-resident. Consequently, the guidelines contained in this directive will also be useful to collection officers who have to collect non-resident accounts.

Digitized by Google

Excise Tax Act

Prior to the amendment of October 20, 2000, subsection 222(1) of the ETA stipulated that a person who collects an amount on account of GST/HST is considered, for all intents and purposes, to hold this amount in trust for Her Majesty until it is paid to the Receiver General.

As for subsection 222(3) of the ETA, it stated that in the event of any liquidation, assignment, receivership or bankruptcy of a person, an amount equal to the amount deemed in trust was considered not to form part of the estate in liquidation, assignment, receivership or bankruptcy.

Section 222 of the ETA was amended in 2000, to reflect the amendments that had previously been made to the ITA deemed trust provisions, except for the fact that section 222 is not effective in the context of a proposal or bankruptcy under the *Bankruptcy and Insolvency Act* ("BIA").

Air Travellers Security Charge Act

The provisions concerning the deemed trust pursuant to the *Air Travellers Security Charge Act* ("ATSCA") will be addressed below in the "Legislative Amendments" section.

Legislative Amendments

Applicable Acts:

- Income Tax Act
- Excise Tax Act
- Air Travellers Security Charge Act
- Canada Pension Plan Act, Employment Insurance Act and Unemployment Insurance Act
- Bankruptcy and Insolvency Act and Companies' Creditors Arrangement Act

Income Tax Act

On April 7, 1997, the Minister of Finance publicly announced his intention to amend the ITA, the Canada Pension Plan Act ("CPP"), the Employment Insurance Act ("EIA") and the ETA in order to clarify the priority of the deemed trust provisions over the security interests held by most creditors.

Subsection 227(4) of the ITA was amended by Bill C-28, which received Royal Assent on June 18, 1998, retroactive to June 15, 1994. In order to secure the payment of unremitted source deductions, subsection 227(4) stipulates that a debtor is considered to hold source deductions amounts in trust for Her Majesty.

Digitized by Google

Furthermore, subsection 227(4.1) states that Her Majesty has a beneficial ownership to the assets of a debtor to the extent of the amount of unremitted source deductions, notwithstanding any security interest granted on those assets. The proceeds of such property are payable to the Crown in priority to any security interest.

The Minister of Finance stressed the importance of establishing this priority, pointing out that source deductions are automatically credited to employees in respect of taxes paid for the year, and that they are remitted to the provinces who are signatories to tax collection agreements in respect of provincial taxes payable by these employees.

The ITA deemed trust cannot be invoked for source deductions attributable to pay periods prior to June 15, 1994.

Excise Tax Act

Subsections 222(1) and 222(3) of the ETA were amended by Bill C-24, which received Royal Assent on October 20, 2000. In accordance with these new subsections, the property of the debtor or the property held by a debtor's secured creditor, in an amount equal to the unremitted GST/HST collected, is considered to be owned by the Crown. This property can be used by the Crown to satisfy the outstanding tax liability of the tax debtor, notwithstanding any security interest in that property. The Crown's security interest has priority over any security interest other than a prescribed security interest. Contrary to ITA deemed trust, the ETA deemed trust does not apply in bankruptcy and insolvency situations.

As the regulation regarding the prescribed security interest has not yet been enacted, collection officers will have to apply Regulation 2201 of the ITA Regulations, dealing with prescribed security interest, to the ETA deemed trust provisions with such modifications as required by the circumstances.

For further information regarding prescribed security interest, please consult the section entitled **Exceptions to the General Priority Rule**.

In addition to the provisions dealing with enhanced requirements to pay and director's liability, the amended deemed trust provisions are intended to ensure the full collection of GST/HST revenues.

Deemed trust amounts collected as of October 20, 2000, or later, are subject to the new provisions pertaining to deemed trusts.

For further details, refer to **Directive ARD-01-01**, entitled **Priority for GST/HST Deemed Trust Amounts**.

Air Travellers Security Charge Act

On March 27, 2002, the ATSCA received Royal Assent and became effective on that date.

As per section 15 of the ATSCA, any debtor who collects an amount on account of the charge is considered to be holding this sum in trust for Her Majesty. Furthermore, and in a fashion similar to that of the ITA and ETA, if the debtor does not remit the sums held in trust to the Receiver General, the property of the

Digitized by Google

debtor (including the property held by the debtor's secured creditors – other than a prescribed security interest) is deemed to be held in trust for Her Majesty. It is to be noted that an ATSCA deemed trust does not apply in a proposal or bankruptcy context.

As the regulation regarding the prescribed security interest has not yet been enacted, collection officers will have to apply Regulation 2201 of the ITA Regulations, dealing with prescribed security interest, to the ATSCA deemed trust provisions with such modifications as required by the circumstances.

For further information regarding prescribed security interest, please consult the section entitled **Exceptions to General Priority Rule**.

Canada Pension Plan Act, Employment Insurance Act and Unemployment Insurance Act

Subsections 23(3), 23(4) and 23(4.1) of the CPP, subsections 57(2), 57(3) and 57(3.1) of the Unemployment Insurance ACT ("UIA") and subsections 86(2), 86(2.1) and 86(2.2) of the Employment Insurance Act ("EIA") were amended by Bill C-28. The effect of the amendments was the same as the effect of the amendments on the ITA deemed trust provisions.

Bankruptcy and Insolvency Act and Companies' Creditors Arrangement Act

Bill C-28 also amended the BIA and the *Companies' Creditors Arrangement Act* ("CCAA") to take into account the amendments to the deemed trust provisions contained in the other acts.

The amendments to the BIA and to the CCAA also have the effect of raising the priority of provincial deemed trust provisions to the same rank as the federal Crown's priority but solely in a bankruptcy or CCAA context. For example, the Ministère du Revenu du Québec ("MRQ") can now claim a priority equal to ours in bankruptcy, for amounts of taxes and of Régie des rentes withheld on the wages of employees. However, if there is no bankruptcy or an arrangement in accordance with the CCAA, the deemed trust for a province does not have a priority equal to ours.

Amounts that Make up The Deemed Trust

In order to satisfy a deemed trust debt, the CRA can seize property of the tax debtor up to the amount of its claim, in priority to the debtor's secured creditor(s). The CRA can also claim from the secured creditor(s) the proceeds of the sale of property belonging to the debtor and on which the secured creditor holds a security interest.

However, in order for a the CRA deemed trust to be well-founded, it is important that collection officers be able to provide justification on how the deemed trust amounts were calculated. Hence, a subsection 152(7) ITA assessment cannot give rise to a deemed trust claim, as it is impossible to confirm the amounts that were withheld, nor can a claim be based on a "T-4 difference."

Applicable acts:

Digitized by Google

- **Income Tax Act**
- **Excise Tax Act**
- **Amounts Collected, Deemed to Have Been Collected, Collectible and Net Tax**
- **Air Travellers Security Charge Act**

Income Tax Act

The ITA deemed trust is made up of amounts that have been deducted from the wages of employees and not remitted to the CRA. More specifically, the ITA deemed trust is composed of the following amounts:

- federal and provincial income tax
- employee contributions to the CPP; and
- EI and UI employee premiums

The ITA deemed trust does not apply to CPP contributions made by the employer nor to the EI premiums paid by the employer. Furthermore, it does not apply to amounts that were not deducted from the earnings of employees and that could have been assessed in accordance with subsection 227(10) of the ITA. Nor does the deemed trust extend to interest and/or penalties that have accrued on the deemed trust amounts.

Excise Tax Act

The ETA deemed trust applies to GST/HST amounts collected or deemed to have been collected (after the input tax credits and other tax adjustments have been deducted) that have not been remitted to the CRA. As with the deemed trust of the ITA, the ETA deemed trust does not encompass interest charges and/or penalties that have accumulated on the deemed trust amounts. Furthermore, the ETA deemed trust does not apply to "collectible" amounts, being amounts charged to the debtor's accounts receivable.

When a debtor files his GST/HST return, the amount of GST/HST collected and collectible is combined as a single amount. In circumstances when there are no accounts receivable, calculating the deemed trust amount is easy. As penalty and interest or other charges do not form part of the deemed trust, these amounts are deducted from the total deemed trust amount. The remaining balance will be the deemed trust amount.

However, if the debtor has accounts receivable, the CRA must subtract the amount of taxes collectible that are due on these accounts from the deemed trust. To do so, the collection officer must multiply the amount of the accounts receivable by 107%. The amount thus calculated will be deducted from the amount of GST/HST indicated in the debtor's return. This calculation does not permit the calculation of the collectible GST/HST to the nearest dollar, but it will ensure that the registrant is receiving fair and equitable treatment by the CRA.

Digitized by Google

Amounts Collected, Deemed to Have Been Collected, Collectible and Net Tax

A debtor is required to file a return based on his filing period (monthly, quarterly or annually). The return must indicate the total amount of his sales for the period concerned as well as the total amount of collected or collectible GST/HST.

The difference between collected and collectible amounts is not always clear. Let's simply say that the collected amounts are the amounts of GST/HST collected on sales and paid by the client (by cheque, debit card, credit card, etc.) at the time of the sale. This means that when a client pays his purchase, the debtor collects the GST/HST. Since the debtor collected the tax on behalf of the Crown, the corresponding amounts are deemed to be held in trust until the end of his filing period, after which the debtor must remit the amount of net tax.

On the other hand, the collectible amounts designate amounts charged to the debtor's accounts receivable. Even if the client has not paid the debtor, the debtor must include this transaction in his total sales amount when he files his return. However, at this stage, the debtor has collected only part of the amount (initial payment) or has not collected any amount. Consequently, the part of the amount of this transaction that applies to GST/HST is a collectible amount and is not included in the deemed trust amount. Once the client has paid the amount payable to the debtor, the amount in question becomes a collected amount.

Net tax is the amount left after having deducted the ITCs and other tax adjustments and it includes collectible and collected GST/HST. As indicated hereinafter, you must determine the collected amount for the deemed trust.

Section 222.1 of the ETA deals with amounts of GST/HST deemed to have been collected. Under this new provision, the purchaser of an account receivable (such as a factor) is not required to remit the GST/HST component of his purchase. In fact, at the time the factor purchases the accounts receivable, the tax is deemed to have been collected by the debtor. This amount is then added to any deemed trust amounts the debtor currently has outstanding.

It is important to note that section 222.1 does not apply to a deemed trust amount that was outstanding at the time of the sale. In the event there are deemed trust amounts outstanding at the time of sale of the accounts receivable to a factor, the Crown is the real owner of the accounts receivable to the extent of the amount of the deemed trust outstanding.

Air Travellers Security Charge Act

In a similar fashion to the ETA deemed trust, ATSCA deemed trust amounts are those that have been collected by the debtor (after certain adjustments including those set out by section 32). This deemed trust does not apply to interest or penalties that could be payable on these amounts, nor to collectible amounts.

Priorities Arising From the Deemed Trust Provisions

As a general rule, the deemed trust provisions hold that Her Majesty has beneficial ownership of property of a debtor in the event the latter fails to remit

Digitized by Google

deemed trust amounts. This beneficial ownership ensures that Her Majesty has a right to the assets of the debtor, in priority to all of the debtor's secured creditors (other than those having a prescribed security interest). The CRA's priority is not conditional on the filing of any claim as it stems directly from the applicable legislation, namely the ITA, the ETA, the ATSCA, the CCP, the EIA and the UIA.

On the one hand, the deemed trust is a mechanism that allows the CRA to seize the property of a debtor to the extent of the amount of the deemed trust. On the other hand, if a secured creditor takes possession of the property on which he has a security interest, the CRA has a right to the proceeds of disposition of the property in priority to virtually all secured creditor(s). However, we must always ensure that the creditor who seizes a debtor's property holds a security interest as defined in subsection 224(1.3) of the ITA, subsection 123(1) of the ETA and section 2 of the ATSCA. Therefore, a lessor and a conditional sales vendor are not considered secured creditors and are not subject to the deemed trust.

For further information, refer to **Directive RCD-99-07** entitled **Priority for Deemed Trust** and **Memorandum 03-09**, entitled **Validating Bank Act Security (S.427 Bank Act).**

Applicable acts:

- **Income Tax Act**
- **Excise Tax Act**
- **Air Travellers Security Charge Act**

Income Tax Act

The CRA's priority arises once the amounts are withheld from the salaries and wages of employees. However, such amounts cannot be claimed before the date the debtor is required to remit them. Section 108 of the Income Tax Regulations stipulates at what moment the debtor must make the remittance to the Receiver General.

The CRA can enforce its priority under the deemed trust either against a third party, such as a secured creditor who takes measures against the employer's property, either directly against the debtor. The **Situations Where the Debtor is not in an Insolvency Situations** section will address this subject more exhaustively. Under proposals or bankruptcies, the priority of the deemed trust under the ITA remains intact against secured creditors. The section **When an Employer is in an Insolvency Situation** will address these situations.

Excise Tax Act

On the other hand, the CRA's priority under the deemed trust provisions of the ETA comes into existence the moment the amounts are collected or are deemed to have been collected. Such amounts cannot be claimed before the date on which the debtor is required to remit these amounts to the Receiver General.

Furthermore, contrary to the ITA deemed trust, the modified deemed trust provisions of the ETA are not enforceable when the debtor has filed a notice of intention to file a proposal, a proposal or has become bankrupt. In other words, a

Digitized by Google

deemed trust debt under the ETA becomes an ordinary claim in a bankruptcy or proposal context unless an enhanced requirement to pay has been issued before the bankruptcy or proposal.

For further information on this subject, please refer to **Communication ARD 2004-035, entitled Collecting GST/HST in an Insolvency.**

As in the case of the deemed trust under the ITA, the CRA can enforce its priority under the deemed trust either against a third party, such as a secured creditor who takes measures against the debtor's property, either directly against the debtor. For further details, refer to the section entitled, **Situations Where the Debtor is not in an Insolvency Situation.**

Air Travellers Security Charge Act

The CRA's priority under the ATSCA comes into existence the moment the amounts are collected or deemed to have been collected. In the same way, such amounts cannot be claimed before the date on which the debtor is required to remit these amounts to the Receiver General.

The provisions of the ATSCA in regards to the deemed trust are not enforceable in cases of the debtor's bankruptcy, notice of intention or proposal. As such, a deemed trust debt under the ATSCA becomes an ordinary claim in a bankruptcy or proposal context unless an enhanced requirement to pay has been issued before the bankruptcy or proposal.

As in the case of the deemed trust under the ITA and the ETA, the CRA can enforce its priority under the deemed trust either against a third party, such as a secured creditor, either directly against the debtor.

For further details, refer to the section entitled, **Situations where the Debtor is not in an Insolvency Situation.**

General Priority Rule

As set out briefly above, the CRA has beneficial ownership to the property of a debtor who is liable for the payment of deemed trust amounts. This beneficial ownership provides the CRA with priority on a debtor's property notwithstanding any security interest on the property. The term "security interest" is defined in subsection 224(1.3), in subsection 123(1) of the ETA and in section 2 of the ATSCA as follows:

> Interest in property that secures payment or performance of an obligation and includes interest created by or arising out of a debenture, mortgage, lien, pledge, charge, deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for.

Please note that the term "security interest" does not include a prescribed security interest. The exceptions to the deemed trust priority rank, including the prescribed security interest, are discussed hereinafter in the **Policy** section and apply to the deemed trusts under ITA, the ETA and the ATSCA.

Digitized by Google

Policy

The present section specifies the policy concerning deemed trusts:

- Introduction
- Exceptions to the General Priority Rule
- Claiming the Net Proceeds of Realization
- Realization of Property by the CRA
- A Third Party Refuses to Sell Seized Property
- Where the Proceeds of the Realization Have Already Been Distributed
- Distribution Prior to June 18, 1998
- Distribution as of June 18, 1998
- Transitional Provisions – GST/HST Deemed Trust
- Confidentiality
- Deemed Trust and Enhanced Requirements to Pay
- Priority of the Deemed Trust Over Provincial Debts
- Proposal Under the BIA or Plan of Arrangement Under the CCAA
- More Than One Secured Creditor
- Application of Payments
- Merger of Corporations

Introduction

The existence of our deemed trust does not have to be proven. The legislation is sufficiently clear in this regard. What is less clear however, is how we calculate the amounts that make up the deemed trust.

When legal action aimed at recovering our deemed trust is contemplated, we must remember that the burden of proof rests with the CRA.

In the case of the deemed trust, the foregoing means that we must be able to demonstrate, upon request, how we came up with the amounts we are claiming on account of the deemed trust. In other words we must be able to explain how

Digitized by Google

they were determined or calculated. These details must be forwarded to the Department of Justice whenever a case is referred to them for legal action in connection with our deemed trust.

The amounts that cannot be positively identified as being part of the deemed trust must not be included as part of our claim. For example, a deemed trust claim cannot be based on a subsection 152(7) ITA assessment nor a "T-4 difference."

Exceptions to the General Priority Rule

As we have seen previously in the section **Priorities Arising from the Deemed Trust Provisions**, the deemed trust provides the CRA with an almost absolute priority over the debtor's creditors with regards to the debtor's property or the proceeds arising from its disposition. However, there are exceptions to this general priority rule that can be found either in the applicable legislation or in the court judgments, which have been included in the CRA's policies.

Therefore, the deemed trust has priority over any security interest as defined under subsection 224(1.3) of the ITA, subsection 123(1) of the ETA and section 2 of the ATSCA, except in the case of:

- an unpaid supplier, farmer, fisherman or aquiculturalist provided for in sections 81.1 and 81.2 of the BIA
- a prescribed security interest as described in new subsection 227(4.2) of the ITA, subsection 222(4) of the ETA and subsection 15(1) of the ATSCA
- a lease or a conditional sales contract; or
- a third party purchaser in good faith

Furthermore, the CRA agrees that legal or court costs, in particular sheriff and bailiff fees have priority over the deemed trust amounts.

Related subjects:

- **Sections 81.1 and 81.2 of the BIA**
- **Prescribed security interest**

Sections 81.1 and 81.2 of the BIA

As a general rule, section 81.1 gives unpaid suppliers a right to repossess goods sold and delivered to the insolvent debtor within thirty days after the goods were delivered.

Under section 81.2, farmers, fishermen, or aquiculturalist have a first charge on the insolvent debtor's inventory, for the amount of the products of agriculture, sea or aquaculture sold and delivered to the debtor. This charge is valid only if the goods were delivered within the 15 days prior to the debtor's bankruptcy.

Digitized by Google

Prescribed Security Interest

Similarly to the ITA deemed trust provisions, Regulation 2201 of the Income Tax Regulations applies retroactively as of June 15, 1994. As for the ETA and ATSCA deemed trust, although the provisions concerning prescribed security interests are not yet effective, the CRA's policy is to apply the deemed trust in regards to these Acts as if a prescribed security interest is currently in effect.

For further information concerning prescribed security interest, please refer to **Directive RCD 00-07**, entitled **Regulation 2201 - Prescribed Security Interest**.

Related subjects:

- **The Deemed Trust Date**
- **Amounts Deducted Prior to the Mortgage Registration**
- **Extension of the Prescribed Security Interest – Insurance or Expropriation Proceeds**
- **What is Excluded from the Prescribed Security Interest**
- **Reduction to the Prescribed Security Interest**
- **Leases and Conditional Sales Contracts**
- **Third Party Purchaser in Good Faith**
- **Court Costs**

The Deemed Trust Date

The deemed trust date, being the date the deemed trust arose, is a concept that goes hand-in-hand with the prescribed security interest. On the one hand, the date is crucial in fixing a point in time from which to determine the property of the employer (at that date) that can be used to satisfy the amount of the deemed trust in which the CRA has a beneficial interest. On the other hand it is necessary to determine the deemed trust date for the purpose of calculating the prescribed security interest.

Employers are required to withhold amounts from their employees' wages on account of income tax and other source deductions. From the date of the actual deduction or withholding, being payday, these funds are held in trust until the date the employer is required to remit these funds. In the same way, the deemed trust date for the purpose of the ETA and the ATSCA is the date when the GST/HST amount or the air travellers' security charge is collected.

In regards to the above, the date on which the debtor is required to remit the trust funds is not a factor.

Amounts Deducted Prior to the Mortgage Registration

Regulation 2201(1) stipulates "...where the mortgage is registered... before the time the amount is deemed to be held in trust by the person." Consequently,

Digitized by Google

unpaid source deductions, which pertain to wages paid before the registration of a mortgage on land or buildings, have priority over the mortgage claim.

Extension of the Prescribed Security Interest - Insurance or Expropriation Proceeds

Regulation 2201(3) specifies that the exception enjoyed by the holder of a mortgage on land or buildings extends to insurance or expropriation proceeds payable with regard to such property.

What is Excluded from the Prescribed Security Interest

As per subsection 2201(3) of the ITA Regulations, a prescribed security interest does not include:

- a lien or any other security that is created by statute
- an assignment of rents or leases
- a mortgage interest in equipment or fixtures that can be removed from the land or building and disposed of separately

Reduction to the Prescribed Security Interest

Regulation 2201 assigns a priority to mortgages on land and buildings that were registered before the deemed trust date. However, in certain circumstances and for sums that must be remitted after January 1, 2000, the prescribed security interest amount may be reduced.

Subsection 2201(2) stipulates that where the debtor fails to pay an amount deemed to be held in trust, the amount of the prescribed security interest is deemed not to exceed the difference between the secured obligation and the total of the following amounts:

- all amounts of all the rights of the secured creditor including guarantees or rights of set-off but not including the mortgage
- all amounts applied after the time of the failure on account of the obligation, so long as any amount deemed

Essentially, the maximum amount of a secured creditor's prescribed security interest is determined by calculating the value of the outstanding obligation (amount due) secured by the mortgage, less the value of any other security the lender may use to satisfy his debt. So, if a secured creditor holds a third party guarantee, the value of the guarantee will reduce the amount of the secured creditor's prescribed security interest.

However, a security interest granted by a debtor on property other than land and buildings (such as inventory or equipment) is not included in the calculation of the prescribed security interest. The reason behind this exclusion is that the CRA already holds a beneficial interest in that property by virtue of the deemed trust provisions.

Digitized by Google

Moreover, the prescribed security interest is limited to the outstanding amount of the obligation at the deemed trust date. Consequently, if advances secured by a mortgage on real estate are made over a period of time and a failure to remit occurs during that period, the portion of these advances made before the deemed trust date is protected by the prescribed security interest, but the portion of the advances made after the deemed trust date is subordinated to the deemed trust.

As well, if the debtor makes any payments pursuant to the mortgage agreement after the deemed trust date, the payments will reduce the amount of the prescribed security interest.

Leases and Conditional Sales Contracts

Collection officers must not invoke the priority of the deemed trust against lessors and conditional sales vendors in order to seize the property that is the object of the lease or the conditional sales contracts. In fact, recent decisions have confirmed that this property is not held in trust on behalf of Her Majesty, as the tax debtor is not the owner of the property.

It is recommended that collection officers review the leases and conditional sales contracts in order to verify that the lessor/instalment vendor remains the owner of the asset for the length of the lease or the conditional sales contract. Otherwise, collection officers should communicate with the regional office of the Department of Justice.

For further details, refer to **Memorandum 02-14** entitled, **Deemed Trust and Leases, CSC and Third Party Purchasers for Value**.

Third Party Purchasers in Good Faith

The CRA has never applied the deemed trust provisions against third parties who have acquired assets from a tax debtor at fair market value in the normal course of business. Factoring companies that buy accounts receivable from debtors for less than their book value are considered third party purchasers acting in good faith.

In view of the decision by the Supreme Court of Canada in the matter of ***First Vancouver***, collection officers must not issue deemed trust claims against factoring companies for collected accounts receivable.

For further information, please refer to **Memorandum 02-14** entitled, **Deemed Trust and Leases, CSC and Third Party Purchasers for Value**.

Court Costs

The CRA will not claim the priority of its deemed trust over legal or court costs. To do so would entail taking the risk that sheriffs, bailiffs and other civil enforcement officers could refuse to act when their services are required.

Claiming the Net Proceeds of Realization

Digitized by Google

When we demand that a secured creditor pay the amount of our deemed trust from the proceeds of realization of the property in which he holds a security interest, the CRA allows him to deduct the actual reasonable disbursements that he incurred to sell the property. As such, the amount realized minus the actual disbursements directly related to the realization represents the "net proceeds of realization."

Some examples of realisation costs are: storage costs, insurance premiums, advertising expenses, bailiff or sheriff fees, transportation fees, towing charges, sales commission and cleaning & preparation costs. Depending on the situation, these may be legitimate costs incurred in the process of disposing of an asset.

Note that the CRA will not authorize any deduction from the proceeds of realisation to defray the *time* the creditor spent on realization. This is an ordinary internal cost of the secured creditor and not an out-of-pocket expense resulting from the realisation process. In realizing its security, the secured creditor is taking a chance that it will recover at least part of its secured claim. Lawyers' fees are an example of an outlay that is not recoverable in priority to our deemed trust.

In short, the secured creditor will have to remit to us the lesser of two amounts:

- the net proceeds of realization, or
- the amount of our deemed trust claim

The purpose of this policy is to avoid a situation where the creditor refuses to take the risk of realizing his security.

Realization of Property by the CRA

The deemed trust provisions are used to ensure the CRA's right to the debtor's property in priority to any secured debtor. Consequently, not only can we invoke the provisions when a third party takes action against the property of a debtor but we can also invoke them to seize property in the debtor's hands. To do so, the CRA will issue a writ of seizure to the sheriff together with a deemed trust claim to let him know that we are claiming on two separate levels.

A Third Party Refuses to Sell Seized Property

There is no legislative provision that allows a secured creditor to leave the property with the CRA so that the latter can realize it in his place. In fact the deemed trust provisions only allow the CRA to claim the proceeds of the sale of the goods covered by the deemed trust. Therefore, the secured creditor will either have to sell the property himself or leave it in the hands of the debtor. The opposite is also true. The CRA cannot force a secured creditor or a third party to sell property covered by the deemed trust. As such, it is possible for a secured creditor to keep property in his possession without the CRA being able to do anything about it. In such situations, we must simply wait for the creditor to sell the property and claim priority to the proceeds of disposition.

Digitized by Google

Where the Proceeds of Realisation Have Already Been Distributed

When a third party (secured creditor or a bailiff, sheriff) proceeds to seize property covered by the deemed trust, the CRA has the right to receive the proceeds of the disposition in priority to any other secured creditor (other than a creditor falling within the exceptions mentioned earlier). When the third party holds the proceeds of disposition, the CRA must simply issue him a deemed trust claim. The following paragraphs address situations where the third party has already distributed the proceeds of the disposition stemming from the sale of the goods covered by the deemed trust.

A. General Rule

When a third party distributes the proceeds of disposition of goods that are subject to the deemed trust before the CRA can produce a deemed trust claim, the CRA nevertheless retains its remedies against the third party.

In fact, it must be remembered that the application of the deemed trust provisions is not conditional on the filing of a claim in the hands of a person who liquidates, realizes or otherwise disposes of the debtor's goods. Even when a claim is not filed before the distribution, circumstances may justify an assessment under sections 159 of the ITA and 270 of the ETA or the institution of a legal action against the person concerned.

For further information regarding this type of assessment in a deemed trust context please refer to **Claim Against a Secured Creditor or Third Party**.

B. Distribution by a Trustee in Bankruptcy

Where the trustee has distributed the proceeds of realization of property, you may object to the dividend sheet, provided the delay for doing so has not elapsed. More information on that recourse is provided under the section **Risky Situations With High Potential of Realization or Situations Where the Trustee Does not Have Sufficient Liquidity**. In certain circumstances, you may also contemplate filing an application in court under section 37 of the BIA. The use of this provision is further discussed in the section **Redemption by the Trustee of Property Encumbered by Security Subsection 128(3) of the BIA**.

C. Distribution by a Bailiff, a Sheriff or the Clerk of a Court

Several recourses are open to the CRA when third parties are charged with realizing property of the debtor or distributing the proceeds of realization of such property and the proceeds of the sale of these goods are distributed without the CRA receiving its deemed trust amount.

First of all, if a payment scheme was followed when distributing the proceeds of the sale or of the realization of the debtor's assets the CRA will be able to claim the amount of its deemed trust from the last creditor on the payment scheme, since they benefited from amounts they should not have received.

Digitized by Google

Secondly, it may be possible to assess under sections 159 of the ITA or 270 of the ETA if there is failure to obtain a discharge certificate. For further information regarding this type of assessment in a deemed trust context, please refer to **Claim Against a Secured Creditor or Third Party**.

Note: It is not possible to issue such an assessment under the ATSCA.

The CRA can also consider the possibility of instituting legal action against the third party in order to recover the amount the CRA is entitled to. To the extent that the executing officer was unable to determine the existence of our deemed trust, no recourse will normally be undertaken. However, if the executing officer was aware of our debt, or should have inquired about the possibility of such a debt, the Department of Justice will be consulted in order to determine the appropriate approach.

Distribution Prior to June 18, 1998

Although the amendments to the deemed trust for source deductions are retroactive to June 15, 1994, the decision to invoke the deemed trust prior to June 18, 1998, must be made on a case-by-case basis. In general, the CRA will rely on the retroactive character of the deemed trust provisions for source deductions where it can be demonstrated that the person in question was aware of our priority and of the impending legislative amendments.

In situations where this criterion is not met, the decision to proceed will be taken in conjunction with your Field Support programs officer at Headquarters, taking into consideration the recommendation of the Department of Justice. Furthermore, it will be necessary to take into account:

- the cost-effectiveness of the measures contemplated, such as the expenses incurred when the case is referred to the Department of Justice
- the evidence available if it goes to court
- the possible impact on the CRA's image, for example if the contemplated action may appear unfair in the public's eye

Distribution as of June 18, 1998

The decision to take action must be made based on the following factors:

- the cost of the action contemplated
- the amounts to be recovered
- the existence of less costly avenues of recovery and

Digitized by Google

- the effect on compliance

When the only recourse available is to initiate legal action to recover the amounts owed to the CRA, the amount will have to be relatively high. The cost associated with the services provided to us by the Department of Justice is high, and since the number of lawyers in the regional offices of the Department of Justice is limited, the time a lawyer spends on a case to recover a modest amount could prevent him from dealing in time with a case that has a higher monetary potential.

A. Minimum Threshold

Please note that Headquarters has adopted a new policy by which a request for assistance will not be routed to the Department of Justice if the CRA's deemed trust claim against a third party is below **PROTECTED**. Of course, local management retains the authority to raise (but not to lower) this minimum threshold to take into consideration various operational realities.

Our deemed trust claims are often filed against financial institutions, trustees, etc. In order to ensure future compliance, certain cases will merit Department of Justice intervention even if the amounts in question are not significant.

Transitional Provisions -- GST/HST Deemed Trust

Under the ETA, the deemed trust arises at the moment of collection by the debtor. In other words, an amount collected on or after October 20, 2000 on account of the deemed trust will be subject to the new deemed trust provisions. Practically speaking, this means that the debtor's reporting period (monthly, quarterly or annually) will be used to determine precisely the deemed trust amount collected in the reporting period that includes October 20, 2000, and this task will be extremely difficult and time consuming. Although these amounts could be determined by an audit, we must recognise the impracticality of requesting an audit for each and every deemed trust account. Therefore, the CRA has determined that the new provisions will be applied to a debtor's first reporting period commencing after the date of Royal Assent.

It must be noted that there could be exceptions to this rule where the outstanding amount warrants it. Consult with your **Field Support** programs officer before pursuing this measure.

Confidentiality

A. The Communication of Information to Prospective Lenders or Purchasers

In order to reduce the impact of the deemed trust provisions on perspective lenders or purchasers, the Department of Finance has indicated that certain information on a debtor's file may be provided to a prospective lender or purchaser. There is no specific provision for the disclosure of information to such persons in sections 241 of

Digitized by Google

the ITA and 295 of the ETA (the ATSCA does not have such provisions) nor can it be regarded as necessary for the purposes of the administration or enforcement of the ITA and the ETA. Therefore it will be necessary to obtain written authorization from the debtor before disclosing any information to a prospective lender or purchaser. We will then have to transmit the information to the third party by letter, within a reasonable amount of time.

The form letters to that effect are exhaustive. **Appendices 8** and **9** attached herein must be used for the disclosure of confidential information under the ITA. Please refer to **Appendices 13** and **14** attached for the disclosure of information under the ETA.

Only the information requested must be provided. The sample letters above will have to be adapted to the circumstances of each case. However, the disclaimer clauses found in the last six paragraphs of **Appendix 9** (for the ITA) and **14** (for the ETA) must be shown on all information disclosure letters.

The CRA staff must keep in mind that:

- a debtor has to authorize a financial institution to access information in its file to get a loan
- under the confidentiality provisions of the ITA and the ETA, the CRA may disclose information with a taxpayer's consent but it is not required to do so
- financial institutions may try to make the CRA liable for providing inaccurate or incomplete information on a debtor's file
- it is important that information be provided in writing only

If no written authorization to disclose information is provided to you, you can forward the information directly to the debtor. No information about the debtor is to be disclosed verbally to the third party, not even confirmation that the information the third party received earlier by letter is correct or that the client's situation is unchanged. If you encounter specific problems, consult your **Field Support Programs officer** at Headquarters before disclosing any information.

Unless a debtor's account is under the responsibility of the Collections Division, collection officers should not have to respond to inquiries.

For further details, refer to the **Collections Manual** chapter entitled, **Confidentiality: Providing Information to a Third Party.**

B. Filing of Claims with Third Parties

It should be noted that you should never send a claim to a secured creditor "in the event that" he decides to realize his security interest. In fact, the confidentiality provisions in the ITA section 241 and in the ETA section 295 are very strict.

Digitized by Google

Note: The ATSCA does not have provisions dealing with confidential information.

Filing a claim as a preventive measure would constitute an unauthorized disclosure of confidential information. Furthermore, such a measure has no advantages for the CRA. Indeed, even though it is definitely preferable to promptly file a claim, the fact remains that our priority for deemed trust amounts can be claimed at any time, regardless of whether a claim in this regard has been filed.

C. Communication of Information to a Third Party who is Liable for a Deemed Trust Amount

Where the CRA must file a claim with a third party for a deemed trust amount, we must use one of the form letters listed within the **Appendix**. These letters contain the details of our claim and the breakdown of our debt. However a third party (primarily a secured creditor) may wish that the CRA provide further proof in support of its claim. In such cases it is appropriate that the collection officer provide the third party with a copy of the Notice of Assessment for the source deductions amount that was used in the calculation of the deemed trust claim by the collection officer who prepared the claim. If the third party is not satisfied with the way the deemed trust was calculated, the collection officers must resist requests for additional documentary proof.

Deemed Trust and Enhanced Requirements To Pay

A. Income Tax Act

Amounts deemed to be held in trust under the ITA are amounts withheld directly on the gross earnings of employees. They are comprised of income tax, employee portion of CPP contributions and employee portion of employment insurance premiums. They do not include penalties, interest nor the employer's CPP and employment insurance contributions. As for enhanced requirements to pay, they allow for the recovery in full of a Paydac account, including penalties, interest and employer contributions. These requirements are issued pursuant to subsection 224(1.2) of the ITA and not under the deemed trust provisions.

B. Excise Tax Act

In the same fashion, amounts deemed to be held in trust under the ETA are net tax amounts that were collected, or deemed to have been collected and do not include collectible amounts nor interest and penalties. The enhanced requirements to pay issued under subsection 317(3) allow for the recovery of the deemed trust amounts in addition to the full amount of GST/HST owed, interest, penalties and other charges.

C. Air Travellers Security Charge Act

Digitized by Google

Deemed trust amounts for the ATSCA are charge amounts that have been collected or deemed to have been collected and do not include collectible amounts nor interest and penalties. The enhanced requirements to pay issued under subsection 75(3) of the ATSCA allow for the recovery of deemed trust amounts in addition to the full amount of charges owed, interest, penalties and other charges.

It is important to respect the above distinctions. Deemed trust claims (under the ITA, the ETA and the ATSCA) must be filed by using letters, not through issuing enhanced requirements to pay, which are to be used to intercept amounts payable to the debtor.

Requirements to pay are issued to a third party who is liable for the payment of an amount to the debtor or to a debtor's secured creditor.

For further information regarding the use of enhanced requirements to pay in sectors other than construction, please refer to **Communication ARD 2004-009**, entitled **Deemed Trusts and Enhanced Requirements To Pay in Sectors Other than Construction**.

Priority of the Deemed Trust Over Provincial Debts

Taking the position that the deemed trust provisions are broad enough, the CRA will demand payment of our deemed trust before certain amounts to which provincial legislation grants special status, such as property tax arrears. However, any application of the deemed trust provisions are subject, where applicable, to the funds sharing agreement (Memorandums of Understanding) entered into by Canada with each applicable province. Collection officers are encouraged to review the funds sharing agreement for their province.

Under subsection 227(4.3) of the ITA and sections 122 of the ETA and 6 of the ATSCA, the deemed trusts arising under these laws have priority over a secured federal or provincial Crown claim. When the federal Crown, the provincial Crown or a Crown agent, holds a security interest in the debtor's property, this interest is subject to the deemed trust provisions under the ITA, the ETA and the ATSCA.

However, the CRA does not assert the priority conferred by the deemed trust provisions over legal and/or court costs. For further details please see section **Exceptions to the General Priority Rule**.

A. Province of Quebec

Income Tax Act

The CRA takes the position that the wording of section 227 of the ITA is sufficient to give it precedence over the provincial government's priority on movable property under the Quebec Civil Code ("QCC"). In situations where concurrent measures were taken by both organizations (CRA and MRQ) with respect to the same property of the debtor, the funds sharing agreement will

Digitized by Google

apply. In the absence of an agreement, or should a conflict arise, the CRA's deemed trust must be paid before the MRQ priority. In the event the CRA is not paid in priority, you will have to contact your **Field Support** programs officer at HQ who could contact the Department of Justice.

Excise Tax Act

The CRA considers that the wording of section 222 of the ETA confers it priority over the province concerning movable property under the QCC. In cases where concomitant measures are taken by the CRA and MRQ on property of the debtor same property, the funds sharing agreement applies. In the absence of an agreement or should a conflict arise, the CRA's deemed trust must be paid before the MRQ priority. In the event the CRA is not paid in priority, you will have to contact your Field Support programs officer at HQ who could contact the Department of Justice.

B. Priority on Employees' Unpaid Salaries

Generally, the CRA must continue to assert the deemed trust priority over the claims of employees for unpaid salaries. In fact, as deemed trust provisions grant the CRA priority over this type of claim, the CRA would be out of place to abdicate its rights and prerogatives.

Occasionally, the CRA may allow employees to be paid before a deemed trust claim. This type of decision will be taken depending on the circumstances of each situation, including the relative importance of amounts in question, the positions held by the employees, the fact of whether employees were aware of the CRA claim (or the organization acting on behalf of the employees) at the time of realization of the debtor's property and the sensitivity of the file.

If collection officers wish to grant priority to employee claims, they must contact their **Field Support** programs officer.

C. Priority of Provincial Sales Tax

The GST is collected together with the Provincial Sales Tax. The provinces of British Columbia, Saskatchewan, Manitoba and Ontario each collect their own provincial sales tax. In these provinces, the priority of the GST deemed trust is established in accordance with the funds sharing agreement (Memorandum of Understanding) concluded with the CRA.

In the provinces of Newfoundland, Nova Scotia and New Brunswick, the CRA collects the Harmonized Sales Tax (HST), on behalf of the provinces. The HST is a combination of the GST and the applicable provincial sales tax. In these provinces, the total GST/HST deemed trust amount grants Her Majesty beneficial ownership on the debtor's property and priority to this property and to all proceeds stemming from the disposition of this property, over all creditors.

Digitized by Google

Subsection 317(12) allows the CRA to issue a requirement to pay in regards to a province, in order to collect GST/HST.

Proposal Under the BIA or Plan of Arrangement Under the CCAA

A. Income Tax Act

As part of a proposal filed under the BIA or a plan of arrangement concluded under the CCAA, collection officers should not invoke the deemed trust priority under the ITA. In fact, as subsections 60(1.1) of the BIA and 18.2(1) of the CCAA provide for the payment in full of source deductions arrears (not only amounts affected by the deemed trust) within six months following approval of the proposal or the court arrangement, it is beneficial to invoke these provisions instead of issuing a deemed trust claim.

For additional information on the application of subsection 60(1.1) of the BIA, please refer to **Communication ARD 2004-039** entitled **The Application of Subsection 60(1.1) of the Bankruptcy and Insolvency Act**.

However, this protection does not apply to consumer proposals. In those situations, it is recommended to insert a clause in the proposal, before its approval, using the wording of subsection 60(1.1) of the BIA to which we would make the necessary adjustments. This approach allows us to recover all of the amounts owing by the debtor. Obviously, this is only possible if the CRA is able to control the vote for the approval of the proposal.

In situations where the proposal does not provide a clause ensuring the payment in full of our source deductions, the CRA will file a deemed trust claim with the trustee or the administrator to recover part of the income tax, employee portion of CPP and Employment Insurance.

More Than One Secured Creditor

It is common for a tax debtor to pledge his property to more than one secured creditor. This means we will often have to collect our deemed trust simultaneously from different sources; for example, from the trustee in bankruptcy, or from a receiver appointed by a secured creditor and a secured creditor acting on his own behalf. In these situations, proofs of claim including property claims will be sent to any person involved in the realization of the debtor's property or in the distribution of the proceeds.

For ETA and ATSCA cases, if an enhanced requirement to pay has been issued before the bankruptcy date refer to **Communication ARD 2004-035** entitled, **Collecting GST/HST in an Insolvency**.

It may seem unfair that a secured creditor would have to pay amounts to the CRA without other creditors in the same class having to do the same. Hence, when feasible, we may claim part of the amount from each of the secured creditors. However, it must be borne in mind that the CRA's mandate is to protect the

Digitized by Google

interests of the Crown by making sure that the amounts owing to it are paid promptly using the quickest and easiest collection methods. Therefore, it is necessary to avoid taking unnecessary risks and, at all times, to choose the most cost-effective option for the CRA.

Application of Payments

The CRA expects that the main difficulty in managing deemed trust files will be to explain the application of payments or other credits on a debtor's account. In all cases where payments or credits are considered in the calculation of our deemed trust amount, we must prepare a table detailing how we arrived at the deemed trust amount that we are claiming. With respect to the ITA, **Appendix 6** includes an area where a breakdown the arrears amount can be clearly indicated. With respect to the ETA, we invite you to refer to the attached **Appendix 15**. A copy of this worksheet must be permanently kept in the file.

We must bear in mind that there is no legal prohibition against the CRA applying payments or credits in the most advantageous fashion. In this regard, the CRA is subject to the general principle that applies to any creditor. In the absence of instructions from the debtor, the creditor may apply a payment wherever it wishes. Consequently, unless the debtor specifies where he wants his payment to be applied, the CRA is free to apply the payment wherever it wants.

In view of the exceptions described in the preceding paragraphs, the CRA will apply payments and credits first against the amounts that are not part of its deemed trust, in order to maximize the amounts that the CRA can recover in priority by means of its deemed trust.

Nonetheless, it is necessary to act prudently and logically. For example, if the CRA assesses a third party for a transfer of property that occurred in 1997 and the latter pays the total amount of the source deductions owed by the transferor for 1997 and prior years, the payment must be applied against the period concerned. Similarly, if a trustee makes payments to satisfy our property claim, these amounts will necessarily have to be applied against the deemed trust.

The GST system automatically allocates arrears payments to the oldest applicable period, then to penalties and interest, and then to the next oldest applicable period. Recent arrears payments and credits are first applied against amounts that are not part of the deemed trust (penalties, interest and collectible amounts) in order to maximize the amounts that the CRA can recover by means of its deemed trust.

Merger of Corporations

Our deemed trust priority will be claimed from a corporation that absorbs another corporation and liquidates its property or from the representative of such a corporation. Although sections 159 of the ITA and 270 of the ETA already provide for the CRA to be paid ahead of unsecured creditors, the deemed trust provisions allow the CRA to be paid ahead of secured creditors.

Digitized by Google

Procedures

The CRA intends to take maximum advantage of the priority ranking of the deemed trust provisions. The measures to be taken and the applicable procedures will depend on the circumstances of each case. The number of possible situations is infinite. That is why it will be necessary to analyse each case and determine the best approach under the circumstances. As a general rule, the collection of an account is effected using the easiest and least costly means for the CRA. This is also true for deemed trust claims.

The following guidelines and procedures should help you determine the approach to take in the various situations you will encounter. However, these guidelines and procedures are not exhaustive. Therefore, do not hesitate to discuss your case with your supervisor. If necessary, your team leader or your technical advisor will be able to contact one of the Field Support programs officer at Headquarters responsible for your region.

Related Topics:

- Situations Where the Debtor is not in an Insolvency Situation
- When an Employer is in an Insolvency Situation
- Net Proceeds of Realization Greater Than the Amount of our Deemed Trust
- Insufficient Net Proceeds of Realization
- Possible Loss Incurred at Realization
- Risky Situations With High Potential of Realization or Situations Where the Trustee Does not Have Sufficient Liquidity
- Objection to Dividend Sheet

Situations Where the Debtor is not in an Insolvency Situation

When the debtor is not in an insolvency situation, the CRA may invoke its deemed trust (ITA, ETA and ATSCA) directly against the debtor because he is deemed to hold the deducted/collected amounts in trust. Therefore, the CRA may seize and sell the debtor's property, to the extent of the amount held in trust.

On the other hand, the CRA may invoke its deemed trust against a secured creditor or a third party who disposes of one of the debtor's assets that is held in trust for Her Majesty. Note that the CRA may only use its deemed trust to claim priority over the proceeds of disposition arising from the sale of property and not to recover property held by the third party.

There may be situations where the collection officer is dissatisfied with the amount realised. Perhaps the collection officer feels the amount realised is low or inadequate or that the realisation costs are unreasonable. In these

Digitized by Google

circumstances, the collection officer can question the sale of the property, but must first consult with his/her supervisor.

Generally, the CRA invokes its deemed trust by a letter sent to the debtor himself or to the third party selling the debtor's property (secured creditor, receiver, bailiff or sheriff).

Related Topics

- **When can a Claim be Issued?**
- **Claim Against a Debtor**
- **Claim Against a Secured Creditor or a Third Party**

When Can a Claim be Issued?

Deemed trust claims are made by using letters referencing the relevant ITA, ETA or ATSCA provisions. These claims do not constitute a legal action and do not require issuing a legal warning to the debtor or to the third party. They can therefore be issued when:

- the debtor's account has just been received and the debtor has not yet been contacted
- the debtor has made a payment arrangement and does not abide by this arrangement
- the debtor has made a payment arrangement and is abiding by this arrangement but a third party takes action against the debtor's property; or
- the source deductions have been deducted from the employee pay checks but have not been remitted to the Receiver General, GST/HST is collected or is deemed to have been collected, but has not been remitted to the Receiver General or the Air Travellers Security Charge has been collected but has not been remitted to the Receiver General.

It is extremely important to make all the necessary efforts to file a claim as soon as possible. Late actions are always disruptive and are not looked upon favourably by the courts. Please refer to **Memorandum 03-12 entitled, Impact of Recent Court Decisions Dealing with Deemed Trust**, which suggests certain methods to expedite the collection of deemed trust amounts.

Claim Against the Debtor

A. The Proceeds of Disposition Have not Been Distributed

When we seize and sell a debtor's property by means of a writ, a deemed trust claim must be filed with the sheriff or bailiff together with the writ instructing him to seize and sell the property. This way, it will be clearly established that we are making claims at two separate levels with different priority rankings:

Digitized by Google

- for our deemed trust, in priority to the secured creditors; and
- as a judgment creditor for the non-trust portion of our claim, after payment to the secured creditors.

Thus, in order to file a deemed trust claim under the ITA, the CRA will use the letter found in the enclosed **Appendix 1** to the sheriff or the bailiff while the **Appendix 10** letter will be used to file a deemed trust claim under the ETA. Obviously, these letters may have to be amended depending on the circumstances of each case.

B. The Proceeds of Disposition Have Been Distributed Before the Filing of Our Claim

When a bailiff or a sheriff charged with realizing a debtor's property, or distributing the proceeds of realization of such property, the CRA must review the special circumstances of each case before deciding if it will take action against this third party. To the extent that this third party was unable to determine the existence of our deemed trust, no recourse will normally be taken. However, if the CRA issued a deemed trust claim with the executing officer before the distribution of the amounts or if the executing officer was aware of our debt or should have inquired about the possibility of such a debt, the Department of Justice will be consulted in order to determine the appropriate approach.

Claim Against a Secured Creditor or a Third Party

A) The Proceeds of Disposition Have not Been Distributed

You should file a claim with any person who is realizing, liquidating, repossessing or otherwise disposing of the assets of a debtor, or any person who purchases these assets. Although the legislation does not contain any requirement to do so, by promptly filing a claim with a person who is preparing to dispose of the debtor's property or of the proceeds arising there from, we increase the odds of receiving what we are owed. Should this person fail to pay the CRA, it will be easier to take recourse against this person since this person was aware of our priority.

Appendix 1 of this Chapter contains an example of a deemed trust claim made under the ITA, which can be adapted to the circumstances of each case. **Appendix 10** contains a similar letter to be used under the ETA. It is important to make all necessary efforts to promptly file a claim. Late actions are always disruptive, are not looked upon favourably by the courts, and can tarnish the CRA's image.

Sale of Business

When the debtor or another person (e.g. monitor, liquidator, etc.) sells a business and the buyer does not pay the full amount, we will send a letter to both parties (see the letters at **Appendix 2** for the ITA and **Appendix 11** for the ETA). If we are advised of the sale

Digitized by Google

after all amounts have been distributed, we must try to obtain payment of our deemed trust from creditors who may not otherwise have been paid.

This does not prevent us from pursuing the remedies provided by provincial legislation governing the sale of businesses. In addition, certain third parties involved in the sale of a business may be considered a "legal representative" within the meaning of the ETA and therefore be subject to the requirement of obtaining a clearance certificate. If you believe you are facing such a situation, you should obtain a legal opinion as to whether it is advisable to issue an assessment against the third party for failure to obtain a clearance certificate.

For further details, refer to **Directive RCD 01-01** entitled, **Person Acting for Another: Section 159 ITA and Section 270 ETA**.

B) The Proceeds of Disposition Have Been Distributed Before the Filing Our Claim

When a secured creditor distributes the proceeds of disposition arising from the sale of assets covered by our deemed trust, the actions to be taken will depend on the facts of each situation.

i. Assessments for Failure to Obtain a Clearance Certificate

It is standard practice for financial institutions – and other secured creditors – to retain the services of a receiver to realize property on which they have a security interest. However, according to section 159 of the ITA and section 270 of the ETA (there are no such provisions for the ATSCA) a receiver must obtain a clearance certificate before distributing the proceeds of disposition of such property. Assessing the receiver for failure to obtain such a certificate will normally be more advantageous for the CRA than having the Department of Justice file a civil suit. On the one hand, issuing an assessment is less costly. On the other hand, assessing under section 159 may make it possible to also recover the portion of the debt not included in the deemed trust from the debtor's account.

In many situations, we may consider issuing an assessment under sections 159 of the ITA and 270 of the ETA. This measure must be considered whenever the distribution was made by a "legal representative" according to the definition of this term in subsections 248(1) of the ITA and 270(1) of the ETA.

Where an assessment under sections 159 of the ITA or 270 of the ETA is being considered, a pre-assessment letter (reproduced in **Appendices 7** for ITA and **12** for the ETA) will first be sent to the third party.

ii. Assessment Against the Director(s)

Digitized by Google

instead of taking civil proceedings against the third party, which is often the most costly option or assessing under section 159 of the ITA and 270 of the ETA, it may be possible to assess the debtor's director(s) under sections 227.1 of the ITA, 323 of the ETA and 81 of the ATSCA. When the indebted debtor is a corporation whose directors are solvent, we may choose to assess the directors instead of trying to recover only the deemed trust portion from the corporation, since a director's liability assessment allows us to recover the entire amount of the source deductions debt.

C) Legal Action

When the secured creditor or another third party fails to pay our deemed trust, and the remedies mentioned above are not available, we will have to refer the case to the Department of Justice. The Department of Justice will first issue a formal demand for payment. If there is failure to pay, the Department of Justice may initiate legal action.

D) Recovery of Amounts

Claims for the payment of deemed trust amounts should be filed with any person(s) who received amounts to the detriment of our deemed trust. Such claims are appropriate under any circumstance. They are based on a very simple principle. If the priority conferred on us by the legislation had been respected, we would have received certain amounts. The person who benefited from those amounts, because of the failure of a third party to comply with the ITA, the ETA or the ATSCA, was not entitled to those amounts and should remit them.

When an Employer is in an Insolvency Situation

One of the most widespread use of our deemed trust provisions is the property claim filed in bankruptcy cases. Although it is the BIA which indicates how to claim what belongs to the Crown, i.e. by filing a property proof of claim, it is the ITA, specifically subsection 227(4.1), which stipulates that the amounts deducted from the wages of employees are the property of the Crown and do not form part of the estate in the event the debtor becomes bankrupt.

When a debtor files an assignment in bankruptcy or when a receiving order is made against him, the CRA may collect the amount of its deemed trust within the bankruptcy estate or by using property held as security by a secured creditor.

As mentioned above, the deemed trust under the ETA and the ATSCA are not effective in insolvency situations (bankruptcies and proposals) unless an enhanced requirement to pay has been issued before the insolvency date, in which case, the CRA may file a proof of property for the requirement to pay amount.

For more information on this topic as it relates to the ETA, please refer to **Communication ARD 2004-035** entitled, **Collecting GST/HST in an Insolvency**.

Digitized by Google

Related Topics:

- Collection of the Deemed Trust Amount Within the Bankruptcy Estate (Other Than by way of Property Encumbered by Security)
- Rejection of Our Property Claim
- Collection of our Deemed Trust Amount Using Property Encumbered by Securities
- Secured Creditor Who Does not Participate in the Bankruptcy Process
- Secured Creditor Participating in the Bankruptcy Process
- Secured Creditor Who Disposes of Property Held as Security – Section 130 of the BIA

Collection of the Deemed Trust Amount Within the Bankruptcy Estate (Other Than by Way of Property Encumbered by Security)

Property of a debtor that is vested in the trustee must be liquidated by the trustee for the benefit of creditors participating in the bankruptcy. Generally, the proceeds of disposition of this property are ultimately distributed to the creditors, according to the portion of their debt.

In order to proceed this way, collection officers must file a property proof of claim with the trustee for the pre-bankruptcy deemed trust portion and a regular proof of claim for the non-trust amounts. Appendix 3 suggests a cover letter for the property claim. This letter can be adapted if necessary to mention that a proof of unsecured claim is also attached.

Rejection of Our Property Claim

It is important to react promptly if the trustee disputes our property claim. Pursuant to subsection 81(2) of the BIA, the Crown has fifteen days to file a motion with the court. If the Department fails to act by this deadline, the Crown will be deemed to have abandoned any right to the property claimed.

Although the amendments to the deemed trust provisions are applicable "notwithstanding the BIA (except sections 81.1 and 81.2)", we must not accept the disallowance of our property claim in order to then claim our deemed trust from the secured creditors. Although supported by legislation, this approach is contrary to the CRA's policy.

Collection of our Deemed Trust Amount Using Property Encumbered by Securities

By virtue of the amendments to the deemed trust provisions, in addition to filing a property claim in the bankruptcy, we can, if appropriate, claim the payment of our deemed trust directly from the secured creditors. It is

Digitized by Google

therefore important that the trustee informs us, without delay, of any decisions or measures he is taking with respect to encumbered assets of the bankrupt. **Appendix 3** suggests a cover letter for these property claims. The letter can be adapted if necessary to mention that a proof of unsecured claim is also attached.

Headquarters expects that a trustee, receiving the letter found in **Appendix 3**, will inform us without delay of any decisions made with respect to the encumbered property. If appropriate, we could then suggest alternatives to the actions he proposes. Situations where it might be advantageous for the CRA to reach an agreement with the trustee or a secured creditor, or both, are described in the following pages. By and large, it will not be appropriate to attempt to force the trustee to realize an asset in which there is no equity for the whole of the preferred and unsecured creditors.

Appendix 4 presents an example of a letter to be used in bankruptcy to claim our deemed trust from a secured creditor. As for the letter in **Appendix 5**, it will be used to claim from the representative of such a creditor, for example, a receiver.

The rights or powers of the secured creditors in a bankruptcy estate, versus our deemed trust claim, were not a major concern before the amendment of the deemed trust provisions. Similarly, relatively little attention was paid to the decisions the trustee made to redeem and realize security or, conversely, to surrender it to the secured creditor.

Since you will have to consider the effects of the trustee's decisions on the recovery of our deemed trust and take action if necessary, it is useful that you get familiarized with the provisions of the BIA applicable to secured claims. The various options are described below.

Secured Creditor Who Does not Participate in the Bankruptcy Process

As stipulated by subsection 69.3(2) of the BIA, the secured creditor may realize his security even if the debtor is bankrupt. A secured creditor may opt out of the bankruptcy process altogether and not file a proof of secured claim. He will then either leave the property with his client, or he will realize the property in accordance with the legislation governing his security interest.

In such circumstances, subject to the secured creditor's interest arising from a prescribed security interest, we will demand that the secured creditor pay us before paying himself out of the net proceeds of realization. The letters suggested in **Appendices 4** and **5** will be used for this purpose.

Secured Creditor Participating in the Bankruptcy Process

When the secured creditor files a proof of secured claim in the bankruptcy, it is up to the trustee to decide what to do with the encumbered property. He can:

- demand that the property be sold pursuant to section 129 of the BIA

Digitized by Google

- redeem the security as provided for by subsection 128(3) of the BIA, by paying the lesser of the amount of the proof of secured claim or the estimated value of the security interest; or

- surrender the property to the secured creditor

Related Topics:

- Secured Realized at the Request of the Trustee – section 129 of the BIA

- Redemption by the Trustee of Property Encumbered by Security – Subsection 128(3) of the BIA

Security Realized at the Request of the Trustee – section 129 of the BIA

Section 129 applies to situations where the trustee and the secured creditor disagree as to the value of the security. In these circumstances, they will agree to realize the property. Any excess of the proceeds of realization over the secured creditor's claim will be transferred to the bankrupt's estate for the benefit of the creditors. This is not a commonly encountered situation; if it occurs, a letter similar to the one in Appendix 5 will be sent to the person who is realizing the property.

Redemption by the Trustee of Property Encumbered by Security – Subsection 128(3) of the BIA

The trustee will choose to redeem the security as allowed under subsection 128(3) when the estimated proceeds of realization of the security

- the trustee's fees and expenses incurred in the realization

- $ of our deemed trust

- $ owing to the secured creditor

= $ for the bankrupt's estate

If the trustee already has the funds or enough assets to pay us from the bankrupt's estate, he will exclude the amount of our deemed trust from his calculation. These situations are not problematic since our deemed trust will be paid in full.

a) Trustee Miscalculation

However, it is possible that the trustee overestimates the potential proceeds of realization. He will then have paid the secured creditor's claim in exchange for a release of the latter's interest in the property, only to learn after the realization that he no longer has enough money to pay our deemed trust.

b) Trustee Who Does Not Recognize His Obligation

Digitized by Google

The trustee may also not recognize his obligation to pay our deemed trust and as such, fail to take it into account when deciding whether he will redeem the security.

In either of the situations described in paragraphs a) and b) above, the CRA will claim the payment of its deemed trust in priority to the fees of the trustee associated with the realization. Only the actual outlays associated with the realization will have priority over our deemed trust. If necessary, we will claim any shortfall from the secured creditor up to the amount that the trustee paid him to redeem his security. **Appendix 6** contains a form letter to be used.

In exceptional cases, we could take a more lenient approach in the first of the two situations described above, if it is clear that the trustee acted prudently and in good faith. The CRA will then allow that a portion of his fees be paid in priority to its deemed trust.

In the second situation, filing a motion in court as allowed under section 37 of the BIA will have to be considered, to demonstrate that the trustee's decisions and actions are prejudicial to the CRA. The court could then issue any order it deems necessary to remedy the situation. Consideration will have to be given to such action when the trustee repeatedly refuses to cooperate, thereby forcing the CRA to claim the deemed trust from the creditors whose security was redeemed, and to incur legal expenses when the latter refuse to remit the amounts claimed.

When we are considering invoking section 37 of the BIA, the Department of Justice must be notified of all the pertinent facts and documents without delay. It will be difficult to convince the court that the CRA has suffered serious harm if we wait months before reacting. In addition, once the trustee is discharged, it is next to impossible to go back on his decisions or actions, whether they were good or bad.

Even if a motion is filed in court under section 37 of the BIA, we will file a deemed trust claim with any third party who has received amounts to which we were legally entitled.

Secured Creditor Who Disposes of Property Held as Security - Section 130 of the BIA

Where the trustee does not exercise his power to redeem the security or require that it be realized, the security is vested with the secured creditor. However, it must be noted that leaving the property with the secured creditor does not make him the owner of that property. The secured creditor is still required to follow the procedures that would have applied outside of bankruptcy.

The letter found at **Appendix 3** should encourage trustees to inform us of any decisions they make concerning the disposition of the assets pledged as security. We will then be able to discuss other possible avenues with them, involving the secured creditor(s) concerned if necessary.

Net Proceeds of Realization Greater Than The Amount of our Deemed Trust

When the estimated net proceeds of realization exceed the amount of our deemed trust, without however being enough to also pay the claim of the secured

Digitized by Google

creditor with an interest in the property, the trustee will have to reach an agreement with the secured creditor. Two avenues are then possible:

- either the secured creditor allows the trustee to realize the property and pay us
- either the secured creditor repossesses the property and realizes it

Under the first scenario, the secured creditor will have to absorb the fees and expenses of the trustee associated with the realization. Unless the CRA has agreed in writing prior to the realization of property encumbered by a security interest, that it would pay realization fees and costs, such amounts are not to be paid ahead of the deemed trust. Unless the trustee knows for sure that the realization will bring enough money to pay in full both the deemed trust and all realization fees and costs, a written agreement will have to be signed with the CRA. This agreement will stipulate the percentage of the proceeds of realization that the CRA considers reasonable under the circumstances, to cover the trustee's fees and expenses.

If the secured creditor wants to realize the property, the trustee should inform him or her of our priority, up to the amount of our property claim. This information will assist the secured creditor in deciding whether it is worth it to realize or not. Ideally, the trustee would obtain a signed commitment from the secured creditor to pay us in priority from the proceeds. One needs to keep in mind, however, that the trustee is under no obligation to even attempt to do so.

Example

Our deemed trust	12 000	
Bank's claim	3 000	
Realization costs	800	
Fees for the realization	3 500	
Percentage stipulated by the agreement with the trustee	20%	
Gross proceeds of realization	16 000	
Amount remitted to the bank	0	(16 000 – 800 – 3500 –12 000)
Amount remitted to the CRA	12 000	[16 000 – (16 000 X 20%)]

Insufficient Net Proceeds of Realization

Where the estimated net proceeds of realization are less than the amount of our deemed trust, the trustee will have to reach an agreement with the secured creditor. Two avenues are possible:

- either the secured creditor releases his security interest in the property, so that the trustee can realize the property and pay the CRA; or
- either the secured creditor repossesses the property and realizes it

Digitized by Google

In both cases, the secured creditor receives nothing. However, it is possible that the secured creditor may choose to realize the property himself, on the chance that the realization will yield a higher amount than initially estimated.

Before the trustee proceeds with the realization, the CRA will sign an agreement with him stating the percentage of the gross proceeds of realization that will cover his fees and expenses. This approach allows us to keep the fees and expenses within reasonable limits. It also has the advantage of encouraging the trustee to try to obtain the maximum possible. There may also be situations where neither the trustee nor the secured creditor or the CRA has any interest in having the property realized.

When the property is left with the secured creditor, while under no obligation in that regard, the trustee could obtain a signed commitment from the secured creditor to pay us in priority. This makes things clearer and easier for all parties.

Possible Loss Incurred at Realization

In certain situations, it will be difficult to predict the potential proceeds of realization. The trustee may request that we guarantee the payment of his fees and expenses in the event that the proceeds of realization are insufficient to cover them. Such a commitment must never be made. There have been cases where the CRA has had to pay substantial amounts unnecessarily because of such a commitment. When neither the secured creditor nor the trustee elects to risk proceeding with realization, the property will normally be left with the debtor.

Risky Situations With High Potential of Realization or Situations Where the Trustee Does Not Have Sufficient Liquidity

You must never give a carte blanche commitment to a trustee. However, you could face a situation where realizing a property entails taking a risk, but where the potential of realization is very high. Such situations must be referred to your **Field Support** programs officer at Headquarters. The same is true of situations where the trustee asks us to advance him funds to allow him to proceed with the realization because he does not have the necessary liquidity. They will help you to determine the best approach given the circumstances of your case.

Objection to Dividend Sheet

Where the dividend sheet provides for the distribution of amounts to certain creditors but not full payment of our property claim, consideration will have to be given to objecting to the dividend sheets, as allowed under subsection 152(6) of the BIA. Because such an objection must be filed within fifteen days following the date on which the trustee mails the dividend sheet, relevant details are to be sent to the Department of Justice as quickly as possible.

Such a situation is not expected to arise frequently. Trustees are familiar with our property claims and it is quite unlikely that a trustee would pay other creditors in priority over our property claim. The fact that the CRA now has direct recourse

Digitized by Google

against secured creditors in no way diminishes the trustee's obligation to pay our property claim in priority.

Resource Material

Directive RCD-98-06, Lien and Charge Registration, issued August 26, 1998.

Directive RDC-99-07, Priority for Deemed Trust, issued June 10, 1999.

Directive RCD-00-07, Regulation 2201 - Prescribed Security Interest, issued May 26, 2000.

Directive ARD-01-01, Priority for GST/HST Deemed Trust Amounts, issued May 23, 2001.

Directive RCD-01-01, Person Acting for Another: Section 159 ITA and Section 270 ETA, January 10, 2001.

Directive RCD-02-01, Deemed Security Interest, issued April 18, 2002

Memorandum 01-22, Enforcing the Deemed Trust Provisions – Business Development Bank of Canada, issued January 11, 2001.

Memorandum 02-14, Deemed Trust and Leases, CSC and Third Party Purchasers for Value, issued August 14, 2002.

Memorandum 03-12, Impact of Recent Court Decisions Dealing with Deemed Trust issued June 19, 2003.

Memorandum 03-09, Validating Bank Act Security (S.427 Bank Act), issued May 13, 2003.

Communication ARD-2004-009, Deemed Trusts and Enhanced Requirements To Pay in Sectors Other than Construction, issued March 3, 2004.

Communication ARD-2004-035, Collecting GST/HST in an Insolvency, issued June 17, 2004.

Communication ARD-2004-039, The Application of Subsection 60(1.1) of the Bankruptcy and Insolvency Act, issued August 25, 2004.

Appendix

Related topics:

- **Appendix 1 – Deemed Trust Claim where the employer is not bankrupt**
- **Appendix 2 – Deemed Trust Claim - Sale**
- **Appendix 3 – Covering letter for property claim**

Digitized by Google

- Appendix 4 – Deemed Trust Claim - Bankruptcy - Secured creditor
- Appendix 5 – Deemed Trust Claim - Bankruptcy - Other person
- Appendix 6 – Deemed Trust Claim - Bankruptcy - Redemption of security interest
- Appendix 7 – Preassessment letter – under section 159 of the ITA
- Appendix 8 – Authorization from an employer - disclosure of confidential information
- Appendix 9 – Letter to third party - status of source deductions account
- Appendix 10 – Deemed Trust Claim – registrant other than bankrupt
- Appendix 11 – Deemed Trust Claim – Sale
- Appendix 12 – Preassessment notice letter – under section 270 of the ETA
- Appendix 13 – Registrant authorization – disclosure of confidential information
- Appendix 14 – Letter sent to a third party – GST/HST account status
- Appendix 15 – GST/HST Deemed Trust (DT) Calculation Sheet
- Appendix 16 – Examples of GST/HST Deemed Trust Calculation

Appendix 1 - Deemed Trust Claim Where the Employer is not Bankrupt

"*Salutation*": (specify in what capacity when applicable)

We have been informed that you are preparing to liquidate, dispose of, or distribute property of the above-named employer. That employer currently owes the Crown amounts deducted from the wages of its employees.

Pursuant to subsections 227(4) or (4.1) of the *Income Tax Act*, 23(3) or (4) of the *Canada Pension Plan*, 57(2) or (3) of the *Unemployment Insurance Act* and 86(2) or (2.1) of the *Employment Insurance Act*, the following amounts are deemed to be held in trust pending payment to Her Majesty:

Income Tax	Canada Pension	Unemployment	Employment	Total

Digitized by Google

Plan Contributions	Insurance Premiums	Insurance Premiums

The above-mentioned provisions give the Crown a beneficial right to these amounts in all the property of the employer and any proceeds arising from that property, with priority over any security interest, other than a prescribed security interest, in such property. Proposed section 2201 of the *Income Tax Regulations* (copy attached) defines what constitutes a "prescribed security interest."

Subject to the priority of the holder of a prescribed security interest for the unpaid balance of the amount secured by the mortgage in question, payment of the total referred to above must be made to the Receiver General from the proceeds of realization of any property of the employer minus realization costs.

Choose one of the following paragraphs:

We draw your attention to section 159 of the *Income Tax Act*, a copy of which is attached, in the event you fail to comply with this claim, in particular subsection 159(3.1), which stipulates that an appropriation, by a legal representative of a taxpayer, of property in the possession or control of the legal representative acting in that capacity is deemed to be a distribution of the property to a person.

If you fail to comply with this claim, the Agency may initiate proceedings against you in order to recover the amounts, which in accordance with the legislation in effect, should have been paid to us.

If you would like more information or clarification, please contact the undersigned at the *"TSO"* Tax Services Office at "*telephone number.*"

Yours truly,

Appendix 2 - Deemed Trust Claim - Sale

"Salutation":

We have been informed that you are preparing to distribute some or all of the proceeds from the sale of property, which was the above-named employer's. That employer currently owes the Crown amounts deducted from the wages of its employees.

Pursuant to subsections 227(4) or (4.1) of the *Income Tax Act*, 23(3) or (4) of the *Canada Pension Plan*, 57(2) or (3) of the *Unemployment Insurance Act* and 86(2) or (2.1) of the *Employment Insurance Act*, the following amounts are deemed to be held in trust pending payment to Her Majesty:

Income Tax	Canada Pension Plan Contributions	Unemployment Insurance Premiums	Employment Insurance Premiums	Total

The above-mentioned provisions give the Crown a beneficial right to these amounts in all the property of the employer and any proceeds arising from that property, with priority over any security interest, other than a prescribed security

Digitized by Google

interest, in such property. Proposed section 2201 of the *Income Tax Regulations* (copy attached) defines what constitutes a "prescribed security interest."

Subject to the priority of the holder of a prescribed security interest for the unpaid balance of the amount secured by the mortgage in question, payment of the total referred to above must be made to the Receiver General from the proceeds of realization of any property of the employer and before payment to any other creditor. We therefore request that you not dispose of the proceeds that would otherwise be payable to the above-named employer or any of its creditors before the amounts shown have been paid in full.

We draw your attention to section 159 of the *Income Tax Act*, a copy of which is attached, in the event you fail to comply with this claim.

If you would like more information or clarification, please contact the undersigned at the "*TSO*" Tax Services Office at "*telephone number.*"

Yours truly,

Appendix 3 - Covering Letter for Property Claim

"*Salutation*":

Enclosed is a property claim in respect of amounts deducted from the wages of the employees of the above-named bankrupt.

Pursuant to subsections 227(4) or (4.1) of the *Income Tax Act*, 23(3) or (4) of the *Canada Pension Plan*, 57(2) or (3) of the *Unemployment Insurance Act* and 86(2) or (2.1) of the *Employment Insurance Act*, these amounts are deemed to be held in trust pending payment to Her Majesty. Consequently, they are not included in the estate of the bankrupt.

Notwithstanding the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), the above-mentioned provisions give the Crown a beneficial right to these amounts in all the property of the employer and any proceeds arising from that property, with priority over any security interest, other than a prescribed security interest, in such property. Proposed section 2201 of the *Income Tax Regulations* (copy attached) defines what constitutes a "prescribed security interest."

Subject to the priority of the holder of a prescribed security interest for the unpaid balance of the amount secured by the mortgage in question, payment of the total referred to above must be made to the Receiver General from the security or the proceeds of realization of any property of the employer and before payment to any other creditor. Unless you are satisfied that you will be able to pay the attached property claim in full, we request that you contact us prior to disposing of property of the bankrupt or proceeds arising from such property, even those charged with a security.

If you would like more information or clarification, please contact the undersigned at the "*TSO*" Tax Services Office at "*telephone number.*"

Yours truly,

Digitized by Google

Appendix 4 - Deemed Trust Claim - Bankruptcy - Secured Creditor

"*Salutation*":

We have been informed that you are a secured creditor of the above-named bankrupt employer and that you are about to liquidate or realize some of the property of that employer which you hold as security in order to obtain payment of your debt. That employer currently owes the Crown amounts deducted from the wages of its employees.

Pursuant to subsections 227(4) or (4.1) of the *Income Tax Act*, 23(3) or (4) of the *Canada Pension Plan*, 57(2) or (3) of the *Unemployment Insurance Act* and 86(2) or (2.1) of the *Employment Insurance Act*, the following amounts are deemed to be held in trust pending payment to Her Majesty and are not included in the estate of the bankrupt:

Income Tax	Canada Pension Plan Contributions	Unemployment Insurance Premiums	Employment Insurance Premiums	Total

Notwithstanding the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), the above-mentioned provisions give the Crown a beneficial right to these amounts in all the property of the employer and any proceeds arising from that property, with priority over any security interest, other than a prescribed security interest, in such property. Proposed section 2201 of the *Income Tax Regulations* (copy attached) defines what constitutes a "prescribed security interest."

Subject to the priority of the holder of a prescribed security interest for the unpaid balance of the amount secured by the mortgage in question, payment of the total referred to above must be made to the Receiver General from the proceeds of realization of any property of the employer minus realization costs.

If you fail to comply with this claim, the Agency may initiate proceedings against you in order to recover the amounts, which, in accordance with the legislation in effect, should have been paid to us.

If you would like more information or clarification, please contact the undersigned at the "*TSO*" Tax Services Office at "*telephone number.*"

Yours truly,

Appendix 5 - Deemed Trust Claim - Bankruptcy - Other person

"*Salutation*":

We have been informed that you are acting as "*capacity, if applicable*" on behalf of a secured creditor of the above-named bankrupt employer, and that you are about to liquidate or realize some of the property of that employer, which you hold as security, to obtain payment from the secured creditor's debt. That bankrupt employer currently owes the Crown amounts deducted from the wages of its employees.

Digitized by Google

Pursuant to subsections 227(4) or (4.1) of the *Income Tax Act*, 23(3) or (4) of the *Canada Pension Plan*, 57(2) or (3) of the *Unemployment Insurance Act* and 86(2) or (2.1) of the *Employment Insurance Act*, the following amounts are deemed to be held in trust pending payment to Her Majesty and are not included in the estate of the bankrupt:

Income Tax	Canada Pension Plan Contributions	Unemployment Insurance Premiums	Employment Insurance Premiums	Total

Notwithstanding the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), the above-mentioned provisions give the Crown a beneficial right to these amounts in all the property of the employer and any proceeds arising from that property, with priority over any security interest, other than a prescribed security interest, in such property. Proposed section 2201 of the Income Tax Regulations (copy attached) defines what constitutes a "prescribed security interest."

Subject to the priority of the holder of a prescribed security interest for the unpaid balance of the amount secured by the mortgage in question, payment of the total referred to above must be made to the Receiver General from the proceeds of realization of any property of the employer minus realization costs.

We draw your attention to section 159 of the *Income Tax Act*, a copy of which is attached, in the event you fail to comply with this claim.

If you would like more information or clarification, please contact the undersigned at the "*TSO*" Tax Services Office at "*telephone number*."

Yours truly,

Appendix 6 - Deemed Trust Claim - Bankruptcy - Redemption of Security Interest

"*Salutation*":

We have been informed that you were a secured creditor of the above-named bankrupt employer and that the trustee redeemed your security as permitted under subsection 128(3) of the *Bankruptcy and Insolvency Act*. That employer owes the Crown amounts deducted from the wages of its employees.

Pursuant to subsections 227(4) or (4.1) of the *Income Tax Act*, 23(3) or (4) of the *Canada Pension Plan*, 57(2) or (3) of the *Unemployment Insurance Act* and 86(2) or (2.1) of the *Employment Insurance Act*, the following amounts are deemed to be held in trust pending payment to Her Majesty and are not included in the estate of the bankrupt:

Income Tax	Canada Pension Plan Contributions	Unemployment Insurance Premiums	Employment Insurance Premiums	Total

Notwithstanding the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), the above-mentioned provisions give the Crown a beneficial right to these amounts in all the property of the employer and any proceeds

Digitized by Google

arising from that property, with priority over any security interest, other than a prescribed security interest, in such property. Proposed section 2201 of the *Income Tax Regulations* (copy attached) defines what constitutes a "prescribed security interest."

Despite the above-mentioned provisions, the trustee responsible for administering the estate of the bankrupt employer elected to redeem your security, without first paying the deemed trust amounts owing to the Crown. Unless you immediately remit the total shown above to the Receiver General, the Agency may seek a court order cancelling the redemption of your security by the trustee, or any other order that the court may consider appropriate.

If you would like more information or clarification, please contact the undersigned at the "*TSO*" Tax Services Office at "*telephone number.*"

Yours truly,

Appendix 7 - Preassessment Letter – Under Section 159 of the ITA

"*Salutation*":

According to our records, on or about "*approximate date of distribution*", in your capacity as (choose one)

- a person designated by a secured creditor of the above-named employer,
- a purchaser of property of the above-named employer,
- you (*choose one*)
- distributed property of that employer
- distributed the proceeds of realization of property of that employer
- distributed the selling price of property of that employer

without paying to the Crown the amounts for which Her Majesty has a beneficial right in the property in question or the proceeds of their realization. Please note that under subsection 159(3.1) of the *Income Tax Act* ("ITA"), you are deemed to have distributed any property of the employer, which you personally appropriated.

Subsections 227(4) or (4.1) of the ITA, 23(3) or (4) of the *Canada Pension Plan*, 57(2) or (3) of the *Unemployment Insurance Act* and 86(2) or (2.1) of the *Employment Insurance Act* grant Her Majesty a beneficial right in all property of the employer, as well as any proceeds arising from such property for amounts which the employer deducted from the wages of its employees, and which the employer failed to remit. The property of the employer includes amounts, which you were required to pay to acquire assets of the employer.

In accordance with subsection 159(2) of the ITA, before disposing of any property of that employer or the proceeds of realization of such property, you were required to obtain a certificate acknowledging payment of all debts of the

Digitized by Google

employer owed to the Crown. Because you failed to do so, we are considering assessing you as permitted under subsection 159(3) of the ITA.

If payment for property on which the Crown has a beneficial right, an "amount", or employer's proceeds of realization, whichever is less, is not received within the next thirty days we may proceed with an assessment of you without further notice.

Please note that section 159 of the ITA covers all types of debts owed to the Crown. Consequently, in addition to the assessment referred to above, you may be subject to other assessments under the same provisions in respect of other debts of the employer. However, the total of the assessments may not at any time exceed the net value of the property distributed or the net proceeds of realization of that property.

If you believe that you should not be assessed under section 159 ITA, or if you wish to bring to our attention facts which may have a bearing on our decision to assess or the amount of the assessment, please contact the undersigned at the "*TSO*" Tax Services Office at "*telephone number.*"

Yours truly,

Appendix 8 - Authorization From an Employer - Disclosure of Confidential Information

"*Date*"

Canada Revenue Agency
Tax Services Office "TSO"
Revenue Collections

"*Salutation*":

Re: "employer"
Employer account number: "BN"

"Employer" authorizes Canada Revenue Agency to disclose to (third party) the following information about this account from the Canada Revenue Agency's existing computerized records:

Any outstanding balance as assessed by Canada Revenue Agency plus any accrued interest and penalties, the associated pay period(s), whether a payment arrangement has been made with Canada Revenue Agency (and, if so, if payments are current), and whether an objection or appeal has been filed (and, if so, its status);

the employer's remittance frequency (e.g. bi-monthly);

the date, the amount and the associated pay period of the last (5) remittances;

any pay period(s) for which no remittances have been received by Canada Revenue Agency by the remittance deadline (other than as covered in paragraph 1 above);

Digitized by Google

any pay period(s) for which no information return (under *Income Tax Regulation* 108(3)) has been filed; and

the date of the last Canada Revenue Agency trust audit and period covered, whether a trust audit is presently ongoing and whether a trust audit has been scheduled with "*employer*."

Please send this information to the attention of "*third party contact*" at the following address: « »

This authorization shall be void unless submitted to Canada Revenue Agency on or before "*expiry date selected by employer*."

(as applicable) I am able to provide this authorization to Canada Revenue Agency on behalf of "*employer*" by virtue of my role as "*title*" or as confirmed by the attached corporate authorization.

Thank you for your assistance.

"Employer"

by:
"*name and title of employer's contact*"

Appendix 9 - Letter to Third Party - Status of Source Deductions Account

"*Date*"

"*Third party name and address*"

"*Salutation*":

Re: "employer"
Employer account number: "BN"

Further to your "*date*" letter, "*employer*" has authorized Canada Revenue Agency to disclose the following information about this account as of "*date*":

1. outstanding balance as assessed by Canada Revenue Agency plus accrued interest and penalties (as detailed below):

   a. unremitted source deductions (tax/CPP/EI): $
   b. unremitted employer contributions (CPP/EI): $
   c. pay period(s) involved:
   d. payment arrangement in place: [yes/no]
      - if so, is employer current under arrangement: [yes/no]
   e. has employer objected to or appealed the assessment(s): [yes/no]
      - if so, status of objection/appeal:

Digitized by Google

2. employer's remittance frequency: [e.g. bi-monthly]

3. date, amount and associated pay period of last [5] remittances:

4. pay period(s) for which no remittances were received by Canada Revenue Agency by the deadline (other than as noted in 1(c) above):
   - if return(s) filed, amount owing as shown by "*employer*":

5. pay period(s) for which "*employer*" did not file a return:

6. date (month/year) of last Canada Revenue Agency trust audit (if any) and period covered:
   - is a trust audit presently ongoing: [yes/no]
   - has a trust audit been scheduled with employer: [yes/no]

("Return" refers to *Income Tax Regulation* 108(3), which requires that remittances be accompanied by a return in the prescribed form.)

An employer is responsible for ensuring the remittance of the appropriate source deductions from payments made to its employees. Canada Revenue Agency does not warrant that the appropriate source deductions have been made by this employer or, if arrears are noted above, that no other arrears exist.

The above information was drawn from Canada Revenue Agency's existing computerized records relating to this account. Canada Revenue Agency has not reviewed the employer's payroll records or otherwise investigated the employer's source deductions in response to your request for information.

You may wish to conduct your own review of the employer's payroll records to assist in determining whether the appropriate source deductions have been deducted and remitted.

Canada Revenue Agency does not have to, nor does it undertake to, notify you of any subsequent assessments or reassessments on this account relating to periods before or after the currency date noted in the first paragraph above.

Canada Revenue Agency's authority to disclose is limited to the information outlined above.

This information is provided for your information only and shall not be relayed to third parties.

Sincerely,

TSO Collection Officer

c.c.: "*employer*"

Digitized by Google

Appendix 10 - Deemed Trust Claim – Registrant Other Than Bankrupt

"*Salutation*": (indicate under what authority, if applicable)

Re: [Registrant]

We have been informed that you are preparing to liquidate, dispose of, or distribute property of the above-named registrant. That registrant currently owes GST/HST amounts collected but not remitted to the Crown.

Pursuant to subsections 222(1) of the *Excise Tax Act*, the following amounts are deemed to be held in trust pending payment to Her Majesty:

Details concerning the GST/HST:

The above-mentioned paragraph gives the Crown a beneficial right to these amounts in all the property of the registrant and any proceeds arising from that property, with priority over any security interest, other than a prescribed security interest.

If you fail to comply with this claim, the Agency may initiate proceedings against you in order to recover the amounts, which, in accordance with the legislation in effect, should have been paid to us.

If you would like more information or clarification, please contact the undersigned at the "*TSO*" Tax Services Office at "*telephone number.*"

Yours truly,

TSO Collection Officer

Appendix 11 - Deemed Trust Claim – Sale

"*Salutation*":

Re: [Registrant]

We have been informed that you are preparing to distribute some or all of the proceeds from the sale of property, which was the above-named registrant's. That registrant currently owes GST/HST amounts collected but not remitted to the Crown.

Pursuant to subsections 222(1) of the *Excise Tax Act*, the following amounts are deemed to be held in trust pending payment to Her Majesty:

Details concerning the GST/HST

The above-mentioned paragraph gives the Crown a beneficial right to these amounts in all the property of the registrant and any proceeds arising from that

Digitized by Google

property, with priority over any security interest, other than a prescribed security interest.

Subject to the priority of the holder of a prescribed security interest for the unpaid balance of the amount secured by the mortgage in question, payment of the total referred to above must be made to the Receiver General from the proceeds of realization of any property of the registrant, before payment to any other creditor. We therefore request that you not dispose of the proceeds that would otherwise be payable to the above-named registrant or any of its creditors before the amounts shown have been paid in full.

If you would like more information or clarification, please contact the undersigned at the "*TSO*" Tax Services Office at "*telephone number.*"

Yours truly,

TSO Collection Officer

Appendix 12 - Preassessment Notice Letter – Under Section 270 of the ETA

"*Salutation*":

According to our files, you have (proceeded to distribute the registrant's property, the proceeds of realization of the registrant's property or the proceeds of the sale of the registrant's property) on or about "*approximate date of distribution*" as a (named person by this registrant's secured creditor or the buyer of this registrant's property). However, you have failed to remit to the Crown amounts entitled to Her Majesty relating to the property in question or the proceeds of its realization. We wish to remind you that, pursuant to subsection 270 of the *Excise Tax Act* ("ETA"), you are deemed to have distributed the appropriated registrant's property.

Subsection 222(1) of the ETA confers to Her Majesty a beneficial right to these amounts in all the property of the registrant, and any proceeds arising from that property, as amounts collected by the registrant but not remitted. The registrant's property includes amounts you were required to pay to acquire the registrant's property.

In accordance with subsection 270 of the ETA, before proceeding with the sale of all the property of that registrant or the distribution of the proceeds of realization of such property, you were required to obtain a certificate acknowledging payment of all debts of the registrant owed to the Crown. Because you failed to do so, we are considering assessing you as permitted under subsection 270 of the ETA.

If payment of the amount indicated above, or the proceeds of realization minus realization costs, whichever is less, is not received within the next thirty days, we may proceed with an assessment to you for having failed to obtain a clearance certificate.

Consequently, in addition to the assessment referred to above, you may be subject to other assessments under the same provisions in respect of other debts of the registrant. However, the total of the assessments may not at any time

Digitized by Google

exceed the net value of the property distributed or the net proceeds of realization of that property.

If you believe that you should not be assessed under section 270 of the ETA or if you wish to bring to our attention facts which may have a bearing on our decision to assess or the amount of the assessment, please contact the undersigned at the "TSO" Tax Services Office at "telephone number."

Yours truly,

TSO Collection Officer

Appendix 13 - Registrant Authorization – Disclosure of Confidential Information

"*Date*"

Canada Revenue Agency
[address]

["*Greetings*":

Re: [Registrant]]
GST/HST account # [ ]

[Person] authorizes Canada Revenue Agency ("CRA") to disclose to [third party] the following information about this account from CRA's existing computerized records:

- any outstanding balance as assessed by CRA plus any accrued interest and penalties, the associated pay period(s), whether a payment arrangement has been made with CRA, (and, if so, if payments are current) and whether an objection or appeal has been filed (and, if so, its status);
- the applicable filing frequency (e.g. bi-monthly);
- the date, amount and associated filing period of the last five remittances;
- any filing periods for which no remittances have been received by CRA by the remittance deadline (other than as covered in paragraph 1 above);
- any filing periods for which no return has been filed
- the date of the last CRA trust audit and period covered, whether a trust audit is presently ongoing and whether a trust audit has been scheduled with [registrant].

Please send this information to the attention of [third party contact] at the following address: [ ].

Digitized by Google

This authorization shall be void unless submitted to CRA on or before [expiry date selected by the registrant].

(as applicable) I am able to provide this authorization to CRA for [person]'s account, by virtue of my role as [title] or as confirmed by the attached corporate authorization.

Thank you for your assistance.

[registrant]

per: [name and title of registrant's contact]

Appendix 14 - Letter Sent to Third Party– GST/HST Account Status

[Date]

[Third party name and address]

[salutation]

Re: [registrant]
GST/HST account # [ ]

Further to your [date] letter, [registrant] has authorized Canada Revenue Agency ("CRA") to disclose the following information about this account (as of [date]):

1. outstanding balance as assessed by CRA, plus accrued interest and penalties (as detailed below): $
   a. GST/HST collected but unremitted (tax/CPP/EI): $
   b. unremitted collectible GST/HST
   c. interest and penalties: $
   d. other charges
   e. reporting period(s) involved:
   f. payment arrangement in place: [yes/no]
   g. if so, is employer current under arrangement: [yes/no]
   h. has employer objected to or appealed the assessment(s): [yes/no] – if so, status of objection/appeal:

2. [registrant's] filing frequency: [monthly, quarterly or annually]:

3. date, amount and associated reporting periods of the last [5] remittances:

4. the reporting period(s) for which no remittances were received by CRA by the deadline (other than as noted in 1(c) above):

   • if a return(s) was filed, the amount owing as shown by [registrant]

5. the reporting period(s) for which [registrant] did not file a return:

   date (month/year) of last CRA trust audit (if any) and period covered:
   -- is a trust audit presently ongoing: [yes/no]

Digitized by Google

– has a trust audit been scheduled with [registrant]: [yes/no]

A registrant is responsible for ensuring the remittance of the appropriate GST/HST collected. CRA does not warrant that this registrant has made the appropriate remittances because no arrears are noted above, and no other arrears exist.

The above information was drawn from CRA's existing computerized records relating to this account. CRA has not reviewed the registrant's books and records or otherwise investigated the registrant's situation in response to your request for information.

You may wish to conduct your own review of the registrant's books and records to assist in determining whether the appropriate remittances have been collected and remitted.

CRA does not undertake to notify you of any subsequent assessments or reassessments on this account relating to periods before or after the currency date noted in the first paragraph above.

CRA's authority to disclose is limited to the information outlined above.

This information is provided for your information only and shall not be relayed to third parties.

Yours truly,

TSO Collection Officer

c.c.: [registrant]

Appendix 15 - Deemed Trust (DT) Calculation Sheet

Name of Account:_____ Account #:_____

Date Prepared:_____

Accounts receivable: No Yes
Indicate if a copy of the accounts receivable is attached or if the registrant provided the amount of accounts receivable verbally

Amount: _____ $ @ 7/107 = _____ $ GST/HST Collectible

Use the RTDP "Retrieve Transaction Detail by Period" screen

Period ended	GST	Penalty	Interest	Other	Total

Digitized by Google

Subtotal					
Less Tax Collectible					
Total					
Account summary:					
DT Old provisions New provisions					
Total DT					
Non trust amounts less payments					
Account balance					

Old provisions – up to October 19, 2000
New provisions– effective starting on October 20, 2000

Appendix 16 - Examples of GST/HST Deemed Trust Calculation

Note: Read the example carefully, and review the Deemed Trust Calculation Sheet following each example.

Example1: Straight-forward deemed trust calculation

Dave's Custom Woodworks annual GST/HST returns for 1998, 1999 and 2000 have been filed but he has not paid the amounts owing. The registrant has no accounts receivable.
A payment of $1,000 was received in November 2000

Steps:

Deemed Trust Calculation:

- The **preliminary** deemed trust calculation indicates a deemed trust total of $13,000.
- Determine the amount of the GST/HST collectible. As the registrant does not have any accounts receivable, this step it is not necessary.
- The November 2000 payment is applied first to the penalties and interest of the 1998 return ($450 + $450). The same treatment is applied for the December 1999 return ($50 + $50).
- After incorporating the payment of $1,000, the **up-to-date** calculation of the deemed trust amounts is: Total $13,000 –

Digitized by Google

Digitized by Google

Directors Liability

Section 227.1 imposes on directors the obligation of being responsible for remittance of withholdings and corporate income tax. If they do not ensure remittance by the corporation, they as directors will share in exposure to CRA.[63]

Liability of directors for failure to deduct - S. 227.1

227.1 (1) Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or 135.1(7) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.

Limitations on liability

(2) A director is not liable under subsection 227.1(1), unless

(*a*) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 223 and execution for that amount has been returned unsatisfied in whole or in part;

(*b*) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

(*c*) the corporation has made an assignment or a bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the date of the assignment or bankruptcy order.

Idem

(3) A director is not liable for a failure under subsection 227.1(1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

Limitation period

(4) No action or proceedings to recover any amount payable by a director of a corporation under subsection 227.1(1) shall be commenced more than two years after the director last ceased to be a director of that corporation.

Amount recoverable

(5) Where execution referred to in paragraph 227.1(2)(*a*) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

Preference

(6) Where a director pays an amount in respect of a corporation's liability referred to in subsection 227.1(1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that Her Majesty in right of Canada would have been entitled to had that amount not been so paid and, where a certificate that relates to that

[63] See "The Supreme Court's Decision in Peoples: A New Standard of Directors' Liability?", R. Lynn Campbell, (2007) vol. 55, no 3, 465 – 80, in the Canadian Tax Journal for some comments.

Digitized by Google

amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is hereby empowered to make.

Contribution
(7) A director who has satisfied a claim under this section is entitled to contribution from the other directors who were liable for the claim.

Soper v. Canada, [1998] 1 FC(A) 124, 1997 CanLII 6352 (FCA); 149 DLR (4th) 297; 51 DTC 5407; [1997] 3 CTC 242, The Federal Appeal That Set Out The Present Environment and its Criteria[64]

Court of Appeal, Marceau, Linden and Robertson JJ.A. Vancouver, May 20; Ottawa, June 27, 1997.

Income tax " Corporations " Appeal from T.C.C. decision taxpayer not satisfying "due diligence" defence in Income Tax Act, s. 227.1(3) " S. 227.1(3) enabling directors to escape liability for unremitted amounts required to be withheld from employees' salaries if establishing exercised degree of care, diligence and skill to prevent failure that reasonably prudent person would have exercised in comparable circumstances " When taxpayer, experienced businessman, becoming director, receiving balance sheet showing net loss of
$132,000 " Neither employees nor other Board members discussing with taxpayer company's failure to make tax remittances " Taxpayer never inquiring whether company complying with remittance obligations " Appeal dismissed " Analysis of common law duty of care, set out in City Equitable Fire Insurance Co., In re, [1925] Ch. 407 (C.A.), whether and to what extent modified by s. 227.1(3) " Meaning of each component i.e. skill, care diligence " Standard of care under s. 227.1(3) containing both objective, subjective elements " More difficult for inside directors to establish due diligence defence " Unless reasons for suspicion, outside directors may rely on day-to-day corporate managers to pay debt obligations " Positive duty to act arising when aware of facts leading to conclusion could reasonably be potential problem with remittances " Whether standard of care met question of fact to be resolved in light of personal knowledge, experience of director " Given ample business experience, taxpayer under positive duty to act when received balance sheet " Not misled, frustrated by other company officials " Doing nothing inadequate to discharge burden imposed by s. 227.1(3).
Construction of statutes " Income Tax Act, s. 227.1(3) enabling directors to escape liability for unremitted amounts required to be withheld from employees' salaries if establishing exercised degree of care, diligence, skill to prevent failure that reasonably prudent person would have exercised in comparable circumstances " Whether, to what extent modifying common law standard of care " As presumption of coherence, Canada Business Corporations Act, s. 122(1)(b), setting out standard of care to be exercised by directors for corporate law purposes, in virtually identical language, considered " Since Canada Business Corporations Act mirroring Ontario Business Corporations Act, inference Parliament intending to send same message to existing, potential directors " S. 227.1(3) containing both subjective, objective elements " Had Parliament wished to strengthen

[64] See "The Supreme Court's Decision in Peoples: A New Standard of Directors' Liability?", R. Lynn Campbell, (2007) vol. 55, no 3, 465 – 80, in the Canadian Tax Journal for some comments.

Digitized by Google

common law standard of care could have done so by omitting "in comparable circumstances".

This was an appeal from a decision of the Tax Court of Canada holding that the taxpayer had failed to satisfy the "due diligence" defence set out in *Income Tax Act* , subsection 227.1(3). In October 1987 the taxpayer, an experienced businessman, became a director of Ramona Beauchamp International (1976) Inc. (hereinafter RBI). The company, which operated a modelling school, wanted taxpayer on the board to enhance its getting listed on the Vancouver Stock Exchange. At the November 1987 meeting of the board, he was given a copy of RBI's balance sheet, which showed a net loss of $132,000. **At no time did any employee or board member of RBI discuss with the taxpayer RBI's failure to make certain tax remittances as required under the Act. Nor did the taxpayer inquire as to whether RBI was complying with its remittance obligations under the Act. In February 1988 he resigned from the board.** *Income Tax Act*, subsection 153(1) imposes a duty on corporations to withhold taxes and other source deductions from an employee's salary and to remit such amounts to the Receiver General of Canada. Subsection 227.1(1) makes a corporation liable for unremitted amounts while at the same time imposing joint and several liability on its directors. But subsection 227.1(3) enables corporate directors to escape liability for non-remittance if they can establish that they "exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances". Pursuant to subsection 227.1(1), the taxpayer was assessed as a director for unremitted employee withholdings of RBI, plus interest and penalties for the period from October 1987 to January 1988. **The Tax Court held that the statutory defence of due diligence was not available to the taxpayer because he had known of RBI's financial difficulties when he accepted the directorship, and took no steps to ensure remittance.**

The issue was whether subsection 227.1(3) involves a subjective element, in the sense that the personal knowledge and background of a director is a relevant consideration, or whether it is an entirely objective standard, to which all directors will be similarly held.

Held, the appeal should be dismissed.

Per Robertson J.A. (Linden J.A. concurring): As the subjective standard had its roots in the common law, the analysis focused on the seminal decision on the common law duty of care, *City Equitable Fire Insurance Co., In re*, [1925] Ch. 407 (C.A.). *City Equitable* established the following principles: (1) Directors are not trustees.

But as agents, directors stand in a fiduciary relationship to their principal, the company. To the extent that a fiduciary is under a duty to act in good faith so too is a trustee and, in this limited sense the comparison of a director with a trustee has validity. The analogy breaks down, however, when consideration is given to the duties of care and skill. **Subsection 227(5), which deems amounts deducted or withheld to be held in trust, regardless of whether the funds deducted or withheld under the Act were actually so segregated, did not raise the standard of care to the trustee threshold. (2) A director need not exhibit in the performance of his or her duties a greater degree of skill and care than may reasonably be expected from a person of his or her knowledge and experience. Thus, the standard of care is partly objective (the standard of a reasonable person), and partly subjective in that the reasonable person is judged on the basis that he or she has the knowledge and experience of the particular individual.**

A director is neither obliged to give continuous attention to the affairs of the company, nor even to attend all meetings of the board. The common law would not, however, permit directors to adhere to a standard of total passivity and irresponsibility. The statutory standard of care will be interp reted and applied in a manner which encourages responsibility. The

Digitized by Google

director who acts irresponsibly, e.g. by failing to attend all board meetings, does so at his own peril. (4) In the absence of grounds for suspicion, a director may rely on company officials to perform honestly duties that have been properly delegated to them. The exigencies of business and the company's articles of association, together, determine whether it is appropriate to delegate a duty. The larger the business, the greater will be the need to delegate.

The next question was whether the subjective element of the common law standard had been eliminated or reduced by statute? The wording of subsection 227.1(3) is virtually identical to the language used in *Canada Business Corporations Act*, paragraph 122(1)(*b*) which sets out for purposes of corporate law, the standard of care to be exercised by directors. Notably, the statutory phrase "care, diligence and skill" reflects the language of the *City Equitable* case. The *Income Tax Act* and the *Canada Business Corporations Act* adopt the same language because both relate to the standard of care to be exercised, although they differ as to whom the care is owed. Since there is a presumption of coherence between statutes, in order to determine whether the common law standard of care was modified by statute, both the due diligence provision in *Income Tax Act*, subsection 227.1(3) and the standard of care provisions in the *Canada Business Corporations Act* had to be considered.

The statutory analysis involved a consideration of each of the statutory standard's constituent elements in turn: skill, care and diligence. At common law, a director was required to exercise only that degree of skill which could reasonably be expected from a person of his or her knowledge and experience. The statutory skill criterion ("skill that a reasonably prudent person would exercise in comparable circumstances") is essentially the same as the common law requirement. Use of "in comparable circumstances" indicates that a reasonably prudent person in comparable circumstances may be an unskilled person. **The subjective element of the common law standard of skill has not been altered by federal statute.**

The statutory enactment does not appear to have altered the common law position that a director is expected to fulfill his or her duties with care by acting reasonably according to the knowledge and experience that he or she actually possesses. The legislation speaks of a reasonably prudent person and the care that that person would exercise in comparable circumstances. In the event that the reasonably prudent person is unskilled, the statute requires only the exercise of a degree of care which is commensurate with that person's level of skill. In this manner skill and care are interconnected. It is insufficient for a director to simply assert that he did his best if, having regard to that individual's level of skill and business experience, he failed to act reasonably prudently.

Diligence is simply the degree of attention or care expected of a person in a given situation. If attention to one's obligations is the essence of diligence, then that aspect of the standard neither adds to nor detracts from the statutory statement in subsection 227.1(3).

Since the language of the *Canada Business Corporations Act* mirrors that of the Ontario *Business Corporations Act*, Parliament intended to send the same message to existing and potential directors. **Had Parliament wished to strengthen the standard of care imposed at common law, it could have easily done so by adopting the appropriate language i.e. similar to that used in the British Columbia *Company Act*, which does not contain the phrase "in comparable circumstances".**

Subsection 227.1(3) embraces a subjective element which takes into account the personal knowledge and background of the director, as well as his or her corporate circumstances in the form of, *inter alia*, the company's organization, resources, customs and conduct. Thus, more is expected of individuals with superior qualifications, e.g. experienced businesspersons. The standard of care set out in subsection 227.1(3) is therefore neither

Digitized by Google

purely objective nor subjective. **The Act contains both objective elements, embodied in the reasonable person language, and subjective elements, inherent in individual considerations like "skill" and the idea of "comparable circumstances". Accordingly, the standard can be properly described as "objective subjective".**

Inside directors, those involved in the day-to-day management of the company and who influence the conduct of its business affairs, will have the most difficulty in establishing the due diligence defence. It will be a challenge for such individuals to argue convincingly that despite their daily role in corporate management, they lacked business acumen to the extent that that factor should overtake the assumption that they knew or ought to have known of the remittance requirements. A director may attempt to satisfy the due diligence requirement by setting up controls to account for remittances, asking for regular reports from the company's financial officers on the ongoing use of such controls, and obtaining confirmation at regular intervals that withholding and remittance has taken place as required by the Act. Or a director might, in certain circumstances, establish and monitor a trust account from which both employee wages and remittances owing to Her Majesty would be paid. While such precautionary measures may be persuasive evidence of due diligence on the part of a director, they are not necessary conditions precedent to the establishment of that defence. A clear dividing line must be maintained between the standard of care required of a director and that of a trustee. **Accordingly, an outside director cannot be required to go to the lengths outlined above. Unless there is reason for suspicion, it is permissible to rely on the day-to-day corporate managers to pay debt obligations such as those owing to Her Majesty. The positive duty to act arises where a director obtains information, or becomes aware of facts, which might lead one to conclude that there is, or could reasonably be, a potential problem with remittances. Whether the standard of care has been met is a question of fact to be resolved in light of the personal knowledge and experience of the director at issue.**

The taxpayer was under a positive duty to act which arose when he received the balance sheet of RBI revealing that the company was experiencing "extremely serious" financial problems. Given his ample business experience, the taxpayer should have been alerted to the existence of a possible problem with remittances, especially since there was no indication that RBI's financial troubles were merely temporary in nature. There was no indication that the taxpayer was misled or frustrated by other company officials during a quest for knowledge about the state of remittances. Doing nothing was inadequate for the purpose of discharging the burden imposed on the taxpayer by subsection 227.1(3), given the precarious financial position of the company.

Per Marceau J.A.: **Parliament has imposed on a director of a corporation a completely new, separate and positive duty. Such duty is owed to the Crown, and consists of an obligation to do what one reasonably can to prevent such failure from occurring. Such a duty is not fulfilled by a director who has never put his mind to the requirement and has remained completely uninterested and passive with respect to it.**

statutes and regulations judicially considered

Bankruptcy Act, R.S.C., 1985, c. B-3.

Business Corporations Act, R.S.O. 1990, c. B.16.

Business Corporations Act, 1982, S.O. 1982, c. 4, s. 134(1)(*b*).

Canada Business Corporations Act, R.S.C., 1985, c. C-44 , s. 122(1)(*b*).

Company Act, R.S.B.C. 1979, c. 59, s. 142(1)(b).

Digitized by Google

Income Tax Act, S.C. 1970-71-72, c. 63, ss. 153(1) (as am. by S.C. 1980-81-82-83, c. 140, s. 104; 1985, c.
45, s. 87; 1987, c. 46, s. 51), 159(2) (as am. by S.C. 1985, c. 45, s. 90), 227(5) (as am. by S.C. 1986, c. 6, s.
118; 1988, c. 55, s. 171), 227.1 (as enacted by S.C. 1980-81-82-83, c. 140, s. 124; 1984, c. 1, s. 100; 1988,
c. 55, s. 172), 242.

cases judicially considered applied:

City Equitable Fire Insurance Co., In re, [1925] Ch. 407 (C.A.). distinguished:

Sanford v. R., reflex, [1996] 1 C.T.C. 2016 (T.C.C.).

considered:

Barnett (JV) v MNR, reflex, [1985] 2 CTC 2336; (1985), 85 DTC 619 (T.C.C); *Fraser (Trustee of) v. M.N.R.* reflex, (1987), 37 B.L.R. 309; 64 C.B.R. (N.S.) 58; reflex, [1987] 1 C.T.C. 2311; 87 DTC 250 (T.C.C.); *Stevenson Estate v. Canada*, [1996] T.C.J. No. 1599 (QL); *Byrt (H.) v. M.N.R.*,reflex, [1991] 2 C.T.C. 2174; (1991), 91 DTC 923 (T.C.C.); *Golfman (W.R.) v. M.N.R.*, reflex, [1990] 2 C.T.C. 2344; (1990), 90 DTC 1863 (T.C.C.); *Davies (J.W.) v. Canada*, reflex, [1994] 1 C.T.C. 2744; (1994), 94 DTC 1716 (T.C.C.).

referred to:

White (J.) v. M.N.R., reflex, [1990] 2 C.T.C. 2566; (1990), 91 DTC 54 (T.C.C.); *Cybulski v. M.N.R.* reflex, (1988), 39 B.L.R. 255; [1988] 2 C.T.C. 2180; 88 DTC 1531 (T.C.C.); *Lalonde (R) v MNR*, [1982] CTC 2749; (1982), 82 DTC 1772 (T.R.B.); *Dixon v. Deacon Morgan McEwen Easson*reflex, (1989), 41 B.C.L.R. (2d) 180 (S.C.); *Denham & Co., In re* (1883), 25 Ch.D. 752 (C.A.); *Cardiff Savings Bank, In re. Bute's (Marquis of) Case*,[1892] 2 Ch. 100; *McCandless (M.W.) v. Canada*, reflex, [1995] 2 C.T.C. 2111; (1995), 95 DTC 484
(T.C.C.); *Kerr v. Law Profession Indemnity Co.*(1994), 22 C.C.L.I. (2d) 28 (Ont. Gen. Div.); *Quantz (C.) v. M.N.R.*, reflex, [1988] 1 C.T.C. 2276; (1988), 88 DTC 2276 (T.C.C.); *Beutler (O.) v. M.N.R.*, reflex, [1988] 1 C.T.C. 2414; (1988), 88 DTC 1286 (T.C.C.); *Bianco v. Minister of National Revenue* reflex, (1991), 2 B.L.R. (2d) 255; [1991] 2 C.T.C. 2449; 91 DTC 1370 (T.C.C.); *Edmondson (S.G.) v. M.N.R.*, reflex, [1988] 2 C.T.C. 2185; (1988), 88 DTC 1542 (T.C.C.); *Shindle (B.) v. Canada*, reflex, [1995] 2 C.T.C. 227; (1995), 95 DTC 5502 (F.C.T.D.); *Snow v. Minister of National Revenue* reflex, (1991), 38 C.C.E.L. 70; [1991] 2 C.T.C. 2198; 91 DTC 832 (T.C.C.); *Fitzgerald (G.) v. M.N.R.*, reflex, [1991] 2 C.T.C. 2595; (1991), 92 DTC 1019 (T.C.C.).

authors cited

Campbell, R. Lynn. "Director's Liability for Unremitted Employee Deductions" (1993), 14 *Adv. Q.* 453. Campbell, R. Lynn. "The Fiduciary Duties of Corporate Directors: Exploring New Avenues" (1988), 36 *Can. Tax J.* 912.

Canada. Department of National Revenue. Taxation. Information Circular No. 89-2. "Directors' Liability" Section 227.1 of the Income Tax Act" (May 1, 1989).

Côté, Pierre-André. *The Interpretation of Legislation in Canada*, 2nd ed., Cowansville (Qué.): Les Éditions Yvon Blais Inc., 1991.

Gower, L.C.B. *The Principles of Modern Company Law*, 3rd ed. London: Stevens & Sons, 1969.

Iacobucci, Frank *et al. Canadian Business Corporations: An Analysis of Recent Legislative Developments*. Agincourt, Ont.: Canada Law Book, 1977.

Krishna, Vern. *The Fundamentals of Canadian Income Tax*, 5th ed. Toronto: Carswell, 1995.

Kroft, Edwin G. "The Liability of Directors for Unpaid Canadian Taxes" in *Report of Proceedings of the Thirty- seventh Tax Conference, 1985* . Toronto: Canadian Tax Foundation, 1986, p. 30:1.

Linden, Allen M. *Canadian Tort Law*, 5th ed. Toronto: Butterworths, 1993.

Digitized by Google

Moskowitz, Evelyn P. "Directors' Liability Under Income Tax Legislation and Other Related Statutes" (1990), 38 *Can. Tax J.* 537.
Ontario. Legislative Assembly. *Interim Report of the Select Committee on Company Law*. Toronto: Queen's Printer, 1967. (Chairman: Allan F. Lawrence).
Welling, Bruce L. *Corporate Law in Canada: The Governing Principles*, 2nd ed. Toronto: Butterworths, 1991. Ziegel, Jacob S. *Cases and Materials on Partnerships and Canadian Business Corporations*, Vol. 1, 3rd ed. Toronto: Carswell, 1994.
APPEAL from the Tax Court decision holding that the taxpayer, a corporate director, had failed to satisfy the "due diligence" defence to liability for the amount of unremitted taxes withheld from employees' salaries set out in *Income Tax Act* , subsection 227.1(3) (*Soper (N.) v. Canada*, reflex, [1995] 2 C.T.C. 2078; (1995), 96 DTC 2046 (T.C.C.)). Appeal dismissed.
counsel:
Henry C. Wood for appellant. *Patricia A. Babcock* for respondent. solicitors:
Epstein Wood & Company, Vancouver, for appellant.
Deputy Attorney General of Canada for respondent.

The following are the reasons for judgment rendered in English by
Marceau J.A.:
I have had the advantage of reading, in draft, the reasons for judgment prepared by my brother Robertson. I am in complete agreement with his conclusion and disposition of the appeal. On the whole, I do not dissociate myself from the reasons he gives. His analysis of the duty of care, diligence and skill imposed by subsection 227.1(3) of the *Income Tax Act* [S.C. 1970-71-72, c. 63 (as enacted by S.C. 1980-81-82-83, c. 140, s. 124)] was, in view of the apparent lack of consistency in the jurisprudence, quite appropriate and welcome. I wish to say, however, that I based my conclusion on much simpler reasoning.
Subsection 227.1(1) [as enacted *idem*; S.C. 1984, c. 1, s. 100] makes a director liable for the failure of his or her corporation to remit the monies withheld as taxes and other source deductions from its employees' salaries, and subsection 227.1(3) relieves a director of his or her liability if he or she can show that he or she exercised a certain degree of care, diligence and skill to prevent such failure. By these provisions, Parliament, I think, has imposed on a director of a corporation a completely new, separate and positive duty. Such duty is owed not to the corporation but to the Crown, and consists of an obligation to do what one reasonably can to prevent such failure from occurring. I simply cannot imagine that such a duty may ever be seen as having been fulfilled by a director who, as here, has never put his or her mind to the requirement and has remained completely uninterested and passive with respect to it.
I, too, would dispose of the appeal as suggested by Mr. Justice Robertson.

The following are the reasons for judgment rendered in English by
Robertson J.A.: Subsection 153(1) [as am. by S.C. 1980-81-82-83, c. 140, s. 104; 1985, c. 45, s. 87; 1987, c. 46, s. 51] of the *Income Tax Act* (the Act) imposes a duty on corporations to withhold taxes and other source deductions from an employee's salary and to remit such amounts to the Receiver General of Canada. Subsection 227.1(1) of the Act makes a corporation liable for unremitted amounts while at the same time imposing joint and several liability on its directors. However, that obligation is tempered by subsection 227.1(3) which enables corporate directors to escape liability for non-remittance if they can establish that they "exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."
This is an appeal from a decision of the Tax Court of Canada [reflex, [1995] 2 C.T.C. 2078]

Digitized by Google

holding that the appellant taxpayer failed to satisfy the so-called "due diligence defence" set out in subsection 227.1(3). Specifically, this Court is asked to consider and reconcile the allegedly inconsistent jurisprudence of the Tax Court. While it is at least arguable that such a conflict in the authorities might be more imagined than real, it is indisputable that the underlying question of the standard of care, diligence and skill to be exercised by a corporate director in the performance of his or her duties has been largely ignored. These reasons will address that fundamental issue.

FACTS

In October of 1987 the appellant taxpayer, an experienced businessman, became a director of Ramona Beauchamp International (1976) Inc. (hereinafter RBI) at the instigation of Ramona Beauchamp for two purposes: first, to promote RBI's interests in the marketplace and, second, to lend his name and reputation in conjunction with a proposed listing of RBI on the Vancouver Stock Exchange. At the relevant time the taxpayer was the chief operating officer of Canada-Wide Magazines. RBI operated a talent agency and a modelling school.

At the time the taxpayer joined the Board of Directors of RBI, he knew that it was experiencing financial difficulties. At the November 1987 meeting of the Board he was given a copy of the balance sheet of RBI which, as of 30 September 1987, showed a net loss of $132,000. At no time did any employee or Board member of RBI discuss with the taxpayer the failure of RBI to make certain tax remittances as required under the Act. Ramona Beauchamp, a co-director, had instructed the other directors of RBI not to discuss with the taxpayer anything other than that which was dealt with at directors' meetings attended by the taxpayer. RBI's failure to remit source deductions to the Department of National Revenue was never raised at any Board meeting. At no time did the taxpayer inquire as to whether RBI was complying with its remittance obligations under the Act. The taxpayer remained a director of RBI from October 1987 until his resignation became effective on 10 February 1988. (Although the Minister asserts at paragraph 4 of his memorandum of fact and law that the taxpayer became a director in June of 1987, the Tax Court Judge's finding on this matter has not been questioned on appeal.)

Pursuant to subsection 227.1(1) of the Act, the taxpayer was assessed as a director for unremitted employee withholdings of RBI, plus interest and penalties in the amount of $13,009.04 for the period October 1987 to January 1988. The taxpayer appealed that assessment to the Tax Court of Canada under the general procedure. After rejecting the taxpayer's argument based on his limited role in RBI, an issue abandoned on this appeal, the Tax Court Judge went on to hold that in the circumstances the statutory defence of due diligence was not available to the taxpayer. In the opinion of the Judge below, the fact that the taxpayer knew of RBI's financial difficulties at the time he accepted the directorship coupled with the fact that he took no steps to ensure remittance was a sufficient basis upon which to conclude that the taxpayer had failed "to exercise the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."

ISSUES

It is often said that the requisite degree of care, skill and diligence to be exercised by a given director in the performance of his or her duties is to be determined as a "question of fact". Such an approach, while perhaps superficially attractive, oversimplifies the problem by failing to recognize that it is first necessary to establish the applicable standard of care. In turn, the pivotal issue is whether the statutory standard involves a subjective element, in the sense that the personal knowledge and background of a director is a relevant

Digitized by Google

consideration, or whether the standard is an entirely objective one, to which all directors would be similarly held. When the issue is placed in this perspective, it is not difficult to understand what has been occurring in the Tax Court of Canada. As a general observation, a majority of judges of that Court have adopted the subjective standard, albeit by implication only. In but a few cases has that standard been rejected: e.g. *White (J.) v. M.N.R.*, reflex, [1990] 2 C.T.C. 2566 (T.C.C.). Moreover, there are a number of cases where the imposition of directors' liability is justified regardless of which standard is chosen. Thus, perhaps the only conflict that truly exists is in the articulation of the proper standard: see *Cybulski v. M.N.R.* reflex, (1988), 39
B.L.R. 255 (T.C.C.), and compare with *Barnett (JV) v MNR*, reflex, [1985] 2 CTC 2336 (T.C.C.). In the end, a measure of consistency has been achieved, if only by virtue of the fact that the judicial qualities of common sense and fairness have filled the gap left by the absence of a precise explanation of the due diligence defence as articulated in subsection 227.1(3).

As the subjective standard has its roots in the common law, my analysis will focus on the seminal decision in this area before turning to the basic question of whether and to what extent that standard has been modified by subsection 227.1(3) of the Act. As that provision is a mirror image of the standard imposed on directors under the *Canada Business Corporations Act* (the CBCA), R.S.C., 1985, c. C-44, and in light of the statutory presumption of coherence between statutes, it remains to determine Parliament's intent. In the reasons that follow, I conclude that the federal legislation includes an objective component but largely adopts the common law position to the extent that the former recognizes the subjective element. It is instructive, however, to begin with an overview of the circumstances giving rise to the adoption of the director liability provisions and the due diligence defence set out in section 227.1 of the *Income Tax Act*.

LEGISLATIVE HISTORY AND FRAMEWORK

Prior to the coming into force of section 227.1 of the Act, the Department of National Revenue faced two related but distinct problems. The first was the non-payment of corporate taxes *per se* and the second was the non-remittance of taxes that were to be withheld at source on behalf of a third party (e.g. employees). The 1981 recession exacerbated both of these problems. As companies experienced difficult financial times, corporations and directors actively and knowingly sought to avoid the payment of taxes in a variety of ways. For example, some companies allowed themselves to be stripped of their assets by a related entity, and left with an uncollectable "I.O.U.", with the result that the Crown's claim for unpaid corporate taxes could not be satisfied. Yet other corporations that were short of capital "sold" their unused investment tax credits or scientific research deductions with little concern for whether the company would subsequently be able to fulfill its obligations under the Act. Non-remittance of taxes withheld on behalf of a third party was likewise not uncommon during the recession. Faced with a choice between remitting such amounts to the Crown or drawing on such amounts to pay key creditors whose goods or services were necessary to the continued operation of the business, corporate directors often followed the latter course. Such patent abuse and mismanagement on the part of directors constituted the "mischief" at which section 227.1 was directed: see E. G. Kroft, "The Liability of Directors for Unpaid Canadian Taxes," in *Report of Proceedings of the Thirty- seventh Tax Conference , 1985* (Toronto: Canadian Tax Foundation, 1986) 30:1, at pages 30:1-30:3, 30:14- 30:15; see also E. P. Moskowitz, "Directors' Liability Under Income Tax Legislation and Other Related Statutes" (1990), 38 *Can. Tax J.* 537, at pages 539-541.

Before the introduction of section 227.1, the means available to the Department for the

Digitized by Google

collection, from directors personally, of amounts owing to the Crown were limited and inadequate. Subsection 159(2) [as am. by S.C. 1985, c. 45, s. 90] of the Act alone imposed personal liability on a director for corporate tax arrears only if a director acting in the capacity of a liquidator or a trustee distributed corporate property before obtaining the requisite tax clearance certificate. In addition to such civil liability, a director was (and still is) subject to criminal liability for corporate tax arrears pursuant to section 242 of the Act if that director "directed, authorized, assented to, acquiesced in, or participated in" the company's commission of an offence under the Act. However, in light of the difficulty of meeting the *mens rea* requirement of section 242, few directorial convictions under that provision have been secured.

It was against this background that efforts were made to facilitate the Department's collection process by broadening directors' exposure to personal liability. The draft legislation, made public in June of 1982, which was a precursor to section 227.1 imposed absolute liability on directors for amounts that the corporation failed to deduct or remit on behalf of a third party as required by the Act. Notably, as originally enacted, section 227.1 did not impose liability for a failure to pay Part VII or Part VIII corporate tax. That development came later by way of amendment to subsection 227.1(1) in 1984: see S.C. 1984, c. 1, section 100, applicable to 1983 and subsequent taxation years.

As noted above, section 227.1 was originally drafted as an absolute liability provision. It was only following a policy review undertaken in September of 1982 by the Department of Finance, in conjunction with the drafting process, that the "due diligence defence" set out in the current subsection 227.1(3) was introduced and the harsh character of the proposed legislation tempered.

In 1989, when the Minister assessed the taxpayer in this case, section 227.1 [as enacted by S.C. 1980-81- 82-83, c. 140, s. 124; 1984, c. 1, s. 100; 1988, c. 55, s. 172)] read in full as follows:

227.1 (1) Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally liable, together with the corporation, to pay that amount and any interest or penalties relating thereto.

A director is not liable under subsection (1), unless

a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court of Canada under section 223 and execution for such amount has been returned unsatisfied in whole or in part;

the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the earlier of the date of the commencement of the proceedings and the date of dissolution; or

the corporation has made an assignment or a receiving order has been made against it under the *Bankruptcy Act* and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the date of the assignment or receiving order.

A director is not liable for a failure under subsection (1) where he exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

No action or proceedings to recover any amount payable by a director of a corporation under subsection (1) shall be commenced more than two years after he last ceased to be a director of that corporation.

Digitized by Google

Where execution referred to in paragraph (2)(*a*) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

Where a director pays an amount in respect of a corporation's liability referred to in subsection (1) that is proved in liquidation, dissolution or bankruptcy proceedings, he is entitled to any preference that Her Majesty in right of Canada would have been entitled to had such amount not been so paid and, where a certificate that relates to such amount has been registered, he is entitled to an assignment of the certificate to the extent of his payment, which assignment the Minister is hereby empowered to make.

A director who has satisfied a claim under this section is entitled to contribution from the other directors who were liable for the claim.

Subsection 227.1(1) thus provides that directors may be held personally liable for the corporation's failure to withhold and remit certain amounts to the Receiver General of Canada. However, the Minister cannot successfully rely upon subsection (1) for recovery of amounts owing unless a series of preconditions are satisfied. Subsection 227.1(2), for example, shields a director from personal liability unless one of the following circumstances arises:

A certificate for the amount of the corporate tax liability has been registered in the Federal Court and execution thereof has been partially or wholly unsatisfied;

The corporation has commenced proceedings for liquidation or dissolution and a claim for the amount of the corporate tax liability is proved within six months after commencement of such proceedings; or

The corporation has made an assignment (or had a receiving order made against it) under the *Bankruptcy Act* [R.S.C., 1985, c. B-3] and a claim for the amount of the corporate tax liability is proved within six months after the date of the assignment or receiving order.

See V. Krishna, *The Fundamentals of Canadian Income Tax*, 5th ed. (Toronto: Carswell, 1995), at pages 1111-1112; see also Information Circular No. 89-2, "Directors' Liability" Section 227.1 of the Income Tax Act" (1 May 1989).

Moreover, pursuant to subsection 227.1(4), the Minister is not entitled to invoke subsection 227.1(1) unless he commences proceedings thereunder within two years of the date that the defendant director ceased to hold that corporate position. Finally and most importantly, for our purposes, subsection 227.1(3) states that a director is not liable under subsection (1) if he or she "exercised the degree of care, diligence and skill to prevent the failure [to deduct, withhold or remit] that a reasonably prudent person would have exercised in comparable circumstances."

During the course of oral argument, a question arose as to whether a finding of director liability might somehow impact negatively upon an employee's liability to pay tax, the inference being that if a director is exonerated then perhaps an employee might somehow be required to provide the funds notionally deducted and still owing to Her Majesty. As I understand the current statutory regime, employees are not held personally liable in the event that a company fails to remit deductions purportedly withheld at source: see *Lalonde (R) v MNR*, [1982] CTC 2749 (T.R.B.). Employees are entitled to apply amounts purportedly deducted at source "as a credit against their taxes payable," whether deducted or not (Moskowitz, *supra* , at page 550). Of course, Parliament could have opted to treat employees in a less generous fashion. Prior to the enactment of section 227.1, however, the departments of Finance and National Revenue had specifically considered and rejected such a course as an alternative to that provision: see Kroft, *supra*, at page 30:13. In short, the issue of director liability under section 227.1 is irrelevant to the question of employee liability for unremitted source deductions.

THE STANDARD OF CARE

Digitized by Google

The starting point for an analysis of the common law duty of care is the seminal judgment of Romer J. in *City Equitable Fire Insurance Co., In re*, [1925] Ch. 407 (C.A.). In that case, an investigation undertaken upon winding up of the company revealed a shortage of funds determined to be largely attributable to fraud on the part of the managing director. Although the other corporate directors were not party to that fraudulent action the Official Receiver, as liquidator, sought to hold them liable for the loss on the basis that they were in a position to prevent the fraud and should have done so. Romer J. found that the other directors had breached their duty of care but further held that an indemnification clause in the company's articles of association prevented the Official Receiver from recovering the missing funds from them. In coming to that conclusion, Romer J. framed in the following terms the minimum standard of care, diligence and skill required of directors by the common law (at pages 426-429):

It has sometimes been said that directors are trustees. If this means no more than that directors in the performance of their duties stand in a fiduciary relationship to the company, the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are, it appears to me to be wholly misleading. I can see but little resemblance between the duties of a director and the duties of a trustee of a will or of a marriage settlement. It is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise . . . . The larger the business carried on by the company the more numerous, and the more important, the matters that must of necessity be left to the managers, the accountants and the rest of the staff. The manner in which the work of the company is to be distributed between the board of directors and the staff is in truth a business matter to be decided on business lines . . . .

In order, therefore, to ascertain the duties that a person appointed to the board of an established company undertakes to perform, it is necessary to consider not only the nature of the company's business, but also the manner in which the work of the company is in fact distributed between the directors and the other officials of the company, provided always that this distribution is a reasonable one in the circumstances, and is not inconsistent with any express provisions of the articles of association. In discharging the duties of his position thus ascertained a director must, of course, act honestly; but he must also exercise some degree of both skill and diligence.

. . .

. . . (1.) A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience . . . . In the words of Lindley M.R.: "If directors act within their powers, if they act with such care as is reasonably to be expected from them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent, they discharge both their equitable as well as their legal duty to the company": see *Lagunas Nitrate Co.* v. *Lagunas Syndicate*. It is perhaps only another way of stating the same proposition to say that directors are not liable for mere errors of judgment. (2.) A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so. (3.) In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly. [For a good review of the common law, see *Dixon v. Deacon Morgan McEwen Easson* reflex, (1989), 41 B.C.L.R. (2d) 180 (S.C.), *per* Bouck J.]

The above quotes reveal a plethora of legal propositions. For purposes of this analysis, I

Digitized by Google

confine myself to the following.

First, it is clear that directors are not to be equated with trustees. As Gower points out, directors are agents of the company rather than its trustees: see L. C. B. Gower, *The Principles of Modern Company Law*, 3rd ed. (London: Stevens & Sons, 1969), at page 516. But as agents, directors stand in a fiduciary relationship to their principal, the company. Admittedly, to the extent that a fiduciary is under a duty to act, for example, in good faith so too is a trustee and, thus, in this limited sense the comparison of a director and a trustee has validity. The analogy breaks down, however, when consideration is given to the duties of care and skill.

Notwithstanding the fact that the director/trustee analogy is generally inappropriate in the corporate context, during the course of oral argument, attention focused on the fact that subsection 227(5) [as am. by S.C. 1988, c. 55, s. 171] of the Act deems amounts deducted or withheld to be held in trust, irrespective of whether the funds deducted or withheld under the Act were actually so segregated. The inference to be drawn was that that provision somehow cloaks a director with the cape of a trustee. In my view, the inference is without legal foundation once regard is had to the true purpose underlying subsection 227(5). The purpose of that subsection is to enable the Minister to allege priority over competing creditors in the event that a corporation is no longer able to meet its continuing fiscal obligations. At this point, a brief explanation is required.

At the time of enactment of section 227.1, subsection 227(5) as it then read dictated that all amounts deducted or withheld under the Act be kept in a separate trust account. In 1986, that requirement was repealed and replaced by a provision which deemed amounts deducted or withheld after 23 May 1985 to be "held in trust . . . separate . . . and apart from the [corporation's] own moneys" irrespective of whether the funds deducted or withheld under the Act were actually so segregated: see S.C. 1986, c. 6, subsection 118(1). The reenactment of subsection 227(5) was apparently motivated by a desire to ameliorate the Department's position vis-à-vis other secured creditors by dispensing with the perceived need for "tracing" funds caused by the original provision in order to establish priority: see Kroft, *supra* , at page 30:5, note 22. While the new deeming provision seeks to ensure that the Crown no longer suffers from the perceived disadvantage of having to trace monies back to an actual trust account, the trust character of source deductions was preserved. It is my understanding that without some sort of trust, the Crown is of the opinion that it would have even greater difficulty establishing the priority of its claim over others. In the circumstances, I do not think it can be reasonably argued that subsection 227(5) reflects Parliament's intent with respect to the statutory standard of care set out in subsection 227.1(3).

The reality is that employers do not actually set aside funds relating to source deductions every time an employee is issued a pay cheque. The withholding of source deductions is a notional concept which does not materialize until the obligation to remit actually arises. In respect of amounts which are notionally withheld from an employee's salary pursuant to subsection 153(1), the regulations under the Act prescribe that remittance must take place within fifteen days of the end of the month in which the withholding occurred. That is a minimum requirement and more frequent remittance is prescribed where average monthly withholdings exceed $15,000.

At least one commentator has suggested that the amendment to abolish the need to establish a separate trust account has the practical effect of lowering the level of diligence that the Act requires of directors in relation to employee withholdings: see R. L. Campbell, "The Fiduciary Duties of Corporate Directors: Exploring New Avenues" (1988), 36 *Can. Tax J.* 912. For purposes of this appeal, it is sufficient that I conclude that subsection 227(5) does not raise the standard of care to the trustee threshold. I return

Digitized by Google

now to some of the other legal propositions established in *City Equitable*.

The second proposition that I wish to discuss is the following: a director need not exhibit in the performance of his or her duties a greater degree of skill and care than may reasonably be expected from a person of his or her knowledge and experience. Thus, the standard of care is partly objective (the standard of the reasonable person), and partly subjective in that the reasonable person is judged on the basis that he or she has the knowledge and experience of the particular individual. It is a hybrid "objective subjective standard". The English courts, true to their aristocratic traditions, appear to have been unwilling to hold directors to a higher standard of account, namely the objective one, for a pragmatic reason: "the facts are that until recently the possession of a title was often regarded as a greater qualification for office than any amount of business acumen and drive, and that the ordinary part-time director was only expected to display such skill (if any) as he happened to possess, and such attention to duty as he thought fit to offer" (Gower, *supra* , at pages 549-550).

Third, a director is not obliged to give continuous attention to the affairs of the company, nor is he or she even bound to attend all meetings of the board. However when, in the circumstances, it is reasonably possible to attend such meetings, a director ought to do so. Subsequent English cases, though, went to more of an extreme, permitting a director to avoid liability despite having missed all board meetings for a period of several years: see e.g. *Denham & Co., In re* (1883), 25 Ch.D. 752 (C.A.); see also *Cardiff Savings Bank, In re. Bute's (Marquis of) Case*, [1892] 2 Ch. 100. Notwithstanding such authorities, it would be silly to pretend that the common law would stand still and permit directors to adhere to a standard of total passivity and irresponsibility. At the risk of getting ahead of myself, it should be noted here that the law today can scarcely be said to embrace the principle that the less a director does or knows or cares, the less likely it is that he or she will be held liable. Further to this point, the statutory standard of care will surely be interpreted and applied in a manner which encourages responsibility. Accordingly, the director who acts irresponsibly, for example, by failing to attend all board meetings now does so at his own peril: see *McCandless (M.W.) v. Canada*, reflex, [1995] 2 C.T.C. 2111 (T.C.C.). That being said, the matter of director passivity will have to be reevaluated in light of the statutory standard discussed below.

Fourth, in the absence of grounds for suspicion, it is not improper for a director to rely on company officials to perform honestly duties that have been properly delegated to them. Further to this point, it is the exigencies of business and the company's articles of association that, together, will determine whether it is appropriate to delegate a duty. The larger the business, for instance, the greater will be the need to delegate.

Those who argue in favour of a subjective standard of care, as established at common law, cite the difficulties associated with formulating and applying an objective standard by which to judge the conduct of all directors. B. L. Welling explains the problem in the following terms in *Corporate Law in Canada: The Governing Principles*, 2nd ed. (Toronto: Butterworths, 1991), at pages 329-330:

. . . few minimum qualifications are required to be a corporate director whereas most identifiable professional groups share among them some minimum entry standards; in addition, directors are required to exercise business judgment and to take business risks varying from extreme conservativism to out-and-out speculation. The combination of these two factors made it difficult for judges and legislators to articulate a minimum standard of competence applicable to all managers in all situations.

Notwithstanding these arguments based on both the absence of stringent pre-requisites for becoming a director and the nature of that office which involves the exercise of business judgment, the question of whether the standard of care should be "upgraded"

Digitized by Google

and if so, to what extent, has long been a subject of debate: see e.g. F. Iacobucci *et al.*, *Canadian Business Corporations: An Analysis of Recent Legislative Developments* (Agincourt, Ontario: Canada Law Book Ltd., 1977), at pages 291-293.

The question I must address is whether the standard of care formulated in *City Equitable* has been upgraded pursuant to subsection 227.1(3) of the Act. For purposes of deciding this appeal, that question may be recast more precisely as follows: has the subjective element of the common law standard been eliminated or reduced by statute? In other words, has the largely subjective standard been "objectified"? Recall that subsection 227.1(3) reads thus:

227.1 . . .

(3) A director is not liable for a failure under subsection (1) where he exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

Interestingly, the wording of that provision is virtually identical to the language used in paragraph 122(1)(*b*) of the *Canada Business Corporations Act* which sets out, for purposes of corporate law, the following general standard of care to be exercised by directors:

122. (1) Every director and officer of a corporation in exercising his powers and discharging his duties shall

. . .

(*b*) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Notably, the statutory phrase "care, diligence and skill" reflects the language of the *City Equitable* case. It is also noteworthy that a number of provinces have corporate legislation containing a provision which mirrors in all material respects paragraph 122(1)(*b*) of the CBCA: see e.g. the Ontario *Business Corporations Act*, *1982* (the OBCA), S.O. 1982, c. 4, s. 134(1)(*b*); but compare the British Columbia *Company Act* (the BCCA), R.S.B.C. 1979, c. 59, s. 142(1)(b), which does not contain the phrase "in comparable circumstances".

In my view, it is not simply a fortuitous occurrence that subsection 227.1(3) of the *Income Tax Act* adopts the same language as found in paragraph 122(1)(*b*) of the *Canada Business Corporations Act*, for both statutory provisions relate to the standard of care to be exercised. Admittedly, the CBCA provision deals with the standard of care owed to the corporation while the taxation provision concerns the standard of care owed to the Crown and Canadian taxpayers. However, that distinction does not serve to nullify the relevance of the standard set out in the CBCA, if only because of the presumption of coherence between statutes. That elementary principle of statutory interpretation is explained by P.-A. Côté in *The Interpretation of Legislation in Canada*, 2nd ed. (Cowansville, Quebec: Les Éditions Yvon Blais Inc., 1991), at pages 288 and 290:

Different enactments of the same legislature are supposedly as consistent as the provisions of a single enactment. All legislation of one Parliament is deemed to make up a coherent system. Thus, interpretations favouring harmony between statutes should prevail over discordant ones, because the former are presumed to better represent the thought of the legislator.

This presumption of coherence in enactments of the same legislature is even stronger when they relate to the same subject matter, *in pari materia*. Apparent conflicts between statutes should be resolved in such a way as to re-establish the desired harmony.

. . .

To sum up, the presumption of coherence in related legislation applies particularly to statutes of the same legislature. But it is also relevant to statutes of different jurisdictions, as one legislature may be deemed to imitate the form or be consistent with the substance of a

Digitized by Google

statute enacted by another.

Thus, in order to determine whether the common law standard of care was modified by statute, it is both appropriate and instructive to consider not only the due diligence provision set out at subsection 227.1(3) of the *Income Tax Act* but also the analogous, and virtually identical, standard of care provisions found in the *Canada Business Corporations Act*.

The question of the extent to which the common law standard might have been "upgraded" by these statutes has been questioned by academics and practitioners alike. Some commentators are of the view that, far from effecting a significant modification of the common law standard of care, the relevant legislative provisions established only a slightly more onerous regime than previously existed and one that retains much of its original, subjective character: see e.g. Welling, *supra* , at page 332. I am in general agreement with that assessment, keeping in mind my earlier comments with respect to director passivity (see discussion *supra*, at page 146). I begin my analysis by considering each of the statutory standard's constituent elements in turn, namely: skill, care and diligence.

Federal company law dictates that a director must "exercise the . . . skill that a reasonably prudent person would exercise in comparable circumstances." By comparison, at common law a director was required to exercise only that degree of skill which could reasonably be expected from a person of his or her knowledge and experience. It has been suggested that the statutory skill criterion is essentially the same as the common law requirement: see Welling, *supra* , at page 333; see also Kroft, *supra*, at pages 30:42-30:43. In reaching that conclusion, those commentators point to the use of the phrase "in comparable circumstances" and, in conjunction therewith, note that a reasonably prudent person might not be at all skilled in the field of corporate management. Put differently, a reasonably prudent person in comparable circumstances may be, for example, an unskilled person. In my view, it is correct to distinguish in this way between a reasonably prudent person and a reasonably skilled person so as to conclude that the subjective element of the common law standard of skill has not been altered by federal statute.

With respect to the duty of care, the *Canada Business Corporations Act* calls upon a director to "exercise the care . . . that a reasonably prudent person would exercise in comparable circumstances." Once again, however, the statutory enactment of a care requirement does not appear to have altered the common law position that a director be expected to fulfill his or her duties with care by acting reasonably according to the knowledge and experience that he or she actually possessed: see Welling, *supra* , at page 333. Put differently, the relevant legislation does not refer to "a reasonably skilled person" who, presumably, would be deemed to possess a certain level of skill in relation to corporate management. Rather, the statute speaks of a reasonably prudent person and the care that that person would exercise in comparable circumstances. Hence, in the event that the reasonably prudent person is unskilled (which possibility is discussed above), the statute requires only the exercise of a degree of care which is commensurate with that person's level of skill. It is in this manner that skill and care are clearly interconnected. That being said, it is worth emphasizing that it is insufficient for a director to assert simply that he or she did his or her best if, having regard to that individual's level of skill and business experience, he or she failed to act reasonably prudently. I turn now to the third and final element of the standard"diligence.

Upon reflection, it seems arguable to me that the term "diligence" is synonymous with the term "care". That is, diligence is simply the degree of attention or care expected of a person in a given situation. At least, that is the way the term is employed in *City Equitable* . If attention to one's obligations is the essence of diligence, then that aspect of the standard neither adds to nor detracts from the statutory statement in subsection 227.1(3) of the

Digitized by Google

Income Tax Act. Others, however, have taken a different approach by contending not only that diligence is an independent element of the statutory standard but also that that requirement, unlike the statutory requirements for skill and care, is more onerous than at common law: see Welling, *supra*, at pages 333-334; see also the Ontario case of *Kerr v. Law Profession Indemnity Co.* (1994), 22 C.C.L.I. (2d) 28 (Ont. Gen. Div.), which deals with the Ontario *Business Corporations Act* [R.S.O. 1990, c. B.16].

Professor Welling posits that the reasonably prudent person serving as a director would surely exercise diligence in attending to his or her duties; a skilled individual should use his or her skills to perform said duties while an unskilled individual should obtain "competent outside advice" in respect of same (*supra* , at page 334). I am reluctant to embrace that analysis unreservedly. Even if a director is unskilled, I fail to see why he or she should not be entitled to rely, as contemplated in *City Equitable*, on advice provided by officials inside the corporation"unless the circumstances are such that the reasonably prudent but unskilled person acting as a director would seek outside advice. If Professor Welling intended his comments on outside advice to apply only to the latter set of circumstances, then there is no disagreement between us. In any event, for purposes of deciding this appeal, I need not attempt to delimit the precise boundaries of the diligence requirement.

In my opinion, it is not surprising that federal legislation has retained the subjective element of the common law standard of care for directors. Even the law of tort adjusts its objective standard of the reasonable person downward so as to account, for example, for the age, experience and intelligence of children. The standard may also be adjusted upward, as it is for professionals: see generally A. M. Linden, *Canadian Tort Law*, 5th ed. (Toronto: Butterworths, 1993), at chapter 5, section B, beginning at page 117. The reasonable person standard is thus hardly inflexible. It adjusts to the circumstances and to the individual qualities of the actor. This is all the more true in the context of federal company or taxation law where that standard, at least as it applies to directors' duties, is explicitly modified by the phrase "in comparable circumstances."

The legislative history of the Ontario *Business Corporations Act*, whose standard of care provisions are virtually identical to those found in the CBCA, supports my conclusion that the common law standard of care, while altered slightly, has not been significantly upgraded by statute. Notably, the *Interim Report of the Select Committee on Company Law* (1967) (the Lawrence Report) recommended a legal standard of conduct for Ontario directors that was framed in the following terms (at paragraph 7.2.3):

"Every director of a company shall exercise the powers and discharge the duties of his office honestly, in good faith and in the best interests of the company, and in connection therewith shall exercise that degree of care, diligence and skill which a reasonably prudent director would exercise in comparable circumstances." [Underlining added.]

The intent of the Committee, in suggesting the words that it did, was clearly to upgrade to a professional level the legal standards for directors imposed at common law: see the Lawrence Report, *supra*, at paragraphs 7.2.2 and 7.2.3. However, the original draft provision met with opposition and the Ontario legislature ultimately adopted a different standard, that of the reasonably prudent person. The standard set out in the enacted provision also contained the phrase "in comparable circumstances".

It was in the wake of a concerted lobbying effort by the corporate bar that the word "person" was ultimately inserted in place of the term "director" in the Ontario*Business Corporations Act* . The essence of the corporate bar's position is captured neatly by J. S. Ziegel *et al.*, Vol. 1, *Cases and Materials on Partnerships and Canadian Business Corporations*, 3rd ed. (Toronto: Carswell, 1994), at pages 474-475:

The concern expressed was that a professional standard could result in liability for a wide

Digitized by Google

group of individuals who serve as directors, ranging from the wife of the majority shareholder in a small company to a prominent chief executive officer of a public company who, because of his prominence, serves on the board to five other public companies.

By abandoning a professional standard for directors, the legislature presumably was signalling to that "wide group of individuals who serve as directors" that they could rest easy since the statutory standard in Ontario was not intended to seriously alter the common law. The reality is that courts have to contend with a wide variety of corporate forms. Bluntly stated, the vast majority of Canadian corporations do not issue shares which trade on the various stock exchanges. The "ma and pa" operation is as much a part of the business fabric of the country as are the enterprises controlled from Bay Street.

Since the language of the *Canada Business Corporations Act* mirrors that of the OBCA, it seems logical to infer that the federal Parliament intended to send out the very same message to existing and potential directors. In any event, had Parliament wished to strengthen the standard of care imposed at common law, it could have easily done so by adopting appropriate language. In this regard, it is helpful to consider section 142 of the British Columbia *Company Act* which reads as follows:

142. (1) Every director of a company, in exercising his powers and performing his functions, shall

act honestly and in good faith and in the best interests of the company; and

exercise the care, diligence and skill of a reasonably prudent person.

(2) The provisions of this section are in addition to, and not in derogation of, any enactment or rule of law or equity relating to the duties or liabilities of directors of a company.

Subsection (2) of that provision indicates that the standard of care for directors set out in paragraph 142(1)(b) is clearly intended to serve as more than a codification of the requirements imposed at common law. Interestingly, neither the Ontario *Business Corporations Act* nor the *Canada Business Corporations Act* contains an explicit statement of this nature to the effect that those statutes represent, without a doubt, an upgrading of common law requirements. Equally relevant is the fact that paragraph 142(1)(b) of the British Columbia *Company Act* refers only to "a reasonably prudent person," which expression is unqualified by the phrase "in comparable circumstances". It seems at least arguable that the British Columbia legislation, which was enacted after the Ontario company legislation, represents an attempt to avoid the legal interpretation associated with the use of that qualifying expression in the OBCA. To the extent that the standard in the British Columbia *Company Act* is more burdensome than the standard in the *Canada Business Corporations Act*, the taxpayer is entitled to rely on the latter standard as reproduced in the *Income Tax Act*.

This is a convenient place to summarize my findings in respect of subsection 227.1(3) of the *Income Tax Act*. The standard of care laid down in subsection 227.1(3) of the Act is inherently flexible. Rather than treating directors as a homogeneous group of professionals whose conduct is governed by a single, unchanging standard, that provision embraces a subjective element which takes into account the personal knowledge and background of the director, as well as his or her corporate circumstances in the form of, *inter alia*, the company's organization, resources, customs and conduct. Thus, for example, more is expected of individuals with superior qualifications (e.g. experienced business-persons).

The standard of care set out in subsection 227.1(3) of the Act is, therefore, not purely objective. Nor is it purely subjective. It is not enough for a director to say he or she did his or her best, for that is an invocation of the purely subjective standard. Equally clear is that honesty is not enough. However, the standard is not a professional one. Nor is it the

Digitized by Google

negligence law standard that governs these cases. Rather, the Act contains both objective elements"embodied in the reasonable person language"and subjective elements"inherent in individual considerations like "skill" and the idea of "comparable circumstances". Accordingly, the standard can be properly described as "objective subjective".

ANALYSIS

There are far too many cases dealing with section 227.1 of the Act. One way to appreciate the breadth of the extant law is to categorize the relevant cases. That task has, in fact, already been accomplished in large part by some of the commentators: see e.g. Moskowitz, *supra*, at pages 556-566; see also R. L. Campbell, "Director's Liability for Unremitted Employee Deductions" (1993), 14 *Adv. Q.* 453.

For example, in some instances the relevant issue will be whether an individual was in fact or in law a director at the relevant time for purposes of imposing personal liability or whether that individual ceased to hold office by operation of a valid resignation. In other cases, such as those involving bankruptcy and receivership, the central issue will be *de jure* control. Yet another cluster of cases, including situations in which a dominant director is able to limit others' influence over corporate affairs, will deal with *de facto* control. I intend to focus on the category of cases respecting the distinction between inside and outside directors since that line of authority is the most pertinent to this appeal.

At the outset, I wish to emphasize that in adopting this analytical approach I am not suggesting that liability is dependent simply upon whether a person is classified as an inside as opposed to an outside director. Rather, that characterization is simply the starting point of my analysis. At the same time, however, it is difficult to deny that inside directors, meaning those involved in the day-to-day management of the company and who influence the conduct of its business affairs, will have the most difficulty in establishing the due diligence defence. For such individuals, it will be a challenge to argue convincingly that, despite their daily role in corporate management, they lacked business acumen to the extent that that factor should overtake the assumption that they did know, or ought to have known, of both remittance requirements and any problem in this regard. In short, inside directors will face a significant hurdle when arguing that the subjective element of the standard of care should predominate over its objective aspect.

In some instances, it is easy to see why inside directors have been held liable. Such is true in respect of *Barnett, supra*, the first case which dealt with the due diligence defence. In that case the taxpayer, as director and sole shareholder of the company, hired a comptroller. When the latter informed the taxpayer that the company was short of cash, the taxpayer instructed that the business' key suppliers should be paid first. In these circumstances, the Tax Court dismissed the taxpayer's appeal from the Minister's assessment which held the taxpayer personally liable for the source deductions withheld but not remitted. Equally understandable is the imposition of liability in the following cases involving inside directors: *Quantz (C.) v. M.N.R.*, reflex, [1988] 1 C.T.C. 2276 (T.C.C.); and*Beutler (O.) v. M.N.R.*, reflex, [1988] 1 C.T.C. 2414 (T.C.C.).

Similarly, the taxpayer in *Fraser (Trustee of) v. M.N.R.* reflex, (1987), 37 B.L.R. 309 (T.C.C.), provides a good example of an inattentive inside director upon whom liability was justifiably visited. The taxpayer in that case was a director, minority shareholder and vice-president of manufacturing operations of a corporation. As of a certain time, he was apprised of the fact that the company was in arrears with Revenue Canada. Nevertheless, the taxpayer did nothing more in respect of that problem than rely on assurances, from the inside directors responsible for the financial side of the business, to the effect that there was no need to worry. Having made no efforts to prevent further defaults, the taxpayer was held personally responsible for the amounts that should have been remitted to the Crown by

Digitized by Google

the corporation.

Of course, not all inside directors have been held liable. The Tax Court has refused to impose liability on an inside director in cases where he or she is an innocent party who has been misled or deceived by co- directors: see *Bianco v. Minister of National Revenue* reflex, (1991), 2 B.L.R. (2d) 255 (T.C.C.);*Edmondson (S.G.) v. M.N.R.*, reflex, [1988] 2 C.T.C. 2185 (T.C.C.); *Shindle (B.) v. Canada*, reflex, [1995] 2 C.T.C. 227 (F.C.T.D.); and *Snow v. Minister of National Revenue* reflex, (1991), 38 C.C.E.L. 70 (T.C.C.). There are also other examples of an inside director being exonerated: see *Fitzgerald (G.) v. M.N.R.*, reflex, [1991] 2 C.T.C. 2595 (T.C.C.).

From the perspective of the taxpayer in this case, however, the most disconcerting decision to emerge from the Tax Court must be *Sanford v. R.*, reflex, [1996] 1 C.T.C. 2016 (T.C.C.). That case concerned the liability of an individual who was, at the relevant time, a co-director with the present taxpayer at RBI. In*Sanford*, the inside director who was assessed as a taxpayer under section 227.1 of the Act was an employee who had invested a substantial sum of money in the company but was subsequently denied the opportunity to participate in the management of the corporation. The company's principals had encouraged the taxpayer to focus on her area of expertise namely, sales, and afforded her little influence in respect of administrative and financial matters in which she had no training. She did, however, have authority to co-sign company cheques along with another director. After learning that the company was in arrears to Revenue Canada, the taxpayer requested and co-signed a cheque to address that problem. Although that cheque was ultimately returned, marked "N.S.F.", the taxpayer did not know at the time it was issued that there were insufficient funds to cover the cheque. From the reasons for judgment, one must infer that liability was avoided because of the taxpayer's limited financial experience and restricted influence on corporate management. As well, when the taxpayer found out that funds were owing to Revenue Canada she took active steps to see that the taxes were paid. I wish to make it clear, however, that the purpose of subsection 227.1(3) is to prevent failure to make remittances and not to cure default after the fact (though, as a practical matter, the provision should have the latter effect as well). I must leave that issue for another day. For the moment, I will refrain from further comment on *Sanford* : see discussion *infra*.

The final case I wish to discuss in this section dealing with inside directors is *Stevenson Estate v. Canada*, [1996] T.C.J. No. 1599 (T.C.C.) (QL). That case provides a quintessential illustration of the difference between the nature of liability for inside as opposed to outside directors and the effect of the subjective element of the standard of care. The company at issue was a family run enterprise whose principal activity was the sale of earthworms. At the relevant time, the directors of that business included "an elderly man of minimal education who had virtually no idea what was going on" and who was a director in name only, as well as "an intelligent woman with considerable business experience" who held the position of Chief Financial Officer of the company (at paragraphs 13 and 11, *per*Bowman T.C.J.). The Tax Court Judge held the inside director liable for failure to meet the standard of care set out in subsection 227.1(3) of the Act and, in doing so, noted that that director "was involved in the company's affairs to a degree that she could not have been oblivious to its financial difficulties"; in contrast, the outside director was exonerated on the basis that he "took no part in the financial affairs of the company and could not have influenced the course of events" (*ibid.*at paragraphs 11 and 13). I turn now specifically to a consideration of outside directors and, in particular, how the standard of care set out in the Act is to be met by them.

In order to satisfy the due diligence requirement laid down in subsection 227.1(3) a director may, as the Department of National Revenue has noted, take "positive action" by setting up controls to account for remittances, by asking for regular reports from the

Digitized by Google

company's financial officers on the ongoing use of such controls, and by obtaining confirmation at regular intervals that withholding and remittance has taken place as required by the Act: see Information Circular, No. 89-2,*supra* , at paragraph 7.

Likewise, some commentators have advised directors that, if they wish to be able to rely successfully on the due diligence defence, it would be wise for them to consider undertaking a number of "positive steps" including, in certain circumstances, the establishment and monitoring of a trust account from which both employee wages and remittances owing to Her Majesty would be paid: see e.g. Moskowitz, *supra* , at pages 566-568.

While such precautionary measures may be regarded as persuasive evidence of due diligence on the part of a director, in my view, those steps are not necessary conditions precedent to the establishment of that defence. This is particularly true with respect to the establishment of a separate trust account for source deductions to be remitted to the Receiver General. It is difficult to hold otherwise given the fact that Parliament abolished that express requirement for the purpose of achieving other legislative goals. Above all, a clear dividing line must be maintained between the standard of care required of a director and that of a trustee. Accordingly, an outside director cannot be required to go to the lengths outlined above. As an illustration, I would not expect an outside director, upon appointment to the board of one of Canada's leading companies, to go directly to the comptroller's office to inquire about withholdings and remittances. Obviously, if I would not expect such steps to be taken by the most sophisticated of business-persons, then I would certainly not expect such measures to be adopted by those with limited business acumen. This is not to suggest that a director can adopt an entirely passive approach but only that, unless there is reason for suspicion, it is permissible to rely on the day-to-day corporate managers to be responsible for the payment of debt obligations such as those owing to Her Majesty. This falls within the fourth proposition in the *City Equitable* case: see discussion *supra*, at page 146-147. The question remains, however, as to when a positive duty to act arises.

In my view, the positive duty to act arises where a director obtains information, or becomes aware of facts, which might lead one to conclude that there is, or could reasonably be, a potential problem with remittances. Put differently, it is indeed incumbent upon an outside director to take positive steps if he or she knew, or ought to have known, that the corporation could be experiencing a remittance problem. The typical situation in which a director is, or ought to have been, apprised of the possibility of such a problem is where the company is having financial difficulties. For example, in *Byrt (H.) v. M.N.R.*, reflex, [1991] 2 C.T.C. 2174 (T.C.C.), an outside director signed financial statements revealing a corporate deficit and thus he knew, or ought to have known, that the company was in financial trouble. The same director also knew that the business integrity of one of his co-directors, who was the president of the corporation too, was questionable. In these circumstances, having made no efforts to ensure that remittances to the Crown were made, the outside director was held personally liable for amounts owing by the corporation to Revenue Canada. According to the Tax Court Judge the outside director had, in contravention of the statutory standard of care, failed to "heed what is transpiring within the corporation and his experience with the people who are responsible for the day-to-day affairs of the corporation" (*supra* , at page 2184, *per* Rip T.C.J.).

Two other cases involving outside directors are worthy of comment as these authorities were relied upon by the appellant in this case: *Golfman (W.R.) v. M.N.R.*,reflex, [1990] 2 C.T.C. 2344 (T.C.C.) and *Davies (J.W.)*

v. Canada, reflex, [1994] 1 C.T.C. 2744 (T.C.C.). In *Golfman*, the taxpayer was a lawyer who had become a director of a corporation for whom he had served as a legal advisor for a

Digitized by Google

number of years. Before becoming a director, the taxpayer had reviewed the most recent financial statements available, which suggested that the company was in good financial shape. Further, he had asked two of his co-directors about the corporation's remittances to Revenue Canada and had been informed that everything was in order. Both of the individuals of whom he had inquired were longstanding acquaintances of the taxpayer as well as senior officers of the company with solid business reputations. Given these facts, it was held that the outside director could not reasonably have been expected to conclude that there might be a problem with remittances. It should also be noted that, upon being informed of the corporation's debt obligation to Her Majesty, the taxpayer resigned immediately.

So too in *Davies, supra*, were the directors relieved of personal liability. In that case, three individuals (a physician and two engineers) were asked to join the board of directors of an eyewear company in order to provide specific forms of expertise. None of these outside directors possessed experience in relation to the daily financial management of a corporation. They relied on the corporation's competent, in-house financial officers to handle withholdings and remittances. Further, for the better part of 1988, the financial reports prepared by those officers gave no indication to the outside directors that arrears owing to the Crown had arisen early in that year and gone unaddressed. Although the existence of a monthly cash shortfall was known early in 1988, the weekly event reports as well as other indicators of the company's financial health all painted a positive financial picture. The Tax Court held that the taxpayers were not personally liable for the amounts owing since there had been no reason for them to suspect that there might be a source deduction problem until late in 1988 when the financial reports suggested such for the first time. In other words, prior to November of 1988 when those financial statements were released, it could not be said that the outside directors could reasonably have been expected to have taken positive action.

It is important to note that whether a company is in serious financial difficulty, such as to suggest a problem with remittances, cannot be determined simply by the fact that the monthly balance sheet bears a negative figure. For example, many firms operate on a line of credit to deal with fiscal fluctuations. In each case it will be for the Tax Court Judge to determine whether, based on the financial information or documentation available to the director, the latter ought to have known that there was a problem or potential problem with remittances. Whether the standard of care has been met, now that it has been defined, is thus predominantly a question of fact to be resolved in light of the personal knowledge and experience of the director at issue.

Applying the foregoing analysis of the law to the facts of this case, I find that the taxpayer was under a positive duty to act which arose, at the latest, in November of 1987 when he received the balance sheet of RBI revealing that the company was experiencing what the Tax Court Judge found, as a matter of fact, to be "extremely serious" financial problems (Appeal Book, at page 43). In light of that finding by the Tax Court Judge, and given the taxpayer's ample experience in the field of business, the balance sheet of November 1987 should have alerted the taxpayer to the existence of a possible problem with remittances. This is all the more true since there was no indication or evidence that RBI's financial troubles were merely temporary in nature. In the circumstances, however, the taxpayer made no inquiries in respect of remittance of employee withholdings.

Counsel for the taxpayer argues in his written submissions that material information was knowingly withheld from the taxpayer by both Ms. Beauchamp and the other directors of RBI, such that a "conspiracy of silence" against the taxpayer denied him any knowledge of the non-remittance of employee withholdings: see appellant's memorandum of fact and law, at paragraph 24. Counsel argues further that the alleged conspiracy deprived the

Digitized by Google

taxpayer of freedom of choice and the ability to exert any influence or control over the management of RBI (*ibid*). I find it difficult to accept the taxpayer's argument to the effect that a "conspiracy of silence" is to blame for his inaction. There was no finding by the Tax Court Judge, nor was there any evidence, to support the understanding that Ms. Beauchamp had given a specific instruction to the other directors that remittances were not to be discussed with the taxpayer. Admittedly, she had instructed the other directors not to discuss with the taxpayer anything other than that which was dealt with at directors' meetings attended by the taxpayer, which matters did not include the issue of remittances. However, there is no indication that the taxpayer was misled or frustrated by other company officials during a quest for knowledge about the state of remittances. In any event, it is unnecessary to decide precisely what steps the taxpayer in this case should have taken after having learned of RBI's grave financial situation and, correlatively, the potential for a remittance problem. Suffice it to say that what the taxpayer did, that is nothing, was inadequate for the purpose of discharging the burden imposed on him by subsection 227.1(3) of the Act, given the precarious financial position of the company.

The difference in outcomes between this case and *Sanford* can be rationalized on the basis of the subjective element of the standard of care. The *Sanford* case involved an individual with no management experience who took active steps and performed her directorial duties reasonably, having regard to her level of skill and experience, and the corporate circumstances in which she found herself. Accordingly, she was able to avoid personal liability for the unremitted amounts. On the contrary, this case concerns an experienced businessman who took no positive steps to ensure remittance of employee withholdings despite the fact that he should have been alerted to a potential problem in that regard. He did absolutely nothing but close his eyes. As a consequence, it can hardly be said that the taxpayer in this case exercised, in his capacity as director of RBI, the degree of care, skill and diligence required by the Act.

For all of these reasons, the appeal must be dismissed. This is one instance in which it is simply not appropriate to visit the taxpayer with costs of the appeal. The issues pursued before this Court transcend his personal interests. Accordingly, no costs should be awarded.

Linden J.A.: I agree.

Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] 3 S.C.R. 461, 2004 SCC 68, A Recent SCC on Identical Director Responsibility (a slight Divergence?)

Present: Iacobucci,* Major, Bastarache, Binnie, LeBel, Deschamps and Fish JJ.

on appeal from the court of appeal for quebec

Corporations — Directors and officers — Fiduciary duty and duty of care — Directors of bankrupt corporation being sued by trustee — Trustee claiming that directors breached fiduciary duty and duty of care — Whether directors owe fiduciary duty or duty of care to corporation's creditors — Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 122(1).

Bankruptcy and insolvability — Reviewable transactions — Transfer of assets between wholly- owned subsidiary and parent corporation — Wholly-owned subsidiary and parent corporation declaring bankruptcy — Parent corporation's directors sued by trustee of wholly-owned subsidiary — Trustee claiming that certain transactions were reviewable — Whether consideration for impugned transactions conspicuously less than fair market value — Whether directors "privy" to transactions — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 100.

Digitized by Google

Wise Stores Inc. ("Wise") acquired Peoples Department Stores Inc. ("Peoples") from Marks and Spencer Canada Inc. ("M & S"). L.W., R.W. and H.W. (the "Wise brothers") were majority shareholders, officers and directors of Wise, and the only directors of Peoples. Because of covenants imposed by M & S, Peoples could not be merged with Wise until the purchase price had been paid. Almost from the outset, the joint operation of Wise and Peoples did not function smoothly. Parallel bookkeeping, combined with shared warehousing arrangements, caused serious problems for both companies. As a result, their inventory records were increasingly incorrect. The situation, already unsustainable, was worsening. L.W. consulted the vice-president of administration and finance of both Wise and Peoples in an attempt to find a solution. On his recommendation, the Wise brothers agreed to implement a joint inventory procurement policy whereby the two firms would divide responsibility for purchasing. Peoples would make all purchases from North American suppliers and Wise would, in turn, make all purchases from overseas suppliers. Peoples would then transfer to Wise what it had purchased for Wise, charging Wise accordingly, and vice versa. The new policy was implemented on February 1, 1994. Before the end of the year, both Wise and Peoples declared bankruptcy. Peoples' trustee filed a petition against the Wise brothers. The trustee claimed that they had favoured the interests of Wise over Peoples to the detriment of Peoples' creditors, in breach of their duties as directors under s. 122(1) of the *Canada Business Corporations Act* ("CBCA"). In the alternative, the trustee claimed that the Wise brothers had in the year preceding the bankruptcy been privy to transactions in which Peoples' assets had been transferred to Wise for conspicuously less than fair market value within the meaning of s. 100 of the *Bankruptcy and Insolvency Act* ("BIA"). The trial judge found the Wise brothers liable on both grounds. The Court of Appeal set aside the trial judge's decision.

Held: The appeal should be dismissed. The Wise brothers did not breach their duties under s. 122(1) of the CBCA, nor were the impugned transactions in violation of s. 100 of the BIA.

The fiduciary duty under s. 122(1)(*a*) of the CBCA requires directors and officers to act in good faith and honestly *vis-à-vis* the corporation. Here, the trial judge found that there was no fraud or dishonesty in the Wise brothers' attempts to solve the mounting inventory problems of Peoples and Wise. The Wise brothers considered the serious inventory management problem and implemented a joint inventory procurement policy they hoped would solve it. In the absence of evidence of a personal interest or improper purpose in the new policy, and in light of the evidence of a desire to make both Wise and Peoples "better" corporations, the directors did not breach their fiduciary duty under s. 122(1)(*a*). An honest and good faith attempt to redress a corporation's financial problems does not, if unsuccessful, qualify as such a breach. The fiduciary duty does not change when a corporation is in the nebulous "vicinity of insolvency". At all times, they owe their fiduciary obligations to the corporation, and the corporations' interests are not to be confused with the interests of the creditors or those of any other stakeholder. There is no need to read the interests of creditors into the fiduciary duty set out in s. 122(1)(*a*) in light of the availability under the CBCA both of the oppression remedy (s. 241(2)(*c*)) and of an action based on the duty of care (s. 122(1)(*b*)).

Directors and officers will not be held to be in breach of the duty of

Digitized by Google

care under s. 122(1)(*b*) of the CBCA if they act prudently and on a reasonably informed basis. The standard of care is an objective one. The decisions of directors and officers must be reasonable business decisions in light of all the circumstances, including the prevailing socio-economic conditions, about which they knew or ought to have known. While courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are often involved in corporate decision-making, they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision. In this case, in adopting the joint inventory procurement policy, the directors did not breach their duty of care in respect of Peoples' creditors. The implementation of the new policy was a reasonable business decision made with a view to rectifying a serious and urgent business problem in circumstances in which no solution may have been possible. The trial judge's conclusion that the new policy led inexorably to Peoples' failure and bankruptcy was factually incorrect and constituted a palpable and overriding error. Many factors other than the new policy contributed more directly to Peoples' bankruptcy.

Section 44(2) of the CBCA as it then read (the provision has since been repealed) cannot exempt directors and officers from potential liability under s. 122(1) for any financial assistance given by subsidiaries to the parent corporation. Nor can the Wise brothers successfully invoke good faith reliance on the opinion of the vice-president of administration and finance under s. 123(4)(*b*) of the CBCA. As a non-professional employee, the vice-president did not belong to any of the professional groups named in s. 123(4)(*b*). He was not an accountant, was not subject to the regulatory overview of any professional organization and did not carry independent insurance coverage for professional negligence.

The trustee's claim under s. 100 of the BIA must fail. The relevant transactions are those spanning the period from February to December 1994 when the new procurement policy was in effect. With regard to all the circumstances of this case, a disparity of slightly more than six percent between fair market value and the consideration received does not constitute a conspicuous difference.

While, in light of this conclusion, there is no need to consider whether the Wise brothers would have been "privy" to the transactions, the disagreement between the trial judge and the Court of Appeal on the interpretation of "privy" in s. 100(2) of the BIA warrants the following comments. Since the provision's remedial purpose is to reverse the effects of a transaction that stripped value from the estate of a bankrupt person, the word "privy" should be given a broad reading to include those who benefit directly or indirectly from, and have knowledge of, a transaction occurring for less than fair market value. This rationale is particularly apt when those who benefit are the controlling minds behind the transaction.

Cases Cited

Applied: *373409 Alberta Ltd. (Receiver of) v. Bank of Montreal*, [2002] 4 S.C.R. 312, 2002 SCC 81;

approved: *Re Olympia & York Enterprises Ltd. and Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254; *Standard Trustco Ltd. (Trustee of) v. Standard Trust Co.* (1995), 26 O.R. (3d) 1;

referred to: *Automatic Self-Cleansing Filter Syndicate Co. v. Cuninghame*, [1906] 2 Ch. 34; *K.L.B. v. British Columbia*, [2003] 2 S.C.R. 403, 2003 SCC 51;

Digitized by Google

Canadian Aero Service Ltd. v. O'Malley, [1974] S.C.R. 592;*820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123, aff'd (1991), 3 B.L.R. (2d) 113;*Teck Corp. v. Millar* (1972), 33 D.L.R. (3d) 288; *Brasserie Labatt ltée v. Lanoue*, [1999] Q.J. No. 1108 (QL); *Regent Taxi & Transport Co. v. Congrégation des Petits Frères de Marie*, [1929] S.C.R. 650, rev'd [1932] 2 D.L.R. 70; *Lister v. McAnulty*, [1944] S.C.R. 317; *Hôpital Notre-Dame de l'Espérance v. Laurent*, [1978] 1 S.C.R. 605; *Dovey v. Cory*, [1901] A.C. 477; *In re Brazilian Rubber Plantations and Estates, Ltd.*, [1911] 1 Ch. 425; *In re City Equitable Fire Insurance Co.*, [1925] 1 Ch. 407; Soper v. *Canada*, [1998] 1 F.C. 124; *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177; *Skalbania (Trustee of) v. Wedgewood Village Estates Ltd.* (1989), 37 B.C.L.R. (2d) 88.

Statutes and Regulations Cited

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 100(1) [repl. 1997, c. 12, s. 81], (2).

Canada Business Corporations Act, R.S.C. 1985, c. C-44, ss. 44(1) [rep. 2001, c. 14, s. 26], (2) [*idem*],

102(1) [repl. *idem*, s. 35], 121, 122(1) [am. *idem*, s. 135 (Sch., item 43)], 123(4) [now 123(5)], 185, 238,

239, 240, 241.

Civil Code of Québec, S.Q. 1991, c. 64, arts. 300, 311, 1457, 2501.

Interpretation Act, R.S.C. 1985, c. I-21, s. 8.1.

Authors Cited

Allen, William T., Jack B. Jacobs and Leo E. Strine, Jr. "Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law" (2001), 26 *Del. J. Corp. L.* 859.

Beck, Stanley M. "Minority Shareholders' Rights in the 1980s". In *Corporate Law in the 80s*, Special Lectures of the Law Society of Upper Canada. Don Mills, Ont.: Richard De Boo, 1982, 311.

Brock, Jason. "The Propriety of Profitmaking: Fiduciary Duty and Unjust Enrichment" (2000), 58 *U.T. Fac. L. Rev.* 185.

Crête, Raymonde, et Stéphane Rousseau. *Droit des sociétés par actions: principes fondamentaux.*
Montréal: Thémis, 2002.

Dickerson, Robert W. V., John L. Howard and Leon Getz. *Proposals for a New Business Corporations Law for Canada*, vols. I and II. Ottawa: Information Canada, 1971.

Gray, Wayne D. "*Peoples v. Wise* and *Dylex*: Identifying Stakeholder Interests upon or near Corporate Insolvency — Stasis or Pragmatism?" (2003), 39 *Can. Bus. L.J.* 242.

Houlden, L. W., and G. B. Morawetz. *Bankruptcy and Insolvency Law of Canada*, vol. 2, 3rd ed. Toronto: Carswell, 1989 (loose-leaf updated 2003, release 9).

Iacobucci, Edward M. "Directors' Duties in Insolvency: Clarifying What Is at Stake" (2003), 39 *Can. Bus. L.J.* 398.

Iacobucci, Edward M., and Kevin E. Davis. "Reconciling Derivative Claims and the Oppression Remedy" (2000), 12 *S.C.L.R.* (2d) 87.

Martel, Paul. "Le 'voile corporatif' — l'attitude des tribunaux face à l'article 317 du Code civil du Québec" (1998), 58 *R. du B.* 95.

McGuinness, Kevin Patrick. *The Law and Practice of Canadian Business Corporations.*
Toronto: Butterworths, 1999.

Digitized by Google

Thomson, David. "Directors, Creditors and Insolvency: A Fiduciary Duty or a Duty Not to Oppress?" (2000), 58 *U.T. Fac. L. Rev.* 31.

APPEAL from a judgment of the Quebec Court of Appeal, [2003] R.J.Q. 796, 224 D.L.R. (4th) 509, 41 C.B.R. (4th) 225, [2003] Q.J. No. 505 (QL), setting aside a decision of the Superior Court (1998), 23 C.B.R. (4th) 200, [1998] Q.J. No. 3571 (QL). Appeal dismissed.

Gerald F. Kandestin, *Gordon Kugler* and *Gordon Levine*, for the appellant.

Éric Lalanne and *Martin Tétreault*, for the respondents Lionel Wise, Ralph Wise and Harold Wise.

Ian Rose and *Odette Jobin-Laberge*, for the respondent Chubb Insurance Company of Canada.

The judgment of the Court was delivered by

MAJOR AND DESCHAMPS JJ. —

Introduction

The principal question raised by this appeal is whether directors of a corporation owe a fiduciary duty to the corporation's creditors comparable to the statutory duty owed to the corporation. For the reasons that follow, we conclude that directors owe a duty of care to creditors, but that duty does not rise to a fiduciary duty. We agree with the disposition of the Quebec Court of Appeal. The appeal is therefore dismissed.

As a result of the demise in the mid-1990s of two major retail chains in eastern Canada, Wise Stores Inc. ("Wise") and its wholly-owned subsidiary, Peoples Department Stores Inc. ("Peoples"), the indebtedness of a number of Peoples' creditors went unsatisfied. In the wake of the failure of the two chains, Caron Bélanger Ernst & Young Inc., Peoples' trustee in bankruptcy ("trustee"), brought an action against the directors of Peoples. To address the trustee's claims, the extent of the duties imposed by s. 122(1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("CBCA"), upon directors with respect to creditors must be determined; we must also identify the purpose and reach of s. 100 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA").

In our view, it has not been established that the directors of Peoples violated either the fiduciary duty or the duty of care imposed by s. 122(1) of the CBCA. As for the trustee's submission regarding s. 100 of the BIA, we agree with the Court of Appeal that the consideration received in the impugned transactions was not "conspicuously" less than fair market value. The BIA claim fails on that basis.

Background

Wise was founded by Alex Wise in 1930 as a small clothing store on St-Hubert Street in Montreal. By 1992, through expansion effected by a mix of internal growth and acquisitions, it had become an enterprise operating at 50 locations with annual sales of approximately $100 million, and it had been listed on the Montreal Stock Exchange in 1986. The stores were, for the most part, located in urban areas in Quebec. The founder's three sons, Lionel, Ralph and Harold Wise ("Wise brothers"), were majority shareholders, officers, and directors of Wise. Together, they controlled 75 percent of the firm's equity.

In 1992, Peoples had been in business continuously in one form or another for 78 years. It had operated as an unincorporated division of Marks & Spencer Canada Inc. ("M & S") until 1991, when it was incorporated as a separate company. M & S itself was wholly owned by the large British firm, Marks & Spencer plc. ("M & S plc.").

Digitized by Google

Peoples' 81 stores were generally located in rural areas, from Ontario to Newfoundland. Peoples had annual sales of about $160 million, but was struggling financially. Its annual losses were in the neighbourhood of $10 million.

Wise and Peoples competed with other chains such as Canadian Tire, Greenberg, Hart, K-Mart, M-Stores, Metropolitan Stores, Rossy, Woolco and Zellers. Retail competition in eastern Canada was intense in the early 1990s. In 1992, M-Stores went bankrupt. In 1994, Greenberg and Metropolitan Stores followed M-Stores into bankruptcy. The 1994 entry of Wal-Mart into the Canadian market, with its acquisition of over 100 Woolco stores from Woolworth Canada Inc., exerted significant additional competitive pressure on retail stores.

Lionel Wise, the eldest of the three brothers and Wise's executive vice-president, had expressed an interest in acquiring the ailing Peoples chain from M & S as early as 1988. Initially, M & S did not share Wise's interest for the sale, but by late 1991, M & S plc., the British parent company of M & S, had decided to divest itself of all its Canadian operations. At this point, M & S incorporated each of its three Canadian divisions to facilitate the anticipated divestiture thereof.

The new-found desire to sell coincided with Wise's previously expressed interest in acquiring its larger rival. Although M & S had initially hoped to sell Peoples for cash to a large firm in a solid financial condition, it was unable to do so. Consequently, negotiations got underway with representatives of Wise. A formal share purchase agreement was drawn up in early 1992 and executed in June 1992, with July 16, 1992 as its closing date.

Wise incorporated a company, 2798832 Canada Inc., for the purpose of acquiring all of the issued and outstanding shares of Peoples from M & S. The $27- million share acquisition proceeded as a fully leveraged buyout. The portion of the purchase price attributable to inventory was discounted by 30 percent. The discount was designed to inject equity into Peoples in the fiscal year following the sale and to make use of some of the tax losses that had accumulated in prior years.

The amount of the down payment due to M & S at closing, $5 million, was borrowed from the Toronto Dominion Bank ("TD Bank"). According to the terms of the share purchase agreement, the $22-million balance of the purchase price would be carried by M & S and would be repaid over a period of eight years. Wise guaranteed all of 2798832 Canada Inc.'s obligations pursuant to the terms of the share purchase agreement.

To protect its interests, M & S took the assets of Peoples as security (subject to a priority in favour of the TD Bank) and negotiated strict covenants concerning the financial management and operation of the company. Among other requirements, 2798832 Canada Inc. and Wise were obligated to maintain specific financial ratios, and Peoples was not permitted to provide financial assistance to Wise. In addition, the agreement provided that Peoples could not be amalgamated with Wise until the purchase price had been paid. This prohibition was presumably intended to induce Wise to refinance and pay the remainder of the purchase price as early as possible in order to overcome the strict conditions imposed upon it under the share purchase agreement.

On January 31, 1993, 2798832 Canada Inc. was amalgamated with Peoples. The new entity retained Peoples' corporate name. Since 2798832 Canada Inc. had been a wholly-owned subsidiary of Wise, upon amalgamation the new Peoples became a subsidiary directly owned and controlled by Wise. The three Wise brothers were Peoples' only directors.

Following the acquisition, Wise had attempted to rationalize its operations by

Digitized by Google

consolidating the overlapping corporate functions of Wise and Peoples, and operating as a group. The consolidation of the administration, accounting, advertising and purchasing departments of the two corporations was completed by the fall of 1993. As a consequence of the changes, many of Wise's employees worked for both firms but were paid solely by Wise. The evidence at trial was that because of the tax losses carried-forward by Peoples, it was advantageous for the group to have more expenses incurred by Wise, which, if the group was profitable as a whole, would increase its after-tax profits. Almost from the outset, the joint operation of Wise and Peoples did not function smoothly. Instead of the expected synergies, the consolidation resulted in dissonance.

After the acquisition, the total number of buyers for the two companies was nearly halved. The procurement policy at that point required buyers to deal simultaneously with suppliers on behalf of both Peoples and Wise. For the buyers, this nearly doubled their administrative work. Separate invoices were required for purchases made on behalf of Wise and Peoples. These invoices had to be separately entered into the system, tracked and paid.

Inventory, too, was separately recorded and tracked in the system. However, the inventory of each company was handled and stored, often unsegregated, in shared warehouse facilities. The main warehouse for Peoples, on Cousens Street in Ville St-Laurent, was maintained for and used by both firms. The Cousens warehouse saw considerable activity, as it was the central distribution hub for both chains. The facility was open 18 hours a day and employed 150 people on two shifts who handled a total of approximately 30,000 cartons daily through 20 loading docks. It was abuzz with activity.

Before long, the parallel bookkeeping combined with the shared warehousing arrangements caused serious problems for both Wise and Peoples. The actual situation in the warehouse often did not mirror the reported state of the inventory in the system. The goods of one company were often inextricably commingled and confused with the goods of the other. As a result, the inventory records of both companies were increasingly incorrect. A physical inventory count was conducted to try to rectify the situation, to little avail. Both Wise and Peoples stores experienced numerous shipping disruptions and delays. The situation, already unsustainable, was worsening.

In October 1993, Lionel Wise consulted David Clément, Wise's (and, after the acquisition, Peoples') vice-president of administration and finance, in an attempt to find a solution. In January 1994, Clément recommended and the three Wise brothers agreed that they would implement a joint inventory procurement policy ("new policy") whereby the two firms would divide responsibility for purchasing. Peoples would make all purchases from North American suppliers and Wise would, in turn, make all purchases from overseas suppliers. Peoples would then transfer to Wise what it had purchased for Wise, charging Wise accordingly, and vice versa. The new policy was implemented on February 1, 1994. It was this arrangement that was later criticized by certain creditors and by the trial judge.

Approximately 82 percent of the total inventory of Wise and Peoples was purchased from North American suppliers, which inevitably meant that Peoples would be extending a significant trade credit to Wise. The new policy was known to the directors, but was neither formally implemented in writing nor approved by a board meeting or resolution.

On April 27, 1994, Lionel Wise outlined the details of the new policy at a meeting of Wise's audit committee. A partner of Coopers & Lybrand was M & S's

Digitized by Google

representative on Wise's board of directors and a member of the audit committee. He attended the April 27th meeting and raised no objection to the new policy when it was introduced.

By June 1994, financial statements prepared to reflect the financial position of Peoples as of April 30, 1994 revealed that Wise owed more than $18 million to Peoples. Approximately $14 million of this amount resulted from a notional transfer of inventory that was cancelled following the period's end. M & S was concerned about the situation and started an investigation, as a result of which M & S insisted that the new procurement policy be rescinded. Wise agreed to M & S's demand but took the position that the former procurement policy could not be reinstated immediately. An agreement was executed on September 27, 1994, effective July 21, 1994, and it provided that the new policy would be abandoned as of January 31, 1995. The agreement also specified that the inventory and records of the two companies would be kept separate, and that the amount owed to Peoples by Wise would not exceed $3 million.

Another result of the negotiations was that M & S accepted an increase in the amount of the TD Bank's priority to $15 million and a new repayment schedule for the balance of the purchase price owed to M & S. The parties agreed to revise the schedule to provide for 37 monthly payments beginning in July 1995. Each of the Wise brothers also provided a personal guarantee of $500,000 in favour of M & S.

In September 1994, in light of the fragile financial condition of the companies and the competitiveness of the retail market, the TD Bank announced its intention to cease doing business with Wise and Peoples as of the end of December 1994. Following negotiations, however, the bank extended its financial support until the end of July 1995. The Wise brothers promised to extend personal guarantees in favour of the TD Bank, but this did not occur.

In December 1994, three days after the Wise brothers presented financial statements showing disappointing results for Peoples in its third fiscal quarter, M & S initiated bankruptcy proceedings against both Wise and Peoples. A notice of intention to make a proposal was filed on behalf of Peoples the same day. Nonetheless, Peoples later consented to the petition by M & S, and both Wise and Peoples were declared bankrupt on January 13, 1995, effective December 9, 1994. The same day, M & S released each of the Wise brothers from their personal guarantees. M & S apparently preferred to proceed with an uncontested petition in bankruptcy rather than attempting to collect on the personal guarantees.

The assets of Wise and Peoples were sufficient to cover in full the outstanding debt owed to the TD Bank, satisfy the entire balance of the purchase price owed to M & S, and discharge almost all the landlords' lease claims. The bulk of the unsatisfied claims were those of trade creditors.

Following the bankruptcy, Peoples' trustee filed a petition against the Wise brothers. In the petition, the trustee claimed that they had favoured the interests of Wise over Peoples to the detriment of Peoples' creditors, in breach of their duties as directors under s. 122(1) of the CBCA. The trustee also claimed that the Wise brothers had, in the year preceding the bankruptcy, been privy to transactions in which property had been transferred for conspicuously less than fair market value within the meaning of s. 100 of the BIA.

Pursuant to art. 2501 of the *Civil Code of Québec*, S.Q. 1991, c. 64 ("C.C.Q."), the trustee named Chubb Insurance Company of Canada ("Chubb"), which had provided directors' insurance to Wise and its subsidiaries, as a defendant in addition to the Wise brothers.

Digitized by Google

The trial judge, Greenberg J., relying on decisions from the United Kingdom, Australia and New Zealand, held that the fiduciary duty and the duty of care under s. 122(1) of the CBCA extend to a company's creditors when a company is insolvent or in the vicinity of insolvency. Greenberg J. found that the implementation, by the Wise brothers *qua* directors of Peoples, of a corporate policy that affected both companies, had occurred while the corporation was in the vicinity of insolvency and was detrimental to the interests of the creditors of Peoples. The Wise brothers were therefore found liable and the trustee was awarded $4.44 million in damages. As Chubb had provided insurance coverage for directors, it was also held liable. Greenberg J. also considered the alternative grounds under the BIA advanced by the trustee and found the Wise brothers liable for the same $4.44 million amount on that ground as well. All the parties appealed.

The Quebec Court of Appeal, *per* Pelletier J.A., with Robert C.J.Q. and Nuss J.A. concurring, allowed the appeals by Chubb and the Wise brothers: [2003] R.J.Q. 796, [2003] Q.J. No. 505 (QL). The Court of Appeal expressed reluctance to follow Greenberg J. in equating the interests of creditors with the best interests of the corporation when the corporation was insolvent or in the vicinity of insolvency, stating that an innovation in the law such as this is a policy matter more appropriately dealt with by Parliament than the courts. In considering the trustee's claim under s. 100 of the BIA, Pelletier J.A. held that the trial judge had committed a palpable and overriding error in concluding that the amounts owed by Wise to Peoples in respect of inventory "were neither collected nor collectible" (para. 125 QL). He found that the consideration received for the transactions had been approximately 94 percent of fair market value, and he was not convinced that this disparity could be characterized as being "conspicuously" less than fair market value. Moreover, he did not accept the broad meaning the trial judge gave to the word "privy". Pelletier J.A. declined to exercise his discretion under s. 100(2) of the BIA to make an order in favour of the trustee. In view of his conclusion that the Wise brothers were not liable, Pelletier J.A. allowed the appeal with respect to Chubb.

Analysis

At the outset, it should be acknowledged that according to art. 300 C.C.Q. and s. 8.1 of the *Interpretation Act*, R.S.C. 1985, c. I-21, the civil law serves as a supplementary source of law to federal legislation such as the CBCA. Since the CBCA does not entitle creditors to sue directors directly for breach of their duties, it is appropriate to have recourse to the C.C.Q. to determine how rights grounded in a federal statute should be addressed in Quebec, and more specifically how s. 122(1) of the CBCA can be harmonized with the principles of civil liability: see R. Crête and S. Rousseau, *Droit des sociétés par actions: principes fondamentaux* (2002), at p. 58.

This case came before our Court on the issue of whether directors owe a duty to creditors. The creditors did not bring a derivative action or an oppression remedy application under the CBCA. Instead, the trustee, representing the interests of the creditors, sued the directors for an alleged breach of the duties imposed by s. 122(1) of the CBCA. The standing of the trustee to sue was not questioned.

The primary role of directors is described in s. 102(1) of the CBCA:

102. (1) Subject to any unanimous shareholder agreement, the directors shall manage, or supervise the management of, the business and affairs of a corporation.

As for officers, s. 121 of the CBCA provides that their powers are delegated to them by the directors:

Subject to the articles, the by-laws or any unanimous shareholder agreement,

Digitized by Google

the directors may designate the offices of the corporation, appoint as officers persons of full capacity, specify their duties and delegate to them powers to manage the business and affairs of the corporation, except powers to do anything referred to in subsection 115(3);
a director may be appointed to any office of the corporation; and
two or more offices of the corporation may be held by the same person.

Although the shareholders are commonly said to own the corporation, in the absence of a unanimous shareholder agreement to the contrary, s. 102 of the CBCA provides that it is not the shareholders, but the directors elected by the shareholders, who are responsible for managing it. This clear demarcation between the respective roles of shareholders and directors long predates the 1975 enactment of the CBCA: see *Automatic Self-Cleansing Filter Syndicate Co. v. Cuninghame*, [1906] 2 Ch. 34 (C.A.); see also art. 311 C.C.Q.

Section 122(1) of the CBCA establishes two distinct duties to be discharged by directors and officers in managing, or supervising the management of, the corporation:

(1) Every director and officer of a corporation in exercising their powers and discharging their duties shall
act honestly and in good faith with a view to the best interests of the corporation; and
exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

The first duty has been referred to in this case as the "fiduciary duty". It is better described as the "duty of loyalty". We will use the expression "statutory fiduciary duty" for purposes of clarity when referring to the duty under the CBCA. This duty requires directors and officers to act honestly and in good faith with a view to the best interests of the corporation. The second duty is commonly referred to as the "duty of care". Generally speaking, it imposes a legal obligation upon directors and officers to be diligent in supervising and managing the corporation's affairs.

The trial judge did not apply or consider separately the two duties imposed on directors by s. 122(1). As the Court of Appeal observed, the trial judge appears to have confused the two duties. They are, in fact, distinct and are designed to secure different ends. For that reason, they will be addressed separately in these reasons.

The Statutory Fiduciary Duty: Section 122(1)(a) of the CBCA

Considerable power over the deployment and management of financial, human, and material resources is vested in the directors and officers of corporations. For the directors of CBCA corporations, this power originates in s. 102 of the Act. For officers, this power comes from the powers delegated to them by the directors. In deciding to invest in, lend to or otherwise deal with a corporation, shareholders and creditors transfer control over their assets to the corporation, and hence to the directors and officers, in the expectation that the directors and officers will use the corporation's resources to make reasonable business decisions that are to the corporation's advantage.

The statutory fiduciary duty requires directors and officers to act honestly and in good faith *vis-à-vis* the corporation. They must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation. They must avoid conflicts of interest with the corporation. They must avoid abusing their position to gain personal benefit. They must maintain the confidentiality of information they acquire by virtue of their position. Directors and officers must serve the corporation selflessly, honestly and loyally: see K. P. McGuinness, *The Law and Practice of Canadian Business*

Digitized by Google

Corporations (1999), at p. 715.

The common law concept of fiduciary duty was considered in *K.L.B. v. British Columbia*, [2003] 2 S.C.R. 403, 2003 SCC 51. In that case, which involved the relationship between the government and foster children, a majority of this Court agreed with McLachlin C.J. who stated, at paras. 40-41 and 49:

Fiduciary duties arise in a number of different contexts, including express trusts, relationships marked by discretionary power and trust, and the special responsibilities of the Crown in dealing with aboriginal interests. . . .

What . . . might the content of the fiduciary duty be if it is understood . . . as a private law duty arising simply from the relationship of discretionary power and trust between the Superintendent and the foster children? In *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574, at pp. 646-47, La Forest J. noted that there are certain common threads running through fiduciary duties that arise from relationships marked by discretionary power and trust, such as loyalty and "the avoidance of a conflict of duty and interest and a duty not to profit at the expense of the beneficiary". However, he also noted that "[t]he obligation imposed may vary in its specific substance depending on the relationship" (p. 646). . .

. . .

. . . concern for the best interests of the child informs the parental fiduciary relationship, as La Forest J. noted in *M. (K.) v. M. (H.)*, *supra*, at p. 65. But the duty imposed is to act loyally, and not to put one's own or others' interests ahead of the child's in a manner that abuses the child's trust. . . . The parent who exercises undue influence over the child in economic matters for his own gain has put his own interests ahead of the child's, in a manner that abuses the child's trust in him. The same may be said of the parent who uses a child for his sexual gratification or a parent who, wanting to avoid trouble for herself and her household, turns a blind eye to the abuse of a child by her spouse. The parent need not, as the Court of Appeal suggested in the case at bar, be consciously motivated by a desire for profit or personal advantage; nor does it have to be her own interests, rather than those of a third party, that she puts ahead of the child's. It is rather a question of disloyalty — of putting someone's interests ahead of the child's in a manner that abuses the child's trust. Negligence, even aggravated negligence, will not ground parental fiduciary liability unless it is associated with breach of trust in this sense. [Emphasis added.]

The issue to be considered here is the "specific substance" of the fiduciary duty based on the relationship of directors to corporations under the CBCA.

It is settled law that the fiduciary duty owed by directors and officers imposes strict obligations: see *Canadian Aero Service Ltd. v. O'Malley*, [1974] S.C.R. 592, at pp. 609-10, *per* Laskin J. (as he then was), where it was decided that directors and officers may even have to account to the corporation for profits they make that do not come at the corporation's expense:

The reaping of a profit by a person at a company's expense while a director thereof is, of course, an adequate ground upon which to hold the director accountable. Yet there may be situations where a profit must be disgorged, although not gained at the expense of the company, on the ground that a director must not be allowed to use his position as such to make a profit even if it was not open to the company, as for example, by reason of legal disability, to participate in the transaction. An analogous situation, albeit not involving a director, existed for all practical purposes in the case of *Phipps v. Boardman* [[1967] 2 A.C. 46], which also supports the view that liability to

Digitized by Google

account does not depend on proof of an actual conflict of duty and self- interest. Another, quite recent, illustration of a liability to account where the company itself had failed to obtain a business contract and hence could not be regarded as having been deprived of a business opportunity is *Industrial Development Consultants Ltd. v. Cooley* [[1972] 2 All E.R. 162], a judgment of a Court of first instance. There, the managing director, who was allowed to resign his position on a false assertion of ill health, subsequently got the contract for himself. That case is thus also illustrative of the situation where a director's resignation is prompted by a decision to obtain for himself the business contract denied to his company and where he does obtain it without disclosing his intention. [Emphasis added.]

A compelling argument for making directors accountable for profits made as a result of their position, though not at the corporation's expense, is presented by J. Brock, "The Propriety of Profitmaking: Fiduciary Duty and Unjust Enrichment" (2000), 58 *U.T. Fac. L. Rev.* 185, at pp. 204-5.

However, it is not required that directors and officers in all cases avoid personal gain as a direct or indirect result of their honest and good faith supervision or management of the corporation. In many cases the interests of directors and officers will innocently and genuinely coincide with those of the corporation. If directors and officers are also shareholders, as is often the case, their lot will automatically improve as the corporation's financial condition improves. Another example is the compensation that directors and officers usually draw from the corporations they serve. This benefit, though paid by the corporation, does not, if reasonable, ordinarily place them in breach of their fiduciary duty. Therefore, all the circumstances may be scrutinized to determine whether the directors and officers have acted honestly and in good faith with a view to the best interests of the corporation.

In our opinion, the trial judge's determination that there was no fraud or dishonesty in the Wise brothers' attempts to solve the mounting inventory problems of Peoples and Wise stands in the way of a finding that they breached their fiduciary duty. Greenberg J. stated:

We hasten to add that in the present case, the Wise Brothers derived no direct personal benefit from the new domestic inventory procurement policy, albeit that, as the controlling shareholders of Wise Stores, there was an indirect benefit to them. Moreover, as was conceded by the other parties herein, in deciding to implement the new domestic inventory procurement policy, there was no dishonesty or fraud on their part.

((1998), 23 C.B.R. (4th) 200, at para. 183)

The Court of Appeal relied heavily on this finding by the trial judge, as do we. At para. 83 QL, Pelletier J.A. stated that:

[TRANSLATION] In regard to fiduciary duty, I would like to point out that the brothers were driven solely by the wish to resolve the problem of inventory procurement affecting both the operations of Peoples Inc. and those of Wise. [This is a] motivation that is in line with the pursuit of the interests of the corporation within the meaning of paragraph 122(1)(a) C.B.C.A. and that does not expose them to any justified criticism.

As explained above, there is no doubt that both Peoples and Wise were struggling with a serious inventory management problem. The Wise brothers considered the problem and implemented a policy they hoped would solve it. In the absence of evidence of a personal interest or improper purpose in the new policy, and in light of the evidence of a desire to make both Wise and Peoples "better" corporations, we find that the directors did not breach their fiduciary duty under s. 122(1)(*a*) of the CBCA. See *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123

Digitized by Google

(Ont. Ct. (Gen. Div.)) (aff'd (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.)), in which Farley J., at p. 171, correctly observes that in resolving a conflict between majority and minority shareholders, it is safe for directors and officers to act to make the corporation a "better corporation".

This appeal does not relate to the non-statutory duty directors owe to shareholders. It is concerned only with the statutory duties owed under the CBCA. Insofar as the statutory fiduciary duty is concerned, it is clear that the phrase the "best interests of the corporation" should be read not simply as the "best interests of the shareholders". From an economic perspective, the "best interests of the corporation" means the maximization of the value of the corporation: see E. M. Iacobucci, "Directors' Duties in Insolvency: Clarifying What Is at Stake" (2003), 39 *Can. Bus. L.J.*398, at pp. 400-1. However, the courts have long recognized that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation. For example, in *Teck Corp. v. Millar* (1972), 33 D.L.R. (3d) 288 (B.C.S.C.), Berger J. stated, at p. 314:

> A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting *bona fide* in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered *bona fide* the interests of the shareholders.
>
> I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees: *Parke v. Daily News Ltd.*, [1962] Ch. 927. But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.

The case of *Re Olympia & York Enterprises Ltd. and Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254 (Div. Ct.), approved, at p. 271, the decision in *Teck*, *supra*. We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.

The various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(*a*) of the CBCA. At all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.

The interests of shareholders, those of the creditors and those of the corporation may and will be consistent with each other if the corporation is profitable and well capitalized and has strong prospects. However, this can change if the corporation starts to struggle financially. The residual rights of the shareholders will generally become worthless if a corporation is declared bankrupt. Upon bankruptcy, the directors of the corporation transfer control to a trustee, who administers the corporation's assets for the benefit of creditors.

Short of bankruptcy, as the corporation approaches what has been described as the "vicinity of insolvency", the residual claims of shareholders will be nearly exhausted.

Digitized by Google

While shareholders might well prefer that the directors pursue high-risk alternatives with a high potential payoff to maximize the shareholders' expected residual claim, creditors in the same circumstances might prefer that the directors steer a safer course so as to maximize the value of their claims against the assets of the corporation.

The directors' fiduciary duty does not change when a corporation is in the nebulous "vicinity of insolvency". That phrase has not been defined; moreover, it is incapable of definition and has no legal meaning. What it is obviously intended to convey is a deterioration in the corporation's financial stability. In assessing the actions of directors it is evident that any honest and good faith attempt to redress the corporation's financial problems will, if successful, both retain value for shareholders and improve the position of creditors. If unsuccessful, it will not qualify as a breach of the statutory fiduciary duty.

For a discussion of the shifting interests and incentives of shareholders and creditors, see W. D. Gray, "*Peoples v. Wise* and *Dylex*: Identifying Stakeholder Interests upon or near Corporate Insolvency — Stasis or Pragmatism?" (2003), 39 *Can. Bus. L.J.* 242, at p. 257; E. M. Iacobucci and K. E. Davis, "Reconciling Derivative Claims and the Oppression Remedy" (2000), 12 *S.C.L.R.* (2d) 87, at p. 114. In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders. If the stakeholders cannot avail themselves of the statutory fiduciary duty (the duty of loyalty, *supra*) to sue the directors for failing to take care of their interests, they have other means at their disposal.

The Canadian legal landscape with respect to stakeholders is unique. Creditors are only one set of stakeholders, but their interests are protected in a number of ways. Some are specific, as in the case of amalgamation: s. 185 of the CBCA. Others cover a broad range of situations. The oppression remedy of s. 241(2)(*c*) of the CBCA and the similar provisions of provincial legislation regarding corporations grant the broadest rights to creditors of any common law jurisdiction: see D. Thomson, "Directors, Creditors and Insolvency: A Fiduciary Duty or a Duty Not to Oppress?" (2000), 58 *U.T. Fac. L. Rev.* 31, at p. 48. One commentator describes the oppression remedy as "the broadest, most comprehensive and most open-ended shareholder remedy in the common law world": S. M. Beck, "Minority Shareholders' Rights in the 1980s", in *Corporate Law in the 80s* (1982), 311, at p. 312. While Beck was concerned with shareholder remedies, his observation applies equally to those of creditors.

The fact that creditors' interests increase in relevancy as a corporation's finances deteriorate is apt to be relevant to, *inter alia*, the exercise of discretion by a court in granting standing to a party as a "complainant" under s. 238(*d*) of the CBCA as a "proper person" to bring a derivative action in the name of the corporation under ss. 239 and 240 of the CBCA, or to bring an oppression remedy claim under s. 241 of the CBCA.

Section 241(2)(*c*) authorizes a court to grant a remedy if

> the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner
>
> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer . . . .

Digitized by Google

A person applying for the oppression remedy must, in the court's opinion, fall within the definition of "complainant" found in s. 238 of the CBCA:

a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,

a director or an officer or a former director or officer of a corporation or any of its affiliates,

the Director, or

any other person who, in the discretion of a court, is a proper person to make an application under this Part.

Creditors, who are not security holders within the meaning of para. (*a*), may therefore apply for the oppression remedy under para. (*d*) by asking a court to exercise its discretion and grant them status as a "complainant".

Section 241 of the CBCA provides a possible mechanism for creditors to protect their interests from the prejudicial conduct of directors. In our view, the availability of such a broad oppression remedy undermines any perceived need to extend the fiduciary duty imposed on directors by s. 122(1)(*a*) of the CBCA to include creditors.

The Court of Appeal, at paras. 98-99 QL, referred to *373409 Alberta Ltd. (Receiver of) v. Bank of Montreal*, [2002] 4 S.C.R. 312, 2002 SCC 81, as an indication by this Court that the interests of creditors do not have any bearing on the assessment of the conduct of directors. However, the receiver in that case was representing the corporation's rights and not the creditors' rights; therefore, the case has no application in this appeal. *373409 Alberta* involved an action taken by the receiver on behalf of the corporation against a bank for the tort of conversion. The sole shareholder, director and officer of 373409 Alberta Ltd., who was also the sole shareholder, director and officer of another corporation, Legacy Holdings Ltd., had deposited a cheque payable to 373409 Alberta Ltd. into the account of Legacy. While it was recognized, at para. 22, that the diversion of money from 373409 Alberta Ltd. to Legacy "may very well have been wrongful *vis-à-vis* [373409 Alberta Ltd.]'s creditors" (none of whom were involved in the action), no fraud had been committed against the corporation itself and the bank, acting on proper authority, had not wrongfully interfered with the cheque by carrying out the deposit instructions. The statutory duties of the directors were not at issue, nor were they considered, and no assessment of the creditors' rights was made. With respect, Pelletier J.A.'s broad reading of*373409 Alberta* was misplaced.

In light of the availability both of the oppression remedy and of an action based on the duty of care, which will be discussed below, stakeholders have viable remedies at their disposal. There is no need to read the interests of creditors into the duty set out in s. 122(1)(*a*) of the CBCA. Moreover, in the circumstances of this case, the Wise brothers did not breach the statutory fiduciary duty owed to the corporation.

The Statutory Duty of Care: Section 122(1)(b) of the CBCA

As mentioned above, the CBCA does not provide for a direct remedy for creditors against directors for breach of their duties and the C.C.Q. is used as suppletive law.

In Quebec, directors have been held liable to creditors in respect of either contractual or extra-contractual obligations. Contractual liability arises where the director personally guarantees a contractual obligation of the company. Liability also arises where the director personally acts in a manner that triggers his or her extra-contractual liability. See P. Martel, "Le 'voile corporatif' — l'attitude des tribunaux face à l'article 317 du Code civil du Québec" (1998), 58 *R. du B.* 95, at pp. 135-36; *Brasserie Labatt ltée v. Lanoue*, [1999] Q.J. No. 1108 (QL) (C.A.), *per* Forget J.A., at para. 29. It is clear that the Wise brothers cannot be held contractually liable as

Digitized by Google

they did not guarantee the debts at issue here. Extra- contractual liability is the remaining possibility.

To determine the applicability of extra-contractual liability in this appeal, it is necessary to refer to art. 1457 C.C.Q.:

Every person has a duty to abide by the rules of conduct which lie upon him, according to the circumstances, usage or law, so as not to cause injury to another.

Where he is endowed with reason and fails in this duty, he is responsible for any injury he causes to another person by such fault and is liable to reparation for the injury, whether it be bodily, moral or material in nature.

He is also liable, in certain cases, to reparation for injury caused to another by the act or fault of another person or by the act of things in his custody. [Emphasis added.]

Three elements of art. 1457 C.C.Q. are relevant to the integration of the director's duty of care into the principles of extra-contractual liability: who has the duty ("every person"), to whom is the duty owed ("another") and what breach will trigger liability ("rules of conduct"). It is clear that directors and officers come within the expression "every person". It is equally clear that the word "another" can include the creditors. The reach of art. 1457 C.C.Q. is broad and it has been given an open and inclusive meaning. See *Regent Taxi & Transport Co. v. Congrégation des Petits Frères de Marie*, [1929] S.C.R. 650, *per* Anglin C.J., at p. 655 (rev'd on other grounds, [1932] 2 D.L.R. 70 (P.C.)):

. . . to narrow the *prima facie* scope of art. 1053 C.C. [now art. 1457] is highly dangerous and would necessarily result in most meritorious claims being rejected; many a wrong would be without a remedy.

This liberal interpretation was also affirmed and treated as settled by this Court in *Lister v. McAnulty*, [1944] S.C.R. 317, and *Hôpital Notre-Dame de l'Espérance v. Laurent*, [1978] 1 S.C.R. 605.

This interpretation can be harmoniously integrated with the wording of the CBCA. Indeed, unlike the statement of the fiduciary duty in s. 122(1)(*a*) of the CBCA, which specifies that directors and officers must act with a view to the best interests of the corporation, the statement of the duty of care in

s. 122(1)(*b*) of the CBCA does not specifically refer to an identifiable party as the beneficiary of the duty. Instead, it provides that "[e]very director and officer of a corporation in exercising their powers and discharging their duties shall . . . exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances." Thus, the identity of the beneficiary of the duty of care is much more open-ended, and it appears obvious that it must include creditors. This result is clearly consistent with the civil law interpretation of the word "another". Therefore, if breach of the standard of care, causation and damages are established, creditors can resort to art. 1457 to have their rights vindicated. The only issue thus remaining is the determination of the "rules of conduct" likely to trigger extracontractual liability. On this issue, art. 1457 is explicit.

The first paragraph of art. 1457 does not set the standard of conduct. Instead, it incorporates by reference s. 122(1)(*b*) of the CBCA. The statutory duty of care is a "duty to abide by [a] rul[e] of conduct which lie[s] upon [them], according to the . . . law, so as not to cause injury to another". Thus, for the purpose of determining whether the Wise brothers can be held liable, only the CBCA is relevant. It is therefore necessary to outline the requirements of the duty of care embodied in s. 122(1)(*b*) of the CBCA.

That directors must satisfy a duty of care is a long-standing principle of the common law, although the duty of care has been reinforced by statute to become more

Digitized by Google

demanding. Among the earliest English cases establishing the duty of care were *Dovey v. Cory*, [1901] A.C. 477 (H.L.); *In re Brazilian Rubber Plantations and Estates, Ltd.*, [1911] 1 Ch. 425; and *In re City Equitable Fire Insurance Co.*, [1925] 1 Ch. 407 (C.A.). In substance, these cases held that the standard of care was a reasonably relaxed, subjective standard. The common law required directors to avoid being grossly negligent with respect to the affairs of the corporation and judged them according to their own personal skills, knowledge, abilities and capacities. See McGuinness, *supra*, at p. 776: "Given the history of the case law in this area, and the prevailing standards of competence displayed in commerce generally, it is quite clear that directors were not expected at common law to have any particular business skill or judgment."

The 1971 report entitled *Proposals for a New Business Corporations Law for Canada* (1971) ("Dickerson Report") culminated the work of a committee headed by R. W. V. Dickerson which had been appointed by the federal government to study the need for new federal business corporations legislation. This report preceded the enactment of the CBCA by four years and influenced the eventual structure of the CBCA.

The standard recommended by the Dickerson Report was objective, requiring directors and officers to meet the standard of a "reasonably prudent person" (vol. II, at. p. 74):

9.19

Every director and officer of a corporation in exercising his powers and discharging his duties shall

. . .

exercise the care, diligence and skill of a reasonably prudent person.

The report described how this proposed duty of care differed from the prevailing common law duty of care (vol. I, at p. 83):

242. The formulation of the duty of care, diligence and skill owed by directors represents an attempt to upgrade the standard presently required of them. The principal change here is that whereas at present the law seems to be that a director is only required to demonstrate the degree of care, skill and diligence that could reasonably be expected from him, having regard to his knowledge and experience— *Re City Equitable Fire Insurance Co.*, [1925] Ch. 425 — under s. 9.19(1)(b) he is required to conform to the standard of a reasonably prudent man. Recent experience has demonstrated how low the prevailing legal standard of care for directors is, and we have sought to raise it significantly. We are aware of the argument that raising the standard of conduct for directors may deter people from accepting directorships. The truth of that argument has not been demonstrated and we think it is specious. The duty of care imposed by s. 9.19(1)(b) is exactly the same as that which the common law imposes on every professional person, for example, and there is no evidence that this has dried up the supply of lawyers, accountants, architects, surgeons or anyone else. It is in any event cold comfort to a shareholder to know that there is a steady supply of marginally competent people available under present law to manage his investment. [Emphasis added.]

The statutory duty of care in s. 122(1)(*b*) of the CBCA emulates but does not replicate the language proposed by the Dickerson Report. The main difference is that the enacted version includes the words "in comparable circumstances", which modifies the statutory standard by requiring the context in which a given decision was made to be taken into account. This is not the introduction of a subjective element relating to the competence of the director, but rather the introduction of a contextual element into the statutory standard of care. It is clear that s. 122(1)(*b*) requires

Digitized by Google

more of directors and officers than the traditional common law duty of care outlined in, for example, *Re City Equitable Fire Insurance*, *supra*.

The standard of care embodied in s. 122(1)(*b*) of the CBCA was described by Robertson J.A. of the Federal Court of Appeal in *Soper v. Canada*, [1998] 1 F.C. 124, at para. 41, as being "objective subjective". Although that case concerned the interpretation of a provision of the *Income Tax Act*, it is relevant here because the language of the provision establishing the standard of care was identical to that of s. 122(1)(*b*) of the CBCA. With respect, we feel that Robertson J.A.'s characterization of the standard as an "objective subjective" one could lead to confusion. We prefer to describe it as an objective standard. To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director or officer are important in the case of the s. 122(1)(*b*) duty of care, as opposed to the subjective motivation of the director or officer, which is the central focus of the statutory fiduciary duty of s. 122(1)(*a*) of the CBCA.

The contextual approach dictated by s.122(1)(*b*) of the CBCA not only emphasizes the primary facts but also permits prevailing socio-economic conditions to be taken into consideration. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions. The establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care. However, even with good corporate governance rules, directors' decisions can still be open to criticism from outsiders. Canadian courts, like their counterparts in the United States, the United Kingdom, Australia and New Zealand, have tended to take an approach with respect to the enforcement of the duty of care that respects the fact that directors and officers often have business expertise that courts do not. Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made. Business decisions must sometimes be made, with high stakes and under considerable time pressure, in circumstances in which detailed information is not available. It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*. Because of this risk of hindsight bias, Canadian courts have developed a rule of deference to business decisions called the "business judgment rule", adopting the American name for the rule.

In *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177, Weiler J.A. stated, at p. 192:

The law as it has evolved in Ontario and Delaware has the common requirements that the court must be satisfied that the directors have acted reasonably and fairly. The court looks to see that the directors made a *reasonable* decision *not a perfect* decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision. This formulation of deference to the decision of the Board is known as the "business judgment rule". The fact that alternative transactions were rejected by the directors is irrelevant unless it can be shown that a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction. [Emphasis added; italics in original; references omitted.]

In order for a plaintiff to succeed in challenging a business decision he or she has to establish that the directors acted (i) in breach of the duty of care and (ii) in a way

Digitized by Google

that caused injury to the plaintiff: W. T. Allen, J. B. Jacobs and L. E. Strine, Jr., "Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law" (2001), 26 *Del. J. Corp. L.* 859, at p. 892.

Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(*b*) of the CBCA if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. In determining whether directors have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made.

The trustee alleges that the Wise brothers breached their duty of care under s. 122(1)(*b*) of the CBCA by implementing the new procurement policy to the detriment of Peoples' creditors. After considering all the evidence, we agree with the Court of Appeal that the implementation of the new policy was a reasonable business decision that was made with a view to rectifying a serious and urgent business problem in circumstances in which no solution may have been possible. The trial judge's conclusion that the new policy led inexorably to Peoples' failure and bankruptcy was factually incorrect and constituted a palpable and overriding error.

In fact, as noted by Pelletier J.A., there were many factors other than the new policy that contributed more directly to Peoples' bankruptcy. Peoples had lost $10 million annually while being operated by M & S. Wise, which was only marginally profitable and solvent with annual sales of $100 million (versus $160 million for Peoples), had hoped to improve the performance of its new acquisition. Given that the transaction was a fully leveraged buyout, for Wise and Peoples to succeed, Peoples' performance needed to improve dramatically. Unfortunately for both Wise and Peoples, the retail market in eastern Canada had become very competitive in the early 1990s, and this trend continued with the arrival of Wal- Mart in 1994. At paras. 152 and 154 QL, Pelletier J.A. stated:

[TRANSLATION] In reality, it was that particularly unfavourable financial situation in which the two corporations found themselves that caused their downfall, and it was M. & S. that, to protect its own interests, sounded the charge in December, rightly or wrongly judging that Peoples Inc.'s situation would only worsen over time. It is crystal-clear that the bankruptcy occurred at the most propitious time for M. & S.'s interests, when inventories were high and suppliers were unpaid. In fact, M. & S. recovered the entire balance due on the selling price and almost all of the other debts it was owed.

. . .

. . . the trial judge did not take into account the fact that the brothers derived no direct benefit from the transaction impugned, that they acted in good faith and that their true intention was to find a solution to the serious inventory management problem that each of the two corporations was facing. Because of an assessment error, he also ignored the fact that Peoples Inc. received a sizable consideration for the goods it delivered to Wise. Lastly, I note that the act for which the brothers were found liable, i.e. the adoption of a new joint inventory procurement policy, is not as serious as the trial judge made it out to be and that, in opposition to his view, the act was also not the true cause of the bankruptcy of Peoples Inc. [Emphasis added.]

Digitized by Google

The Wise brothers treated the implementation of the new policy as a decision made in the ordinary course of business and, while no formal agreement evidenced the arrangement, a monthly record was made of the inventory transfers. Although this may appear to be a loose business practice, by the autumn of 1993, Wise had already consolidated several aspects of the operations of the two companies. Legally they were two separate entities. However, the financial fate of the two companies had become intertwined. In these circumstances, there was little or no economic incentive for the Wise brothers to jeopardize the interests of Peoples in favour of the interests of Wise. In fact, given the tax losses that Peoples had carried forward, the companies had every incentive to keep Peoples profitable in order to reduce their combined tax liabilities.

Arguably, the Wise brothers could have been more precise in pursuing a resolution to the intractable inventory management problems, having regard to all the troublesome circumstances involved at the time the new policy was implemented. But we, like the Court of Appeal, are not satisfied that the adoption of the new policy breached the duty of care under s. 122(1)(*b*) of the CBCA. The directors cannot be held liable for a breach of their duty of care in respect of the creditors of Peoples.

The Court of Appeal relied on two additional provisions of the CBCA that in its view could rescue the Wise brothers from a finding that they breached the duty of care: ss. 44(2) and 123(4).

Section 44 of the CBCA, which was in force at the time of the impugned transactions but has since been repealed, permitted a wholly-owned subsidiary to give financial assistance to its holding body corporate:

44. (1) Subject to subsection (2), a corporation or any corporation with which it is affiliated shall not, directly or indirectly, give financial assistance by means of a loan, guarantee or otherwise

. . .

(2) A corporation may give financial assistance by means of a loan, guarantee or otherwise

. . .

to a holding body corporate if the corporation is a wholly-owned subsidiary of the holding body corporate;

While s. 44(2) as it then read qualified the prohibition under s. 44(1), it did not serve to supplant the duties of the directors under s. 122(1) of the CBCA. The Court of Appeal erred in concluding that s. 44(2) served as a blanket legitimization of financial assistance given by wholly-owned subsidiaries to parent corporations. In our opinion, it is incumbent upon directors and officers to exercise their powers in conformity with the duties of s. 122(1).

Although s. 44(2) authorized certain forms of financial assistance between corporations, this cannot exempt directors and officers from potential liability under s. 122(1) for any financial assistance given by subsidiaries to the parent corporation.

When faced with the serious inventory management problem, the Wise brothers sought the advice of the vice-president of finance, David Clément. The Wise brothers claimed as an additional argument that in adopting the solution proposed by Clément, they were relying in good faith on the judgment of a person whose profession lent credibility to his statement, in accordance with the defence provided for in s. 123(4)(*b*) (now s. 123(5)) of the CBCA. The Court of Appeal accepted the argument. We disagree.

The reality that directors cannot be experts in all aspects of the corporations they

Digitized by Google

manage or supervise shows the relevancy of a provision such as s. 123(4)(*b*). At the relevant time, the text of s. 123(4) read:

123. . . .

. . .

(4) A director is not liable under section 118, 119 or 122 if he relies in good faith on

financial statements of the corporation represented to him by an officer of the corporation or in a written report of the auditor of the corporation fairly to reflect the financial condition of the corporation; or

a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by him.

Although Clément did have a bachelor's degree in commerce and 15 years of experience in administration and finance with Wise, this experience does not correspond to the level of professionalism required to allow the directors to rely on his advice as a bar to a suit under the duty of care. The named professional groups in s. 123(4)(*b*) were lawyers, accountants, engineers, and appraisers. Clément was not an accountant, was not subject to the regulatory overview of any professional organization and did not carry independent insurance coverage for professional negligence. The title of vice-president of finance should not automatically lead to a conclusion that Clément was a person "whose profession lends credibility to a statement made by him". It is noteworthy that the word "profession" is used, not "position". Clément was simply a non-professional employee of Wise. His judgment on the appropriateness of the solution to the inventory management problem must be regarded in that light. Although we might accept for the sake of argument that Clément was better equipped and positioned than the Wise brothers to devise a plan to solve the inventory management problems, this is not enough. Therefore, in our opinion, the Wise brothers cannot successfully invoke the defence provided by s. 123(4)(*b*) of the CBCA but must rely on the other defences raised.

The Claim Under Section 100 of the BIA

The trustee also claimed against the Wise brothers under s. 100 of the BIA. That section reads:

100. (1) Where a bankrupt sold, purchased, leased, hired, supplied or received property or services in a reviewable transaction within the period beginning on the day that is one year before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, the court may, on the application of the trustee, inquire into whether the bankrupt gave or received, as the case may be, fair market value in consideration for the property or services concerned in the transaction.

(2) Where the court in proceedings under this section finds that the consideration given or received by the bankrupt in the reviewable transaction was conspicuously greater or less than the fair market value of the property or services concerned in the transaction, the court may give judgment to the trustee against the other party to the transaction, against any other person being privy to the transaction with the bankrupt or against all those persons for the difference between the actual consideration given or received by the bankrupt and the fair market value, as determined by the court, of the property or services concerned in the transaction.

The provision has two principal elements. First, subs. (1) requires the transaction to have been conducted within the year preceding the date of bankruptcy. Second, subs. (2) requires that the consideration given or received by the bankrupt be "conspicuously greater or less" than the fair market value of the property concerned.

Digitized by Google

The word "may" is found in both ss. 100(1) and 100(2) of the BIA with respect to the jurisdiction of the court. In *Standard Trustco Ltd. (Trustee of) v. Standard Trust Co.* (1995), 26 O.R. (3d) 1, a majority of the Ontario Court of Appeal held that, even if the necessary preconditions are present, the exercise of jurisdiction under s. 100(1) to inquire into the transaction, and under s. 100(2) to grant judgment, is discretionary. Equitable principles guide the exercise of discretion. We agree.

Referring to s. 100(2) of the BIA, in *Standard Trustco*, *supra*, at p. 23, Weiler J.A. explained that:

When a contextual approach is adopted it is apparent that although the conditions of the section have been satisfied the court is not obliged to grant judgment. The court has a residual discretion to exercise. The contextual approach indicates that the good faith of the parties, the intention with which the transaction took place, and whether fair value was given and received in the transaction are important considerations as to whether that discretion should be exercised.

We agree with Weiler J.A. and adopt her position; however, this appeal does not turn on the discretion to ultimately impose liability. In our view, the Court of Appeal did not interfere with the trial judge's exercise of discretion in reviewing the facts and finding a palpable and overriding error.

Within the year preceding the date of bankruptcy, Peoples had transferred inventory to Wise for which the trustee claimed Peoples had not received fair market value in consideration. The relevant transactions involved, for the most part, transfers completed in anticipation of the busy holiday season. Given the non-arm's length relationship between Wise and its wholly-owned subsidiary Peoples, there is no question that these inventory transfers could have constituted reviewable transactions.

We share the view of the Court of Appeal that it is not only the final transfers that should be considered. In fairness, the inventory transactions should be considered over the entire period from February to December 1994, which was the period when the new policy was in effect.

In *Skalbania (Trustee of) v. Wedgewood Village Estates Ltd.* (1989), 37 B.C.L.R. (2d) 88 (C.A.), the test for determining whether the difference in consideration is "conspicuously greater or less" was held to be not whether it is conspicuous to the parties at the time of the transaction, but whether it is conspicuous to the court having regard to all the relevant factors. This is a sound approach. In that case, a difference of $1.18 million between fair market value and the consideration received by the bankrupt was seen as conspicuous, where the fair market value was $6.6 million, leaving a discrepancy of more than 17 percent. While there is no particular percentage that definitively sets the threshold for a conspicuous difference, the percentage difference is a factor.

As for the factors that would be relevant to this determination, the court might consider, *inter alia*: evidence of the margin of error in valuing the types of assets in question; any appraisals made of the assets in question and evidence of the parties' honestly held beliefs regarding the value of the assets in question; and other circumstances adduced in evidence by the parties to explain the difference between the consideration received and fair market value: see L. W. Houlden and G. B. Morawetz, *Bankruptcy and Insolvency Law of Canada* (3rd ed. (loose-leaf)), vol. 2, at p. 4-114.1.

Over the lifespan of the new policy, Peoples transferred to Wise inventory valued at $71.54 million. As of the date of bankruptcy, it had received $59.50 million in property or money from Wise. As explained earlier, the trial judge adjusted the outstanding difference down to a balance of $4.44 million after taking into account, *inter alia*, the

Digitized by Google

reallocation of general and administrative expenses, and adjustments necessitated by imported inventory transferred from Wise to Peoples. Neither party disputed these figures before this Court. We agree with the Court of Appeal's observation that these findings directly conflict with the trial judge's assertion that Peoples had received no consideration for the inventory transfers on the basis that the outstanding accounts were "neither collected nor collectible" from Wise. Like Pelletier J.A., we conclude that the trial judge's finding in this regard was a palpable and overriding error, and we adopt the view of the Court of Appeal.

We are not satisfied that, with regard to all the circumstances of this case, a disparity of slightly more than 6 percent between fair market value and the consideration received constitutes a "conspicuous" difference within the meaning of s. 100(2) of the BIA. Accordingly, we hold that the trustee's claim under the BIA also fails.

In addition to permitting the court to give judgment against the other party to the transaction, s. 100(2) of the BIA also permits it to give judgment against someone who was not a party but was "privy" to the transaction. Given our finding that the consideration for the impugned transactions was not "conspicuously less" than fair market value, there is no need to consider whether the Wise brothers would have been "privy" to the transaction for the purpose of holding them liable under s. 100(2). Nonetheless, the disagreement between the trial judge and the Court of Appeal on the interpretation of "privy" in s. 100(2) of the BIA warrants the following observations.

The trial judge in this appeal had little difficulty finding that the Wise brothers were privy to the transaction within the meaning of s. 100(2). Pelletier J.A., however, preferred a narrow construction in finding that the Wise brothers were not privy to the transactions. He held, at para. 135 QL, that:

[TRANSLATION] . . . the legislator wanted to provide for the case in which a person other than the co-contracting party of the bankrupt actually received all or part of the benefit resulting from the lack of equality between the respective considerations.

To support this direct benefit requirement, Pelletier J.A. also referred to the French version which uses the term *ayant intérêt*. While he conceded that the respondent brothers received an indirect benefit from the inventory transfers as shareholders of Wise, Pelletier J.A. found this too remote to be considered "privy" to the transactions (paras. 139-40 QL).

The primary purpose of s. 100 of the BIA is to reverse the effects of a transaction that stripped value from the estate of a bankrupt person. It makes sense to adopt a more inclusive understanding of the word "privy" to prevent someone who might receive indirect benefits to the detriment of a bankrupt's unsatisfied creditors from frustrating the provision's remedial purpose. The word "privy" should be given a broad reading to include those who benefit directly or indirectly from and have knowledge of a transaction occurring for less than fair market value. In our opinion, this rationale is particularly apt when those who benefit are the controlling minds behind the transaction.

A finding that a person was "privy" to a reviewable transaction does not of course necessarily mean that the court will exercise its discretion to make a remedial order against that person. For liability to be imposed, it must be established that the transaction occurred: (a) within the past year; (b) for consideration conspicuously greater or less than fair market value; (c) with the person's knowledge; and (d) in a way that directly or indirectly benefited the person. In addition, after having considered the context and all the above factors, the judge must conclude that the case is a proper one for holding the person liable. In light of these conditions and of

Digitized by Google

the discretion exercised by the judge, we find that a broad reading of “privy” is appropriate.

Disposition

For the foregoing reasons, we would dismiss the appeal with costs to the respondents.

Appeal dismissed with costs.

Solicitors for the appellant: Kugler Kandestin, Montréal.
Solicitors for the respondents Lionel Wise, Ralph Wise and Harold Wise: de Grandpré Chait,
Solicitors for the respondent Chubb Insurance Company of Canada: Lavery, de Billy, Montréal.

Digitized by Google

* Iacobucci J. took no part in the judgment.

Her Majesty the Queen v. Kevin Richard Buckingham, 2011 FCA 142, A Recent case on the New Purely Objective Test of Diligence and Care based on People's

MAINVILLE J.A.

REASONS FOR JUDGMENT

[1] In reasons cited as 2010 TCC 247 ("Reasons"), Webb J. of the Tax Court of Canada found that the respondent was not liable as a director of various corporations for the amounts the corporations failed to remit as source deductions under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), the *Canada Pension Plan*, R.S.C 1985, c. C-8 and the *Employment Insurance Act*, S.C. 1996, c. 23, but was so liable after February 2003 for the failure to make GST/HST remittances under the *Excise Tax Act*, R.S.C. 1985, c. E-15.

[2] The Crown appeals the judgment concerning the employee source deductions remittances in file A-224-10, while the respondent appeals the judgment concerning the GST/HST remittances in file A-225-10. Both appeals have been consolidated.

[3] These consolidated appeals raise the issue of the appropriate standard of care, diligence and skill required of a director under subsection 227.1(3) of the *Income Tax Act* (and related provisions of the *Canada Pension Plan* and of the *Employment Insurance Act*) and under subsection 323(3) of the *Excise Tax Act*.

Context

[4] The respondent and his family acquired control of Mosaic Technologies Corporation ("Mosaic") around 1997 in order to carry on an education services business. Shortly thereafter, Mosaic secured educational facilities in various locations across Canada. Mosaic also had a division that prepared online courses for large corporations and governments.

[5] The shares of Mosaic started to trade on the TSX Venture Exchange in 1998 or 1999. The company incurred an operating loss of $970,866 in 1999, made a profit of $253,110 in 2000 and then incurred losses of $451,161 in 2001 and $1,446,396 in 2002. After various unsuccessful efforts in 2002 and in early 2003 to secure additional capital and financing, the corporation unsuccessfully attempted to sell its assets and part of its business in order to pay its creditors. Mosaic ceased all operations in or shortly after September of 2003.

[6] The respondent was the chairman of the board of Mosaic and its largest shareholder. The trial judge found that he was involved in its day-to-day operations and played a significant role in these operations.

[7] The respondent was assessed pursuant to section 323 of the *Excise Tax Act* for GST/HST remittances which Mosaic had failed to make in March and June of 2003, as well as for associated penalties and interest. He was also assessed pursuant to section 227.1 of the *Income Tax Act*, section 21.1 of the *Canada Pension Plan* and section 83 of the *Employment Insurance Act* for Mosaic's failure to remit employee source deductions for the period of October 2002 to August 2003, as well as for associated penalties and interest.

Digitized by Google

Similar assessments were made against the respondent for the failures to remit employee source deductions by the various subsidiaries of Mosaic, namely Multimedia Ventures (Alberta) Inc., Multimedia Ventures Inc., and 6678 British Columbia Ltd.

[8] The respondent appealed all of these assessments to the Tax Court of Canada solely on the basis that he was not liable for these amounts as a result of the provisions of subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* which exonerate a director of liability where he "exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."

The Reasons of the trial judge

[9] Relying on his decision in *Higgins v. Canada*, 2007 TCC 469, the trial judge concluded, at

paragraphs 16 to 18 of his Reasons, that the "objective subjective" test set out in *Soper v. Canada*, [1998] 1 F.C. 124 (C.A.) ("*Soper*"), regarding the standard of care, diligence and skill required under subsection 227.1(3) of the *Income Tax Act* had been modified by the Supreme Court of Canada's decision in *Peoples Department Stores Inc.(Trustee of) v. Wise*, 2004 SCC 68, [2004] 3 S.C.R. 461 ("*Peoples Department Stores*"). The trial judge found that an objective standard should thus be used for the purposes of applying both subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act*, and that this standard incorporated the reasonable business decision test laid out in *Peoples Department Stores*.

[10] The question for the trial judge was therefore whether the respondent had acted prudently on a reasonably informed basis and whether his business decisions were reasonable in light of the circumstances about which he knew or ought to have known in order to prevent the failures to remit (Reasons at paras. 31, 56 and 82).

[11] The trial judge was however of the view that the analysis required in relation to remittances of employee source deductions should be dealt with separately from the analysis related to remittances of GST/HST. The need for a distinct analysis flowed, in the trial judge's view, from the fact that the "amounts for payroll deductions are not funded from a third party but are paid from whatever resources the company might have available to it" (Reasons at para. 33). For the trial judge, the remittance obligations related to source deductions are part of employee costs and are funded **through the general revenues of the corporation which may be insufficient to fund these remittances. On the other hand, remittances of the GST/HST are funded by third parties from whom the GST/HST is collected. This distinction lead the trial judge to conclude that two separate analyses of the standard of care, diligence and skill were required, one for the remittances of source deductions, and one for the remittances of GST/HST (Reasons at paras. 33 and 74-75).**

[12] Turning his attention to the employee source deductions remittances, the trial judge accepted the respondent's evidence that reasonable business measures were taken in 2002 and in January and February of 2003 to address the financial difficulties of Mosaic and to avoid failures to remit taxes, including work on a proposed equity issue, attempts to secure a line of credit, reductions in expenditures, and attempts to merge with another company.

[13] The trial judge found, at paragraphs 58 to 65 of his Reasons, that the facts

Digitized by Google

before him were similar to those in *Canada v. McKinnon*, [2001] 2 F.C. 203 (C.A) 2000 D.T.C. 6593 (*sub nom. Worrell v. Canada*) [2001] 1 C.T.C. 79 ("*Worrell*"), where emphasis was placed on the continued effort to find new investors. The trial judge also referred to this Court's decision in *Smith v. Canada*, 2001 FCA 84, 198 D.L.R. (4th) 257, for the principle that a director is only required to act reasonably. He concluded, at paragraphs 66 to 73 of his Reasons, that the respondent had done all that he could in the circumstances to secure additional funding for Mosaic through various means, and that consequently he had met the standard of care required of him under subsection 227.1(3) of the Income Tax Act.

[14] The trial judge further noted that following the failure to secure new funding, as of February 2003 the efforts of Mosaic turned towards the sale of its assets in order to pay creditors, including the arrears in employee source deductions remittances. Mosaic notably entered into a $1.6 million arrangement in May of 2003 for the sale of its online course development division. An amount of $600,000 was received from this sale in June of 2003 and used to pay various creditors, of which

$100,000 was sent to the Receiver General as a partial payment of the outstanding remittances. However, the $1 million balance of the sale price was never subsequently received.

[15] The trial judge further recognized, at paragraphs 69 to 72 of his Reasons, that even if the focus of the respondent's efforts after February of 2003 was directed towards selling assets in order to pay arrears or to correct failures in remittances, rather than towards preventing failures to occur, and even if the employee source deductions remittances had been diverted, a defence under subsection 227.1(3) of the *Income Tax Act* could nevertheless be successful:

[69] It also seems reasonable that while the Appellant is trying to arrange for a capital injection or a merger or the sale of a division or assets, that the company should continue to operate as long as there is a reasonable expectation that such events would occur. It does not seem to me that this reasonable expectation would have ended before the deal with GITI collapsed. After the deal with GITI collapsed in February 2003, the steps changed from seeking capital injections to liquidating assets. It seems to me that the liquidation of assets was more directed towards paying arrears (or correcting defaults) than it would be in preventing defaults from occurring. [Emphasis added]

[70] There would be a time delay from the time when the GITI deal collapsed and the employment of employees could be terminated. Reasonable notice is required to terminate employment without cause. As Justice Major noted in *The Queen in right of the Province of British Columbia* v. *Ossie Sylvester,* [1997] 2 S.C.R. 315:

1 Employment involves, among other things, a contract between the employer and employee. An employee who is wrongfully dismissed without reasonable notice of termination is entitled to damages for breach of contract. These damages represent the salary the employee would have earned had the employee worked during the notice period, less any amounts credited to mitigation.

[71] Employees simply cannot be dismissed without proper notice. This would mean that the obligation to pay salaries (or compensation for proper notice) will continue after any decision is made to dismiss employees and such costs (which will give rise to requirements to remit amounts under the applicable legislation) will be incurred regardless of whether the company has sufficient revenue to cover such costs. No

Digitized by Google

third party is necessarily providing the funds to the company to cover such costs.

[72] As well since Maxim was acquiring a division it seems reasonable that the employees of that division would be retained until the sale was completed and it seems to me that the Appellant would have had a reasonable expectation that the deal with Maxim would close.

[16] The trial judge nevertheless reached a different conclusion concerning the failure to remit GST/HST. He rejected the defence of the respondent, which had been essentially the same as that submitted for the failure to remit employee source deductions, and explained his decision to do so in the following terms (Reasons at para. 82):

The liquidation of assets was not undertaken to prevent failures to remit GST/HST. As noted by the Appellant, the decision to sell assets was made to realize cash so that the company could pay its bills. This would be done to cure defaults in remittances, not prevent failures to remit. As a result, it does not seem to me that the Appellant has satisfied the standard of care imposed on him pursuant to subsection 323(3) of the Excise Tax Act to prevent the failure to remit the net tax that was payable on April 30, 2003 and July 30, 2003.

The position of the Crown

- [17] The Crown argues that the trial judge committed an error in law by incorporating a cash - flow analysis into the duty of care, diligence and skill defence under subsection 227.1(3) of the *Income Tax Act*. This, in the Crown's view, significantly expands the defence available under that subsection and, if accepted, would pass to the Crown part of the risk associated with continuing a business which is facing financial difficulties. This is particularly offensive for the Crown in light of

the trial judge's finding at paragraph 33 of his Reasons that the respondent "had admitted that the amounts that had been deducted from the payroll payments were being used to pay other bills."

[18] By using amounts withheld on employee source deductions to pay third party creditors, the respondent tried to refinance his business in an effort to save it. Preferential payments were made to creditors other than the Crown purely for the purpose of continuing and preserving the continued operation of the business in order to attempt to salvage the respondent's investment. For the Crown this is exactly the mischief which section 227.1 of the *Income Tax Act* was intended to avoid.

- **[19] The Crown asserts that the trial judge failed to draw the distinction made in *Worrell* between actions which might be reasonable from a business point of view, and actions which would have prevented the failure to remit employee source deductions, and he thus erred in equating a general business intent with the more specific requirements of section 227.1 of the *Income Tax Act* which are directed to preventing the failure to remit.**

The position of the respondent

[20] In the respondent's view, *Worrell* stands for the proposition that insofar as the directors can demonstrate that they have made serious and reasonable efforts to resolve the financial difficulties faced by their corporation, they have met the standard of care, diligence and skill required to sustain a defence under either subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act*.

[21] In this case, the trial judge recognized that the respondent had made serious

Digitized by Google

and reasonable efforts to resolve the financial difficulties of Mosaic and of its subsidiaries, and applied the principles set out in *Worrell* to find that the respondent had successfully established a defence under subsection 227.1(3) of the *Income Tax Act*.

[22] The respondent adds that the trial judge erred in law by failing to follow *Worrell* with respect to the GST/HST remittances. Rather, the trial judge carried out a separate and distinct analysis of these remittances based on his concern that GST/HST funds are received from third parties, while source deductions are funded from the general revenues of the business. For the respondent, the trial judge erred in drawing this sharp contrast between GST/HST and source deduction remittances. Treating the GST/HST remittances separately from the source deduction remittances also resulted in the trial judge reaching contradictory findings of fact.

The issues

[23] These consolidated appeals raise three principal issues:

Is the applicable standard of care, diligence and skill under subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* an objective standard?

Does the standard under subsection 227.1(3) of the *Income Tax Act* apply differently than under subsection 323(3) of the *Excise Tax Act*?

Can a successful defence under subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act* be sustained where the efforts of the directors are focussed on curing failures to remit rather than towards preventing such failures?

Standard of review

[24] The decision of *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, sets out the applicable standard of appellate review in an appeal from a judgment of the Tax Court of Canada. The standard of review on a question of law is correctness, while findings of fact are not to be disturbed unless it can be established that the trial judge made a palpable and overriding error. The application of a legal standard to a set of facts is a question of mixed fact and law which is also subject to deference unless an extricable question of law can be identified.

[25] Whether a defence under subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act* has been established requires the application of a legal standard to a set of facts. Accordingly, these determinations generally constitute questions of mixed fact and law that are reviewable on a standard of palpable and overriding error: *Hartrell v. Canada*, 2008 FCA 59, 2008 D.T.C. 6173 at para.

3. However, the three issues raised by these consolidated appeals also raise extricable questions of law to which a standard of correctness applies.

The pertinent legislative provisions

[26] Paragraph 153(1)(*a*) of the *Income Tax Act* provides for income tax withholdings from employee wages, and for the remittance of these withholdings to the Receiver General. Subsection 227.1(1) of the *Income Tax Act* sets out that the directors of a corporation which has failed to so withhold and remit are jointly and severally, or solidarily, liable together with the corporation to pay the concerned amount and any related interest or penalties. Subsections 227.1(2) and (3) of the *Income Tax Act* provide for certain limitations on this liability of directors, notably by allowing a

Digitized by Google

defence of care, diligence and skill:

[27] Subsections 21(1) and 21.1(1) and (2) of the *Canada Pension Plan* set out similar withholding and remittance obligations in relation to contributions to the Canada Pension Plan:

[28] Similar provisions are also found in subsections 82(1) and 83(1) and (2) of the *Employment Insurance Act*:

[29] Paragraphs 228(1) and (2) of the *Excise Tax Act* require the filing of returns and the payment of remittances for the net tax owed in relation to goods and services, while subsection 323(1) provides that the directors of a corporation which has failed to so remit are jointly and severally, or solidarily, liable together with the corporation to pay the concerned amounts and any related interest or penalties. Subsections 323(2) and (3) provide for certain limitations on the liability of directors which are similar to those set out in the *Income Tax Act* for employee source deductions:

Analysis

The standard of care, diligence and skill

[30] There has been some debate in recent years as to whether the objective standard of care, diligence and skill developed by the Supreme Court of Canada in *Peoples Department Stores* in relation to paragraph 122(1)(*b*) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("CBCA") can extend to subsection 227.1(3) of the *Income Tax Act* and to subsection 323(3) of the *Excise Tax Act* which use almost identical language in their English versions and similar language in their French versions: *Hartrell v. Canada*, above at para.12; compare *Higgins v. Canada*, above at paras. 6 to 11, with *Liddle v. Canada*, 2009 TCC 451, 2009 D.T.C. 1296 at paras. 33 to 35. Paragraph 122(1)(*b*) of the CBCA reads as follows:

122. (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall (*b*) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.	**122.** (1) Les administrateurs et les dirigeants doivent, dans l'exercice de leurs fonctions, agir : *b*) avec le soin, la diligence et la compétence dont ferait preuve, en pareilles circonstances, une personne prudente.

Digitized by Google

[31] Though similar, the provisions of paragraph 122(1)(*b*) of the CBCA and of subsections 227.1(3) of the *Income Tax Act* and 323(3) of the *Excise Tax Act* have fundamentally different purposes. The different purposes to which these various provisions relate must inform the application of the standard of care, diligence and skill in each case.

[32] The duty of care in paragraph 122(1)(*b*) of the CBCA does not refer to an identifiable party as the beneficiary of the duty: *Peoples Department Stores* at para. 57. Thus, the identity of the beneficiaries of the duty of care under paragraph 122(1)(*b*) of the CBCA is open-ended and includes all creditors. This provision sets out a standard of behaviour that should reasonably be expected, though it does not provide an independent foundation for claims: *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, [2008] 3 S.C.R. 560 at para. 44.

[33] On the other hand, subsection 227.1(1) of the *Income Tax Act* and subsection 323(1) of the *Excise Tax Act* specifically provide that the directors "are jointly and severally, or solidarily, liable, together with the corporation, to pay the amount and any interest or penalties relating to" the remittances the corporation is required to make. Subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* do not set out a general duty of care, but rather provide for a defence to the specific liability set out in subsections 227.1(1) and 323(1) of these respective Acts, and the burden is on the directors to prove that the conditions required to successfully plead such a defence have been met. The duty of care in subsection 227.1(3) of the *Income Tax Act* also specifically targets the prevention of the failure by the corporation to remit identified tax withholdings, including notably employee source deductions. Subsection 323(3) of the *Excise Tax Act* has a similarly focus. The directors must thus establish that they exercised the degree of care, **diligence and skill required "to prevent the failure". The focus of these provisions is clearly on the prevention of failures to remit.**

[34] This *caveat* being stated, I agree with the trial judge that the "objective subjective" standard set out in *Soper* has been replaced by the objective standard laid down by the Supreme Court of Canada in *Peoples Department Stores*. I come to this conclusion in light of the language used in subsection 227.1(3) of the *Income Tax Act* and in subsection 323(3) of the *Excise Tax Act*, and also by applying the principle of the presumption of coherence between statutes.

[35] The words of legislation are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the legislation, the purpose of the legislation, and the intention of Parliament: *Bell ExpressVu Limited Partnership v. Rex,* [2002] 2 S.C.R. 559 at para. 26**. Both subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* refer to the degree of care, diligence and skill "that a reasonably prudent person would have exercised in comparable circumstances." The reference to a reasonably prudent person is a clear indication that the test is objective rather than subjective.**

[36] Moreover, the language used in paragraph 122(1)(*b*) of the CBCA is similar to that used in both subsections 227.1(3) of the *Income Tax Act* and 323(3) of the *Excise Tax Act*. This is not a mere coincidence, but rather a further indication that the standard of care, diligence and skill required by **all these provisions is similar. Similar legislative language dealing with similar matters should be given a similar interpretation unless the legislative context indicates otherwise: *Pointe-Claire (City) v Quebec (Labour Court)*, [1997] 1 S.C.R. 1015 at para. 61; *R. v. Ulybel Enterprises Ltd.*, [2001] 2 S.C.R. 867, 2001 SCC 56 at para. 52; *Bell ExpressVu Limited Partnership v. Rex*, above at para. 27; Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (Markham, Ontario: LexisNexis Canada 2008) at pp. 223 to 225.**

Digitized by Google

[37] Consequently, I conclude that the standard of care, skill and diligence required under subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act* is an objective standard as set out by the Supreme Court of Canada in *Peoples Department Stores*.

[38] This objective standard has set aside the common law principle that a director's management of a corporation is to be judged according to his own personal skills, knowledge, abilities and capacities: *Peoples Department Stores* at paras. 59 to 62. To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director are important as opposed to the subjective motivations of the directors: *Peoples Department Stores* at para. 63. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions through the establishment of good corporate governance rules: *Peoples Department Stores* at para. 64. Stricter standards also discourage the appointment of inactive directors chosen for show or who fail to discharge their duties as director by leaving decisions to the active directors. Consequently, a person who is appointed as a director must carry out the duties of that function on an active basis and will not be allowed to defend a claim for malfeasance in the **discharge of his or her duties by relying on his or her own inaction: Kevin P. McGuinness, *Canadian Business Corporations Law*, 2nd ed. (Markham, Ontario: LexisNexis Canada, 2007) at 11.9.**

[39] An objective standard does not however entail that the particular circumstances of a director are to be ignored. These circumstances must be taken into account, but must be considered against an objective "reasonably prudent person" standard. As noted in *Peoples Department Stores* at paragraph 62:

The statutory duty of care in s. 122(1)(*b*) of the CBCA emulates but does not replicate the language proposed by the Dickerson Report. The main difference is that the enacted version includes the words "in comparable circumstances", which modifies the statutory standard by requiring the context in which a given decision was made to be taken into account. This is not the introduction of a subjective element relating to the competence of the director, but rather the introduction of a contextual element into the statutory standard of care. It is clear that s. 122(1)(*b*) requires more of directors and officers than the traditional common law duty of care outlined in, for example, *Re City Equitable Fire Insurance, supra* [[1925] 1 Ch. 407].

[40] The focus of the inquiry under subsections 227.1(3) of the *Income Tax Act* and 323(3) of the *Excise Tax Act* will however be different than that under 122(1)(*b*) of the CBCA, since the former require that the director's duty of care, diligence and skill be exercised to prevent failures to remit. In order to rely on these defences, a director must thus establish that he turned his attention to the required remittances and that he exercised his duty of care, diligence and skill with a view to preventing a failure by the corporation to remit the concerned amounts.

Does the standard under subsection 323(3) of the Excise Tax Act *apply differently than under subsection 227.1(3) of the* Income Tax Act*?*

[41] Since GST/HST is paid by third parties, while employee source deductions are funded by general business revenues which may be insufficient to allow their payment, the trial judge was of the view that an analysis under subsection 227.1(3) of the *Income Tax Act* must be carried out separately from an analysis under subsection 323(3) of the *Excise Tax Act*. This distinction resulted in two different applications of the standard of care, diligence and skill defence.

[42] However, employee source deductions are also paid by third parties, the employees, and there is therefore no fundamental conceptual difference between

Digitized by Google

employee source deductions remittances and GST/HST remittances which justify a separate analysis of the duty of care, diligence and skill defence on the sole basis of the origin of the funds. This notably flows from subsection 153(3) of the *Income Tax Act* which states that any amount withheld from employee remuneration "shall, for the purposes of this Act, be deemed to have been received at that time by the person to whom the remuneration, benefit, payment, fees, commissions or other amounts were paid." Similar provisions are found in subsection 21(5) of the *Canada Pension Plan* and in subsection 82(7) of the *Employment Insurance Act*.

[43] Consequently, the amounts withheld from employee remuneration for income tax, Canada Pension Plan and Employment Insurance purposes are deemed to have been paid by the employee for all purposes associated with these Acts, including for the purposes of assessing the liability of directors for the failure of their corporation to remit the amounts so withheld.

[44] In addition, subsection 227(4) of the *Income Tax Act* provides that those who deduct or withhold an amount under this Act are deemed to hold the amount separate and apart in trust for Her Majesty and for payment in the manner and at the time provided under the Act.

[45] The cash-flow analysis proposed by the trial judge is thus incompatible with the applicable provisions of the *Income Tax Act*. The liability of the directors under subsection 227.1(1) is not conditional on the existence of sufficient cash in the corporation to pay the remittances of employee source deductions, quite the contrary.

[46] The cash-flow analysis proposed by the trial judge also assumes that the time frame in which to assess the director's conduct begins when the corporation runs out of cash. The assessment of the director's conduct rather begins when it becomes apparent to the director, acting reasonably and with due care, diligence and skill, that the corporation is entering a period of financial difficulties: *Soper* at para. 50.

[47] The distinction proposed by the trial judge would also convert the liability of directors under section 323 of the *Excise Tax Act* into an absolute liability, which is clearly not the intention of Parliament in light of subsection 323(3) of that Act. The distinction would also result in directors having a lesser responsibility in relation to employee source deductions remittances than in relation to GST/HST remittances, a distinction which is not supported by the words of either section 227.1 of the *Income Tax Act* or section 323 of the *Excise Tax Act*. Since both these legislative provisions are drafted in similar terms, they should consequently be applied in a similar fashion. The introduction of a distinction which is not set out in the legislation should be avoided.

Can a defence under subsection 227.1(3) of the Income Tax Act or under subsection 323(3) of the Excise Tax Act be sustained where the efforts of the directors are focussed on curing failures to remit rather than preventing such failures?

[48] **An important question arising from this appeal is whether a successful defence under subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act* can be sustained where the directors continue to operate the business of the corporation knowing that this could lead to and has in fact resulted in failures to remit in circumstances where they have a reasonable expectation that the failures could be cured, notably through asset sales or through the sale of part or all of the business.** The trial judge took two apparently contradictory positions in this matter, accepting such a defence in regard to the employee source deductions remittances (Reasons at paras. 69 to 72) but rejecting it in regard to the GST/HST remittances (Reasons at para. 82).

[49] The traditional approach has been that a director's duty is to prevent the failure to

Digitized by Google

remit, not to condone it in the hope that matters can be rectified subsequently: *Canada v. Corsano*, [1999] 3 **F.C. 173 (C.A.) at para. 35, *Ruffo v. Canada*, 2000 D.T.C. 6317, [2000] 4 C.T.C. 39 (F.C.A.). Contrary to the suppliers of a corporation who may limit their financial exposure by requiring cash-in-advance payments, the Crown is an involuntary creditor. The level of the Crown's exposure to the corporation can thus increase if the corporation continues its operations by paying the net salaries of the employees without effecting employee source deductions remittances, or if the corporation decides to collect GST/HST from customers without reporting and remitting these amounts in a timely fashion. In circumstances where a corporation is facing financial difficulties, it may be tempting to divert these Crown remittances in order to pay other creditors and thus ensure the continuation of the operations of the corporation. It is precisely such a situation which both section 227.1 of the *Income Tax Act* and section 323 of the *Excise Tax Act* seek to avoid. The defence under subsection 227.1(3) of the *Income Tax Act* and under subsection 323(3) of the *Excise Tax Act* should not be used to encourage such failures by allowing a due diligence defence for directors who finance the activities of their corporation with Crown monies on the expectation that the failures to remit could eventually be cured.**

[50] The respondent however relies on *Worrell* for the proposition that this traditional approach has been modified. *Worrell* concerned the application of the defence of care, diligence and skill in circumstances where the corporation's ability to make remittance payments was at the discretion of its bank and where it was reasonable for the directors to believe that, by continuing the business of the corporation, they could restore its fortunes. While recognizing that it will normally not be sufficient for directors to simply carry on a business knowing that a failure to remit was likely but hoping that the company's future would revive with an upturn in the economy or in its market position, the Court also recognized in *Worrell* that where a reasonable expectation supported this belief in order to avoid future failures to remit, the defence of due diligence could be established in certain exceptional circumstances. *Worrell* must however be read in light of the particular facts of that case, including notably "the limitations placed on [the directors] by the bank's *de facto* control of the company's finances" (*Worrell* at para. 79), and it should therefore not be understood as providing for a new approach to the due diligence defence.

[51] **It is thus important to note that *Worrell* did not modify the focus of the defence of care, diligence and skill, which is to prevent the failure to remit, not to cure failures to do so**. As noted in *Worrell* at paragraph 34:

However, whether the directors did enough to exempt themselves from liability for the unremitted source deductions and G.S.T. will depend, in part at least, on the fourth principle to be found in the case law: the due diligence required of company directors by subsection 227.1(3) is to prevent the failure to remit. This has been held to mean that, if directors become liable *prima facie* for a company's failure to remit, they normally cannot claim the benefit of subsection 227.1(3) if their efforts were capable only of enabling them to remedy defaults after they have occurred. Accordingly, of the measures taken in an attempt to rescue [their corporation], the most relevant to this inquiry are limited to the ones that were logically capable of preventing failures to remit the source deductions and G.S.T. when they became due. [Emphasis added]

[52] Parliament did not require that directors be subject to an absolute liability for the remittances of their corporations. Consequently, Parliament has accepted that a corporation may, in certain circumstances, fail to effect remittances without its directors incurring liability. What is required is that the directors establish that they were specifically concerned with the tax remittances and that they exercised their duty of care, diligence and skill with a view to preventing a failure by the corporation to remit the concerned amounts.

Digitized by Google

[53] In this case, the trial judge found that until February 2003, the respondent had a reasonable expectation that the efforts being made would succeed in avoiding the failures to remit taxes, but that subsequent to that time, the efforts were rather aimed at curing defaults in remittances (Reasons at para. 69, reproduced above). This finding of fact has not been challenged before us. Thus, by the end of February 2003 the respondent no longer had any reasonable expectation of preventing the failures of employee source deductions remittances and of GST/HST remittances.

[54] However, the trial judge further found that it was reasonable for the respondent to believe that the sale of the online course development division for $1.6 million could provide funds for the payment of arrears on remittances. Was this sufficient to dispel the respondent's liability for the remittances for the period after February 2003? The trial judge found that it was in relation to the employee source deduction remittances, but not in relation to GST/HST remittances.

[55] The trial judge justified his approach based on the reasoning that even if all the employees had been laid-off shortly after February 2003, reasonable notice would have been required giving rise to related source deductions remittances regardless of whether the company had sufficient revenues to cover such costs. He further found that in light of the contemplated sale of the online course development division for
$1.6 million, it was reasonable that the employees of that division be retained until the sale was completed. I find neither of these arguments persuasive.

[56] A director of a corporation cannot justify a defence under the terms of subsection 227.1(3) of the *Income Tax Act* where he condones the continued operation of the corporation by diverting employee source deductions to other purposes. The entire scheme of section 227.1 of the *Income Tax Act*, read as a whole, is precisely designed to avoid such situations. In this case, though the respondent had a reasonable (but erroneous) expectation that the sale of the online course development division could result in a large payment which could be used to satisfy creditors, he consciously transferred part of the risks associated with this transaction to the Crown by continuing operations knowing that employee source deductions would not be remitted. This is precisely the mischief which subsection 227.1 of the *Income Tax Act* seeks to avoid.

[57] Once the trial judge found as a matter of fact that the respondent's efforts after February 2003 were no longer directed towards the avoidance of failures to remit, no successful defence under either subsection 227.1(3) of the *Income Tax Act* or subsection 323(3) of the *Excise Tax Act* could be sustained. [58] The trial judge was consequently correct in concluding that a defence under subsection 323(3) of the *Excise Tax Act* was not available after February 2003 in light of his finding that the respondent's focus had shifted away from avoiding failures to remit the taxes owed. The trial judge however erred in not applying the same reasoning to the defence under subsection 227.1(3) of the *Income Tax Act* concerning the failures to remit employee source deductions after February 2003.

Conclusion

[59] I would grant the appeal in file A-224-10, set aside the judgment of the Tax Court of Canada in Docket 2008-2817(IT)G and, giving the judgment which should have been rendered, refer the matter back to the Minister of National Revenue for reconsideration and reassessment on the basis that the respondent is liable under section 227.1 of the *Income Tax Act*, section 21.1 of the *Canada Pension Plan* and section 83 of the *Employment Insurance Act* as a director of Mosaic Technologies Corporation, Multimedia Ventures (Alberta) Inc., Multimedia Ventures Inc. and 6678 British Columbia Ltd. for the amounts these corporations failed to remit under these Acts for the period subsequent to February 2003 as well as for any interest or penalties relating to these amounts.

Digitized by Google

[60] I would also dismiss the appeal in file A-225-10. I would order only one set of costs in favour of the Crown in file A-224-10.
"Robert M. Mainville" J.A.
"I agree
M. Nadon J.A." "I agree
J.D. Denis Pelletier J.A."

---

81 It shouldn't be possible to file a fairness application in clear instances of director neglect.
20120928
Docket: T-915-11 Citation: 2012 FC 1146
Ottawa, Ontario, September 28, 2012 PRESENT: The Honourable Mr. Justice Phelan BETWEEN:
T & S FIRST CHOICE RENOVATIONS LIMITED

And **Applicant**
CANADA REVENUE AGENCY **Respondent**

REASONS FOR JUDGMENT AND JUDGMENT

INTRODUCTION

[1] This judicial review concerns a decision of the Canada Revenue Agency [CRA] denying T & S First Choice Renovation Limited's [First Choice] request for the cancellation or waiver of penalties and interest with respect to its corporate tax, payroll and GST accounts for the 2007 tax year. The decision letter was only concerning the payroll 2007 accounts. GST for 2007 and 2008 and payroll for 2008 were considered in a second letter. That second letter was a first administrative review. Both letters a re in the Applicant's Record; CRA only included the one that was under judicial review.

[2] The original style of cause suggested that the decision was in respect of Mr. Dakha personally but the record indicates t hat the decision was made in respect of the corporation only. The only debt at issue is that of the corporation even though Mr. Dakha used personal money in the amount of $10,000 to try to address the corporate liability.

[3] In the course of argument, it was made clear by counsel for the Respondent that this matter did not involve either Mr. Dakha or his associate Mr. Sidhu personally and that no claim has been advanced against them personally.

BACKGROUND

[4] The application for tax relief is based on s 220(3.1) of the *Income Tax Act*, RSC 1985, c 1 (5th Supp), which gives the Minister of National Revenue the discretion to waiver or cancel in whole or in part penalties and interest otherwise payable.

Digitized by Google

220. (3.1) The Minister may, on or before the day that is ten calendar years after the end of a taxation year of a taxpayer (or in the case of a partnership, a fiscal period of the partnership) or on application by the taxpayer or partnership on or before that day, waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer or partnership in respect of that taxation year or fiscal period, and notwithstanding subsections 152(4) to (5), any assessment of the interest and penalties payable by the taxpayer or partnership shall be made that is necessary to take into account the cancellation of the penalty or interest.

(3.1) Le ministre peut, au plus tard le jour qui suit de dix années civiles la fin de l'année d'imposition d'un contribuable ou de l'exercice d'une société de personnes ou sur demande du contribuable ou de la société de personnes faite au plus tard ce jour-là, renoncer à tout ou partie d'un montant de pénalité ou d'intérêts payable par ailleurs par le contribuable ou la société de personnes en application de la présente loi pour cette année d'imposition ou cet exercice, ou l'annuler en tout ou en partie. Malgré les paragraphes 152(4) à (5), le ministre établit les cotisations voulues concernant les intérêts et pénalités payables par le contribuable ou la société de personnes pour tenir compte de pareille annulation.

[5] The CRA, which acts as the Minister's delegate, has issued an information circular (Canada Revenue Agency, Income Tax Information Circular IC07-1, "Taxpayer Relief Provisions" (May 31, 2007)) explaining the policy to be applied. There are three circumstances where relief may be granted:

extraordinary circumstances – natural disasters, serious illness or accident and the like;

actions of the CRA – processing delays, misinformation and similar actions; and

inability to pay or financial hardship – for a person, prolonged inability to supply necessities or for a corporation, extreme financial difficulty and jeopardy to continued operations.

[6] The factors which are examined are:

whether or not the taxpayer has a history of compliance with tax obligations;

whether or not the taxpayer has knowingly allowed a balance to exist on which arrears interest has accrued;

whether or not the taxpayer has exercised a reasonable amount of care and has not been negligent or careless in conducting their affairs under the self-assessment system; and

whether or not the taxpayer has acted quickly to remedy any delay or omission.

[7] Mr. Dakha and Mr. Sidhu were the directors of First Choice. Mr. Dakha was largely responsible for business development.

[8] Mr. Dakha was seriously injured in a motorcycle accident in 2007 which meant that he could not continue to work. The business lost revenue and ceased operations in 2008.

[9] First Choice, through Mr. Dakha, applied for tax relief in 2008 and the final decision regarding the 2007 payroll taxes was issued in April 2011.

Digitized by Google

ANALYSIS

[10] It is well-established that the standard of review for the Minister's discretion is reasonableness (*Tefler v Canada (Revenue Agency)*, 2009 FCA 23).

[11] I can find nothing unreasonable in the Minister's decision. The factors were examined and a rational conclusion was reached on each:

There was no causal connection between Mr. Dakha's injury and the failure to meet tax obligations as there was another director capable of meeting the fiscal obligations.

The continuity of operations was a moot point as the corporation had ceased operations in 2008 for reasons other than pending tax liabilities.

The corporation had not made a meaningful attempt to address the tax portion of the debt although Mr. Dakha certainly did.

The corporation had not exercised reasonable care in conducting its tax affairs because it had past problems with compliance. The corporation had allowed penalties to accrue on its accounts since 2002.

[12] Under all these circumstances, I cannot see where the Minister's decision in respect of First Choice is unreasonable.

CONCLUSION

[13] This judicial review will be dismissed without costs.

JUDGMENT

THIS COURT'S JUDGMENT is that the application for judicial review is dismissed without costs.

"Michael L. Phelan"

Judge

Digitized by Google

The Attorney General Of Canada v. Lynda Mckinnon et al, A-421-98, Continuing Business in Face of Lack of Liquidity and Inside Directors' Diligence

REASONS FOR JUDGMENT EVANS J.A.

INTRODUCTION

[1] Company directors are jointly and severally liable to Revenue Canada for employee source deductions and Goods and Services Tax ("G.S.T.") that their company has failed to remit and that cannot be recovered from it. However, it is a defence for a director to establish that he or she exercised the care, diligence and skill of a reasonably prudent person in comparable circumstances to prevent the failure.

[2] This case concerns the application of this defence of due diligence to a situation where, because the company had run into financial difficulties, its ability to make remittance payments was at the discretion of the bank to which it was indebted, but where it was also reasonable for the directors to believe that, by continuing to operate the business, they could restore the fortunes of the company.

[3] Whether the directors in this case satisfied the statutory standard of due diligence by exercising the degree of care, skill and diligence to prevent such failures as would be shown by a reasonably prudent person in comparable circumstances depends largely on the particular facts. However, some important legal issues about the scope of the due diligence defence are also raised. [4] The proceeding argued before the Court is an appeal by the Crown against a decision of the Tax Court of Canada, dated June 4, 1998, in which McArthur J.T.C.C. allowed the taxpayer's appeal against a notice of assessment, both because the directors did not have *de facto* control of the company's finances and because they had exercised the requisite degree of care, skill and diligence to be exempted from liability for the company's failure to remit the employer portions of Canada Pension Plan ("C.P.P.") and Unemployment Insurance ("U.I.") deductions, and G.S.T.

[5] In addition, there are five other related proceedings. Each respondent is party to two proceedings: an appeal under the *Income Tax Act* in respect of the company's failure to remit C.P.P. and U.I., and an application for judicial review in respect of unremitted G.S.T. under the *Excise Tax Act*. The appeals are in files A-422-98, A-423-98 and A-425-98. The section 28 proceedings are in files A-421-98, A-424-98 and A- 426-98.

[6] The proceedings were heard together on common evidence; Mr. Worrell testified on behalf of both himself and the other respondents, his co-directors, Ms. McKinnon and Mr. Lapointe, who, together, were the active directors and managers of the company, Abel Metal Limited ("Abel"). Accordingly, one set of reasons will suffice to dispose of all six cases. A copy of these reasons will be placed in each of the files and, when filed, shall become reasons for judgment in each of the matters.

FACTUAL BACKGROUND

[7] Abel had been in business in the Toronto area for the best part of thirty years, manufacturing and supplying non-structural metal components used in construction. During the recession that hit the construction industry in the late 1980s and early 1990s Abel suffered serious losses. It began to experience financial difficulties in the fall of 1992, which continued into the following year. Nonetheless, in 1993 it still employed seventy people.

[8] Abel's bank, the Canadian Imperial Bank of Commerce, expressed concern over the company's April 1993 financial statement. As a result, one of the directors, Mr. Lapointe,

Digitized by Google

gave a personal guarantee to the bank of Abel's debt, which then stood at $1.6 million. Abel had reached the limit of its credit line by either the fall of 1992, or early in 1993. **Although in the past Abel had always paid its bills, on September 30, 1993 the bank dishonoured a company remittance cheque to Revenue Canada for insufficient funds, without giving prior notice to its customer.**

[9] Abel's already difficult financial situation had been made worse when its request for bonding in June 1993 was refused because there was insufficient equity in the company. The formal letter of refusal from the bonding company was dated August 30, 1993. Unless Abel could come up with new capital of some
$350,000, or find another source of bonding, the refusal of bonding would severely limit its ability to obtain profitable new contracts and to contain its already serious cash flow problem.

[10] In an attempt to extricate itself from its financial troubles, on October 16, 1993 Abel engaged a Mr. Humphreys, a chartered accountant, who had had considerable success in assisting other companies in the construction industry that had fallen into financial difficulty. Together with two of Abel's directors, he met with bank officials to discuss the bank's concerns and to try to work out solutions.

[11] However, on October 18, only two days later, the bank dishonoured a cheque for $46,000 drawn by Abel in favour of the Receiver General of Canada in respect of September payroll source deductions. At about the same time, the bank started to reduce the company's line of credit. In a letter dated October 22, 1993 the bank informed Abel that it should be careful not to issue cheques that would take it beyond its credit limit with the bank. **The bank also appointed BDO Dunwoody to "monitor" Abel's finances and to report to the bank on the company's prospects.**

[12] The bank also required the directors of Abel to seek approval almost daily for permission to pay the company's creditors. After the October cheque was dishonoured for insufficient funds, it was clear both to the directors and Mr. Humphreys that the bank could not be counted on to honour any cheques issued by Abel in respect of G.S.T. or source deduction remittances. Nonetheless, Ms. McKinnon continued to prepare remittance cheques in the hope that the bank would honour them, which, on a few occasions, it did on a discretionary basis.

[13] Mr. Humphreys was satisfied that Abel was a viable company: it was well established in the construction business and had weathered previous cyclical downturns in the industry. His view was that, with an injection of new capital, the company could be turned around quickly and, even if none were forthcoming, Abel would be profitable within eighteen months.

[14] Despite strenuous efforts, Mr. Humphreys could produce only one potential investor, but he was not acceptable to the bank. At this point, on April 27, 1994, the bank decided to call in its loans and Abel filed for bankruptcy. The company probably had been insolvent for the previous twelve months, even though it had apparently paid all its bills before the bank first dishonoured the first remittance cheque in September 1993.

[15] Nearly all of the company's debt to Revenue Canada for unremitted payments, from which the respondents' personal liability derives, accrued after October 18, 1993 when the bank started to exercise control over the cheques issued by Abel. After Abel filed for bankruptcy, the trustee paid some of the money owing, namely, all the outstanding employee portions of the deductions. However, the employer portions of C.P.P. and U.I., and the G.S.T., were not paid. The unpaid remittances (including interest and late payment penalties) amounted to $133,747.00 and were the subject of the assessments with which this appeal is concerned.

[16] In addition, section 21.1 of the *Canada Pension Plan*, R.S.C. 1985, c. C-8 and subsection 54(1) of the *Unemployment Insurance Act*, R.S.C 1985, c. U-1 respectively

Digitized by Google

incorporate section 227.1 of the *Income Tax Act* with regard to directors' liability for failing to remit C.P.P. and U.I. source deductions.

THE TAX COURT'S DECISION

[17] On the facts essentially as outlined above, McArthur J.T.C.C. held (at paragraph [16]) that, from October 18, 1993, when Abel's payroll remittance cheque was dishonoured, until the company filed for bankruptcy in April of the following year,

[I]t was the bank, and not the directors, that controlled the finances of Abel. This restriction on the directors' freedom of choice is sufficient to relieve the [directors] of personal liability for both the payroll assessment and the GST assessment. The [directors] did not have the freedom of choice to govern the corporation and prevent the failures to remit....

[18] Hence, since the directors had no *de facto* control over the payment of the company's debts, they were not liable under subsection 227.1(1), since this provision assumes that the directors had freedom of choice in this regard. He relied on *Robitaille v. Canada*, [1990] 1 C.T.C. 121 (F.C.T.D.) as the leading authority for this proposition, although he also noted that directors who lose *de facto* financial control of the company to its banker have also been excused under subsection 227.1(3) on the ground that, if in fact it was not within their power to prevent the company's default in making payroll remittances to Revenue Canada, they had satisfied the due diligence defence.

[19] In response to the argument that, in this situation, it was within the power of the directors of Abel to have prevented the company's foreseeable defaults by closing the business, McArthur J.T.C.C. relied on *Fancy v. Minister of National Revenue,* [1988] 2 C.T.C. 2256 (T.C.C.). In that case, where the circumstances were somewhat similar to those of the instant case, Couture C.J.T.C.C. had rejected this argument (at page 2261), on the ground that the liability created by subsection 227.1(1) was not absolute, but was conditional upon the directors'... personal conduct in respect of the circumstances linked to the omission by their company to remit the deductions from its employees' salary.

[20] McArthur J.T.C.C. inferred from this statement that if a reasonable person would, like the directors in this case, have continued to operate the company, subsection 227.1(3) provided a defence to the Crown's contention that they were personally liable for Abel's foreseeable failure to make remittances. The Judge found (at paragraph [19]) that, in not closing the company down prior to October 18, 1993, the "appellants took a common sense approach" in view of: the company's "obligation to its employees not to shut down without satisfactory evidence that the business was not viable"; its history of surviving previous recessions in the construction industry; Mr. Humphreys' advice, and his attempts to persuade the bank to honour its cheques to the Receiver General of Canada and to find investors acceptable to the bank; and Mr. Lapointe's guarantee.

[21] After doing what it reasonably could, the Judge concluded, the company lost effective control of its finances to the bank as from October 18, 1993, which relieved the directors of any personal liability for subsequent defaults.

ISSUES

Did the *de facto* control exercised by the bank over the company's ability to make remittances to Revenue Canada exclude the directors from the scope of subsection 227.1(1)?

If the answer to Issue 1 is in the negative, did the directors exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances to prevent the failures to remit so as to establish a defence under subsection 227.1(3)?

Digitized by Google

ANALYSIS

some general principles

[22] While there is no shortage of cases on the application of subsection 227.1(3), relatively few contain statements of principle on the approach to be taken to its interpretation and application. Rather, reasons for judgment tend to be framed in terms of the facts of the particular case: analysis often does not proceed much beyond the proposition that whether the "due diligence" defence has been established is to be determined by a consideration of all the circumstances of the case.

[23] In the absence of a developed analytical framework, cases are readily distinguishable on their facts, even when those facts, including the facts in the instant appeal, conform to a recurring general pattern. Inevitably, but without express advertence, some decisions exhibit a relatively strict approach to subsection 227.1(3), while others, including the decision under appeal here, adopt a view more favourable to the director.

[24] Nonetheless, amid this wilderness of single instances some general guidance on section

227.1 is available, most notably from this Court in *Soper v. Canada,* [1998] 1 F.C. 124 (F.C.A.). First, writing for the majority in *Soper, supra,* Robertson J.A. (at paragraph [11]) put subsection 227.1(3) into context by explaining its rationale:

Non-remittance of taxes withheld on behalf of a third party was likewise not uncommon during the recession. Faced with a choice between remitting such amounts to the Crown or drawing such amounts to pay key creditors whose goods or services were necessary to the continued operation of the business, corporate directors often followed the latter course. Such patent abuse and mismanagement on the part of directors constituted the "mischief" at which section 227.1 was directed....

[25] Whether or not non-remittance of taxes in the circumstances described above can always properly be characterised as "patent abuse and mismanagement", the conduct of the directors in the present case does not, in any event, fall within the precise mischief identified by Robertson J.A. The allegation here is not that the directors chose to pay creditors other than the Crown, but that they continued to operate the business in circumstances where they knew, or ought reasonably to have known, that the bank, which controlled their financial life support, was likely to honour cheques to pay creditors essential to the ability of the company to remain in business, but not to permit the company to discharge its debts to the Crown, for as long, at least, as the bank believed that the company's continued operation would best protect its interest as a creditor of the company.

[26] Second, *Soper, supra,* clarified the "due diligence" test applicable under subsection 227.1(3). Robertson J.A. held that the test is hybrid "objective-subjective" in nature. Thus, in deciding whether a director has "exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have shown in comparable circumstances", the court must take into account the characteristics of the directors whose conduct is in question, including their levels of relevant skill, experience and knowledge. The court must then ask whether, if faced with similar circumstances, a reasonably prudent director, with comparable levels of skill, experience and qualifications would have acted in the same way as these directors: paragraph [25]. Applying this test, Robertson J.A. said (at paragraph [44]):

... inside directors, meaning those involved in the day-to-day management of the company and who influence the conduct of its business affairs, will have the most difficulty in establishing the due diligence defence.

[27] To relate this to the facts of our case, it is clear that the "due diligence"

Digitized by Google

owed by the respondents is at the high end of the spectrum. They were "inside" directors who managed the company, with which they had been associated from its early days, and were very experienced in and knowledgeable about the company's business.

[28] Third, "due diligence" normally requires that, when a director becomes aware, or ought to have become aware, that the company is falling behind with its remittances, he or she should take some positive steps to prevent the default, such as an attempt to increase the company's operating line of credit with its bank or to come to an arrangement with the bank that would enable it to make remittances. Directors have also alerted Revenue Canada to the problem and attempted to arrange to make payments by instalments.

[29] It is clear that the directors of Abel did take some positive steps to try to extricate the company from its financial difficulties. In particular, they engaged the services of Mr. Humphreys, who advised them that the company was viable, with or without an injection of new capital, and made efforts, with some success, to find interested investors.

[30] There were also discussions with the bank over the honouring of cheques drawn in favour of Abel's suppliers and employees. While it is unclear from the evidence whether either Mr. Humphreys or the directors discussed with the bank the remittance cheques to Revenue Canada, it was clear to them that the bank would honour such cheques only at its discretion, as indeed it occasionally did.

[31] It is equally clear that the directors were aware that, unless there was an early injection of capital by an investor approved by the bank, or the bank changed its position by regularly honouring the company's cheques to Revenue Canada, Abel was likely to be in default in its remittances for eighteen months, the time that Mr. Humphreys had estimated that it would take for Abel to regain its financial footing.

[32] However, whether the directors thereby did enough to exempt themselves from liability for the unremitted source deductions and G.S.T. will depend, in part at least, on the fourth principle to be found in the case law: **the due diligence required of company directors by subsection 227.1(3) is to *prevent* the failure to remit. This has been held to mean that, if directors become liable *prima facie* for a company's failure to remit, they normally cannot claim the benefit of subsection 227.1(3) if their efforts were capable only of enabling them to remedy defaults after they had occurred. Accordingly, of the measures taken in an attempt to rescue Abel, those most relevant to this inquiry are limited to** the ones that were logically capable of preventing failures to remit the source deductions and G.S.T. when they became due.

[33] **This point was made in *Corsano v. The Queen*, [1999] 3 F.C. 173 (F.C.A), where the Court emphasised (at paragraph [35]) that a director's duty is to *prevent* default, not to condone it in the hope that matters can be rectified subsequently.** And, in *Soper, supra*, Robertson J.A. said (at paragraph [48]) that the purpose of the subsection

.... is to prevent failure to make remittances and not to cure default after the fact (though, as a practical matter, the provision should have the latter effect as well).

Similarly, in *Canales v. The Queen*, 97 DTC 49 (T.C.C.) McArthur J.T.C.C. (at page 50) described it as a well established principle that

... the Appellant must demonstrate that a reasonable attempt was made to prevent the failure to deduct and remit and not just an attempt to remedy the situation after the failure.

Most recently, writing for this Court in *Ruffo v. Minister of National Revenue* (F.C.A.: A-429-97; April 13, 2000), Létourneau J.A. said (at paragraph [6]):

The appellant's duty as a director was to anticipate and prevent the failure to pay the sums owing and not to commit such failure or perpetuate it as he did from March 1992 in the hope that at the end of the day the firm would again become profitable or there would be enough

Digitized by Google

money, even if it were wound up, to pay all the creditors.
[34] In our case, the most important thing done by the directors to *prevent* Abel's failures to remit was to engage Mr. Humphreys to find new sources of investment for the company: his advice had been that, with the injection of approximately $350,000, the company could be turned around quickly and he expressed confidence that a suitable investor could be found. In addition, **the fact that remittance cheques continued to be prepared by Ms. McKinnon in the hope that the bank would honour them can also be considered a potentially preventative measure. The directors did not continue simply to operate the business on the basis of an assurance that the company was sufficiently robust to enable them wait eighteen months to take advantage of an anticipated economic recovery.**
[35] Fifth, directors incur no personal liability under subsection 227.1(1), and therefore do not need to invoke subsection 227.1(3), if at any time the company's debt to Revenue Canada, including interest and late payment penalties, is discharged. This is because subsection 227.1(2) qualifies subsection 227.1(1) by providing, in effect, that a director is liable to pay to the Crown the amounts not remitted by the company only after all efforts to collect have been exhausted.
[36] Thus, in this case, while Abel had failed to remit the employee portions of the payroll deductions, these amounts were subsequently paid to Revenue Canada by Abel's trustee in bankruptcy. Accordingly, the directors were never vicariously liable under subsection 227.1(1) to pay them.
[37] Sixth, a director who has lost legal control over the company, on the appointment of a receiver-manager for instance, is not liable to Revenue Canada for company debts that are incurred subsequently. Some cases have extended this principle to situations where directors have lost *de facto* control over the company's finances to another, typically its bank. Non-liability in these situations has been explained both on the ground that the charging provision, subsection 227.1(1), assumes that the directors were able freely to choose whether the company remitted its payroll deductions, and because directors who lacked the necessary control over the company's finances could not be said to have failed to show "due diligence".

The Case Law
[38] A number of cases have been decided on the basis of facts that fall broadly within the pattern presented by the instant case. While the facts of no two cases are ever identical, the decisions can be divided into two categories: those that favour the Crown, and those that favour the directors. I first examine those relied on by the appellant, the Crown.
[39] In *Deschênes v. Canada (Minister of National Revenue)* (T.C.C.; No. 87-1364 (IT); September 1, 1989) the taxpayer wished to keep the business going despite its financial problems and negotiated an agreement with the bank that enabled it to pay the employees' wages, but did not also ask it to honour cheques drawn for source deductions. The company was in default in making its remittances and went intvb5rtfo bankruptcy.
[40] In response to the taxpayer's argument that, in the circumstances, there was nothing else that he could reasonably have done to prevent the failures to remit, Lamarre-Proulx J.T.C.C. said:
... the testimony of the appellant himself, cited above, indicates that it was he who deliberately chose not to pay the income tax and unemployment insurance deductions. That was a risk the **appellant took. It was a risk taken in difficult circumstances, certainly; but it was still a deliberate choice which remained unchanged for a period of several weeks, and was**

Digitized by Google

contrary to the duty of the director of a corporation to act with care, diligence and skill in remitting source deductions from employee salaries.

[41] I should note that, unlike in our case, there was apparently no evidence in *Deschênes, supra,* that the bank had indicated that it would not necessarily honour cheques drawn in favour of Revenue Canada by M. Deschênes' company. In addition, the Judge seems to have been influenced by the fact that, as an endorsee of two bank loans, the taxpayer hoped that, by keeping the business going, he would avoid being called upon to honour the endorsements. Finally, there was no finding of the reasonableness, or otherwise, from a business standpoint of the taxpayer's continuing to operate the company in the hope of turning its fortunes around.

[42] The Crown also relies on *Hamel v. Minister of National Revenue,* 92 DTC 1288 (T.C.C.), where the facts are closer to those of our case and the cases relied on in the Tax Court were expressly considered. The Judge in *Hamel, supra,* concluded that, having made a conscious decision to continue in business, rather than to cease operating, the directors had not demonstrated "due diligence" and consequently remained vicariously liable for the company's failures to remit, even though there was nothing else that they could have done to prevent them.

[43] The evidence was that, as the company got into financial difficulty, the bank closely supervised its operations and from February to June, when the company ceased operating, the bank increased its credit to enable the company to pay its employees and essential suppliers. However, the bank refused to honour cheques for the source deductions; the directors had discussed this topic with the bank, although no arrangement was ever made with respect to the remittances. Nor, the Judge found, did the directors speak with Revenue Canada about their problem.

[44] The Judge concluded (at page 1291) as follows:

If one agrees to continue operating a business despite the financial difficulties it is experiencing, and if one accepts to pay employees and suppliers, one must also discharge one's income tax obligations. One must be able to show, if not positive steps, at least concrete facts which may explain one's inaction during such a long period of time. The decision made jointly with the bank to continue operating for several months when the animals could have been sold earlier implies that the parties had some hope of deriving some benefit from it eventually, if only by limiting their losses. Such a decision, however, implies a responsibility to ensure that the business was not being financed out of what was owed to the government.

I should note that no finding was made about the business prudence of the directors' decision, made jointly with the bank, to continue to operate the company.

[45] I turn now to the principal cases relied on by the directors, starting with the earliest, *Fancy v. Minister of National Revenue,* 88 DTC 1641 (T.C.C.), which concerned the liability of husband and wife directors of an excavating company that had failed to remit source deductions. When the company ran into financial difficulties its banker monitored all its cheques and refused to authorize a deduction remittance cheque, a fact of which Ms. Fancy notified Revenue Canada as soon as she became aware of it.

[46] From the company's beginning, the bank had financed its operation, securing its loans by a general assignment of the company's accounts receivable. Hence, Couture C.J.T.C.C. held (at page 1643), the bank had always been "in effective control of the company's cash flow" and "in a position to dominate the finances of the company and to dictate its fate." The Judge concluded that the taxpayers had shown the degree of care and skill required to bring them within subsection 227.1(3) in view of: the encumbrance that the directors had placed on the company's receivables; their attempts to raise additional capital to see the company through its difficulties; and their hope that the bank would allow the company to

Digitized by Google

meet its obligations to Revenue Canada. They were, he said (at page 1644), "victims of circumstances over which they had no effective control."

[47] Couture C.J.T.C.C. rejected the argument that, when they became aware of the seriousness of the company's financial difficulties, the taxpayers should have ceased its operations, on the ground that such a proposition "[d]oes not reflect the true intent of the legislation." His reason for so concluding was that the liability created by subsection 227.1(1) was not absolute and if, through their personal conduct in connection with the company's failure to remit, the directors had exercised the degree of care, diligence and skill required to satisfy subsection 227.1(3), they were exempted from liability.

[48] Couture C.J.T.C.C. appears to have approached subsection 227.1(3) by asking whether the taxpayers had, in a broad sense, acted honestly and responsibly when faced with a difficult situation, and when the assignment to the bank of their accounts receivable had further restricted their ability to remit source deductions. On the facts, his conclusion that they were not liable is hardly surprising. However, in my opinion the Judge's analysis is open to question in that there was little evidence of any concrete steps taken by the directors to *prevent* the defaults that were clearly foreseeable if the business were continued.

[49] *Robitaille v. The Queen*, 90 DTC 6059 (F.C.T.D.) is the other case that is regularly cited in support of a broad approach to the exemption from liability under subsection 227.1(1) when taxpayers' ability to remit source deductions has been curtailed by the *de facto* control exercised over the company's finances by its banker. However, the facts of that case were so out of the ordinary that, in my opinion, the decision sheds little light on the application of the statutory exemption of directors from liability in more familiar commercial contexts, such as that of the case under appeal.

[50] Mme Robitaille was the wife of one of the principals of the company and had been made a director only to comply with a statutory requirement that a federally incorporated company had to have at least three directors. She had played no active role in the company, and learned of its financial difficulties, including its failure to remit source deductions to Revenue Canada, only after the bank had assumed *de facto* control of its affairs. In any event, Addy J. concluded (at page 6063), even if she had been informed of the situation earlier, "she could not have done anything about it." Further, such was the control exercised by the bank over the affairs of the company, partly as a result of the assignment of its inventory to the bank, that Revenue Canada dealt with the bank, not with the company directors, over the remittances and the continuation of the business.

[51] In these circumstances, it is hardly surprising that the Court exempted the taxpayer from personal liability for the company's failures to remit. However, despite some broad statements by Addy J., in my opinion this case cannot be regarded as authority for the general proposition that once a bank exercises control over the cheques written by a company, the directors are not vicariously liable for source deductions not remitted to Revenue Canada.

[52] *Robitaille, supra*, was followed in *Champeval v. Minister of National Revenue*, 90 DTC 1291 (T.C.C.), affirmed 99 DTC 5115 (F.C.T.D.), where the company had also made a general assignment of its receivables to the bank, which thus had absolute control over incoming funds and decided which of the cheques drawn by the company it would honour. In concluding that the appellant was not liable because the bank's total control over the company prevented liability from arising under subsection 227.1(1), the Judge also took into account the efforts that the taxpayer had made to come to an arrangement with Revenue Canada on the remittances.

[53] Finally, it remains to consider the recent decision of MacKay J. in *Clarke v. The Queen*, 2000 DTC 6230 (F.C.T.D). In that case, the directors were held not liable for remittances

Digitized by Google

due after the appointment of a receiver-manager, who assumed the legal powers of the directors, or for those that had become due during earlier when the bank had put the company into "soft receivership". In contrast, the directors were found liable for source deductions that should have been remitted during the month when, concerned about the financial state of the company and its ability to recover its loan, the bank had appointed a firm of accountants to monitor the company and to report to the bank on the company's financial status and prospects. In the same month, a cheque written by the company to the Receiver General of Canada was dishonoured by the bank for insufficient funds.

[54] MacKay J. found (at paragraph [7]) that, while the company was in "soft receivership", the firm of chartered accountants appointed by the bank for this purpose

...was to have the final say in all operations, including accounts receivable, sale of inventory and of equipment, contracts, purchases, payables and payments, personnel, changes in and forecasting of operations.

In addition, the company's chequebook was taken into the custody of the "soft receiver" and the bank exercised ultimate authority over the cheques that it would honour.

[55] MacKay J. held that, since the directors had no control in fact over the company, liability under subsection 227.1(1) was accordingly never engaged. He quoted with approval the following words of Addy J. in *Robitaille, supra* (at page 6063):

The exercise of freedom of choice on the part of the director is essential in order to establish personal liability.

Conclusions

Subsection 227.1(1): a requirement of control?

[56] With all respect to those who have taken a different view, in my opinion it is inappropriate to import into subsection 227.1(1) a requirement that it is only engaged if the directors have *de facto* control over the financial operation of the company, particularly the payment of its bills.

[57] First, these words are not contained in the statute, and courts should normally not add words to those in the statutory text approved by Parliament.

[58] Second, the due diligence exemption in subsection 227.1(3) will prove broad enough to provide a defence to directors who have acted with propriety in attempting to prevent defaults by their company. It is therefore unnecessary to read the notion of control into subsection (1) in order to ensure that directors are not saddled with liability when their conduct to prevent the company's failure to remit satisfied the standard of the care that a reasonable person would have exercised in comparable circumstances to prevent the defaults.

[59] Moreover, "control" is not a monolithic concept and it will inevitably be difficult to determine whether, in a given case, the directors retained sufficient "control" to trigger subsection (1). The situation is different on the appointment of a receiver whose legal powers supercede those of the directors who, in a functional sense, cease to be directors and thus fall outside the ambit of subsection 227.1(1): see, for example, *Drover v. Canada* (1998), 161 D.L.R. (4th) 518 (F.C.A), at paragraph [4].

[60] Third, if the concept of "control" extends to a *de facto* inability to take measures to ensure that remittances are paid when they fall due because the company's bank will not honour cheques in favour of Revenue Canada, then a director would not become liable under subsection 227.1(1), regardless of whether it was reasonable to keep the business going, and of the length of time that it was operated without making remittances when legally due. The reasonableness of a director's conduct is only relevant as a defence under subsection 227.1(3) once liability under subsection (1) has been engaged.

[61] Therefore, in my respectful view, the decision of McArthur J.T.C.C. that the directors of

Digitized by Google

Abel were not liable for the unremitted source deductions and G.S.T. cannot be supported on the ground that subsection 227.1(1) was not triggered because the bank's insistence that it approve any cheques written by the company deprived the taxpayers of control of the company's finances.

Subsection 227.1(3): the due diligence defence

[62] McArthur J.T.C.C. acknowledged that, prior to October 18, 1993, when the bank dishonoured a cheque payable to Revenue Canada, the directors could have closed the business. However, he concluded that, in following Mr. Humphreys' advice to keep the business going, the directors acted with "due diligence". I should also note that on October 25, 1993 BDO Dunwoody had submitted a report to the bank, with a copy to Abel, in which it recommended that the business not be closed down because closure would probably result in a loss of between 80-90% of the value of Abel's $2 million worth of receivables arising from its construction contracts.

[63] In my view, the question is whether, throughout the whole period of the defaults, starting from September 1993 and ending in April 1994, the directors exercised the degree of care, diligence and skill of the reasonably prudent person in comparable circumstances to prevent the company's failures to remit the source deductions and G.S.T.

[64] I accept that the directors of Abel are not personally liable for the amounts due prior to the dishonouring of the remittance cheque on October 18, 1993. Admittedly, the directors were well aware of the financial difficulties of the company, especially as a result of the refusal of bonding in the summer of 1993. They also knew that the bank had expressed its concerns after seeing the financial statement for April 1993, had moved Abel's account from the local branch to a department that handled troubled accounts and had dishonoured a remittance cheque at the end of September. [65]However, a few days before the second cheque was dishonoured on October 18, there had been a meeting of the bank officers handling the Abel file, Mr. Humphreys and two of the directors of the company. As a result of the discussions at this meeting, the directors believed that the bank was satisfied with the way in which the company was dealing with its problems. Nonetheless, the bank did not warn Abel that it proposed to dishonour its cheques and, prior to the dishonouring of the cheque in October, it had not started to reduce the line of credit. It is also significant in this context that in the past Abel had always paid its bills.

[66] Consequently, the focus of this appeal should be on the conduct of the directors after October 18, 1993 when the bank dishonoured the second remittance cheque, and whether they exercised the requisite care, diligence and skill to prevent the company's subsequent failures to remit which they knew were likely to occur.

[67] Because he based his decision principally on the ground that the bank so controlled Abel's finances that subsection 227.1(1) was never engaged, the Tax Court Judge dealt relatively briefly with the due diligence defence. However, he did say that, in light of the advice that they had received from Mr. Humphreys and the efforts that he was making to find a new investor, the support that they apparently received from the bank, the cyclical nature of the construction industry, the history of the company and their duty to the employees, the taxpayers "took a common sense approach" in deciding not to close the business. However, it is not altogether clear from the reasons for judgment whether the Judge considered the possibility that the directors should have closed the business *after* October 18, 1993.

[68] In my opinion, it is essential to keep in mind the relevant question in this appeal: did the directors exercise due diligence *to prevent the company's failure to remit*? This is not necessarily the same as asking whether it was reasonable from a business point of view for the directors to continue to operate the business. In order to avail themselves of the defence

Digitized by Google

provided by subsection 227.1(3) directors must normally have taken positive steps which, if successful, could have prevented the company's failure to remit from occurring. The question then is whether what the directors did to prevent the failure meets the standard of the care, diligence and skill that would have been exercised by a reasonably prudent person in comparable circumstances.

[69] It will normally not be sufficient for the directors simply to have carried on the business, knowing that a failure to remit was likely but hoping that the company's fortunes would revive with an upturn in the economy or in their market position. In such circumstances directors will generally be held to have assumed the risk that the company will subsequently be able to make its remittances. Taxpayers are not required involuntarily to underwrite this risk, no matter how reasonable it may have been from a business perspective for the directors to have continued the business without doing anything to prevent future failures to remit.

[70] This point was recently made in *Ruffo v. R.,* [1998] 2 C.T.C. 2203 (T.C.C.), affirmed by this Court on April 13, 2000 (A-429-97), where Lamarre-Proulx J.T.C.C. stated at paragraph [20]:

I am of the opinion that the case law of the Court is consistent on the diligence that the director of a corporation must show to avoid the liability prescribed in subsection 227.1(3) of the Act. It is the diligence that is concerned with preventing the failure that can, in many instances, differ from the diligence that the director must exercise toward the corporation.

[71] She went on to cite with approval the following statements by Rip J.T.C.C. in *Merson v. R.*, 89 DTC 22, where he said (at page 28):

The prudence required by subsection 227.1(3) in the exercise of care diligence and skill is different from that required by a director performing his duties, under corporate law, notwithstanding that subsection 227.1(3) and subsection 122(1)(b) of the *Canadian Business Corporations Act*, for example, both use identical words. The exercise of care, diligence and skill by the director contemplated by subsection 227.1(3) is not founded on the director's obligations to the corporation; it is based on one of the corporation's obligations under the Act and the failure of the corporation to fulfil such obligation. A director who manages a business is expected to take risks to increase the profitability of the business and the duties of care, diligence and skill are measured by this expectation. The degree of prudence required by subsection 227.1(3) leaves no room for risk.

[72] I do not understand Rip J.T.C.C.'s statement that the "degree of prudence required by subsection 227.1(3) leaves no room for risk" to mean that section 227.1 imposes strict liability on directors whose company ultimately proves to be unable to make good defaults in its remittances. Such a view would clearly be contrary to subsection 227.1(3), which only becomes relevant when Revenue Canada is unable to recover the money that the company ought to have remitted.

[73] Rather, I take him to have meant that, if directors decide to continue the business in the expectation that the company will turn around and will be able to make good its remittance defaults after they have occurred, if the company nonetheless fails without paying its tax debts, it is no defence for the directors to say that the risk that they took would have been taken by a reasonable person. The subsection 227.1(3) defence only applies if it can be demonstrated that the directors exercised the care, diligence and skill that a reasonably prudent business person in comparable circumstances would have exercised to prevent a future default.

[74] Whether directors have exercised due diligence to prevent such failures from occurring has both a legal and a factual aspect. As matter of law, the liability of a director for unremitted source deductions and G.S.T. does not crystallise until the conditions

Digitized by Google

prescribed by subsection 227.1(2) have been satisfied. Moreover, if the remittances are made in full, albeit late, the directors will not be liable for the company's previous failure to remit.

[75] However, the fact that, before crystallisation, the liability of the director is inchoate is not incompatible with a finding that there was a failure to remit when no remittance was made on the date prescribed in the relevant legislation as the date when the remittance was due. Thus, for example, subsection 108(1) of the *Income Tax Regulations,* C.R.C. 1978, c. 945 provides that amounts deducted from employees' wages in a month pursuant to subsection 153(1) of the Act shall be remitted to the Receiver General on or before the fifteenth day of the following month.

[76] Accordingly, in my view, the directors of Abel could not have obtained the benefit of subsection 227.1(3) on the basis of an assertion that they had continued the business, reasonably relying on Mr. Humphreys' advice that it could be turned around in eighteen months' time by which time the economy should have improved. Even if the company successfully positioned itself to take advantage of the economic upturn and became profitable, it would only have become able to discharge its accrued liability and to prevent future failures to remit. Following this advice could not have prevented any failures to remit that occurred prior the revival of the company's fortunes, even if the advice had proved to be correct.

[77] Given the limitations placed upon them by the bank's *de facto* control of the company's finances, I am satisfied that, on the facts of this case, the directors exercised the degree of care, diligence and skill to prevent failures to remit that would have been shown by a reasonably prudent person in comparable circumstances. That Ms. McKinnon continued to prepare remittance cheques, admittedly without a realistic hope that the bank would honour them all, also indicates that the directors were not unmindful of the company's debt to Revenue Canada.

[78] Much more important, in my view, were Mr. Humphreys' continued efforts to find a new investor, given his belief that the company could then quickly be turned around. He told the directors that he was confident that a new investor could be found. Indeed, he identified potential investors within two weeks of being hired, spoke with twelve people who expressed an interest in investing in Abel and produced one who was willing to invest, but who proved unacceptable to the bank for reasons that are not disclosed.

[79] As long as these efforts were being made in good faith by a person with a successful track record in rescuing companies in the construction industry, the directors of Abel could reasonably say that, if an investor were found and approved by the bank, the company would obtain bonding and be in a position to bid on lucrative contracts, which might well have persuaded the bank to increase its line of credit again or, at least, to honour Abel's next remittance cheque.

[80] Hence, if Mr Humphreys had succeeded in finding an investor acceptable to the bank, the failures to remit might have been prevented. The fact that, in the event, he was not successful and the failures occurred, does not render the directors liable if they had made reasonable efforts to prevent them. The Court would be reluctant to second guess the likely efficacy of the directors' efforts to prevent failures to remit from occurring.

[81] However, it would not have been open to the directors to have relied indefinitely on Mr. Humphreys' advice if there was no indication of potential investor interest in the company. The company's viability and the likelihood of its attracting new investors would have had to be reassessed from time to time in order for the directors successfully to invoke the due diligence defence provided by subsection 227.1(3).

Digitized by Google

CONCLUSIONS

[82] For these reasons, I have concluded that the directors satisfied the due diligence test in subsections 227.1(3) of the *Income Tax Act* and 353(3) of the *Excise Tax Act*, and would therefore dismiss the appeals and the applications for judicial review with one set of costs, including taxable disbursements in each of the matters.

"John M. Evans" J.A.

"I agree
A.J. Stone J.A."

CONCURRING REASONS FOR JUDGMENT ROTHSTEIN J.A.

[1] I am in general agreement with the reasons of Evans J.A. **However, I wish to emphasize that whether the due diligence defence will be successful is fact-driven in each case, i.e. always comparing what the directors did to prevent the failure with what a reasonably prudent person would have done in comparable circumstances. I agree with Evans J.A. that the due diligence defence is established on the facts of this case. However, I would prefer not to hypothesize as to what other facts or circumstances might or might not provide grounds for a successful due diligence defence.**

[2] I agree with the disposition of the matter as set forth in the reasons of Evans J. A.

"Marshall Rothstein"
J.A.

Normand Cadrin v. Her Majesty The Queen, A-112-97, Inside vs Outside Directors and Their Differing Actions

DÉCARY J.A.

[1] According to the respondent, the appellant, in his capacity as director of the Société Elzéar Plourde Ltée during the period at issue, became jointly and severally liable under section 227.1 of the *Income Tax Act*, S.C. 1970-71-72, c. 63, as amended (the Act), where a corporation fails to deduct or withhold certain amounts at the source. It is clear that under subsection 3 of this section, "[a] director is not liable . . . where he exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances".

[2] The Judge of the Tax Court of Canada found the appellant liable in a decision[1] issued before this Court clarified the interpretation to be given to subsection 227.1(3) of the Act in *Soper v. Canada*, **[1998] 1 F.C. 124 (C.A.). In *Soper*, Mr. Justice Robertson made a distinction between "inside directors" ("meaning those involved in the day-to-day management of the company and who influence the conduct of its business affairs") who "will have the most difficulty in establishing the due diligence defence" (at p. 156) and the "outside directors" for whom, "unless there is reason for suspicion", it is permissible "to rely on the day-to-day corporate managers to be responsible for the payment of debt obligations such as those owing to Her Majesty" and who have a duty to act when they "[obtain] information, or [become] aware of facts, which might lead [them] to conclude that there is, or could reasonably be, a potential problem with remittances" (at p. 160). Robertson J.A. added, "Put differently, it is indeed incumbent upon an outside director to take positive steps if he or she knew, or**

Digitized by Google

ought to have known, that the corporation could be experiencing a remittance problem".

[3] First, counsel for the appellant argued that the simple fact that an outside director is unaware and does not take steps to learn of the duties which the law imposes on him is sufficient, according to *Soper*, to exonerate him from all liability. This argument is without merit. Robertson J.A. took great care to clarify that "total passivity and irresponsibility" are no excuse, "that the law today can scarcely be said to embrace the principle that the less a director does or knows or cares, the less likely it is that he or she will be held liable" and that "the statutory standard of care will surely be interpreted and applied in a manner which encourages responsibility" (at p. 146). It is true that the standard of the reasonable person "adjusts to the circumstances and to the individual qualities of the actor" (at p. 152) and that "more is expected of individuals with superior qualifications" (at p. 155), but the fact remains that the law requires a minimum amount of care, however variable, and that a total lack of care does not meet the requirements of the law. If the appellant's only excuse were total passivity based on total ignorance, he would not escape liability under subsection 3 of section 227.1.

[4] Second, counsel for the appellant argued that even if ignorance is no excuse (as we have just stated), it is nonetheless not fatal. As soon as an outside director does, without knowing as it were, what he should have done under the circumstances had he been aware of the situation, he would escape all liability.

[5] This argument is sound in the instant case. The outside director who gets involved to the extent of his role in the business and his abilities meets the standard of care in principle. If he ensures that the business is viable before investing money in it, if he surrounds himself with reliable and competent people who undertake the day-to-day management of the business, if he stays generally informed about what is happening, if nothing happens which should arouse suspicion about the payment of the corporation's liabilities, if he acts quickly when problems arise, he should not as a general rule be held liable.

[6] In our view, had the Trial Judge been aware of the criteria this Court has since set in *Soper* and particularly the different approach to be taken depending on whether it is an inside or outside director, he would necessarily have come to the conclusion that the appellant was not liable.

[7] The appellant was in fact just a silent partner, who, moreover, functioned from a distance, as his own affairs were conducted from Quebec City and those of the business in which he had invested, from Jonquière. He had taken all of the business and accounting precautions before investing and had every reason to rely on the day-to-day management which his partner had undertaken. He regularly inquired about the affairs of the business and was unaware of any problems. The Judge stated that at the end of 1990, [TRANSLATION] "the management of the company . . . seemed excellent and very competent" and that the managing partner "always insisted that the company was in an excellent financial position". The Judge also held that it was only at the beginning of December 1991 that the appellant found out through his bank statements that for the first time, the corporation had not paid him the monthly loan payment and he learned from his partner that the company was "in difficulty". The appellant reacted immediately. He summoned his partner at once to Quebec City for a meeting with his accountant and an audit of the financial statements. On the day at issue, namely December 12, 1991, the accountant audited the corporation"s books and stated that it was headed for a loss of $200,000.00 at the end of December 1991. (The Trial Judge erred in finding that this loss occurred in February 1991.) The appellant then tried to convince members of his family to help him to

Digitized by Google

save the business, but in vain. On December 16, 1991, the appellant went to Jonquière to meet the manager of the bank with which the corporation did business. When the corporation"s vulnerable financial position was confirmed, he contacted his lawyers in Quebec City who immediately dictated to him a letter of resignation as director.

[8] It also appears from various documents and testimony that in his findings of fact, the Trial Judge did not take into consideration that for several months, the managing partner had hidden certain problems from the appellant and had even misappropriated funds in the amount of approximately $155,000.00 in the fall of 1991.

[9] In these circumstances, knowing that the appellant"s alleged liability is for the months of September, November and December 1991 (and curiously not October 1991), the Trial Judge could not find that the appellant demonstrated culpable passivity. The Judge dealt with the matter as if the appellant was an inside director, which he was not.

[10] The appeal will be allowed, the judgment of the Tax Court of Canada will be reversed, the appellant"s appeal of the assessment issued by the Minister of National Revenue for 1991 will be allowed and the assessment in the amount of $28,985.00 will be set aside. The appellant is entitled to costs before this Court and the Tax Court of Canada.

Robert Décary J.A.

Alexander Bruce Cameron v. Her Majesty The Queen, A-763-99, A Properly Complying Outside Director with Adverse Management

REASONS FOR JUDGMENT

(Delivered from the Bench at Calgary, Alberta, on Tuesday, June 19, 2001) LINDEN J.A.

The main issue in this case is whether the Tax Court Judge correctly held the appellant, a director of a corporation, liable for the failure of the corporation to make certain tax remittances during his tenure in office, pursuant to subsection 227.1(1) of the Income Tax Act.

The appellant contends that the Tax Court Judge erred and that he is not liable for the failure to remit because he exercised due diligence with regard to his responsibilities in accordance with subsection 227.1(3) which reads:

227.1 (3) A director is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstance.

In our respectful view, the Tax Court Judge did not correctly apply the jurisprudence of this Court as outlined in Soper [1998] I.F.C.R. 124; Smith [2001] F.C.J. 448; Worrell [2000] F.C.J. 1730, and Corsano [1999] 3 F.C.

173. First, he appears to have held the appellant to a stricter standard of care than the statute and jurisprudence require. He stated that the appellant had a "duty to prevent defalcation (default, according to the brief of the Crown) under the circumstance." That is not the law; his duty was only to use reasonable care to prevent defalcation (or default). As Justice Sharlow explained in Smith, supra;

"A director is required only to act reasonably in the circumstance. The fact that his efforts are unsuccessful does not establish that he has failed to act reasonably."

She concluded that the standard is reasonableness, "not perfection."

Moreover, the Tax Court Judge held that the appellant took "no positive action to set up or place into existence controls to account for remittances and the ongoing use of any controls." Although the appellant made "some efforts to protect Revenue Canada's arrears", he said, these were "immaterial." Here too, however, he erred, because, although positive steps are required of directors, they need only be reasonable, positive steps, not

Digitized by Google

foolproof ones.
According to these principles and based on largely uncontested facts, the appellant, in our view, complied with his legal obligation under subsection 227.1(3), that is, the objective-subjective standard to act as a reasonably prudent person would have in the circumstance of this case.
True, the appellant was a lawyer, but his role as a director of the corporation was primarily to help raise money for it through a public offering. He was not a hands-on person involved in the day-to-day operation of the company, but he was concerned mainly with general policy. He was not a signing officer and had only limited influence on management. He was, therefore, more an outside director than an inside one. While these facts certainly do not exempt him from his legal obligation, something he himself recognized, they are relevant matters in assessing whether he behaved in a reasonably prudent manner.
Let us look more closely at his conduct. Early in his tenure of office, and on many occasions thereafter, the appellant, because he was aware of some problems, frequently asked management about the status of the tax remittances and he was always assured that they were in order. He unwisely relied on these false assurances; in fact, the remittances were not in order as management professed.
In September of 1994, documentary evidence emerged to demonstrate that management had not been truthful and that past remittance amounts were still owing and that current obligations were still not being met. Included in this documentation were an auditor's report, draft financial statements, and a letter from Revenue Canada dated September 19, 1994 to the effect that arrears of $205,000 were owing.
As a result of this, the appellant, Cameron, and his fellow directors decided to appoint Mr. McArthur, an accountant who had done a report about the corporation's financial status, as a director of the company and Chief Financial Officer to correct and oversee these matters. In addition, a certified management accountant, Mr. Solomon was appointed to be specifically responsible for remittance compliance. As a result of these efforts, it appeared as though matters were brought under control and that remittances were being made as required by law.
In addition, as part of this clean up operation, on September 28, 1994 an assignment agreement was entered into between the corporation and Revenue Canada, whereby the expected proceeds of a fire insurance claim with the Zurich Insurance Company were assigned to Revenue Canada up to an amount
$215,000 in return for the assignee's agreement not to take steps to enforce the debt owing, that is a "standstill agreement".
A further step was later taken by the Board of Directors on March 23, 1995 to set aside monies as a second potential source for paying the overdue remittances. Out of the monies received from the public offering
$213,000 was earmarked to repay the Alberta Opportunities Corporation and the arrears of source deductions. None of these funds were to be disbursed without the written authorization of one of the outside directors, which included Mr. Cameron.
At the meeting, however, it also became known that there were arrears of $25,000 in current source deductions. The Board directed that these arrears be paid immediately. The Board decided to meet again on April 12, 1995.
It was at the April 12, 1995 meeting that the appellant and the other board members learned that the $25,000 had not been paid as ordered. A cheque had been issued, but it was returned N.S.F. Another cheque covering the amount was later issued for $38,703.09 on May 4, 1995. Surprisingly, the April 12, 1995 board meeting was mistakenly told that the source deductions were current.
At this same April 12 meeting, the appellant learned that management had not complied

Digitized by Google

with the board's direction to protect $213,000 from the proceeds of the public offering and that $113,000 of it had been spent without the consent of any outside director. This caused Mr. McArthur to resign from the Board. The appellant understandably became angry, decided to resign that evening and eventually did resign as of June 6, 1995.

These uncontested facts indicate that the appellant was not passive. He did as much as he could reasonably be expected to do in order to protect the interests of Revenue Canada. He may not have been as attentive, as skeptical and as assertive as he might have been, especially in allowing himself to be misled by management. But it is not easy to see what more he was required to do in the circumstances to comply with his director's duty to be reasonably prudent in the circumstances.

In the light of this conclusion, there is no need to deal with the issues concerning the allocation of the various amounts received by Revenue Canada from the corporation and the other various sources.

The appeal should be allowed, with costs, and the assessment should be vacated on the basis that the appellant met the standard of due diligence required of him in these circumstances, according to subsection 227.1(3) of the Income Tax Act.

"Allen M. Linden" J.A.

Thomas Gerald Liddle v. Her Majesty the Queen, 2011 FCA 159, The Possibility of another Dominant Director Seemingly Interfering Not Enough To Absolve Duty of Care

STRATAS J.A.

[1] This is an appeal from the judgment of Justice Diane Campbell of the Tax Court of Canada: 2009 TCC 451.

[2] The Tax Court judge found that the appellant was liable, as a director of AquaNorth Farms Inc., to pay certain tax amounts that AquaNorth Farms Inc. should have paid but did not, along with penalties and interest. Specifically, AquaNorth Farms Inc. failed to remit GST under the *Excise Tax Act*, R.S.C. 1985, c. E-
15. It also failed to make payroll source deductions under the *Canada Pension Plan*, R.S.C. 1985, c. C-8 and the *Employment Insurance Act*, S.C. 1996, c. 23.

The finding of liability

[3] Before the Tax Court judge were two main questions, both of which she determined against the appellant:

Was the appellant a director of AquaNorth Farms Inc. at the time that that corporation was required to remit GST and payroll source deductions?

The Tax Court judge answered this in the affirmative, finding that the appellant was a director at the relevant time. Therefore, the appellant was liable to pay the amounts that AquaNorth Farms Inc. should have paid: see the *Canada Pension Plan*, *supra*, subsection 21.1(1), the *Employment Insurance Act*, *supra*, subsection 83(1) and the *Excise Tax Act*, *supra*, subsection 323(1).

Did the appellant exercise due diligence? Specifically, did he act with “the degree of care, diligence and skill to prevent [AquaNorth Farms Inc.’s] failure [to remit GST and payroll source deductions to the Minister] that a reasonably prudent person would have exercised in comparable circumstances?” (See subsection 227.1(3) of the *Income Tax Act*, R.S.C. 1985,
c. 1 (5th Supp.), made applicable to the appellant by subsection 21.1(2) of the *Canada Pension Plan*, *supra*, and subsection 83(2) of the *Employment Insurance Act*, *supra*; see

Digitized by Google

also subsection 323(3) of the *Excise Tax Act*, *supra*.)
The Tax Court judge answered this in the negative, finding that the appellant had not exercised due diligence.
[4] In answering these two main questions, the Tax Court judge made a number of factual findings. One important factual finding was that AquaNorth Farms Inc. became subject to the tax liabilities while the appellant still had effective control of AquaNorth's finances and daily operations. Another important factual finding was that the appellant took no proactive steps to ensure that AquaNorth remitted to the Minister amounts that it was deducting from employee paycheques and GST amounts that it was collecting from its customers. In this Court, the onus is on the appellant to demonstrate that the Tax Court judge's factual findings are vitiated by palpable and overriding error: *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235, 2002 SCC
33. We are not satisfied that any such error is present. Indeed, the factual findings of the Tax Court judge are well-supported by the evidentiary record.
[5] We see no legal error in the Tax Court judge's consideration of whether the appellant was a director at the relevant time. On the question of due diligence, the Tax Court judge carefully considered the legal test for due diligence that should be applied to the evidence before us. She adopted the tests set out by this Court in *Soper v. The Queen*, 97 D.T.C. 5407 at page 5416 and *Hartnell v. The Queen*, 2008 D.T.C. 6173 at paragraph 12. Here, likewise, we see no legal error on the part of the Tax Court judge.
The involvement of another director
[6] The appellant submitted that another director of AquaNorth Farms Inc. was heavily involved at the times in question. Even if that is the case, by itself that does not give the appellant any defence. The express words of the provisions of subsection 21.1(1) of the *Canada Pension Plan*, subsection 83(1) of the *Employment Insurance Act*, and subsection 323(1) of the *Excise Tax Act*, make the appellant "jointly and severally, or solidarily, liable" for the full amounts that AquaNorth Farms Inc. failed to remit to the Minister.
The Tax Court judge's failure to grant an adjournment
[7] In the Tax Court, the appellant requested that the trial be adjourned under section 137 of the *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a for three reasons: he wanted to obtain legal counsel to represent him, he was not aware that a particular individual would be called as a witness against him, and he had not received some information he sought from the Minister. The Tax Court judge refused the adjournment. Among other things, the Tax Court judge found that some of the comments he made during his request for an adjournment were misleading.
[8] We note that adjournments are discretionary matters related to trial management and, as a result, this Court will interfere only where a trial judge is shown to be clearly wrong: *Superior Filter Recycling Inc. v. The Queen*, 2006 DTC 6491 at paragraph 2; *Wagg v. Canada*, 2003 FCA 303 at paragraphs 21 and 26. In our view, no such error has been demonstrated in this case. It is apparent to us that the Tax Court judge was mindful of the need for the appellant to have a fair trial. Further, there were a number of reasons supporting the Tax Court judge's discretionary refusal to grant the appellant an adjournment. These include the following:
The appellant had ample opportunity to retain counsel before the trial.
Absent a specific request during discoveries, there is no requirement in the Rules for parties to exchange the names of their respective witnesses before trial. Before trial, the appellant was notified by the Crown that it would be calling two witnesses but the appellant did not ask the Crown who they were.
The appellant could have pursued his requests for further information by various means in

Digitized by Google

a timely way under the Rules and the *Access to Information Act*, R.S.C. 1985, c. A-1, but did not do so.
The misleading nature of the comments the appellant made during his request for an adjournment.
Disposition
[9] For the foregoing reasons, we shall dismiss the appeal, with costs. "David Stratas"
J.A.

Gordon E. Smith v. Her Majesty The Queen, 2001 FCA 84, a case of Outside Turning to Inside Director and Failing Financial Resources

SHARLOW J.A.
REASONS FOR JUDGMENT

Gordon E. Smith has been assessed under subsection 227.1(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) and subsection 323(1) of the *Excise Tax Act*, R.S.C. 1985, c. E-15 for amounts owed by a corporation of which he was a director. He appealed the assessments to the Tax Court of Canada under the informal procedure on a number of grounds, including the due diligence defence. His appeal was dismissed on February 9, 2000 (reported as *Smith v. Her Majesty the Queen*, 2000 D.T.C. 1888, [2000] 2 C.T.C. 2494, 2000 G.T.C. 758, [2000] G.S.T.C. 12, 16 C.B.R. (4th) 289). Mr. Smith now seeks judicial review of the Tax Court decision.
Mr. Smith did not include a transcript of the Tax Court proceedings in the application record. He indicated that the transcript was "unavailable". It appears that he asked for a transcript and was told by a Tax Court official that the Tax Court did not have one. As a self-represented litigant who is not a lawyer, Mr. Smith apparently was unaware that if the proceedings had been recorded, as they apparently were in this case, he could have ordered a transcript himself and taken steps to have the transcript included in the application record. Instead, Mr. Smith included in his application record an affidavit in which he made certain assertions about the oral evidence given at trial.
Counsel for the Crown did not cross-examine Mr. Smith on his affidavit. Nor did she produce a transcript of the proceedings or include in the respondent's record an affidavit that contradicted Mr. Smith's version of the facts. In these circumstances, I am inclined to accept Mr. Smith's assertions about the oral evidence that was before the Tax Court Judge. I also note that many of the statements in Mr. Smith's affidavit are legal arguments that should have been in the memorandum of argument rather than the affidavit, and I have treated them accordingly.
I turn now to the merits of this application. The assessments challenged by Mr. Smith were issued under subsection 227.1(1) of the *Income Tax Act* and subsection 323(1) of the *Excise Tax Act*, which read as follows:

Mr. Smith has raised a number of issues, but it is necessary to consider only one. That is whether he met the due diligence test in subsection 227.1(3) of the *Income Tax Act* and subsection 323(3) of the *Excise Tax Act*. Those provisions read as follows:
The directors' liability provisions were enacted to strengthen the Crown's ability to enforce the statutory obligation imposed on certain taxpayers to remit taxes payable by other parties, such as tax withheld at source from wages paid to employees, and net

Digitized by Google

GST collected from customers. Normally, the Crown's remedies against a corporation that fails to remit these third party taxes would be limited to the corporation's assets. That is a necessary incident of separate corporate personality. However, it was perceived that a corporation, particularly a corporation in financial difficulty, might prefer to default on its obligation to remit taxes, in order to satisfy creditors whose claims were more immediately pressing. It was apparently thought necessary to enact legislation that would deter corporations from making such a choice.

Consequently, subsection 227.1(1) of the Income Tax Act and subsection 323(1) of the Excise Tax Act were enacted to impose liability, subject to certain conditions, on the directors of a corporation that had failed to remit tax collected from others: Soper v. Canada, [1998] 1 F.C. 124, 215 N.R. 372, 149 ***D.L.R. (4th) 297, [1997] 3 C.T.C. 242, 97 D.T.C. 5407 (F.C.A.). This is based on the presumption that a decision by a corporation to default on its remittance obligations would originate with the directors: Kalef v. Canada (1996), 194 N.R. 39, 39 C.B.R. (3d) 1, [1996] 2 C.T.C. 1, 96 D.T.C. 6132 (F.C.A.).***

The obligations of corporate directors under these provisions are subject to a number of statutory preconditions (subsection 227.1(2) of the *Income Tax Act* and subsection 323(2) of the *Excise Tax Act*) that are not in issue in this case. In addition, a director may have recourse to the statutory due diligence defence in subsection 227.1(3) of the *Income Tax Act* and subsection 323(2) of the *Excise Tax Act*.

The *Soper* decision, *supra*, established that the standard of care described in the statutory due diligence defence is substantially the same as the common law standard of care in *Re City Equitable Fire Insurance Co.*, [1925] Ch. 407 (Eng. C.A.). It follows that what may reasonably be expected of a director for the purposes of subsection 227.1(1) of the *Income Tax Act* and subsection 323(1) of the *Excise Tax Act* depends upon the facts of the case, and has both an objective and a subjective aspect.

The subjective aspect of the standard of care applicable to a particular director will depend on the director's personal attributes, including knowledge and experience. Generally, a person who is experienced in business and financial matters is likely to be held to a higher standard than a person with no business acumen or experience whose presence on the board of directors reflects nothing more, for example, than a family connection. However, the due diligence defence probably will not assist a director who is oblivious to the statutory obligations of directors, or who ignores a problem that was apparent to the director or should have been apparent to a reasonably prudent person in comparable circumstances (*Hanson v. Canada* (2000) 260 N.R. 79, [2000] 4 C.T.C. 215, 2000 D.T.C. 6564 (F.C.A.)).

In assessing the objective reasonableness of the conduct of a director, the factors to be taken into account may include the size, nature and complexity of the business carried on by the corporation, and its customs and practices. The larger and more complex the business, the more reasonable it may be for directors to allocate responsibilities among themselves, or to leave certain matters to corporate staff and outside advisers, and to rely on them.

The inherent flexibility of the due diligence defence may result in a situation where a higher standard of care is imposed on some directors of a corporation than on others. **For example, it may be appropriate to impose a higher standard on an "inside director" (for example, a director with a practice of hands-on management) than an "outside director" (such as a director who has only superficial knowledge of and involvement in the affairs of the corporation).**

Digitized by Google

That is particularly so if it is established that the outside director reasonably relied on assurances from the inside directors that the corporation's tax remittance obligations were being met. See, for example, *Cadrin v. Canada* (1998), 240 N.R. 354, [1999] 3 C.T.C. 366, 99 D.T.C. 5079 (F.C.A.).

In certain circumstances, the fact that a corporation is in financial difficulty, and thus may be subject to a greater risk of default in tax remittances than other corporations, may be a factor that raises the standard of care**. For example, a director who is aware of the corporation's financial difficulty and who deliberately decides to finance the corporation's operations with unremitted source deductions may be unable to rely on the due diligence defence (*Ruffo v. Canada*, 2000 D.T.C. 6317 (F.C.A.)). In every case, however, it is important to bear in mind that the standard is reasonableness, not perfection.**

Against this statutory background, it is necessary to summarize the facts of this case and to consider how the Tax Court Judge applied the relevant principles.

Mr. Smith was a director of ECO Superwood (B.C.) Ltd. (ECO) from February of 1993 until at least October 31, 1995. It is not clear when he ceased to be a director, but nothing turns on that termination date.

The Crown asserts that between November 1, 1993 and October 31, 1995, ECO became liable for unremitted employee source deductions and unremitted net GST. On that basis, Mr. Smith was assessed under subsection 227.1(1) of the *Income Tax Act* and subsection 323(1) of the *Excise Tax Act* for a total of $27,385.12, consisting of unremitted employee source deductions of $7,036.15 for October, 1995, plus $6.00 interest, and unremitted net GST of $17,569.05 for the period November 1, 1993 to October 31, 1995, plus $1,434.14 interest and $1,339.78 in penalties.

In February of 1993, when Mr. Smith first became a director of ECO, he was a high school teacher with a Master of Arts degree. He retired from his teaching career in June of 1995. He had no business training and no business experience before the events that led to this appeal. Mr. Smith was a minority shareholder of ECO, having invested approximately $10,000. He made the investment because he felt that ECO had a good and useful product.

By 1993, ECO had faced some business difficulties that led to discord between the majority and minority shareholders. Mr. Smith was aware of that and was also aware that the ECO was experiencing financial difficulties. He was elected to the board of directors in order to act as a liaison between the two groups and to try to restore harmony. In his role as director, he was not expected to participate in the day to day operations of ECO, nor was he expected to understand the details of its financial affairs.

At the outset, Mr. Smith sought legal advice about the legal duties of directors, and was generally aware of his obligation to exercise reasonable care and skill. **He also learned about his obligations to ensure that ECO fulfilled its obligation to remit source deductions. At the first board meeting after his appointment, April 6, 1993, he proposed a motion that priority be given to the payment of Revenue Canada accounts. That motion was approved.**

There is evidence that the directors were presented with reports at every meeting which led Mr. Smith to believe that the Revenue Canada remittances were not in default. The Crown appears to have accepted this, at least in so far as the obligations of ECO to pay net GST prior to June of 1995 were concerned. In summarizing the Crown's arguments, the Tax Court Judge says at paragraph 59:

Digitized by Google

The Appellant [Mr. Smith] knew from the start that there were difficulties existing in the Company and that it was behind in source deductions. He may not have known that the Company was behind in GST remittances until June of 1995.

For the period ending in June of 1995, Mr. Smith was not assessed for unremitted source deductions, but he was assessed for unremitted GST even though he had no knowledge of ECO's failure to remit GST.

The Tax Court Judge found that Mr. Smith was an "inside director" at the time of his election. As I read his reasons for decision, he based that conclusion on the following facts (paragraphs 123 and 124):

He [Mr. Smith] was an educated man possessing a Master of Arts Degree, although he was not in business and in spite of the fact that until the time he became associated with the Company he was unfamiliar with such business affairs. This is not a case where the Appellant was unaware of his position nor did he become a director reluctantly (even though he did indicate that he may have been pushed into it) and the actions that he took in allowing himself to be appointed as a director showed that he became so deliberately.

Before he became a director he inquired of the legal duties of a director from a lawyer. He checked the provisions regarding a director's responsibility in the statute. He admitted himself that when he became a director in February of 1993 he was aware of the financial difficulties facing the Company. When he attended the first meeting of the Board of Directors he asked about the duties and responsibilities of a director and was authorized to consult the Company's lawyer about it. He was aware of the fact that a director had at least "to act at all times with the care, diligence and skill expected of a competent person in the circumstances."

In my respectful view, the Tax Court Judge appears to have misdirected himself when he determined that Mr. Smith was an "inside director" at the time of his appointment because of his education, his willingness to act as a director, and his efforts to understand his obligations. **Generally, for purposes of the due diligence defence, "inside directors" are those who are "involved in the day-to-day management of the company and who influence the conduct of its business affairs" (*Soper, supra*, paragraph 43).** Those words simply do not describe the role of Mr. Smith when he first became a director. **The facts that are relevant to the determination of whether a person is an "inside director" relate to the tasks that the person undertakes as a director and the degree of the person's involvement in the business of the corporation.**

This error in the characterization of Mr. Smith's initial role as a director seems to have led the Tax Court Judge to err further by imposing a standard of care that was too high. Contrary to the conclusion of the Tax Court Judge, it seems to me that as an outside director, **it was reasonable for Mr. Smith to do exactly what he did, which was to propose a motion to keep the Revenue Canada accounts current, and thereafter to rely on the inside directors and officers of the company to ensure that those instructions were followed.**

The Tax Court Judge suggested that Mr. Smith should have done more. He should have sought more reports from corporate officials, asked more questions about actual balances and payments, or even had himself appointed as signing authority and monitored the payments himself. In my view, those are not steps that could reasonably have been expected of Mr. Smith, given his limited role as a director and the circumstances in which he took on that role. I conclude, therefore, that the due diligence defence is made out for the period up to and including June of 1995.

The situation changed in June of 1995, when Mr. Smith's role in the affairs of ECO changed from that of an outside director to that of an inside director. At that time, ECO was in serious

Digitized by Google

financial decline and Mr. Smith attempted to assist in various attempts to keep it afloat and for that purpose became more active in the affairs of ECO. His more extensive involvement in the financial affairs of the corporation made him an inside director of ECO after June of 1995. He remained so at least until the end of October 1995 when the affairs of ECO were taken over by a receiver. He has not been assessed for any obligation that arose after that time.

It is clear from the evidence that by June of 1995 the corporation's financial resources were so depleted that there was little that could have been done to meet its remittance obligations. **Despite the difficulties, however, Mr. Smith was not idle. In fact, the corporation's remittance obligations with respect to employee source deductions were met, except for the month of October.** There also remained outstanding some unremitted GST for the period from June to October, 1995.

During that period Mr. Smith spent considerable effort in trying to ascertain the amount of the corporation's liabilities, and thought that he had done so, having relied on corporate officers and also on information that he received from Revenue Canada. As it turned out, that information was not accurate, but Mr. Smith cannot have been expected to know that. Given his limited experience in tax and business affairs, it was reasonable for him to accept that the information given to him was reliable.

He also learned that the corporation was about to receive a federal government research grant in an amount that, as best he could determine, would have been sufficient to cover the corporation's obligations**. He went to great lengths to attempt to ensure that the grant would be applied against the corporation's obligations. That did not happen, but there is nothing in the record to suggest that Mr. Smith was to blame for that. If there were difficulties within the various government departments that made it difficult or impossible to accede to Mr. Smith's request for the grant to be used to pay the corporation's obligations, that is not apparent from the record.**

The Tax Court Judge appears to have recognized the efforts made by Mr. Smith in and after June of 1995, but he noted, at paragraph 138:

The actions that he took did not have the effect of ensuring that Revenue Canada received any of the monies here.

and, at paragraph 142:

The Court is satisfied that the actions taken by the Appellant did nothing to prevent the failure.

It appears to me that these comments reveal another error in the Tax Court Judge's application of the due diligence defence. **A director is required only to act reasonably in the circumstances. The fact that his efforts are unsuccessful does not establish that he has failed to act reasonably.**

For these reasons, I would allow this application for judicial review with costs. The decision of the Tax Court Judge should be quashed and the matter referred back to the Tax Court with a direction that Mr. Smith's appeal be allowed and the assessments vacated.

Karen R. Sharlow J.A.

"I agree

Marc Noël J.A."

"I agree

John M. Evans J.A."

Jean Ruffo v. The Minister Of National Revenue, A-429-97, A Clear Case of Improper Shifting of Financial Priorities with the Proper Result

LÉTOURNEAU, J.A.

[1] The appellant has failed to persuade us that Lamarre-Proulx J. of the Tax Court of

Digitized by Google

Canada misconstrued and misapplied the legal principles applicable in this case,[1] which were more fully developed by this Court in *Soper v. Canada*,[2] *Drover and Her Majesty the Queen*,[3] *Cadrin and Her Majesty the Queen*,[4] and *Wheeliker v. R.*[5]

[2] Clearly, the appellant, who was the chief executive officer and a director of Les Services Alimentaires le Banquetier Inc., prolonged the company"s agony until its death through bankruptcy on May 19, 1993 by partially financing it with the statutory deductions he was supposed to levy on the employees" wages and remit to the Receiver General of Canada.

[3] This is clearly apparent from the following extracts from the appellant"s testimony:

Q. So this was a report that you received, you said, every month, correct?
A. Yes.
Q. On different accounts of the company?
A. Yes, I have to say yes.
...
Q. So are you in a position to say...
A. Yes.
Q. ... whether the thirty thousand and ninety-one ($30,091) is in fact owing?
A. Yes, in fact, that was the amount owing.
Q. So, it was during ninety-two (92) that the company stopped making the remittances of federal deductions at source, is that correct?
A. Yes.
Q. And you were able to observe, when you were balancing the monthly books, that in fact there were deductions that were not being remitted?
A. Yes.
Q. What was your... All right, you were operating with a... you had some cash-flow problems, is that correct?
A. Yes.
Q. What strategy did you...
A. Sorry, yes?
Q. What strategy or what was your policy for the payment of the accounts so as to continue operating the company, were all the accounts being paid on an equal footing or were there some suppliers or were there certain debts that were paid more urgently?
A. The two accounts that were paid unquestionably, in priority, were the wages and the raw materials we needed in order to make the products.
Q. What were...
A. When I say in priority it was according to the priorities established by the suppliers. There are some suppliers with whom we had a much larger line of credit than with others.
Q. All right. And why did you give priority at that point to the payment of those two accounts, that is, the employees and the suppliers?
A. That was the only way to stay alive.
Q. So, you were aware, month after month, that there were some deductions at source that were unpaid, that you made the decision not to pay them in order to continue the operation of the company, is that correct?
A. Completely. Can I make a comment, however?

4. Furthermore, as of July 15, 1992, the appellant was hoping, for example, to get $200,000.00 pursuant to an oral cooperative agreement with Homard Gidney Lobsters Ltd. But the only means of redress appearing on the company"s books, if this amount was paid at that time, which was not the case, consisted of paying
the accumulated overdue accounts without any steps being taken to secure the payment

Digitized by Google

of the ongoing deductions and preventing a future breach of this obligation.[6] In fact, no remittance was made in accordance with this recovery plan and the failures to deduct continued in the following months while the firm was
electing to pay the other creditors.

[5] As Vinelott J. said, in relation to the duty of a company manager to make the aforementioned deductions and remittances:[7]

The directors of a company ought to conduct its affairs in such a way that it can meet these liabilities when they fall due, not only because they are not moneys earned by its trading activities, which the company is entitled to treat as part of its cash flow... but, more importantly, because the directors ought not to use moneys which the company is currently liable to pay over to the Crown to finance its current trading activities.

[6] The appellant"s duty as a director was to anticipate and prevent the failure to pay the sums owing and not to commit such failure or perpetuate it as he did from March 1992 on in the hope that at the end of the day the firm would again become profitable or there would be enough money, even if it were wound up, to pay all the creditors.[8]

[7] While a director may, under subsection 227.1(3) of the *Income Tax Act*, be relieved of personal liability for unpaid deductions by showing that he acted with diligence, the appellant has not, in the circumstances, demonstrated the requisite diligence.

[8] For these reasons, the appeal will be dismissed with costs.

Gilles Létourneau
J.A.

1- *Ruffo v. R.*, [1988] 2 C.T.C. 2203 (T.C.C.).

2- [1998] 1 F.C. 124 (F.C.A.).

3- F.C.A. no. A-331-97, May 13, 1998.

4- F.C.A. No. A-112-97, December 17, 1998.

5- [1999] 2 C.T.C. 395.

6- Appeal record, vol. II, p. 178.

7- *Re Stanford Services Ltd.*, [1987] B.C.L.C. 607, at p. 617.

8- Wheeliker v. R., [1999] 2 C.T.C. 395, at p. 415.

Jane Hanson v. Her Majesty The Queen, A-792-96, Ignorance of the Law Not Equal to Proper Conduct: The Need to Remedy the Ignorance

REASONS FOR JUDGMENT OF THE COURT
(Delivered from the Bench at Toronto, Ontario on Monday, October 2, 2000)

LÉTOURNEAU J.A.

[1] The Tax Court of Canada ruled that the appellant, as a majority shareholder and director of the Telfer's Restaurant Corporation (874990 Ontario Limited) ("Corporation"), was liable under subsection 227.1(1) of the *Income Tax Act* ("*Act*") for the amount of unpaid source deductions, interest and penalties payable by the Corporation in bankruptcy.

[2] At pages 5 and 6 of his decision, the learned Tax Court Judge made credibility findings which were adverse to the appellant as to the extent of her knowledge and experience in business matters generally and in this particular business. We cannot say that

Digitized by Google

these findings are capricious or unsupported by the evidence and, in any event, we are not in a position nor are we willing to second-guess him in this respect.

[3] In addition, he concluded that the appellant knew that she was a director and that she had been so appointed in order to secure for her son and family the majority on the Board of directors. He was also of the view that the appellant was not aware of her responsibilities, but that she made no effort, and failed to take any step, to find out what they were. He quoted with approval this statement of Bonner T.C.C.J. in *Black* v. *The Queen*, 93 D.T.C. 1212, at page 1215:

The appellant cannot take shelter under subsection 227.1(3) by claiming that his actions met the standard of a reasonably prudent person who was ill-informed as to the requirements of the *Act.* A reasonably prudent person who is aware that he is a director but who is uncertain as to the extent of his responsibilities as director is under a duty to at least attempt to discover what is required of him and to discharge that duty.

Nothing in that language [subsection 227.1(3)] suggests the existence of a legislative intention to offer relief to a director who fails to act because he is ignorant of and indifferent to his responsibilities and those of his company ... It is equally illogical to suggest that a director ... ignorant of his responsibilities and who fails to attempt to identify and fulfil them can meet the 227.1(3) standard.

[emphasis added]

[4] The appellant takes issue with this statement of the law because it imposes on a taxpayer-director a minimum standard of behaviour, that of making inquiries as to what is or her duties are. **She says further that the statement is inconsistent with what was said in the subsequent decisions of this Court, which, admittedly, the Tax Court Judge did not have the benefit of reading. Indeed, what the appellant is offering as a justification for her failure to prevent a breach of section 227 of the *Act* is that, in fact, she was ignorant of the law.**

[5] Generally, ignorance of the law is not a valid excuse for criminal or civil liability. Furthermore, subsequent to the judgment on this appeal, this Court decided *Cadrin* v. *R.*, [1999] 3 C.T.C. 366. In *Cadrin, supra*, this Court said, at p. 368, that total passivity based on total ignorance would not allow a taxpayer to escape liability under ss. 227.1(3). **Implicit in this conclusion is a minimum duty to remedy one's ignorance.**

[6] But, of course, as this Court also said in *Cadrin, supra* at p. 368, if a taxpayer without knowing the law does what the law requires him or her to do or what he or she should have done in the circumstances, this is sufficient to escape liability although he or she took no steps to ascertain the law.

[7] There is in this case no evidence, as in *Cadrin*, that the appellant without knowing the law did what she was required to do. She did not stay generally informed about what was happening with the business nor did she inquire when she was told that the business was encountering a "rocky spot" (Transcript, p. 41) or that things were not going great (Transcript, pp. 29-30).

[8] In our view, the decision in *Black, supra*, is not inconsistent with what was decided in *Cadrin, supra*. The appellant had to meet the single objective standard of care provided for in ss. 227.1(3) of the *Act* which takes into account in its application some of the attributes of the person who failed to meet the standard: see *Canada* v.*Corsano*, [1999] 3 F.C. 173 (F.C.A.) leave to appeal to the **Supreme Court of Canada denied on April 20th, 2000, *Soper* v.*Canada*, [1998] 1 F.C. 124 (F.C.A.). She had to do that by leading evidence that, as a director, she exercised the degree of care, diligence and skill to prevent the on-going failure to deduct and remit under section 227.1 of the *Act* that a reasonably prudent person would have exercised in these circumstances. The Tax**

Digitized by Google

Court Judge concluded that she had not done that. We agree.
[9] Accordingly, the appeal will be dismissed with costs.
"Gilles Létourneau"
J.A.

Her Majesty The Queen v. Gary J. Corsano, A-752-97, De facto Directors

REASONS FOR JUDGMENT

LÉTOURNEAU

[1] I have had the advantage of reading the reasons of my colleague Justice Noël and I share his opinion as to the liability of the respondents. However, I came to this conclusion by a different process that I must expose and involves an analysis of the legal issues related to the interpretation of subsections 227.1 (1) and
(3) of the *Tax Act on income* (the Act), and the use of the defense of the degree of care and diligence. The meaning and scope of the term "director" in subsection 227.1 (1) of the *Tax Act on income*
[2] Subsection 227.1 (1) of the Act makes severally liable for the directors of a company which has failed to deduct or withhold and remit to Revenue Canada when she was required to do, the taxes due on wages and salaries. Sections 153 and 227.1, which are strongly linked, provide:

153 (1) Every person paying at Any Time in a taxation year

(A) salary or wages or other remuneration, ...

Shall deduct or Withold therefrom Such Amount as may be determined in Accordance with prescribed rules and Shall, at Such time as may be prescribed, gave That Amount to the Receiver General on account of the payee's tax for the year under this Part or Part XI. 3, as the case may be, ...

227.1 (1) Liability of directors for failure to deduct - Where a corporation to deduct Has Failed Withhold year or as required by subsection Amount 135 (3) or section 153 or 215, Has Failed to year Amount handed Such Gold Has Failed to pay year Amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, Withhold, or pay the Amount recovered are jointly and severally liable, together with the corporation, to pay That Amount Any interest or penalties and Relating thereto.

153 (1) Every person paying at any time for a taxation year

a) salary, wages or other remuneration, ...

shall deduct or withhold the amount as may be prescribed and shall, at the time prescribed, remit that amount to the Receiver General on account of the payee's tax or the depositary for the year under this Part or Part XI.3.

227.1 (1) Liability of directors for failure to deduct - Where a corporation has failed to

Digitized by Google

deduct or withhold an amount as required by subsection 135 (3) or section 153 or 215, or failed to pay this amount or has failed to pay an amount of tax under Part VII or VIII for a taxation year, the directors of the company, when it was required to deduct, withhold, remit or pay the amount are jointly and severally liable with the corporation, to pay that amount, including interest and penalties thereon.

[3] The judge of the Tax Court adopted the view of the respondents and concluded that the term "administrator" found in the *Companies Act* of Nova Scotia means that administrators law and not the administrators fact recognized by the common law in Nova Scotia. On appeal, the parties presented conflicting arguments and well structured, supporting or challenging the legal conclusion of the judge of the Court of Tax. With respect, I believe that the claims of the respondents are diversion and tend to mask the real issue in this case and the approach that should be taken to determine their responsibility with respect to the transfer of funds involved in Revenue Canada. As is often the case with all the diversions, it raises some interesting questions, though not relevant to most.

[4] In fact, the key provision in this case is subsection 227.1 (1) of the Act. This is the scope of this provision must be determined and not the *Companies Act* of Nova Scotia. We talked a lot, but is not relevant in my opinion, the use of free and ambiguous term "administrator" in the *Companies Act* of Nova Scotia, as well as the scope and interpretation of this law. As we will see later, this is because the respondents have misinterpreted a previous decision of this Court as well as the purpose of subsection
227.1 (1) of the Act.

[5] Subsection 227.1 (1) of the Act makes all responsible directors of a company which has failed to remit monies owed to Revenue Canada. **In this section, the term "director" is in no way restricts or explained. One of the basic rules of legislative drafting, dictated by a rule of interpretation thereof, provides that the use of a generic term without restrictions or clarifications expresses the legislature's intention to give a broad sense. Here, using the term "directors" without restrictions in subsection 227.1 (1), the legislature intended that covers all genres of directors recognized law firms, including the administrators of law and fact.**

[6] It is worth repeating that the parties agree on the fact that the common law of Nova Scotia has integrated the concept of de facto director, a conclusion which the judge of the Tax Court arrives too. In this regard, I hasten to add that this legal reality exists in a form very similar in all common law jurisdictions in Canada.

[7] However, despite this, the judge of the Tax Court concluded that the term "director" in subsection 227.1 (1) of the Act includes only the administrators of law. It is based first of all on the decision of this Court in *The Queen v. Her Majesty. Kalef* [4] when he misinterprets. This is evident from the following extracts from his decision (on pages 8 and 9):

Because the law is clear that, for the purposes of subsection 227.1 (1) of the Act, it is necessary to discover the meaning of "administrator", examine the constitutive law of the Corporation should do and avoid the general principles of common law. Therefore, even if the appellants were perhaps de facto directors at common law, they were not under the *Companies Act* and they should not be held vicariously liable under Article 227.1 of the Act ...

[...]

It seems clear that analyzing the definition of "administrator" of the *Ontario Business Corporations Act* , which is almost identical to that in paragraph 2 (1) f) of the *Companies Act* , the Federal Court of Appeal has concluded that the definition was the administrator of law.

[8] Let us say immediately that this Court has never decided in *Kalef* that the definition of the *Ontario Business Corporations Act* administrator was right. The Court had to determine

Digitized by Google

whether a director of a corporation ceases to hold office for the purposes of subsection 227.1 (4) of the Act when a trustee is appointed. The Court concluded that Mr. Kalef did not satisfy the conditions set out in the *Ontario Business Corporations Act* that would have indicated that he had ceased to hold the office of director. It was therefore remained a director, despite the appointment of a trustee in bankruptcy.

[9] Notre Cour n'a jamais non plus décidé que l'interprétation du terme " administrateur ", dans le paragraphe 227.1(1) de la Loi, ne pouvait se fonder que sur la législation constitutive d'une compagnie à l'exclusion de la common law. Voici ce qu'a dit notre collègue le juge McDonald de la Cour d'appel à ce sujet :

The *Tax Act on income* does not define the term "administrator" and it does not establish criteria regarding when a person ceases to hold that office . Given the silence of the *Tax Act on income* , it is logical to turn to the law governing the incorporation of the company to find an answer.

[Emphasis in original.]

[10] In this case, it was not necessary to invoke the common law as statutory law stated when a person ceases to hold the office of director.

[11] Moreover, the Court noted that the statute law must help us to find an answer. It offers nothing exclusive or decisive, especially in the context of this appeal that the question at issue for the purposes of section 227.1 of the Act is not whether a person has ceased to hold office administrator (question usually set by legislation), but rather whether a person acted ostensibly as an administrator, becoming a de facto director (question generally governed by common law principles). In the words of Judge McDonald, "it makes sense" to turn to the right, which can provide an answer to the silence of the Act. In this instance, the answer lies in the common law.

[12] I would like to repeat here that the question in relation to subsection 227.1 (1) of the Act deals with the liability of directors of a company which, as a soul leader of this company, failed in their task of prevent the accomplishment of the illegal act and it is not intended to determine whether they undertake the liability of the company, which is the case, I think. In 1906, the Manitoba Court of Appeal, in *MacDonald v.. Drake* [5] , rejected the contention of the defendants that a legislative provision making directors jointly and severally liable for unpaid wages could not reach the administrators of law. The court concluded that even if the defendants were not de jure directors, because they did not have their own required actions, it was clear that they were elected, took part in the meetings, and acted as administrators. So they were de facto directors, making them personally liable. Judge Phippen of the Court of Appeal stated, at p. 229 and 230:

[TRANSLATION]

The law is clear: the acts of de facto directors within the powers of the Company to the responsibility of the Company and its directors ...

I do not believe that the defendants, who have enjoyed the benefits of their position, can now ~~rely on the fact that they held irregularly to escape a debt (which is not fine) to employees~~ which are protected by law.

[13] In the context of an allegation of misfeasance and breach of fiduciary obligations in *Northern Trust Co. v. Butchart* [6] , the Chief Justice of the Court of King's Bench of Manitoba, concluding that the directors were jointly and severally liable for such acts, said:

[TRANSLATION]

They were elected legally or illegally, their situation is the same. They were de facto directors and are responsible for all acts and omissions of their own making, in the same way as if they had been directors of law.

Digitized by Google

[14] *The Law of Canadian Companies* [7] , FW Wegenast wrote: [TRANSLATION]
The administrator is obviously can not invoke its own irregular status, for example , to escape his responsibility ... or to be exempt from a statutory obligation to pay wages or for failure to make statements to the government ... and in this case, a de facto director is in the same position as executor by interference.
[Emphasis in original.]
[15] The judge of the Tax Court also concluded that the term "director" in subsection 227.1 (1) of the Act must be interpreted restrictively because the provision imposes vicarious liability. He writes on page 9 of his reasons:
The vicarious liability under subsection 227.1 (1) applies only to the "administrator". Subsection 159 (3) also imposes a vicarious liability to certain persons who transfer property. It is important to note that section 159 (2) of the *Act* allocates responsibility to a large number of people. He mentions the "assignee, liquidator, receiver, receiver-manager, administrator, executor or other similar person." Certainly if we had intended subsection 227.1 (1) has a scope, you could use other words more about the "administrator", for example by adding the words "or is law "or" including persons who act as directors, "or the words" director "," frame ", or" any other person performing such functions. " In my opinion, a provision which imposes vicarious liability should be interpreted strictly and that is what I did.
[16] I have already said that if the legislature wanted to paragraph 227.1 (1) applies to all kinds of directors, he had nothing else to do what he did, c that is to say using the term "administrator" without attaching restrictions. Because the term "assignee, liquidator, receiver, receiver-manager, administrator, executor" cited by the judge of the Tax Court in this extract from his reasons, one might ask whether the legislature should also say, for ensure a wide scope to the relevant provision: [TRANSLATION] "assignee of fact or law, the liquidator of fact or law ... Director of fact or law, executor of fact or law." Just ask to meet them. In drafting the paragraph 227.1 (1) to give a wide scope, the legislature he had to say, at the risk of forgetting some other types of administrators that liability applies to directors of the Company, that If they are in fact or in law, active or inactive [8] , volunteer or paid, internal or external, a for-profit or not? Is it not more reasonable to assume that the legislature, in using the term "administrator" without limit or specify wanted him understand all types of administrators that there may be in Canada under provincial law?
[17] It is apparent that the legislature intended to give a broad meaning to the term "director" in subsection 227.1 (1) looking at the nature of the responsibilities entrusted to the company and its directors, the nature of the debt of the company and the links between the corporation, directors, employees and Her Majesty. In my opinion, the judge of the Tax Court has lost sight of these elements and, therefore, gave a restrictive interpretation in subsection 227.1 (1).
[18] The debt owed to the appellant are not of the same nature as trade payables due to suppliers in the normal course of business. Further, Her Majesty is not in the same situation a supplier chooses to do business with a given company. It is a creditor has not chosen to be in the sense that they are owed on the number of employees of the company and the salary they receive. In addition, these are generally composed of taxes and contributions to social security schemes and insurance, should benefit both employees and the public. In addition, it is not the money earned by the company as a result of its business activities. That is why, in England, the courts have held that these debts were owed to Her Majesty of nature "quasi-fiduciary". In *In Re Lo-Line Electric Motors Ltd.* [9] , Sir Nicolas Browne-Wilkinson VC, emphasized this fact, as well as harm to employees of a company. He quoted with approval the following passage from the decision of the judge in Vinelott *Stanford Re Services Ltd.* [10] : [TRANSLATION]

Digitized by Google

The directors of a company should conduct the affairs of this so that "it can meet these obligations at maturity, and not just because they are not earned by the company through its business, it is right to consider working capital (that is to say that the people with whom it deals to expect and whether the company), but, more importantly, because that directors should not fund the ongoing operations of the company with the money that it shall pay to Her Majesty. If they do and if, therefore, the amounts payable under CFE, contributions to insurance National and VAT is not paid within the time specified, and can not be recovered in the event of liquidation, the court may infer that the directors have continued their activities then they should have known that the company could not meet its current and future obligations and it endangered unjustifiably amounts owing to Her Majesty that should have been remitted to the Treasury as revenue to finance business activities may or may not produce a profit. C ' is, I think, to follow a false trail, or at least make an unnecessary, as to whether the failure to pay such debts would be considered unethical in the world of business. A director who leaves such a situation fails to produce to keep informed, to the extent possible, the financial position of the company ... or it is improperly pursuing business and are risking not intended for this purpose.

[19] In my view, subsection 227.1 (1) should not have be interpreted so narrowly that had the effect of undermining the valid social objectives covered by this provision. The fact that it makes directors personally liable for their own failures does not justify the restrictive interpretation that the judge of the Tax Court gave the term "administrator". Given the broad sense of the term "director" in subsection 227.1 (1), failure to recognize the responsibility of persons acting as directors of returns is to endorse and encourage acts or omissions of such persons, damaging to employees and the public, in a situation almost trustee. In this context, words used by Hodgins JA, the Court of Appeal in *Re Owen Sound Lumber Co* [11] . are quite appropriate:

[TRANSLATION]

On the second point, I agree with Justice Middleton to say that when directors have assumed responsibility trustee administrator, they have become leaders in all respects as if they had been appointed formal . To hold otherwise would mean that a person can commit illegal acts affecting the assets of the company, while enjoying immunity if it can demonstrate that it has been named an irregular manner. If this were the case, it would be fashionable to take over the load in this way rather than accept a legitimate but less advantageous.

[20] With respect, I think this statement even more relevant when the mistakes in a quasi-fiduciary position are detrimental to both employees and the public.

The standard of prudence and care in this instance

[21] At pages 19 and 20 of his reasons, the judge of the Tax Court opined that the standard of care applicable to directors of a nonprofit corporation such as Louisbourg Harbourfront Park Limited Corporation (the company) was not as rigorous as that which applies to the directors of for-profit companies. It relies on the decision of this Court in *Soper c. Her Majesty the Queen* [12] which, in his opinion, has set "different standards of care applicable to inside and outside directors" [13] . I note in passing that this Court has stated in *Soper* it does not establish a different standard of care as it was internal or external administrators. Robertson JA stated the following, at p. 156:

I would first like to point out that adopting this analytical approach, I do not suggest that accountability is simply based on the fact that a person is considered an inside director as opposed to an outside director. This qualification is quite simply the starting point of my analysis.

[22] Relying on the decision *Soper* , the respondents argued that the standard of care set out in subsection 227.1 (3) of the Act is a flexible standard and, therefore, there are different

Digitized by Google

standards applicable to situations different. As a result, there would be a standard for inside directors, one for outside directors, one for administrators nonprofit corporations, one for volunteer administrators and yet another for those who are paid. If we accept this approach, we manage to raise the thorny question: what standard or combination of standards the Court should apply to a person who is both an outside and volunteer a non-profit profit?

[23] It is true that this Court has stated in *Soper* that "the standard of care set out in subsection 227.1 (3) of the Act is fundamentally flexible" [14] . It is clear, however reading the judgment that it is the application of the standard is flexible, because knowledge of the factors and circumstances varied and different must be assessed to determine whether, in a given situation a director has complied with the standard of care under the Act. Subsection 227.1 (3) establishes a single standard applicable to all directors, that whether they have exercised the degree of care, diligence and skill required to prevent the failure that a reasonably prudent person prudence would exercise in comparable circumstances.

[24] I agree with counsel for the appellant that the purpose of subsection 227.1 (1) is to make directors responsible for deducting and remitting taxes for employees, and that this responsibility n is not different depending on whether or not the company has a profit, and I would add as the directors are paid or not, or whether they are active or inactive. All directors of all companies are responsible for any breach of the sole standard of care set out in subsection 227.1 (3) of the Act. The flexibility lies in the application of the standard, since the qualifications, skills and attributes of directors vary from one situation to another. It's the same circumstances surrounding the failure to retain and remit the sums due.

[25] With respect, I consider that the judge of the Tax Court erred in finding the existence of a standard of care different and less rigorous for-profit corporations. In doing so, he has misused and misinterpreted the evidence that was presented.

The application of the respondents to the standard of care and diligence

[26] In this instance, the failure to withhold and remit amounts owing to Her Majesty began in November 1992. Respondents Lawrence, Parsons, and MacDonald Wheeliker have learned a directors' meeting of 13 January 1993, while Corsano and Maindiratta respondents were informed at the meeting of February 3, 1993. Respondents Corsano, and Wheeliker Maindiratta know the financial difficulties of the Company since November 1992.

[27] Despite this, it is surprising that the failure to withhold and remit amounts owing to Her Majesty lasted until the bankruptcy of the Company in October 1993. This means that when the respondents were aware of the financial difficulties of the Company or the failure to remit the sums due, it was their duty to prevent the failure to pay the amounts due and to come and not only repair the breach afterwards[15]. At best, this duty is imposed intervention to certain directors for nine months. At worst, it is imposed on others for 12 months.

[28] The evidence shows that no specific measures have been taken to ensure that the Company fails to deliver the deductions due and to come when she began to have financial difficulties. The directors have decided to no action to this effect at their meetings on 13 January and 3 February 1993.

[29] At the meeting of March 3, 1993, the respondent Corsano found that discounts were in default and ordered the Director General to pay the arrears when he would receive a scheduled payment. There is no evidence that measures have been taken to the current and future discounts. Several checks were signed by the directors and given to suppliers until September 1993. The May meeting of the Board of Directors has not resulted in corrective actions to prevent failure. Nothing was done to verify whether the order to pay the arrears, given the March meeting had been met.

[30] At the July meeting, the respondent Corsano have learned that the order he had given to the Director General in March had no result and arrears were not paid to Her Majesty. He

Digitized by Google

also noted that no payment had been made for the period. Corsano has ordered that all cash receipts are used to pay amounts owing to Her Majesty. This however, should not be taken literally, since suppliers should be paid to ensure the operation of the Company [16] . In fact, shortly after this meeting, the respondent Corsano spoke with the Director General to pay a supplier rather than Revenue Canada [17] . The evidence shows that no payment has been made of amounts owing to Her Majesty and no follow-up was intended to ensure the implementation of this Directive. In addition, it must be repeated that no specific action has been initiated, such as the introduction of controls for payments to be made, the request periodic reports of the Director General on the situation, and regular checking that the payments had been made. The failure lasted several months. In fact, the directors have delegated their authority on the matter to the Chief, but they failed to exercise any control despite the fact that it was clear that it did not work. It was more than an abdication of a delegation.

[31] The judge of the Tax Court has outlined a number of reasons to support its conclusion that the respondents had acted with the degree of care, diligence and skill required in the circumstances.

[32] He first concluded that the freedom of action of the council was to a large extent restricted by the Louisbourg Harbourfront Park Society (Louisbourg) owned 96% of shares of the Company. The evidence in this case does not support this conclusion on the issue. It is true that Louisbourg has refused to release its shares to the Company to be privatized. However, this is far short of undue interference in the obligation secured by the Company under subsection 227.1 (1) of the Act. In his testimony, the Chairman, Mr. Wheeliker has admitted against Louisbourg-examination that did nothing to interfere with

the control exercised by the Board on the Company's business [18] . It has not interfered with the policy decisions taken by the board, nor does it intervened in the ongoing operations of the Company [19] .

Although it has no doubt that Louisbourg wanted to see the company continue its activities, there is no evidence to demonstrate that it has prevented the Company to take the deductions and remit to Revenue Canada.

[33] Second, the judge of the Tax Court gave a positive character to the fact that the March meeting, the Board had instructed the Director General of Revenue Canada to pay the full amount of receive Enterprise Cape Breton Corporation. In my opinion, this does not resolve the issue. Such payment would have settled the arrears, but nothing is planned for deductions and discounts. Nothing was done to stop the failure to prevent omissions and predictable future.

[34] Third, the judge of the Tax Court has interpreted positively the fact that the Board had taken all due care to hire a qualified person as CEO, and he had reason to trust him. With respect, the evidence shows that the directors knew early on that money owed to Revenue Canada were not paid. In addition, administrators stated that the Chief did not follow their instructions to pay money owed to Revenue Canada. However, no immediate action or diligence has been taken to remedy the situation facing the refusal to obey the general manager, or to correct the past and to come. In his testimony, Mr. Corsano admitted that he had serious concerns about the ability of the CEO to lead the Corporation, primarily because it did not comply with the directives of directors, but he did not use its primary administrator to convene a board meeting to discuss this issue and decide on appropriate corrective action [20]

[35] Fourth, to determine whether the respondents had done due diligence, the judge of the Tax Court took into account the fact that the administrators were convinced that the value of the Company's assets were sufficient to meet the demands of all creditors, including

Digitized by Google

Revenue Canada. With respect, this element is not relevant. Administrators have an obligation to prevent omissions and not to endorse systematically, as did the respondents in the hope that eventually there will be enough money to pay all creditors.

[36] Fifth, he was convinced that the directors have made inquiries about payments during Council meetings. It could be convinced that the way to meet the less stringent standard that applies to the situation. However, the burden imposed by subsection 227.1 (3) is much heavier.

[37] Finally, it also took into account the fact that Louisbourg abruptly fired all directors and forced the company into bankruptcy, thereby preventing these administrators continue to try to operate the business and improve its financial situation.

[38] Again, in my opinion, this factor is not taken into account in determining the degree of care and diligence that directors have shown. They were already guilty of failure to withhold and remit the source deductions for nearly a year when they were dismissed. As the court said in *Re Stanford Services Ltd.* , in the passage cited above, the directors of a company should conduct the affairs of the latter so that it can "meet these obligations at maturity because administrators ... should not fund the ongoing operations of the company with money that it shall pay to Her Majesty. "

[39] In conclusion, I believe that the factors that the judge of the Tax Court considered, singly or together, can not justify its conclusion as to the liability of directors under subsection 227.1 (1) and (3) of the Act.

[40] It is sad to have to conclude that the respondents, especially those who have acted voluntarily giving their time, did not exercise the degree of care and diligence to prevent the failure to withhold and remit covered , which breach has persisted all knew for a whole year. **This Court does not fulfill its duty to enforce the law if she was endorsing the acts or omissions of experienced and knowledgeable administrators who did not exercise the degree of care, diligence and skill that is expected of them under subsection 227.1 (3) of the Act.**

[41] For these reasons, I would allow the appeals and set aside the decision of the judge of the Tax Court. I would dismiss the appeals of the respondents Wheeliker, Maindiratta Corsano and contributions made by the Minister of National Revenue under subsection 227.1 (1) of the *Tax Act on income* . The respondents Lawrence MacDonald and Parsons, I would think making the decision that due to the judge of the Tax Court, to welcome their calls and send some contributions to the Minister for that it modifies that given responsibility to withhold and remit covered only begins January 13, 1993. As the appellant did not seek costs, I would make no order about it.

"Gilles Létourneau" JCA

Certified translation Laurier Parenteau, LL.L.

Bruno Hartrell v. Her Majesty The Queen, 2008 FCA 59, A Clear Case of *de facto* Director Liability and People's Interpreted.

Digitized by Google

RYER J.A.

REASONS FOR JUDGMENT OF THE COURT

(Delivered from the Bench at Toronto, Ontario, on February 13, 2008)

[1] This is an appeal from a decision of Paris J. of the Tax Court of Canada (the "TCC") (2006 TCC 480) dismissing the appeal of Mr. Bruno Hartrell against an income tax assessment, pursuant to subsection 227.1(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA"), in relation to his 1998 taxation year.

The assessment arose out of the failure of Toronto Lynx Soccer Club Inc. ("LYNX") to remit source deductions, in the amount of $47,434.46, to the Canada Revenue Agency (the "CRA") in 1998, as required by section 153 of the ITA.

[2] The appellant argues that the TCC erred in upholding the assessment against him on the basis that subsection 227.1(1) of the ITA was not applicable to him because he was never formally appointed, and did not, in fact, function as a director of LYNX in 1998. In the alternative, the appellant argues that if he did function as a director in 1998, he was entitled to rely on the due diligence defence under subsection 227.1(3) of the ITA.

[3] The determinations of the TCC as to whether Mr. Hartrell was liable, pursuant to subsection 227.1(1) of the ITA, for the 1998 source deductions that LYNX failed to remit, on the basis **that he, in fact, functioned as a director of LYNX and whether the due diligence defence that is contained in subsection 227.1(3) of the ITA, has been established require the application of a legal standard to a set of facts. Accordingly, these determinations constitute questions of mixed fact and law that are reviewable on a standard of palpable and overriding error, unless it is clear that there has been an extricable error of law, in which event a standard of correctness will apply. (See *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235.)**

[4] The TCC determined that in accordance with the decision in this Court in *Wheeliker v. R.*, [1999] 2 **C.T.C. 395 (F.C.A.), a person who was not formally appointed as a director can nonetheless have liability pursuant to subsection 227.1(1) of the ITA if that person has, in fact, functioned as a director of the corporation in question.**

[5] **We are of the view that in making this determination on the basis of *Wheeliker*, the TCC correctly apprehended the proper legal standard with respect to the issue of whether liability under subsection 227.1(1) of the ITA can be assessed against a person who has not formally been appointed as a director.**

[6] The TCC reviewed the evidence of several witnesses, including Mr. Hartrell, and numerous documents. **Based upon that review, the TCC concluded that Mr. Hartrell had played a significant role in the affairs of LYNX and that the Minister's assumption that Mr. Hartrell performed the function of a director of LYNX had not been shown to be incorrect. In so finding, the TCC declined to accept Mr.** Hartrell's assertion that he was no more than a passive investor in LYNX.

[7] We are of the view that the evidence before the TCC was sufficient to enable the TCC to conclude that Mr. Hartrell had, in fact, functioned as a director of LYNX in 1998. Moreover, it was open to the TCC to decline to accept Mr. Hartrell's testimony to the effect that he was a mere passive investor in LYNX. Accordingly, we are unpersuaded that the TCC committed any palpable and overriding error in reaching its conclusion that Mr. Hartrell was subject to liability under subsection 227.1(1) of the ITA on the basis that he, in fact, functioned as a director of LYNX in 1998.

[8] Pursuant to subsection 227.1(3) of the ITA, liability in respect of a failure to remit source deductions will not be imposed on a person who has, in fact, functioned as a director, if that person has exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

[9] The TCC determined that the legal test with respect to the defence of due diligence

Digitized by Google

under subsection 227.1(3) of the ITA was to be interpreted in accordance with paragraph 30 of the decision of this Court in *Soper v. R.*, [1997] 3 C.T.C. 242 (F.C.A.) which the TCC reproduced in paragraph 37 of its reasons. That paragraph reads as follows:

The standard of care set out in subsection 227.1(3) of the *Act* is, therefore, not purely objective. Nor is it purely subjective. It is not enough for a director to say he or she did his or her best, for that is an invocation of the purely subjective standard. Equally clear is that honesty is not enough. However, the standard is not a professional one. Nor is it the negligence law standard that governs these cases. Rather, the *Act* contains both objective elements embodied in the reasonable person language – and subjective elements inherent in individual considerations like "skill" and the idea of "comparable circumstances" Accordingly, the standard can be properly described as "objective subjective".

[10] The principles with respect to the test for the due diligence defence in subsection 227.1(3) of the ITA that were laid down in *Soper* have been affirmed by this Court in *Worrell v. R.*, [2000] 1 C.T.C. 79 (F.C.A.). [11] The appellant submits that the TCC erred by not adopting the test in *Worrell*. We are of the view that this argument must fail. By adopting the test in *Soper*, which was approved in *Worrell*, the TCC has adopted the test that the appellant advocates. We agree with the respondent that the TCC did not adopt the decision in *Thibeault v. The Queen*, 2005 TCC 393, [2006] G.S.T.C. 165, with respect to the test for the due diligence defence, and that by its reliance on *Soper*, the TCC adopted the proper legal test with respect to the due diligence defence under subsection 227.1(3) of the ITA.

[12] The appellant argued that the decision of the Supreme Court of Canada in *Peoples Department Stores Inc. (Trustees of)* v. *Wise* 2004 SCC 68 changed the test with respect to the due diligence defence from the "objective subjective" test, in *Soper*, to simply an "objective" test. Whether *Peoples Department Stores* can be said to have eliminated the subjective aspects of the due diligence defence in subsection 227.1(3) of the ITA is not entirely clear since that the decision dealt with a provision of the *Canada Business Corporation Act* R.S.C. 1985, c. B-3. In that regard, the Supreme Court of Canada, in paragraph 63 of the decision, stated that:

With respect, we feel that Robertson J.A.'s characterization of the standard as an "objective subjective" one could lead to confusion. **We prefer to describe it as an objective standard. To say that the standard is objective makes it clear that the factual aspects of the circumstances surrounding the actions of the director or of the officer are important in the case of the s.122(1)(b) duty of care, as opposed to the subjective motivation of the director or officer which is the central focus of the statutor fiduciary duty of s.122(1)(a) of the CBCA.**

If *Peoples Department Stores* did change the test to be applied under subsection 227.1(3) of the ITA to one that requires due diligence to be demonstrated on a purely objective standard, such a new test would be more difficult to meet than a test that contains some elements of subjectivity. As such, we are unable to see how the potential application of *Peoples Department Stores* could be helpful to the appellant.

[13] **The TCC found that Mr. Hartrell, an experienced chartered accountant, was aware that LYNX had failed to remit the correct amount of source deductions in a number of months in 1998 and that he did nothing to prevent those failures**. The TCC based this finding on the evidence before it, in particular Mr. Hartrell's testimony, as well as correspondence between Mr. Hartrell and Mr. Iantorno, the president of LYNX. **The TCC rejected Mr. Hartrell's argument that because he caused LYNX to provide post-dated cheques to the CRA in 1999, after the deficiencies had arisen, he had taken reasonable efforts to prevent the deficient remittances that arose in 1998. The TCC held that these cheques were provided long after the deficient remittances had occurred and that the due diligence defence requires steps to be taken to prevent**

Digitized by Google

such occurrences. Moreover, the TCC found that Mr. Hartrell could have caused LYNX to pay the arrears out of the funding that was provided to LYNX between January and August of 1999. [14] Based upon the evidence before the TCC, we are of the view that it was open to the TCC to make these factual findings. Accordingly, we are not persuaded that the TCC made any palpable and overriding error in applying due diligence defence in *Soper* to these factual findings and in reaching the conclusion that Mr. Hartrell had failed to exercise the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances to prevent the source deduction remittance shortfalls that occurred in 1998.

[15] For these reasons, the appeal will be dismissed with costs.

"C. Michael Ryer"

J.A.

Dupont Roofing & Sheet Metal Inc. v. The Minister of National Revenue, 2011 FC 160, No Need for Notice of Assessment of DAS Liability Before Tax Debt Certification

REASONS FOR JUDGMENT AND JUDGMENT

[1] This is an application for judicial review pursuant to section 18.1 of the *Federal Courts Act*, R.S.C. 1985,

c. F-7 of the act of certifying on June 11, 2004 in Federal Court, as Court File No. 6552-04, that the amount of $204,704.21 plus interest from May 15, 2004 is payable by the applicant and has not yet been paid.

BACKGROUND:

[2] The applicant company ("Dupont") was in the roofing business. In 2000, Dupont formed a joint venture with another firm, Applewood Roofing and Sheet Metal Inc. ("Applewood"). Together, they took possession of 94 Kenhar Street in Toronto. For administrative purposes, Applewood occupied unit 16 and Dupont occupied unit 17 at that address but both units were used as a combined work space. Applewood's bookkeeper, Mrs. Manuel, did the record keeping for both companies and they shared a mailbox.

[3] Mr. Luis Gomes, one of the two directors of Dupont, along with Manuel Da Silva, deposed that Applewood controlled all revenues and only transferred to Dupont the net amounts payable to employees. Due to disagreements over payment of Dupont's business expenses, the firms severed ties in August 2003. At the time of separation, Mr. Gomes says Applewood owed Dupont between $200,000 and $250,000. It was acknowledged by Mr. Gomes during his cross-examination that he was aware that this was the approximate amount of money owed in tax debt to the Canada Revenue Agency ("CRA").

[4] On April 4, 2003, CRA Trust Examiner, Mr. Domenic Pizzonia, produced a form of audit document called a "trust report" for Dupont. According to the respondent, it is the normal practice of the CRA to audit those employers, such as Dupont, that are required under the *Income Tax Act*, 1985, c.1 (5thSupp.) ("ITA") to calculate, withhold and remit tax from wages paid to employees. In the trust report attached to Mr. Pizzonia's affidavit, at p. 000268 of the applicant's Book of Affidavits, it is stated that Dupont was "negligent in filing 2001 and 2002 T4s" and "[A]udit was flagged from T4 Matching".

[5] In conducting the trust examination, Mr. Pizzonia met with Dupont's directors, Messers. Gomes and Da Silva and Mrs. Manuel, the bookkeeper. Following a review of the relevant books and records, Mr. Pizzonia calculated the amount of payroll taxes outstanding that the employer was required to collect and remit, including income tax, employment insurance premiums and Canada Pension Plan premiums, plus penalties and interest was

Digitized by Google

$162,550.43. He communicated these results to the applicant's directors by personally handing over a form at the meeting. Mr. Pizzonia submitted his report to CRA for processing. The matter was then assigned to a Trust Compliance Officer, Mr. Anthony Gentile.

[6] Mr. Gentile's evidence, supported by the electronic diary entries automatically generated by the CRA database, is that he followed his general practice for causing CRA's system to issue notices of failures to remit payroll assessments for the 2001 ($38,738.29) and 2002 ($122,672.76) tax years relying upon the information and conclusions in Mr. Pizzonia's final trust examination report. These were done on April 23, 2003 and April 25, 2003 respectively. The assessment for 2001 had to be manually mailed, according to the CRA practice at the time, for assessments for a taxation year two years prior to the date of the assessment. Mr. Gentile followed his general practice to arrange for a manual mailing through the Toronto North Taxation Centre. The assessment for the 2002 taxation year was generated electronically by the computer to be mailed from the Sudbury Tax Centre. Returned mail containing notices of assessments generated by Mr. Gentile would have been directed to him. He reviewed the CRA electronic diary and found no record of a returned notice pertaining to the 2001 and 2002 assessments.

[7] CRA relies on a computer system to issue the tax debt certificates that are approved and signed by a designate of the Minister of National Revenue and filed in the Federal Court Registry. In this case, another CRA Officer, Mr. Don Ballanger, was responsible for issuing the certification of the accumulated tax debt on May 15, 2004. He states that a review of the electronic diary and historics records showed an amount owing of $204, 704.21 as of that date. Under cross-examination, Mr. Belanger acknowledged that the certification process does not involve any form of verification that notices of assessment were actually mailed to the applicant.

[8] Mr. Gomes denies having received the underlying assessments of the tax debt for Dupont certified by the Minister in 2004. He says that the practice when Dupont and Applewood shared space was for Applewood's secretary to collect the mail. After Applewood and Dupont severed ties, Mrs. Manuel gave Mr. Gomes a computer, hard drive and documents still in her possession. Mr. Gomes put the box of records in storage to deal with later at the new location. In January, 2005 Dupont experienced a fire at that address. All records were destroyed in the fire.

[9] On April 29, 2005, Mr. Gomes received a Derivative Director's Liability Assessment in which he was assessed as being one of the directors of the applicant Dupont and therefore liable under the statute to pay the unremitted tax debt. In February, 2006, his counsel forwarded a notice of objection to the CRA on behalf of Mr. Gomes. In subsequent correspondence, counsel sought copies of the underlying corporate assessments. Despite repeated requests, they were not produced by the CRA. In a letter dated June 10, 2007 the CRA Access to Information and Privacy Directorate advised applicant's counsel that the Sudbury Tax Centre and the Toronto North Tax Service Office were unable to locate copies of the assessments. On cross-examination Mr. Gentile advised that he could have reproduced the 2001 and 2002 underlying corporate assessments if requested by someone with authority to do so.

[10] Enforcement of the tax certificate was held in abeyance pending review of the objection. The assessment was confirmed and notice issued to Mr. Gomes in July 2008. Appeals in respect of Mr. Gomes' personal liability filed in the Tax Court of Canada and in the Ontario Superior Court of Justice (in respect of the tax debt owed to the province) are being held in abeyance until this application is determined.

ISSUES:

[11] **The several issues raised by the parties can be reduced to two:**

Digitized by Google

Was it necessary for the Minister to issue notices of assessment to the taxpayer for unpaid payroll taxes and if so, has it been established that notice was given?
If notice of assessment was required and was not given to the taxpayer, should the certificate be declared a nullity?

ARGUMENTS & ANALYSIS:

Standard of Review

[12] In the present matter, the Minister's discretion to certify the debt was exercised by a designate relying upon the historics record maintained in the CRA electronic database. To the extent that questions of natural justice, legitimate expectation and procedural fairness arise in this matter, the Court must determine whether fairness requires that the decision be overturned: *eBay Canada Limited et al. v. MNR*, 2008 FCA 348 at para. 36. Otherwise, the issues involve questions of mixed fact and law in which the legal question cannot be extricated from the factual findings and deference should be shown: *Canada (Citizenship and Immigration) v. Khosa* 2009 SCC 12, [2009] 1 S.C.R. 339 at para. 89.

[13] This matter is, in my view, analogous to a judicial review of a fairness decision by tax officials as the applicant is, in effect, seeking relief from the negative decision he received in response to his objection to the derivative liability assessment. As stated by Justice James O'Reilly in *Sandler v. Canada (Attorney General)*, 2010 FC 459, 2010 D.T.C. 5073 at para. 7, this Court "can overturn the Minister's decision under the fairness provision only if it was unreasonable, in the sense that it falls outside the range of possible acceptable outcomes based on the facts and the law", citing *Telfer v. Canada (Revenue Agency)*, 2009 FCA 23 at para. 25. See also: *Osborne v. The Attorney General of Canada*, 2010 FC 673. The overall standard of review on this application should therefore be reasonableness.

Assessment and Notice Requirements

[14] The applicant's case essentially rests on the argument that the formal requirements of notice under the ITA and other tax statutes apply to assessments for failure to remit payroll taxes. The applicant does not dispute that a tax liability arose from the corporate activities but argues that the obligation to actually pay the debt does not arise until a notice of assessment is issued and mailed to the taxpayer. The applicant submits that a certificate can only be issued upon default of payment
following these actions. Failing proof of issuance of the assessment and proof of mailing of the notice to the taxpayer, the certificate is invalid and must be quashed.

[15] **The applicant alleges that notices of the underlying corporate assessments were never issued, or, if issued, were never mailed to Dupont. While it is not necessary to prove receipt, the burden of proving the existence of the notices and the date of mailing falls on the Minister. This, asserts the applicant, is within the Minister's knowledge and the respondent alone controls the means of adducing evidence of the completion of either act.**

[16] In this case, the applicant contends, the Minister's evidence contains significant inconsistencies and falls short of establishing that notices of assessment were in fact created and mailed to the applicant. The respondent has been unable to produce the corporate assessments. Moreover, the evidence pertaining to the respondent's mailing practices at the relevant time was not first hand knowledge but was based on "information and belief", contrary to Rule 81 of the *Federal Courts Rules*, SOR/98-106. It was within the power of the respondent to provide direct evidence of CRA's mailing procedures, especially in light of the importance of mailing procedures in this application. As witnesses with that knowledge did not provide evidence, the applicant could not directly cross-examine the source of the information relied on by the respondent.

[17] The applicant further submits that its right to procedural fairness has been breached

Digitized by Google

by the Minister's certification of the amount payable without first issuing Notices of Assessment. The scheme of the tax legislation provides that a taxpayer may object to a liability imposed after the taxpayer has been assessed: subsection 165(1) of the ITA; Sections 27.1, 92, 22 CPP, EI and ITA (Ontario) respectively. The respondent is required to "give a taxpayer adequate notice of the basis of reassessment, so that a taxpayer can fairly appeal or respond": *Frederick J. Buccini v. Her Majesty the Queen*, 2000 DTC 6685 (FCA), at para. 16, referring to *Continental Bank of Canada v. R.* [1998] 2 S.C.R. 358.

[18] The applicant argues it is fair and reasonable for it to have the legitimate expectation that before the Minister "certifies" an "amount payable" pursuant to subsection 223(2) of the ITA, the Minister would have first ascertained the amount payable via the normal assessment process and then would have completed that assessment process by issuing (i.e. mailing) a Notice of Assessment to the applicant. This would allow the applicant the opportunity to respond by objecting. In the result, the certificate should be nullified as the Minister has not satisfied the burden of proving that the assessment had been mailed.

[19] The respondent's position is that the CRA is not required to mail notices for failure to remit payroll taxes before certifying a payroll tax debt. The ITA requires all employers to calculate, withhold and remit payroll taxes from employee wages. There is no requirement for the mailing of notices of assessment prior to these amounts becoming due. Employers regularly become liable to pay amounts to the Crown without being assessed by the Minister. If the Minister assesses an employer for failure to remit payroll taxes that have become payable, those outstanding amounts are payable to the Receiver General, even if they are in dispute. If an employer fails to comply with source deduction requirements, any outstanding "amount payable", plus interest, may be certified by the Minister of National Revenue for the purpose of securing the debt or as a precursor to collection: *In the Matter of an Assessment or Assessments by the Minister of National Revenue Under the Income Tax Act, the Canada Pension Plan and the Unemployment Act Against 92000 Holdings Limited*, 93 DTC 5047 at para. 5. Collections restrictions, which otherwise prevent the Minister from certifying a tax debt until a notice of assessment has been mailed, do not apply to payroll taxes, in the respondent's submission: ITA s. 225.1(6)(b); *Canada (Minister of National Revenue) v. Swiftsure Taxi Co*, 2004 FC 980, [2004] 4 C.T.C. 304 at para. 16; *Jus D'Or Inc. v. CCRA,* 2007 FC 754 at paras. 12-**15.**

[20] **Further, the respondent submits, mailing requirements are procedural fairness requirements material to pursuing rights of appeal. They do not restrict the collection of payroll debts. Should there have been a true error on the part of the Minister in failing to mail the assessment, the respondent contends that Dupont's remedy is to request an extension of time for filing a Notice of Objection prior to appealing to the Tax Court of Canada.**

[21] **I agree with the applicant that where proof of the issuance and mailing of a notice of assessment is required, the onus falls on the Minister. This is because the facts are "peculiarly within his [the Minister's] knowledge and he alone controls the means of adducing evidence of them": *Aztec Industries Inc. v. Her Majesty the Queen*, 95 DTC 5235, [1995] 1 C.T.C. 327 (FCA) at para. 12. Here, the applicant's counsel has effectively pointed out shortcomings in the Minister's evidence concerning the mailing of the underlying assessments such as the lack of direct evidence from a mailroom employee and inconsistencies in the evidence of the Minister's witnesses as to the procedures followed in 2003. But, if it is necessary to find that notices of assessment were mailed, I am satisfied on the basis of the Minister's evidence that the two notices of failures to remit payroll assessments for the 2001 and 2002 tax years were placed into the CRA mail stream and mailed to Dupont in 2003.** [22] As stated by Justice Marshall Rothstein in *Kovacevic v. Canada,* 2003

Digitized by Google

FCA 293, 308 N.R. 266 at para. 16:
[w]hen legislation requires that documents be sent by a large organization such as a government department by ordinary mail, but does not require registered or certified mail or evidence of a more formal means of sending … [G]enerally it would be sufficient to set out in an affidavit, from the last individual in authority who dealt with the document before it entered the normal mailing procedures of the office, what those procedures were.
That standard, in my view, was satisfied by Mr. Gentile's evidence.
[23] I note that in *Kovacevic*, the legislation required the use of registered mail and the evidence fell short of proving that was done. **However, I do not think it was necessary in this case for the Minister to prove that notices of assessment were mailed to Dupont in order to establish that certification of the tax debt was reasonable. There is no factual dispute in this matter that Dupont, through its controlling directors, was aware of the outstanding tax liability. They had met with Mr. Pizzonia and had received from him the trust report setting out the amounts owing for the unpaid payroll taxes in 2001 and 2002.**
[24] Mr. Gomes acknowledged in his evidence that he was aware of the debt and that it was roughly the same amount that Dupont was owed by Applewood. Mr. Gomes also acknowledged not having attended to his tax records between the time Dupont and Applewood separated in 2003 and the fire that occurred in January, 2005, thereby displaying a degree of negligence with respect to his corporate responsibilities, tantamount to wilful blindness. He could not say whether the notices were in his box of records or not as he did not examine the contents of the box. The urgency of the matter was only brought home to him when he received the Director's Derivative Liability Assessment in 2005 which attributes the corporation's tax debt to him in his personal capacity.
[25] **The jurisprudence relied upon by the applicant to advance the claim that the Minister is required to provide the taxpayer with a notice of assessment involve cases pertaining to personal income tax, not payroll taxes. So, although the Minister may be obliged to provide an individual with a notice assessment, the same is not true for the withholding and remitting of payroll taxes. Section 153 of the ITA explicitly instructs those persons who pay out wages to deduct a certain percentage of the salary for taxes and remit that amount to the Receiver General:**
[27] Section 153 of the ITA and s. 108 of the Regulations both apply to the applicant Dupont. In allowing Applewood to transfer only net amounts to Dupont to pay its employees, it failed to adhere to the tax scheme.
[28] Further, the provisions in subsections 225.1(1) and following prohibit the Minister from, among other things, certifying an assessed tax debt or giving notice of such a liability until after the collection-commencement day in respect of the amount. Subsection 225.1(6)(b) makes it clear that these provisions do not apply to amounts required to be deducted or withheld:

[29] **Therefore, as correctly argued by the respondent, it is not necessary to mail notices of assessment prior to these amounts becoming due.** This is consistent with the duty of the Minister to promote and protect the public interest by ensuring the ITA is applied fairly: *Canada (Minister of National Revenue) v. Swiftsure Taxi Co.,* 2004 FC 980, [2004] 4 C.T.C. 304 at para. 16; *Jus D'Or Inc. v. CCRA,* 2007 FC 754 at paras. 12-15.
[30] Subsection 227(9.4) of the *Act* places the liability for paying taxes resulting from failure to remit an amount deducted or withheld on the person responsible for failing to do so:[32] In other words, the CRA is entitled to verify that payroll taxes have been properly remitted to the Receiver General. Nothing in the present matter suggests that the CRA pursued a course of action that was beyond the ambit of its power as provided by the ITA. The

Digitized by Google

applicant Dupont did fail to withhold employee tax and remit that tax to the Receiver General. The CRA had the statutory authority to follow up on that failure through the certification of the tax debt.

[33] **Having found that it was unnecessary for the Minister to issue notices of assessment to the taxpayer Dupont for unpaid payroll taxes, the question of whether the applicant received these assessments becomes moot.** In any event, and has already been suggested, the applicant may apply to the Minister to request an extension of time for filing a notice of objection prior to appealing to the Tax Court of Canada: ITA s. 166.1(1); ITA s. 166.2(5) (b) (iii).

[34] Based on the foregoing, I cannot find that it was unreasonable for the Minister to certify the debt in the amount of $204,704.21 plus interest. The ITA does not require the Minister to provide notices of assessments to corporate taxpayers who have an ongoing obligation to remit payroll taxes. Furthermore, it is clear from the evidence that the applicant was either fully aware, or ought to have been aware, of the debt owed and the obligation to pay it. As such, the certificate shall not be declared a nullity and this application for judicial review is dismissed with costs to the respondent.

JUDGMENT

IT IS THE JUDGMENT OF THIS COURT that:

the Certificate filed in the Federal Court Registry under s.223 of the *Income Tax Act* on June 11, 2004 as Court File No. 6552-04 that the amount of $204, 704.21 plus interest from May 15, 2004 was payable by the applicant and had not been paid is valid;

the application for judicial review of the decision to certify the applicant's tax debt and the Certificate is dismissed; and

the respondent is awarded costs fixed at $2000.00.

"Richard G. Mosley" Judge

Giovanni Zen v. MNR, 2010 FCA 180, The Minister Does Not have to Issue Additional Assessments to realize the Interest Accruing

REASONS FOR JUDGMENT EVANS J.A.

INTRODUCTION

[1] Giovanni Zen was a director of Pacific Refineries Inc. in the years when, in breach of its statutory duty, it failed to remit to the Minister of National Revenue payroll source deductions in respect of its employees. The Minister issued notices of assessment to Pacific Refineries for the amount owing. The Minister also issued a notice of assessment to Mr Zen on the basis that he was jointly and severally liable for the tax debt that Pacific Refineries incurred while he was a director. Neither Pacific Refineries nor Mr Zen discharged the liability. Both are liable for the interest that has continued to accrue.

[2] The question to be decided in this appeal is whether Mr Zen is required to pay the interest that accrued on the unpaid debt after the Minister of National Revenue issued the notice of assessment to him, or whether the Minister must issue another notice of assessment with respect to that interest before he can take steps to collect it. In other words, the question is not whether Mr Zen is jointly liable with Pacific Refineries for the accrued interest (it is conceded that he is), but whether the Minister

Digitized by Google

can collect it without having to issue a notice of assessment for this amount.

[3] The appellant says that, even though subsection 227.1(1) of the *Income Tax Act,* R.S.C. 1985, c. 1 (5th Supp) (ITA), imposes on directors a continuing liability for interest on their corporation's unpaid tax debt and the amount of their liability in respect of that debt has been assessed, no provision of the ITA requires them to pay interest that accrues after the assessment. Consequently, he argues, the Minister cannot take collection measures without a further assessment. [4] The Minister, on the other hand, submits that, once the amount owing by a director by virtue of subsection 227.1(1) has been assessed under subsection 227(10), those provisions, when read together, require the director to pay subsequently accrued interest without the need for a further assessment. Accordingly, collection measures can be taken against the director to recover both the amount assessed and the interest that has subsequently accrued.

[5] Mr Zen appeals from a decision of the Federal Court (2009 FC 531), in which Justice Blanchard (Judge) granted an application by the Minister for a compliance order in respect of requirements for information (RFIs) issued to Mr Zen to determine his ability to pay the interest that has accrued on Pacific Refineries' debt since his liability for that debt was assessed. At the same time, the Judge dismissed an application for judicial review by Mr Zen to set aside the RFIs, which he has challenged on the ground that he is not liable to pay the unassessed interest that accrued after the assessment.

[6] The Judge held that the combined effect of subsections 227.1(1) and 227(10) of the ITA imposes an obligation on Mr Zen to pay the post-assessment interest, and that the Minister was **therefore authorized to issue RFIs to assist in collecting it from him. In my view, the Judge correctly interpreted the relevant provisions of the ITA, which are appended to these reasons, and I would therefore dismiss the appeal.**

FACTUAL AND LEGAL BACKGROUND

[7] The relevant facts can be stated briefly. Mr Zen was a director of Pacific Refineries from 1981 to 1986. Starting in 1982, the Minister issued notices of assessment to Pacific Refineries under subsection 227(10) determining the amount that it owed for failing to remit payroll source deductions as required by subsection 153(1) of the ITA. The amounts in question related mainly to income tax, but also included relatively small amounts for Canada Pension Plan and Unemployment Insurance. **The assessments issued to Pacific Refineries also included penalties, and a substantial amount of interest, imposed at that time by subsection 227(9) (see now subsection 227(9.2)).**

[8] On December 8, 1986, the Minister also issued a notice of assessment to Mr Zen pursuant to subsection 227(10) with respect to his liability under subsection 227.1(1). The amount assessed was $103,463.62, which included the amounts of the payroll source deductions that Pacific Refineries had failed to remit, as well as penalties and the interest that had accrued to date.

[9] Having filed a notice of objection to the assessment, which the Minister confirmed on July 3, 1987, Mr Zen appealed to the Tax Court, but discontinued his appeal on January 5, 1996. Mr Zen also unsuccessfully applied to the Minister for relief under the "fairness package" in respect of the 1986 assessment.

[10] Because the amount for which Mr Zen had been assessed remained unpaid, the Minister served him with RFIs under paragraph 231.2(1)(*a*) of the ITA seeking net worth information in order to determine his ability to pay the outstanding balance which, as of February 26, 2006, the Minister calculated to be $615,587.20. **This comprised the amount of the 1986 assessment ($103,463.62) and the interest that had subsequently accrued over the nearly twenty years that the**

Digitized by Google

assessed amount remained unpaid. [11] Following the institution of the present proceedings, Mr Zen paid to the Minister on February 21, 2007, the amount for which he had been assessed in 1986, that is, $103,463.62**. The Minister acknowledged the payment on May 15, 2008, and advised Mr Zen that his outstanding balance was now $629,849.47, comprising the interest that had accrued since the 1986 assessment. Because the RFIs under review in these proceedings were issued after Mr Zen had paid the 1986 balance, they relate solely to his ability to pay the post-1986 assessment interest. If Mr Zen is not liable to pay the unassessed interest, the RFIs are unauthorized and must be set aside.**

DECISION OF THE FEDERAL COURT

[12] The Judge stated that subsection 227.1(1) makes directors jointly and severally liable for the amount of any payroll source deductions that their corporation failed to remit "and any interest or penalties relating to it". He noted that subsection 227(10) empowers the Minister to assess "at any time" the amount payable under subsection 227.1(1) and provides that, when a notice of assessment is issued, "Divisions I and J of Part I apply with any modifications that the circumstances require." Division I of Part I of the ITA includes section 161, the section on interest. Among other things, subsection 161(1) requires the taxpayer to pay interest "at the prescribed rate" on the balance of "the taxpayer's taxes payable" outstanding on the due date.

[13] The Judge held that, when subsections 227.1(1) and 227(10) are read together, it is clear that directors are liable to pay interest accruing after their liability has been assessed under subsection 227(10), without the need for a further assessment. He noted that, while the ITA does not expressly impose this liability to pay, subsection 227(10) incorporates subsection 161(1), "with any modifications that the circumstances require". To modify subsection 161(1) so that it applies, not only to a taxpayer's taxes payable, but also to a director's third party debt under subsection 227.1(1), would not, the Judge held (at para. 26), be a substantive change, because Parliament clearly intended directors to be liable on an ongoing basis for the accruing interest and penalties owed by their corporation with respect to amounts that it had failed to remit.

[14] The position adopted by the appellant, the Judge said (at para. 28),

… would result in the Minister having to issue a new assessment in order to collect what is clearly a continuing liability of directors for accrued interest under the Act.

This would be inconsistent with the clear language of the Act and the intention of Parliament.

ISSUE AND ANALYSIS

[15] The issue to be decided in this appeal is whether directors, to whom notices of assessment have been issued under subsection 227(10) in respect of their joint and several liability for a corporate tax debt, are required to pay interest that has accrued after those assessments were issued, when that interest has not itself been the subject of a notice of assessment. This issue has not previously been considered by this Court.

Appellant's argument

[16] Counsel conceded that it is open to the Minister to issue a notice of assessment to Mr Zen for the amount of interest that has accrued since the 1986 assessment was issued. Subsection 227.1(1) provides that directors are jointly and severally liable for an amount not remitted by a corporation in breach of the ITA "and any interest or penalties relating to it." Subsection 227(10) empowers the Minister to assess a director "at any time" for an amount

Digitized by Google

payable under section 227.1.

[17] Since Mr Zen discontinued his appeal against the 1986 assessment, it would seem that he could not object to an assessment of the interest that has accrued since 1986 on the ground that he was not jointly liable with the corporation for the amount of either the source deductions not remitted by Pacific Refineries, or the penalties and interest that had accrued up to the date of the assessment. He could, however, refuse to pay the amount of subsequently accrued interest that the Minister was seeking to collect, on the ground that it had not been calculated correctly. **Nonetheless, without another assessment, counsel submits, Mr Zen is not indebted to the Minister for the interest that has accrued since 1986. Accordingly, the RFIs issued in respect of that interest are not authorized by the ITA and must be set aside.**

[18] The conceptual basis of the appellant's argument is the well established legal principle that, in the absence of a provision in the ITA to the contrary, taxpayers are not required to pay an amount for which the ITA makes them liable until the Minister has issued a notice of assessment of the amount payable.

[19] Subsection 161(1) is an exception to this general principle. It provides that when a taxpayer is late in paying the amount of her "taxes payable", the taxpayer "shall pay to the Receiver General interest at the prescribed rate" on the balance owing. The effect of this provision is that, once a taxpayer has been assessed, he or she can be required, without the need for another assessment, to pay interest that accrues on the amount of the tax debt after the assessment was issued.

[20] In contrast, counsel for Mr Zen says, subsection 227.1(1) only makes a director jointly and severally liable for the corporation's unpaid tax debt. Accordingly, he argues, a director can be required to pay that debt, including any penalty and accrued interest, only after the Minster has issued a notice of assessment under subsection 227(10).

[21] No provision of the ITA, counsel submits, requires the director to pay interest that accrues after the assessment. He says that section 161 does not apply to interest accruing on assessments made under subsection 227(10) with respect to the joint and several liability imposed on a director by subsection 227.1, because that liability is not for "taxes payable". Therefore, in order to collect from Mr Zen the interest that has accrued since the 1986 assessment, the Minister must issue another notice of assessment.

ITA, section 160

[22] Counsel for Mr Zen says that cases decided under section 160 of the ITA support his argument. Like subsection 227.1(1), section 160 is essentially a collection provision, in the sense that both make a third party jointly and severally liable for the tax debt of a principal tax debtor, in order to enhance the Minister's ability to recover the tax owed by the principal debtor.

[23] Subsection 160(1) provides that, when a person with an unpaid tax liability transfers property in a non-arm's length transaction, the transferee is jointly and severally liable for the transferor's tax debt, including interest payable by the transferor. The Minister can assess the transferee under subsection 160(2) "at any time" for the amount owing under subsection 160(1).

[24] However, unlike the joint and several liability imposed on a director by subsection 227.1(1), the amount of a transferee's liability under section 160 is not coterminous with that of the tax debtor. Thus, a transferee is not liable for an amount that exceeds the lesser of the following two amounts: the value of the property transferred, minus any consideration given for it by the transferee (subparagraph 160(1)(*e*)(i)), and the total tax and interest that the transferor was liable to pay in or in respect of the year of the transfer and any preceding years (subparagraph 160(1)(*e*)(ii)).

Digitized by Google

[25] *Algoa Trust v. Her Majesty The Queen,* 98 DTC 1614 (T.C.C.) is a leading authority on section
160. The transferee of property in that case, Algoa Trust, successfully appealed against a notice of assessment issued to it under subsection 160(2). The assessment included interest on the transferor's unpaid tax. Algoa Trust appealed on the ground that, when the amounts that it had already paid on account of its liability under section 160 were included, the amount of the assessment exceeded the value of the property transferred. *Algoa Trust* is thus distinguishable from the present appeal because subsection 227.1(1) contains no analogous cap on a director's liability for the corporation's debt.

[26] However, Justice Dussault also made the following more general statements about the nature of the liability imposed by section 160 and the transferee's liability for interest.

[3] The rule stated in s. 160 of the Act does not have the effect of creating a tax debt. The effect of the provision is not to create a second debt: there is only one tax debt. The wording of the Act is quite clear: the purpose of s. 160 is essentially to add another debtor who is jointly and severally liable with the transferor. This new debtor is called the transferee. There is thus no new debt created under the Act and the obligation arises not from the assessment but from the Act itself. Fundamentally, therefore, there is only one debt and only that debt can bear interest.

[4] First, subsection (1) of s. 160 in fact states that the transferee is jointly and severally liable and that his or her liability is limited to the lesser of the two amounts mentioned in s. 160(1)(*e*)(i) and (ii), namely (i) the value of the property transferred less the consideration, and (ii) the total of all amounts which the transferor is liable to pay in or in respect of the year of the transfer or any preceding year, that is to say, for the year of the transfer and for any preceding years.

[5] Secondly, s. 160(2) provides that the Minister of National Revenue ("the Minister") may at any time make an assessment. This is also quite clear. However, the limit imposed in s. 160(1)(*e*) must be observed for each assessment.

[6] Thirdly, I would say that there is no provision of the Act regarding interest that may be applicable to an assessment issued pursuant to s. 160 of the Act. This is logical, since there is no new tax debt and an assessment under s. 160 already incorporates the interest which the transferor owed in addition to the tax. The assessment may also incorporate penalties and interest thereon. (Emphasis added)

[27] Counsel for Mr Zen relies on these passages for two propositions. First, like the liability imposed by section 160, the liability of a director under subsection 227.1(1) is not a tax debt. There is only one tax debt, namely that of the corporation that failed to remit. Section 160 and subsection 227.1(1) merely add a second debtor in order to assist the Crown in recovering the tax debt owed by the principal debtor. I agree with this analysis, which I do not understand the Minister to have challenged in the present appeal.

[28] The second proposition on which counsel for Mr Zen relies is that interest is not applicable to an assessment under subsection 160(2) of the amount owed by the transferee. In my opinion, however, this proposition does not assist Mr Zen. Whether or not interest is applicable to Mr Zen's 1986 assessment is not determinative of his liability for accruing interest, because subsection 227.1(1) provides that directors are jointly and severally liable to pay the amount that the corporation ought to have remitted "and any interest … relating to it." **Thus, even if Mr Zen is not liable to pay interest on his unpaid 1986 assessment, he is liable to pay the interest that has accrued since 1986 on Pacific Refineries' unpaid tax debt**.

[29] However, because subsection 227.1(1) is only a charging provision it cannot resolve the issue raised by this appeal: is the Minister authorized to institute legal proceedings to recover from a director interest on an unpaid corporate tax debt that accrued after the director

Digitized by Google

was assessed?

[30] Counsel relies on *Ho-A-Shoo v. Attorney General of Canada*, 2000 DTC 6293 (Ont. Sup. Ct. J.) (*Ho-A-Shoo*), also a section 160 case, for the proposition that the Minister cannot require the transferee to pay interest that accrues after the transferee has been assessed under subsection 160(2). Dr Ho-A-Shoo was the representative plaintiff in a class action against the Minister by transferees of property from a tax debtor at less than market value. They were seeking to recover payments that they had made to the Minister which, they alleged, were in excess of their liability under section 160.

[31] On a motion by the Minister to strike the action, Justice Cumming formulated (at para. 11) the first issue in the class action as whether the Minister was authorized to demand from a transferee of property an amount of interest that both exceeded the limit on her liability imposed by subparagraph 160(1)(*e*)(i) (the market value of the transferred property) and had not been the subject of a notice of assessment.

[32] Relying on *Algoa Trust*, Justice Cumming held (at paras. 12-13) that the Minister could not assess under subsection 160(2) for an amount that exceeded the caps that subsection 160(1) imposed on the liability of a transferee of property. To this extent, *Ho-A-Shoo* is distinguishable from the present case.

[33] However, the Judge also addressed an argument analogous to that advanced in the present case by Mr Zen's counsel (who, incidentally, had also represented Dr Ho-A-Shoo), namely that section 160 does not authorize the Minister to recover from a transferee interest accruing after the transferee had been assessed, unless it had been the subject of a subsequent assessment.

[34] Relying again on *Algoa Trust*, Justice Cumming held (at para. 21) that the joint and several liability of a transferee under section 160 is not a tax debt. It is therefore not a debt in respect of "taxes payable" for the purpose of section 161. Accordingly, the Minister could not rely on that as the basis of the transferee's obligation to pay interest. See also *Kirkwood v. Her Majesty The Queen*, 2003 DTC 277 (T.C.C.) at para. 26.

Summary of conclusions

[35] First, Pacific Refineries was liable to pay the assessed amount of payroll source deductions that it had failed to remit, together with penalties and interest accrued to that time.

[36] Second, Mr Zen was jointly and severally liable under subsection 227.1(1) for Pacific Refineries' tax debt and penalties, as well as the interest accruing on it.

[37] Third, Mr Zen's liability under subsection 227.1(1) for the corporation's debt arises from his joint liability with the corporation, and is not itself a tax debt.

[38] Fourth, by virtue of subsection 227(10), the Minister may assess at any time the amount of Mr Zen's joint and several liability under subsection 227.1(1) for the corporation's debt, together with penalties and accrued interest.

[39] Fifth, subsection 161(1) as enacted does not require a director to pay interest accruing on **a corporation's debt after the Minister has issued a notice of assessment to the director under subsection 227(10). This is because subsection 161(1) applies to "taxes payable" under Parts I, I.3, VI or VI.1. The amount assessed under subsection 227(10) in respect of the joint and several liability imposed on the director by subsection 227.1(1) is not for "taxes payable", let alone for "taxes payable" under those Parts of the ITA, since sections 227 and 227.1 are located in Part XV.**

[40] To this extent, I agree with the submissions of counsel for Mr Zen. However, one other issue remains to be considered. Subsection 227(10) provides that, when the Minister assesses the amount payable by a director under subsection 227.1(1) and sends a notice of assessment, "Divisions I and J of Part I apply with any

Digitized by Google

modifications that the circumstances require." Section 161 is found in Division I of Part I of the ITA.

[41] The question to be decided is whether the modifications to subsection 161(1) that would be required for it to apply to an assessment under subsection 227(10) are permitted by the words "with any modifications that the circumstances require."

ITA, subsection 161(1): "with any modifications that the circumstances require"

[42] In order to apply subsection 161(1) to an assessment under subsection 227(10), it would be necessary to add to paragraphs (*a*) and (*b*) of subsection 161(1) words such as "or any amount for which a director is liable under subsection 227.1(1)".

[43] I return to a question raised, but not clearly answered, in *Ho-A-Shoo*. Justice Cumming expressed dissatisfaction (at para. 16), from a policy perspective, with a result that exempted transferees from liability for unassessed interest on their unpaid joint and several liability for the transferor's tax debt. He asked himself (at para. 18) if the words of subsection 160(2) which he italicized might not make interest chargeable "in respect of a transferee's unpaid fixed liability determined under s. 160".

[44] Subsection 160(2) thus deems an amount assessed under that provision to have been "tax payable": section 152 requires the Minister to determine the amount, if any, of the tax payable for the year by a taxpayer. Nonetheless, Justice Cumming seems to have concluded that these words were not enough to attract the obligation to pay interest imposed by subsection 161(1). His reasons do not address the possibility of modifying subsection 161(1).

[45] In 2007, the Government introduced an amendment to subsection 160(2) in *Bill C-10* which was intended to put beyond doubt a taxpayer's liability to pay interest, despite the absence of an assessment. If enacted, the amendment would have added, after the words "the provisions of this Division", "(including, for greater certainty, the provisions in respect of interest payable)". Section 161 is in the same Division of Part I of the ITA as section 160. *Bill C-10* lapsed on the dissolution of Parliament in September 2008.

[46] However, even without this proposed amendment, subsection 160(2) would seem better suited than subsection 227(10) to attract subsection 161(1). Unlike subsection 160(2), subsection 227(10) does not treat assessments made under it as though they had been made under section 152, that is, for "taxes payable under Part I". Nonetheless, I do not regard the differences between subsections 160(2) and 227(10) as necessarily determinative of whether it is permissible for a court to modify subsection 161(1) by adding words that would enable the interest provisions of the section to apply to assessments under subsection 227(10) in respect of a director's liability under subsection 227.1(1).

[47] In my view, the modern approach to statutory interpretation should be applied to the interpretation of the words "with any modifications that the circumstances require" as they appear in subsection 227(10). Hence, they are to be read "in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament": *Placer Dome Canada Ltd. v. Ontario (Minister of Finance),* 2006 SCC 20, [2006] 1 S.C.R. 715 at para. 21. This is subject only to the proviso that, when tax legislation is precise, unequivocal and detailed, and taxpayers are entitled to rely on its clear meaning in structuring their affairs, the text of the statute should "play a dominant role in the interpretive process".

[48] While the statutory words "any modifications that the circumstances require" appear to confer a broad power on the courts, counsel for Mr Zen submits that the jurisprudence demonstrates that this provision, as previously worded, had generally been regarded as quite narrow.

Digitized by Google

[49] Thus, in *Ketz v. Her Majesty The Queen*, 79 DTC 5142 (F.C.T.D.) (*Ketz*), the Court refers (at 5144) to authorities interpreting the Latin phrase *mutatis mutandis*, which the current drafting of subsection 227(10) replaces. These authorities restrict the scope of the phrase *mutatis mutandis* to necessary changes in points of detail, as opposed to changes to the very substance of the provision in question.

[50] The current legislative phrase, "with any modifications that the circumstances require", has been considered in *Lord Rothermere Donation v. Her Majesty The Queen*, 2009 TCC 70, 2009 DTC 312 at para. 21 (*Rothermere*). In that case, Justice Archambault held that the current phrase (in the French text *« avec les modifications nécessaires »*) enables more extensive changes to be made to a statutory provision than were permitted by *mutatis mutandis*: no longer are they limited to points of detail.

[51] Justice Archambault also noted (at para. 21) that when the words *mutatis mutandis* were first replaced, the English version referred to "such modifications as circumstances require". The English version of the text, but not the French, was subsequently changed again, and "any" was substituted for "such". Justice Archambault observed that if Parliament had intended to preserve the narrow scope that the courts had given to *mutatis mutandis*, it could easily have expressly limited permitted modifications to points of detail, rather than permitting any modifications that circumstances require.

[52] Whether the changes to the statutory text also changed the law is not an easy question. The words *mutatis mutandis* in subsection 227(10) seem first to have been replaced with English and French words in 1983 by the *Income Tax Act (No. 2),* 29-30-31-32 Elizabeth II, 1980-81-82-83, c. 40, subsection 123(2). The English text of subsection 227(10) was amended again by the *Income Tax Amendments Act, 1997,* c. 19, subsection 226(3), which changed "such modifications" to "any modifications" in the English version; no corresponding change was made to the French text.

[53] It is reasonable to conclude that when Parliament in 1983 replaced the Latin phrase in subsection 227(10) with "plain" English and French words it merely intended to make the provision more accessible. This suggests that the change was in the nature of a consolidation of the law. There is a strong presumption that consolidations are not intended to make substantive changes to the law: Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (Markham, Ontario: LexisNexis Canada Inc., 2008) at 655-59.

[54] On the other hand, the amendments to the pre-1983 version were enacted by Parliament as a small part of a large series of amendments to the ITA, and the change to the English text in 1997 was made for reasons other than the elimination of Latin. These considerations suggest that the amendments to subsection 227(10) may have been intended to have had a substantive effect.

[55] However this may be, I need express no concluded opinion on the matter. I am satisfied that, when the modification power conferred by subsection 227(10) is viewed contextually and purposively, the modification required to subsection 161(1) to make it applicable to an assessment under subsection 227(10) in respect of the liability imposed by subsection 227.1(1), is closer to a change in point of detail than to a change to the very substance of subsection 161(1).

[56] In contrast, the modification refused in *Ketz* would have extended to non-residents the benefit of a general averaging provision that Parliament had provided to residents. Justice Dubé concluded (at 5144-45):

… residence for the previous year is an essential condition for the application of subsection 118(1), not merely a point of detail. … If it had been the intention of Parliament to open the general averaging provisions of subsection 118(1) to non-residents, that intention would

Digitized by Google

have been clearly spelled out in the statute.
In other words, the modification would have decreased the amount of tax payable by non-resident taxpayers by conferring on them a benefit that Parliament had conferred only on taxpayers resident in Canada. Since the proposed modification would have reduced the amount of tax for which non-residents were otherwise liable, it constituted a substantive change in the law and the statutory scheme.
[57] The reasons in *Ho-A-Shoo* do not explain why the modification provision in subsection 160(2) did not apply in that case. However, the plaintiff also alleged that her payment exceeded a statutory cap on her liability under section 160 (that is, the value of the property transferred). Therefore, the modification required to render her liable for unassessed interest under subsection 161(1) would have amounted to a substantive change to the ITA.
[58] The dispute in *Rothermere* concerned the date from which interest was payable by the Minister on tax refunds. The ITA had been amended so that interest on refunds under Part I did not start to accrue until forty five days after the filing deadline had elapsed. This enabled the Minister to process timely returns without incurring interest. The question was whether an "any modifications that the circumstances require" clause enabled the provision to be applied to refunds in respect of Part XIII tax as well. Justice Archambault held (at para. 30) that, although more than "a point of detail", the modification proposed was permissible, because "the result is in harmony with the scheme of the Act and the intent of Parliament" (para. 28).
[59] Although he does not address the issue explicitly, Justice Blanchard's reasons indicate (at paras. 21-26) that he concluded that subsection 161(1) could be modified so that it applies to assessments under subsection 227(10). For the following reasons, I agree that the modifications required to make subsection 161(1) applicable to assessments under subsection 227(10) in respect of liability imposed by subsection 227.1(1) do not change the very substance of subsection 161(1). [60] First, as counsel conceded, to modify subsection 161(1) so as to apply it to Mr Zen's liability to pay the interest accruing on Pacific Refineries' tax debt does not increase the amount for which he is liable under subsection 227.1(1). True, the legal basis of the liability of a director under subsection 227.1(1) is not a tax debt, and the amount assessed under subsection 227(10) is therefore not for "tax payable". Nonetheless, the single debt for which Mr Zen is jointly liable with Pacific Refineries is a tax debt, at least to the extent that it arose from the corporation's failure to remit income tax source deductions.
[61] Second, subsection 227(10) authorizes the Minister to issue an assessment of a liability under subsection 227.1(1) "at any time". Hence, if the Minister were to issue a notice of assessment tomorrow requiring payment of the interest that accrued after Mr Zen's 1986 assessment, counsel agrees that he would be required to pay the amount assessed, if it had been properly calculated. Thus, the modification to subsection 161(1) does not alter the amount that the Minister can require Mr Zen to pay pursuant to subsection 227.1(1).
[62] Third, counsel for the appellant also agreed that there was no reason of policy or principle why a director who has been assessed under subsection 227(10) in respect of a liability under subsection 227.1(1) should not be liable to pay subsequently accruing interest as if the amount owing were "tax payable". After all, once the amount of a corporation's tax debt has been assessed, for which a director is jointly liable, the corporation is now liable to pay accruing interest without the need for another assessment by virtue of subsection 227(9.2).
[63] Subsection 227(10) could have been modelled on subsection 160(2), and deemed the amount assessed under it to be tax payable under section 152, so as to make section 161

Digitized by Google

applicable. Further, the amendment proposed to subsection 160(2), which was designed to make it quite clear that the interest provisions of Part I apply, could have been extended to subsection 227(10). However, given the complexity of the ITA, I draw no particular inference from these disparities in provisions located in different Parts of the Act.

[64] Fourth, the effect of modifying section 161 as proposed, and thereby requiring Mr Zen to pay the interest that has accrued since the 1986 assessment, would deprive him of the procedural rights of objection (subsection 165(1)) and appeal (subsection 169(1)) that arise following the issue of a notice of assessment.

[65] However, Mr Zen has already been assessed for the amount of the corporation's debt, including the penalties and interest that had accrued up to the date of that assessment in 1986. He exercised his rights to object and appeal but, with the benefit of legal advice, discontinued his appeal. Consequently, since the discontinuance of the appeal would seem to preclude Mr Zen from disputing the correctness of the 1986 assessment, there would appear to be little left for Mr Zen to appeal if the Minister were required to issue a notice of assessment with respect to the interest that has accrued since the 1986 assessment. It would always be open to Mr Zen, in the course of enforcement proceedings in the Federal Court, to challenge the correctness of the Minister's calculation of the amount of the post-assessment interest, which is a largely mechanical exercise. [66] Accordingly, Mr Zen will not be deprived of a fair opportunity to challenge in a judicial proceeding the calculation of the amount of interest owing if the modification enables the Minister to start proceedings with a view to collecting the post-1986 assessment interest without having to issue another notice of assessment.

[67] Fifth, modifying section 161 so as to make it applicable to a subsection 227(10) assessment of liability under subsection 227.1(1) enables the Minister to commence collection measures as soon as a director had been advised by the Minister of the amount of interest that had accrued since the last assessment was issued. Normally, the Minister does not commence collection proceedings until an objection to a notice of assessment has been determined and, if the Minister's decision is appealed, the Tax Court has decided the appeal, or the time for objecting and appealing has elapsed. See Canada Revenue Agency, Tax Guide, P148, "Resolving Your Dispute: Objections and Appeal Rights under the *Income Tax Act*" (December 2009) at 19, online: http://www.cra arc.gc.ca/E/pub/tg/p148/p148-09e.pdf.

[68] The loss of an opportunity to further delay the collection of the interest that has continued to accrue by virtue of subsection 227.1(1) may well thus be detrimental to Mr Zen.

[69] Nonetheless, since, for twenty years, Mr Zen has had the use of money that the 1986 assessment required him to pay, an argument that he is entitled to further delay the collection of the interest that has accrued since 1986 is unlikely to evoke much sympathy among Canadian taxpayers. There seems no valid reason for treating directors who are jointly liable with their corporation for its tax debts differently from the corporation itself (see now subsection 227(9.4)) or, indeed, from other taxpayers who can be required, as a result of section 161 (with or with out necessary modifications), to pay accrued interest on tax debts without the need for a further notice of assessment and the consequential benefit of the postponement of collection measures.

[70] The modification to subsection 161(1) required in the present case to enable the Minister, without having to issue another assessment, to collect the amount for which Mr Zen is liable would thus be consistent with the scheme of the ITA, and would enhance its efficient administration.

[71] On the other hand, to adopt Mr Zen's position that the power to modify in

Digitized by Google

subsection 227(10) does not permit the modification required here opens up the possibility of an unending succession of notices of assessment, notices of objection, and appeals, which are apt to serve little purpose other than to delay the collection of tax. Thus, by the time that one notice of assessment for interest accrued was issued, objected to, and appealed, additional interest would have accrued, and another notice would be required before that interest could be collected.

[72] In my opinion, there is little to commend in an interpretation of the modification power in subsection 227(10) that is likely to result in even more delay in the collection of accrued interest, and serves only to deprive Mr Zen of the opportunity to postpone the payment of an amount for which he is liable under subsection 227.1(1).

[73] A statutory modification provision confers an unusual power on courts. The normal role of the judicial branch of government with respect to legislation is to interpret and apply the law as enacted by the Legislature. A cornerstone of parliamentary democracy is that changes to the law require the authorization of the Legislature. However, the exigencies of administration in the modern state have also long required Legislatures to delegate extensive law-making powers. In Canada, these powers are most often delegated to politically accountable bodies and officials with an institutional expertise in public administration, such as the Governor (or Lieutenant Governor) in Council, individual Ministers of the Crown, and municipalities.

[74] The fact that courts have neither of these qualities counsels a cautious approach to the scope of the power delegated to them to modify provisions of the ITA, and indicates that it should be interpreted more narrowly than the current text suggests. Thus, determining whether a proposed modification is permitted by the delegated power (to use the terminology associated with *mutatis mutandis*: is it a change in detail or in substance?) requires a court to consider whether considerations of efficiency outweigh the benefits of subjecting it to the scrutiny of the normal legislative process.

[75] In my opinion, the modifications to subsection 161(1) proposed in the present case do not warrant the costs of requiring a Parliamentary amendment. They do not involve the kinds of technical issues, policy choices or wide ranging implications for the administration of the ITA which our notions of democratic and responsible government require to be left to be resolved through the legislative process.

[76] For all the above reasons, the modifications to subsection 161(1) required to apply it to an assessment under subsection 227(10) of a liability under subsection 227.1(1) are, in my opinion, the very kind contemplated by Parliament when it conferred the power to modify. They do not change the very substance of the provision.

CONCLUSIONS

[77] For these reasons, I would dismiss the appeal with costs.

"John M. Evans" J.A.
"I agree
Pierre Blais C.J." "I agree
M. Nadon J.A."

Directors' Liability Section 227.1 of the *Income Tax Act,* Section 323 of the *Excise Tax Act,* Section 81 of the *Air Travellers Security Charge Act,* and subsection 295(1) of the *Excise Act, 2001*
IC 89-2R2
DATE: **March 24, 2006**

Digitized by Google

This Circular cancels and replaces Information Circular IC89-2R, dated June 27, 1997 and IC89-2R-Erratum, dated August 8, 1997.

Notice to the reader:

- This is an HTML version of the original document. It is also available in other formats, including PDF (which is an exact rendition of the original).
- This version is only available electronically.

---

1. This Circular outlines the consequences which corporate directors may face, when the corporation, of which they are a director, fails to deduct, withhold, remit, or pay certain amounts of money held in trust for the Crown. Under these circumstances, corporate directors may be held personally liable pursuant to section 227.1 of the *Income Tax Act* ("ITA"), section 323 of the *Excise Tax Act* ("ETA"), section 81 of the *Air Travellers Security Charge Act* ("ATSCA"), subsection 295(1) of the *Excise Act, 2001* ("EA2001"), and similar provisions of the *Canada Pension Plan,* and the *Employment Insurance Act*.

2. While the purpose of this Circular is to provide information on section 227.1 of the ITA, section 323 of the ETA, section 81 of the ATSCA, and subsection 295(1) of the EA2001, the Circular itself is not law. The law is set out in the statutes, and a copy of the relevant provisions of the ITA, the ETA, the ATSCA, and the EA2001 is attached as Appendix A.

3. Corporations (for-profit, non-profit, or not-for-profit) are required to deduct, withhold, collect, remit, or pay amounts for

(a) patronage dividends (subsection 135(3) of the ITA);

(b) salary, wages, certain benefits, and payments out of various plans (subsection 153(1) of the ITA);

(c) refundable tax (Part VII of the ITA) for share-purchase tax credits designated by the corporation;

(d) refundable tax (Part VIII of the ITA) for scientific research and experimental development tax credits designated by the corporation;

(e) dividends, interest, or proceeds of disposition received on behalf of beneficial owners of shares, if the corporation is a broker or dealer in securities, and if such owners are unknown;

(f) the payment or crediting of certain amounts to non-residents;

(g) the goods and services tax/harmonized sales tax ("GST/HST") (Part IX of the ETA);

(h) the air travellers security charge (ATSCA); and,

(i) the Excise duty payable (EA2001).

4. This Circular focuses on (b), (g), (h) and (i) in paragraph 3.

5. Corporate directors who are in office when the corporation, of which they are a director, fails to deduct, withhold, collect, remit, or pay the amounts in (b), (g), (h), and (i) of paragraph 3, may be personally liable, together with the corporation, to pay part or all of these amounts:

(a) in the case of a failure to remit or pay, the unpaid amount, plus any related penalties and interest;

(b) in the case of a failure to deduct or withhold amounts from any remuneration, a penalty of 10 or 20 per cent (as the case may be) of the amount that should have been deducted, plus any related interest;

(c) in the case of a failure to collect and/or remit amounts of GST/HST, the amount of that GST/HST that should have been remitted, plus penalties and interest;

(d) in the case of a failure to repay GST/HST refund amounts, to which the corporation was not entitled, that were paid to, or applied to the liability of the corporation, on or after June 29, 2005, plus penalties and interest;

(e) in the case of a failure to pay Air Travellers Security Charge amounts that were or should have been collected, the amount that should have been paid, plus interest; and,

Digitized by Google

(f) in the case of a failure to pay Excise duty amounts that were or should have been collected, the amount that should have been paid plus interest.

The Rules for Liability

6. There are three basic rules to the general rule of personal liability:
(a) the Agency must demonstrate its inability to recover the amounts directly from the corporation;
(b) the Agency must start proceedings to assess directors no later than two years after they have ceased to be directors; and
(c) directors must be unable to show that they exercised the degree of care, diligence, and skill ("due diligence") required to prevent the failure.

The Agency's Obligation

7. To demonstrate its inability to recover the amounts directly from the corporation, the Agency must:
(a) show that its execution against the corporation was returned unsatisfied; or
(b) prove a claim against the corporation in dissolution or liquidation; or
(c) prove a claim against the corporation in bankruptcy.

Limitation

8. Directors are not liable if the Agency commences proceedings to assess them more than two years after they cease to be directors. Directors cease to be directors by resigning, or by operation of law (e.g., they become personally bankrupt).
Directors continue to be directors, although with reduced rights and powers, after a trustee, receiver, liquidator, or other like person, acting in a similar capacity, has been appointed.

Types of Directors

9. The ITA, the ETA, the ATSCA, and the EA2001 do not distinguish between directors, be they passive, nominee, or outside directors. Consequently, their lack of involvement in the affairs of the company may not absolve them from liability. Further, directors who relinquish their responsibilities to co-directors, officers, or employees may be held liable.

De Facto Directors

10. Officers, employees, and others who are not legally appointed as directors, but who perform the functions that directors would perform, may be liable.

Due Diligence

11. Directors should ensure that the corporation is properly withholding deductions. Moreover, a corporation and its directors must act responsibly. Above all, the directors must make every reasonable effort, while deductions, GST/HST, ATSCA, and Excise duty amounts are withheld and collected, to ensure that those amounts will be remitted and paid.
12. Directors are not liable if they exercise due diligence, that is, the diligence that a reasonably prudent person would exercise in comparable circumstances to ensure that the corporation deducts, withholds, collects, remits, or pays the amounts due. The Agency expects that a director should attempt to take positive action to this end by methods such as:
(a) establishing an account for withholdings from employees and remittances of source deductions, as well as for remittances of GST/HST and ATSCA net amounts, and Excise duty;
(b) calling upon financial officers of the corporation to report regularly on the status of the account; and
(c) obtaining regular confirmation that withholdings and remittances have in fact been made during all relevant periods.
13. As well, if the corporation is experiencing financial difficulties, the responsibilities of directors may include the following:
(a) obtaining from the financial institution where the line of credit is extended, an enforceable undertaking to pay all amounts due to the Crown when due;

Digitized by Google

(b) if the corporation is in receivership or is bankrupt, advising the receiver and manager or trustee in writing of the banking arrangements in place for the payment of the source deductions withheld, net GST/HST and ATSCA, and Excise duty.

14. To demonstrate that they exercised due diligence, directors must show that they took reasonable steps to **prevent** the failure. In other words, the steps must be taken before the failure has occurred, and not after the failure has already occurred.

15. Directors are obliged to be aware of what is happening in the corporation of which he or she is a director. Effective lines of communication between directors and the corporation's responsible employees must be maintained.

16. Directors may not claim that they were uninformed as to the requirements of the applicable statutes. A reasonably prudent person, who is aware that he or she is a director, but who is uncertain as to the extent of the responsibilities as a director, is under a duty to at least attempt to discover what is expected of him or her, and to discharge that duty.

17. While directors may delegate their statutory responsibilities to other directors, they are nonetheless responsible for ensuring that payroll deductions, GST/HST, ATSCA, and Excise duty are remitted.

18. The due diligence test is subjective as well as objective. It is objective in that there has to be a standard against which to judge a director, i.e., a reasonable person; it is subjective in the sense that the director must have done what a reasonably prudent person would have done in the circumstances. What constitutes due diligence, then, would vary with the circumstances of each case.

Assessment Policy

19. Following an initial investigation, the Agency will inform, in writing, directors who may be liable, that one or more assessments under section 227.1 of the ITA, section 323 of the ETA, section 81 of the ATSCA, or subsection 295(1) of the EA2001 are being considered.

20. It is in the interest of each director to respond and to explain all actions taken to ensure that the corporation deducted, withheld, remitted, or paid and, where possible, to provide documentation of these actions. The Agency will consider the merits of every response before deciding to issue an assessment.

21. If a director does not reply within the time set out in the proposal letter, the Agency may issue an assessment without further notice.

22. The provisions of section 227.1 of the ITA, section 323 of the ETA, section 81 of the ATSCA, and subsection 295(1) of the EA2001 are remedial, not penal, and as such are a means of collection. Each director may be assessed for the full amount of its corporation's liability, but a director who pays an amount towards this liability is entitled to:

(a) the same preference in liquidation, dissolution, or bankruptcy proceedings as would otherwise have been available to the Crown; and,

(b) a contribution from all other directors who are liable.

APPENDIX A

INCOME TAX ACT

227.1(1) Liability of directors for failure to deduct

(1) **Liability of directors for failure to deduct.** – Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally liable, together with the corporation, to pay that amount and any interest or penalties relating thereto.

227.1(2) Limitations on liability

(2) **Limitations on liability.** – A director is not liable under subsection (1), unless

Digitized by Google

(a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 223 and execution for that amount has been returned unsatisfied in whole or in part;
(b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or
(c) the corporation has made an assignment or a receiving order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the date of the assignment or receiving order.

227.1(3) Idem

(3) **Idem.** – A director is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

227.1(4) Limitation period

(4) **Limitation period.** – No action or proceedings to recover any amount payable by a director of a corporation under subsection (1) shall be commenced more than two years after the director last ceased to be a director of that corporation.

227.1(5) Amount recoverable

(5) **Amount recoverable.** – Where execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

227.1(6) Preference

(6) **Preference.** – Where a director pays an amount in respect of a corporation's liability referred to in subsection (1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that Her Majesty in right of Canada would have been entitled to had that amount not been so paid and, where a certificate that relates to that amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is hereby empowered to make.

227.1(7) Contribution

(7) **Contribution.** – A director who has satisfied a claim under this section is entitled to contribution from the other directors who were liable for the claim.

227(10) Assessment

(10) **Assessment.** – The Minister may at any time assess any amount payable under
(a) subsection 227(8), 227(8.1), 227(8.2), 227(8.3) or 227(8.4) or 224(4) or 224(4.1) or section 227.1 or 235 by a person,
(b) subsection 237.1(7.4) by a person or partnership,
(c) subsection 227(10.2) by a person as a consequence of a failure of a non-resident person to deduct or withhold any amount, or
(d) Part XIII by a person resident in Canada,
and, where the Minister sends a notice of assessment to that person or partnership, Divisions I and J of Part I apply with any modifications that the circumstances require.

EXCISE TAX ACT

323(1) Liability of directors (prior to June 29, 2005)

(1) **Liability of directors.** – Where a corporation fails to remit an amount of net tax as required under subsection 228(2), the directors of the corporation at the time the corporation was required to remit the amount are jointly and severally liable, together with the corporation, to pay that amount and any interest thereon or penalties relating thereto.

323(1) Liability of directors (as at June 29, 2005)

Digitized by Google

(1) **Liability of Directors. –** If a corporation fails to remit an amount of net tax as required under subsection 228(2) or (2.3) or to pay an amount as required under section 230.1 that was paid to, or was applied to the liability of, the corporation as a net tax refund, the directors of the corporation at the time the corporation was required to remit or pay, as the case may be, the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay the amount and any interest on, or penalties relating to, the amount.

323(2) Limitations

(2) **Limitations.** – A director of a corporation is not liable under subsection (1) unless

(a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 316 and execution for that amount has been returned unsatisfied in whole or in part;

(b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

(c) the corporation has made an assignment or a receiving order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the date of the assignment or receiving order.

323(3) Diligence

(3) **Diligence.** – A director of a corporation is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

323(4) Assessment

(4) **Assessment.** – The Minister may assess any person for any amount payable by the person under this section and, where the Minister sends a notice of assessment, sections 296 to 311 apply, with such modifications as the circumstances require.

323(5) Time limit

(5) **Time limit.** – An assessment under subsection (4) of any amount payable by a person who is a director of a corporation shall not be made more than two years after the person last ceased to be a director of the corporation.

323(6) Amount recoverable

(6) **Amount recoverable.** – Where execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

323(7) Preference

(7) **Preference.** – Where a director of a corporation pays an amount in respect of a corporation's liability referred to in subsection (1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that Her Majesty in right of Canada would have been entitled to had the amount not been so paid and, where a certificate that relates to the amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is empowered to make.

323(8) Contribution

(8) **Contribution.** – A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

AIR TRAVELLERS SECURITY CHARGE ACT

81(1) Liability of Directors

(1) **Liability of Directors.** – If a corporation fails to pay an amount as and when required under this Act, the directors of the corporation at the time it was required to pay it are jointly and severally or solidarily liable, together with the corporation, to pay it and any interest that is payable under this Act.

Digitized by Google

81(2) Limitations

(2) **Limitations.** – A director of a corporation is not liable unless

(a) a certificate for the amount of the corporation's liability has been registered in the Federal Court of Canada under section 74 and execution for that amount has been returned unsatisfied in whole or in part;

(b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved, and a claim for the amount of the corporation's liability has been proved within six months after the earlier of the date of commencement of the proceedings and the date of the dissolution; or

(c) the corporation has made an assignment or a receiving order has been made against it under the *Bankruptcy and Insolvency Act*, and a claim for the amount of the corporation's liability has been proved within six months after the date of assignment or receiving order.

81(3) Diligence

(3) **Diligence.** – A director of a corporation is not liable for a failure under subsection (1) if the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

81(4) Assessment

(4) **Assessment.** – The Minister may assess any person for any amount payable by the person under this section and, if the Minister sends a notice of assessment, sections 39 to 52 apply with any modifications that the circumstances require.

81(5) Time Limit

(5) **Time Limit.** – An assessment of any amount payable by a person who is a director of a corporation shall not be made more than two years after the person ceased to be a director of the corporation.

81(6) Amount Recoverable

(6) **Amount Recoverable.** – If execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

81(7) Preference

(7) **Preference.** – If a director of a corporation pays an amount in respect of the corporation's liability that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference to which Her Majesty would have been entitled had the amount not been so paid, and if a certificate that relates to the amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is empowered to make.

81(8) Contribution

(8) **Contribution.** – A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

EXCISE ACT, 2001

295(1) Liability of directors.

(1) **Liability of directors.** – If a corporation fails to pay any duty or interest as and when required under this Act, the directors of the corporation at the time it was required to pay the duty or interest are jointly and severally or solidarily liable, together with the corporation, to pay the duty or interest and any interest that is payable on the duty or interest under this Act.

295(2) Limitations

(2) **Limitations.** – A director of a corporation is not liable unless

(a) a certificate for the amount of the corporation's liability has been registered in the Federal Court under section 288 and execution for that amount has been returned unsatisfied in whole or in part;

(b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

Digitized by Google

(c) the corporation has made an assignment or a bankruptcy order has been made against it under the Bankruptcy and Insolvency Act and a claim for the amount of the corporation's liability has been proved within six months after the date of the assignment or bankruptcy order.

295(3) Diligence

(3) **Diligence.** – A director of a corporation is not liable for a failure under subsection (1) if the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

295(4) Assessment

(4) **Assessment.** – The Minister may assess any person for any amount of duty or interest payable by the person under this section and, if the Minister sends a notice of assessment, sections 188 to 205 apply with any modifications that the circumstances require.

295(5) Time limit

(5) **Time limit.** – An assessment of any amount payable by a person who is a director of a corporation shall not be made more than two years after the person ceased to be a director of the corporation.

295(6) Amount recoverable

(6) **Amount recoverable.** – If execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

295(7) Preference

(7) **Preference.** – If a director of a corporation pays an amount in respect of the corporation's liability that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference to which Her Majesty would have been entitled had the amount not been so paid, and if a certificate that relates to the amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is empowered to make.

295(8) Contribution

(8) **Contribution.** – A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

2002, c. 22, s. 295; 2004, c. 25, s. 198.

Agathe Létourneau v. The Queen, 2011 FCA 354, A Resigned Director "Pulled Back In" with Falsified Minutes that was Exonerated

NADON J.A.

REASONS FOR JUDGMENT

Digitized by Google

[1] This is an appeal from a judgment dated April 15, 2010, by Justice Réal Favreau (the judge) of the Tax Court of Canada, 2010 TCC 203, in which the judge dismissed the appellant's appeal from an assessment made by the Minister of National Revenue (the Minister) under section 227.1 of the *Income Tax Act* (the ITA) for the amount of $70,848.41.
[2] More specifically, the Minister assessed the appellant for unremitted source deductions by 9034-1751 Québec Inc. (the company). The judge concluded that the appellant, as the director of the company, had to be held solidarily liable together with the company for the payment of the source deductions, including interest and penalties thereon, which the company had to deduct, withhold and remit to the Receiver General for Canada.
[3] As the judge pointed out at paragraph 4 of his reasons, the issue before him principally concerned the date on which the appellant resigned as director of the company. Before the judge, the appellant claimed that she became a director on January 4, 1999, and that she resigned on December 9, 1999.
Consequently, she argued that she could not be held responsible for the company's debts because the assessment made by the Minister to collect the sum payable was statute barred, having been made more than two years after the date she ceased to be a director of the company. The judge rejected the appellant's arguments. In so concluding, he accepted the Minister's argument that the two-year limitation period provided in subsection 227.1(4) of the ITA was inapplicable given the appellant's misrepresentations.
[4] The sole issue before the Court is to determine whether the judge erred in concluding that the appellant had to be held solidarily liable for the company's tax debts. For the following reasons, I conclude that the judge erred and that the appeal should be allowed.

Facts
[5] A brief summary of the facts will assist in understanding the appeal. More specifically, in order to properly understand the judge's findings of fact and conclusions of law, I consider it important to describe certain aspects of the evidence filed before the judge and to briefly summarize the testimonies of the appellant and of Mr. Jean Fontaine (Jean Fontaine). It should be noted that the following facts, other than the date on which the appellant resigned as director, are not disputed by the parties.
[6] The company was incorporated on April 23, 1996, under Part 1A of the Quebec *Companies Act*, RSQ, c. C-38. Until it ceased carrying on its business in April 2002, the company operated six convenience stores under the Pétroles Sonerco banner. One of these convenience stores was located in St-Hyacinthe, Quebec, and operated under the name Accommodation Grandmaître.
[7] On February 1, 2002, the company filed a notice of intention to make a proposal. The proposal was not acted upon.
[8] On March 5, 2002, the Minister assessed the company for unremitted source deductions for the year 2002, in the amount of $824.65. On March 6, 2002, the Minister issued a second assessment for the company for unremitted source deductions for the year 2001, in the amount of $70,023.76.
[9] The company assigned its assets on April 18, 2002, and was officially struck off by the Registraire des entreprises du Québec, Quebec's enterprise registrar, on May 7, 2004.
[10] On May 4, 2006, the Minister assessed the appellant for $70,848.41 under section 227.1 of the ITA.
[11] **According to the company's register of directors, the appellant was a director from January 4, 1999, to December 9, 1999.** As of that date, the sole director on the register is Jean Fontaine, gas pump attendant and manager at the St-Hyacinthe convenience store. He was responsible for managing the employees of the convenience

Digitized by Google

store and for purchasing gas and various supplies. I note that Jean Fontaine was also a director from April 23, 1996, to December 2, 1996, and from May 12, 1997, to January 4, 1999. [12] The position held by Jean Fontaine at the St-Hyacinthe convenience store had been offered to him by Marcel Létourneau, the appellant's spouse, whom Jean Fontaine trusted implicitly, according to the judge. Jean Fontaine followed Marcel Létourneau's advice to the letter. **In fact, Jean Fontaine testified that he never refused to sign documents that Marcel Létourneau asked him to sign even though he did not always know enough to understand the nature and consequences of the documents.**

[13] In his capacity as company director, Jean Fontaine signed several documents, including corporate resolutions; an application to open an account for the company at the Bourg-Joli Caisse populaire in St- Hyacinthe dated January 24, 2000, according to which he was one of the company's cheque signing officers (the second being Ms. Guylaine Lemay, the company's comptroller); an application to open an account and become a corporate member for the company; and a resolution and declaration regarding the administration of a corporation. In addition, Jean Fontaine signed many cheques, including several payable to Marcel Létourneau, dated March and April 2001, and the annual information returns by a corporation for the years 1998, 2000 and 2001. These returns were filed with the Registraire des entreprises du Québec ("CIDREQ"). I note that on February 23, 2000, the company's annual return for 1999 was filed with CIDREQ, naming Jean Fontaine as its director, president and secretary. The truth of the information provided in this return was certified by Jacques Matte, the company's authorized counsel. Lastly, it was Jean Fontaine who signed, in his capacity as director, the assignment of the company's assets on April 18, 2002.

[14] Jean Fontaine's testimony reveals that, in fact, he had no knowledge of the company's operations during his time as director. Moreover, he recognized that he had never reviewed the company's books or the A-1 share certificates that he signed on April 23, 1996, in his capacity as secretary and president of the company.

[15] Regarding the appellant's testimony, he revealed the following. The appellant married Marcel Létourneau in 1966. She acknowledged that she was the company's director from January 4, 1999, to December 9, 1999, that is, until the day on which she tendered her resignation. By a shareholder resolution, the company accepted her resignation and appointed Jean Fontaine as director on December 9, 1999, an office that he accepted on the very same day.

[16] According to the company's register of shareholders, the appellant held 100 Class "A" shares in the company from January 4, 1999, to January 3, 2001. She allegedly acquired these shares from Jean Fontaine on January 4, 1999, and then reassigned them to him on January 3, 2001.

[17] The appellant also testified that she had been a shareholder of Gestion Aghmana Inc., which owned a commercial building in Rouyn-Noranda and in which the company operated a convenience store. Moreover, the appellant's testimony allegedly revealed that, following the company's bankruptcy, the appellant signed and filed a proof of claim with the company's bankruptcy trustee on May 6, 2002, regarding a $158,000 loan extended to the company by Gestion Aghmana Inc.

[18] In addition, the appellant testified that during her period as director of the company, she was not involved in the day-to-day management of the company's operations, since this was the responsibility of Guylaine Lemay who, among other things, took care of the bookkeeping and accounting in Victoriaville, home to Marcel Létourneau's offices.

[19] As of December 9, 1999, the date on which the appellant submits having resigned as director, she was not in any way authorized to sign company cheques or bank resolutions. Moreover, she was never present at the Victoriaville office where the company was

Digitized by Google

administered and where the books were kept. In short, the appellant in no way participated in the company's administration, and she performed no duties of administration as of December 9, 1999.

Minister's Reply to the Notice of Appeal

[20] At paragraph 10 of his Reply to the Notice of Appeal, the Minister assumed a number of facts, including the following:

[TRANSLATION]

(b) The appellant was a director of 9034 starting on January 4, 1999.

. . .

9034's register of directors was falsified in such a way as to make it appear as though the appellant had resigned from her directorship on December 9, 1999.

In reality, the appellant was a director until at least as recently as January 3, 2002.

Decision of the Tax Court of Canada

[21] The judge concluded that the appellant had to be held solidarily liable together with the company for the payment of the unremitted source deductions the company owed. Before explaining the judge's reasons, I reproduce the provisions of the ITA that are at the heart of the dispute before us:

[22] First, the judge summarized the facts disclosed by the evidence, particularly those disclosed by the testimonies of the appellant and of Jean Fontaine. Second, the judge examined the relevant statutory provisions, specifically subsections 227(10), 227.1(1) and 227.1(4) of the ITA, leading him to observe that even though the Minister was under no time limit to assess an amount payable by a person under section 227.1 of the ITA, no action or proceedings to recover any amount assessed could be commenced "more than two years after the director last ceased to be a director of that corporation" under subsection 227.1(4).

[23] **In light of these provisions, the judge indicated that the date that the appellant last ceased to be a director of the company had to be determined. On the basis of his analysis of the evidence, the judge concluded that the appellant remained a director of the company until May 7, 2004, the date on which the company was officially struck off the enterprise register. According to the judge, the register of directors was falsified regarding the appellant's resignation as company director. More specifically, the judge was of the opinion that unexplained corrections had been made to the register of directors to substitute the date of January 3, 2002, with that of December 9, 1999. Because of this falsification, the appellant's true date of resignation from her directorship was unknown, and her letter of resignation could not be recognized as valid and effective. These findings led the judge to conclude the following at paragraph 31 of his reasons:**

[31] Since the evidence does not reveal that the appellant resigned from her position as director, went bankrupt, was unable to perform her duties, or availed herself of protective supervision, or that the company was liquidated before its registration was struck off, the appellant must be deemed never to have lost her status as director until the company was struck off the register.

[24] After concluding that the appellant remained director of the company until May 7, 2004, the judge examined the appellant's argument based on subsection 227.1(4) of the ITA and according to which the Minister's remedy was statute barred since the Minister's assessment of the appellant, dated May 4, 2006, was made after the two-year limitation period provided for in subsection 227.1(4). The judge rejected this argument at paragraph 21 of his reasons since the Minister's assessment, dated May 7, 2006, was made less

Digitized by Google

than two years after the company was officially struck off the register of enterprises, that is, on May 7, 2004, and was therefore not statute barred.

[25] Notwithstanding the judge's analysis of this question, at paragraphs 39 and 40 of his reasons, the judge seemed to assume that the Minister's remedy was statute barred unless it was possible to rely on subsection 152(4) of the ITA. At paragraphs 21 and 39 of his reasons he wrote as follows:

[21] The reassessment against the appellant is dated May 4, 2006. That is more than two years after the appellant ceased, for the last time, to be a shareholder of 9034-1751 Québec Inc., whether that date was December 9, 1999, or January 3, 2002. It is also more than two years after the CRA first consulted the original minute book of 9034-1751 Québec Inc. on January 24, 2004, and more than two years after 9034-1751 Québec Inc. made an assignment of its property on April 18, 2002. However, it is within the two-year period that began on the date that Quebec's Registraire des entreprises cancelled 9034-1751 Québec Inc.'s registration, because that cancellation took place on May 7, 2004.

. . .

[39] The assessment against the appellant was made beyond the normal reassessment period. Subsection 227(10) of the ITA authorizes the Minister to assess a person for an amount contemplated by section 227.1 of the ITA at any time, in which case Divisions I and J of Part I of the ITA apply to the assessment. Those divisions encompass subsection 152(4), which restricts the Minister's power to reassess beyond the regular reassessment period to the situations contemplated in paragraphs (*a*) and (*b*) of that subsection. The situation contemplated in subparagraph 152(4)(*a*)(i) is one where the taxpayer or person filing the return has made a misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or in supplying any information under the ITA.

[26] The judge was of the opinion, as appears from paragraph 39 of his reasons, that subsection 227(10) *in fine* provided that the Minister could at any time assess any amount payable by a person under section 227.1 and, where the Minister sent a notice of assessment to that person, divisions I and J of Part I of the ITA applied with any modifications that the circumstances required. **In addition, the judge found that subsection 152(4) of the ITA stipulated that the Minister could make an assessment or reassessment after the taxpayer's normal reassessment period when the taxpayer in question had "made a misrepresentation that is attributable to neglect, carelessness or wilful default or [had] committed any fraud in filing the return or in supplying any information under the ITA". In other words, according to the judge, the two-year limitation period became inapplicable when the taxpayer's conduct matched that described in subparagraph 152.4(*a*)(i).**

[27] At paragraph 40 of his reasons, the judge indicated that the Minister had the burden of demonstrating that he was entitled to assess the appellant beyond the normal reassessment period and stated that he was satisfied that the Minister had met his burden of proof. Specifically, the judge wrote that since the register of directors was improperly altered and these alterations had prevented the Minister from making a reassessment during the normal period contemplated by the ITA and since the appellant had been aware of these alterations, the Minister's recovery proceedings were not subject to the two-year limitation period. Consequently, according to the judge, the appellant had to be held solidarily liable for the company's debts.

[28] For these reasons, the judge dismissed the appellant's appeal from the Minister's assessment with costs.

Analysis

Digitized by Google

[29] As indicated at paragraph 4 of my reasons, it is my view that the judge erred in concluding that the appellant had to be held solidarily liable for the company's tax debts. The judge made a palpable and overriding error in concluding that the appellant had never resigned as director. In so concluding, he failed to consider ample evidence that supported the appellant's argument and gave too much weight to certain aspects of the evidence, including the fact that Jean Fontaine acted on behalf of Marcel Létourneau. Consequently, this Court can intervene (see *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235).

[30] As a result of this error, the judge wrongly concluded that the appellant knew of the falsification of her actual date of resignation as director in the register of the directors. Since the evidence reveals that the appellant resigned on December 9,1999, she cannot be held liable for the company's tax debt for unremitted source deductions for 2001 and 2002.

[31] The cornerstone of the judge's reasons is the fact that a correction was made to the register of directors regarding the appellant's resignation date, by which the date of January 3, 2002, was substituted with that of December 9, 1999. According to the judge, since the appellant had not filed any evidence to enlighten the Court as to the falsification of the register of directors or the reasons therefor, and since, in his opinion, the appellant alone could benefit from it, the register was consequently altered "with the appellant's full knowledge" (paragraph 33 of the judge's reasons). According to the judge, the purpose of the appellant's actions was to limit her liability for the company's debt for 2001 and 2002.

[32] Another factor leading the judge to his conclusion was his finding that the appellant was not credible and that her testimony lacked detail. At paragraph 37 of his reasons, the judge stated the following:

[37] . . . Among other things, she had no recollection, or merely vague recollections, of the $158,000 loan advanced by Gestion Aghmana Inc., of Ms. Lambert's mortgage on her Florida condominium, of the reasons for her resignation as a director of 9034-1751 Québec Inc., or of that company's fake wage payments to Ms. Lambert to repay her personal mortgage debt.

[33] Lastly, the judge concluded, at paragraph 38 of his reasons, that Jean Fontaine "was merely used as a proxy for the appellant's spouse". The judge had the following to say:

[38] . . . The evidence is that he signed the documents that Marcel Létourneau placed before him. In actual fact, Jean Fontaine was never a director of 9034-1751 Québec Inc. and never did any accounting or bookkeeping. The administration of 9034-1751 Québec Inc. was done from Victoriaville, not from Saint-Hyacinthe. In addition, Mr. Fontaine had no knowledge of the business of the other five convenience stores managed by 9034-1751 Québec Inc., with the exception of the information obtained during the yearly rounds of the stores with Marcel Létourneau. His claim that he could become the owner of a convenience store by virtue of his overtime is not realistic and cannot be accepted. No price for the store, and no terms and conditions of acquisition, were agreed upon with Marcel Létourneau. The purchases and sales of the shares in 9034-1751 Québec Inc. were done with no regard for their actual value. Indeed, Mr. Fontaine's memory faltered when it came to explaining why the shares of 9034-1751 Québec Inc. were transferred so often and why EI [employment insurance] source deductions were made from the salary that 9034-1751 Québec Inc. paid him in 2002, when he was a shareholder of the company and was therefore not entitled to EI.

[34] In my opinion, the evidence does not support the judge's conclusion that the appellant never resigned as director. There is no question that Jean Fontaine was appointed director on December 9, 1999, to replace the appellant and that he held that position until the company was dissolved on May 7, 2004. Following the appellant's resignation letter dated December 9, 1999, Jean Fontaine was appointed director by a shareholders'

Digitized by Google

resolution, and he accepted that position on the same day. On January 24, 2000, he opened the company's bank account at the Bourg-Joli Caisse populaire, and only he and Guylaine Lemay were authorized to sign cheques. He also signed the account application forms and the banking resolution as well as all of the company's cheques during 2000 and 2001. In fact, Jean Fontaine was the only person who acted on behalf of the company during the period starting on December 9, 1999, and ending the day on which the company was dissolved on May 7, 2004, which explains why Jean Fontaine, in his capacity as director, signed the assignment of the company's assets on April 18, 2002.

[35] Jean Fontaine's testimony was in no way challenged by the judge. On the contrary, it was because of his testimony that the judge concluded that Jean Fontaine was merely acting as a proxy for Marcel Létourneau. The judge implicitly recognized that the company's *de jure* director was Jean Fontaine and that he was acting under the control of the *de facto* director, Marcel Létourneau.

[36] Another factor supporting the appellant's position that she resigned on December 9, 1999, is the company's annual return for 1999 filed with CIDREQ on February 23, 2000, which names Jean Fontaine as its new director. This document fully corroborates the testimonies of Jean Fontaine and of the appellant, according to which the appellant resigned on December 9, 1999, and was replaced by Jean Fontaine the very same day.

[37] The evidence also clearly revealed that the appellant did nothing as director of the company from December 9, 1999, onwards. The judge recognized this fact at paragraph 34 of his reasons.

[38] In my opinion, the evidence could lead to only one conclusion, namely, that the appellant stopped being a director of the company on December 9, 1999. Why did the judge conclude that the appellant never resigned as a director? At paragraphs 30, 31 and 32, above, I explained the judge's reasoning. One of the factors he considered was the fact that Jean Fontaine was merely used as a proxy for Marcel Létourneau. In my opinion, this factor is irrelevant with respect to the appellant's resignation date. Marcel Létourneau's control over Jean Fontaine could not, in itself, lead to the conclusion that the appellant never resigned. At best, this fact could have led to the conclusion that Marcel Létourneau was the company's *de facto* director during the period Jean Fontaine performed his duties as director.

[39] Another factor the judge took into account to conclude as he did is the falsification of the register of directors, which, in his opinion, was attributable to the appellant, who was seeking to limit her liability for the company's debt for 2001 and 2002. This resulted entirely from his conclusion that the appellant had never actually resigned as director. Since, in my opinion, as I have just explained, the evidence is clear that the appellant ceased to be a director on December 9, 1999, when she was replaced by Jean Fontaine, it follows that the appellant had no interest in altering the register of directors. Since all the bank and corporate documents as of December 9, 1999, namely, the cheques, annual returns and documents concerning the opening of the account at the Bourg-Joli Caisse populaire, publicly disclose that Jean Fontaine was the director during those years, it seems impossible to conclude, with respect, that the entry in the register of directors that the appellant resigned on December 9, 1999, is fraudulent. The entry in the register of directors merely confirms the actual situation, namely, that Jean Fontaine became director on December 9, 1999, replacing the appellant.

[40] Consequently, in my view, by concluding that the correction made to the register of directors was fraudulent, the judge failed to consider important evidence, including the documentary evidence, that corroborated the testimonies of the appellant and of Jean Fontaine according to which there was a change in director on December 9, 1999.

[41] Another factor the judge took into account to conclude that the appellant never resigned as director was her lack of credibility. However, even though the appellant was not

Digitized by Google

credible regarding, for example, the
$158,000 loan extended to the company by Gestion Aghmana Inc. Ms. Lambert's mortgage and the reasons for her resignation as director of the company, the fact remains that the documentary evidence and testimony amply demonstrate that the appellant was no longer director as of December 9, 1999.

[42] Thus, as a result of my conclusion that the appellant did resign on December 9, 1999, and that she was therefore not a director in 2001 and 2002, she cannot be held liable for the company's tax debt for source deductions the company failed to deduct, withhold and remit to the Receiver General for Canada in 2001 and 2002.

[43] Before the judge and before this Court, the parties assumed that the Minister's assessment of the appellant dated May 4, 2006, was a "[proceeding] to recover any amount payable by a director of a corporation" within the meaning of subsection 227.1(4) of the ITA. While I entertain doubt as to the merit of this premise, it is not necessary for this Court, given the conclusion I have reached, to determine whether the Minister's assessment was such a proceeding within the meaning of subsection 227.1(4). In any event, as the appellant resigned as director on December 9, 1999, the Minister's "action or proceedings" to recover the company's tax debt are statute barred since they were commenced more than two years after the appellant last ceased to be a director of the company.

[44] Finally, we do not need to determine whether, by operation of section 227.10 *in fine*, subsection 152(4) applies in the present matter.

Decision

[45] For these reasons, I would allow the appeal with costs, set aside the judgment of the Tax Court of Canada and, rendering the judgment that ought to have been rendered, I would allow the appellant's appeal of the Minister's assessment with costs and refer the matter back to the Minister for reassessment on the basis that the appellant resigned as director of the company on December 9, 1999.

"M. Nadon" J.A.

"I agree.
Johanne Trudel J.A."

"I agree.
Robert M. Mainville"

Amount recoverable – 227(5)

) Where execution referred to in paragraph 227.1(2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

Preference – 227(6)

Where a director pays an amount in respect of a corporation's liability referred to in subsection 227.1(1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that Her Majesty in right of Canada would have been entitled to had that amount not been so paid and, where a certificate that relates to that amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is hereby empowered to make.

Contribution – 227(7)

A director who has satisfied a claim under this section is entitled to contribution from the other directors who were liable for the claim.

Digitized by Google

Applying payments under collection agreements - 228

228. Where a payment is made to the Minister on account of tax under this Act, an Act of a province that imposes a tax similar to the tax imposed under this Act, or any two or more such Acts, such part of that payment as is applied by the Minister in accordance with the provisions of a collection agreement entered into under Part III of the *Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act* against the tax payable by a taxpayer for a taxation year under this Act discharges the liability of the taxpayer for that tax only to the extent of the part of the payment so applied, notwithstanding that the taxpayer directed that the payment be applied in a manner other than that provided in the collection agreement or made no direction as to its application.

CRA Internal Operations Manual - Director's Liability

(See image pages below)

Digitized by Google

DIRECTORS' LIABILITY 1

Overview 1

Legislation 1

Background Information 1
Directors' Responsibility 2
Types of Directors 2
Active Directors 2
Passive Directors 2
Nominee Directors 2
Outside Directors/Independent Directors 3
De Facto Directors 3
Definition of Liability 3
Directors' Entitlement 3
Directors' Entitlement to Preference 4
Directors' Entitlement to Contribution 4
Interview Questions for Directors 4
When a Director ceases to be a Director 5

Policy 6
Amounts Covered Under Directors' Liability 6
Proving a Director's Liability Claim in a Proposal or in a Bankruptcy 7
Proving a Director's Liability Claim Under the Companies' Creditors Arrangement Act (CCAA) 8
When is a Director Not Liable 9
When to Raise a Director's Liability Assessment 9
When a Director's Liability Assessment Should not be Raised 10
The Due Diligence Provision 11
Responsibility to Exercise Due Diligence 12
Responsibility When Financial Difficulty Experienced 12
The Pre-Assessment Proposal Letter 13
Method of Service for Pre-Assessment Proposal Letters 13
No Response to the Pre-Assessment Proposal Letter 13
Director's Response to the Pre-Assessment Proposal Letter 14
Verifying Documents Relating to Directors' Liability 14
Document Analysis by the Forensic Sciences Division 15
Follow-Up to the Director's Response 16
Assessment Amount Limit 16
Approval Authority 17
Referring Cases to the Department of Justice 17
When to Refer a Case to the Department of Justice 17
Cases That Are Not Referred to the Department of Justice 18
Reassessing Joint and Several Liabilities 19
Resolving a Disputed Memorandum Assessment 19
Request for Adjustment to a Memorandum Assessment 19
Notice of Objection or Appeal Filed Subsequent to a Request for Adjustment 20
Notice of Objection or Appeal is Outstanding When Request for Adjustment is made 20
Where Time to File Notice of Objection or Extension Order has not Expired 20
When Should Reassessment be made or Adjustment Request be Declined? 20
Reassessment Approval Authority 21
Statutory Period to Reassess 21

Digitized by Google

Procedures 21
Completing a Director's Liability Assessment 22
Conducting the Initial Investigation 22
Directors' Liability Checklist 24
Required Evidence Relating to the Status of the Company 24
Required Evidence Relating to the Directors 26
Required Evidence Relating to CRA 28
Obtaining a Defence 29
Investigation Required Before Requesting an Opinion 30
Requesting an Opinion on a Director's Liability 30
Raising a Director's Liability Assessment 32
Obtaining Approval 33
Approval Memorandum 33
Completion of a Director's Liability Notice of Assessment Form 34
Completion of the T779 Form 34
Completion of the GST259 Form 36
Director's Liability Assessment Verses 38
Notice of Reassessment for Director's Liability Where a Notice of Objection Exists 39
Notice of Reassessment for Director's Liability Where No Objection or Appeal Exists 40
Additional Assessment for Director's Liability 42
Cancellation of Director's Liability Assessment 42
Director's Liability Particulars of Assessment 43
Amounts Not to Be Included Within the Particulars of Assessment 44
Amended Director's Liability Particulars of Assessment 44
Interest Charges on Director's Liability Memorandum Assessments 45
Collection Action on Directors' Liability Assessments 45
Collection Measures 46
Maintaining the Director's Liability Assessment 47
Updating all Applicable Accounts 47
Preparing the Working Paper 48
Maintaining Documents When the Assessment is Raised 50
Retention of Primary Assessment Information 51
Applying Payments 51
Payment Allocation for Memorandum Assessment 52
Application of Payments 52
Situations Where a Notice of Objection is Filed 52
Directors' Entitlement to Preference 54
Assignment of Certificate 55
Obtaining Approval 55
Examples of an Assignment of Certificate 55

Resource Material 56

APPENDIX 56
APPENDIX "A" 56

IN THE MATTER OF AN ASSESSMENT OR ASSESSMENTS BY 57

THE MINISTER OF NATIONAL REVENUE UNDER ONE OR MORE OF THE .. 57

***INCOME TAX ACT*, CANADA PENSION PLAN, *UNEMPLOYMENT*..... 57**

Digitized by Google

INSURANCE ACT, EMPLOYMENT INSURANCE ACT AGAINST: 57

INSERT NAME OF DEBTOR CORPORATION (AS PER CERTIFICATE) 57

INSERT ADDRESS OF DEBTOR CORPORATION (AS PER CERTIFICATE) ... 57

APPENDIX "B" 58

Digitized by Google

Directors' Liability

Collections Manual Updates

Overview

The directors of a corporation have the responsibility to ensure that the corporation withholds certain amounts on behalf of the Crown and remits them to Canada Revenue Agency (CRA). If a corporation fails to do so, its directors may be held jointly and severally liable with the corporation under the provisions of the *Income Tax Act*, section 227.1, the *Excise Tax Act*, section 323, the *Air Travellers Security Charge Act*, subsection 81(1) and similar provisions of the Canada Pension Plan, *Unemployment Insurance Act* and *Employment Insurance Act* for which CRA is administratively responsible.

A Directors' Liability assessment is a **memorandum assessment** raised to collect trust fund debts from the corporate directors. A memorandum assessment is raised when a person other than the original tax debtor is jointly and severally liable with the tax debtor for an amount payable under one of the Acts administered by the CRA.

A memorandum assessment does not appear within any of the accounting systems used by Revenue Collections, except as series of detailed diary entries within the ACSES system, and is therefore commonly referred to as a "memo-assessment." For further details, refer to the chapter entitled **Memorandum Assessments**.

For further information, it is recommended that Training Manual **HQ8920, Director's Liability Handbook** be reviewed in its entirety. Also, refer to Training Manual **TD8900-000, Liability of Directors**.

Legislation

This section identifies legislation related to Directors' Liability:

- Canada Pension Plan, section: 21.1
- *Income Tax Act*, section: 227.1, 227(10) and the related provincial legislation
- *Excise Tax Act*, section 323
- *Unemployment Insurance Act*, subsection: 54(1)
- *Employment Insurance Act*, subsection 83(1)
- *Air Travellers Security Charge Act*, subsection 81(1)

Background Information

This section identifies background information related to Directors' Liability:

- **Directors' Responsibility**
- **Types of Directors**

Digitized by Google

- Definition of Liability
- Directors' Entitlement
- Interview Questions for Directors
- When a Director ceases to be a Director

Directors' Responsibility

A director's responsibility includes exercising due diligence as well as taking specific actions when the corporation experiences financial difficulty.

Although there are several types of directors, the courts do not make a distinction and base their decision on the facts of each case. It will not always be easy to determine the category into which a director of a given corporation falls. However, once identified as a director, an individual is subject to directors' liability.

Types of Directors

A director is defined as an individual appointed or elected according to law, who is authorized to manage and direct the affairs of a corporation. There are numerous types of directors.

Related Topics:

- Active Directors
- Passive Directors
- Nominee Directors
- Outside Directors/Independent Directors
- De Facto Directors

Active Directors

An individual elected as a director, who is actively involved in the operations of the company.

Passive Directors

An individual who abdicates some or all of their duties to manage the corporation and merely rely on their co-directors and officers.

Nominee Directors

An individual who is elected on the understanding that they were merely elected to obey instructions, given by someone else, usually another director, officer or shareholder.

Digitized by Google

Outside Directors/Independent Directors

An individual who is not also an officer or employee of the corporation and who has neither a substantial stock interest in the corporation nor material business dealings with the corporation.

De Facto Directors

An individual who publicly exercises the function of a director, such as:

- voting on the board
- signing corporate documents as a director
- serving in discussions or negotiation regarding corporate matters
- being presented as a director on annual corporation filings
- controlling the operations of the company but who was not elected as a director

Note: These types of directorships are difficult to prove. Prior to the consideration of any directors' liability assessment where evidence of a de facto directorship exists, the issue must be formally forwarded to the Department of Justice for a legal opinion as to the validity of such an assessment.

Definition of Liability

Sections 227.1 of the ITA and 323 of the ETA clearly define directors' liability. Although the wording in subsection 227.1(1) ITA and subsection 323(1) ETA are similar, there are variances that make their interpretation and the instances in which they can be applied substantially different.

For example, subsection 323(1) of the ETA stipulates that directors can only be held liable if they were directors *"...at the time the corporation was required to remit the amount"*. Conversely, subsection 227.1(1) of the ITA states that liability occurs *"...at the time the corporation was required to deduct, withhold, remit or pay the amount"*.

Because of this difference, directors' liability assessments issued pursuant to 323(1) of the ETA may only be raised for amounts in which the director in question was lawfully a director on the day following the last day the corporation was required to remit these amounts as outlined within the remitting requirements in subsection 228(2) of the ETA.

However assessments issued pursuant to 227.1 of the ITA, can be raised for amounts in which the director in question was lawfully a director during the time amounts were to have been deducted or withheld.

Directors' Entitlement

Both the ITA and the ETA indicate that a Director who pays an amount in respect of a directors' liability balance owing is entitled to take certain actions to collect the amount from the other directors.

Digitized by Google

Related Topics:

- **Directors' Entitlement to Preference**
- **Directors' Entitlement to Contribution**

Directors' Entitlement to Preference

Subsection 227.1(6) of the ITA and subsection 323(7) of the ETA, stipulate that a director who pays an amount in respect of the balance owing that is proved in liquidation, dissolution or bankruptcy proceedings, is entitled to any preference that the Crown would have been entitled to had that amount not been so paid. Where a certificate that relates to that amount was registered, the director is entitled to an assignment of the certificate to the extent of the director's payment.

For more information, refer to the **Procedures** section entitled, **Directors' Entitlement to Preference**.

Directors' Entitlement to Contribution

Subsection 227.1(7) of the ITA and subsection 323(8) of the ETA, stipulate that a director who makes the payment of the liability can proceed with action against the other directors to recover a portion of the amount that was paid on behalf of the corporation. As opposed to the Preference provision pursuant to 227.1(6) no assignment is required for a Director to exercise his entitlement to contribution. The fact that a Director has personally paid a Directors' Liability claim is sufficient for him to file claim against the other Directors.

Interview Questions for Directors

When interviewing a director, the answers to the following questions may help determine whether to raise a director's liability assessment.

1. Are you presently a director of the company? If not, when did you cease to be a director? Please provide details.
2. Do (did) you receive and review regular financial statements and reports on the company's operation? If so, how often were they reviewed?
   a) Does (did) the report include a balance sheet?
   b) Did you review the monthly general ledger trial balance and the monthly bank reconciliation?
3. Do you know whether or not the company has or had an internal control system in place to ensure payment of accounts to CRA?
   a) Who initiated the system?
   b) When were the accounts due to be remitted?

Digitized by Google

c) Does (did) the company keep a separate bank account to keep the accounts separate and apart form the company's other funds? If so, what is the account number, and with what financial institution?

4. What positive steps did you take to ascertain the company's position on accounts and to prevent the failure to remit these when collected?

5. Were there factors that you believe prevented you from ensuring CRA received the accounts collected?

6. Have you ever sought advice, legal or otherwise, to help you determine what were your duties and responsibilities as a director. If so, please elaborate.

7. Do (did) you attend directors' meetings on a regular basis? Did you attend the last directors' meeting? If not, why? Do you know when and where it was held?

8. Are you or were you the signing officer of the company? If so, were or are there more than two signatures required on company cheques? Who were or are the authorized persons to sign corporate cheques?

9. Have you co-signed or guaranteed any of the company's loans? If so, in what amounts and what are the names and addresses of the creditors? What is/was the primary security?

10. Did the company assign its accounts receivable to the bank or finance company?

11. Do (did) you receive director's fees or any other remuneration from the company?

12. Do (did) you or a company owned or controlled by you, have any business dealing with the above business? If so, how much money is owed you or your company? What product or services were provided?

13. If you are not the principal or majority shareholder, are you related to the company's principal or majority shareholder? If so, what is that relationship?

14. Describe the circumstances which led you to become a director?

15. Where are the minute books, directors' registers and share registers of the company maintained or kept? If at company's lawyer or accountant's office, please provide name, address and telephone number if possible.

When a Director ceases to be a Director

A director ceases to be a director in the following situations:

- a person prohibited by the court (for e. g. declared of unsound mind)
- personal bankruptcy
- death
- upon resigning as a director

Digitized by Google

Note: It is important to remember that a director does not automatically cease to be a director when their corporation is adjudged bankrupt, or placed into receivership. This position is reinforced by the case law, ***Kalef v. M.N.R.*** **(95 DTC 487 (T.C.C.)).**

Policy

This section identifies policy related to Directors' Liability:

- **Amounts Covered Under Directors' Liability**
- **Proving a Director's Liability Claim in a Proposal or in a Bankruptcy**
- **Proving a Director's Liability Under the Companies' Creditors Arrangement Act (CCAA)**
- **When is a Director Not Liable**
- **When to Raise a Director's Liability Assessment**
- **When a Director's Liability Assessment Should not be Raised**
- **The Due Diligence Provision**
- **The Pre-Assessment Proposal Letter**
- **Assessment Amount Limit**
- **Approval Authority**
- **Referring Cases to the Department of Justice**
- **Reassessing Joint and Several Liabilities**

Amounts Covered Under Directors' Liability

The amounts covered under directors' liability include:

- employer contributions and employee deductions
- Goods and Services Tax (GST) Amounts or Harmonized Sales Tax (HST) Amounts
- air Travellers Security Charge Amounts

Employer contributions and employee deductions:

- federal tax, provincial tax, Canada Pension Plan and employment insurance
- amounts that should have been withheld and remitted from payments or credits made to non-residents
- related penalties, not including late filing penalties or law costs

Digitized by Google

- related interest

GST Amounts:

- net tax the corporation was required to remit; including all amounts owing as a result of any notional assessments raised

  Note: Net tax does not include unwarranted refunds prior to June 29, 2005.

  For additional details, refer to Communication TSDMB-2003-002 (ARD), **The Collection of Unwarranted GST/HST Refunds in a Director's Liability Situation** and Communication TSDBM-2005-035 (ARD), **Bill C-43, Part 3, Change to Subsection 323(1) of the Excise Tax Act**.

- related penalties, not including late filing penalties or law costs

- related interest

  Note: A director cannot be held liable for any "tax payable assessment" issued pursuant to paragraph 296(1)(b) of the ETA. For further details, refer to Communication TSDMB-2005-018 (ARD) entitled, **Assessment of insolvent purchasers, pursuant to Section 296(1)(b) of the Excise Tax Act**; Directive RCD-96-12 entitled, **Assessment of insolvent purchasers under 296(1)(b) of the ETA**; and to Memorandum 03-08, entitled **Liability of a Purchaser Under S. 296(1)(B) Excise Tax Act**.

Also, refer to Directive RCD-00-11, entitled **Assessing Directors for GST When Corporations are in a Partnership** and Memorandum 03-05 entitled, **Liability of Partnerships and Partners for GST/HST**.

Air Travellers Security Charge Amounts:

- security charge amounts the corporation was required to remit; including all amounts owing as a result of any notional assessments raised

- related interest

Note: The wording of the ATSCA does not provide an avenue to include assessed penalties in a memorandum assessment

Proving a Director's Liability Claim in a Proposal or in a Bankruptcy

When a director of a corporation is bankrupt or files an insolvency proposal, the trustee may report, on the Statement of Affairs, the corporation's liability for payroll deductions or GST trust funds during the period of directorship. If the estate has funds to pay that liability, the trustee may request the Agency to prove a claim. If it is your intention to raise a Directors' Liability assessment it is not necessary to prove a contingent claim as subsection 149(2) of the BIA provides and extension of time for filing a claim while requiring the trustee to set aside a dividend to support that claim.

For additional details see Directive RCD 00-25, **Proving a Directors' Liability Claim in a Proposal or in a Bankruptcy**.

Digitized by Google

Proving a Director's Liability Claim Under the Companies' Creditors Arrangement Act (CCAA)

Unless the Agency has assessed the directors before the company has filed under the CCAA, assessing them **during** a CCAA proceeding is not normally supported by the Court.

Based on the Court's stance:

1. We should consider assessing directors as soon as there are any indications the company is experiencing cash-flow problems.

2. We should analyse the CCAA plan as soon as possible and consider whether it is appropriate to assert that the Crown's claims be put in a separate class of creditors.

3. If the plan calls for a full and final satisfaction of the debt, we should never vote to accept the plan and then later attempt to recover the difference from the directors (unless the plan is in default).

A plan under the CCAA may include in its terms, provisions for the compromise of claims against directors of the company. Such claims will have arisen before the proceedings under the CCAA have started. However, the right to that compromise is limited where the claims:

- relate to contractual rights of one or more creditors, e.g., personal guarantees of the directors

- are based on allegations of misrepresentations made by directors to creditors or wrongful or oppressive conduct by the directors

If the court agrees to a compromise, it will grant a stay of proceedings against the directors.

For additional detail refer to the Directive ARD-01-02, **The Companies' Creditors Arrangement Act**.

Care must also be given to ensure that any "Claims Bar Dates" set by the Court are satisfied. On occasion, during a CCAA proceeding, the Court may set a Claims Bar Date against potential claims held by creditors against corporate directors. A Claims Bar Date acts as deadline for creditors to submit any contingent claims they may potentially hold against the corporate directors, in respect of the corporate liability.

Once the Court sets a Claims Bar Date, creditors in turn have a limited period of time to file their contingent claim with the Monitor. Not doing so may prohibit a creditor's right to take any action against the corporate directors upon satisfaction of the CCAA Plan of Arrangement.

Therefore, where a Claims Bar Date has been issued by the Court for claims against corporate directors, the Agency must file a claim with the Monitor within the prescribed period. Failure to do so will likely preclude the Agency from pursuing a director's liability assessment following satisfaction of the CCAA Plan of Arrangement.

> Note: CRA claims in these circumstances will represent amounts in which the corporate directors could be held liable and do not necessarily represent the actual amounts to be assessed. These claims are "contingent claims" and their sole purpose is to satisfy the Claims Bar Date set by the Court so as not to prohibit the Agency from any action against a corporate director that is applicable.

Digitized by Google

When is a Director Not Liable

A director is not liable when:

- that director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances

  Note: For further details refer to the section entitled **The Due Diligence Provision**.

- more than two years have elapsed since the director last ceased to be a director of that corporation

  Note: To determine whether a director ceased holding the office of director of the corporation, collection officers must determine what the applicable Company Act or Business Corporations Act provides. For further details refer to Communication ARD-2004-027, entitled **Director's Liability - Bonch v. The Queen**.

- CRA did not:

  - prove the claim within six months following the date of the voluntary dissolution or liquidation proceedings began

  - prove the claim against the corporation within six months following the date of bankruptcy

  - file a claim with a Receiver and/or Receiver/Manager within six months following the date of Receivership

    Note: A director does not cease to be a director upon the corporation becoming bankrupt or being put into receivership.

  - file a certificate for the amount of the corporation's liability and the execution for that amount was returned unsatisfied in whole or in part

  - file a claim with a Monitor in a CCAA proceeding where a Claims Bar Date was issued by the Court, within the prescribed period set

When to Raise a Director's Liability Assessment

Raise a Director's Liability assessment:

- after every attempt is made to collect the amount through normal collection action

- after all amounts owing by the corporation have been assessed and that all outstanding reporting periods have been assessed

- when the potential memorandum assessment exceeds the minimum balance set for directors' liability assessments; refer to the section entitled **Assessment Amount Limit**

- after identifying who the corporate directors are

- after ensuring through an investigation, that the assessment will be collectible by confirming that the director(s) holds an ability to pay

Digitized by Google

Note: If there is more than one director and it is clear that at least one of them is capable of satisfying the proposed assessment, the Agency's policy is to assess all the directors and take Collections action against those with the ability to pay.

- when due diligence was not exercised; refer to the section entitled **The Due Diligence Provision**

- up to two years after the director last ceased to be a director of that corporation

  Note: The issuance of a directors' liability assessment constitutes the start of a proceeding against that director. Therefore, you must raise the assessment before the end of the two-year deadline. If a corporation has more than one director, a date for this deadline will have to be established for each director.

- after CRA's inability to recover the amounts from the corporation were demonstrated by:

  - a nil report or the return of an unsatisfied execution in whole or in part against the corporation

  - the proving of a claim against the corporation within six months following the date of dissolution or liquidation proceedings began

  - the proving of a claim against the corporation within six months following the date of bankruptcy

  - the filing of a claim with a Receiver and/or Receiver/Manager within six months following the date of Receivership

- In the case of a corporate bankruptcy, any time after bankruptcy and up to two years after the director resigned

  Note 1: A director does not cease to be a director upon the corporation becoming bankrupt or being put into receivership.

  Note 2: A Director's Liability Assessment should not preclude the Agency from taking any applicable action against a third party pursuant to subsection 227(4.1) of the ITA to exercise our priority for deemed trust. Such an action should not be delayed by the resolution of any Director's Liability assessment.

When a Director's Liability Assessment Should not be Raised

A director's liability assessment should not be raised if:

- the director alleges that the corporation was in receivership, liquidation or bankruptcy, such that a financial institution, receiver, liquidator or trustee was in full control of the corporation at the time the law required source deductions or GST/HST to be remitted, whether or not the director was a director at the time the source deductions where withheld or GST/HST was collected, provided CRA has no contradictory evidence in its possession

  Note 1: This situation is intended to cover circumstances where, at the time the remittance was due, a third party (receiver, trustee, and liquidator) was in control of the corporation, and inhibited the corporation from remitting. However, in order not

Digitized by Google

to assess, the facts must be similar to the facts in **Swertz v. M.N.R., 90 DTC 1056 (T.C.C.).**

Note 2: Such circumstances may warrant a Memorandum Assessment pursuant to subsections 227(5) and 227(5.1) of the ITA and sections 265 and 266 of the ETA.

- CRA has not satisfied the appropriate precondition to assessment set out in subsection 227.1(2) of the Income Tax Act (ITA) or subsection 323(2) of the Excise Tax Act (ETA) or if such an assessment is statute barred under 227.1(4) of the ITA or 323(5) of the ETA

- an investigation has confirmed that none of the director(s) would hold an ability to pay such an assessment

  Note: If there is more than one director and it is clear that at least one of them is capable of satisfying the proposed assessment, the Agency's policy is to assess all the directors and take Collections action against those with the ability to pay.

- the director claims to have been locked out of the corporate affairs by one or more of the other directors or due to a minority shareholding and satisfactory evidence to this effect is provided

- the assessment against the company was raised pursuant to
  - paragraph 296(1)(b); or
  - paragraph 296(1)(d) pertaining to unwarranted refunds prior to June 29, 2005

  For further details on paragraph 296(1)(b) refer to the Bankruptcy chapter, and Communication TSDMB-2005-035 Bill C-43, Part 3, Change to Subsection 323(1) of the Excise Tax Act and Communication ARD-2005-018 Assessment of insolvent purchasers, pursuant to paragraph Section 296(1)(b) of the Excise Tax Act, and Directive RCD-96-12 Assessment of Insolvent Purchasers under 296(1)(b) of the ETA, and Memorandum 03-08 Liability of a Purchaser Under paragraph, 296(1)(b) Excise Tax Act.

The Due Diligence Provision

Subsections 227.1(3) of the ITA, 323(3) of the ETA and 81(3) of the ATSCA define the "Due Diligence Provision." The Due Diligence Provision states that a director is not liable if that director exercised the same degree of care, diligence and skill that a reasonably prudent individual would have exercised, in comparable circumstances, to ensure that the corporation deducts, withholds, remits or pays the amounts due. The onus to prove due diligence, rests with the director.

The test of due diligence under subsections 323(3) of the ETA and 227.1(3) is summarized in this Federal Court of Appeal decision, *"The test of due diligence under subsections 323(3) is not whether every conceivable step has been taken, but rather what steps to prevent failure a reasonably prudent person would have exercised in comparable circumstances,"* **Moriyama v. Her Majesty, 2005 FCA 207.**

Cases involving a defence of due diligence are based on the facts specific to each case. A director who claims due diligence is required to describe the positive steps and actions taken to avoid the creation of the debt. However, the explanations often tend to deviate from the main question:

Digitized by Google

"What did the director do to ensure that the required source deductions and/or GST/HST net tax were paid?"

If the director cannot satisfactorily answer this question, the conclusion will often be that they have not "exercised the degree of care, diligence and skill," specified in subsections 227.1(3) of the ITA and 323(3) of the ETA.

For further information refer to the section, **When to Refer a Case to the Department of Justice** and **Cases That Are Not Referred to the Department of Justice**.

Related Topics:

- **Responsibility to Exercise Due Diligence**
- **Responsibility When Financial Difficulty Experienced**

Responsibility to Exercise Due Diligence

It is a director's responsibility to exercise due diligence, including:

- establishing controls to account for withholdings from employees and remittances of source deductions and GST/HST amounts
- calling upon financial officers of the corporation to report regularly on the continued implementation of these controls
- obtaining regular confirmation that withholdings and remittances have in fact been made during all relevant periods

Responsibility When Financial Difficulty Experienced

A director is responsible for exercising due diligence when the corporation experiences financial difficulties. Refer to **Responsibility to Exercise Due Diligence**.

As well, a director's responsibility when it is determined that the corporation is experiencing financial difficulties may include the following:

- obtaining from the financial institution where the line of credit is extended, an enforceable undertaking to pay all amounts due to the Crown when due
- establishing a separate trust account into which amounts of GST/HST collected would be deposited
- establishing a separate payroll trust account into which the gross payrolls would be deposited for subsequent disbursement to employees, with the difference to be remitted to the Crown when due
- if the corporation is placed in receivership or is adjudged bankrupt, advising the receiver and manager or trustee in writing of the banking arrangements in place for the payment of the source deductions withheld and of GST/HST payable

Digitized by Google

The Pre-Assessment Proposal Letter

A pre-assessment proposal letter must be issued to all directors identified prior to the assessment of any directors' liability.

The pre-assessment letter (ELCS 19713) gives each director an opportunity to present relevant facts which may prove that they should not be held liable for the corporation's unpaid source deductions and/or GST/HST net tax.

The letter advises the director of the Agency's intention to assess and informs them that they have 30 days in which to respond. It also informs the directors of the amount of the projected assessment.

This letter further advises the director that information regarding the Agency's position regarding the due diligence defence can be found within **Information Circular 89-2R**, available to the director by calling the CRA Toll Free number (1-800-969-2221) or the CRA website address at **www.cra.gc.ca/formspubs**.

Circular 89-2R informs the directors of corporations of their responsibility to deduct and remit payroll deductions and GST/HST net tax on behalf of the Crown and of their steps they must take to avoid being held personally liable. It also explains the implications to which directors are liable if they do not comply with these provisions.

Related Topics:

- **Method of Service for Pre-Assessment Proposal Letters**
- **No Response to the Pre-Assessment Proposal Letter**
- **Director's Response to the Pre-Assessment Proposal Letter**
- **Verifying Documents Relating to Directors' Liability**
- **Follow-up to the Director's Response**

Method of Service for Pre-Assessment Proposal Letters

It is recommended that all pre-assessment letters be issued by way of:

- registered mail/priority post; or
- hand delivery (with an Affidavit of Service completed immediately upon service)

The use of one of the above methods of service will ensure that evidence regarding proof of service will exist should this information be required at a later date.

> Note: The use of regular mail prohibits any evidence regarding proof of service from existing. For this reason, it is recommended that regular mail not be used when issuing a directors' liability pre-assessment letter.

No Response to the Pre-Assessment Proposal Letter

Digitized by Google

A second pre-assessment letter should be sent if the director does not reply to the first letter after the 30-day deadline. A second letter (ELCS 19718), stressing the importance of providing a reply, must be sent. After the second letter is sent, a new 30-day deadline is granted. It is important that the steps taken to solicit a response from the director be recorded in the ACSES diary.

The Agency must show that it has made a reasonable effort to contact the director for a response. If, after these steps, the director has still not responded, proceed with the assessment immediately.

Director's Response to the Pre-Assessment Proposal Letter

Responses to the pre-assessment letter will vary and it will be up to the Collector in most cases to analyze them and to exercise judgment as to their validity. If the response received cites a due diligence defence, refer to section The Due Diligence Provision.

Although the pre-assessment letter mentions due diligence, there are two other reasons which are occasionally cited in a director's response:

- the director claims not to have been a director at the time of default; or
- the director claims that the two year deadline to assess has expired

These two reasons are fairly easy to prove since they involve written and dated documents that are normally not subject to interpretation. If the director cites one of these two reasons, it is up to them to provide the Agency with the proof. The following are documents which you can request:

- copy of a letter of resignation forwarded to the company's registered office
- evidence from the corporate Minute Book regarding the resignation
- Director's resolution and minutes of any Directors' Meetings
- copy of the Registrar of Companies search
- copy of the corporate Notice of Dissolution
- evidence that the director was not involved in the company
- evidence that the corporate charter was revoked more than two years ago
- evidence of a Letter of Resignation dated more that two years ago delivered to the registered offices of the company
- GST/HST amounts not assessed within the 4 year time limit

Verifying Documents Relating to Directors' Liability

On occasion, the information forwarded by a director as evidence to why they were not directors at the time of default, may be highly suspect. For example, Collectors may be in receipt of a resignation letter or a document from a corporate Minute Book that may have been back-dated to give the appearance that a resignation took place using a falsified date.

Digitized by Google

Or circumstances may exist where the signatures within documents supplied are also highly suspect.

In these circumstances, it is recommended that Collectors consider the use of forensic analysis to verify the validity of the documents in question. This service is provided to Revenue Collections by the Forensic Sciences Division, Laboratory & Scientific Services Directorate, Canada Border Services Agency.

Related Topic:

- Document Analysis by the Forensic Sciences Division

Document Analysis by the Forensic Sciences Division

Forensic document analysis is provided free of cost to Revenue Collections by the Forensic Sciences Division of the Laboratory & Scientific Services Directorate, Canada Border Services Agency.

The Forensic Sciences Division can provide document analysis of handwriting and other aspects of documents to determine their origin and authenticity. Document analysis can provide a variety of information to support collection investigation particularly in matters where collection actions would otherwise be prohibited because of time limitations such as the two year limitation for directors' liability assessments.

For example, TSOs would be able to utilize these services in instances where there are questions relative to dating and/or signatures on documents such as:

- directors' letters of resignation
- transfer documents
- disputed registration forms

Document analysis includes but is not limited to:

- handwriting comparisons
- detection of forgeries and alterations
- Ink, stamp impressions and paper analysis
- chronology or sequence of inscriptions
- dating of documents
- expert testimony in court

Where circumstances warrant the use of this service, forward all documents that require analysis to:

Forensic Sciences Division
Laboratory & Scientific Services Directorate
Canada Border Services Agency
79 Bentley Avenue
Ottawa On K1E 6T7

Digitized by Google

Forward the original documents along with a cover letter outlining the reason for the forensic analysis (i.e. hand writing analysis is required to verify director's signature or document dating analysis is required to confirm resignation dates etc.). Referrals must have the approval of a Manager, Revenue Collections and/or the Assistant Director, Revenue Collections, and must be submitted under their signature.

Refer to Memorandum 99-03, entitled, **Laboratory and Scientific Services** for further details.

To ensure receipt of the documents required for analysis, the Forensic Sciences Division requires that all documents forwarded to them be sent by way of a **private courier** and not by Canada Post.

Upon completion of their forensic review, the Forensic Sciences Division will return to Collections a Forensic Report detailing their findings along with the original documents forwarded.

For more information on these services consult the **Forensic Sciences Division**

Follow-Up to the Director's Response

If you accept the reason cited within the response given by the director, you must document your decision and send him/her a letter advising that no assessment will be issued. There is no letter within ELCS, which advises that the Agency accepts the arguments given. You must compose one.

If you reject the director's arguments, you must advise of the Agency's intention to assess. Issue the pre-assessment letter (ELCS 19696), which informs the director of the Agency's refusal to accept their arguments. It grants an additional deadline of 15 days to clarify or substantiate any reasons, which might allow exemption from liability. The letter also informs the director of the Agency's intent to assess upon expiry of the deadline, unless receipt of any new information is received. The letter also indicates the amount of the assessment being considered.

If the director presents additional arguments, you must examine any new facts prior to raising the assessment. If there is no response to the pre-assessment letter, proceed immediately with the assessment.

Assessment Amount Limit

It is recommended that the minimum assessment amount be set at **PROTECTED.** However, Tax Services Office (TSO) Management may use their discretion when considering an assessment below the recommended assessment balance limit.

In these circumstances, TSO Management will take into consideration:

- current TSO workloads
- cost effectiveness
- previous compliance history

Digitized by Google

Approval Authority

The Approval authority for a directors' liability assessment is delegated to the following:

- Director, Tax Services Office
- Assistant Director, Revenue Collections
- Manager, Revenue Collections

For further details please refer to Memorandum 01-21 entitled, **Delegation of the Minister's Powers under the Income Tax Act, Excise Tax Act and Customs Act**.

Referring Cases to the Department of Justice

All initial referrals to the Department of Justice are made under the signature of either:

- Director, Tax Services Office
- Assistant Director, Revenue Collections
- Manager, Revenue Collections
- Team Leader, Revenue Collections

To ensure the efficient operation and wise utilization of Justice services only certain cases are referred to the Department of Justice.

For further details please refer to Memorandum 01-21 entitled, **Delegation of the Minister's Powers under the Income Tax Act, Excise Tax Act and Customs Act**.

Related Topics:

- **When to Refer a Case to the Department of Justice**
- **Cases That Are Not Referred to the Department of Justice**

When to Refer a Case to the Department of Justice

Refer a case to the Department of Justice when:

- an assessment is to be based upon an allegation that an individual is a de facto director
- it is claimed that the individual had resigned at the time source deductions Goods and Services Taxes (GST) or Harmonised Sales Tax (HST) should have been remitted and this information differs from that found in the corporate registry or obtained from other sources
- a director claims to have acted with due diligence by relying on someone else in the corporation to ensure that source deductions and GST/HST were remitted in accordance with the law, for example: another director, manager who was relied upon, misled the director by using misleading words or documents and assured the

Digitized by Google

director that remittances were being made on time and in full, when that was not the case or where there was a division of responsibilities amongst the directors

Note: Do not make the referral until the directors, co-directors, employees and the company's auditor are interviewed to verify or rebut the director's allegations.

- one of the situations described in **Cases That Are Not Referred to the Department of Justice** would otherwise exonerate the director

Where, after examination a case does not meet these guidelines or the guidelines outlined in **Cases That Are Not Referred to the Department of Justice**, refer to **Investigation Required Before Requesting an Opinion**.

For further detail, refer to the directives, **RCD-95-12** and **RCD-96-09**, both of which are entitled **Directors' Liability.**

Cases That Are Not Referred to the Department of Justice

Cases that are not referred to the Department of Justice include situations where:

- a director relying on a due diligence defence does not provide a factual basis for a defence, for example: the director does not explain why the source deductions, Goods and Services Tax (GST), or Harmonized Sales Tax (HST) were not remitted in such a way that would exonerate the director from liability
- the facts described by a director in support of a due diligence defence all relate to actions taken after the failure to remit source deductions or GST/HST occurred
- the director simply alleges no knowledge of the default and there is no evidence the director was misled
- the due diligence defence is that the corporation did not have enough cash flow or funds on hand to remit source deductions or GST/HST assuming there was no receivership or action by a bank to restrict the availability of cash flow prior to the default, or that the director did not fully understand his or her legal obligations are responsibilities under the law
- the director claims that no source deductions or GST/HST were remitted as a result of the corporation's bank or financial institution refusing to continue to honour future remittance cheques and the director remained in the office without taking the appropriate steps to have such amounts remitted
- a nominee director who is a professional or business person admits that nothing was done to prevent the failure to remit and does not allege that the director was relying on someone else to ensure that remittances were made in accordance with the law

Where, after examination, a case does not meet these guidelines or the guidelines outlined in **When to Refer a Case to the Department of Justice**, refer to **Investigation Required Before Requesting an Opinion**.

Refer to **Case Law** for related cases. For further detail, refer to the directives, **RCD-95-12** and **RCD-96-09**, both of which are entitled **Directors' Liability**.

Digitized by Google

Reassessing Joint and Several Liabilities

In many circumstances, it is not unusual for additional relevant facts to come to light after an assessment has been issued. In some instances, had the additional information been available at the outset it may have impacted the amount included on the Notice of Assessment, or resulted in the assessment not having been made at all.

Accordingly, the following policies have been developed to provide Tax Services Offices with guidance and direction concerning the circumstances when Revenue Collections should consider downward reassessments of joint and several liabilities.

The policies outlined below can be found within Communication ARD-2004-014, entitled, Reassessing Joint and Several Liabilities.

Related Topics:

- Resolving a Disputed Memorandum Assessment
- Request for Adjustment to a Memorandum Assessment
- Notice of Objection or Appeal Filed Subsequent to a Request for Adjustment
- Notice of Objection or Appeal is Outstanding When Request for Adjustment is made
- Where Time to File Notice of Objection or Extension Order has not Expired
- When Should Reassessment be made or Adjustment Request be Declined?
- Reassessment Approval Authority
- Statutory Period to Reassess

Resolving a Disputed Memorandum Assessment

It is not uncommon for disputes to arise after an assessment has been issued. When a dispute results in the amount of a debt being re-determined or recalculated, it does not constitute a compromise settlement, but rather is a re-consideration of the actual amount owed. When amounts are re-determined or recalculated, the appropriate adjustments are made within the Agency's records and a Notice of Reassessment is issued to inform the taxpayer accordingly.

Issuing reassessments to resolve disputes cannot be done on an ad hoc basis; there must be a proper basis for doing so.

Request for Adjustment to a Memorandum Assessment

Occasionally Revenue Collections is requested to reconsider a memorandum assessment that has been issued against a third party under one of the various joint and several liability provisions. Such requests may emanate from recipients who have been assessed, or their representatives. In some instances the third party who has been assessed, or the person's representative, is able to provide additional information to demonstrate that the amount assessed is in error.

Digitized by Google

Although rare, there have also been instances when counsel of the Department of Justice has requested Revenue Collections to consider an adjustment to a memorandum assessment. Although not always the case, usually counsel is representing the Agency in the dispute process when such a request has been made.

Revenue Collections Divisions will only reconsider the amount of a third party's liability and issue a reassessment to adjust the amount when there is a proper basis to do so and an objection or appeal **is not** outstanding. In the event an Objection or Appeal **is** outstanding, Revenue Collections should leave matters to the Appeals Division to handle the case and follow any instructions they may issue as a result of disposing of the Objection or Appeal.

Notice of Objection or Appeal Filed Subsequent to a Request for Adjustment

Occasionally, Revenue Collections may have been requested to reconsider a memorandum assessment and a Notice of Objection or Appeal is filed subsequently. Once a Revenue Collections Officer becomes aware that an Objection or Appeal is outstanding, he or she is encouraged to pass any additional information that they have gathered to the Appeals Division along with any observations, conclusions or recommendations they have made or wish to make. The Appeals Officer would benefit from this information and any additional work that has been done.

Notice of Objection or Appeal is Outstanding When Request for Adjustment is made

Unless instructed to do so by Appeals, whenever an assessment is subject to a notice of objection or appeal, Revenue Collections Division **must not** make an adjustment to a memorandum assessment under any circumstance. In the event a request for an adjustment is received from a person who has been assessed under one of the memorandum assessment provisions, the person's representative, or counsel of the Department of Justice and a Notice of Objection or Appeal is outstanding, the person making the request should be referred to the Appeals Division. When disposing with the objection or appeal, the Appeals Division will issue instructions to Revenue Collections if and when appropriate.

Where Time to File Notice of Objection or Extension Order has not Expired

In the event a request is received for an adjustment and an Objection or Appeal has not been filed, the collection officer can reconsider the facts and can complete the necessary steps to have the assessment varied when the facts warrant it. However, a third party should be informed of their right to file an objection, or to apply for an extension of time to object when time to do so has not lapsed, particularly when the request is denied or there is a chance the time may expire before a decision can be made.

When Should Reassessment be made or Adjustment Request be Declined?

When it is clear from the additional information that the amount of a memorandum assessment is in error, it would be appropriate for Revenue Collections to proceed with a reassessment provided a Notice of Objection or Notice of Appeal **is not** outstanding.

In the event a request for an adjustment is received and it is not clear from the additional information provided that the assessment is incorrect, the request for adjustment should be declined. It may be that the Tax Services Office staff may choose to obtain advice from the Department of Justice or the **Field Support Section** in advance of making such a decision.

Digitized by Google

Reassessment Approval Authority

A Collection Officer should not commit to an adjustment being made as a result of receiving a request. Instead, the matter should be referred to the person within the local office who has been delegated the authority to approve memorandum assessments to seek concurrence with the Collection Officer's recommendation.

For further details refer to the section **Approval Authority**.

The person who made the request for the adjustment should be informed of the decision of whether or not an adjustment will be made, and if the decision is made to make an adjustment, then a reassessment should be issued accordingly.

For further details refer to the section **Notice of Reassessment for Director's Liability Where no Objection or Appeal Exists**.

Statutory Period to Reassess

When an objection or appeal is not outstanding, careful attention must be given to ensure the normal reassessment period has not passed when considering an adjustment.

Under subsection 152(4) of the *Income Tax Act* (ITA), a three-year statutory reassessment period commences once a memorandum assessment has been issued. Accordingly, the issuance of a reassessment, or any subsequent reassessments of the same transaction or event that was dealt with in the original notice of assessment, becomes statute barred after 3 years have passed from the initial assessment date.

In the case of a memorandum assessment issued under the *Excise Tax Act* (ETA), a reassessment must be made within 4 years of a third party becoming liable for an amount. The third party becomes liable at the time the memorandum assessment is issued. Subsection 298(1) of the ETA provides that reassessments must be made within 4 years from the time the amount becomes payable.

Accordingly, reassessments of memorandum liabilities under the ITA and ETA **must not** be processed once the normal (re)assessment period noted above has passed.

Procedures

This section identifies procedures related to Director's Liability:

- **Completing a Director's Liability Assessment**
- **Collection Action on Directors' Liability Assessments**
- **Maintaining the Director's Liability Assessment**
- **Applying Payments**
- **Situations Where a Notice of Objection is Filed**
- **Directors' Entitlement to Preference**

Digitized by Google

Completing a Director's Liability Assessment

When raising a Director's liability assessment, it is important to give directors the full opportunity to provide a due diligence defence and to seek out all relevant information. For details refer to the Policy section entitled **The Due Diligence Provision**.

Related Topics:

- **Conducting the Initial Investigation**
- **Directors' Liability Checklist**
- **Obtaining a Defence**
- **Investigation Required Before Requesting an Opinion**
- **Requesting an Opinion on a Director's Liability**
- **Raising a Director's Liability Assessment**

Conducting the Initial Investigation

To conduct an initial investigation:

Note: The order in which the initial investigation is completed may vary depending on the case and the information already obtained.

1. Confirm that all attempts were made to recover the debt using normal collection action.

   Note: Where garnishment action is taken to collect the arrears, withdrawal of the garnishee could prohibit the assessment of directors. Refer to the chapter **Garnishment** for further detail.

2. In the case of a bankruptcy, confirm that a proof of claim was filed within six months of the date of the assignment.

3. In the case where non-payment resulted from a corporate liquidation, dissolution or receivership, confirm that:

   - a claim was filed within six months
   - where applicable, proof of dissolution cancellation of certificate of incorporation was obtained
   - where applicable, copies of documents appointing the receiver was obtained

4. Determine the identity of the directors at the time the liability arose, for example: dates of election, appointment and resignation, by obtaining:

   - provincial/federal corporation records

     Note: A federal search is obtained from Industry Canada.

Digitized by Google

- directors' register
- a copy of any relevant information in the corporate minute book

  Note: If it is not possible to obtain a copy, review the corporate minute book.

- copy of directors' letters of resignation
- copy of directors' resolutions and minutes of meetings listing directors

  Note: If the director(s) is not willing/able to provide these documents, the use of a Requirement for Information and Documents may be warranted. Refer to the chapter, **Requirements for Information**, for further details.

5. Review the company's minute book to determine:
   - the extent of positive action taken to prevent non-compliance
   - the dates of directors election
   - appointment and resignation of directors
   - banking and signing authorities
   - amalgamation
   - corporate name changes
   - treatment of the amounts of tax collected
   - declaration of dividends
   - redemption of shares
6. Determine the period outstanding that makes up the balance of the account by:
   - analyzing account information on the various systems available to collection officers, such as ACSES, BW, SUDS, etc.
   - reviewing audit information, for example: payroll audit, GST/HST audit
   - reviewing the company's payroll records
   - reviewing proofs of claim
   - examining copies of corporate Notices of Assessment

   Note: If necessary, request the appropriate audit.
7. Determine the potential to collect the liability from the directors by:
   - conducting asset searches
   - identifying the incomes

Digitized by Google

Even if it appears that only one director has sufficient assets from which to effect collection, assess all directors.

Directors' Liability Checklist

It is important that adequate documentation and information is gathered from a company, the directors and CRA to substantiate an assessment in the courts.

Related Topics:

- **Required Ev cvidence Relating to the Status of the Company**
- **Required Evidence Relating to the Directors**
- **Required Evidence Relating to CRA**

Required Evidence Relating to the Status of the Company

The following describes situations relating to the status of the company and the evidence required.

a) Situations where the company is indebted:

- to CRA under either or both statutes the *Income Tax Act* (ITA) and the *Excise Tax Act* (ETA) for a total amount equal to or exceeding the Tax Services Offices (TSO) threshold for directors' liability assessment
- for an amount under the local threshold, but other reasons justify that its directors be assessed

Required evidence:

- a print-out of the company's account under each statute owing

b) Situations where the company failed to remit payroll deductions and/or net GST/HST:

Required evidence:

- the account historic (where applicable), and all pertinent reports including any trust examination
- an account reconciliation in spreadsheet form denoting:
  - the months and years to which the assessments apply, the amounts of federal tax, UI premiums, EI premiums and CPP contributions, with applicable penalty and interest
  - the months and years to which the assessments apply for provincial tax, plus applicable penalty and interest

Digitized by Google

- the periods of GST/HST plus applicable penalty and interest

c) Situations where the company has cash-flow problems, and has no immediate assets from which to effect payment:

Required evidence:

- a court action recommended
- a certificate
- an enforcement of judgment or writ
- the Sheriff's or Bailiff's return

d) Situations where the name of the company has been struck off the Registrar's records on its own request and where a liquidator is or is not appointed (the charter was revoked) due to the company's failure to file the appropriate return with the Registrar:

Required evidence:

- a court action is recommended, except when a liquidator is appointed
- a certificate
- an enforcement of judgment or writ
- the Sheriff's or Bailiff's return
- a notice of dissolution when the company is struck off at it's own request
- a letter to the liquidator (within six months of dissolution) requesting payment

e) Situations where the company is formally and voluntarily wound up:

Required evidence:

- special resolution
- letter to the liquidator (within six months of the day the special resolution was passed) requesting payment

f) Situations where the company was wound up by court order requested by the company or by a third party.

Required evidence:

- a letter to the liquidator (within six months of the Court Order) requesting payment
- a Court Order

g) Situations where the company is in receivership.

Digitized by Google

Required evidence:

- a notice of Receivership
- a Claim filed with a Receiver (within 6 months of Receivership)
- a court action recommended
- a certificate
- an enforcement of judgment or writ
- the Sheriff's or Bailiff's return

h) Situations where the company is bankrupt.

Required evidence:

- a Notice of Bankruptcy
- a Proof of Claim (filed within six months of bankruptcy)
- a reconciliation of the account to Proof of Claim

i) Situation where the company was incorporated.

Required evidence:

- articles of incorporation showing the names of the incorporators

Required Evidence Relating to the Directors

The following describes situations relating to the director and the evidence required.

a) Situations determining who the directors of the company were at the time of the failure to remit.

Required evidence:

- a copy from the Minute Book or the Directors' register of the appropriate directors
- a corporate registry search

b) Situations where each director owned shares

Required evidence:

- a share register
- a corporate registry search

c) Situations where none of the directors could be assessed either because their tenure as director did not coincide with the failure to remit or the two-year limitation period for assessing has expired.

Digitized by Google

Required evidence:

- a resignation of the Director in the Minute Book
- comparison of tenure of directorship with the time of the failure to remit
- a corporate registry search

d) Situations where one of the directors could not be assessed either because after considering an assessment under the other statute, their defence has been accepted for the same period and with regard to the same corporation or an assessment has been raised under the other statute, appealed and vacated and the reasons for such a vacation would also apply to the assessment contemplated:

Required evidence:

- details and copies of relevant documents from the other file

e) Situations where at least one director has the ability to pay.

Required evidence:

- details on assets and incomes of these directors

f) Situations where we advised the director by registered mail of our intention to assess them for their corporation's failure to remit.

Required evidence:

- a copy of the pre-assessment proposal letter

g) Situations where the account was brought forward 30 days from the date of the letter.

Required evidence:

- an entry on ACSES or on the log of action

h) Situations where the director asked for an extension of time to reply.

Required evidence:

- a letter from the director or his representative

i) Situations where the director claimed not to be a director at the time of the failure.

Required evidence:

- a copy of letter of resignation forwarded to the company's registered office
- an excerpt of the relevant piece of corporate legislation showing conditions for a director's resignation to be acceptable
- evidence from the Minute Book

Digitized by Google

- Directors' resolutions and minutes of meetings listing directors
- a copy of Registrar of Companies' search
- a copy of the Notice of Dissolution and of the Notice of Revocation
- evidence that the director was or was not involved in the company

j) Situations where the director claimed that CRA is outside the time limit as per 227.1(4) of the ITA, 323(5) of the ETA.

Required evidence:

- evidence that the corporate charter was revoked more than 2 years ago
- evidence that the company dissolved more than 2 years ago
- evidence of a personal Bankruptcy more than 2 years ago
- a copy of a letter of resignation dated more than 2 years ago delivered to the registered offices of the company

Required Evidence Relating to CRA

The following describes the evidence required by CRA.

a) Situations where CRA accepted or refuted the defence:

Required evidence:

- if defence accepted, provide an analysis of the information
- if defence refuted, document your findings
- write a letter to the director to that effect

b) Situations where the director provided a defence or made further representation about his defence.

Required evidence:

- information from the director

c) Situations where CRA accepted the new representation or refuted the new information.

Required evidence:

- the analysis of the director's new information
- a letter to the director to that effect

d) Situations where the director did not reply to the pre-assessment proposal letter and/or CRA followed up by registered mail or telephoned the director.

Digitized by Google

Required evidence

- record in ACSES diary or in log of action

e) Situations where CRA issued a Notice of Assessment.

Required evidence:

- Notice of Assessment (T779) or Third Party Notice of Assessment (GST 259)
- a dummy ledger card for each director assessment

f) Situations where there is a follow-up of the assessment.

Required evidence:

- confirmation that routine collections letters were sent
- ACSES diary or log of action

g) Situation where assessment(s) appealed.

Required evidence:

- review the checklist to ascertain no relevant document is missing
- send photocopies of all the documents in the docket to the Appeals officer, including printing of any relevant ACSES Diary or log of action entries

Obtaining a Defence

A review of the Policy sections entitled **The Due Diligence Provision** and **The Pre-Assessment Proposal Letter**, are recommended in advance of a review of this section.

To obtain a defence:

1. Complete a pre-assessment proposal letter available on the Electronic Letter Creation System (ELCS 19713) to the Directors.

   Note: The pre-assessment letter gives the Director 30 days to respond.

2. Send the letter by registered mail.
3. If a request is made to extend the time to respond, grant the extension providing the reasons given are reasonable.
4. If a response is received claiming due diligence, verify the evidence submitted by:

   a) Interviewing the directors (where applicable).

   b) Reviewing the books and records.

5. If no response is received, either:

Digitized by Google

a) Contact the director by telephone to provide a further opportunity to present a due diligence defence, or

b) Send the second Pre-Assessment Letter (ELCS 19718) by registered mail requesting the director confirm that a response was not sent and to further warn that an assessment is being considered.

6. If the director's response is insufficient, a formal rejection of the director's arguments is required through the issuance of the final Pre-Assessment Letter (ELCS 19696).

7. If you are not certain as to the validity of the due diligence response received, a referral to the Department of Justice may be required. Review the guidelines provided within the section **Referring Cases to the Department of Justice**.

8. If you are satisfied that the director met the standard required, send a letter to the director advising that the Agency will not pursue the matter further.

Investigation Required Before Requesting an Opinion

Before requesting a Department of Justice Opinion:

1. Review the guidelines outlined in **When to Refer a Case to the Department of Justice** and **Cases That Are Not Referred to the Department of Justice**.

2. Refer to **Case Law** relating to due diligence defences to determine if a decided case settles the matter, or where the facts of a case do not correspond with the guidelines in **When to Refer a Case to the Department of Justice** and **Cases That Are Not Referred to the Department of Justice**.

3. If the case law is unclear, consult with the:

   - Team Leader
   - Revenue Collections Technical Advisor or Resource/Complex Case Officer
   - Programs Officer in Headquarters

4. If ambiguity still exists after consultation, request an opinion from the Department of Justice. Refer to **Requesting an Opinion on a Directors' Liability** for further detail.

Requesting an Opinion on a Director's Liability

To request an opinion concerning the liability of a director:

1. Prepare a letter in the name of the appropriate delegated authority to the Department of Justice;

   Note: For further details please refer to Memorandum 01-21, entitled **Delegation of the Minister's Powers under the Income Tax Act, Excise Tax Act and Customs Act**.

   a) Identify the company, including:

Digitized by Google

- account number
- amount of debt
- name

b) Provide an account reconciliation, indicating

- the months and years or the filing periods of the various defaults reconciled to the Notice(s) of Assessment against the corporation

2. Provide details regarding the account's history including:

- compliance history
- payment arrangements made
- any legal actions taken
- any recovery made by way of legal action and/or voluntary payments made
- the current status of the corporation (i.e. active, dissolved, bankrupt)

3. Provide details of the directors, including:

- the names of the directors
- dates of appointment
- shares owned in the company
- dates of resignation
- if applicable, details of personal bankruptcy

a) If applicable, provide the following details:

- date of bankruptcy
- date of the receivership
- details of a liquidation or winding-up
- any further details regarding the bankruptcy

b) Request the Department of Justice to provide an explanation of why, in their opinion, the director's representations are considered or are not considered sufficient to exempt the director from liability.

4. Attach copies of relevant documents, including:

- copy of the corporate information registered with the appropriate federal or provincial official indicating the directors of the corporation at all relevant times

Digitized by Google

and if not available, copy of the corporate minute book, including resolutions relating to elections, appointments and resignations and the director's register

- copies of the letters or other documents evidencing or containing the due diligence or other defence offered by the director

  Note: It is not necessary to provide the pre-assessment proposal letter.

- copy of CRA's proof of claim filed in the Bankruptcy or voluntary liquidation of the corporation

- copy of the nulla bona or partial return from the sheriff or bailiff

- copies of the Writs of Seizure and Sale certificates and/or memorial of judgment issued

- copies of subsequent conversations

5. In the case of a "de facto" director provide a complete description of the factual circumstances which give rise to the proposed assessment.

   Note: This description should be based upon a thorough examination of the relevant corporate documents as well as interviews of knowledgeable persons, for example: directors, officers, bookkeepers, accountants, managers and persons in a supervisory position, as to the extent of the individual's involvement in the direction of the corporate affairs.

6. Obtain the required approval as outlined within the section entitled **Obtaining Approval**.

Raising a Director's Liability Assessment

There are numerous components involved in the completion of a director's liability assessment. The following sections clearly outline in detail the steps required.

Related Topics:

- **Obtaining Approval**
- **Approval Memorandum**
- **Completion of a Director's Liability Notice of Assessment Form**
- **Completion of the T779 Form**
- **Completion of the GST259 Form**
- **Director's Liability Assessment Versee**
- **Notice of Reassessment for Director's Liability where a Notice of Objection Exists**

Digitized by Google

- Notice of Reassessment for Director's Liability Where No Objection or Appeal Exists
- Additional Assessment for Director's Liability
- Cancellation of Director's Liability Assessment
- Director's Liability Particulars of Assessment
- Amounts Not to Be Included Within the Particulars of Assessment
- Amended Director's Liability Particulars of Assessment
- Interest Charges on Director's Liability Memorandum Assessments

Obtaining Approval

Prior to proceeding with a proposed director's liability assessment, approval from the applicable authority level must be received.

The delegated approval levels for a director's liability assessment are as follows:

- Director, Tax Services Office
- Assistant Director, Revenue Collections Division
- Manager, Revenue Collections Division

For further details please refer to Memorandum 01-21, entitled Delegation of the Minister's Powers under the Income Tax Act, Excise Tax Act and Customs Act.

> Note: Local Revenue Collections Divisional policy will dictate which of the above authority levels are to be used.

Approval Memorandum

It is recommended that written approval be sought prior to the assessment being issued in the form of a Memorandum addressed to the applicable signing authority.

The Memorandum should include the following information:

1) Name of the debtor company
2) Account number
3) TSO date
4) Total of the debt outstanding
5) A detailed summary outlining the Collections history of the account including the following information:

Digitized by Google

- all voluntary payments made to the debt
- any legal actions taken and the amounts recovered
- when and how the corporation ceased business operations (where applicable)
- evidence that a **Direction to Enforce Writ** was executed and returned "Satisfied in Whole or in Part" (where applicable)
- that a Proof of Claim was filed within 6 months of the corporation's assignment in bankruptcy, receivership, or liquidation/dissolution proceeding (where applicable)
- a list of all the director(s) of record and whether they are eligible for assessment
- any details regarding due diligence claimed or not claimed by the director(s) of record
- the amounts for which the directors of record will be assessed
- details regarding the collectibility of the proposed assessment against the director(s) of record
- the opinion requested from the Department of Justice where one was required in respect of the proposed assessment

6) The name(s) of the applicable authority level(s) for signature

Note: A detailed Memorandum as noted above will also serve to provide the Appeals Division with a complete summary of the account in the likelihood of a Notice of Objection being filed.

Completion of a Director's Liability Notice of Assessment Form

A Notice of Assessment Form can be completed upon receipt of **written concurrence** from the applicable delegated authority.

Note: Local TSO Divisional Policy will determine at what stage the Notice of Assessment Form is completed. Some Collections Divisions require that the applicable Notice of Assessment Form be completed after Managerial approval while others allow for its completion concurrent with the Approval Memorandum. Please refer to your local policy for the approved workflow.

A Director's Liability Notice of Assessment consists of the following two components:

- a form T779 for source deductions and/or a form GST 259 for GST/HST amounts; and
- an attachment detailing the assessment known as the Particulars of Assessment

Completion of the T779 Form

Digitized by Google

The T779 Notice of Assessment Form is composed of two parts:

- Part 1 being the "Assessment Portion", and
- Part 2 being the "Remittance Form" portion

The following is a breakdown detailing all the required components within each part:

Part 1:

1. In the area identified as **"Control No"**:
   - Insert the control number of the Notice of Assessment if not already printed.
2. In the area identified as **"Date of Mailing"**:
   - Insert the date of mailing of the Notice of Assessment.
3. In the area identified as **"Tax Services Office"**:
   - Insert the name of the Tax Services Office that generated the assessment.
4. In the area identified as **"Total amount assessed"**:
   - Insert the total amount assessed as identified within the Particulars of Assessment.
5. In the area identified as **"Name/Address"**:
   - Insert the full name (including all known aliases) of the director being assessed, and
   - Insert the mailing address of the director being assessed.

   Note: It is imperative that the mailing address used is correct. Mail the Notice of Assessment to the designated address as provided by the director. If no such address has been supplied, use all internal and external sources available to confirm the proper mailing address.
6. In the area identified as **"This notice of Assessment/Reassessment is in respect of the following"**:
   - Insert the appropriate ITA S.227.1 assessment verse.

     Note: Refer to **Director's Liability Assessment Verses** for the appropriate wording.
   - Insert as a reference contact the Collections Officer's name and phone number.
7. In the area identified as Commissioner of the Canada Revenue Agency
   - Insert the Commissioner's name.

Part 2:

Digitized by Google

1. In the area identified as **"Remitted by"**:

   - Insert the name and address of the director being assessed.

   Note: The name and address should be the same as what is indicated within Part 1.

2. In the area identified as **"Mail this part with your payment to"**:

   - Insert the Ottawa Technology Centre address.

3. In the area identified as **"TSO Code"**:

   - Insert your TSO code number.

4. In the area identified as **"Assessment in respect of"**:

   - Insert the name of the corporation to which the assessment pertains, and

   - Insert the account number of the corporation to which the assessment pertains.

For an example see T779 Notice of Assessment Form (these forms are read only, existing forms have been used and updated forms with the CRA name will be inserted at a later date).

Completion of the GST259 Form

The GST259 Notice of Assessment Form is composed of two parts:

- Part 1 being the "Assessment Portion", and

- Part 2 being the "Remittance Form" portion

The following is a breakdown detailing all the required components within each part:

Part 1:

1. In the area identified as **"Control No"**:

   - Insert the control number of the Notice of Assessment.

2. In the area identified as **"Name and Address"**:

   - Insert the full name (including all known aliases) of the director being assessed, and

   - Insert the mailing address of the director being assessed.

   Note: It is imperative that the mailing address used is correct. Mail the Notice of Assessment to the designated address as provided by the director. If no such address has been supplied, use all internal and external sources available to confirm the proper mailing address.

3. In the area identified as **"Mailing Date"**:

Digitized by Google

- Insert the date of mailing of the Notice of Assessment.

4. In the area identified as **"Business Number"**:

   - Insert the account number of the corporation to which the director's liability pertains.

5. In the area identified as **"Reference No"**:

   - Insert the RDP (Regional District Province) code along with the business number noted above.

6. In the area identified as **"This Notice of Assessment is issued in respect of the liability under"**:

   - Insert the appropriate GST 323(1) assessment verse.

   Note: Refer to **Director's Liability Assessment Verses** for the appropriate wording.

7. In the area identified as **"Amount Assessed"**:

   - Insert the total amount assessed as identified within the Particulars of Assessment.

8. In the area identified as **"For more information, please contact"**:

   - Insert the Collection Officer's name, phone number and the Tax Services office address.

9. In the area identified as Commissioner of the Canada Revenue Agency

   - Insert the Commissioner's name.

Part 2:

1. In the area identified as **"Business Number"**:

   - Insert the account number of the corporation to which the director's liability pertains.

2. In the area identified as **"For the Account of"**:

- Insert the name of the corporation to which the director's liability pertains.

3. In the area identified as **"Remitted by"**:

   - Insert the full name (including all known aliases) of the director being assessed as identified in the area **"Name and Address"**.

4. In the area identified as **"Reference No"**:

   - Insert the RDP (Regional District Province) code along with the business number noted above.

Digitized by Google

Please refer to **GST259 Notice of Assessment Form** for an example. (These forms are read only existing forms have been used and updated forms with the CRA name will be inserted at a later date.)

Director's Liability Assessment Verses

Use the following verse in assessments issued to a director(s) for ITA subsection 227.1 assessments:

> The liability under subsection 227.1 (1) of the *Income Tax Act* and (insert the corresponding liability under the *Provincial Tax Act* (*)), subsection 21.1 (1) of the Canada Pension Plan, and subsection 83(1) of the *Employment Insurance Act*, (**) in the amount of $**(insert total amount assessed)** being the amount of the unpaid deductions, interest and penalties payable by **(insert name of corporation)** in respect of a Notice of Assessment dated **(insert date(s) of the Notice of Assessment(s) issued against the corporation) (***)**. Please see the attached Particulars of Assessment for additional information.
>
> Note **(*)**: For a list of corresponding applicable Provincial Tax Acts refer to the chapter **Memorandum Assessments, Provincial Statutory Authority to Impose Liability.**
>
> Note **(**)**: Amounts withheld before June 30, 1996 must include "and subsection 54(1) of the *Unemployment Insurance Act (1994)*."
>
> Note **(***)**: In the case of multiple assessment dates use the term "in respect of Notices of Assessment dated (insert the assessment dates)."

ITA example:

> The liability under subsection 227.1 (1) of the *Income Tax Act* and section 57 of the *British Columbia Income Tax Act*, subsection 21.1 (1) of the Canada Pension Plan, and subsection 83(1) of the *Employment Insurance Act*, in the amount of $100,000.00 being the amount of the unpaid deductions, interest and penalties payable by ABC Limited in respect of Notices of Assessment dated January 10, 2004, October 15, 2004 and February 2, 2005. Please see the attached Particulars of Assessment for additional information.

Use the following verse in assessments issued to a director(s) for ETA subsection 323(1) assessments:

> The liability under subsection 323(1) of the *Excise Tax Act* in the amount of $ **(insert total amount assessed)** in respect of a failure to remit net tax as required under subsection 228(2) by **(name of registrant)** on or about **(date(s) of failure)**. Please see the attached Particulars of Assessment for additional information.

ETA example:

> The liability under subsection 323(1) of the *Excise Tax Act* in the amount of $100,000.00 in respect of a failure to remit net tax as required under subsection

Digitized by Google

228(2) by ABC Limited on or about March 31, 2005, April 30, 2005, May 31, 2005 and July 31, 2005. Please see the attached Particulars of Assessment for additional information.

Use the following verse in assessments issued to a director(s) for ATSCA subsection 81(1) assessments:

The liability under subsection 81(1) of the *Air Travellers Security Charge Act* in the amount of $_____ being unpaid amounts owing and interest (until the Act is amended, we cannot include penalties in Director's liability assessments because the wording does not include penalties) payable by (insert name of corporation) in respect of a Notice of Assessment dated (insert date of the Notice of Assessment issued against the corporation). Please see the particulars of the assessment for additional information.

ASTCA example:

The liability under subsection 81(1) of the *Air Travellers Security Charge Act* in the amount of $10,000.00 being unpaid amounts owing and interest payable by ABC Limited in respect of Notices of Assessment dated March 31, 2005 and April 30, 2005. Please see the particulars of the assessment for additional information.

Notice of Reassessment for Director's Liability Where a Notice of Objection Exists

Please review the section entitled, **Reassessing Joint and Several Liabilities**, prior to the completion of a reassessment to any Director's Liability assessment.

Note: The reassessment balance is the new balance owing and not the difference between the original assessment balance and the newly reassessed balance owing. For example, if the original assessed balance is $100,000 and the reassessed balance is now $80,000, the amount indicated above must be $80,000 and not $20,000.

Use the following verse for reassessments issued to a director(s) for ITA subsection 227.1 assessments:

The above adjustment is issued in response to your notice of objection and the Notice of Reassessment is issued under paragraph 165(3) of the *Income Tax Act*. The reassessment concerning the obligation under subsection 227.1 of the *Income Tax Act* and **(insert the corresponding liability under the *Provincial Tax Act*, Canada Pension Plan, *Employment Insurance Act*, and/or *Unemployment Insurance Act*)** in the amount of **$(insert reassessment balance)**, amends the previous Notice of Assessment dated **(insert original date of assessment)** bearing # **(insert control number from original assessment)**. Please see the attached Particulars of Reassessment for additional information.

ITA example:

The above adjustment is issued in response to your notice of objection and the Notice of Reassessment is issued under paragraph 165(3) of the *Income Tax Act*. The reassessment concerning the obligation under subsection 227.1 of the *Income*

Digitized by Google

Tax Act and section 57 of the *British Columbia Income Tax Act*, subsection 21.1(1) of the Canada Pension Plan, and subsection 83(1) of the *Employment Insurance Act*, in the amount of $80,000.00, amends the previous Notice of Assessment dated April 1, 2005 bearing # 123456. Please see the attached Particulars of Reassessment for additional information.

Use the following verse for reassessments issued to a director(s) for ETA subsection 323(1) assessments:

The above adjustment is issued in response to your notice of objection and the Notice of Reassessment is issued under paragraphs 301(3) and 301(5) of the *Excise Tax Act* in the amount of **$(Insert reassessment balance)**, amends the previous Notice of Assessment dated **(insert original date of assessment)** bearing **# (Insert control number from original assessment)**. Please see the attached Particulars of Reassessment for additional information.

ETA example:

The above adjustment is issued in response to your notice of objection and the Notice of Reassessment is issued under paragraphs 301(3) and 301(5) of the *Excise Tax Act* in the amount of $80,000.00, amends the previous Notice of Assessment dated August 15, 2005 bearing # 123456. Please see the attached Particulars of Reassessment for additional information.

Use the following verse for reassessments issued to a director(s) for ATSCA subsection 81(1) assessments:

The above adjustment is issued in response to your notice of objection and the Notice of Reassessment is issued under subsection 43 (8) of the *Air Travellers Security Charge Act* in the amount of $**(insert reassessment balance)**, amends the previous Notice of Assessment dated **(insert original date of assessment)** bearing **# (insert control number from original assessment)**. Please see the attached Particulars of Reassessment for additional information.

ATSCA example:

The above adjustment is issued in response to your notice of objection and the Notice of Reassessment is issued under subsection 43(8) of the *Air Travellers Security Charge Act* in the amount of $80,000.00, amends the previous Notice of Assessment dated August 15, 2005 bearing # 123456. Please see the attached Particulars of Reassessment for additional information

Notice of Reassessment for Director's Liability Where No Objection or Appeal Exists

Circumstance may arise wherein amounts that have been assessed may warrant a re-determination or re-calculation. Revenue Collections Divisions may reconsider the amount of a third party's liability and issue a reassessment to adjust the amount when there is a proper basis to do so and an objection or appeal **is not** outstanding. For further details refer to the sections **Resolving a Disputed Memorandum Assessment** and **Request for Adjustment to a Memorandum Assessment.**

Note: The reassessment balance is the new balance owing and not the difference between the original assessment balance and the newly reassessed balance owing.

Digitized by Google

For example, if the original assessed balance is $100,000 and the reassessed balance is now $80,000, the amount indicated above must be $80,000 and not $20,000.

Use the following verse for reassessments issued to a director(s) for ITA subsection 227.1 assessments **where a third party has provided information prior to the filing of an Objection or Appeal that would result in an amendment to the original amount assessed:**

The above adjustment is issued in response to additional information provided. The reassessment concerning the obligation under subsection 227.1 of the *Income Tax Act* and **(insert the corresponding liability under the *Provincial Tax Act*, Canada Pension Plan, *Employment Insurance Act*, and/or *Unemployment Insurance Act*)** in the amount of **$(insert reassessment balance; see "Note" below)**, amends the previous Notice of Assessment dated **(insert original date of assessment)** bearing # **(insert control number from original assessment).** Please see the attached Particulars of Reassessment for additional information.

ITA example:

The above adjustment is issued in response to additional information provided. The reassessment concerning the obligation under subsection 227.1 of the *Income Tax Act* and section 57 of the *British Columbia Income Tax Act*, subsection 21.1(1) of the Canada Pension Plan, and subsection 83(1) of the *Employment Insurance Act*, in the amount of $80,000.00, amends the previous Notice of Assessment dated April 1, 2005 bearing # 123456. Please see the attached Particulars of Reassessment for additional information.

Use the following verse for reassessments issued to a director(s) for ETA subsection 323(1) assessments **where a third party has provided information prior to the filing of an Objection or Appeal that would result in an amendment to the original amount assessed:**

The above adjustment is issued in response to additional information provided. The reassessment concerning the obligation under subsection 323(1) of the *Excise Tax Act* in the amount of **$(insert reassessment balance; see "Note" below)**, amends the previous Notice of Assessment dated **(insert original date of assessment)** bearing # **(insert control number from original assessment).** Please see the attached Particulars of Reassessment for additional information.

ETA example:

The above adjustment is issued in response to additional information provided. The reassessment concerning the obligation under subsection 323(1) of the *Excise Tax Act* in the amount of $80,000.00, amends the previous Notice of Assessment dated August 15, 2005 bearing # 123456. Please see the attached Particulars of Reassessment for additional information.

Use the following verse for reassessments issued to a director(s) for ATSCA subsection 81(1) assessments **where a third party has provided information prior to the filing of**

Digitized by Google

an Objection or Appeal that would result in an amendment to the original amount assessed:

The above adjustment is issued in response to additional information provided. The reassessment concerning the obligation under subsection 81(1) of the *Air Travellers Security Charge Act* in the amount of **$(insert reassessment balance; see "Note" below)**, amends the previous Notice of Assessment dated **(insert original date of assessment)** bearing **# (insert control number from original assessment).** Please see the attached Particulars of Reassessment for additional information.

ATSCA example:

The above adjustment is issued in response to additional information provided. The reassessment concerning the obligation under subsection 81(1) of the *Air Travellers Security Charge Act* in the amount of $80,000.00, amends the previous Notice of Assessment dated August 15, 2005 bearing # 123456. Please see the attached Particulars of Reassessment for additional information

Additional Assessment for Director's Liability

Use the following verse in circumstances where an Additional Assessment for a director's liability is required:

An additional assessment pertaining to the liability under **(insert section or subsection of the ITA, ETA or ATSCA)** and **(insert the corresponding liability under the *Provincial Tax Act*, Canada Pension Plan, *Employment Insurance Act*, and *Unemployment Insurance Act*)** in the amount of **$(insert additional assessment amount)** and is in addition to the assessment dated **(insert original assessment date)** bearing **# (insert control number from original assessment).** Please see the attached Particulars of Assessment for additional information.

ITA example:

An additional assessment pertaining to the liability under subsection 227.1 (1) of the *Income Tax Act* and section 57 of the *British Columbia Income Tax Act*, subsection 21.1 (1) of the Canada Pension Plan, and subsection 83(1) of the *Employment Insurance Act* in the amount of $150,000.00 and is in addition to the assessment dated April 1, 2005 bearing # 123456. Please see the attached Particulars of Assessment for additional information.

ETA example:

An additional assessment pertaining to the liability under subsection 323(1) of the *Excise Tax Act* in the amount of $150,000.00 and is in addition to the assessment dated August 15, 2005 bearing # 123456. Please see the attached Particulars of Assessment for additional information.

ATSCA example:

An additional assessment pertaining to the liability under subsection 81(1) of the *Air Travellers Security Charge Act* in the amount of $150,000.00 and is in addition to the assessment dated August 15, 2005 bearing # 123456. Please see the attached Particulars of Assessment for additional information.

Cancellation of Director's Liability Assessment

Digitized by Google

A director's liability assessment may require it to be cancelled upon instruction from the Appeals Division.

Use the following verse for the cancellation of ITA director's liability assessments:

> The above adjustment is issued in response to your notice of objection and the Notice of Assessment is issued under paragraph 165(3) of the *Income Tax Act*. This notice cancels the Notice of Assessment dated **(insert original date of assessment)** bearing # **(insert control number from original assessment).**

Use the following verse for the cancellation of ETA director's liability assessments:

> The above adjustment is issued in response to your notice of objection and the Notice of Assessment is issued under paragraphs 301(3) and 301(5) of the *Excise Tax Act*. This notice cancels the Notice of Assessment dated **(insert original date of assessment)** bearing # **(insert control number from original assessment).**

Use the following verse for the cancellation of ATSCA director's liability assessments:

> The above adjustment is issued in response to your notice of objection and the Notice of Assessment is issued under subsection 43 (8) of the *Air Travellers Security Charge Act*. This notice cancels the Notice of Assessment dated **(insert original date of assessment)** bearing # **(insert control number from original assessment).**

Director's Liability Particulars of Assessment

In order to explain and support any memorandum assessment, you must always prepare a separate attachment known as the Particulars of Assessment.

In the case of a director's liability assessment, the Particulars of Assessment must indicate the following:

- the name of the principle tax debtor and the account number
- the name and the account number of the person being held jointly and severally liable
- the date of the joint and several liability
- the dates of all applicable failure to remit assessments (source deductions), failure to remit net tax assessments (GST/HST) or failure to remit security charge amounts (ATSCA)
- for source deductions, the amount of federal tax, provincial tax, employment insurance premiums, unemployment insurance premiums and CPP contributions for each assessment period owing
- for GST/HST, the period end date of each assessment owing
- for GST/HST, the amount of tax owing for each assessment period owing

Digitized by Google

- for ATSCA, the fiscal month end date of each assessment owing
- for ATSCA, the amount of charges owing for each assessment period owing
- all applicable penalty and interest for each assessment period owing

  For details refer to the section **Interest Charges on Director's Liability Memorandum Assessments**.

  Note: Penalties can not be included in Director's Liability Memorandum Assessments raised under the ATSCA.

- the total amount assessed
- reference to all the relevant sections of the Acts used to assess

For further details refer to **Amounts Not to Be Included Within the Particulars of Assessment**.

In addition, a specific comment must be entered within the attachment that clearly makes the link between the Notice of Assessment form being issued and the Particulars of Assessment. Therefore the following notation should be noted within the attachment:

> This attachment is in addition to and forms part of the attached Notice of Assessment dated **(insert date of assessment)** bearing **# (insert control number of Form T779 or GST 259 Form)**.

In circumstances where the director's liability assessment requires the completion of a reassessment or an additional assessment an amended Particulars of Assessment or Particulars of reassessment is required.

For examples of how a directors' liability Particulars of Assessment should look like, refer to the following:

- **ITA Subsection 227.1 Particulars of Assessment**
- **ETA Subsection 323(1) Particulars of Assessment**

Amounts Not to Be Included Within the Particulars of Assessment

The following are not to be included within the Particulars of Assessment:

- law costs
- T4 Late Penalties nor any interest attached to these penalties

Amended Director's Liability Particulars of Assessment

In circumstances where the director's liability assessment requires the completion of a reassessment or additional assessment an amended Particulars of Assessment or Particulars of Reassessment is required.

Digitized by Google

The contents of amended Particulars of Assessment/Reassessment should include all the items as outlined within the section **Director's Liability Particulars of Assessment**, including:

- an accounting sufficient to detail the basis for the reassessment or additional assessment, and
- the revised balance

Note: The details of any amended Particulars of Assessment or Reassessment must provide a link between what is being assessed/reassessed with what was originally assessed.

Interest Charges on Director's Liability Memorandum Assessments

On memorandum assessments specific to director's liability, interest is charged:

- from the date of the corporation's failure to deduct, withhold, remit or pay its required source deductions or its GST/HST net tax

Note: A memorandum assessment, including interest charges, cannot exceed the total amount of the primary debt. In a case where the primary debtor is declared bankrupt, interest ceases to be charged against the primary (bankrupt) account. However, interest may still be charged to the memorandum assessment until such time as the debit equals that of the primary account as of the date of bankruptcy.

Collection Action on Directors' Liability Assessments

Under Section 225.1 of the *Income Tax Act*, the 90 days collection restrictions must be observed before taking legal action. Although the *Excise Tax Act* and *Air Travellers Security Charge Act* permit immediate collection action on mailing of a Notice of Assessment, collection action on all Memorandum Assessments will be held in abeyance for ninety days (appeal period).

However, for amounts under the *Excise Tax Act* and the *Air Travellers Security Charge Act*, the ninety days restriction is not applicable in cases where the Tax Services Office determines the existence of a potential danger of loss. In such instances, advise Headquarters through your applicable **Field Support** representative, of the details surrounding the case, requesting authority to waive the ninety-day period.

Note: It is recommended that the referral made to Field Support be in the same style and manner as used within a Jeopardy proceeding. Therefore, Collections Officers should complete both a "Statement of Facts" and a "Risk Analysis" for review by Field Support. This process is required so that it can be clearly shown that on the balance of probabilities, any further delay in collection action would place the account at risk. For further details regarding the steps required to prepare these documents, refer to the **Collection in Jeopardy** chapter, specifically the sections entitled, **Completing a Statement of Facts** and **Risk Analysis**. The referral to Field Support can be made via e-mail providing that the above are included within. For further information please contact your applicable Field Support representative.

If the primary debt is under Appeal or the primary tax debtor filed a Notice of Objection, Collection action should not be initiated on the memorandum assessment, until such time that the Appeal is resolved.

Digitized by Google

Related Topic:

- **Collection Measures**

Collection Measures

Memorandum assessments, including those relating to Directors' Liability, are collected in the same manner as T1 accounts. In Directors' Liability the debts assessed are in fact jointly and severally liable to the primary debt owing; however the "trust" status of the primary debts does not extend itself to the memorandum assessment.

The following Collection measures should be undertaken immediately upon the issuance of a Directors' Liability assessment:

- Set up a Keep Code 6 against the director(s) assessed; this will ensure that any T1 refund created from an Allowable Business Investment Loss or other credit to which the director(s) is entitled is intercepted and retained. For further details regarding Keep Code 6, refer to the Chapter **Receiving and Managing Accounts** and for information on Allowable Business Investment Loss consult **Director's Liability Handbook HQ8920-000**.

- Issue the required routine Collections letters available in the ELCS system during the 90 day collections restriction period:

  1. At 30 days from the issuance of the Notice of Assessment, issue the "First Collection Letter", ELCS 19619.

  2. At 60 days from the issuance of the Notice of Assessment, issue the "Second Collection Letter", ELCS 19620.

  3. At 90 days from the issuance of the Notice of Assessment, issue the "Pre-Legal Letter", ELCS 19621.

  Note: Any actions taken must be done in accordance with the Collections restrictions noted in the above section Collection Action on Directors' Liability Assessments.

- Update the ACSES diary or GST Log of Action confirming the issuance the routine Collection letters.

- It is mandatory to try to contact the director after the 90-day period has elapsed. If no response has been made to the routine collections letters issued, proceed with the issuance the "Legal Action Letter" (ELCS 19614) giving the director 15 days to satisfy the assessed liability.

- Update the ACSES diary or GST Log of Action confirming the issuance the "Legal Action Letter".

- If no Notice of Objection is filed, or if the director has not responded to any of the legal warning letters issued, proceed with legal action to resolve the account.

Digitized by Google

Maintaining the Director's Liability Assessment

Maintaining the Director's Liability Assessment involves updating all applicable accounts on the system, the proper retention of all applicable documents and the proper application of payments received.

Related Topics:

- Updating all Applicable Accounts
- Preparing the Working Paper
- Maintaining Documents When the Assessment is Raised
- Retention of Primary Assessment Information

Updating all Applicable Accounts

To update the account:

1. Create a dummy account card using the 2nd copy of Form T779. As no such copy exists with Form GST259, it is recommended that you use a photocopy of the completed Form GST259 used in the assessment.

2. Cross-reference the account card to the primary tax debtor.

3. Make a diary notation of the joint and several liability on the **primary tax debtor's account**, within the ACSES system including:

   - the name (including all known aliases) of the director(s) assessed
   - the account number(s) of the director(s) assessed
   - the applicable section of the Act under which the liability arose, i.e. ITA 227.1(1) or ETA 323(1)
   - the amount assessed
   - the date of assessment (being the mailing date of the Notice of Assessment)
   - how the Notice of Assessment was issued (certified mail, hand delivery)

4. Make a diary notation of the joint and several liability **on the director's account,** within the ACSES system including;

   - the name and the business number of the primary tax debtor to which the joint and several liability relates to;
   - the applicable section of the Act under which the liability arose, i.e. ITA 227.1(1) or ETA 323(1)
   - the amount assessed

Digitized by Google

- the date of assessment (being the mailing date of the Notice of Assessment)
- how the Notice of Assessment was issued (certified mail, hand delivery)

Note: If multiple directors are assessed, the ACSES account of each director should be updated with the assessment information noted above of each director assessed. This will ensure that proper cross-referencing of information will occur.

5. Record any payments or credits received on the dummy card or "Working Paper", including:
   - the date of payment
   - the amount paid and from/by which director it was received

   Note: If the payment is made by cheque, record sufficient detail to allow for the identification of the financial institution, the branch location, the account holders and the account number.

   - the taxation year the payment is being applied to

   Note: Refer to the section **Applying Payments** for further detail.

   - record any interest charges as a memo entry within the dummy card. Do not post to the memorandum assessment account.
6. Make a diary notation in the ACSES account of both the primary tax debtor and the director(s), detailing the payments received and the information to be noted within the dummy card/working paper.

Preparing the Working Paper

The Working Paper will act as the summary of all the information to which the assessment is based upon. The Working Paper will provide written documentation to:

- identify the director(s) liability
- identify the basis for the memorandum assessment

Note: It is sufficient to use the assessment's Approval Memorandum as the basis for the Working Paper. Should an Approval Memorandum not exist, then a Working Paper should be prepared. Refer to the section, **Approval Memorandum** for details.

To prepare the Working Paper:

1. Summarize the director's identification, including:
   - full name
   - account number
2. Provide a breakdown of the primary corporate liability, including:
   - dates of assessments

Digitized by Google

- details of assessments, including:
  - federal tax
  - provincial tax
  - Canada Pension Plan
  - employment insurance
  - corresponding penalties
  - corresponding interest

Note: It is sufficient to attach a copy of the Particulars of Assessment to the Working Paper if the primary corporate balance equals the director's assessed balance.

3. Details of payments made to the primary corporate debt, including:
   - dates
   - amount of payments

   Refer to **Applying Payments** for the proper allocation method.

4. Details of director's liability, including:
   - the director's name
   - account number
   - amount of assessment
   - date of assessment
   - Notice of Assessment's control number
   - applicable sections of the Acts assessment raised under

5. Details of the memorandum assessment, including the component amount, for example: portion of federal tax, provincial tax, pension plan, etc. that makes up the assessment.

   Note: It is sufficient to attach a copy of the Particulars of Assessment.

6. The working paper and all related primary debt information is to be obtained and retained until the file has been concluded. A separate docket must be established for the retention of all information relating to the original assessment and third party assessment. Refer to the section, **Maintaining Documents When the Assessment is Raised**.

Digitized by Google

Maintaining Documents When the Assessment is Raised

Maintain the following documents in a docket when an assessment is raised. This docket should be associated at all times with any docket pertaining to the primary debtor account:

- directors' information including:
  - evidence supporting the fact that the person was a director during the relevant time
  - directors' financial data
  - documentation related to history

  Note: This is when the assessment is being raised on a repeat instance of failure to exercise due diligence.
  - copy of tax debtor's response to the pre-assessment proposal letter
  - copies of any correspondence
- spreadsheet (account reconciliation) detailing how the debt was arrived at, including:
  - month(s) or filing periods
  - year(s)
  - amounts of Federal tax
  - amounts of Unemployment/Employment Insurance premiums
  - amounts of Canada Pension Plan contributions
  - amounts of Goods and Services net tax
  - applicable interest
  - applicable penalty

  Note: These are reconciled to the Proof of Claim, Federal Certificate, Writ of Seizure and Sale or Memorial of Judgment.
- copy of any legal documents, including:
  - Certificate
  - Writ of Seizure and Sale
  - Return of Nulla Bona

Digitized by Google

- Partial Return of Execution
- Proof of Claim

- acknowledgment of the registered mail, Receipt Card
- if applicable, memorandum to file regarding the telephone conversation(s) with the director(s) when no response was received to the pre-assessment proposal letter
- copies of all correspondence to and from the Department of Justice
- copies of the assessment information, including:
  - trust or GST audit documents
  - memorandum Notice of Assessment/Reassessment

Retention of Primary Assessment Information

Collections Officers should obtain and retain primary debt information until such time as the file has been:

- paid in full
- resolved at all Appeals stages
- deleted from active inventory

A separate docket must be established for the retention of all information relating to the primary assessment. The docket should include the following:

- the Notice of Assessment of the primary account
- all pertinent audit information
- tax years for all affected taxation years
- all pertinent trust account information

Note: Adverse case law in respect of third party assessments holds that even though the primary debtor may not have appealed or objected to an original amount owing, the secondary debtor (person to which the memorandum assessment is issued) is entitled to object or appeal the amounts relating to the primary debtor's assessment. Furthermore, within these decisions, the Courts have required that the Agency produce the Notices of Assessment and/or the underlying information supporting the primary debtor's assessment.

For further details refer to Memorandum 01-09, entitled **Third Party Assessments - Retention of Primary Assessment Information**.

Applying Payments

Digitized by Google

Note: Appeals Officers handling an objection have complete **decisional independence** relative to the recommendation to confirm, vacate, or vary the assessment.

The Revenue Collections Officer will:

- provide a copy of the report explaining the basis of the assessment and all supporting documentation (not the entire Collections docket) to the Appeals Officer within five (5) working days of the request by Appeals
- explain the basis of the assessment when requested to do so by the Appeals Officer
- attend meetings with the Appeals Officer and the client, when requested to do so by the Appeals Officer and when the client agrees
- review any new or additional information, if requested by the Appeals Officer, and provide comments in writing within fifteen (15) working days of date of the request
- arrange for the issuance of a Notice of Reassessment, where the assessment is varied or vacated by the Appeals Officer, within ten (10) working days of the date of the request

3. Collection action is not taken against a debt until a decision is received from the first level of the Appeal process (Tax Court of Canada). For details refer to the section, **Collection Action on Directors' Liability Assessments**.

4. If the tax debtor advises that an appeal will be made to the Federal Court of Canada, payment in full or acceptable security covering the amount in dispute is required.

5. As noted above, if the assessment is varied or vacated, complete a Notice of Reassessment within ten (10) working days from the date of request. Refer to the section **Notice of Reassessment for Director's Liability Where a Notice of Objection Exists** for further detail.

6. Send the Notice of Reassessment to the tax debtor.

Directors' Entitlement to Preference

A director who pays an amount in respect of the balance owing that is proved in liquidation, dissolution or bankruptcy proceedings, is, pursuant to subsection 227.1(6) of the ITA and subsection 323(7) of the ETA, entitled to any preference that the Crown would have been entitled to had that amount not been so paid.

Where a Certificate that relates to that amount was registered, the director is entitled to an assignment of the certificate to the extent of the directors' payment.

Once the assignment has been made, the director will hold the same rights and remedies previously available to the Agency. For example, the director will be able to file a Proof of Claim within the estate of the bankrupt corporation with a value equal to that of the assignment made.

Related Topics:

Digitized by Google

- **Assignment of Certificate**
- **Obtaining Approval**
- **Examples of an Assignment of Certificate**

Assignment of Certificate

It is recommended that written approval be sought prior to the Assignment being issued in the form of a Memorandum addressed to the applicable signing authority.

The Memorandum should include the following information:

1. Name of the director to which the Assignment will be made
2. Name of the debtor company
3. TSO date of the account
4. Total of the debt outstanding
5. The Certificate's number and the date issued from the Federal Court
6. A detailed summary outlining the Collections history of the account including information relating to the director's satisfaction of the corporate liability
7. The name(s) of the applicable authority level(s) for signature

Obtaining Approval

The delegated approval levels for the assignment of a certificate are as follows:

- Director, Tax Services Office
- Assistant Director, Revenue Collections Division
- Manager, Revenue Collections Division

For further details please refer to Memorandum 01-21, entitled, **Delegation of the Minister's Powers under the Income Tax Act, Excise Tax Act and Customs Act**.

> Note: Local Collections Divisional Policy will dictate which of the above authority levels will be used.

Examples of an Assignment of Certificate

For examples of an Assignment of Certificate refer to the following:

- **Appendix "A": ITA Subsection 227.1(6) Assignment of Certificate**
- **Appendix "B": ETA Subsection 323(7) Assignment of Certificate**

Digitized by Google

Note: The above examples are not templates but merely samples of the suggested wording to be used.

If you have any questions, please contact your appropriate Field Support representative.

Resource Material

Training and Learning Directorate, Director's Liability Handbook (HQ8920), issued May 2004.

Training and Learning Directorate, Liability of Directors (TD8600), issued September 2000.

Directive RCD-95-12, Directors' Liability, issued December 20, 1995.

Directive RCD-96-09, Directors' Liability, issued May 3, 1996.

Directive RCD-96-13, Application of Interest in Respect of Memorandum Assessments, issued October 27, 2004.

Directive RCD-96-14, The Employment Insurance Act, issued October 29, 1996.

Directive RCD-00-11, Assessing Directors for GST When Corporation are in a Partnership, issued May 31, 2000.

Directive RCD-00-25, Proving a Directors' Liability Claim in a Proposal in a Bankruptcy, issued September 15, 2000.

Memorandum 99-03, Laboratory and Scientific Services, issued March 15, 1999

Memorandum 01-09, Third Party Assessments - Retention of Primary Assessment Information, issued July 6, 2001.

Memorandum 02-06, National Protocol Agreement for Memorandum Assessments, issued June 12, 2002.

Communication ARD-2003-002, The Collection of Unwarranted GST/HST Refunds in a Director's Liability Situation, issued October 21, 2003.

Communication ARD-2004-014, Reassessing Joint and Several Liabilities, issued April 8, 2004.

Communication ARD-2004-027, Director's Liability - Bonch v. The Queen, issued June 2, 2004.

APPENDIX

APPENDIX "A"

Court File No.: ITA-**(Insert)**

Digitized by Google

FEDERAL COURT

IN THE MATTER OF the *Income Tax Act*,

and

IN THE MATTER OF an assessment or assessments by the Minister of National Revenue under one or more of the *Income Tax Act*, Canada Pension Plan, *Unemployment Insurance Act*, *Employment Insurance Act* against:

Insert Name of Debtor Corporation (as per Certificate)
Insert Address of Debtor Corporation (as per Certificate)

ASSIGNMENT

WHEAREAS a Certificate in the same style as above was registered under section 223 of the *Income Tax Act* on the **(Insert Certificate Date in this manner; 1st day of July, 2005)** in the Federal Court of Canada under Court File No. ITA **(Insert Certificate number)** for the amount of **$(insert Certificate amount)** together with additional interest pursuant to one or more of the said Act at the rates from time to time prescribed for subsection 222(3) of the *Income Tax Act*, compounded daily, from the **(insert effective interest date in this manner; 15th day of June, 2005)**, to the date of payment, all amounts payable by **(insert name of Debtor Corporation)**, herein called the corporation.

AND WHEAREAS the corporation is liable to pay those amounts under the above enactments;

AND WHEAREAS pursuant to section 227.1 of the *Income Tax Act*, the director of the corporation became jointly and severally liable together with the corporation to pay the aforesaid amounts;

AND WHEAREAS (insert name of director) is or purports to be the director of the corporation, who has paid to the Minister of National Revenue and amount of **$(insert amount paid by the director)** in respect of the amounts which the director and the

Digitized by Google

corporation are jointly and severally liable to pay by virtue of that section.

THE MINISTER OF NATIONAL REVENUE pursuant to subsection 227.1(6) thereof and the corresponding provisions of the above enactments hereby makes an assignment of the Certificate to **(insert name of director)**, the director of the corporation, to the extent only the amount of **$(Insert amount paid by director)** paid to the Receiver General in respect of the amounts for which the director and the corporation are jointly and severally liable to pay as aforesaid.

Dated at , this day of , 2005.

(Insert name and position of authorised person and signature above.)

APPENDIX "B"

Court File No.: GST-**(Insert)**

FEDERAL COURT

IN THE MATTER OF the *Excise Tax Act*,

and

IN THE MATTER OF an assessment or assessments by the Minister of National Revenue under the *Excise Tax Act*:

Insert Name of Debtor Corporation (as per Certificate)
Insert Address of Debtor Corporation (as per Certificate)

ASSIGNMENT

WHEAREAS a Certificate in the same style as above was registered under section 323(1) of the *Excise Tax Act* on the **(Insert Certificate Date in this manner; 1st day of July, 2006)** in the Federal Court of Canada under Court File No. GST-**(Insert Certificate number)** for the amount of **$(Insert Certificate amount)** together with additional interest pursuant to one or more of the said Act at the rates from time to time prescribed for

Digitized by Google

Digitized by Google

Records and books - S. 230

230. (1) Every person carrying on business and every person who is required, by or pursuant to this Act, to pay or collect taxes or other amounts shall keep records and books of account (including an annual inventory kept in prescribed manner) at the person's place of business or residence in Canada or at such other place as may be designated by the Minister, in such form and containing such information as will enable the taxes payable under this Act or the taxes or other amounts that should have been deducted, withheld or collected to be determined. [65]

Records and books

(2) Every qualified donee referred to in paragraphs (*a*) to (*c*) of the definition "qualified donee" in subsection 149.1(1) shall keep records and books of account — in the case of a qualified donee referred to in any of subparagraphs (*a*)(i) and (iii) and paragraphs (*b*) and (*c*) of that definition, at an address in Canada recorded with the Minister or designated by the Minister — containing

---

[65] In Capital Vision Inc., Cvi Art Management, The Capital Vision Group Inc., Bdo Dunwoody LLP, 671514 Ontario Ltd., 1271724 Ontario Inc., Greg Coleman, Ralph T. Neville, Gerry John Hogenhout and Paul Bain v. Minister Of National Revenue, 2002 FCT 1317 such was provided as:
"all documents, including, but not limited to, accounts, agreements, books, charts or tables, correspondence, diagrams, forms, images, invoices, letters, maps, memoranda, plans, returns, statements, telegrams, vouchers, and any other thing containing information, whether in writing or in any other form"

Digitized by Google

(*a*) information in such form as will enable the Minister to determine whether there are any grounds for the revocation of its registration under this Act;
(*b*) a duplicate of each receipt containing prescribed information for a donation received by it; and
(*c*) other information in such form as will enable the Minister to verify the donations to it for which a deduction or tax credit is available under this Act.

Idem, lawyers
(2.1) For greater certainty, the records and books of account required by subsection 230(1) to be kept by a person carrying on business as a lawyer (within the meaning assigned by subsection 232(1)) whether by means of a partnership or otherwise, include all accounting records of the lawyer, including supporting vouchers and cheques.

Minister's requirement to keep records, etc.
(3) Where a person has failed to keep adequate records and books of account for the purposes of this Act, the Minister may require the person to keep such records and books of account as the Minister may specify and that person shall thereafter keep records and books of account as so required.

Limitation period for keeping records, etc.
(4) Every person required by this section to keep records and books of account shall retain
(*a*) the records and books of account referred to in this section in respect of which a period is prescribed, together with every account and voucher necessary to verify the information contained therein, for such period as is prescribed; and
(*b*) all other records and books of account referred to in this section, together with every account and voucher necessary to verify the information contained therein, until the expiration of six years from the end of the last taxation year to which the records and books of account relate.

Electronic records
(4.1) Every person required by this section to keep records who does so electronically shall retain them in an electronically readable format for the retention period referred to in subsection 230(4).

Exemptions
(4.2) The Minister may, on such terms and conditions as are acceptable to the Minister, exempt a person or a class of persons from the requirement in subsection 230(4.1).

Exception where no return filed
(5) Where, in respect of any taxation year, a person referred to in subsection 230(1) has not filed a return with the Minister as and when required by section 150, that person shall retain every record and book of account that is required by this section to be kept and that relates to that taxation year, together with every account and voucher necessary to verify the information contained therein, until the expiration of six years from the day the return for that taxation year is filed.

Exception where objection or appeal
(6) Where a person required by this section to keep records and books of account serves a notice of objection or where that person is a party to an appeal to the Tax Court of Canada

Digitized by Google

under this Act, that person shall retain every record, book of account, account and voucher necessary for dealing with the objection or appeal until, in the case of the serving of a notice of objection, the time provided by section 169 to appeal has elapsed or, in the case of an appeal, until the appeal is disposed of and any further appeal in respect thereof is disposed of or the time for filing any such further appeal has expired.

Exception where demand by Minister
(7) Where the Minister is of the opinion that it is necessary for the administration of this Act, the Minister may, by registered letter or by a demand served personally, require any person required by this section to keep records and books of account to retain those records and books of account, together with every account and voucher necessary to verify the information contained therein, for such period as is specified in the letter or demand.

Permission for earlier disposal
(8) A person required by this section to keep records and books of account may dispose of the records and books of account referred to in this section, together with every account and voucher necessary to verify the information contained therein, before the expiration of the period in respect of which those records and books of account are required to be kept if written permission for their disposal is given by the Minister.

Books and Records Retention/Destruction
IC78-10R4

DATE: **June 2005**
SUBJECT: **Books and Records Retention/Destruction**
This circular cancels and replaces Information Circular 78-10R3 dated October 5, 1998.

Notice to the reader:
This is an HTML version of the original document. It is also available in other formats, including PDF (which is an exact rendition of the original).
This version is only available electronically.

Contents
Introduction
Who has to keep books and records?
Records to be kept
Location of records
Keeping records
Electronic records management and imaging
Retention period
Inspections, audits and examinations
Foreign-based information or documents
Inadequate records
Offences and penalties
Inadequate records and failure to provide information
Appendix
Part LVIII – Keeping books and records

Introduction
1. This circular gives information and guidance to persons who are required by law to keep books

Digitized by Google

and records in French or English in Canada according to sections 230 and 230.1 of the *Income Tax Act*, section 87 of the *Employment Insurance Act*, and section 24 of the *Canada Pension Plan*. It does not reflect the requirements imposed by other statutes, whether federal, provincial/territorial, or municipal, to maintain adequate books and records. IC05-1, *Electronic Record Keeping* contains information related to keeping electronic books and records.

2. The sections and subsections referred to in this circular are from the *Income Tax Act*. Parallel provisions for most of these matters exist in the *Employment Insurance Act* and the *Canada Pension Plan*. Where significant differences do exist, they are indicated. The *Excise Tax Act* has similar requirements and information concerning Books and Records in a GST/HST environment can be found in the GST/HST Memoranda Series 15.1 and 15.2. The *Excise Act, 2001*, also has similar requirements and can be found in Excise Duty Memoranda Series 9.1.1.

Who has to keep books and records?

3. For the purpose of this circular, **person** has the meaning assigned by subsection 248(1) of the *Income Tax Act* (the Act). Therefore, in addition to individuals, a "person" in this context includes a corporation, a trust, and any exempt entity listed in subsection 149(1) of the Act such as a registered charity, a registered Canadian amateur athletic association, and a non-profit organization.

4. Books and records must be kept by every:

person carrying on a business;

person who is required to pay or collect taxes or other amounts according to the acts mentioned in paragraph 1 above;

registered charity or registered Canadian amateur athletic association; and

registered agent of a registered political party or an official agent for a candidate in a federal election.

Records to be kept

5. For the purpose of this circular, a **record** has the meaning assigned by subsection 248(1) of the Act. A " 'record' includes an account, an agreement, a book, a chart or table, a diagram, a form, an image, an invoice, a letter, a map, a memorandum, a plan, a return, a statement, a telegram, a voucher, and any other thing containing information, whether written or in any other form."

6. As a general rule, the Canada Revenue Agency (CRA) does not specify the books and records to be kept. However, books and records have to:

permit the taxes payable or the taxes or other amounts to be collected, withheld, or deducted by a person to be determined;

substantiate the qualification of registered charities or registered Canadian amateur athletic association for registration under the Act;

permit the verification of all charitable, athletic, and political donations received for which a deduction or tax credit is available; and

be supported by source documents that verify the information in the books and records.

7. A **source document** includes items such as sales invoices, purchase invoices, cash register receipts, formal contracts, credit card receipts, delivery slips, deposit slips, work orders, dockets, cheques, bank statements, tax returns, and general correspondence whether written or in any other form.

8. In addition, other documents, whether written or any other form, including supporting documents such as accountants working papers that were used to determine the obligations and entitlements with respect to taxes payable, collectible or to be remitted are considered part of the books and records of the taxpayer and must be made available to the CRA.

Location of records

Digitized by Google

9. The books and records must be kept at the person's place of business or residence in Canada or another place designated by the Minister and must, upon request, be made available to officers of the CRA for audit purposes at all reasonable times. Books and records kept outside Canada and accessed electronically from Canada are not books and records in Canada. Access to electronic records means that the taxpayer must provide an acceptable copy of the electronic records in an electronically readable and useable format to CRA auditors so that they can process the electronic records on CRA equipment.

Keeping records

10. Keeping **books and records** pertains to a system of recording financial and other information. Records are considered to be kept electronically when information is created, processed, maintained and stored electronically.

11. The Canada Revenue Agency recognizes:

traditional books and records (including supporting source documents) produced and retained in paper format; and

books and records produced and retained in an electronically readable format that can be related back to the supporting source documents and which are supported by a system capable of producing an accessible and useable copy. **More information is available in IC05-1** *Electronic Record Keeping*.

12. A person who is required to keep books and records is responsible for keeping the books and records in a way that will ensure the reliability and readability of the information recorded.

13. All books and records (including source documents) that originate in paper format must be kept except where an acceptable imaging or microfilming program, as explained in the following section, is in place. Paper format also includes paper source documents that are entered into an electronic record-keeping system.

14. A person who is required to keep records and who records them electronically must retain those records in an electronically readable format. This means that a person who uses computerized systems to generate books and records must retain the electronic records, even when a hard copy is kept. Electronically readable format means information that is supported by a system capable of producing an accessible and useable copy.

Accessible copy means that the taxpayer must provide an acceptable copy of the electronic records in an electronically readable and useable format to CRA auditors to allow them to process the electronic records on CRA equipment.

A copy is useable if the electronic records can be processed and analysed with CRA software.

The useable copy must be in a common data interchange format that is compatible with CRA software.

Electronic files retained in an encrypted or backup format must be able to be restored at a later date to an accessible and useable state to meet CRA requirements.

The CRA is prepared to offer advice on electronic record-keeping issues and to respond to questions concerning the types of formats that are compatible with the CRA's software. All questions and concerns should be directed to the attention of the Electronic Commerce Audit Specialist (ECAS) at the nearest CRA tax services office. Advice provided by the ECAS must not be construed or viewed as an audit, inspection or a ruling issued by the CRA. It is the person's responsibility to keep, maintain, retain and safeguard its records.

15. A person should ensure that proper back-up records are maintained at all times. If any electronic records required to be maintained are lost, destroyed, or damaged, the person must report this situation to the Director of the local tax services office and recreate the files within a reasonable period of time.

16. A person who keeps records whether in writing or any other form, is not relieved of any of the record keeping, readability, retention, and access responsibilities because he or she contracts out

Digitized by Google

the record keeping function to a third party such as a bookkeeper, accountant, an electronic commerce transaction manager, an application service provider, an Internet service provider, through a time share, service bureau, or other such arrangements. The person must ensure that these requirements are met in the event of third party changes such as, software and/or hardware conversions and upgrades, bankruptcy, or migration to/from a third party. The person is responsible for keeping the records and for providing access to authorized CRA officials.

Electronic records management and imaging

17. When original source documents and records are in an electronic format, they must be kept in an electronically readable format even if they have been transferred to another medium such as microfilm.

18. To ensure the reliablilty, integrity and authenticity of electronic records, the pending national standard publication entitled *Electronic Records as Documentary Evidence* (CAN/CGSB-72.34 2005) will outline electronic record management policies, procedures, practices and documentation that will assist in establishing the legal validity of an electronic record.

19. **Electronic image** means the representation of a source document that can be used to generate an intelligible reproduction of that document, or the reproduction itself.

In the case of paper source document an intelligible reproduction means that:

the reproduction is made with the intention of standing in place of the source document;

the interpretation of the reproduction, for the purposes for which it is being used, gives the same information as the source document; and

the limittions of the reproduction (e.g., resolution, tone, or hues) are well defined and do not obscure significant details.

20. Imaging and microfilm (including microfiche) reproductions of books of original entry and source documents have to be produced, controlled, and maintained according to the latest national standard of Canada, as outlined in the publication called *Microfilm and Electronic Images as Documentary Evidence* (CAN/CGSB-72.11-93).

These standards are available from:

Canadian General Standards Board

Mailing address:

Sales Centre

Canadian General Standards Board

Gatineau, QC K1A 1G6

Street address:

Place du Portage Phase 3, 6B1

11 Laurier Street

Gatineau, Quebec

Telephone number:

Ottawa Area (819) 956-0425 *or*

Toll free from the rest of Canada: 1-800-665-2472

Fax number:

(819) 956-5644

E-mail:

ncr.cgsb-ongc@pwgsc.gc.ca

21. An acceptable imaging program as explained in the Canadian General Standards publications mentioned in paragraph 20 requires that:

(a) a person in authority within the organization has confirmed in writing that the program will be part of the usual and ordinary activity of the organization's business;

(b) systems and procedures are established and documented;

(c) a logbook is kept showing:

Digitized by Google

the date of the imaging;
the signatures of the persons authorizing and performing the imaging;
a description of the records imaged; and
whether source documents are destroyed or disposed of after imaging, and the date a source document was destroyed or disposed of;
(d) the imaging software maintains an index to permit the immediate location of any record, and the software inscribes the imaging date and the name of the person who does the imaging;
(e) the images are of commercial quality and are legible and readable when displayed on a computer screen or reproduced on paper;
(f) a system of inspection and quality control is established to ensure that c), d), and e) above are maintained; and
(g) after reasonable notification, equipment in good working order is available to view, or where feasible, to reproduce a hard copy of the image.
22. Paper source documents that have been imaged in accordance with the latest national standard of Canada (see paragraph 20), may be disposed of and their images kept as permanent records.
23. The taxpayer is responsible for ensuring that the imaging is done in an acceptable manner when the imaging has been done by a third party.

Retention period
24. Books and records have to be kept for the period or periods provided by subsections 230(4) to (7) and Regulation Part 5800 of the *Income Tax Regulations* or until the Minister gives written permission for their disposal. Failure to comply with this requirement could result in prosecution by the CRA.
25. Subsection 230(4.1) of the Act requires every person who keeps records electronically to retain them in an electronically readable format for the retention period outlined in subsection 230(4).
26. Under the Act, books, records, and their related accounts and source documents, other than those referred to in paragraphs **27 and 28** below, have to be kept for a minimum of six years from the end of the last tax year to which they relate. The tax year is the fiscal period for corporations and the calendar year for all other taxpayers. Under the *Employment Insurance Act* and *Canada Pension Plan*, the retention period begins at the end of the calendar year to which the books and records relate.
27. The prescribed retention periods for certain books, records, and their related accounts and source documents are specified in Regulation Part 5800 (see Appendix). The required retention periods can be summarized as follows:
for a corporation, two years from the date of the dissolution of the corporation (in the case of corporations that amalgamate or merge, books and records have to be retained on the basis that the new corporation is a continuation of each amalgamating corporation);
for any non-incorporated business, six years from the end of the tax year in which the business ceased;
for the duplicate donation receipts of a registered charity or registered Canadian amateur athletic association, other than receipts for donations of property which are to be held for a period of not less than ten years, two years from the end of the calendar year in which the donations were made;
for other specified records of registered charities and registered Canadian amateur athletic associations, two years from the date the registration is revoked; and
for records relating to political contributions, two years from the end of the calendar year to which they relate.
There are no similar provisions in the *Employment Insurance Act* or *Canada Pension Plan*.
28. Exceptions to the rules outlined in paragraphs **24 and 25** above are:
The Minister may exempt a person or class of persons from the requirement to keep records electronically according to subsection 230(4.2) of the Act.

Digitized by Google

Books and records may be destroyed at an earlier time than outlined elsewhere in this circular if the Minister gives written permission for their disposal. To get such permission, a person can use Form T137, *Request for Destruction of Books and Records*, or can apply in writing to the director of his or her tax services office. A written request, signed by the person or an authorized representative, should provide the following information:
(a) a clear identification of books, records, or other documents to be destroyed;
(b) the tax years for which the request applies;
(c) details of any special circumstances which would justify destroying the books and records at an earlier time than that normally permitted; and
(d) any other pertinent information.
The Minister may, by registered letter or by a demand, served personally by a representative of the CRA, require specific records to be kept for an additional period of time that will be stipulated in the letter or demand.
If a return required by section 150 of the Act is filed late, the books and records referred to in paragraph **26** above must be kept for six years from the day the return is filed.
Every book and record necessary for dealing with a notice of objection or appeal must be kept until the notice of objection or appeal is disposed of and the time for filing any further appeal has expired.
In the case of paragraph **27** above, only the books and records of a deceased taxpayer or a trust can be destroyed upon receipt of a clearance certificate issued according to subsection 159(2) concerning the distribution of all property.
When the CRA gives permission to destroy books and records, this permission applies only to information required to be kept under the legislation administered by the CRA , and does not imply permission to destroy any books and records required to be kept under any other legislation, or by any other department or government agency.
29. The minimum retention period for the records referred to in paragraph 26 above is generally determined by the last tax year when a record may be required for purposes of the Act, and not the year when the transaction occurred and the record was created. For example, documentation relating to long term transactions such as records supporting the acquisition and capital cost of investments and other capital property held by a person (including registered charities and registered Canadian amateur athletic associations), should be maintained until the day that is six years from the end of the last tax year in which such a transaction could enter into any calculation for income tax purposes.

Inspections, audits and examinations
30. A person authorized by the Minister under section 231.1 may inspect, audit or examine relevant documents, property or processes of any person and of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer. This person may, at reasonable times, enter any premises or place of business and require persons therein to provide reasonable assistance and answer all proper questions.

Foreign-based information or documents
31. “Foreign-based information or documents” refers to any information or document that is available or located outside Canada and that may be relevant to the administration and enforcement of the Act.
32. The Minister may, by notice served personally or by registered or certified mail, require a person resident in Canada or a non-resident person who carries on business in Canada, to provide any foreign-based information and/or documents. It is an offence not to produce any foreign-based information, as and when required.

Digitized by Google

Inadequate records

33. If a person has failed to keep adequate books and records, subsection 230(3) of the Act provides that the Minister can specify what books and records shall be kept.

34. If the CRA finds that the books and records are inadequate, the CRA will ordinarily request a written agreement that books and records be maintained as required. The CRA will follow up the request by letter or visit within a reasonable period of time (usually not less than a month) to ensure compliance.

35. If there has been no compliance within the time allowed, the CRA will issue a formal requirement letter. The letter describes the information to be recorded in the books and describes the legal consequences and penalties for failing to comply.

36. A person who destroys or otherwise disposes of books and records to evade the payment of tax is subject to prosecution according to section 239 of the Act. Information Circular 73-10, *Tax evasion*, discusses CRA policies on tax evasion.

Offences and penalties

Inadequate records and failure to provide information

37. If a person fails to provide any information or documents including books and records, section 231.2 specifies that the Minister can require the person to provide the information or documents requested.

38. If the person fails to maintain adequate books and records or provide the information or documents under section 231.2 such action may result in prosecution by the CRA. On a summary conviction, and in addition to any penalty otherwise payable, a taxpayer is subject to imprisonment and/or a fine not less than $1,000.

39. Alternatively under section 231.7 the Minister may apply to the court for a Compliance Order in which a judge would order the person to provide any access, assistance, information or document sought by the Minister under section 231.1 or 231.2.

40. If a person fails or refuses to comply with an order, a judge may find the person in contempt of court, and the person is subject to the processes and the punishments of the court to which the judge is appointed.

APPENDIX

Part LVIII – Keeping books and records

5800. (1) For the purposes of paragraph 230(4)(a) of the Act, the required retention periods for records and books of account of a person are prescribed as follows:

(a) in respect of

(i) any record of the minutes of meetings of the directors of a corporation,

(ii) any record of the minutes of meetings of the shareholders of a corporation,

(iii) any record of a corporation containing details with respect to the ownership of the shares of the capital stock of the corporation and any transfers thereof,

(iv) the general ledger or other book of final entry containing the summaries of the year-to-year transactions of a corporation, and

(v) any special contracts or agreements necessary to an understanding of the entries in the general ledger or other book of final entry referred to in subparagraph (iv),

the period ending on the day that is two years after the day that the corporation is dissolved;

(b) in respect of all records and books of account that are not described in paragraph (a) of a corporation that is dissolved and in respect of the vouchers and accounts necessary to verify the information in such records and books of account, the period ending on the day that is two years after the day that the corporation is dissolved;

(c) in respect of

Digitized by Google

(i) the general ledger or other book of final entry containing the summaries of the year-to-year transactions of a business of a person (other than a corporation), and
(ii) any special contracts or agreements necessary to an understanding of the entries in the general ledger or other book of final entry referred to in subparagraph (i),
the period ending on the day that is six years after the last day of the taxation year of the person in which the business ceased;
d) in respect of
(i) any record of the minutes of meetings of the executive of a registered charity or registered Canadian amateur athletic association,
(ii) any record of the minutes of meetings of the members of a registered charity or registered Canadian amateur athletic association,
(iii) all documents and by-laws governing a registered charity or registered Canadian amateur athletic association, and
(iv) all records of any donations received by a registered charity that were subject to a direction by the donor that the property given be held by the charity for a period of not less than 10 years,
the period ending on the day that is two years after the date on which the registration of the registered charity or the registered Canadian amateur athletic association under the Act is revoked;
(e) in respect of all records and books of account that are not described in paragraph (d) and that relate to a registered charity or registered Canadian amateur athletic association whose registration under the Act is revoked, and in respect of the vouchers and accounts necessary to verify the information in such records and books of account, the period ending on the day that is two years after the date on which the registration of the registered charity or the registered Canadian amateur athletic association under the Act is revoked;
(f) in respect of duplicates of receipts for donations (other than donations referred to in subparagraph (d)(iv)) that are received by a registered charity or registered Canadian amateur athletic association and are required to be kept by that charity or association pursuant to subsection 230(2) of the Act, the period ending on the day that is two years from the end of the last calendar year to which the receipts relate; and
(g) notwithstanding paragraphs (c) to (f), in respect of all records, books of account, vouchers and accounts of a deceased taxpayer or a trust in respect of which a clearance certificate is issued pursuant to subsection 159(2) of the Act with respect to the distribution of all the property of such deceased taxpayer or trust, the period ending on the day that the clearance certificate is issued.

(2) For the purposes of subsection 230.1(3) of the Act, with respect to the application of paragraph 230(4)(a) of the Act, the required retention period for records and books of account that are required to be kept pursuant to section 230.1 of the Act is prescribed to be the period ending on the day that is two years after the end of the last calendar year to which the records or books of account relate.

Most of Canada Revenue Agency publications are available on the CRA Web site www.cra.gc.ca/formspubs under the heading “Forms and Publications”.

Books, Records and Other Requirements for Taxpayers Having Foreign Affiliates

IC 77-9R

BOOKS, RECORDS AND OTHER REQUIREMENTS FOR TAXPAYERS HAVING FOREIGN AFFILIATES

NUMBER: 77-9R June 22, 1983

This circular cancels and replaces Information Circular 77-9 dated May 24, 1977. Current revisions are designed by vertical lines.

Digitized by Google

1. This circular is for the guidance and information of taxpayers resident in Canada who have foreign affiliates, beneficial interests in certain non-resident trusts deemed by paragraph 94(1)(d) to be non-resident corporations and/or beneficial interests in non-resident discretionary trusts.

Income Tax Returns

2. All taxpayers with foreign affiliates, beneficial interests in certain non-resident trusts deemed by paragraph 94(1)(d) to be non-resident corporations and/or beneficial interests in non-resident discretionary trusts are asked to respond to the following questions with their income tax returns:

(a) Individual Taxpayers (T1 Returns)

(i) Did you have any controlled foreign affiliates at any time during the taxation year?

(ii) Did you, or any controlled foreign affiliate of yours, or any corporation or trust with which you did not deal at arm's length, have a beneficial interest, at any time during the taxation year, in a non-resident discretionary trust to which subsection 94(1) applies?

(b) Corporate Taxpayers (T2 Returns)

(i) Did the corporation have any foreign affiliates at any time during the taxation year?

(ii) Did the corporation, or any controlled foreign affiliate of the corporation, or any other corporation or trust with which the corporation did not deal at arm's length, have a beneficial interest, at any time during the taxation year, in a non-resident discretionary trust to which subsection 94(1) applies?

(c) Trusts (T3 Returns)

(i) Did the trust have any controlled foreign affiliates at any time during the taxation year?

(ii) Did the trust, or any controlled foreign affiliate of the trust, or any corporation or any other trust with which the trust did not deal at arm's length, have a beneficial interest, at any time during the taxation year, in a non-resident discretionary trust to which subsection 94(1) applies?

If a "yes" answer is given to any of the foregoing questions, a supplementary schedule will be required. Where in the case of a corporate taxpayer the positive answer is to question (i), the schedule will require details of the full name and address of each foreign affiliate with a distinction being made between controlled foreign affiliates and other foreign affiliates. In the case of individuals and trusts the necessary data will be only for controlled foreign affiliates. Where the positive answer is to question (ii), the full name and address of each trust and of the trustees of that trust will be required.

3. Financial statements of a controlled foreign affiliate in respect of its taxation year (as defined in paragraph 95(1)(g) of the Act) ending in the taxation year of the taxpayer resident in Canada must accompany the income tax return filed in respect of that taxation year. Financial statements of foreign affiliates that are not required to be filed should, nevertheless, be retained by the Canadian taxpayer and be available for examination by the Department.

4. Financial statements to be filed or retained by the Canadian taxpayer should be:

(a) those that have been accepted by taxation authorities in the foreign jurisdiction, or

(b) where they are not required by such authorities, those that have been certified by auditors.

Where the Canadian taxpayer is of the opinion that these financial statements are unreliable or inconsistent with the basis used for other corporations in the group and he has compiled a revised version, then that revised version should also be filed with the annual income tax return or remain available for examination as the case may be.

5. All financial statements of controlled foreign affiliates should be translated into English or French if they are presented in a language other than English or French.

Books, Records and Financial Information

6. Corporations

(a) Where the Canadian taxpayer is a corporation, requirements will vary depending on whether or not the foreign affiliate is

Digitized by Google

(i) a controlled foreign affiliate (including a non-resident trust that is deemed to be a controlled foreign affiliate), or
(ii) any other foreign affiliate.
(b) The provisions of subsection 230(1) of the Act make it the responsibility of the Canadian taxpayer to ensure that adequate books and records are maintained in Canada or elsewhere.
(c) In the case of a controlled foreign affiliate, adequate books, records and supporting schedules should be available in Canada, on request, to substantiate the information disclosed in the taxpayer's returns.
(d) Where other foreign affiliates are involved, requirements will vary depending upon the circumstances. If the Canadian taxpayer has a substantial interest in the foreign affiliate and is able to make a suitable arrangement to acquire, or there are other circumstances which enable the taxpayer to obtain the information, the Department would normally expect that there would be the same information available as there would be for a controlled foreign affiliate. Where the taxpayer is unable to obtain the required information and can demonstrate that a reasonable effort was made to do so, or where it can be demonstrated to the Department's satisfaction that it is not practical to make such an effort, the Department may, depending on the circumstances, accept less. For example, a corporation resident in Canada may be unable to obtain all the income tax returns and other information required to compute the various amounts defined in section 5907 of the Regulations for a particular foreign affiliate of the corporation because of restrictions imposed by a law of a foreign jurisdiction or by the directors of the foreign affiliate. If a reasonable effort has been made to obtain the required information, the corporation may compute such amounts using alternative documentation providing the Department is satisfied that, having regard to all the circumstances, a reasonable approximation of such amounts can be obtained through the use of such alternative documentation. What would ordinarily be expected to be made available would be the financial statements and other information that the Canadian taxpayer or a foreign affiliate is entitled to receive in its right as a shareholder under the corporation or other statutes of the foreign jurisdiction.

Retention of Books, Records, and Information
7. The requirements for the retention of records and books of account of a Canadian taxpayer are set out in Information Circular 78-10R. These requirements also apply to the books, records and information maintained by the Canadian taxpayer on the affairs of a foreign affiliate.
8. As a minimum, these records should be sufficient to substantiate the computation of foreign accrual property income and any deductions claimed under subsection 91(5) or section 113 in respect of dividends received from the foreign affiliate. It will be necessary to retain records relating to the surplus accounts, foreign taxes paid, reorganizations, amalgamations and changes in participating percentage or surplus entitlement percentage and any other relevant information beyond the mandatory retention period if these transactions have future tax consequences.
9. Foreign accrual property income is defined in paragraph 95(1)(b) of the Act and generally excludes income and losses from active businesses. The Department's interpretation of income from an active business is set out in Interpretation Bulletin IT-73R3.
10. Where the foreign jurisdiction requires the income or profit from an active business to be computed in accordance with the income tax law of that jurisdiction, depreciation or capital cost allowance would be calculated according to the foreign taxation regulations unless an election is made pursuant to subsection 5907(2.1) of the Regulations. Capital cost allowance or depreciation schedules need not be filed but should be retained. Where the foreign jurisdiction has no such requirements, the active business income should be calculated under Part 1 of the Income Tax Act.
11. Foreign accrual property income calculations of a controlled foreign affiliate must be computed under Part I of the Act. Capital cost allowance may be claimed on assets situated abroad for the

Digitized by Google

purpose of calculating foreign accrual property income; however, appropriate capital cost allowance schedules must be filed with the annual return.

Foreign Exchange
12. Foreign currency conversions will, except in the cases noted in subsection 5903(2) of the Regulations, be made in accordance with the normal law. The Department has issued a number of Interpretation Bulletins (e.g. IT-95R, IT-174R, IT-205) on the subject of conversions.
13. Subsection 5907(6) of the Regulations describes the currency to be used for recording the amounts referred to in subsection 5907(1) and (2).

Subsection 93(1) Elections
14. When a valid election has been made, there is no provision whereby it can be withdrawn or replaced with an amended election. However, where it is evident that the corporation intended to elect on the full amount of the available exempt surplus, the taxable surplus in respect of which a full deduction is available
under section 113, or the capital gain otherwise determined in respect of the disposition of the shares and the taxpayer is not attempting to obtain any undue tax advantage and due and reasonable care was exercised in making the election, the Department will, if the taxpayer so requests in writing, consider revisions to the amounts designated in its election in the following circumstances:
(a) the amount designated in the election is based, in part, on the determination of one or more fair market values and a reasonable effort has been made to establish the value and it is subsequently determined that the fair market value was other than the estimated amount,
(b) typographical, clerical or other similar errors or omissions have been made in an otherwise valid election, or
(c) exempt surplus, taxable surplus and/or tax paid in respect to taxable surplus has changed due to circumstances that are beyond the control of the taxpayer.
15. Requests for revisions to the amount designated in an election made under subsection 93(1) must be signed by an authorized officer of the corporation and should set out in detail the reasons for the requested revision. These requests should be submitted to the District Taxation Office.

The Tax Audit
IC 71-14R3
June 18, 1984
This circular cancels and replaces Information Circular No. 71-14R2 dated February 5, 1979.
1. This circular describes the role, the policies and practices of the tax audit - the examination of taxpayers' books and records to determine accurately the taxes, interest and penalties payable under the law.
2. While there is, in Canada, a high standard of public compliance with the law, a self-assessment tax system can be maintained only through vigilant and continuous inspection of returns. The primary purpose of the tax audit is to monitor and maintain the self-assessment system. As such, it plays an important role in the achievement of the objectives of the Department which are to collect the taxes imposed by law through the encouragement of voluntary compliance and to maintain public confidence in the integrity of the tax system.
3. While the prospect of being subjected to a tax audit is a strong inducement to voluntary compliance, particularly in view of the penalties applicable for gross negligence or wilful non-compliance, the personal contact afforded by an audit is an ideal vehicle for promoting an atmosphere in which taxpayers can realize that each is bearing a lawful share of the tax burden, and not more than that share.

Digitized by Google

The law and the system

4. The Canadian income tax system is one of self-assessment. In it, every corporation and every taxable individual, estate or trust is required by law to file an annual return of income in prescribed form and to determine the taxes payable for the year. After initial processing and correction of obvious errors made in completing the return, and after completion of a matching program, which matches certain information in the return with that in other returns or from other sources, the return may be selected for audit and thus subjected to a detailed examination. The selection of returns for audit is explained in 14 to 19 below.

5. The Income Tax Act requires taxpayers to keep such records and books of account as are required to determine the taxes payable and authorizes the Department to audit these for any purpose related to the enforcement or administration of the Act. To this end, the Act further authorizes the Department to request and receive from any person information, records, documents etc, within a reasonable, stipulated time.

6. Under the Act, the Department may re-assess tax returns:

(a) at any time in cases of fraud or misrepresentation, or where a waiver, specifying matters on which a reassessment may be issued, has been filed; or

(b) at any time up to 4 years after the date of mailing the original assessment, in all other cases.

The taxpayers

7. Of the 15 million individuals who filed returns for the 1981 taxation year, approximately eighty percent were salary or wage earners, pensioners, etc.; the remaining twenty percent were persons reporting income from unincorporated businesses, professions, farming , fishing, and investments, rentals and commissions. In addition some 500,000 corporations and 200,000 trusts filed returns for the same year.

8. Wage and salary earners present relatively few compliance problems. For the most part, their taxes are collected through payroll deductions and their incomes are readily verified by reference to information filed by their employers. The requirement to maintain books and records has little application to these taxpayers and, save for certain cases, such as when the deduction of some expenses from wages and salary may be permitted, there is little need for audit activity. The Department's audit program is directed mainly at those individuals deriving income from businesses and professions, as well as corporations and trusts.

Audit programs

9. The following principles are observed in developing the audit program:

(a) Total compliance is, and will remain, an elusive goal;

(b) The most effective and least expensive form of compliance is voluntary compliance;

(c) Recovering undeclared taxes encourages voluntary compliance;

(d) The recovery of undeclared taxes could theoretically be obtained by a complete audit every four years. In certain cases, however, the scope and complexity of taxpayers' affairs suggests that for reasons of practicability as well as the preservation of good relations with these taxpayers, audits be scheduled more frequently and cover less than a four year period;

(e) Each taxpayer group should receive at least a nominal amount of audit attention:

(f) Categorizing taxpayers for audit purposes should be done on a rational and impartial basis. Taxpayers of any group should be satisfied that the audit program is based on fair and non-discriminatory criteria.

10. The application of these principles is reviewed continuously, by

Digitized by Google

(a) analyzing and evaluating the results of completed audits;

(b) comparing audit results to the audit programs and evaluating variances;

(c) considering the effect of audit actions on compliance;

(d) preparing alternative audit programs showing different coverage emphasis and techniques directed towards identified areas of non-compliance;

(e) conducting compliance measurement surveys of various taxpayer groups;

(f) researching alternatives to methods of taxpayer classification and grouping.

11. Each year the audit program is modified in keeping with the resources allotted to the Department. In order to make optimum use of limited resources, careful consideration is given to identifying those groups of taxpayers or organizations most in need of attention and selecting audit actions most likely to improve compliance.

12. Essentially, the audit program is based on the estimated number of returns filed by each taxpayer group, and the number of returns that can be audited with the available staff. Variations in coverage are influenced by the degree of non-compliance within various taxpayer groups as measured by results from previous audit programs and compliance measurement surveys.

13. The current grouping of taxpayers into "categories" is quite detailed. Within the initial classification by type of return (T1, T2, T3), categories are established by type of occupation or business, gross income, net income, and any other relevant and impartial criteria.

Selection of files for audit - Other than projects

14. The selection of returns to be audited is greatly facilitated by the computer records of all returns filed. This allows returns to be sorted into various groupings in order that the selection criteria can be applied. In some cases sophisticated comparisons are made of selected financial information of current and prior years and between taxpayers engaged in similar businesses or occupations. These systems generate lists of returns for potential audit selection from which specific returns are chosen by supervisors in each District Office.

15. There are at present no rigid rules for the screener to follow other than the dictates of objectivity and impartiality. Computerized selection criteria are being perfected on an ongoing basis.

16. While the majority of files audited are selected in the screening process described above, there are three other common means of selection. These are:

(a) Audit projects - Frequently, the compliance of a particular group of taxpayers is tested. If the test results indicate that there is significant non-compliance within the group, its members may come under audit on a project basis which may have local, regional or national application.

(b) Leads - Information from other files, from audits or investigations or from outside sources including informers may lead to the selection of a particular file for audit;

(c) Secondary files - A file may be selected for audit because of its association with another file previously selected. For example, if several taxpayers share a single place of business and are under the same control, and one of their files has been selected for audit, it is usually more convenient both for the Department and the taxpayers to have all the records examined during the same audit engagement. In addition, the affairs of such taxpayers are often so interwoven as to require the auditor to examine them together.

Compliance measurement audits

17. A compliance measurement survey, using statistical sampling techniques attempts to establish the degree of non-compliance in various sectors of the population as well as in the entire

Digitized by Google

population.
18. By auditing a randomly selected sample of returns and examining the tax recoveries from this sample, it is possible to project (within certain tolerances of probability) the potential tax recoveries for the whole group. This constitutes a measurement of the amount and proportions of non-compliance. By periodically checking the non-compliance for a particular group of taxpayers, in relation to audit activity within that group, it is possible to estimate the effects of audit on compliance. Intensification or reduction of audit effort takes place depending on whether the compliance has increased or decreased in that group.
19. Additional data collected from these sample audits is computer analyzed in an attempt to detect patterns which could be helpful in the future selection of files for audit.
Audit Activities
20. The "field audit" is the main tool in the Department's audit program. this action can require from a few hours to several weeks depending on the nature of the examination and/or the size and complexity of the taxpayer's operations. The "field audit" is usually a detailed but sometimes restricted examination of books and records normally conducted at the taxpayer's place of business. The field audit can be conducted by one auditor or a team of auditors. Team audits use two or more auditors and may include individuals with different skills such as electronic data processing and, as circumstances require, may be directed by a case manager. Another form of audit is the industry-wide audit, which involves the coordinated audits of a number of corporations within one industry. Other specialists, such as Business Equity Valuators and Real Estate Appraisers, are available to assist auditors in situations concerning valuations and appraisals of equities and various properties respectively.
21. Before beginning a field audit. the auditor will contact the taxpayer to arrange a convenient date to commence the audit and will then begin a review of the taxpayer's file. In this preliminary review, the auditor examines the return selected for audit, the attached financial statements for prior years, audit reports from previous audits and any other information on file. In so doing, the auditor can plan, in a general way, an approach to the audit and prepare a list of queries to raise.
22. On arriving at the taxpayer's place of business, the auditor will present an official identification card. Before beginning the examination of books and records, the auditor may want to discuss with the taxpayer the general nature of the business or tour the premises to gain a better understanding of the transactions recorded in the books. Cooperation by the taxpayer in this regard permits a faster and more efficient audit and is, consequently, of mutual benefit.
23. The scope of the audit is determined by the auditor with the advice and direction of a supervisor. They decide which records should be examined and what audit techniques should be employed. The audit might extend to examination of the taxpayer's ledgers, journals, bank accounts, sales invoices, shipping and receiving records, purchase vouchers, expense accounts, inventories, investments, agreements, contracts, appointment books, share records and minutes, etc. Throughout the audit, the auditor may need to obtain information and assistance from the employees of the taxpayer, particularly those on the accounting staff.
24. In a small minority of cases (for example, when the records are inadequate, or the income reported appears inconsistent with the taxpayer's standard of living) the auditor may have net worth statements prepared to determine income, or to confirm income established by other audit approaches.
25. The auditor does not usually question items one by one as the examination proceeds since many will answer themselves during the course of the audit. The preliminary list of queries will be modified and periodically a group of outstanding questions will be presented to the taxpayer. Should the taxpayer's return require an adjustment the steps described under the heading "Reassessment" are taken.
Delays in audit
26. Although the actual time of audit may be only one or two weeks, the elapsed time from start to

Digitized by Google

finish may be longer. Unavoidable delays may occur when the taxpayer wishes to consult with advisers, or is called out of town before completion of the audit. Similarly, the auditor may cause the delay by deciding to request an interpretation from Head Office on a particularly complex or contentious point of law.
27. Sometimes, however, unnecessary delays are caused by taxpayers or their representatives failing to provide information or documents as requested. Faced with this situation, the auditor can obtain the information, by
(a) a written request to the taxpayer and/or the taxpayer's representative. The taxpayer or a representative will be given a reasonable period to provide the information.

(b) A formal requirement under the Act (conviction for failure to comply would result in a fine).

(c) A reassessment based on the incomplete information available (to dispute the reassessment, the taxpayer might then need to produce the missing information).
28. It is departmental policy to use with moderation the somewhat arbitrary method outlined in (c) above. Problems can usually be avoided if the taxpayer advises the auditor of any valid reason for delay in providing the requested information.
Determination of tax
29. It should be remembered that the role of the auditor is to determine the correct tax payable, even if this involves a downward adjustment of tax and a consequent refund.
30. In the determination of the correct tax, the auditor will not challenge generally accepted accounting principles as observed by the taxpayer unless:
(a) The taxpayer has been inconsistent in their application;

(b) A certain practice is specifically prohibited by the Income Tax Act or Regulations;

(c) There is legal precedent for not recognizing the principle for tax purposes;

(d) It appears the principle is being applied only as part of a scheme for tax evasion or tax avoidance.
Reassessments
31. When an audit is completed, the auditor may propose to adjust the tax payable by reassessing the taxpayer's return. Initially the proposal will be discussed with the taxpayer and/or representative and, if they request or it is reasonable to expect that the taxpayer will need an opportunity to analyse the proposed adjustments, the auditor will confirm the proposal in writing and allow a reasonable period in which to make representations. If the taxpayer is in full agreement with the changes, the auditor may proceed with the reassessment without a written proposal.
32. If the auditor does not have any proposed adjustments to the taxpayer's income tax return, the auditor will so notify the taxpayer and/or representative.
33. Should an audit be delayed by the circumstances described in 27 above and a reassessment proposed on the basis of available information, the taxpayer will be advised of the proposed change in writing and given a reasonable period to provide the missing information. If the taxpayer provides the requested information in this interval and should it alter the auditor's proposed reassessment, the taxpayer will be notified as in 31 above.
34. The policy of taxpayer notification does not apply when the Department suspects the taxpayer is attempting to avoid payment of taxes, as contemplated by subsection 158(2) of the Act. For more information on the subject of avoiding payment of assessed taxes, see Information Circular 75-16R, "Collection Policy."
Reassessment of prior year's returns
35. The subject of reassessing prior years' returns is dealt with in Information Circular 75-7R2,

Digitized by Google

"Reassessment of a Return of Income".

Audit review

36. With audit activities being conducted in 28 District Offices, the Department is concerned with achieving uniformity of interpretation and application of the law. This is the prime objective of the audit review system which encompasses the District Offices and Head Office. Each District Office has a review section responsible for achieving this objective within the District while the Audit Programs Division of Head Office is charged with ensuring uniformity across the country.

Digitized by Google

Requests for Information

Subsections 231.1-231.2 provide the statutory authority to the Minister to inspect, audit or examine any book or record related to any taxpayer or to inspect any property in furtherance of verifying compliance with the Act.

Requests for information (RFIs) are a means by which the Minister ascertains a fuller picture of the tax position of a taxpayer. They are a statutory power that has been enforced by the courts, subject to certain restrictions depending on the situation, even though they are not extensively used per statistics released under the Access to Information Act.

The ITA deals with them in primary two categories:

the first is requests made to specific taxpayers about themselves, and
the second is to taxpayers about others dealing with the former.

In the case of the 1st, directly to a taxpayer about his affairs, the court has held, like In Carrefour Langelier Inc. and The Canada Customs and Revenue Agency[66] the Trial Court, citing, provided:

> [8] Rothstein J.(as he then was) said in *AGT Ltd. v. Canada (Attorney General of Canada)*, [1996] 3 F.C. 505 (T.D.):
>
> > It is not necessary that a requirements notice set out the grounds or particulars for which the documents sought are required.
> >
> > ***As long as the documents pertain to a genuine inquiry into the tax liability of a person, they may be the subject of a requirements notice under subsection 231.2(1).***

In this case, the tax collection arm was attempting to value a parent corporation's shares that were indirectly held, at the end, as a bankrupt's property.

Practically "any document" may be requested if it is relevant to a taxpayer's tax position and it would include compelling taxpayer's tax accountants to divulge their client's files to CRA (since there is no accountant-client privilege in Canada) as well as create new documents such as answer questionnaires and other questions, if actual documentary evidence does not exist to reflect on what exactly a situation is. [67]

Definitions - S. 231
231. In sections 231.1 to 231.7,

"authorized person" « *personne autorisée* »
"authorized person" means a person authorized by the Minister for the purposes of sections 231.1 to 231.5;

"document" « *document* »
"document" includes money, a security and a record;

"dwellinghouse" « *maison d'habitation* »
"dwelling-house" means the whole or any part of a building or structure that is kept or occupied as a permanent or temporary residence and includes

(*a*) a building within the curtilage of a dwelling-house that is connected to it by a

---

[66] 2003 FC 1260

[67] See "Protections Against Self-Incrimination in Income Tax Audits, Investigations, and Inquiries" by William I. Innes and Matthew G. Williams in the Canadian Tax Journal, (2001), Vol. 49, No. 6 / no 6, pg. 1459, for a lengthy discussion of CRA's investigatory powers .

Digitized by Google

doorway or by a covered and enclosed passageway, and

(*b*) a unit that is designed to be mobile and to be used as a permanent or temporary residence and that is being used as such a residence;

"judge" « *juge* »

"judge" means a judge of a superior court having jurisdiction in the province where the matter arises or a judge of the Federal Court.

Inspections - S. 231.1

231.1 (1) An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act,

(*a*) inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act, and

(*b*) examine property in an inventory of a taxpayer and any property or process of, or matter relating to, the taxpayer or any other person, an examination of which may assist the authorized person in determining the accuracy of the inventory of the taxpayer or in ascertaining the information that is or should be in the books or records of the taxpayer or any amount payable by the taxpayer under this Act, and for those purposes the authorized person may

(*c*) subject to subsection 231.1(2), enter into any premises or place where any business is carried on, any property is kept, anything is done in connection with any business or any books or records are or should be kept, and

(*d*) require the owner or manager of the property or business and any other person on the premises or place to give the authorized person all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act and, for that purpose, require the owner or manager to attend at the premises or place with the authorized person.

Prior authorization

(2) Where any premises or place referred to in paragraph 231.1(1)(*c*) is a dwelling-house, an authorized person may not enter that dwelling-house without the consent of the occupant except under the authority of a warrant under subsection 231.1(3).

Application

(3) Where, on *ex parte* application by the Minister, a judge is satisfied by information on oath that

(*a*) there are reasonable grounds to believe that a dwelling-house is a premises or place referred to in paragraph 231.1(1)(*c*),

(*b*) entry into the dwelling-house is necessary for any purpose relating to the administration or enforcement of this Act, and

(*c*) entry into the dwelling-house has been, or there are reasonable grounds to believe that entry will be, refused, the judge may issue a warrant authorizing an authorized person to enter the dwelling-house subject to such conditions as are specified in the warrant but, where the judge is not satisfied that entry into the dwelling-house is necessary for any purpose relating to the administration or enforcement of this Act, the judge may

(*d*) order the occupant of the dwelling-house to provide to an authorized person reasonable access to any document or property that is or should be kept in the

Digitized by Google

dwelling-house, and

(*e*) make such other order as is appropriate in the circumstances to carry out the purposes of this Act, to the extent that access was or may be expected to be refused and that the document or property is or may be expected to be kept in the dwelling-house.

Requirement to provide documents or information - S. 231.2

231.2 (1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act (including the collection of any amount payable under this Act by any person), of a listed international agreement or, for greater certainty, of a tax treaty with another country, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,

(*a*) any information or additional information, including a return of income or a supplementary return; or

(*b*) any document.

Unnamed persons

(2) The Minister shall not impose on any person (in this section referred to as a "third party") a requirement under subsection 231.2(1) to provide information or any document relating to one or more unnamed persons unless the Minister first obtains the authorization of a judge under subsection 231.2(3).

Judicial authorization

(3) A judge of the Federal Court may, on application by the Minister and subject to any conditions that the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection (1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") if the judge is satisfied by information on oath that

(*a*) the person or group is ascertainable; and

(*b*) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act.

(*c*) and (*d*) [Repealed, 1996, c. 21, s. 58(1)]

Search warrant - S. 231.3

231.3 (1) A judge may, on *ex parte* application by the Minister, issue a warrant in writing authorizing any person named therein to enter and search any building, receptacle or place for any document or thing that may afford evidence as to the commission of an offence under this Act and to seize the document or thing and, as soon as practicable, bring it before, or make a report in respect of it to, the judge or, where the judge is unable to act, another judge of the same court to be dealt with by the judge in accordance with this section.

Evidence in support of application

(2) An application under subsection 231.3(1) shall be supported by information on oath establishing the facts on which the application is based.

Evidence

(3) A judge may issue the warrant referred to in subsection 231.3(1) where the judge is

Digitized by Google

satisfied that there are reasonable grounds to believe that

(*a*) an offence under this Act was committed;

(*b*) a document or thing that may afford evidence of the commission of the offence is likely to be found; and

(*c*) the building, receptacle or place specified in the application is likely to contain such a document or thing.

Contents of warrant

(4) A warrant issued under subsection 231.3(1) shall refer to the offence for which it is issued, identify the building, receptacle or place to be searched and the person alleged to have committed the offence and it shall be reasonably specific as to any document or thing to be searched for and seized.

Seizure of document

(5) Any person who executes a warrant under subsection 231.3(1) may seize, in addition to the document or thing referred to in that subsection, any other document or thing that the person believes on reasonable grounds affords evidence of the commission of an offence under this Act and shall as soon as practicable bring the document or thing before, or make a report in respect thereof to, the judge who issued the warrant or, where the judge is unable to act, another judge of the same court to be dealt with by the judge in accordance with this section.

Retention of things seized

(6) Subject to subsection 231.3(7), where any document or thing seized under subsection 231.3(1) or 231.3(5) is brought before a judge or a report in respect thereof is made to a judge, the judge shall, unless the Minister waives retention, order that it be retained by the Minister, who shall take reasonable care to ensure that it is preserved until the conclusion of any investigation into the offence in relation to which the document or thing was seized or until it is required to be produced for the purposes of a criminal proceeding.

Return of things seized

(7) Where any document or thing seized under subsection 231.3(1) or 231.3(5) is brought before a judge or a report in respect thereof is made to a judge, the judge may, of the judge's own motion or on summary application by a person with an interest in the document or thing on three clear days notice of application to the Deputy Attorney General of Canada, order that the document or thing be returned to the person from whom it was seized or the person who is otherwise legally entitled thereto if the judge is satisfied that the document or thing

(*a*) will not be required for an investigation or a criminal proceeding; or

(*b*) was not seized in accordance with the warrant or this section.

Access and copies

(8) The person from whom any document or thing is seized pursuant to this section is entitled, at all reasonable times and subject to such reasonable conditions as may be imposed by the Minister, to inspect the document or thing and to obtain one copy of the document at the expense of the Minister.

AGT Limited v. The Attorney General Of Canada, A-514-96/[1997] 2 F.C. 878, The

Digitized by Google

Balancing of State Interest in a Regulatory Environment, and the Taxpayer's Right to Privacy

REASONS FOR JUDGMENT DESJARDINS J.A.

This appeal deals with the validity and enforceability of three notices of requirements issued by the Minister of National Revenue (the "Minister") to the appellant AGT Limited (AGT) pursuant to subsection 231.2(1) of the *Income Tax Act.*

These notices of requirements read in their substantive parts:

For the purposes related to the administration or enforcement of the Income Tax Act, pursuant to the provisions of subsection 231.2(1) thereof, I hereby require from you within 30 days from the date of delivery of this notice, file copies of correspondence, agreements, reports, memoranda, schedules, working papers, minutes of meetings, notes to files, telexes, facsimile transmissions and other documents in your possession or under your control, and in the manner originally kept relating directly or indirectly to the following:

documents and information filed with the Canadian Radio and Telecommunication Commission and not previously provided for the years 1990 to July 1995

The aforementioned enumeration of classes of documents or information is not to be presumed to be exhaustive of the material which the officer or officers of this Department will wish to review and subsequent reference may be made to classes or specific documents or information which must be provided pursuant to this agreement.

...

If this requirement is not complied with you may be liable to prosecution without further notice under subsection 238(1).

The documents and information sought by the Minister under the notices of requirements are materials the appellant filed with the Canadian Radio-television and Telecommunications Commission (the "CRTC") for the

years 1990 to July 1995, which now enjoy the status of confidential material by virtue of a decision of the CRTC made pursuant to sections 350 and 358 of the *Railway Act*,[3] and sections 18 and 19 of the *CRTC Telecommunications Rules of Procedure*.[4]

The facts

The appellant is a telephone company whose activities have been regulated by the CRTC since October 4, 1990. Prior to October 4, 1990, telephone service in the province of Alberta was provided by the Alberta Government Telephones Commission. Being a Crown corporation exempt from federal and provincial income tax, it never claimed capital cost allowance. For accounting purposes, however, it did calculate an annual depreciation expense which it included in the calculation of its revenue requirement. Pursuant to the *Alberta Government Telephones Reorganization Act*,[5] the Commission was restructured as of October 4, 1990, for purposes of privatization. Telus Corporation was formed to act as a holding corporation to facilitate the privatization of the provincial Crown agent. Most telephone operations and assets were transferred to the appellant, a subsidiary of Telus which became a regulated business under the jurisdiction of the CRTC. AGT became, at the same time, a taxable entity.

In preparation for the organization and privatization of the Alberta Government Telephones Commission, the Minister was asked for an advanced tax ruling as to whether depreciable assets for tax purposes should be valued at original cost,

Digitized by Google

approximately $ 4 billion, or a net book value, i.e. original cost less depreciation of about $ 2.2 billion. The tax ruling allowed the original cost as undepreciated capital cost.

In October 1991, the appellant filed an application to the CRTC for a Revenue Requirement proceeding, initially for 1992. The revenue requirement is intended to cover AGT's expenses, costs of capital and other items; but of relevance here, is the fact that the allowed revenue is also intended to cover AGT's income tax liability.

During the course of its application to the CRTC, AGT took a more conservative approach on its income tax liability than in its income tax returns to the Minister. Before the CRTC, the corporate taxpayer furnished the CRTC with certain documents on which it claimed and obtained confidentiality pursuant to sections 18 and 19 of the *CRTC Telecommunications Rules of Procedure*. The Minister of National Revenue, who had been conducting a general audit of AGT involving the review and verification of the financial statements and tax returns filed by the appellant in 1990 and 1991,[6] became aware of the confidential material the appellant had filed with the CRTC. As a result of an internal memo, three representatives of the Minister visited the CRTC on 22 June 1995, so as to have access to the material. The CRTC, however, refused to release the confidential documents.

In July 1995, after attempting unsuccessfully to obtain the confidential documents in issue directly from the CRTC, the Minister issued the notices of requirements under subsection 231.2(1) of the Act requiring AGT to produce the documents in question.

The taxpayer applied for judicial review to the Trial Division of this Court challenging the validity and enforceability of the notices of requirements. The application was dismissed in a decision which is now reported.[7]

The parties' contentions

The appellant has pressed upon us two key arguments. Firstly, that the notices of requirements were not authorized under subsection 231.2(1). Secondly, that the documents sought to be seized were privileged under the "Wigmore Rules" as outlined in cases such as *R. v. Gruenke*.[8] We chose not to **hear the respondent on this second issue, since we are satisfied that the motions judge did not err in his disposition of that argument.**

With regard to the first issue, the appellant contends that the notices of requirements are invalid because they do not meet the conditions set out by the Supreme Court of Canada in *R. v. McKinlay Transport Ltd.*,[9] namely that the documents "be relevant to the filing of the income tax return", and that the seizure be "reasonable" within the meaning of section 8 of the *Charter of Rights and Freedoms*.[10]

With regard to the threshold test for relevance, the appellant submits that although *McKinlay* stands for the proposition that seizures under subsection 231.2(1) of the *Income Tax Act* have a lower threshold test than the "reasonable rounds" test for seizure in a criminal law context it is still incumbent upon the Minister to demonstrate to the court, by affidavit or otherwise, that the notices of requirements are designed to seek production of

Digitized by Google

only those documents that may be relevant to his compliance verification function. To issue a notice of requirement which deliberately disregards the potential relevance of a document is clearly outside the scope of the section.

In the case at bar, there are issues as between the Minister and AGT with regard to the classification of certain assets for tax purposes.[11] The appellant submits that the Minister has admitted that the notices of requirements seek the production of information which is irrelevant to these issues. During cross- examination, Ms. Sharon Marlene White, a representative of the respondent, conceded that AGT could not be forced to give its opinion on the risk assessment of those assets.[12] She made clear, however, that the Minister is interested in the facts underlying the risk assessment. The following exchange then occurred:[13]

Q You just issued the requirement knowing that a consequence may be that you would end up with information that you are not entitled to?

A I issued a requirement asking for all documents filed with the CRTC, whatever they may be. [Emphasis added]

Such an admission, claims the appellant, indicates that the Minister is operating an impermissible fishing expedition. The Minister, it says, is entitled to business records a taxpayer is obligated to keep, but not to opinion documents and business strategies.

The appellant further argues that the seizure is unreasonable because the appellant's privacy interest in the documents sought to be seized outweighs the state's interest in those documents. The appellant submits that it has a compelling privacy interest in the documents because, at the time the notices of requirements were issued, the sought for documents enjoyed confidentiality by virtue of the CRTC's decision which had determined that it is in the public interest that the documents remain confidential. **The fact that the appellant is not required by the Act to maintain the type of documents in issue is further evidence that the state's interest in obtaining the documents does not outweigh the appellant's privacy interest. The motions judge should have considered that the documents at issue came into existence by compulsion of law for a very specific purpose since the information was prepared and provided to the CRTC so as to allow the CRTC to discharge its statutory duty. The diversion which the Minister is seeking is, therefore, unreasonable.**

The appellant finally argues that the Minister's extra-legal conduct in seeking access to the information is clearly at odds with the rule of law and the values embodied by section 8 of the Charter. The attempt to obtain the documents through the CRTC is an intricate part of the seizure in issue and goes to the determination of whether the seizure was reasonable.

The respondent maintains that the notices of requirements meet the legal requirements of *McKinlay*. The Minister is entitled to obtain documents which might contain not only facts, but which might reveal the roadmap followed by the taxpayer in his assessment. The Minister is entitled to have access to documents which might flag situations likely to assist him in the enforcement of the Act.

Analysis

The seminal case is *McKinlay* where the Supreme Court of Canada found that subsection 231(3) of the *Income Tax Act*, now 231.2(1), constitutes a valid seizure within the meaning of section 8 of the Charter. The Court upheld the Minister's warrantless demand for a taxpayer's private documents and information, in the

Digitized by Google

context of the administration or enforcement of the Act, on the basis that there was a lower standard of reasonableness for the production of those documents.

Wilson J., speaking for herself and Lamer C.J.,[14] noted that the federal *Income Tax Act* was a regulatory statute, and that the meaning to be given to the word "unreasonable", as found in section 8 of the Charter, would be less strict in an administrative and regulatory context:[15]

It is consistent with this approach, I believe, to draw a distinction between seizures in the criminal or quasi-criminal context to which the full rigours of the *Hunter* criteria will apply, and seizures in the administrative or regulatory context to which a lesser standard may apply depending upon the legislative scheme under review. I do not believe that when the Chief Justice said in *Simmons* at p. 527 that departures from the *Hunter* criteria would be rare he was applying his mind to searches or seizures in the context of regulatory legislation. I think he was addressing as in the cases of *Hunter* and *Simmons* themselves searches or seizures in a criminal or quasi-criminal context. It is with these considerations in mind that I examine the reasonableness of s. 231(3) of the *Income Tax Act*.

She then continued:[16]

At the beginning of my analysis I noted that the *Income Tax Act* was based on the principle of self- reporting and self-assessment. The Act could have provided that each taxpayer submit all his or her records to the Minister and his officials so that they might make the calculations necessary for determining each person's taxable income. The legislation does not so provide, no doubt because it would be extremely expensive and cumbersome to operate such a system. However, a self-reporting system has its drawbacks. Chief among these is that it depends for its success upon the taxpayers' honesty and integrity in preparing their returns. While most taxpayers undoubtedly respect and comply with the system, the facts of life are that certain persons will attempt to take advantage of the system and avoid their full tax liability.

Accordingly, the Minister of National Revenue must be given broad powers in supervising this regulatory scheme to audit taxpayers' returns and inspect all records which may be relevant to the preparation of these returns. The Minister must be capable of exercising these powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act. Often it will be impossible to determine from the face of the return whether any impropriety has occurred in its preparation. A spot check or a system of random monitoring may be the only way in which the integrity of the tax system can be maintained. If this is the case, and I believe that it is, then it is evident that the *Hunter* criteria are ill-suited to determine whether a seizure under s. 231(3) of the *Income Tax Act* is reasonable. The regulatory nature of the legislation and the scheme enacted require otherwise. The need for random monitoring is incompatible with the requirement in *Hunter* that the person seeking authorization for a search or seizure have reasonable and probable grounds, established under oath, to believe that an offence has been committed. If this *Hunter* criterion is inapplicable, then so too must the remaining *Hunter* criteria since they all depend for their vitality upon the need to establish reasonable and probable grounds. For example, there is no need for an impartial arbiter capable of acting judicially since his central role under *Hunter* is to ensure that the person seeking the authorization has reasonable and probable grounds to believe that a particular offence has been committed, that there are reasonable and probable grounds to believe that the authorization will turn up something relating to that particular offence, and that the authorization only goes so far as to allow the seizure of documents relevant to that

Digitized by Google

particular offence.

This is not to say that any and all forms of search and seizure under the *Income Tax Act* are valid. The state interest in monitoring compliance with the legislation must be weighed against an individual's privacy interest. The greater the intrusion into the privacy interests of an individual, the more likely it will be that safeguards akin to those in *Hunter* will be required. Thus, when the tax officials seek entry onto the private property of an individual to conduct a search or seizure, the intrusion is much greater than a mere demand for production of documents. The reason for this is that, while a taxpayer may have little expectation of privacy in relation to his business records relevant to the determination of his tax liability, he has a significant privacy interest in the inviolability of his home.

In my opinion, s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the *Income Tax Act* can be effected. It involves no invasion of a taxpayer's home or business premises. It simply calls for the production of records which may be relevant to the filing of an income tax return. A taxpayer's privacy interest with regard to these documents *vis-à-vis* the Minister is relatively low. The Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them. **At the same time, the taxpayer's privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies.**

The appellant claims in essence that although subsection 231.2(1) of the Act has been declared constitutionally valid, each notice of requirement issued under that provision must meet the test of relevancy and reasonableness.

The short answer to this contention is that once a statutory provision is declared valid, as was done with respect to subsection 231.2(1) of the Act in *McKinlay*, the constitutional analysis ends. Only a statutory analysis is then required. It is under this analysis that I now consider the appellant's arguments about relevancy and reasonableness.

Under the *Income Tax Act*, the Minister is concerned with verifying the tax liability of the taxpayer which is first revealed in the taxpayer's return. It will often be "impossible to determine from the face of the return whether any impropriety has occurred in its preparation".[17] Because of the nature of the conduct regulated by the *Income Tax Act*, there are, in many cases, no ways of determining whether proscribed conduct has been engaged in, short of studying the process by which a suspected corporation or business has made and implemented its decision.[18] Investigatory mechanisms which force corporations and other businesses to divulge what they and only they can know about their internal affairs are part of the state's interest in the enforcement of the Act.[19]

While an individual or a corporation's interest in having business strategies kept in confidence is recognized,[20] the balancing no doubt favours the state. Wilson J. in *McKinlay* recognizes that the "Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them".[21] There is an ultimate safeguard. Not all of those documents are necessarily admissible against the taxpayer in a court of law or in another proceeding. Only those in accord with the rules of evidence shall be admissible.

The fact that the documents in issue were prepared for another forum, namely for

Digitized by Google

providing the CRTC with information required under a rate setting process, does not prevent the Minister from having access to them since they are relevant to the potential tax liability of the taxpayer. Moreover, the fact that they were sealed by order of the CRTC from public access does not prevent the Minister from having access to them when he is engaged in enforcing the Act. These propositions follow from *McKinlay*.

The notices of requirements constitute the least intrusive means by which effective monitoring of compliance with the Act can be effected.[22] The fact that the Minister used extra-legal means to try to obtain the documents is an irrelevant consideration with respect to the validity of the notices of requirements. The fact of the matter is that those documents were not obtained from the CRTC. Subsection 231.2(1) is drafted in broad language, but its scope has been reduced through the rules of interpretation[23] to situations where the information sought by the Minister is relevant to the tax liability of some specific person or persons, and when the tax liability of such person or persons is the subject of a genuine and serious inquiry. Given these criteria, I find that no error was committed by the motions judge.

I would dismiss this appeal with costs.

The appellant asked, in the event the appeal is dismissed, that the judgment of this Court be stayed for a period of ninety days so as to allow the appellant to submit an application to the Supreme Court of Canada for leave to appeal to that Court. The respondent agreed. On consent, I would stay this judgment for a period of ninety days. If an application for leave to appeal to the Supreme Court of Canada is filed before the expiry of that period, the stay would stand until the application is disposed of by that Court.

"Alice Desjardins"
J.A.
"I agree
A.J. Stone J.A."
"I agree
Linden J.A."

1 R.S.C. 1985 (5th Supp.), c. 1. Subsection 231.2(1) provides as follows: 231.2(1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,
any information or additional information, including a return of income or a supplementary return; or (b) any document.

2 A.B. at 320-21.

3 R.S.C. 1985, c. R-3 as am.

4 SOR/79-554, 27 July 1979, Canada Gazette Part II, vol. 133, no. l5.

5 S.A. 1990, c. A-23.5.

Digitized by Google

[6] Affidavit of Ms. Sharon Marlene White, Comm. Appendix I, vol. III, at p. 295.

[7] *AGT Ltd. v. Canada (Attorney General) (T.D.),* [1996] 3 F.C. 505; 96 DTC 6388.

[8] [1991] 3 S.C.R. 263.

[9] [1990] 1 S.C.R. 627.

[10] Part I of the *Constitution Act, 1982*, being Schedule B of the *Canada Act 1982* (U.K.), 1982, c. 11.

[11] A.B. at 442.

[12] A.B. at 444-46.

[13] A.B. at 450-53.

[14] Both La Forest J. and L'Heureux-Dubé J. concurred with Wilson J. subject to what they had said in the case of *Thomson Newspapers Ltd. v. Canada (Director of Investigation & Research, Restrictive Trade Practices Commission*) 67 D.L.R. (4th) 161 (S.C.C.), released concurrently, Sopinka J. agreed with the disposition of the case as suggested by Wilson J., but for different reasons.

[15] *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627 at 647-48.

[16] *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627 at 648-50.

[17] *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627 at 648, per Wilson J.

[18] See La Forest J. in *Thomson Newspapers Ltd. v. Canada (Director of Investigation & Research, Restrictive Trade Practices Commission)* 67 D.L.R. (4th) 161 at 234 (S.C.C.).

[19] See La Forest J. in *Thomson Newspapers Ltd. v. Canada (Director of Investigation & Research, Restrictive Trade Practices Commission)* 67 D.L.R. (4th) 161 at 234 (S.C.C.).

[20] See La Forest J. in *Thomson Newspapers Ltd. v. Canada (Director of Investigation & Research, Restrictive Trade Practices Commission*) 67 D.L.R. (4th) 161 at 209 (S.C.C.).

[21] *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627.

[22] *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627 at 650.

[23] *James Richardson & Sons v. M.N.R.*, [1984] 1 S.C.R. 614 at 625, which, like *McKinlay*, dealt with subsection 231(3) of the *Income Tax Act*, S.C. 1970-71-72, c. 63 as am. (now with differences that are inconsequential for purposes of this case, subsection 231.2(1) of the present *Income Tax Act*).

Bankruptcy Proceedings

A RFI easily ranks over even the Bankruptcy and Insolvency Act since they are not “a proceeding” which prevents them from being pursued under that Act. Such was the case in The Minister Of National Revenue and Gerald L. Stern[68] where the court held:

[7] With all due respect, I disagree. In my view, the Minister is entitled to issue a letter pursuant to section 231.2 of the Act even if the taxpayer has filed a proposal under the

[68] T-218-04

Digitized by Google

Bankruptcy and Insolvency Act. [8] Beaudry J., in *Carrefour Langelier Inc. v. Canada (Customs and Revenue Agency)* 2003 FC 1403, wrote at paragraph [9]:

The applicant urges that the requirement letter is a proceeding and therefore there is a serious issue to be tried. I share the respondent's view that section 231.2 of the Act is a power to investigate, which is devolved to the Minister and it is not a "proceeding" within the meaning of section 69.3 of the *Bankruptcy and Insolvency Act*. Once the information is obtained, the respondent will be in a position to establish the fair market value of Mr. Glassman's shares and may share the information with the trustee for the benefit of the other creditors in the bankruptcy.

[9] In the present case, the Minister is exercising his power to investigate under 231.2 of the Act, and the lack of co-operation by the taxpayer over the years justifies this investigation. The Respondent admits in his affidavit that the CCRA provable claim is substantial. The effect of subsection 69.3(1) is to impede independent action by any creditor against the debtor or his property, now vested in the trustee. It has no effect on the right of the Minister under section 231.2 of the Act to obtain further information relevant to the tax debt of the Respondent. As stated by Justice Nadon in *Vancouver Trade Mart Inc. (Trustee of) v. Canada (Minister of National Revenue - M.N.R.),* [1997] F.C.J. No. 1467 (paragraph 28):

Section 231.2(1) of the Act simply allows the Minister, in proper circumstances, to obtain production of relevant information and documents so as to properly administer and enforce the provisions of the Income Tax Act.

This was further added to in the decision of Donald Fabi And The Minister Of National Revenue[69] where

the Trial Court reflected extensively on the jurisprudence when the taxpayer attempted to argue that a search for ancillary assets under bankruptcy was “a proceeding”. It held:

10. As his replies were incomplete, on or about December 15, 2003, I sent Donald Fabi two requirements to provide documents and information issued pursuant to subsection 231.2(1) of the *Income Tax Act*, so as to obtain information and/or documents relating to the hypothecary loans and purchase of a lot and condominium in Florida . .

[15] Mr. Phaneuf informed the Court that the purpose of one of the two requirements was meant to cast some light on a financing application made to the Bank by Mr. Fabi in July 1998 in order to purchase and/or make a new outlay on a condominium in Florida, and the purpose of the other was to cast some light on a financing application made to the Bank by Mr. Fabi in July 1998 in order to purchase the seaside lot in Florida with other individuals.

Thus, the requirements to provide documents and information which are the subject of the application for judicial review were sent in the course of the collection investigation and were in no way part of an investigation or prosecution for criminal offences.

…

[18] He ended by stating [TRANSLATION] "that the Agency has not instituted any criminal investigation involving Donald Fabi".

…

[20] The parties did not discuss this issue of the applicable standard of review before this Court. The applicant is seeking a ruling that the Minister's decision is null and void and is asking the Court to quash the two requirements on the ground that they were issued contrary to subsection 69.1(1) of the BIA.

[21] Before this Court, the two parties argued that in this case it was the Minister's powers which were at issue, and consequently the standard of review was that of correctness. I

---

[69] 2004 FC 1779

Digitized by Google

agree with this point of view, since the question is one of jurisdiction. In support of this, I cite the reasons for judgment of Bastarache J. in *Pushpanathan v. Canada (Minister of Citizenship and Immigration)*, [1998] 1 S.C.R. 982, at paragraph 28:

¶ 28 Although the language and approach of the "preliminary", "collateral" or "jurisdictional" question has been replaced by this pragmatic and functional approach, the focus of the inquiry is still on the particular, individual provision being invoked and interpreted by the tribunal. Some provisions within the same Act may require greater curial deference than others, depending on the factors which will be described in more detail below. To this extent, it is still appropriate and helpful to speak of "jurisdictional questions" which must be answered correctly by the tribunal in order to be acting *intra vires*. But it should be understood that a question which "goes to jurisdiction" is simply descriptive of a provision for which the proper standard of review is correctness, based upon the outcome of the pragmatic and functional analysis. In other words, "jurisdictional error" is simply an error on an issue with respect to which, according to the outcome of the pragmatic and functional analysis, the tribunal must make a correct interpretation and to which no deference will be shown.

[22] Mr. Fabi's counsel argued that the two requirements to provide documents and information issued by the Minister pursuant to subsection 231.2(1) of the Act are subject to the stay mentioned in subsection 69.1(1) of the BIA.

[23] That provision states that, subject to subsections (2) to (6), on the filing of a proposal in respect of an insolvent person, no creditor has any remedy against the insolvent person or the insolvent person's property, or shall commence or continue any action, execution or other proceeding, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged or the insolvent person becomes bankrupt.

…

[25] In support of his argument, Mr. Fabi's counsel cited extensive case law, which I summarize:

The Supreme Court of Canada's judgment in *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627. The Supreme Court concluded that although a requirement for information or documents issued pursuant to the *Income Tax Act* constitutes a seizure within the meaning of section 8 of the Charter, it is not an unreasonable seizure.

The Supreme Court of Canada's judgment in *Vachon v. Canada (Employment and Immigration Commission)*, [1985] 2 S.C.R. 417. In that case, the Supreme Court held that the recovery of an overpayment by source deduction from unemployment insurance benefits payable is a remedy or proceeding against the debtor or his property within the meaning of the former subsection 49(1) of the *Bankruptcy Act*.

The Supreme Court of Canada's judgment in *M & D Farm Ltd. v. Manitoba Agricultural Credit Corporation*, [1999] 2 S.C.R. 961. In that case, the appellant had obtained a stay of proceedings from a tribunal pursuant to the federal *Farm Debt Review Act*, after being informed by the Corporation that it intended to commence proceedings to recover amounts owed under a mortgage. Despite the stay, the Corporation obtained an order under a provincial Act to commence foreclosure proceedings, but took no action until the federal stay had expired. The Supreme Court held that the application for leave based on the provincial Act was a "proceeding within the meaning of s. 23 of the federal Act". In his reasons, Binnie J. considered other means of collection used by creditors while the section 23 stay was in effect and concluded that the courts have generally held them to be invalid. He mentioned *Davies v. Canadian Imperial Bank of Commerce*, [1987] B.C.J. No. 632, which involved an examination for discovery on a farm foreclosure, and *Nelson's Lazy H Ranches (1984) Ltd. v. Canadian Imperial Bank of Commerce*, [1992] 3 W.W.R. 574 (Alta. C.A.), in which an order affirming an order of sale and vesting made during a stay pursuant

Digitized by Google

to section 23 of the federal Act was held to be void.

Bisaillon v. Canada, [1999] F.C.J. No. 898. In that case, Létourneau J.A. granted a stay of a requirement to provide documents and information until judgment was rendered by the Court of Appeal. At paragraph 27 of his reasons, he writes:

¶ 27 However, I am far from persuaded that, as the applicants maintained, first, the strict rules applicable to the description of the content of search warrants are those that should govern the content of a requirement of information such as the one at issue, and second, that the instant requirement is illegal because it is nothing less than a fishing expedition. While a search warrant is most intrusive and invasive of taxpayer's privacy, the requirement of information in the case at bar is clearly analogous to the procedure for examining a debtor after judgment, similar to that mentioned in arts. 543 *et seq.* of the *Code of Civil Procedure*, which authorizes the examination of a third party able to supply information on a debtor's assets and income and compulsion of the third party to produce documents relating to those assets (art. 281): but I do not have to decide that point. [Emphasis added.]

The judgment of the Ontario Court of Appeal in *Jones v. Ontario*, O.N.C.A. C38961. Mr. Jones had filed a bankruptcy proposal approved by the Ontario Supreme Court. The question before the Court of Appeal was whether the periodic tax payments made by Mr. Jones after the date of his proposal under the BIA could be applied to reduce his tax obligations incurred before the said proposal. The Court of Appeal held that they could not.

Sabey (Trustee of), [1996] B.C.J. No. 2820, is similar to *Jones, supra*. The Court did not allow Revenue Canada to reimburse itself, after notice of a bankruptcy proposal, from a tax refund payable to Mr. Sabey. The Court reasoned that allowing such reimbursement would give Revenue Canada preference at the expense of other creditors.

Similar circumstances can be found in *Condominium Plan No. 78R15349 v. Fayad*, 2001 SKQB 104. The heart of the judgment of Dawson J. is found at paragraphs 23 and 24 of his reasons, which I quote:

¶ 23 The courts have consistently given a very broad meaning to both "remedy" and "proceedings" as used in s. 69. The words have been interpreted to include any kind of attempt at recovery, judicial or extrajudicial. In this case, without the registered caveat there is no security. Without security the applicant cannot foreclose on the condominium to collect its levy. The registration of the caveat is a process taken relative to or for the purpose of execution. The registration of the caveat is the means by which the applicant's rights are enforced. Section 69 is sufficiently broad to include the registration of a caveat, registered as security for the unpaid levy.

¶ 24 Section 69 of the Bankruptcy Act requires a creditor who wishes to seek a remedy or commence a proceeding despite the s. 69 stay, to apply to the Bankruptcy court to have the stay removed in relation to their action. Without doing this, any prior proceeding or remedy violates s. 69. The levy against Mr. Fayad was unsecured at the time of his filing for bankruptcy. The Applicant's actions of registering the caveat violates s. 69. The applicant is not entitled to enforce the caveat.

[26] Counsel for the Minister responded by putting forward two major points:

the cases referred to by the applicant were cited out of their legislative context; and

this Court has already decided the point at issue in two cases.

[27] There is no question that the context - the legislative background surrounding the problems of an issue and the purpose of the legislation - are essential factors in correctly interpreting Act.

[28] In this regard, I have only to cite the following passage from the reasons for judgment of Iacobucci J. in *Re Rizzo & Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27:

Digitized by Google

¶ 20 At the heart of this conflict is an issue of statutory interpretation. Consistent with the findings of the Court of Appeal, the plain meaning of the words of the provisions here in question appears to restrict the obligation to pay termination and severance pay to those employers who have actively terminated the employment of their employees. At first blush, bankruptcy does not fit comfortably into this interpretation. However, with respect, I believe this analysis is incomplete.

¶ 21 Although much has been written about the interpretation of legislation (see, e.g., Ruth Sullivan, *Statutory Interpretation* (1997); Ruth Sullivan, *Driedger on the Construction of Statutes* (3rd ed. 1994) (hereinafter "*Construction of Statutes*"); Pierre-André Côté, *The Interpretation of Legislation in Canada* (2nd ed. 1991)), Elmer Driedger in *Construction of Statutes* (2nd ed. 1983) best encapsulates the approach upon which I prefer to rely. He recognizes that statutory interpretation cannot be founded on the wording of the legislation alone. At p. 87 he states:

Today there is only one principle or approach, namely, the words of an act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

Recent cases which have cited the above passage with approval include: *R. v. Hydro-Québec*, [1997] 1 S.C.R. 213, *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411; *Verdun*
v. Toronto Dominion Bank, [1996] 3 S.C.R. 550; *Friesen v. Canada*, [1995] 3 S.C.R. 103.

¶ 22 I also rely upon s. 10 of the *Interpretation Act*, R.S.O. 1980, c. 219, which provides that every Act "shall be deemed to be remedial" and directs that every Act shall "receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Act according to its true intent, meaning and spirit".

¶ 23 Although the Court of Appeal looked to the plain meaning of the specific provisions in question in the present case, with respect, I believe that the court did not pay sufficient attention to the scheme of the *ESA*, its object or the intention of the legislature; nor was the context of the words in issue appropriately recognized. I now turn to a discussion of these issues.

[29] Counsel for the Minister also properly raised two recent judgments of this Court, in particular the judgment of Beaudry J. in *Carrefour Langelier Inc. v. Canada (Customs and Revenue Agency)*, 2003 FC 1403, and that of Blais J. in *Canada (Minister of National Revenue - M.N.R.) v. Stern*, 2004 FC 763.

[30] In *Carrefour Langelier*, *supra*, Beaudry J., ruling on a motion for an interim stay of a requirement to provide pursuant to section 231.2 of the Act, concluded that the argument made by the applicant, namely that a requirement under section 231.2 of the Act is "another proceeding" within the meaning of subsection 69.3(1) of the BIA, raises no serious issue to be tried. At paragraph 9 of his reasons, he wrote this:

¶ 9 The applicant urges that the requirement letter is a proceeding and therefore there is a serious issue to be tried. I share the respondent's view that section 231.2 of the Act is a power to investigate, which is devolved to the Minister and it is not a "proceeding" within the meaning of section 69.3 of the *Bankruptcy and Insolvency Act*. Once the information is obtained, the respondent will be in a position to establish the fair market value of Mr. Glassman's shares and may share the information with the trustee for the benefit of the other creditors in the bankruptcy. [Emphasis added.]

[31] In *Stern, supra*, the respondent relied on section 69.3 of the BIA to oppose to the Minister's efforts to investigate his sources of income before his bankruptcy. Blais J. dismissed this argument, relying on the judgment of Beaudry J. in *Carrefour Langelier, supra*. He wrote:

¶ 6 The Respondent suggests that, given the effect of section 69.3 of the *Bankruptcy and*

Digitized by Google

Insolvency Act, sources of income of Mr. Stern in the pre-bankruptcy period could not possibly be relevant to the Minister's enforcement or collection of his tax liability.

¶ 7 With all due respect, I disagree. In my view, the Minister is entitled to issue a letter pursuant to section 231.2 of the Act even if the taxpayer has filed a proposal under the *Bankruptcy and Insolvency Act*.

¶ 8 Tremblay-Lamer J. [*sic*] [Beaudry J.], in *Carrefour Langelier Inc. v. Canada (Customs and Revenue Agency)* 2003 FC 1403, wrote at paragraph [9]:

The applicant urges that the requirement letter is a proceeding and therefore there is a serious issue to be tried. I share the respondent's view that section 231.2 of the Act is a power to investigate, which is devolved to the Minister and it is not a "proceeding" within the meaning of section 69.3 of the *Bankruptcy and Insolvency Act*. Once the information is obtained, the respondent will be in a position to establish the fair market value of Mr. Glassman's shares and may share the information with the trustee for the benefit of the other creditors in the bankruptcy

¶ 9 In the present case, the Minister is exercising his power to investigate under 231.2 of the Act, and the lack of co-operation by the taxpayer over the years justifies this investigation. The Respondent admits in his affidavit that the CCRA provable claim is substantial. The effect of subsection 69.3(1) is to impede independent action by any creditor against the debtor or his property, now vested in the trustee. It has no effect on the right of the Minister under section 231.2 of the Act to obtain further information relevant to the tax debt of the Respondent. As stated by Justice Nadon in *Vancouver Trade Mart Inc. (Trustee of) v. Canada (Minister of National Revenue - M.N.R.)*, [1997] F.C.J. No. 1467 (paragraph 28):

Section 231.2(1) of the Act simply allows the Minister, in proper circumstances, to obtain production of relevant information and documents so as to properly administer and enforce the provisions of the *Income Tax Act*. [Emphasis added.]

[34] In *Slattery (Trustee of) v. Slattery*, [1993] 3 S.C.R. 430, the Supreme Court of Canada noted that a civil proceeding brought by a trustee in bankruptcy against the wife of a bankrupt to obtain a judgment declaring that certain property registered in the wife's name was part of the bankrupt's estate, or held in trust for that estate, was a proceeding relating to the administration and enforcement of the Act, the exception contained in subsection 241(3), and consequently the testimony of two Revenue Canada employees who had participated in an investigation into the bankrupt's affairs was authorized in connection with the trustee's action.

[35] That case also responds to an argument by counsel for Donald Fabi, that with the Court's leave pursuant to subsection 163(2) of the BIA the Minister could question Donald Fabi, who if so ordered had to provide documents. At page 454 of the report, Iacobucci J. considered that the possible existence of an alternative procedure did not disentitle the Minister to the right he had under another Act.

[36] At page 450 of the report Iacobucci J. wrote that the purposes of the Act include a desire to permit an effective and fair distribution of the assets of a bankrupt person and a desire to protect creditors of insolvent persons. He noted that the bankruptcy process is aimed at the proper protection of debtor, creditor and public interests. He noted that the ultimate purpose and result of prosecution of the trustee was to increase the estate of the bankrupt taxpayer, and this provided the relation or connection with enforcement of the *Income Tax Act*.

[37] I refer to the Federal Court of Appeal judgment in *Tower v. Canada (Minister of National Revenue - M.N.R.)*, 2003 FCA 307, dealing once again with a requirement under section 231.2 of the *Income Tax Act*. Malone J.A. wrote the following at paragraph 29:

¶ 29 A number of cases have dealt with the scope of subsection 231.2(1) (see *R. v.*

Digitized by Google

McKinlay Transport Ltd., supra; *James Richardson & Sons, Ltd. v. Minister of National Revenue et al., supra*; *AGT Ltd. v. Canada (Attorney General), supra*; and *R. v. Jarvis*, [2002] 3 S.C.R. 757 at paragraph 51). The relevant principles from these authorities establish that the determination of a taxpayer's tax liability is a purpose related to the administration and enforcement of the Act. A requirement is valid if the requested information may be relevant in the determination of the tax liability of the named taxpayer. This is a low threshold. Subsection 231.2(1) gives the Minister a broader authority to obtain information than would be the case if, for example, the Minister were conducting pre-trial examinations for discovery in the context of an income tax appeal.

[38] In *McKinlay Transport*, *supra*, the Supreme Court of Canada noted that the *Income Tax Act* was based on the principle of self-reporting and self-assessment. In such a scheme, the Court acknowledged that in supervising the scheme, the Minister had to be given "broad powers . . . to audit taxpayers' returns and inspect all records which may be relevant to the preparation of these returns".

[39] Wilson J. wrote the following, concerning subsection 231(3) of the *Income Tax Act*:

¶ 35 In my opinion, s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the *Income Tax Act* can be effected. It involves no invasion of a taxpayer's home or business premises. It simply calls for the production of records which may be relevant to the filing of an income tax return. A taxpayer's privacy interest with regard to these documents *vis-à-vis* the Minister is relatively low. The Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them. At the same time, the taxpayer's privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies.

[40] *R. v. Fitzgibbon*, [1990] 1 S.C.R. 1005, also supports the arguments of counsel for the Minister. In that case, the issue was whether it was necessary to obtain the Bankruptcy Court's consent pursuant to subsection 49(1) of the *Bankruptcy Act* (now subsection 69.1(1)) in order to legally make a compensation order under the *Criminal Code* as part of the penalty imposed on an undischarged bankrupt. The Supreme Court of Canada concluded that the Bankruptcy Court's authorization was not required, but the beneficiaries of the compensation order had to obtain its consent when they sought to file the order in the Superior Court in order to apply or execute it. Cory J. gave the Court's reasons.

[41] In the view of Cory J., such an order is not a remedy or an order for recovery against the property of the bankrupt offender within the meaning of subsection 49(1) of the *Bankruptcy Act*. He wrote:

¶ 23 In contrast, a compensation order is an order made against the person of the offender, imposing upon him or her an obligation to pay the amount ordered. It is only when the compensation order is filed with the Superior Court of the province that it becomes an order enforceable against the person and property of the offender. There is a fundamentally important distinction between the original compensation order, which is an order against the person by which the court recognizes an acknowledged indebtedness, and the subsequent filing in the Superior Court which can convert that personal order into an order against the property of the accused.

¶ 24 Section 49(1) of the *Bankruptcy Act* would preclude the enforcement of the latter. This is because such an enforcement would result in the granting of the very priorities which the *Bankruptcy Act* seeks to avoid. However, the original compensation order made at the time of sentencing is an order against the offender personally recognizing an acknowledged indebtedness and is not immediately enforceable. Until the order is filed with the Superior Court, it simply imposes a future obligation upon the offender to pay. It is neither a

Digitized by Google

remedy nor an order for recovery against the property of the bankrupt offender within the meaning of s. 49(1). Thus s. 49(1) does not prohibit the making of a compensation order. [Emphasis added.]

[42] Cory J. also considered that such a result did not undermine the integrity of the Act, because the net effect of the compensation order was simply to prove that the victims had a valid claim as unsecured creditors in the bankrupt's estate. It did not give the victims priority over the other unsecured creditors. Priority would only arise if the beneficiaries of the order sought to execute the order and attach the property of the bankrupt, pursuant to the provisions of the *Criminal Code*. Cory J. concluded that the trustee in bankruptcy would then have to be notified and the consent of the Bankruptcy Court obtained pursuant to subsection 49(1) before execution of the order could proceed. That is why he concluded that the integrity of the *Bankruptcy Act* was maintained.

[43] Counsel for Mr. Fabi argued that the requirements to provide under section 231.2 of the *Income Tax Act* did not enjoy any exemption under the BIA, such as that Act provides in section 69.42 for the Minister of Finance, the Governor in Council and the Attorney General of Canada.

[44] He also relied on two new legislative provisions in support of his argument that the Minister's requirements in the case at bar are recovery proceedings covered by subsection 69.1(1) of the BIA.

[45] The first, providing for a new prescription period, is an amendment to section 222 of the *Income Tax Act* following the Supreme Court of Canada's judgment in *Markevich v. Canada*, [2003] 1 S.C.R. 94. "Action" is defined as "an action to collect a tax debt of a taxpayer and includes a proceeding in a court and anything done by the Minister under . . . any provision of this Part", which is Part XV containing section 231.

[46] The second amendment which concerns us is in section 231.2. As mentioned, that section authorizes the Minister to issue requirements "for any purpose related to the administration or enforcement of this Act". In 2000, Parliament specified that the administration and enforcement of the Act included "the collection of any amount payable under this Act".

[47] In my opinion, the arguments of counsel for Mr. Fabi cannot be accepted. The argument based on section 69.42 of the BIA would only be valid if this Court were to find that a requirement under section 231.2 of the *Income Tax Act* was a "action, execution or other proceeding" within the meaning of subsection 69.1(1) of the BIA of this Act.

[48] In my view, the arguments of counsel for Mr. Fabi cannot be accepted. The validity of his argument relies on an acknowledgement by this Court that a requirement issued under section 231.2 of the *Income Tax Act* is covered by subsection 69.1(1) of the BIA, which is not the case.

[49] Further, the legislative amendments mentioned do not have the effect of altering the Minister's investigative power under section 231.2 in a recovery proceeding.

At appeal the taxpayer attempted to argue that the RFI was a collection steep since it seemed to fall within the statutory ITA provisions that dealt with that collections however the court held:

[2] Those requests were made pursuant to paragraph 231.2(1)(*a*) and (*b*) of the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1 (the Act). They sought to obtain from the appellant information as to the ownership or transfer of a building and/or lot owned by him in Florida. These applications, set out in an affidavit by a representative of the defendant, had three purposes: to determine the value of the appellant's assets, to discover what had happened with the selling price of the building, if applicable, and to ascertain, if no purchase was made as the appellant claimed, what had happened with the money disbursed by the bank to acquire the properties.

…

Digitized by Google

[9] The information which the Minister sought to obtain was also relevant and necessary to establish the appellant's tax debt. The latter submitted that his tax debt had already been determined in the proposal and amounted to $183,621.09, according to the proof of claim filed by the respondent with the trustee. I am ready to follow the appellant in this respect, but the tax debt does not include debts to come, that is, a debt which has not yet been determined and which might relate to undeclared or concealed taxable assets.

[10] Indeed, the appellant's undeclared assets may give rise to a taxable income if they exist. The affidavit by Mr. Phaneuf, who is employed by the Agency, indicates at paragraph 14 that the purpose of the request for information was to determine whether the appellant's undeclared assets had been transferred, in which case the transfer or disposition, especially to related persons, could give rise to a tax debt for the appellant.

[11] With respect, I am of the view that the requests for information by the Minister, made in this case to determine, for tax purposes, the existence or value of an asset which might be concealed or the amount of its selling price or price of disposal, do not constitute an action in view of collecting claims provable in bankruptcy. The Minister is responsible for implementing and enforcing the Act. This duty, which he performs in the public interest, includes the determination of a taxpayer's tax debt. Determining a taxpayer's tax obligation is an objective relating to the administration and enforcement of the Act. In order to carry out this duty properly, the Minister must be able to ask questions in order to obtain and determine the facts and amounts: *Tower v. M.N.R.*, [2004] 1 F.C.R. 183 (F.C.A.).

[12] At this stage, according to the evidence, this is the objective pursued by the requests for production of information and documents made by the Minister. If the Minister thereafter wishes to proceed to the next stage, that is the collection of the new tax debt so established, if any, then paragraph 69.1(1)(*a*) of the *Bankruptcy and Insolvency Act* will come into play. It cannot be assumed at this point, and there is no evidence to this effect in the record, that the Minister will ignore paragraph 69.1(1)(*a*) of the *Bankruptcy and Insolvency Act* and will not proceed to collect the new tax debt by way of an amended claim, as he is allowed to do by section 121 of that Act.

…

[15] I am of the view that this reading by the appellant of subsection 222(1) ignores the very first parts of the definition of the word "action": the action must be "an action to collect" a tax debt. I agree with the judge, who thus ruled at paragraph 49 of his reasons: the Minister's power set out at section 231.2 of the Act does not relate to collection. The power is not a collection action.

…

[17] With respect, it seems clear to me that the words "anything done by the Minister under . . . this Part" are qualified by the fact that a collection action must be at stake, and therefore that the action taken pursuant to this Part referred to by subsection 222(1) is a collection measure. The words "under this Part" contained in the definition of subsection 222(1) do not have the effect of transforming a power of investigation into a collection action.

…

[20] I say wrongly because, firstly, the appellant's reasoning is based on the premise that the section 232.1 power of investigation is a collection action or an action taken in view of collection, subject to the limitation period. As we have already noted, that is false.

[21] Secondly, the appellant has ignored the comment made by this Court in *Tower v. M.N.R., supra*; at paragraph 32 of that decision, the Court recalled that **"there is no statutory time limit" applicable to the exercise of this power.** The Court has thus implicitly but necessarily concluded that the Minister's power to impose a requirement to provide information is not a collection action, still less an action aiming at the collection of a tax debt already determined when, as in this case, its purpose is to determine the

Digitized by Google

existence …

Deloitte & Touche Inc., The Trustee of the Estate of Vancouver Trade Mart Inc., a bankrupt v. Attorney General Of Canada representing the Minister Of National Revenue, T-1071-96, Trustee Papers under a s. 231.2 Request

INTRODUCTION:
The Applicant, a trustee in bankruptcy, seeks to set aside a decision of the Minister of National Revenue (the "Minister") requiring him to provide documents, pursuant to section 231.2 of the *Income Tax Act* (Canada) (the "Act").
Specifically, the Applicant received a letter dated April 10, 1996 from the Director of Taxation, Vancouver Tax Services, requiring him to produce certain documents, namely his working papers and account analyses relating to a bankrupt company and its shareholders.
The letter dated April 10, 1996 is as follows:
For purposes related to the administration or enforcement of the Income Tax Act, pursuant to the provisions of Section 231.2 of the said Act, I hereby require from you within thirty (30) days from the date of service hereof:
All your working papers and your account analyses relating to each of Vancouver Trade Mart Inc., Mr. George Lee (aka Heng-Loung George Lee), Mrs. Julie Lee, Mr. Edward J. Lee and Mr. Irwin J. Lee, for the period January 1, 1989 to December 31, 1995.
The required working papers and account analyses are to include:
Shareholders" accounts.
Accounts Payable including payables to sub-trades and related companies.
Building construction cost.
Intercompany accounts.
Disbursement of loan proceeds.
Disbursement analysis prior to bankruptcy.
To comply with this notice, you should provide the working papers and account analyses required to Peter Ling of this Department who may be contacted at 691-3666 to arrange for attendance at your office for that purpose.

FACTS:
I begin with the relevant facts. The Applicant is the trustee of the estate of a bankrupt company, Vancouver Trade Mart Inc. ("VTM"). On December 1, 1994 a judgment creditor filed a petition before the Supreme Court of British Columbia seeking a Receiving Order against VTM. On January 13, 1995 VTM filed a Notice of Intention to make a proposal pursuant to Part III, Division 1 of the *Bankruptcy and Insolvency Act* (the "Bankruptcy Act"). The Applicant agreed to act as trustee under the proposal and appointed Mr. Colin Topley to act on its behalf in the matter. Mr. Topley, a senior vice-president of the Applicant, was, at all material times herein, a licensed trustee in bankruptcy, a certified general accountant and a certified fraud examiner. On March 13, 1995, VTM filed its proposal to creditors. The Applicant was named as trustee in the proposal. The first meeting of VTM"s creditors took place on April 3, 1995. The meeting was adjourned to April 19, 1995 at which time the creditors rejected VTM"s proposal. Thus, VTM"s assignment into bankruptcy deemed effective as of December 1, 1994. Also on April 19, 1995 the Applicant was confirmed as trustee to the bankruptcy of VTM.
At all material times herein, VTM had been controlled by George and Julie Lee and their children, Edward and Irwin Lee. As of April 19, 1995, the Department of National Revenue

Digitized by Google

began a full audit of VTM, which included a review of VTM"s shareholders and related companies.

The auditor assigned to this audit was Mr. Peter Ling. In the course of performing his audit, Mr. Ling contacted George Lee who informed him that all of VTM"s books and records were in the possession of the Applicant. Mr. Ling contacted the Applicant and, on May 10, 1995 he was allowed to review a certain number of VTM"s documents, namely bank statements, cancelled cheques, supplier"s invoices, financial statements, etc.

During the course of reviewing the aforesaid documents, Mr. Ling was informed by representatives of the Applicant that they had conducted their own audit of VTM and that they had noticed "irregularities" between VTM and its shareholders. Mr. Ling stated in his affidavit that the Applicant "suspected that George Lee had appropriated VTM funds for his personal use".

Mr. Ling, following the receipt of this information, requested that the Applicant provide him with its working papers "including year-end adjusting journal entries, working trial balances, shareholders" account analyses and other account analyses done by VTM"s previous accountants". In October 1995, Mr. Ling was permitted by the Applicant to review VTM"s former accountant"s working papers. On October 26, 1995, Mr. Ling was allowed to make photocopies of the accountant"s working papers, including the year-end adjusting journal entries, the journal ledger, general ledger listings and all trial balances pertaining to VTM.

At the end of October 1995, Mr. Ling wrote to the Applicant requesting that he be allowed to review its account analyses of the bankrupt company, including its analyses of the shareholder accounts. At the end of November 1995 the Applicant advised Mr. Ling that it would not comply with his request. For the present purposes, paragraphs 31, 32 and 33 of Mr. Ling"s affidavit dated June 1996 are relevant:

Specifically, the purpose of examining that part of the Forensic Audit which includes an account analysis relating to VTM, George Lee, Julie Lee, Edward Lee and Irwin Lee for the period January 1, 1989 to December 31, 1995 is to determine whether any of those persons have misused or appropriated funds from VTM, directly or indirectly, and if so, to determine if assessments should be issued against them for example, but not restricted to the provisions of sections 15, 56 and 160 of the *Income Tax Act*.

If I am provided with the required parts of the Forensic Audit as specified in the Requirement Notice dated April 10, 1996, then I will not have to duplicate the same audit exercise already performed by Colin Topley or Deloitte & Touche Inc. as trustee for VTM.

I require those parts of the Forensic Audit of Colin Topley relating to VTM, George Lee, Julie Lee, Edward Lee and Irwin Lee, for the period January 1, 1989 to December 31, 1995 for purposes related to the administration and enforcement of the *Income Tax Act* and for no other purpose.

As it appears from Mr. Ling"s statements, he seeks the Applicant"s papers for the purpose of completing his audit of George, Julie, Edward and Irwin Lee for the period of January 1, 1989 to December 31, 1995.

LEGISLATION:

The Minister"s request for the Applicant"s working papers and account analyses stems from section 231.2(1) of the Act which provides:

231.2 (1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,

any information or additional information, including a return of income or a supplementary return; or

any document.

Digitized by Google

Also of relevance, is the definition of the word "documents" which appears in section 231 of the Act. "Documents", is defined as follows:
"documents" includes money, securities and any of the following, whether computerized or not: books, records, letters, telegrams, vouchers, invoices, accounts and statements (financial or otherwise); ***ISSUES:***
The issues raised by the Applicant, as they appear from the grounds set forth in the Originating Notice of
Motion, are:
The correct construction of section 231.2 of the *Income Tax Act* does not entitle the Minister of National Revenue to require production of the work product including working papers and account analyses of a forensic accountant.
Section 231.2 of the *Income Tax Act* does not entitle the Minister of National Revenue to require production from a Trustee in Bankruptcy of his working papers and account analyses generated as part of the Trustee"s administration of the bankrupt"s estate and with a view to obtaining legal advice with respect to the realization of the bankrupt"s assets.
Section 231.2 of the *Income Tax Act* should not be interpreted so as to allow the Minister of National Revenue to obtain the working papers and accounts analyses of a Trustee in Bankruptcy when the Minister of National Revenue is in competition with the Trustee for monies in the hands of third parties.
The Requirement names Vancouver Trade Mart Inc. the bankrupt and George Lee, Mrs. Julie Lee, Mr. Edward J. Lee and Mr. Irwin J. Lee. No *bona fide* investigation of the tax liability of these individuals is being carried out by the Minister of National Revenue.
The interpretation of section 231.2 of the *Income Tax Act* argued by the Respondent would render section 231.2 to be of no force and effect because it justifies an unreasonable search contrary to section 8 of the *Charter of Rights and Freedoms*.
By the time this matter came up for hearing, the Applicant had abandoned the fourth ground. Thus, only grounds 1, 2, 3 and 5 remain for adjudication.

ANALYSIS:
I will begin my analysis with the fifth ground to the effect that the Minister"s interpretation of section 231.2(1) of the Act amounts to the justification of an unreasonable search, contrary to section 8 of the *Charter of Rights and Freedoms* (the "Charter"). I cannot agree.
Both sides relied on the Supreme Court of Canada"s decision in *McKinlay Transport Ltd. v. The Queen,* [1990] 1 S.C.R. 627. On the one hand, the Applicant submits that, contrary to the taxpayer"s position in *McKinlay* , the Applicant herein has "high expectations of privacy". In the Applicant"s submission, this distinguishes the facts of the present case from those in *McKinlay* . Consequently, according to the Applicant, if the documents requested by the Minister have to be produced, this will constitute an unreasonable seizure, and thus a breach of section 8 of the Charter.
On the other hand, the Respondent submits that there is nothing in the record to distinguish between this case and *McKinlay*. In the Respondent"s submission, the reasoning of Wilson J., who delivered the reasons of the majority of the Supreme Court in *McKinlay* , is applicable to the facts of the present case. As both sides refer essentially to the same passage from Wilson J."s reasons, I will quote these reasons. At page 642, Madam Justice Wilson states:
... First, s. 231(3), even construed narrowly in accordance with prior authority, envisages the compelled production of a wide array of documents and not simply those which the state requires the taxpayer to prepare and maintain under the legislation. Second, the legislation contemplates that parties who are not the subject of an investigation or audit can be compelled to produce documents relating to another taxpayer who is the subject of such

Digitized by Google

investigation or audit. Thus, compelled production reaches beyond the strict filing and maintenance requirements of the Act and may well extend to information and documents in which the taxpayer has a privacy interest in need of protection under s. 8 of the *Charter* although it may not be as vital an interest as that obtaining in a criminal or a quasi-criminal context. I would therefore conclude that the application of s. 231(3) of the *Income Tax Act* to the appellants constitutes a "seizure" since it infringes on their expectations of privacy. It remains to be determined, however, whether the state"s intrusion on that privacy interest is unreasonable or, to put it another way, whether it violates the taxpayers" reasonable expectation of privacy.

And at pages 648, 649 and 650:

At the beginning of my analysis I noted that the *Income Tax Act* was based on the principle of self- reporting and self-assessment. The Act could have provided that each taxpayer submit all his or her records to the Minister and his officials so that they might make the calculations necessary for determining each person"s taxable income. The legislation does not so provide, no doubt because it would be extremely expensive and cumbersome to operate such a system. However, a self-reporting system has its drawbacks. Chief among these is that it depends for its success upon the taxpayers" honesty and integrity in preparing their returns. While most taxpayers undoubtedly respect and comply with the system, the facts of life are that certain persons will attempt to take advantage of the system and avoid their full tax liability.

Accordingly, the Minister of National Revenue must be given broad powers in supervising this regulatory scheme to audit taxpayers" returns and inspect all records which may be relevant to the preparation of these returns. The Minister must be capable of exercising these powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act. ... A spot check or a system of random monitoring may be the only way in which the integrity of the tax system can be maintained. If this is the case, and I believe that it is, then it is evident that the *Hunter* criteria are ill-suited to determine whether a seizure under s.231(3) of the *Income Tax Act* is reasonable. The regulatory nature of the legislation and the scheme enacted require otherwise. The need for random monitoring is incompatible with the requirement in *Hunter* that the person seeking authorization for a search or seizure have reasonable and probable grounds, established under oath, to believe that an offence has been committed. ...

This is not to say that any and all forms of search and seizure under the *Income Tax Act* are valid. The state interest in monitoring compliance with the legislation must be weighed against and individual"s privacy interest. The greater the intrusion into the privacy interests of an individual, the more likely it will be that safeguards akin to those in *Hunter* will be required. Thus, when the tax officials seek entry onto the private property of an individual to conduct a search or seizure, the intrusion is much greater than a mere demand for production of documents. The reason for this is that, while a taxpayer may have little expectation of privacy in relation to his business records relevant to the determination of his tax liability, he has a significant privacy interest in the inviolability of his home.

In my opinion, s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the *Income Tax Act* can be effected. It involves no invasion of a taxpayer"s home or business premises. It simply calls for the production of records which may be relevant to the filing of an income tax return. A taxpayer"s privacy interest with regard to these documents *vis-a-vis* the Minister is relatively low. The Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them. At the same time, the taxpayer"s privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies.

Digitized by Google

I agree with the Respondent that there is no distinction to be made. Consequently, the Minister"s request for documents under section 231.2(1) of the Act does not, in my view, constitute an unreasonable seizure. The Respondent submits that the Applicant"s "own reasonable expectation of privacy has not been infringed, and neither has the creditors". I agree. The purpose of section 8 of the Charter is to prevent the state from intruding "unwarrantedly" into the affairs of individuals. That is certainly not the case here.

The Applicant argued that it had a very high expectation of privacy "respecting its work product, working papers and account analyses that are confidential documents to be used by the trustee in the administration of the bankrupt estate". Unfortunately, the Applicant has not been able to persuade me that there is such a "very high expectation of privacy" as concerns its work as trustee of a bankrupt estate.

I am therefore of the view that the applicant cannot succeed on the fifth ground.

With respect to the other grounds, counsel for the Applicant regrouped them into two issues:

the correct construction of section 231.2(1) of the ***Income Tax Act*** does not require a Trustee in Bankruptcy to produce to the Department of National Revenue Taxation the work product including working papers and account analyses generated as part of the Trustees administration [*sic*] of the Bankrupt Estate pursuant to his appointment under the ***Bankruptcy and Insolvency Act***.

The working papers and account analyses generated as part of the Trustee"s administration of the Bankrupt Estate and with a view to obtaining legal advice with respect to the realization of the Bankrupt"s assets are all subject to solicitor/client privilege and as such not producible on service of a Requirement under section 231.2(1) of the ***Income Tax Act*** .

With respect to the first issue, counsel for the Applicant advanced four reasons why section 231.2 of the *Income Tax Act* "should not be construed to include the trustee"s working papers and account analyses". The four reasons advanced by counsel are the following:

to construe it as including the work product of the Trustee developed during the administration of the Estate would authorize a warrantless search, contrary to Section 8 of the *Charter of Rights and Freedoms*;

the construction including a Requirement to produce the Trustee"s work product will produce a conflict between the provisions of two Federal statutes, namely the *Bankruptcy and Insolvency Act* and the *Income Tax Act*. There is a presumption of coherence and consistency between the entire body of statute law of the Parliament of Canada;

a construction that would include the Trustee"s work product would produce an absurd result, contrary to reasonableness, common sense and logic;

such a construction constitutes an expropriation without compensation and due process of the property of the Applicant, contrary to the presumption against this.

I have already dealt with the first reason which is, in effect, the fifth ground of the Originating Notice of Motion.

The second reason advanced by the Applicant is that the Minister"s interpretation of section 231.1(1) of the Act creates a conflict between the Act and the *Bankruptcy Act* . After due consideration of the Applicant"s written and oral arguments, I am at a loss to understand what conflict would be created by requiring the Applicant to produce the documents which the Minister requires. I agree entirely with the Respondent"s position on this issue. I adopt, for the present purposes, the statement which appears at paragraph 75 of the Respondent"s brief. It reads as follows:

No conflict is created between the *Income Tax Act* and the *Bankruptcy and Insolvency Act* by the application of Section 231.2(1). All that Section 231.2(1) does is oblige the Applicant to provide information for the enforcement of a regulatory Statute, it does not impair his ability to act as a trustee. Producing the documents in question in this case will not affect the creditors

Digitized by Google

legal rights in any way. The trustee is still free to institute legal proceedings on behalf of the general creditors if that is in the best interests of the bankrupt estate. In short, the trustee can comply with the *Income Tax Act* in this case without breaching any portion of the *Bankruptcy and Insolvency Act*.

Contrary to what the Applicant asserts, it does not necessarily follow that because the Minister will have access to Mr. Topley"s working papers and account analyses, the creditors of the bankrupt estate will be prejudiced. At the end of the day, the bankruptcy court will have to decide, if called upon, whether payments made by VTM to its shareholders are void. If void, the funds will revert to the bankrupt estate and thus, in all likelihood, no tax liability will have been created as far as the shareholders are concerned.

As a last argument on this point, the Applicant submits that to allow the Minister to obtain the Applicant"s working papers "to defeat the claims of the trustee in bankruptcy would clearly produce an incoherence that the Parliament of Canada could never have intended". The fact that section 231.2(1) of the Act may allow the Minister to obtain Mr. Topley"s working papers does not, in my view, create the incoherence which, the Applicant submits, Parliament could not have intended.

Section 231.2(1) of the Act simply allows the Minister, in proper circumstances, to obtain production of relevant information and documents so as to properly administer and enforce the provisions of the *Income Tax Act*. The Applicant fails on this point.

The third reason advanced by the Applicant is that, should it be compelled to produce its work papers and account analyses, an absurd result would be reached "contrary to reasonableness, common sense and logic". I have not been persuaded that the interpretation which the Minister has adopted leads to either an absurd result or is contrary to reasonableness, common sense and logic.

The next reason advanced by the Applicant is that the Minister"s interpretation of section 231.2(1) of the Act leads to "expropriation without compensation and due process" of his property. Relying on the Federal Court of Appeal"s decision in *La Ferme Filiber Ltee. v. The Queen* , [1980] 1 F.C. 128, the Respondent argues that the requirement under section 231.2(1) of the Act does not constitute and cannot constitute expropriation. At page 130 of the report of *La Ferme*, Marceau J. states:

An expropriation implies dispossession of the expropriated party and appropriation by the expropriating party; it necessarily requires a transfer of property or rights from one party to the other. There is nothing of that kind here. Defendant has not acquired anything belonging to plaintiff.

...

If the legal proposition on which this action is based were to be admitted, and the adoption or amendment of a regulation such as that in question here were to be regarded as constituting a disguised act of expropriation with respect to anyone whose commercial activities were interfered with thereby, it is easy to imagine the proliferation of claims that would follow. There is no doubt that the establishment or amendment of a regulation of this kind may create extremely unfortunate situations, and the action appears to provide a striking example of this. If however, in such special cases, the government has not made any exceptional provision for the payment of compensation, there is no legal principle I know of which can force it to do so.

I agree with Marceau J., as I must, that, for there to be an expropriation, there necessarily must occur a transfer of property or rights from one party to the other. That is not the case in the present matter. I should mention that during the hearing counsel for the Applicant, rightly in my view, conceded that the expropriation point must fail.

I will now address the second issue raised by the Applicant. The Applicant submits that its working papers and account analyses are subject to a solicitor/client privilege and that,

Digitized by Google

consequently, it cannot be compelled to produce what the Minister has required it to produce under section 231.2(1) of the Act.

The Applicant"s submission is that Mr. Topley"s review of VTM"s pre-proposal transactions was commenced in order to submit the work to legal counsel for the purpose of an opinion regarding the advisability of legal proceedings. Consequently, the Applicant argues that all of the work performed in relation to pre-proposal transactions is subject to a solicitor/client privilege and thus that the Minister cannot compel the production of these documents. Once again, I cannot agree with the position taken by the Applicant.

In *Susan Hosiery Ltd. v. Minister of National Revenue*, (1969) 69 D.T.C. 5278 (ex. ct.), Jackett P. (later Chief Justice Jackett of the Federal Court of Canada) at 5281-5283, explained the solicitor/client privilege as follows:

In an attempt to avoid misunderstanding as to the effect of the decision that I propose to deliver, it may be well for me to attempt to put in my own words the law, as I understand it, on the understanding that, except in so far as is necessary for the decision of this case, I reserve the right to reconsider the precise extent of the doctrines that I am attempting to describe.

As it seems to me, there are really two quite different principles usually referred to as solicitor and client privilege, *viz*:

all communications, verbal or written, of a confidential character, between a client and a legal adviser directly related to the seeking, formulating or giving of legal advice or legal assistance (including the legal adviser"s working papers, directly related thereto) are privileged; and

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

In considering the ambit of these principles, it is well to bear in mind the reasons for them.

In so far as the solicitor-client communications are concerned, the reason for the rule, as I understand it, is that, if a member of the public is to receive the real benefit of legal assistance that the law contemplates that he should, he and his legal adviser must be able to communicate quite freely without the inhibiting influence that would exist if what they said could be used in evidence against him so that bits and pieces of their communications could be taken out of context and used unfairly to his detriment unless their communications were at all times framed so as not only to convey their thoughts to each other but so as not to be capable of being misconstrued by others. The reason for the rule, and the rule itself, extends to the communications for the purpose of getting legal advice, to incidental materials that would tend to reveal such communications, and to the legal advice itself. It is immaterial whether they are verbal or in writing.

Turning to the "lawyer"s brief" rule, the reason for the rule is, obviously, that, under our adversary system of litigation, a lawyer"s preparation of his client"s case must not be inhibited by the possibility that the materials that he prepares can be taken out of his file and presented to the Court in a manner other than that contemplated when they were prepared. What would aid in determining the truth when presented in the manner contemplated by the solicitor who directed its preparation might well be used to create a distortion of the truth to the prejudice of the client when presented by someone adverse in interest who did not understand what gave rise to its preparation. If lawyers were entitled to dip into each other"s briefs by means of the discovery process, the straightforward preparation of cases for trial would develop into a most unsatisfactory travesty of our present system.

What is important to note about both of these rules is that they do not afford a privilege against the discovery of facts that are or may be relevant to the determination of the facts in issue. What is privileged is the communications or working papers that came into existence by reason of the desire to obtain a legal opinion or legal assistance in the one case and the materials created for the lawyer"s brief in the other case. The facts or documents that happen to be reflected in such communications or materials are not privileged from discovery if,

Digitized by Google

otherwise, the party would be bound to give discovery of them...

In my view, it follows that, whether we are thinking of a letter to a lawyer for the purpose of obtaining a legal opinion or of a statement of facts in a particular form requested by a lawyer for use in litigation, the letter or statement itself is privileged but the facts contained therein or the documents from which those facts were drawn are not privileged from discovery if, apart from the facts having been reflected in the privileged documents, they would have been subject to discovery. For example, the financial facts of a business would not fall within the privilege merely because they had been set out in a particular way as requested by a solicitor for purposes of litigation, but the statement so prepared would be privileged.

Jackett P. then went on to examine the application of the solicitor/client privilege to "accountant"s materials". At 5283, he put it as follows:

Applying these principles, as I understand them, to materials prepared by accountants, in a general way, it seems to me

that no communication, statement or other material made or prepared by an accountant as such for a business man falls within the privilege unless it was prepared by the accountant as a result of a request by the business man"s lawyer to be used in connection with litigation, existing or apprehended; and

that, where an accountant is used as a representative, or one of a group of representatives, for the purpose of placing a factual situation or a problem before a lawyer to obtain legal advice or legal assistance, the fact that he is an accountant, or that he uses his knowledge and skill as an accountant in carrying out such task, does not make the communications that he makes, or participates in making, as such a representative, any the less communications from the principal, who is the client, to the lawyer; and similarly, communications received by such a representative from a lawyer whose advice has been so sought are none the less communications from the lawyer to the client.

The first principle stated by Jackett P. in *Susan Hosiery* encompasses all communications, whether verbal or written, between a client and his legal adviser pertaining to the legal advice sought by that client. The second principle stated by Jackett P., is the "brief" privilege. This privilege, according to a well known author[1], covers the following:

It is pointed out in para 17 of the 16th Report of the Law Reform Committee that the privilege covers three kinds of communication:

communications between the client or his agents and the client"s professional legal advisers;

communications between the client"s professional legal advisers and third parties, if made for the purpose of pending or contemplated litigation;

communications between the client or his agent and third parties, if made for the purpose of obtaining information to be submitted to the client"s professional legal advisers for the purpose of obtaining advice upon pending or contemplated litigation.

Thus, communications between a client and third parties will be privileged if they came into existence for the purpose of obtaining information for submission to the client"s legal advisers in order to obtain legal advice concerning pending or contemplated litigation.

Before turning to the facts of this case, reference should be had to the decision of the House of Lords in *Waugh v. British Railways Board*, (1979) 2 All ER 1169 where the House of Lords formulated the "dominant purpose" test in regard to the solicitor"s "brief" privilege. This is how Lord Edmund-Davies formulated the test at 1182 and 1183:

... And in my judgment we should start from the basis that the public interest is, on balance, best served by rigidly confining within narrow limits the cases where material relevant to litigation may be lawfully withheld. Justice is better served by candour than by suppression. For, as it was put in the *Grant v. Downs* majority judgment, "privilege...detracts from the fairness of the trial by denying a party access to relevant documents or at least subjecting him to surprise".

Digitized by Google

Adopting that approach, I would certainly deny a claim to privilege when litigation was merely one of several purposes of equal or similar importance intended to be served by the material sought to be withheld from disclosure, and a fortiori where it was merely a minor purpose. On the other hand, I consider that it would be going too far to adopt the "*sole* purpose" test applied by the majority in *Grant v. Downs* , which has been adopted in no United Kingdom decision nor, as far as we are aware, elsewhere in the Commonwealth. Its adoption would deny privilege even to material whose outstanding purpose is to serve litigation, simply because another and very minor purpose was also being served. But, inasmuch as the *only* basis of the claim to privilege in such cases as the present one is that the material in question was brought into existence for use in legal proceedings, it is surely right to insist that, before the claim is conceded or upheld, such a purpose must be shown to have played a paramount part. Which phrase or epithet should be selected to designate this is a matter of individual judgment. Lord Denning MR, as we have seen, favoured adoption of the phrase employed in the Law Reform Committee"s report, viz "material which came into existence...*wholly or mainly*" for the purpose of litigation. "Wholly" I personally would reject for the same reason as I dislike "solely", but "mainly" is nearer what I regard as the preferable test. Even so, it lacks the element of clear paramountcy which should, as I think, be the touchstone. After considerable deliberation, I have finally come down in favour of the test propounded by Barwick CJ in *Grant v. Downs* in the following words:

"Having considered the decisions, the writings and the various aspects of the public interest which claim attention, I have come to the conclusion that the Court should state the relevant principle as follows: a document which was produced or brought into existence either with the *dominant* purpose of its author, or of the person or authority under whose direction, whether particular or general, it was produced or brought into existence, of using it or its contents in order to obtain legal advice or to conduct or aid in the conduct of litigation, at the time of its production in reasonable prospect, should be privileged and excluded from inspection."

Dominant purpose, then, in my judgment, should now be declared by this House to be the touchstone. It is less stringent a test than "sole" purpose, for, as Barwick CJ added -

"...the fact that the person...had in mind other uses of the document will not preclude that document being accorded privilege, if it were produced with the requisite dominant purpose".

The "dominant purpose" test was recently adopted by the British Columbia Court of Appeal in *Shaughnessy Golf & Country Club v. Uniguard Services Ltd. and Chahal* , (1986) 1 B.C.L.R. (2d) 309. I see no reason why I should not follow this test.

I now turn to the facts relevant to this issue. The Applicant"s position is summarized at p. 20 of its memorandum of fact and of law:

Mr. Topley, an accountant and partner in Deloitte & Touche Inc. and representing Deloitte & Touche Inc., the client, prepared the working papers and analysis for the purpose of obtaining legal opinion and legal advice and to facilitate legal action on behalf of the client, Deloitte & Touche Inc., the Trustee of the Bankrupt Vancouver Trade Mart Inc. It is therefore respectfully submitted that this Court should order that all of the working papers and analyses enumerated in Exhibit "F" of the Affidavit of Colin Topley, sworn and filed herein, are subject to solicitor/client privilege and accordingly are not producible pursuant to the Notice of Requirement issued by the Respondent to the Applicant.

The Applicant"s working papers and analyses are listed in exhibit "F" to the affidavit of Colin Topley. The explanation offered by Mr. Topley concerning these documents appears at paragraph 31 of his affidavit:

... Most of those working papers and analyses are incomplete. All have been prepared by the Trustee since the outset of the Proposal process for presentation to legal counsel and the Inspectors with a view to the pursuit of realizations for the general benefit of Vancouver Trade Mart"s creditors.

Digitized by Google

During his examination on discovery held on October 16, 1996, Mr. Topley explains, at page 13, the creation of his working papers as follows:

My ending product was created from a combination from documents from Vancouver Trade Mart and subsequent interviews with other parties and, ah, subsequent access pursuant to various court orders. We"ve got -- some of which I think we got the court orders earlier this year in the spring.

The work done by Mr. Topley included examining VTM"s financial statements, memoranda, check stubs, ledger accounts, bank records, communication files, reports to shareholders and all other documents containing relevant information on the activities of the bankrupt company.

The Applicant, through Colin Topley, originally retained the firm of Ladner Downs on January 13, 1995 to provide legal advice with respect to VTM"s proposal to creditors under Part III, Division of the *Bankruptcy Act*

. The Applicant, with the help of legal counsel, examined VTM"s pre-proposal business transactions to determine if any of these transactions were voidable under federal or provincial law.

It cannot be disputed, in my view, that the work done by the Applicant and legal counsel prior to the meeting of April 19, 1995, i.e. when the creditors rejected VTM"s proposal, was primarily done for the purpose of convincing the creditors that VTM"s proposal should be accepted.

The object of the work undertaken by the trustee was to inform the inspectors to the bankruptcy in order to allow them to make proper decisions, initially with respect to VTM"s proposal and subsequently regarding the assets of the bankrupt estate.

It appears from the evidence that it was only on April 19, 1995, i.e. at the first meeting of the bankruptcy inspectors, that the creditors tentatively authorized the Applicant to retain legal counsel "to recover property from the fraudulent preference payments and dividends paid". (see page 43 of the examination on discovery of Colin Topley)

At the May 16, 1995 meeting of the inspectors the Applicant presented an invoice for its fees and those of legal counsel. At that meeting, the Applicant also sought the inspector"s consent to seek a legal opinion regarding possible litigation. The fees of both trustee and legal adviser were ratified by the inspectors but they informed the trustee that they were unwilling to incur any future risk and thus were not prepared to pay for the trustee"s work concerning "reviewable transactions". During his examination on discovery, at page 49, Mr. Topley made it clear that the creditors were not prepared to pay for legal bills nor were they prepared to "make any investment or funding of the ongoing administration of the estate". The creditors authorized the Applicant to carry on with its investigation but on the condition that its fees and those of legal counsel would only be paid if there was a recovery.

Paragraphs 30.(1)(d) and (e) of the *Bankruptcy Act* the allow the trustee, with the approval of the inspectors of the bankrupt estate, to institute or defend legal proceedings in relation to the property of the bankrupt and, in that regard, to retain solicitors to conduct the litigation. The legislation provides:

30. (1) The trustee may, with the permission of the inspectors, do all or any of the following things:

bring, institute or defend any action or other legal proceeding relating to the property of the bankrupt;

employ a solicitor or other agent to take any proceedings or do any business that may be sanctioned by the inspectors;.

As I pointed out above, it was only on May 16, 1995 that the inspectors of the bankrupt estate authorized the Applicant to retain solicitors in respect of a number of matters. These matters, as they appear from the resolutions passed at the May 16, 1995 meeting are the

Digitized by Google

following:
Resolution #18:
BE IT RESOLVED that the Trustee engage **Harper Grey Easton** to provide an opinion to the Trustee on the merits of any possible causes of action the Trustee may have against Mr. George Lee, and/or Mrs.
Julie Lee and/or Mr. Edward Lee or any of their related companies in relation to any transaction(s) that may be attackable and voided for the benefit of the Estate.
Resolution #19:
BE IT RESOLVED that the Trustee engage **Harper Grey Easton** and initiate steps to void and recover payments to non related Creditors and others that are deemed fraudulent preferences and settlements within the meaning of the Bankruptcy and Insolvency Act and the provincial statutes including the Fraudulent Preferences Act, The Fraudulent Settlement Act or the Companies Act. For more certainty the payments identified are set out in pages five (5) to nine (9) of the Trustee"s Report to Inspectors dated 12 April 1995.
Resolution #19B:
BE IT RESOLVED that the Trustee be authorized to engage **Harper Grey Easton** to initiate proceedings to void and recover funds paid by Vancouver Trade Mart Inc. to any financial institution in addition to payments set out in Pages 5 to 9 of the Trustees Report to Inspectors dated 12 April 1995 that can be deemed a fraudulent preference or settlement within the meaning of the Bankruptcy and Insolvency Act and the provincial statutes of the Fraudulent Preferences Act, the Fraudulent Settlement Act or the Companies Act.
Resolution #20:
BE IT RESOLVED that the Trustee engage **Harper Grey Easton** to assist the Trustee with the examination of the Directors of Vancouver Trade Mart including George Lee, Julie Lee, Edward Lee, Victor Elias and John Gorman.
Resolution #21:
BE IT RESOLVED that, the Trustee engage **Harper Grey Easton** to obtain appropriate Court Orders for the Trustee to obtain the books and records from various financial institutions, law firms, officers and directors of Vancouver Trade Mart where such books and records reflect transactions with Vancouver Trade Mart and will assist in identifying and recovering the property of Vancouver Trade Mart.
I should point out that the documents which the Minister seeks to obtain, and which the Applicant refuses to provide, have not been filed in the record so that I have not had the opportunity of examining them. Thus, contrary to what went on before Mr. Justice Teitelbaum in *Gregory v. Canada (Minister of National Revenue*), (1992) D.T.C. 6518, I have not been provided with a proper explanation regarding the contents of the documents sought by the Minister. In this regard, I have already referred to paragraph 31 of Mr. Topley"s affidavit and to page 13 of his examination on discovery.
Mr. Topley"s position, and thus the Applicant"s position, is that his working papers and account analyses were all prepared for the purpose of obtaining legal advice regarding possible litigation. Whether or not counsel requested this work to be done appears to be of no relevance.
In his written and oral arguments, counsel for the Applicant submitted that the evidence was clear, and not contradicted, that the working papers and analyses, were prepared for the purpose of seeking advice from legal counsel, Ladner Downs and Harper Grey Easton. I cannot agree with that submission. That is certainly the opinion of Mr. Topley but the evidence does not support his opinion. What the evidence shows is that the Applicant, through Mr. Topley, complied with the duties imposed upon it by the *Bankruptcy Act*. As Mr. Topley stated during his examination on discovery, at page 21:
It was my mandate as a trustee to do a review of the transactions, and because of the nature

Digitized by Google

of the transactions I engaged Mr. Geoffrey Thompson[2] to assist me to evaluate and guide me in the process.

Later on Mr. Topley was asked whether he needed a lawyer "to tell you how to do your job as a trustee?". He answered that he did not need a lawyer.

There is no evidence before me that either Ladner Downs or Harper Grey Easton requested Mr. Topley to prepare any report for their possible use in legal proceedings. In *Gregory, supra*, many of the documents in respect of which privilege was sought, were reports and opinions obtained by the solicitors from experts who had been retained in order to enable the solicitors to provide legal advice to their clients. That is certainly not the case in the present instance. The evidence does not satisfy me that the work was undertaken so as to enable counsel to give legal advice.

I am not satisfied that the documents which the Minister seeks to obtain were prepared for the "dominant purpose" of obtaining legal advice. In my view, the evidence does not come close to supporting that position. Before concluding, I wish to say that there cannot be much doubt that the Applicant"s working papers and accounts analyses are "documents" within the meaning of section 231.2(1) of the Act. I have already referred to the definition of "documents" which appears in section 231. The definition is a broad one and, in my view, is broad enough to include the documents sought herein by the Minister. There can also not be much doubt that the Applicant is a "person" within the meaning of section 231.2(1).

Counsel for the Applicant argued that "documents" in section 231.2(1) was meant to include source documents only and not documents such as those created by a trustee in bankruptcy. In view of the wording of the section, I cannot see how I can so restrict the meaning of the word "document". I would have to disregard the plain meaning of the words in the section to agree with the Applicant.

In *Gregory, supra*, no issue appears to have arisen with respect to the nature of the documents sought by the Minister. In that case, many of the documents sought by the Minister from the Applicant, a lawyer, were not "source documents" but rather opinions received by the applicant from lawyers and accountants. Teitelbaum J. refused to order the Applicant to produce the documents solely on the ground that they were privileged.

CONCLUSION:

For these reasons, this application shall be dismissed. "MARC NADON"

JUDGE

Ottawa, Ontario

Charter Implications

There have been arguments over whether a RFI constitutes an unreasonable search of a taxpayer's affairs by the state as was the case of R. v. Mckinlay Transport Ltd.[70] where the Supreme Court held:

> During an income tax audit of the appellants, Revenue Canada, pursuant to s. 231(3) of the *Income Tax Act*, served them with letters demanding information and the production of documents. Because the appellants failed to comply with these demands, an information was issued alleging that they had breached s. 238(2) of the Act. A Provincial Court judge quashed

[70] [1990] 1 S.C.R. 627

Digitized by Google

the information holding that s. 231(3) violated the guarantee to protection against unreasonable search and seizure in s. 8 of the *Canadian Charter of Rights and Freedoms*. The Ontario Supreme Court allowed respondent's appeal. The court found that s. 231(3) did not authorize a seizure within the meaning of s. 8. The judgment was upheld by the Court of Appeal.

Held: The appeal should be dismissed.
Per Lamer and Wilson JJ.: A demand for information or documents under s. 231(3) of the *Income Tax Act*, coupled with its enforcement mechanism in s. 238(2), does not violate s. 8 of the *Charter*. The purpose of ss. 231(3) and 238(2), when read together, is not to penalize criminal conduct but to enforce compliance with the Act. While a demand under s. 231(3) constitutes a "seizure", for the reasons given in *Thomson*, it is not an unreasonable one.
The *Income Tax Act* is essentially a regulatory statute which controls the manner in which income tax is calculated and collected. It is based on the principle of self-reporting and self-assessment. To ensure compliance with the Act, the Minister of National Revenue must be given broad powers to audit taxpayers' returns and inspect all relevant records whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act. The integrity of the tax system can be maintained only by a system of random monitoring and s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the Act can be effected. A taxpayer's expectation of privacy with regard to the documents in question *vis-à-vis* the Minister is relatively low. The taxpayer's privacy interest is protected as much as possible by s. 241 of the Act which forbids the disclosure of the taxpayer's records or the information contained therein to other persons or agencies. Therefore, the seizure contemplated by s. 231(3) is reasonable and does not infringe s. 8 of the *Charter*.
The standard of review of what is "reasonable" in a given context must be flexible if it is to be realistic and meaningful. It is consistent with this approach to draw a distinction between seizures in the criminal or quasi-criminal context to which the full rigours of the *Hunter* criteria will apply, and seizures in the administrative or regulatory context to which a lesser standard may apply depending upon the legislative scheme under review. In light of the regulatory nature of the legislation and the scheme enacted, it was evident in this case that the *Hunter* criteria were ill-suited to determine whether a seizure under s. 231(3) of the Act was reasonable.
Per La Forest J.: As in *Thomson*, the *Income Tax Act*, though supported by penal sanctions, including imprisonment, is essentially of an administrative nature. For the reasons I gave in *Thomson* and, subject to these reasons, for those given by Wilson J. in this appeal, s. 231(3) of the Act is reasonable and does not violate s. 8 of the *Charter*.
Per L'Heureux-Dubé J.: Subject to the reasons I gave in *Thomson*, s. 231(3) of the *Income Tax Act* does not violate s. 8 of the *Charter*. While a demand under s. 231(3) of the Act may be considered a seizure within the meaning of s. 8, such a seizure is reasonable.
Per Sopinka J.: For the reasons I gave in *Thomson*, neither the letters of demand herein nor s. 231(3) of the *Income Tax Act* violate s. 8 of the *Charter*. The letters of demand do not constitute a seizure and s. 231(3) does not authorize a seizure within the meaning of s. 8.
In Jean-Alain Bisaillon, Hypnat Ltée, Hypnat Ltée, Courtier, And Her Majesty The Queen And Minister Of National Revenue[71] the argument was put forward again when the CRA made a RFI to a bank that held a payable to a taxpayer who was being charged for alternate violations. It held:
[2] The motions judge properly came to the conclusion that in the action brought by the

[71] A-315-99

Digitized by Google

appellants there were no serious questions of law to be tried.

[3] In fact, *McKinlay Transport Ltd.,* a judgment by the Supreme Court of Canada, applies in the case at bar and disposes of the constitutional arguments made by the appellants. In that case the Supreme Court concluded that:

- the Act is essentially a regulatory measure;
- s. 231(3) (the predecessor of s. 231.2(1)) is not criminal or quasi-criminal law;
- application of that subsection constitutes a seizure since it infringes the individual"s expectations of privacy;
- only unreasonable seizures contravene s. 8 of the *Charter of Rights and Freedoms*;
- seizure in an administrative and regulatory context must be distinguished from seizure in a criminal or quasi-criminal situation;
- in a taxation system based on the principle of self-reporting and self-assessment, the Minister of National Revenue has to have broad powers to audit taxpayers' returns and inspect records which may have been used to prepare those returns;
- the Minister of National Revenue must be able to exercise these powers whether or not he has reasonable grounds to believe that a particular taxpayer has breached the Act;
- s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the Act can be carried out; and
- the taxpayer's privacy interest with regard to documents which may be relevant in income tax returns is relatively low in relation to the Minister.

[4] In our opinion, it is not a serious argument for the appellants to say that a requirement to provide documents or information, like the one at bar, infringes the constitutional provisions of ss. 7 and 8 of the Charter when that requirement is made as part of a genuine administrative investigation for the purpose of recovering money owed and with a real objective of collecting information in that connection. Of course, it cannot be used as a stratagem for the covert purpose of obtaining information to be used in criminal proceedings.

[5] Having said that, the fact that the Minister has reasonable grounds to believe that an offence may have been committed or the fact that the information obtained pursuant to the ministerial requirement may eventually be used for other than the administrative or civil purpose for which it was initially requested does not have the effect of distorting the initial requirement or its purpose, transforming the administrative investigation into a criminal one and preventing the information requested from being obtained and used to ensure compliance with the Act at the civil and administrative level.

[9] Further, if as the appellants alleged and feared the Department's Investigations Branch were to see fit to use the said information in the criminal proceedings, the appellants charged might then assert their constitutional rights at the time the infringement was imminent and so oppose their use in that forum.[2] **The mere possibility that wrongful use might be made of information obtained pursuant to an administrative investigating power exercised in accordance with the Act clearly cannot compromise the existence of that power or prevent or invalidate its exercise.**

[10] Similarly, we consider that there is no merit in the appellants' argument that the requirement of information addressed to the Laurentian Bank of Canada is nothing but an illegal "fishing expedition". *McKinlay Transport Ltd., supra*, and *Richardson v. Minister of National Revenue*[72] recognized that it is often

difficult for the Minister making a requirement for information or documents to know exactly what documents he is looking for, and so to describe them with great precision and an

[72] [1984] 1 S.C.R. 614, at 625

Digitized by Google

abundance of detail.

…

[12] Finally, the requirement of information pursuant to s. 231.2(1) meets each of the criteria of validity laid down in *Richardson*:

- **the Minister is acting for a legitimate purpose specified and authorized by the Act, namely the collection of a due and payable tax debt;**
- **the requirement of information relates to the tax liability of a person (Hypnat Ltée), that liability is under administrative investigation and the obtaining of information is necessary in general to ensure compliance with the Act, and in particular the collection of money owed to Revenue Canada;**
- **the person from whom the information is sought does not have to be the one whose liability to tax is under investigation; and**
- **the requirement is valid even though the giving of the information may disclose private transactions involving persons who are not under investigation and may not be liable to tax.**

In Javed Ahmad, Naheed Surrya Ahmad, Tahira Parveen Chaudhry, Khush B.R. Chaudhry v. The Minister Of National Revenue the taxpayer attempted to argue the same and the Court held:

Section 7 and Right to Silence

[25] In the tax audit *per se* there is no suspect and no accused. The procedure is entirely administrative in nature.

[28] In the *Tyler* case[2], the Court prohibited the respondent Minister from communicating the signed
statements obtained under paragraph 231.2(1)(a) to the RCMP. Here, the applicants have already provided those statements to the Minister. What they are objecting to is the production of supporting documents under paragraph 231.2(1)(b).

Section 8

[29] In the *McKinlay* case at page 649, the Supreme Court of Canada reviewed the constitutionality of subsection 231(3) of the *Income Tax Act* (now subsection 231.2(1) of the *Income Tax Act*) and concluded that even if a Requirement for Production of Documents is a "seizure" within the meaning of section 8 of the Charter, such "seizure" is reasonable and, hence, is not a violation of section 8;

In my opinion, s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the Income Tax Act can be effected. It involves no invasion of a taxpayer's home or business premises. It simply calls for the production of records which may be relevant to the filing of an income tax return. A taxpayer's privacy interest with regard to these documents vis-à-vis the Minister is relatively low. The Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them. At the same time, the taxpayer's privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies.

Subsections 11(c) and (d), Section 13 and Right to Silence

[30] The tax audit conducted by Revenue Canada is not an investigation in a criminal process; it is purely administrative in a civil context.

[31] The protection afforded by subsections 11(c) and (d) is a protection against testimonial compulsion of an accused and a protection against self-incrimination.

[32] Revenue Canada has collected little information at this point in its audit on the applicants' tax position and there is no evidence in the record that information was conveyed from Revenue Canada to the RCMP or any other person in relation to Javed Ahmad's and

Digitized by Google

Naheed Surrya Ahmad's criminal proceedings.
[33] Even though Javed Ahmad and Naheed Surrya Ahmad are facing criminal charges under the *Narcotic Control Act*, the production of the requested documents, pursuant to the *Income Tax Act*, does not deprive them of their constitutional rights under the *Canadian Charter of Rights and Freedoms*.
[34] With respect to Tahira Parveen Chaudhry and Khush B.R. Chaudhry, they have not been charged with any criminal offences and, therefore, the protection afforded by the Charter under subsections 11(c) and
(d) does not apply to them in the course of a tax audit, which is purely administrative.
… CONCLUSION
[36] I find that the request for production under paragraph 231.2(1)(b) of the *Income Tax Act* is for a valid purpose and does not constitute an abuse of process.
[37] I also find that the request does not infringe the applicants' rights under sections 7, 8, 11(c), 11(d) and section 13 of the Charter or their right to silence.
[38] I further find that the applicants are not entitled to an order in the nature of mandamus compelling the Minister to immediately return all information and documents provided to date under paragraph 231.2(1)(a) of the *Income Tax Act*.

Jarvis/Ling and the Charter's Effect on RFI's use By SI Investigators

If there is one set of cases that have determined when a Sec 231.1(1)-(2) RFI can be used legitimately under the ITA and not offend the Charter it is the two cases of R. v. Jarvis and R. v. Ling[73] These two cases set the line where CRA prerogative in furthering tax evasion prosecution and the individuals' right to oppose self-incrimination meet.

R. v. Jarvis, [2002] 3 S.C.R. 757, 2002 SCC 73, The Case That 'Changed The World' on Self-Incrimination, Delineation between Auditor and SI Investigator and Evidence Collection

Warren James Jarvis *Appellant*
v.
Her Majesty The Queen *Respondent*
and
The Attorney General for Ontario,
the Attorney General of Quebec and
the Criminal Lawyers' Association (Ontario) *Interveners*
Indexed as: R. *v.* Jarvis
Neutral citation: 2002 SCC 73.
File No.: 28378.
2002: June 13; 2002: November 21.
Present: McLachlin C.J. and L'Heureux-Dubé, Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour and LeBel JJ.
on appeal from the court of appeal for alberta

Income tax — Administration and enforcement — Audits and investigations — Whether distinction can be drawn between audit and investigation under Income Tax Act —

[73] 2002 SCC 74, [2002] 3 S.C.R. 814

Digitized by Google

If so, circumstances in which tax official's inquiry constitutes penal investigation — Whether evidence obtained during audit pursuant to ss. 231.1(1) and 231.2(1) of Income Tax Act can be used to further investigation or prosecution of offences under s. 239(1) of the Act without violating taxpayer's Charter rights — Canadian Charter of Rights and Freedoms, ss. 7, 8 — Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 231.1, 231.2.

Income tax — Administration and enforcement — Audits and investigations — Sections 231.1(1) and 231.2(1) of Income Tax Act available "for any purpose related to administration or enforcement" of Income Tax Act — Whether "enforcement" of Income Tax Act includes investigation and prosecution of offences under s. 239 of Act — Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 231.1(1), 231.2(1), 239.

Constitutional law — Charter of Rights — Fundamental justice — Principle against self-incrimination — Extent to which taxpayer under investigation for offences under s. 239 of Income Tax Act benefits from principle against self-incrimination — Canadian Charter of Rights and Freedoms, s. 7.

Constitutional law — Charter of Rights — Unreasonable search or seizure — Taxpayer under investigation for offences under s. 239 of Income Tax Act — Whether documents obtained under ss. 231.1(1) and 231.2(1) of Income Tax Act after penal investigation has commenced violate taxpayer's right against unreasonable search or seizure — Canadian Charter of Rights and Freedoms, s. 8 — Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 231.1(1), 231.2(1).

Constitutional law — Charter of Rights — Exclusion of evidence — Tax evasion — Revenue Canada receiving information alleging that taxpayer had committed tax evasion — Statements and documents obtained during inquiry by tax auditor pursuant to ss. 231.1(1) and 231.2(1) of Income Tax Act transferred to investigator — Investigator obtaining further information with requirement letters to various banks and search warrant — Taxpayer charged with tax evasion — Whether evidence against taxpayer obtained in violation of his rights under Canadian Charter of Rights and Freedoms — If so, whether evidence should be excluded — Canadian Charter of Rights and Freedoms, s. 24(2).

Revenue Canada began an inquiry following a tip that the appellant taxpayer had not reported sales of his late wife's art in his tax returns for the 1990 and 1991 taxation years. In February 1994, the auditor sent letters to the taxpayer indicating that his file had been selected for audit and requesting certain books and records. The auditor visited art galleries and gathered enough information to determine that the tip had some validity. On March 16, she obtained further information by phone from the taxpayer and his accountant. On April 11, the auditor and her supervisor met the taxpayer to review his records. He was not cautioned. He answered questions, provided banking information, signed a bank authorization, and provided materials including records of sales and expenses related to the art. By late April, the auditor had obtained the additional records and information requested from the taxpayer and she concluded that he had grossly omitted revenues in the relevant returns. On May 4, the auditor referred her entire file to the Special Investigations Section of Revenue Canada, which began an investigation to determine whether prosecution for tax evasion was merited. Despite numerous requests concerning the status of the audit, the auditor deliberately did not inform the taxpayer that his file had been referred to the investigative section. After a review of the file, and on the basis of the books and records obtained from the taxpayer at the April 11 meeting, the investigator determined that reasonable and probable grounds existed to seek a search warrant to investigate for tax evasion. In November, a search warrant issued under the *Criminal Code* authorized the searches of a Revenue Canada's office and the respective residences of the taxpayer and

Digitized by Google

his accountant. In early 1995, requirement letters issued to various banks under s. 231.2(1) of the *Income Tax Act* by the investigator provided additional information.

The taxpayer was charged with tax evasion under s. 239 of the Act. The trial judge held that the audit had effectively become an investigation as of March 16, 1994. Since the auditor failed to caution the taxpayer at the April 11 meeting, the statements and documents gathered at that meeting were obtained in violation of his rights under s. 7 of the *Canadian Charter of Rights and Freedoms* and reference to that information in the Information to Obtain A Search Warrant was removed. The trial judge concluded that what remained did not provide "reasonable grounds" for a search warrant and, as a result, the execution of the searches violated the taxpayer's s. 8 *Charter* rights. He also concluded that the banking records obtained by way of s. 231.2(1) in early 1995 violated the taxpayer's s. 8 rights. Pursuant to s. 24(2) of the *Charter*, the 1995 banking information and the evidence obtained at the April 11 meeting and through the searches were excluded. The trial judge granted a motion for a directed verdict of acquittal. The summary conviction appeal judge ordered a new trial, holding that only the taxpayer's statements during the April 11 meeting should have been excluded from the Information to Obtain and that the search warrant otherwise had been validly issued. The Court of Appeal dismissed a further appeal and affirmed the order for a new trial.

Held: The appeal should be dismissed.

Although the *Income Tax Act* relies upon self-assessment and self-reporting, the Minister of National Revenue has broad powers for the administration and enforcement of the Act. Under ss. 231.1 and 231.2, a person authorized by the Minister has the powers to: enter a taxpayer's place of business or place of record keeping; require the taxpayer and third parties to answer questions put to them; and require the taxpayer and third parties to furnish information and documents upon request. To ensure compliance with the self-reporting requirements of the Act, s. 239 creates offences which carry significant penalties, including incarceration. Section 239 bears the formal hallmarks of criminal legislation and, even though the Act is a regulatory statute, non-compliance with its mandatory provisions will in some cases lead to criminal charges. In prosecution thereof, the state is pitted against the individual in an attempt to establish culpability. To conduct an appropriately contextual *Charter* analysis, the various regulatory and penal considerations must all exert some influence.

The scope of *Charter* rights and freedoms will vary according to the circumstances. This case concerns both s. 7 and s. 8 of the *Charter* and the exclusion of evidence under s. 24(2) of the *Charter* from a trial for offences under s. 239. The taxpayer's liberty interest under s. 7 was engaged by the introduction at his trial of statutorily compelled information. In giving expression to the principle against self-incrimination, however, s. 7 does not envelop an abstract and absolute rule that prevents the use of statutorily compelled information in all contexts. A contextual analysis involves balancing the principle against self-incrimination with the principle that relevant evidence should be available to the trier of fact. The reasonable expectation of privacy guaranteed by s. 8 of the *Charter* also is context-specific. At some point, the public's interest in being left alone by government must give way to the government's interest in intruding on privacy to advance its goals. Generally, there is a diminished expectation of privacy in records produced during the ordinary course of regulated activities and there is a relatively low privacy interest in records relevant to a tax return.

A distinction can be drawn between the audit and investigative powers under the *Income Tax Act*. By their express terms, both ss. 231.1(1) and 231.2(1) are available for any

Digitized by Google

purpose related to the "administration" or "enforcement" of the Act. Although this wording seems broad, when read in context, these sections do not include the prosecution of s. 239 offences. In particular, the existence of a prior authorization procedure under s. 231.3(1) where an offence is suspected implies that the separate statutory inspection and requirement powers are unavailable for the purpose of prosecutorial investigations. A warrant under s. 231.3 of the Act covers generally the same ground as does the *Criminal Code*'s s. 487 warrant. When a tax official exercises his or her investigative function, the parties are in an adversarial relationship because of the liberty interest that is at stake. It follows that there must be some measure of separation between the audit and investigative functions.

Where the predominant purpose of an inquiry is the determination of penal liability, there exists an adversarial relationship between the taxpayer and the state. To determine whether the predominant purpose of an inquiry is the determination of penal liability, one must look to all factors that bear upon the nature of the inquiry. Apart from a clear decision to pursue a criminal investigation, no one factor is determinative. Even where reasonable grounds to suspect an offence exist, it will not always be true that the predominant purpose of an inquiry is the determination of penal liability. The following factors assist in ascertaining whether an inquiry's purpose is to investigate penal liability: (a) Did authorities have reasonable grounds to lay charges or could a decision have been made to proceed with a criminal investigation? (b) Was the general conduct of the authorities consistent with a criminal investigation? (c) Did the auditor transfer his or her file to the investigators? (d) Was the auditor's conduct such that he or she was acting as an agent for the investigators? (e) Does it appear that the investigators intended to use the auditor as their agent? (f) Is the evidence relevant to taxpayer liability generally or only to penal liability? and, (g) Do other circumstances or factors suggest that an audit became a criminal investigation?

Wherever the predominant purpose of an inquiry or question is the determination of penal liability, all *Charter* protections that are relevant in the criminal context must apply. When this is the case, investigators must provide the taxpayer with a proper warning. With respect to s. 7 of the *Charter*, the constitutional protections against self-incrimination prohibit tax officials who are investigating the offences from having recourse to the inspection and requirement powers under ss. 231.1(1) and 231.2(1). Rather, tax officials who exercise the authority to conduct such investigations must seek search warrants under s. 231.3 of the Act or s. 487 of the *Criminal Code* in furtherance of their investigation. With respect to s. 8 of the *Charter*, taxpayers have very little privacy interest in materials they are obliged to keep under the Act or to produce during an audit. Once an auditor has inspected or required a document under ss. 231.1(1) and 231.2(1), the taxpayer cannot be said to have a reasonable expectation that the auditor will guard its confidentiality. As a consequence, there is no general rule that prevents auditors from passing files containing validly obtained audit materials to investigators. Nor is there any reason that the CCRA cannot conduct parallel administrative audits and criminal investigations. However, if the CCRA simultaneously conducts an administrative audit and criminal investigation, investigators can avail themselves only of that information obtained pursuant to the audit powers prior to the commencement of the criminal investigation. They cannot avail themselves of information obtained pursuant to such powers subsequent to the commencement of the investigation into penal liability.

Whether an inquiry is in furtherance of an audit or a penal investigation is a question of mixed fact and law and is not immune from appellate review. The record in this case does not support a finding that the auditor used her misleading tactics to obtain

Digitized by Google

information from the taxpayer or his accountant under ss. 231.1(1) and 231.2(1) for the predominant purpose of determining the taxpayer's penal liability under s. 239. There was no investigation into penal liability prior to May 4, 1994. Accordingly, the material that the trial judge excluded from the Information to Obtain A Search Warrant owing to a *Charter* violation was in fact validly gathered pursuant to the auditor's inspection and requirement powers. Since the searches were made pursuant to a valid warrant, the evidence obtained during these searches should be admissible in a new trial. The usage of the banking information obtained by the investigator pursuant to s. 231.2(1) requirement letters in early 1995, after the investigation was underway, violated the taxpayer's s. 7 rights and should be excluded.

Cases Cited

Referred to: *British Columbia Securities Commission v. Branch*, [1995] 2 S.C.R. 3; *R. v. Norway Insulation Inc.* (1995), 23 O.R. (3d) 432, aff'g [1995] 2 C.T.C. 451; *R. v. Araujo*, [2000] 2 S.C.R. 992, 2000 SCC 65; *Del Zotto v. Canada*, [1997] 3 F.C. 40, rev'd [1999] 1 S.C.R. 3; *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627; *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425; *Knox Contracting Ltd. v. Canada*, [1990] 2 S.C.R. 338; *143471 Canada Inc. v. Quebec (Attorney General)*, [1994] 2 S.C.R. 339; *R. v. Hydro-Québec*, [1997] 3 S.C.R. 213; *Smerchanski v. M.N.R.*, [1977] 2 S.C.R. 23; *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154; *Comité paritaire de l'industrie de la chemise v. Potash*, [1994] 2 S.C.R. 406; *R. v. Grimwood*, [1987] 2 S.C.R. 755; *R. v. Ling*, [2002] 3 S.C.R. 814, 2002 SCC 74; *Re Ramm*, [1958] O.R. 98; *Hunter v. Southam Inc.*, [1984] 2 S.C.R. 145; *General Motors of Canada Ltd. v. City National Leasing*, [1989] 1 S.C.R. 641; *R. v. Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606; *Baron v. Canada*, [1993] 1 S.C.R. 416; *Edmonton Journal v. Alberta (Attorney General)*, [1989] 2 S.C.R. 1326; *Symes v. Canada*, [1993] 4 S.C.R. 695; *R. v. Lyons*, [1987] 2 S.C.R. 309; *Canadian Broadcasting Corp. v. New Brunswick (Attorney General)*, [1991] 3 S.C.R. 459; *Re B.C. Motor Vehicle Act*, [1985] 2 S.C.R. 486; *Reference re ss. 193 and 195.1(1)(c) of the Criminal Code (Man.)*, [1990] 1 S.C.R. 1123; *R. v. S. (R.J.)*, [1995] 1 S.C.R. 451; *R. v. P. (M.B.)*, [1994] 1 S.C.R. 555; *R. v. Jones*, [1994] 2 S.C.R. 229; *R. v. Fitzpatrick*, [1995] 4 S.C.R. 154; *R. v. White*, [1999] 2 S.C.R. 417; *R. v. Plant*, [1993] 3 S.C.R. 281; *Smith v. Canada (Attorney General)*, [2001] 3 S.C.R. 902, 2001 SCC 88; *Bell ExpressVu Limited Partnership v. Rex*, [2002] 2 S.C.R. 559, 2002 SCC 42; *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27; *R. v. Gladue*, [1999] 1 S.C.R. 688; *Canadian Bank of Commerce v. Canada (Attorney General)*, [1962] S.C.R. 729; *James Richardson & Sons, Ltd. v. M.N.R.*, [1984] 1 S.C.R. 614; *R. v. Multiform Manufacturing Co.*, [1990] 2 S.C.R. 624; *R. v. Bjellebo*, [1999] O.J. No. 965 (QL); *R. v. Pheasant*, [2001] G.S.T.C. 8; *R. v. Chusid* (2001), 57 O.R. (3d) 20; *R. v. Roberts*, [1998] B.C.J. No. 3184 (QL); *R. v. Dial Drug Stores Ltd.* (2001), 52 O.R. (3d) 367; *Samson v. Canada*, [1995] 3 F.C. 306, leave to appeal refused, [1996] 1 S.C.R. ix (*sub nom. Samson v. Addy*); *R. v. Yip* (2000), 278 A.R. 124, 2000 ABQB 873; *R. v. Anderson* (2001), 209 Sask. R. 117, 2001 SKQB 334; *R. v. Seaside Chevrolet Oldsmobile Ltd.* (2002), 248 N.B.R. (2d) 132, 2002 NBPC 5; *R. v. Warawa* (1997), 208 A.R. 81; *R. v. Coghlan*, [1994] 1 C.T.C. 164; *Gorenko v. La Reine*, [1997] R.J.Q. 2482, aff'd [1999] Q.J. No. 6268 (QL); *Roncarelli v. Duplessis*, [1959] S.C.R. 121; *Babcock v. Canada (Attorney General)*, [2002] 3 S.C.R. 3, 2002 SCC 57; *Canada (Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748.

Digitized by Google

Statutes and Regulations Cited

Act to amend the Income War Tax Act, S.C. 1944, c. 43, s. 11.
Business Profits War Tax Act, 1916, S.C. 1916, c. 11.
Canadian Charter of Rights and Freedoms, ss. 7, 8, 24.
Criminal Code, R.S.C. 1985, c. C-46, s. 487.
Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 2, 150(1), 151, 152(1), (4), 162, 163, 230(1), 231.1 [am. 1994, c. 21, s. 107], 231.2, 231.3 [*idem*, s. 108], 238(1), 239(1), (2), 241 [am. 1994, c. 7, Sched. VIII, s. 137(1)].
Income War Tax Act, 1917, S.C. 1917, c. 28, s. 8.
Interpretation Act, R.S.C. 1985, c. I-21, s. 12.

Authors Cited

Driedger, Elmer A. *Construction of Statutes*, 2nd ed. Toronto: Butterworths, 1983.
Krishna, Vern. *The Fundamentals of Canadian Income Tax*, 6th ed. Scarborough, Ont.: Carswell, 2000.
Oxford English Reference Dictionary, 2nd ed. Edited by Judy Pearsall and Bill Trumble. Oxford: Oxford University Press, 1996, "enforce".

APPEAL from a judgment of the Alberta Court of Appeal (2000), 149 C.C.C. (3d) 498, 271 A.R. 263, 234 W.A.C. 263, 87 Alta. L.R. (3d) 52, 193 D.L.R. (4th) 656, [2001] 3 W.W.R. 271, [2000] A.J. No. 1347 (QL), 2000 ABCA 304, affirming a judgment of Lutz J. (1998), 225 A.R. 225, 63 Alta. L.R. (3d) 236, 98 D.T.C. 6308, [1999] 3 W.W.R. 393, [1998] 3 C.T.C. 252, [1998] A.J. No. 651 (QL), allowing the Crown's appeal from a judgment of the Provincial Court acquitting a taxpayer of tax offences and ordering a new trial. Appeal dismissed.

Alan D. Macleod, *Q.C.*, and *Wendy K. McCallum*, for the appellant.

S. David Frankel, *Q.C.*, *Bruce Harper* and *Janet Henchey*, for the respondent.

Trevor Shaw, for the intervener the Attorney General for Ontario.

Gilles Laporte and *Monique Rousseau*, for the intervener the Attorney General of Quebec.

Scott K. Fenton, for the intervener the Criminal Lawyers' Association (Ontario).

The judgment of the Court was delivered by

1 IACOBUCCI AND MAJOR JJ. -- Is there a distinction between the Canada Customs and Revenue Agency's ("CCRA") audit and investigative functions under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("ITA")? If it is indeed correct to draw such a distinction, when does the CCRA exercise its audit function and when does it exercise its investigative function? Finally, what are the legal consequences for the taxpayer when the CCRA exercises its investigative function?

2 Ultimately, we conclude that compliance audits and tax evasion investigations must be treated differently. While taxpayers are statutorily bound to co-operate with CCRA auditors for tax assessment purposes (which may result in the application of regulatory penalties), there is an adversarial relationship that crystallizes between the taxpayer and the tax officials when the predominant purpose of an official's inquiry is the determination of penal liability. When the officials exercise this authority, constitutional protections against self-incrimination prohibit CCRA officials who are investigating ITA offences from having recourse to the powerful inspection and requirement tools in ss. 231.1(1) and 231.2(1). Rather, CCRA officials who exercise the authority to conduct such investigations must seek search warrants in furtherance of their investigation.

3 Here, the material that the trial judge excluded from the Information to Obtain A Search Warrant owing to a *Charter* violation was in fact validly gathered pursuant to

Digitized by Google

the auditor's inspection and requirement powers. Accordingly, the searches ultimately carried out were authorized by warrant, and no s. 8 violation occurred. Therefore, we would dismiss the appeal and confirm the Court of Appeal of Alberta's order of a new trial.

I. Factual Background

4 The appellant, Warren Jarvis, is a farmer in Alberta. His wife, Georgia Jarvis, was, until the time of her death, an artist earning income from the sale of her works. Mrs. Jarvis reported this income on her annual individual tax returns.

5 Mrs. Jarvis died on October 22, 1990. A few of her original works and a number of limited edition prints remained unsold at the time; as well, it appears that the appellant may also have had some additional prints created subsequent to his wife's death. The appellant was therefore able to continue the sale of his late wife's art, which he did. In 1992, as art sales began to dissipate, the appellant, in an apparent attempt to put the past behind him, moved into a rural log cabin, roughly 80 kilometres north-west of Calgary.

6 Early in 1994, an anonymous informant addressed a typewritten letter ("the lead") to the Chief of Audit in the Calgary District Taxation Office of what was then Revenue Canada. For reasons of confidentiality, the lead is not in evidence in this case. We do know, however, that the lead alleged that the appellant had failed to report substantial income related to the 1990 and 1991 taxation years. Furthermore, the lead listed six Calgary art galleries that had purchased Mrs. Jarvis's art work from the appellant.

7 Although internal departmental policies identified all tax leads from informants as being the responsibility of the Special Investigations Section, the lead was in fact referred to the Business Audit Section. There, it was assigned to Donna Goy-Edwards, an experienced business auditor. Goy-Edwards took sole control over the file, reporting to her supervisor, John Moriarty.

8 On February 16, 1994, Goy-Edwards prepared an "Audit Plan," consisting of three separate tasks:

1) Clear lead.

2) Review disposition of all assets at date of death in Oct/90. Review all tax consequences.

3) Audit accordingly.

Not all leads received by the CCRA are substantiated; hence, "clearing" a lead refers to a process whereby the auditor reviews source documents for the purpose of determining the validity of the allegations contained in the lead. To this end, Goy-Edwards attempted on February 16 and 17 by telephone to reach the appellant and the accountant, Tom Burke, who had prepared the 1990 and 1991 tax returns. She was unable to reach either, but left two voice messages on the appellant's telephone answering machine.

9 Goy-Edwards then sent two letters to the appellant on February 17. The letters were addressed simply "General Delivery, Cremona, Alberta". One letter dealt with the appellant in his capacity as executor of his wife's estate, indicating that "[t]he file of the Late Georgia Jarvis has been selected for audit for the [1990] taxation year" and that "this letter will serve as a formal notice of the audit in progress". The other letter concerned the appellant in his personal capacity, and specified that his file had "been selected for audit for the taxation years 1990 & 1991", adding again that the letter constituted formal notice of the audit. In each instance, the appellant was requested to make available certain enumerated books and records. Finally, the letters stated that the respective files would be held in abeyance for a 15-day period to allow the appellant "an opportunity to contact the writer and make arrangements to have the books and records made available for the audit".

Digitized by Google

10 On March 7, 1994, shortly after the 15-day period elapsed without word from the appellant, Goy-Edwards commenced contact with third-party sources. She researched departmental library services for written information on Mrs. Jarvis's art work, to obtain facts about her works and discover where they were being displayed. Through these efforts, she was able to locate three additional galleries, not listed in the lead, that had purchased art from the appellant. Goy-Edwards then personally contacted or visited all nine galleries. She identified herself as a Revenue Canada employee and requested that she be granted access to certain of their books and records pertaining to art sales.

11 Between March 7 and 16, Goy-Edwards was able to obtain information from each of the galleries regarding the sale of Mrs. Jarvis's works. From the particulars contained in purchase invoices and cancelled cheques, the auditor determined that the appellant had grossed $358,409 from sales to the nine galleries between October 23 and December 31, 1990. For the 1991 calendar year, the figure was $221,366. Endorsements found on the reverse side of the cheques also disclosed information regarding the appellant's banking arrangements. Independently, Goy-Edwards calculated that, for sales accruing to Mrs. Jarvis from January 1, 1990 until her death, the cost of sales was 29.5 percent of gross. Based on all of this information, along with the appellant's tax returns for the 1990 and 1991 taxation years, Goy-Edwards determined that the lead had some validity.

12 Twice on March 8, the appellant attempted to reach Goy-Edwards by telephone, leaving messages that he had called. These calls were not immediately returned. On March 16, Jarvis's accountant, Burke, telephoned Goy-Edwards, who explained the audits that she was conducting, advised of the taxation years concerned, and made some enquiries as to the appellant's financial affairs. Burke informed the auditor that the file was likely to be in disarray, owing to the appellant's poor record-keeping skills and the general apathy towards financial and taxation matters that the appellant had exhibited since Mrs. Jarvis's death; in fact, Burke had seen no source documents, since the appellant was in the habit of providing only summaries of his income.

13 Burke explained that, for taxation purposes, after Mrs. Jarvis's death the income accruing from the sale of her art, net of expenses, was reported as part of the appellant's farming income. According to the accountant, the appellant netted somewhere in the vicinity of $58,000 for art sold in the 1990 taxation year, and precisely $43,061.79 for 1991. Goy-Edwards requested that Burke submit copies of the income summaries that the appellant had provided him. Burke replied that he would first have to speak to the appellant and obtain his authorization to release the information.

14 Later the same afternoon, Burke called back to advise Goy-Edwards that he had spoken to the appellant, and to pass on instructions for Goy-Edwards personally to call the appellant concerning the audit. The auditor immediately telephoned the appellant, confirmed that the latter was to gather the documentation requested in the February 17 letters, and made arrangements to meet at the appellant's farm on April 11, 1994 to "commence a review of the books and records". The record indicates that the parties might have chosen this date in order to provide the appellant with sufficient time to amass the documentation, since many of his belongings were still packed up from his move.

15 Goy-Edwards made no mention of the fact that she had already contacted third party sources. In response to one of her questions, however, the appellant confirmed the $58,000 figure relative to 1990 net art sales income. Finally, Goy-Edwards advised the appellant that she would be accompanied by an assistant during the audit. The appellant stated that he would not have any difficulties with this.

16 On April 11, Goy-Edwards was in fact accompanied to the appellant's

Digitized by Google

residence by her supervisor, Moriarty, whom she introduced on this occasion as her "team leader". The judge at first instance expressly disbelieved Goy-Edwards' explanation that Moriarty came along to provide navigational assistance because of her lack of familiarity with the area in which the appellant lived. The supervisor was present in an observational role.

17 During the interview, Moriarty did not actively take notes. Moreover, Goy-Edwards took the lead in all discussions, with Moriarty interjecting only occasionally to obtain clarification.

18 The appellant was not cautioned as to his rights. He answered all of the auditor's questions, which dealt primarily with the art sales but which also touched upon his farming operations. The appellant stated that all information pertaining to art sales was contained in the contracts and receipt books he kept. He provided information about his banking arrangements, and indicated that he would take steps to access the records pertaining thereto. In addition, the appellant signed a bank authorization for an account held with the Bank of Montreal, the existence of which he had not disclosed until Goy-Edwards posed a question about it: the auditor knew of the account from her third-party source investigations. She agreed to hold the authorization in abeyance for a short while in order to give the appellant the opportunity personally to obtain the documentation.

19 Goy-Edwards enquired into the inventory of originals and prints at the date of Mrs. Jarvis's death, as well as the appellant's role in selling the art. Her purpose with these lines of questioning was to compare the responses given by the appellant to the information that she had previously obtained from the departmental library. Finally, the appellant provided the auditor with art sale-related materials, including the two receipt books tracking sales and a number of other receipts documenting expenses. Goy-Edwards removed these books and records for later examination.

20 A few days after the interview, on April 15, Burke telephoned Goy-Edwards for an updated report on the state of the file. Goy-Edwards briefed the accountant as to the April 11 meeting, and stated that she would keep him apprised of the audit's progress.

21 In late April 1994, Goy-Edwards obtained many of the records and much of the information requested from the appellant. Subsequently, she performed various calculations to determine whether all the income related to the art sales had been properly reported. As a result of these calculations, Goy-Edwards noted a discrepancy of approximately $700,000 between the appellant's earned and reported income over the two taxation years in question. On this basis, the auditor concluded that the appellant had grossly omitted revenues, suggesting that fraud was a possibility, and that further action was warranted.

22 Therefore, rather than completing the audit, on May 4, 1994, Goy-Edwards prepared a "Form T134" to refer the matter -- along with her entire file, which contained records of all contacts, conversations, and calculations made in respect of the matter -- to the Special Investigations Section of Revenue Canada. This latter division was charged in the present case with determining whether further investigation with a view to possible prosecution for tax evasion was merited. The record indicates that, in general, not every referral from the Business Audit Section necessarily results in charges being laid, and that files are on occasion returned to the Business Audit Section after Special Investigations makes a decision not to proceed with a criminal investigation.

23 Goy-Edwards did not attempt to contact the appellant or Burke to advise them that the file was no longer under her control. Two days later, on May 6, the appellant's son Jim left a telephone message with the auditor, indicating that he would be

Digitized by Google

sending the requested Bank of Montreal statements on the following Monday. The statements were in fact delivered on that date, and were passed on to Special Investigations. Again, the appellant, his son and his accountant were not notified that the appellant's file had been referred to the investigative section.

24 Inside Special Investigations, the appellant's file was assigned to investigator Diane Chang. Chang met with Goy-Edwards for one to two hours towards the end of May 1994 in order to discuss the file. At some point shortly thereafter, Chang had to contact Goy-Edwards again in order to clarify certain of the notations contained in the auditor's file. There may have been one or two conversations of this nature, but there is nothing in the record that would suggest that Chang, or any other investigator, ever instructed or requested Goy-Edwards, under the guise of an audit, to obtain further information from or about the appellant.

25 The investigator then reviewed Goy-Edwards's files, performed her own calculations and analyses, and gathered some information from other internal sources in order to determine if there were reasonable and probable grounds to obtain a search warrant to further an investigation into tax evasion. In June 1994, Chang determined that such reasonable and probable grounds did exist, and began preparing an Information to Obtain A Search Warrant. For the next several months, Chang worked on the Information to Obtain and sought approval from her supervisors in Special Investigations to attend before an issuing justice. Departmental approval was not granted until November 1994, despite the fact that very little new information was received in the intervening period.

26 Meanwhile, Burke had been attempting to reach Goy-Edwards to obtain updates on the audit. As a consequence, Goy-Edwards contacted Chang. Goy-Edwards asked what an appropriate response would be. Chang told the auditor "to stall": she did not want the appellant to discover that his file had been referred to Special Investigation. Contrary to departmental policy, which specifies that all contacts about a file should be recorded on "Forms T2020", Chang did not record this conversation with Goy-Edwards.

27 On September 8, Burke again phoned Goy-Edwards to inquire about the file. She told him that she had been unable to make progress with the audit because of an injury; Goy-Edwards later testified that, shortly before that time, she had tumbled hard off of her bicycle, sustaining injuries to her head, torso, and legs. Goy-Edwards did not mention to Burke that she had referred the file to Special Investigations back in May. Burke left the appellant a message on the same day, keeping him abreast of what news the auditor had provided.

28 Burke left another message for Goy-Edwards on October 21, 1994, while the auditor was out of her office. Upon returning at the beginning of November, Goy-Edwards informed Moriarty that Burke had called. Moriarty, in turn, spoke to the Chief of the Special Investigations Section early on November 2 about how best to handle the issue. They determined, based on departmental policy, that if Goy-Edwards was asked about the file, she would have to "inform the [taxpayer] that the issue has been referred" to Special Investigations.

29 Also on November 2, and very shortly after this discussion, Goy-Edwards returned Burke's call. The auditor left a message with the accountant's wife to the effect that she had been out of town and that she "ha[d] nothing to report on the file". In addition, Goy-Edwards asked that Burke be informed that "the file has been in a holding pattern due to other work demands including other projects"; the auditor later acknowledged that it was a mistake to use these terms to describe the status of the file.

30 Goy-Edwards recorded the details of the November 2 call on a Form

Digitized by Google

T2020, which she then delivered to Chang. Concerned about the message Goy-Edwards had left for Burke, and troubled by the fact that she had personally given Goy-Edwards the instructions to stall, Chang approached her section manager.

31 Chang, the section manager, and the Chief of Special Investigations all met on November 3 to discuss the policy regarding disclosure to the appellant. Departmental policy was confirmed to be that, if Goy-Edwards or any other Revenue Canada official were asked anything about the appellant's file, that person should explain that the file was in Special Investigations. All parties were aware of the message that Goy-Edwards had left for Burke on the previous day, and the section manager and the chief expressed bewilderment as to why the auditor had spoken as she did. Still, subsequent to this meeting, no remedial steps were taken to advise either Burke or the appellant of the file's transfer.

32 On November 23, 1994, Chang swore the Information to Obtain before Fradsham Prov. Ct. J. in Calgary. Chang based her grounds for belief that the appellant had committed offences, in part, upon analyses that she had conducted from the books and records that the appellant had provided to Goy-Edwards at the April 11 meeting.

33 A warrant was issued under s. 487 of the *Criminal Code*, R.S.C. 1985, c. C-46, authorizing searches of the appellant's residence, Burke's residence (place of business), and the Calgary office of Revenue Canada (in order to seize the books and records that Goy-Edwards had borrowed from the appellant during the April 11 meeting). The warrant was executed at all three locations on November 29. The fruit of the searches ultimately served as a substantial portion of the respondent Crown's evidence at the appellant's trial.

34 In early 1995, Chang drew up requirement letters pursuant to s. 231.2(1) of the ITA. These were issued to the appellant's various banking institutions, which complied with the requirements and provided Chang with the documentation which she sought.

35 The appellant was brought to trial on three counts of making false or deceptive statements in an income tax return (s. 239(1)(*a*) of the ITA) and two counts of wilfully evading or attempting to evade payment of taxes (s. 239(1)(*d*) of the ITA). The respondent sought to tender documents seized pursuant to the warrant. The appellant objected, and two separate *voir dires* were held to determine the admissibility of the documents.

36 Coincidentally, the issuing justice, Judge Fradsham, was also the trial judge. He felt that the audit had effectively become an investigation as of March 16, 1994, and excluded all information obtained by ss. 231.1(1) and 231.2(1) from that day forward: (1997), 195 A.R. 251 (Prov. Ct.) and (1997), 204 A.R. 123 (Prov. Ct.). Judge Fradsham granted the appellant's motion for a directed verdict of acquittal on August 7, 1997. The respondent's appeal to the Court of Queen's Bench of Alberta was successful, and a new trial was ordered: (1998), 225 A.R. 225. The Court of Appeal of Alberta dismissed a further appeal, and affirmed the summary conviction appeal judge's order for a new trial: (2000), 271 A.R. 263. The appellant was granted leave to appeal to this Court on May 17, 2001: [2001] 1 S.C.R. xii.

II. Relevant Statutory and Constitutional Provisions

37 *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)

> **231.1** (1) An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act,
>
> (*a*) inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to

Digitized by Google

the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act, and

(*b*) examine property in an inventory of a taxpayer and any property or process of, or matter relating to, the taxpayer or any other person, an examination of which may assist the authorized person in determining the accuracy of the inventory of the taxpayer or in ascertaining the information that is or should be in the books or records of the taxpayer or any amount payable by the taxpayer under this Act,

and for those purposes the authorized person may

(*c*) subject to subsection (2), enter into any premises or place where any business is carried on, any property is kept, anything is done in connection with any business or any books or records are or should be kept, and

(*d*) require the owner or manager of the property or business and any other person on the premises or place to give the authorized person all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act and, for that purpose, require the owner or manager to attend at the premises or place with the authorized person.

(2) Where any premises or place referred to in paragraph (1)(*c*) is a dwelling-house, an authorized person may not enter that dwelling-house without the consent of the occupant except under the authority of a warrant under subsection (3).

(3) Where, on *ex parte* application by the Minister, a judge is satisfied by information on oath that

(*a*) there are reasonable grounds to believe that a dwelling-house is a premises or place referred to in paragraph (1)(*c*),

(*b*) entry into the dwelling-house is necessary for any purpose relating to the administration or enforcement of this Act, and

(*c*) entry into the dwelling-house has been, or there are reasonable grounds to believe that entry will be, refused,

the judge may issue a warrant authorizing an authorized person to enter the dwelling-house subject to such conditions as are specified in the warrant but, where the judge is not satisfied that entry into the dwelling-house is necessary for any purpose relating to the administration or enforcement of this Act, the judge may

(*d*) order the occupant of the dwelling-house to provide to an authorized person reasonable access to any document or property that is or should be kept in the dwelling-house, and

(*e*) make such other order as is appropriate in the circumstances to carry out the purposes of this Act,

to the extent that access was or may be expected to be refused and that the document or property is or may be expected to be kept in the dwelling-house.

231.2 (1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,

(*a*) any information or additional information, including a return of income or a supplementary return; or

(*b*) any document.

Digitized by Google

. . .

231.3 (1) A judge may, on *ex parte* application by the Minister, issue a warrant in writing authorizing any person named therein to enter and search any building, receptacle or place for any document or thing that may afford evidence as to the commission of an offence under this Act and to seize the document or thing and, as soon as practicable, bring it before, or make a report in respect of it to, the judge or, where the judge is unable to act, another judge of the same court to be dealt with by the judge in accordance with this section.

(2) An application under subsection (1) shall be supported by information on oath establishing the facts on which the application is based.

(3) A judge may issue the warrant referred to in subsection (1) where the judge is satisfied that there are reasonable grounds to believe that

(*a*) an offence under this Act was committed;

(*b*) a document or thing that may afford evidence of the commission of the offence is likely to be found; and

(*c*) the building, receptacle or place specified in the application is likely to contain such a document or thing.

(4) A warrant issued under subsection (1) shall refer to the offence for which it is issued, identify the building, receptacle or place to be searched and the person alleged to have committed the offence and it shall be reasonably specific as to any document or thing to be searched for and seized.

(5) Any person who executes a warrant under subsection (1) may seize, in addition to the document or thing referred to in that subsection, any other document or thing that the person believes on reasonable grounds affords evidence of the commission of an offence under this Act and shall as soon as practicable bring the document or thing before, or make a report in respect thereof to, the judge who issued the warrant or, where the judge is unable to act, another judge of the same court to be dealt with by the judge in accordance with this section.

(6) Subject to subsection (7), where any document or thing seized under subsection (1) or (5) is brought before a judge or a report in respect thereof is made to a judge, the judge shall, unless the Minister waives retention, order that it be retained by the Minister, who shall take reasonable care to ensure that it is preserved until the conclusion of any investigation into the offence in relation to which the document or thing was seized or until it is required to be produced for the purposes of a criminal proceeding.

(7) Where any document or thing seized under subsection (1) or (5) is brought before a judge or a report in respect thereof is made to a judge, the judge may, of the judge's own motion or on summary application by a person with an interest in the document or thing on three clear days notice of application to the Deputy Attorney General of Canada, order that the document or thing be returned to the person from whom it was seized or the person who is otherwise legally entitled thereto if the judge is satisfied that the document or thing

(*a*) will not be required for an investigation or a criminal proceeding; or

(*b*) was not seized in accordance with the warrant or this section.

(8) The person from whom any document or thing is seized pursuant to this section is entitled, at all reasonable times and subject to such reasonable conditions as may be imposed by the Minister, to inspect the document or thing

Digitized by Google

and to obtain one copy of the document at the expense of the Minister.

239. (1) Every person who has

(*a*) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation,

(*b*) to evade payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,

(*c*) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,

(*d*) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act, or

(*e*) conspired with any person to commit an offence described in paragraphs (*a*) to (*d*),

is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

(*f*) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or

(*g*) both the fine described in paragraph (*f*) and imprisonment for a term not exceeding 2 years.

(2) Every person who is charged with an offence described in subsection (1) may, at the election of the Attorney General of Canada, be prosecuted on indictment and, if convicted, is, in addition to any penalty otherwise provided, liable to

(*a*) a fine of not less than 100%, and not more than 200%, of the amount of the tax that was sought to be evaded; and

(*b*) imprisonment for a term not exceeding 5 years.

. . .

241. (1) Except as authorized by this section, no official shall

(*a*) knowingly provide, or knowingly allow to be provided, to any person any taxpayer information;

(*b*) knowingly allow any person to have access to any taxpayer information; or

(*c*) knowingly use any taxpayer information otherwise than in the course of the administration or enforcement of this Act, the *Canada Pension Plan* or the *Unemployment Insurance Act* or for the purpose for which it was provided under this section.

(2) Notwithstanding any other Act of Parliament or other law, no official shall be required, in connection with any legal proceedings, to give or produce evidence relating to any taxpayer information.

(3) Subsections (1) and (2) do not apply in respect of

(*a*) criminal proceedings, either by indictment or on summary conviction, that have been commenced by the laying of an information or the preferring of an indictment, under an Act of Parliament; or

(*b*) any legal proceedings relating to the administration or enforcement of this Act, the *Canada Pension Plan* or the *Unemployment Insurance Act* or any other Act of Parliament or law of a province that provides for the imposition or collection of a tax or duty.

Digitized by Google

. . .

(4) An official may

(*a*) provide to any person taxpayer information that can reasonably be regarded as necessary for the purposes of the administration or enforcement of this Act, the *Canada Pension Plan* or the *Unemployment Insurance Act*, solely for that purpose;

(*b*) provide to any person taxpayer information that can reasonably be regarded as necessary for the purposes of determining any tax, interest, penalty or other amount that is or may become payable by the person, or any refund or tax credit to which the person is or may become entitled, under this Act or any other amount that is relevant for the purposes of that determination;

. . .

(5) An official may provide taxpayer information relating to a taxpayer

(*a*) to the taxpayer; and

(*b*) with the consent of the taxpayer, to any other person.

Canadian Charter of Rights and Freedoms

7. Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.

8. Everyone has the right to be secure against unreasonable search or seizure.

24. (1) Anyone whose rights or freedoms, as guaranteed by this Charter, have been infringed or denied may apply to a court of competent jurisdiction to obtain such remedy as the court considers appropriate and just in the circumstances.

(2) Where, in proceedings under subsection (1), a court concludes that evidence was obtained in a manner that infringed or denied any rights or freedoms guaranteed by this Charter, the evidence shall be excluded if it is established that, having regard to all the circumstances, the admission of it in the proceedings would bring the administration of justice into disrepute.

III. Judicial History

A. *Provincial Court of Alberta -- Criminal Division* (1997), 195 A.R. 251 (First *voir dire*)

38 Judge Fradsham's extensive reasons were issued on February 25, 1997. Applying the "predominant purpose" test enunciated in *British Columbia Securities Commission v. Branch*, [1995] 2 S.C.R. 3, he concluded at para. 50 that, during the April 11 meeting, Goy-Edwards was "seeking out confirmatory proof of her opinion that this was a matter of serious underreporting of income which should be prosecutorily [*sic*] pursued by Special Investigations". In his view, she was conducting an investigation, and not a mere audit.

39 Following *R. v. Norway Insulation Inc.* (1995), 23 O.R. (3d) 432 (Gen. Div.), Judge Fradsham held that s. 8 of the *Charter* precludes the use of s. 231.1(1) powers to further an investigation, in contradistinction to an audit. When an investigation of s. 239 offences is underway, the taxpayer who is the object of the investigation is entitled to exercise his or her right to silence. In this case, the appellant had been told that an audit was underway, and Judge Fradsham therefore took him to have been labouring under the presumption that he was obliged to co-operate. The failure to caution the appellant on that occasion violated his rights under s. 7 of the *Charter*. The statements and documents

Digitized by Google

obtained at the meeting were therefore "tainted", and reference to them in the Information to Obtain had to be removed. Judge Fradsham also excised certain paragraphs from the Information to Obtain on the basis of the fact that they were erroneous. What remained, in Judge Fradsham's opinion, did not provide "reasonable grounds to believe that in the place sought to be searched there are things that will afford evidence of the commission of an offence" (para. 106). As a result, the execution of the search and seizure violated the appellant's s. 8 *Charter* rights. Judge Fradsham excluded the evidence under s. 24(2) of the *Charter*.

B. *Provincial Court of Alberta -- Criminal Division* (1997), 204 A.R. 123 (Second *voir dire*)

40 A second *voir dire* was held in June 1997, to determine the admissibility of the banking records obtained by the requirement letters. On this occasion, Judge Fradsham held that the audit had effectively become an investigation as of March 16, 1994, since by that date, "Ms. Goy-Edwards had already arranged for her supervisor to attend the April 11 meeting" (para. 5). In his view, Revenue Canada was unable to rely upon its "audit tools" from that day forward. Judge Fradsham found that all banking information obtained by way of s. 231.2(1) after March 16 should be excluded pursuant to s. 24(2) of the *Charter*.

C. *Court of Queen's Bench of Alberta* (1998), 225 A.R. 225

41 Subsequent to Judge Fradsham's granting a directed verdict of acquittal, the respondent sought to appeal this ruling, along with the earlier evidentiary rulings, to the Court of Queen's Bench. In an oral judgment, the summary conviction appeal judge held that only the appellant's utterances from the April 11 meeting should have been excluded from the Information to Obtain. Lutz J. found, at para.12, that the other evidence (i.e., the banking documents, sales books, etc.), was "to a great extent already in the possession of the [respondent]." Excising the tainted allegations from the Information to Obtain, he found that the search warrant was still validly issued; therefore, no s. 8 breach occurred.

42 Lutz J. did, however, uphold Judge Fradsham's ruling on the bank statements obtained pursuant to the requirements, as well as his ruling on the application of s. 24(2) of the *Charter*.

D. *Court of Appeal of Alberta* (2000), 271 A.R. 263

43 Berger J.A., for the court, affirmed the summary conviction appeal judge's order for a new trial. He held that only the appellant's statements ought to have been excluded from the Information to Obtain, pursuant to s. 7 of the *Charter*. The other documents and records were not "derivative evidence", and were admissible. Berger J.A. also upheld the warrant on amplification and found no s. 8 breach. He declined to find that the s. 7 breach was so egregious as to warrant excluding the evidence obtained by the searches under s. 24(2) of the *Charter*.

IV. Issues

44 This appeal raises the following specific issues:

- Did the Court of Appeal of Alberta err in ruling the April 11, 1994 oral statements inadmissible?
- Did the Court of Appeal of Alberta err in admitting the documents given to the auditors on April 11, 1994?
- Did the Court of Appeal of Alberta err in finding that amplification saved the search warrant?
- Should the banking records obtained under s. 231.2 of the ITA be excluded?

The respondent concedes the third issue, in light of *R. v. Araujo*, [2000] 2 S.C.R. 992, 2000

Digitized by Google

SCC 65. And in our analysis, we have melded the others for the purposes of discussion.

V. Analysis

45 The determination of this appeal will turn on the overarching questions set out in the first paragraph of these reasons. Is there an audit/investigation distinction under the ITA? Where is the line between the two functions drawn? To what extent do taxpayers under investigation for ITA offences benefit from the principle against self-incrimination under s. 7 of the *Charter*? Is a s. 8 violation made out where documents are obtained under colour of the ITA's "audit powers" after a prosecutorial investigation has commenced?

46 By way of introduction to these issues, it is useful to discuss the statutory context of the ITA, and whether s. 239 offences are properly considered regulatory or criminal for the purposes of *Charter* analysis. Second, we will turn to the *Charter* provisions at issue, and the manner in which they receive application. Third, we shall consider whether an audit/investigation distinction exists under the ITA, and whether ss. 231.1(1) and 231.2(1) can be employed for the investigation of a s. 239 offence. After answering that question, we will set out a test to determine those circumstances in which the predominant purpose of an inquiry is the determination of penal liability. Finally, we will discuss the consequences under the *Charter* of an audit's having become a criminal investigation.

A. *Overview of the Statutory Context*

(1) The *Income Tax Act*

47 The ITA legislative scheme has received ample attention from this Court. While it is not necessary in this appeal to engage in a detailed review of ITA jurisprudence, in the interest of situating the statutory provisions at issue in their proper context, we shall commence our analysis with a brief overview of some important features of the Canadian income tax system and the manner in which it is administered.

48 Governments, indisputably, require revenue in order to finance their operations and to implement social programmes. Currently, the collection of federal income tax -- a measure first introduced at that level during the First World War by *The Business Profits War Tax Act, 1916*, S.C. 1916, c. 11, and *The Income War Tax Act, 1917*, S.C. 1917, c. 28, and thought to be temporary -- comprises a crucial source of federal revenue, not to mention a crucial source of revenue for a good number of provincial governments (see *Del Zotto v. Canada*, [1997] 3 F.C. 40 (C.A.), at para. 19, *per* Strayer J.A., whose dissenting reasons were affirmed by a unanimous panel of this Court: [1999] 1 S.C.R. 3). In this connection, because the ITA controls the manner in which federal income tax is calculated and collected, this Court has recognized it as being "essentially a regulatory statute": *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627, at p. 641, *per* Wilson J. (See also: La Forest J., concurring in the same case, at p. 650, where he described the ITA as "essentially of an administrative nature"; *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425, at p. 506, *per* La Forest J.; *Knox Contracting Ltd. v. Canada*, [1990] 2 S.C.R. 338, at p. 354, *per* Cory J.; *143471 Canada Inc. v. Quebec (Attorney General)*, [1994] 2 S.C.R. 339, at p. 378, *per* Cory J.; *R. v. Hydro-Québec*, [1997] 3 S.C.R. 213, at para. 46, *per* Lamer C.J. and Iacobucci J.) The ITA is both detailed and complex.

49 Every person resident in Canada during a given taxation year is obligated to pay tax on his or her taxable income, as computed under rules prescribed by the Act (ITA, s. 2; *Smerchanski v. M.N.R.*, [1977] 2 S.C.R. 23, at p. 32, *per* Laskin C.J.). The

Digitized by Google

process of tax collection relies primarily upon taxpayer self-assessment and self-reporting: taxpayers are obliged to estimate their annual income tax payable (s. 151), and to disclose this estimate to the CCRA in the income return that they are required to file (s. 150(1)). (See also in this regard: *McKinlay Transport*, *supra*, at pp. 636 and 648; V. Krishna, *The Fundamentals of Canadian Income Tax* (6th ed. 2000), at p. 22.) Upon receipt of a taxpayer's return, the Minister is directed, "with all due dispatch", to conduct an examination and original assessment of the amount of tax to be paid or refunded, and to remit a notice of assessment to this effect (ss. 152(1) and 152(2)). Subject to certain time limitations, the Minister may subsequently reassess or make an additional assessment of a taxpayer's yearly tax liability (s. 152(4)).

50 While voluntary compliance and self-assessment comprise the essence of the ITA's regulatory structure, the tax system is equipped with "persuasive inducements to encourage taxpayers to disclose their income": Krishna, *supra*, at p. 767. In this connection, Krishna writes at p. 772, the "system is 'voluntary' only in the sense that a taxpayer must file income tax returns without being called upon to do so by the Minister". For example, in promotion of the scheme's self-reporting aspect, s. 162 of the ITA creates monetary penalties for persons who fail to file their income returns. Likewise, to encourage care and accuracy in the self-assessment task, s. 163 of the Act sets up penalties of the same sort for persons who repeatedly fail to report required amounts, or who are complicit or grossly negligent in the making of false statements or omissions.

51 It follows from the tax scheme's basic self-assessment and self-reporting characteristics that the success of its administration depends primarily upon taxpayer forthrightness. As Cory J. stated in *Knox Contracting*, *supra*, at p. 350: "The entire system of levying and collecting income tax is dependent upon the integrity of the taxpayer in reporting and assessing income. If the system is to work, the returns must be honestly completed." It is therefore not surprising that the Act exhibits a concern to limit the possibility that a taxpayer may attempt "to take advantage of the self-reporting system in order to avoid paying his or her full share of the tax burden by violating the rules set forth in the Act" (*McKinlay Transport*, *supra*, at p. 637). The nature of the tax collection scheme, however, creates an obstacle in this regard:

> Often it will be impossible to determine from the face of the return whether any impropriety has occurred in its preparation. A spot check or a system of random monitoring may be the only way in which the integrity of the tax system may be maintained.
> (*McKinlay Transport*, *supra*, at p. 648)

Accordingly, "the Minister of National Revenue must be given broad powers in supervising this regulatory scheme to audit taxpayers' returns and inspect all records which may be relevant to the preparation of these returns" (*ibid.*).

52 The sections within Part XV of the ITA provide the Minister with "Administration and Enforcement" powers. They also impose reciprocal obligations upon taxpayers: for example, in furtherance of the overall reporting and verification scheme, s. 230(1) of the ITA requires all taxpayers, for various specified periods of time, to maintain books and records of account at their place of business or residence in Canada. These documents must be kept "in such form and containing such information as will enable the taxes payable under [the ITA] or the taxes or other amounts that should have been deducted, withheld or collected to be determined".

53 The provisions that are central to the instant appeal vest the Minister with extensive powers that may be used "for any purpose related to the administration or

Digitized by Google

enforcement" of the ITA. Section 231.1(1) continues the inspection power that was introduced in *An Act to amend the Income War Tax Act*, S.C. 1944, c. 43, s. 11. Paragraph (*a*) allows a person authorized by the Minister to "inspect, audit or examine" a wide array of documents, reaching beyond those that the ITA otherwise requires the taxpayer to prepare and maintain. In the course of the inspection, audit or examination, para. (*c*) provides that the authorized person may enter into any premises or place that is not a dwelling-house; furthermore, para. (*d*) imposes a correlative duty upon persons at the premises or place to provide "all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act". (Section 231.1(2) requires that, absent the occupant's consent, a judicial warrant be obtained for entry into a dwelling-house.)

54 The requirement power in s. 231.2(1) boasts an even longer pedigree: its origins are found in s. 8 of the original *Income War Tax Act, 1917*. By this power, the Minister may compel any person to produce any information or any document. Again, the scope of this power "reaches beyond the strict filing and maintenance requirements of the Act" (*McKinlay Transport*, *supra*, at p. 642, *per* Wilson J.).

55 To be effective, self-enforcing regulatory schemes require not only resort to adequate investigation, but also the existence of effective penalties: *Thomson Newspapers*, *supra*, at p. 528; *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154, at p. 250, *per* Cory J.; *Comité paritaire de l'industrie de la chemise v. Potash*, [1994] 2 S.C.R. 406, at p. 421, *per* La Forest J. In the ITA context, see *Hydro-Québec*, *supra*, at para. 46, and *Knox Contracting*, *supra*, at p. 355. To this end, s. 238(1) sets out a summary conviction offence that is triggered by non-compliance with the filing requirements or with other of the Act's provisions -- including ss. 231.1(1) and 231.2(1), and the documentary retention rules imposed by s. 230(1). Section 238's purpose is inherently pragmatic or instrumental: the offence exists "not to penalize criminal conduct but to enforce compliance with the Act" (*R. v. Grimwood*, [1987] 2 S.C.R. 755, at p. 756; *McKinlay Transport*, *supra*, at p. 641; *143471 Canada*, *supra*, at p. 378).

56 Section 239(1) creates a number of additional offences. It speaks of false or deceptive statements, destruction or alteration of documents, false or deceptive documents, wilful evasion of income tax, and conspiracy to engage in prohibited activities. In Cory J.'s words from *Knox Contracting*, *supra*, at pp. 349-50: "Those who do evade the payment of income tax not only cheat the State of what is owing to it, but inevitably increase the burden placed upon the honest taxpayers." As a consequence, the s. 239(1) offences carry rather significant penalties. They may be proceeded on by way of summary conviction or by way of indictment at the election of the Attorney General (s. 239(2)).

57 As with the s. 238 offence, this Court has recognized the centrality of s. 239 to the income tax *régime*: see Strayer J.A.'s reasons, endorsed on appeal to this Court, in *Del Zotto*, *supra*, at para. 23, where he described s. 239 as being "designed to ensure compliance with the self-reporting requirements of the *Income Tax Act*". Moreover, the presence in the ITA of s. 239 does nothing to alter the regulatory or administrative nature of the inspection and requirement powers, even though s. 239 "relate[s] to conduct that might well be discovered by the[ir] exercise" (*Thomson Newspapers*, *supra*, at p. 516, *per* La Forest J. See also *Comité paritaire*, *supra*, at p. 421). As already mentioned, it is under ss. 239(1)(*a*) and (*d*) that the appellant in the present case was ultimately charged.

58 Having discussed the general statutory context, we will now deal specifically with the important distinction between regulatory and criminal statutory provisions.

(2) <u>The Regulatory vs. Criminal Distinction</u>

Digitized by Google

59 The parties have engaged in a spirited debate over the proper contextualization of the ITA offences for the purposes of *Charter* analysis. The respondent defines the ITA as comprising an "integrated regulatory scheme", the implication being that a person accused of offences thereunder attracts little *Charter* protection. Meanwhile, the appellants in both the present case and its companion, *R. v. Ling*, [2002] 3 S.C.R. 814, 2002 SCC 74, as well as the intervener, the Criminal Lawyers' Association (Ontario), submit that the Act is essentially a "dual-purpose statute" and that the s. 239 offences constitute "quintessential criminal law". It follows in the appellant Jarvis's submission that, where tax avoidance or evasion is being investigated, "the taxpayer must be afforded the Charter protection that is the right of any Canadian suspected or accused of a crime" (appellant's factum, at para. 33). It is plain that the s. 239 offences are no trifling matter as this provision bears at least the formal hallmarks of criminal legislation, namely, prohibitions coupled with penalties (see *Hydro-Québec*, *supra*, at para. 35). They may be prosecuted upon indictment, and conviction can carry up to five years' incarceration. It is because of these factors that the penal sanctions in s. 239 are, in certain contexts, referred to as "criminal".

60 That is not to say, however, that they are "purely" or "quintessentially" criminal for *Charter* purposes. The cases cited in support of the appellant's favoured characterization are of limited relevance. The present case does not consider a number of issues such as: whether the ITA offences are constitutionally supportable under the federal criminal law power (*Hydro-Québec*, *supra*); the characterization of s. 239 offences for the purpose of determining the appeal procedure from the issuance of a s. 231.3 search warrant (*Knox Contracting*, *supra*); or whether making false statements on an income tax return constitutes a "criminal offence" under provincial legislation, so as to render revocable a person's licence to practice as a public accountant (*Re Ramm*, [1958] O.R. 98 (C.A.)). In any case, the contextual approach to *Charter* application is not a mere exercise in taxonomy.

61 As La Forest J. stated in *Wholesale Travel*, *supra*, at p. 209, "what is ultimately important are not labels (though these are undoubtedly useful), but the values at stake in the particular context". In this connection, differing levels of *Charter* protection may obtain under the same statute, depending on the circumstances. Compare *Hunter v. Southam Inc.*, [1984] 2 S.C.R. 145, and *Thomson Newspapers*, *supra*: each dealt with the former *Combines Investigation Act*, R.S.C. 1970, c. C-23, which, although it created penal offences, was recognized on the whole to embody "a complex scheme of economic regulation" (see *General Motors of Canada Ltd. v. City National Leasing*, [1989] 1 S.C.R. 641, at p. 676, *per* Dickson C.J.; *Thomson Newspapers*, *supra*; *R. v. Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606, at pp. 648-49). The provisions impugned in *Hunter v. Southam* authorized entry onto private premises and hence attracted a much greater expectation of privacy than the provision ordering the production of documents in *Thomson Newspapers*.

62 In this measure, the ITA presents no different consideration. Wilson J. acknowledged as much in *McKinlay Transport*, *supra*, at p. 649, where she suggested that greater s. 8 protection would obtain under the ITA if tax officials were to enter onto private property in order to conduct a search or seizure for the purposes of the Act, rather than to compel the same documentation by way of requirement letters (see para. 53 of these reasons re: s. 231.1(2); see also *Baron v. Canada*, [1993] 1 S.C.R. 416, at pp. 443-44; *Del Zotto*, *supra*, at paras. 12-13, *per* Strayer J.A. (dissenting)). In sum, the ITA is a regulatory statute, but non-compliance with its mandatory provisions can in some cases lead to criminal charges being laid. In prosecution thereof, the state is pitted against the individual in an attempt to establish culpability. Stiff jail terms can result from a conviction. To conduct an

Digitized by Google

appropriately contextual *Charter* analysis in these cases, the various regulatory and penal considerations must all exert some influence.

B. *Contextual Approach to Charter Rights*

63 At this stage, it is a firmly established principle that the *Charter* must receive contextual application. The scope of a particular *Charter* right or freedom may vary according to the circumstances: *Edmonton Journal v. Alberta (Attorney General)*, [1989] 2 S.C.R. 1326, at pp. 1355-56, *per* Wilson J.; *McKinlay Transport*, *supra*, at p. 644; *Symes v. Canada*, [1993] 4 S.C.R. 695, at p. 793, *per* L'Heureux-Dubé J. (dissenting); *143471 Canada*, *supra*, at p. 347 (*per* Lamer C.J.) and at pp. 361-62 (*per* La Forest J., dissenting); *Comité paritaire*, *supra*, at p. 420, *per* La Forest J.

64 For present purposes, where ss. 7 and 8 of the *Charter* are at issue, it is instructive to note both that the requirements of fundamental justice relevant to the former section "are not immutable; rather, they vary according to the context in which they are invoked" (*R. v. Lyons*, [1987] 2 S.C.R. 309, at p. 361, *per* La Forest J.) and that context will determine the expectation of privacy that one can reasonably expect the latter section to protect (*Thomson Newspapers*, *supra*, at pp. 495-96, *per* Wilson J., dissenting, and at p. 506, *per* La Forest J.; *McKinlay Transport*, *supra*, at pp. 645 and 647; *Canadian Broadcasting Corp. v. New Brunswick (Attorney General)*, [1991] 3 S.C.R. 459, at p. 478, *per* Cory J.; *Baron*, *supra*, at p. 436, *per* Sopinka J.; *British Columbia Securities Commission v. Branch*, *supra*, at para. 51, *per* Sopinka and Iacobucci JJ.).

65 It is worth repeating that the appellant does not attack the constitutionality of ss. 231.1(1) and 231.2(1). Rather, his argument is that the admission into evidence in tax evasion proceedings of statements and documents that were compelled by Revenue Canada officials under these sections was a violation of his rights under ss. 7 and 8 of the *Charter*. He thus argues that the evidence should be excluded under s. 24(2) of the *Charter*. In *McKinlay Transport*, *supra*, this Court considered whether the predecessor provision to s. 231.2, employed in conjunction with an income tax audit, infringed s. 8 of the *Charter*. Wilson J. held that, although the provision authorized a "seizure" for *Charter* purposes, it provided "the least intrusive means by which effective monitoring of compliance with the *Income Tax Act* can be effected" (p. 649). Wilson J. noted that the taxpayer's privacy interest in the compellable records was also relatively weak, and ruled that the provision was constitutional. Faced with the *McKinlay Transport* decision, the appellant did not raise the constitutionality of ss. 231.1(1) and 231.2(1) at his trial, but instead invoked s. 24(2) of the *Charter* in order to "deprive from the Crown (for prosecution purposes) the fruits of their [*sic*] deception" (appellant's factum, at para. 45).

(1) Section 7

66 Section 7 of the *Charter* reads as follows:

> **7.** Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.

A court conducting an analysis under s. 7 must first determine whether there exists a real or imminent deprivation of life, liberty, security of the person, or a combination thereof. Next, the court must identify the relevant principle or principles of fundamental justice and, finally, determine whether the deprivation is in accordance with this principle or principles.

67 It is beyond doubt that the appellant's s. 7 liberty interest is engaged by the introduction of statutorily compelled information at his trial for the s. 239 offences, owing to the threat of imprisonment on conviction: see *Re B.C. Motor Vehicle Act*, [1985] 2 S.C.R. 486, at p. 515, *per* Lamer J. (as he then was); *Reference re ss. 193 and 195.1(1)(c) of the*

Digitized by Google

Criminal Code (Man.), [1990] 1 S.C.R. 1123. The relevant principle of fundamental justice in the present case is the principle against self-incrimination, an elemental canon of the Canadian criminal justice system, standing for the notion that individuals should not be conscripted by the state to promote a self-defeating purpose: *R. v. S. (R.J.)*, [1995] 1 S.C.R. 451, at para. 81, *per* Iacobucci J. This Court has clearly established that the principle against self-incrimination finds residual expression under s. 7: *Thomson Newspapers*, *supra*; *R. v. P. (M.B.)*, [1994] 1 S.C.R. 555, at p. 577, *per* Lamer C.J.; *R. v. Jones*, [1994] 2 S.C.R. 229, at p. 256, *per* Lamer C.J.; *S. (R.J.)*, *supra*; *Branch*, *supra*; *R. v. Fitzpatrick*, [1995] 4 S.C.R. 154; *R. v. White*, [1999] 2 S.C.R. 417.

68 In giving expression to this principle, however, s. 7 does not envelop an abstract and absolute rule that would prevent the use of information in all contexts in which it is statutorily compelled: *Jones*, *supra*, at p. 257; *S. (R.J.)*, *supra*, at paras. 96-100; *Fitzpatrick*, *supra*, at paras. 21 and 24; *White*, *supra*, at para. 45. A court must begin "on the ground", with a concrete and contextual analysis of all the circumstances, in order to determine whether or not the principle against self-incrimination is actually engaged: *Fitzpatrick*, at para. 25; *White*, at para. 46. This analysis necessarily involves a balancing of principles. One must, in assessing the limits on compellability demanded by the principle against self-incrimination, consider the opposing principle of fundamental justice suggesting that relevant evidence should be available to the trier of fact in a search for truth: *S. (R.J.)*, at para. 108, *per* Iacobucci J. These competing interests will often be brought to the foreground in regulatory contexts, where the procedures being challenged have generally been designed (and are employed) as part of an administrative scheme in the public interest: *Fitzpatrick*, at para. 27. As the Court stated in *White*, at para. 48:

> In some contexts, the factors that favour the importance of the search for truth will outweigh the factors that favour protecting the individual against undue compulsion by the state. This was the case, for example, in *Fitzpatrick*, *supra*, where the Court emphasized the relative absence of true state coercion, and the necessity of acquiring statements in order to maintain the integrity of an entire regulatory regime. In other contexts, a reverse situation will arise, as was the case, for example, in *Thomson Newspapers*, *supra*, *S. (R.J.)*, *supra*, and *Branch*, *supra*. In every case, the facts must be closely examined to determine whether the principle against self-incrimination has truly been brought into play by the production or use of the declarant's statement.

(2) Section 8

69 Section 8 of the *Charter* provides that:

> **8.** Everyone has the right to be secure against unreasonable search or seizure.

For the application of s. 8, there must first be a search or seizure. Subsequently, it must be determined whether the search or seizure was unreasonable. Like the Fourth Amendment of the U.S. Constitution, s. 8 protects a reasonable expectation of privacy: *Hunter v. Southam*, *supra*, at p. 159, *per* Dickson J. (as he then was). What is reasonable, however, is context-specific. In the application of s. 8, "an assessment must be made as to whether in a particular situation the public's interest in being left alone by government must give way to the government's interest in intruding on the individual's privacy in order to advance its goals, notably those of law enforcement" (*id.*, at pp. 159-60).

70 In *R. v. Plant*, [1993] 3 S.C.R. 281, at p. 293, Sopinka J. listed several factors that will determine the parameters of the protection afforded by s. 8 with respect to informational privacy:

Digitized by Google

> Consideration of such factors as the nature of the information itself, the nature of the relationship between the party releasing the information and the party claiming its confidentiality, the place where the information was obtained, the manner in which it was obtained and the seriousness of the crime being investigated allows for a balancing of the societal interests in protecting individual dignity, integrity and autonomy with effective law enforcement.

71 The context-specific approach to s. 8 inevitably means, as Wilson J. noted in *Thomson Newspapers*, *supra*, at p. 495, that "[a]t some point the individual's interest in privacy must give way to the broader state interest in having the information or document disclosed". Naturally, if a person has but a minimal expectation with respect to informational privacy, this may tip the balance in the favour of the state interest: *Plant*, *supra*; *Smith v. Canada (Attorney General)*, [2001] 3 S.C.R. 902, 2001 SCC 88.

72 Generally, an individual has a diminished expectation of privacy in respect of records and documents that he or she produces during the ordinary course of regulated activities: see, e.g., *Thomson Newspapers*, *supra*, at p. 507, *per* La Forest J.; *143471 Canada*, *supra*, at p. 378, *per* Cory J.; *Comité paritaire*, *supra*, at pp. 420-21; *Fitzpatrick*, *supra*, at para. 49. In the particular context of the self-assessment and self-reporting income tax regime, a taxpayer's privacy interest in records that may be relevant to the filing of his or her tax return is relatively low: *McKinlay Transport*, *supra*, at pp. 649-50.

C. *Audit vs. Investigation*

73 As mentioned above, the *Charter* issues in this appeal touch upon the admission into evidence in a s. 239 prosecution of documents and utterances compelled by ss. 231.1(1) and 231.2(1). This problem did not arise in *McKinlay Transport*, where the appellants were charged under s. 238 for failing to comply with requirement letters, but there was no allegation that the requirements were <u>themselves</u> being used to further the investigation of an offence. In brief, this Court has yet to consider the extent to which the use of ss. 231.1(1) and 231.2(1) to build a prosecutorial case infringes a taxpayer's constitutional rights.

(1) <u>Submissions of the Parties</u>

74 The submissions of the parties in this regard stand in stark opposition. The parties seeking to rely upon the distinction describe ss. 231.1(1) and 231.2(1) as "audit" functions, i.e., fundamentally directed towards compliance and civil reassessment concerns. The appellant submits that the Crown can no longer use the ss. 231.1(1) and 231.2(1) "audit powers" from the point at which its predominant purpose is to investigate a s. 239 offence. The Criminal Lawyers' Association (Ontario) and the appellant in the companion case, *Ling*, submit that the inspection and requirement powers may be used at any time, but that a person accused of a s. 239 offence must benefit from use and derivative use immunity relative to any information that is compelled from him during the audit process.

75 On the other hand, the respondent submits that there is no rigid audit/investigation distinction. It reiterates that the ITA is an integrated regulatory scheme, and argues that all of the powers are assigned to a single person, the Minister, whose function under the Act does not change: the fact that the Minister delegates the use of these powers to various CCRA functionaries is irrelevant, as is the internal organizational structure of the department. According to the respondent, the ss. 231.1(1) and 231.2(1) powers are available in all circumstances, save two: where charges have been laid under s. 239 and the sole purpose for their exercise is to obtain prosecutorial evidence, and where the laying of charges is deliberately delayed in order for prosecutors to use the powers to build their case. The respondent concedes, as well, that s. 231.1(1)(*d*) does not countenance queries

Digitized by Google

into the mental state, or *mens rea*, required to prove the ITA offences; the definition of "proper questions" in that paragraph does not extend that far, and answers to such questions should therefore be excluded under s. 24(2).

76 The intervening Attorneys General for Ontario and Quebec support the respondent's position. With respect to the proper use of ss. 231.1(1) and 231.2(1), the Attorney General of Quebec adopts a "sole purpose" approach, similar to the respondent's. For its part, the Attorney General for Ontario submits that there is no reasonable expectation of privacy in incriminatory information gathered pursuant to regulatory powers; however, the abuse of process doctrine and s. 7 of the *Charter* might find application in situations of improper conduct, such as "where there is no legitimate interest left in an audit and the auditors have become mere agents of an enforcement objective" (Attorney General for Ontario's factum, at para. 49).

(2) Our View

77 Analysis must begin with the words of the Act, and the proper construction of ss. 231.1(1) and 231.2(1). The approach to statutory interpretation can be easily stated: one is to seek the intent of Parliament by reading the words of the provision in context and according to their grammatical and ordinary sense, harmoniously with the scheme and the object of the statute (*Interpretation Act*, R.S.C. 1985, c. I-21, s. 12; *Bell ExpressVu Limited Partnership v. Rex*, [2002] 2 S.C.R. 559, 2002 SCC 42; *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27; *R. v. Gladue*, [1999] 1 S.C.R. 688; E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87).

78 By their express terms, both ss. 231.1(1) and 231.2(1) are available "for any purpose related to the administration or enforcement" or, in French, "*pour l'application et l'exécution*" of the ITA. Although these terms are, at first glance, extremely broad, we ultimately come to the conclusion that, in the entire context, they do not include the prosecution of s. 239 offences.

79 As several of this Court's recent cases have illustrated, the words employed in the English and French versions of a federal statute are equally authoritative and should be read together in order to ascertain the proper meaning of the terms. The meaning of "administration" is clear. On the other hand, the ordinary sense of the term "enforcement" could conceivably encompass both assessment of tax liability and prosecution of offences (the *Oxford English Reference Dictionary* (2nd ed. 1996) defines "enforce" as "compel observance of (a law etc.)"). As for the French version, it provides negligible assistance here, since the two terms are rendered in equally wide scope, as "*l'application et l'exécution*". Hence, the question remains: does "enforcement" of the ITA include the prosecution of the s. 239 criminal offences?

80 This Court considered the scope of the requirement power in *Canadian Bank of Commerce v. Canada (Attorney General)*, [1962] S.C.R. 729, *James Richardson & Sons, Ltd. v. M.N.R.*, [1984] 1 S.C.R. 614. At p. 625 of the *Richardson* case, Wilson J. held that the provision could not be employed for a "fishing expedition", and that it was "only available to the Minister to obtain information relevant to the tax liability of some specific person or persons if the tax liability of such person or persons is the subject of a genuine and serious inquiry".

81 The respondent's interpretation of "proper questions" for the purposes of s. 231.1(1)(*d*) implies that the words "administration or enforcement", as they are used in the context of s. 231.1(1), do not extend to the investigation of ITA offences. Additionally and, in our view, more significantly, it is useful to contrast the language of ss. 231.1(1) and 231.2(1) with that of s. 231.3(1), which sets out an *ex parte* application process for a warrant

Digitized by Google

to search "for any document or thing that may afford evidence [of] the commission of [the] offence under this Act" (emphasis added). The existence of a prior authorization procedure where the commission of an offence is suspected creates a strong inference that the separate statutory inspection and requirement powers are unavailable to further a prosecutorial investigation.

82 In response to a question put to him during the appeal, counsel for the respondent submitted that the s. 231.3(1) warrant power was "residual", in the sense that it was intended to provide protection against the eventuality that a taxpayer, informed of an audit against him or her, would destroy his or her records in order to be charged with non-compliance under s. 238 rather than evasion under s. 239; the theory advanced being that the warrant, because of its being issued *ex parte*, would allow the authorities to act before the taxpayer were even aware of the audit.

83 We cannot accept that argument. First, we find it difficult to imagine why Parliament, if it truly desired to create such a safeguard for tax assessment purposes, would attach three such onerous pre-requisites to its issuance. The s. 231.3 warrant issues only in circumstances where the judge is satisfied that there are reasonable grounds to believe: that an ITA offence was committed (s. 231.3(3)(*a*)); that a document or thing affording evidence of the offence is likely to be found (s. 231.3(3)(*b*)); and that the place specified in the application for the warrant is likely to contain the document or thing (s. 231.3(3)(*c*)). Plainly, s. 231.3 is concerned with offences against the Act, and not with auditorial verifications. It follows that the s. 231.3 warrant covers generally the same ground as does the *Criminal Code*'s s. 487 warrant (see *R. v. Multiform Manufacturing Co.*, [1990] 2 S.C.R. 624), which was in fact the route chosen by Revenue Canada to obtain evidence of the offences in the present case. According to one expert, it is now the CCRA's standard practice to use s. 487 of the *Criminal Code* rather than s. 231.3 of the ITA: see Krishna, *supra*, at p. 810. Second, and perhaps more fundamentally, Parliament made it an offence under s. 239(1)(*b*) to destroy records or books of account; substituting a charge under one paragraph of s. 239(1) for another would be a Pyrrhic victory for the miscreant taxpayer.

84 Although the taxpayer and the CCRA are in opposing positions during an audit, when the CCRA exercises its investigative function they are in a more traditional adversarial relationship because of the liberty interest that is at stake. In these reasons, we refer to the latter as the adversarial relationship. It follows that there must be some measure of separation between the audit and investigative functions within the CCRA. Of course, having determined this, it remains for us to determine the bounds between the ITA audit and investigation and then to discuss the legal consequences. To this, we now turn.

D. *Delineating the Bounds Between Audit and Investigation: Nature of the Inquiry*

85 We have been directed to a plethora of cases that have attempted to draw the line between audit and investigation for income tax purposes. There is a lack of consensus on the matter. Some courts have stated that the investigation begins at the time when there are reasonable and probable grounds to believe that an offence has occurred: see *R. v. Bjellebo*, [1999] O.J. No. 965 (QL) (Gen. Div.), at para. 171; *R. v. Pheasant*, [2001] G.S.T.C. 8 (Ont. C.J.), at para. 68; *R. v. Chusid* (2001), 57 O.R. (3d) 20 (S.C.J.), at para. 61.

86 Some cases have referred to "reasonable suspicions" of an offence as engaging the audit/investigation tripwire: *R. v. Roberts*, [1998] B.C.J. No. 3184 (QL) (Prov. Ct.), at paras. 39-40; *R. v. Dial Drug Stores Ltd.* (2001), 52 O.R. (3d) 367 (C.J.), at p. 387. Still other cases have held that the test is one of "predominant purpose": see the lower court judgments in the case at bar; *Samson v. Canada*, [1995] 3 F.C. 306 (C.A.), leave to appeal

Digitized by Google

refused, [1996] 1 S.C.R. ix (*sub nom. Samson v. Addy*); *R. v. Yip* (2000), 278 A.R. 124, 2000 ABQB 873, at para. 34; *R. v. Anderson* (2001), 209 Sask. R. 117, 2001 SKQB 334, at para. 36; *R. v. Seaside Chevrolet Oldsmobile Ltd.* (2002), 248 N.B.R. (2d) 132, 2002 NBPC 5, at para. 51. Another has purported to have applied the same test, only to find that the predominant purpose will always be investigatory when "matters are placed in the hands of" Special Investigations Section: see *R. v. Warawa* (1997), 208 A.R. 81 (Q.B.), at paras. 11-12 and 134.

87 In *Norway Insulation*, *supra*, LaForme J. held, at p. 437, that the regulatory nature of an inquiry "changed after Special Investigations became involved and directed the subsequent work". He also agreed with the trial judge (reasons at [1995] 2 C.T.C. 451 (Ont. Ct. (Prov. Div.)) that it was when the first auditor developed the opinion, ultimately erroneous, that there was "sufficient evidence" of an offence, that the inquiry changed hue. Finally, in *R. v. Coghlan*, [1994] 1 C.T.C. 164 (Ont. Ct. (Prov. Div.)), at p. 172, Judge Ratushny opined that it was only when "Revenue Canada decides to lay criminal charges" that the criminal investigation begins. Otherwise, "the searches or seizures are for the bona fide purpose of determining compliance with the *Income Tax Act*, whether or not Revenue Canada suspects a criminal offence during that time" (*ibid.*). *Coghlan* was followed in *Gorenko v. La Reine*, [1997] R.J.Q. 2482 (Sup. Ct.), at p. 2500 (aff'd [1999] Q.J. No. 6268 (QL) (C.A.), leave to appeal to S.C.C. granted and appeal discontinued, [2000] 2 S.C.R. ix).

88 In our view, where the predominant purpose of a particular inquiry is the determination of penal liability, CCRA officials must relinquish the authority to use the inspection and requirement powers under ss. 231.1(1) and 231.2(1). In essence, officials "cross the Rubicon" when the inquiry in question engages the adversarial relationship between the taxpayer and the state. There is no clear formula that can answer whether or not this is the case. Rather, to determine whether the predominant purpose of the inquiry in question is the determination of penal liability, one must look to all factors that bear upon the nature of that inquiry.

89 To begin with, the mere existence of reasonable grounds that an offence may have occurred is by itself insufficient to support the conclusion that the predominant purpose of an inquiry is the determination of penal liability. Even where reasonable grounds to suspect an offence exist, it will not always be true that the predominant purpose of an inquiry is the determination of penal liability. In this regard, courts must guard against creating procedural shackles on regulatory officials; it would be undesirable to "force the regulatory hand" by removing the possibility of seeking the lesser administrative penalties on every occasion in which reasonable grounds existed of more culpable conduct. This point was clearly stated in *McKinlay Transport*, *supra*, at p. 648, where Wilson J. wrote: "The Minister must be capable of exercising these [broad supervisory] powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act." While reasonable grounds indeed constitute a necessary condition for the issuance of a search warrant to further a criminal investigation (s. 231.3 of the ITA; *Criminal Code*, s. 487), and might in certain cases serve to indicate that the audit powers were misused, their existence is not a sufficient indicator that the CCRA is conducting a *de facto* investigation. In most cases, if all ingredients of an offence are reasonably thought to have occurred, it is likely that the investigation function is triggered.

90 All the more, the test cannot be set at the level of mere suspicion that an offence has occurred. Auditors may, during the course of their inspections, suspect all manner of taxpayer wrongdoing, but it certainly cannot be the case that, from the moment such suspicion is formed, an investigation has begun. On what evidence could investigators

Digitized by Google

ever obtain a search warrant if the whiff of suspicion were enough to freeze auditorial fact-finding? The state interest in prosecuting those who wilfully evade their taxes is of great importance, and we should be careful to avoid rendering nugatory the state's ability to investigate and obtain evidence of these offences.

91 The other pole of the continuum is no more attractive. It would be a fiction to say that the adversarial relationship only comes into being when charges are laid. Logically, this will only happen once the investigators believe that they have obtained evidence that indicates wrongdoing. Because the s. 239 offences contain an element of mental culpability, the state will, one must presume, usually have some evidence that the accused satisfied the *mens rea* requirements before laying an information or preferring an indictment. The active collection of such evidence indicates that the adversarial relationship has been engaged, since it is irrelevant to the determination of tax liability. Moreover, although there are judicial controls on the unauthorized exercise of power (*Roncarelli v. Duplessis*, [1959] S.C.R. 121; *Babcock v. Canada (Attorney General)*, [2002] 3 S.C.R. 3, 2002 SCC 57, at para. 25), we believe that allowing CCRA officials to employ ss. 231.1(1) and 231.2(1) until the point where charges are laid, might promote bad faith on the part of the prosecutors. Quite conceivably, situations may arise in which charges are delayed in order to compel the taxpayer to provide evidence against himself or herself for the purposes of a s. 239 prosecution. Although the respondent argued that such situations could be remedied by the courts, we view it as preferable that such situations be avoided rather than remedied. It is for this reason that the test is as set out above.

92 Whether a matter has been sent to the investigations section is another factor in determining whether the adversarial relationship exists. Again, though, this, by itself, is not determinative. An auditor's recommendation that investigators look at a file might result in nothing in the way of a criminal investigation since there is always the possibility that the file will be sent back. Still, if, in an auditor's judgment, a matter should be sent to the investigators, a court must examine the following behaviour very closely. If the file is sent back, does it appear that the investigators have actually declined to take up the case and have returned the matter so that the audit can be completed? Or, does it appear, rather, that they have sent the file back as a matter of expediency, so that the auditor may use ss. 231.1(1) and 231.2(1) to obtain evidence for a prosecution (as was found to be the case in *Norway Insulation*, *supra*)?

93 To reiterate, the determination of when the relationship between the state and the individual has reached the point where it is effectively adversarial is a contextual one, which takes account of all relevant factors. In our opinion, the following list of factors will assist in ascertaining whether the predominant purpose of an inquiry is the determination of penal liability. Apart from a clear decision to pursue a criminal investigation, no one factor is necessarily determinative in and of itself, but courts must assess the totality of the circumstances, and make a determination as to whether the inquiry or question in issue engages the adversarial relationship between the state and the individual.

94 In this connection, the trial judge will look at all factors, including but not limited to such questions as:

(a) Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation could have been made?

(b) Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?

(c) Had the auditor transferred his or her files and materials to the investigators?

Digitized by Google

(d) Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?

(e) Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?

(f) Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea*, is the evidence relevant only to the taxpayer's penal liability?

(g) Are there any other circumstances or factors that can lead the trial judge to the conclusion that the compliance audit had in reality become a criminal investigation?

It should also be noted that in this case we are dealing with the CCRA. However, there may well be other provincial or federal governmental departments or agencies that have different organizational settings which in turn may mean that the above factors, as well as others, will have to be applied in those particular contexts.

E. *Charter Consequences*

95 With respect to the consequences related to s. 8 of the *Charter*, *McKinlay Transport*, *supra*, makes it clear that taxpayers have very little privacy interest in the materials and records that they are obliged to keep under the ITA, and that they are obliged to produce during an audit. Moreover, once an auditor has inspected or required a given document under ss. 231.1(1) and 231.2(1), the taxpayer cannot truly be said to have a reasonable expectation that the auditor will guard its confidentiality. It is well known, as Laskin C.J. stated in *Smerchanski*, *supra*, at p. 32, that "[t]he threat of prosecution underlies every tax return if a false statement is knowingly made in it". It follows that there is nothing preventing auditors from passing to investigators their files containing validly obtained audit materials. That is, there is no principle of use immunity that prevents the investigators, in the exercise of their investigative function, from making use of evidence obtained through the proper exercise of the CCRA's audit function. Nor, in respect of validly obtained audit information, is there any principle of derivative use immunity that would require the trial judge to apply the "but for" test from *S. (R.J.)*, *supra*. If a particular piece of evidence comes to light as a result of the information validly contained in the auditor's file, then investigators may make use of it.

96 On the other hand, with respect to s. 7 of the *Charter*, when the predominant purpose of a question or inquiry is the determination of penal liability, the "full panoply" of *Charter* rights are engaged for the taxpayer's protection. There are a number of consequences that flow from this. First, no further statements may be compelled from the taxpayer by way of s. 231.1(1)(*d*) for the purpose of advancing the criminal investigation. Likewise, no written documents may be inspected or examined, except by way of judicial warrant under s. 231.3 of the ITA or s. 487 of the *Criminal Code*, and no documents may be required, from the taxpayer or any third party for the purpose of advancing the criminal investigation. CCRA officials conducting inquiries, the predominant purpose of which is the determination of penal liability, do not have the benefit of the ss. 231.1(1) and 231.2(1) requirement powers.

97 The predominant purpose test does not thereby prevent the CCRA from conducting parallel criminal investigations and administrative audits. The fact that the CCRA is investigating a taxpayer's penal liability, does not preclude the possibility of a simultaneous investigation, the predominant purpose of which is a determination of the same taxpayer's tax liability. However, if an investigation into penal liability is subsequently commenced, the investigators can avail themselves of that information obtained pursuant to

Digitized by Google

the audit powers prior to the commencement of the criminal investigation, but not with respect to information obtained pursuant to such powers subsequent to the commencement of the investigation into penal liability. This is no less true where the investigations into penal liability and tax liability are in respect of the same tax period. So long as the predominant purpose of the parallel investigation actually is the determination of tax liability, the auditors may continue to resort to ss. 231.1(1) and 231.2(1). It may well be that there will be circumstances in which the CCRA officials conducting the tax liability inquiry will desire to inform the taxpayer that a criminal investigation also is under way and that the taxpayer is not obliged to comply with the requirement powers of ss. 231.1(1) and 231.2(1) for the purposes of the criminal investigation. On the other hand, the authorities may wish to avail themselves of the search warrant procedures under ss. 231.3 of the ITA or 487 of the *Criminal Code* to access the documents necessary to advance the criminal investigation. Put another way, the requirement powers of ss. 231.1(1) and 231.2(1) cannot be used to compel oral statements or written production for the purpose of advancing the criminal investigation.

98 In summary, wherever the predominant purpose of an inquiry or question is the determination of penal liability, criminal investigatory techniques must be used. As a corollary, all *Charter* protections that are relevant in the criminal context must apply.

F. *Summary*

99 By way of summary, the following points emerge:

1. Although the ITA is a regulatory statute, a distinction can be drawn between the audit and investigative powers that it grants to the Minister.
2. When, in light of all relevant circumstances, it is apparent that CCRA officials are not engaged in the verification of tax liability, but are engaged in the determination of penal liability under s. 239, the adversarial relationship between the state and the individual exists. As a result, *Charter* protections are engaged.
3. When this is the case, investigators must provide the taxpayer with a proper warning. The powers of compulsion in ss. 231.1(1) and 231.2(1) are not available, and search warrants are required in order to further the investigation.

VI. Application to the Facts of the *Jarvis* Case

100 Whether or not a given inquiry is auditorial or investigatory in nature is a question of mixed fact and law. It involves subjecting the facts of a case to a multi-factored legal standard (*Canada (Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748, at para. 35) and, accordingly, Judge Fradsham's finding is not immune from appellate review.

101 In our view, although Goy-Edwards's conduct throughout her dealings with the appellant and his accountant was not praiseworthy — and at points appears deceptive — we do not think that the record rises to support a finding that she obtained information under ss. 231.1(1) and 231.2(1) while conducting an investigation, the predominant purpose of which was a determination of Jarvis's penal liability. While Goy-Edwards did on several occasions mislead the appellant and his accountant as to the status of the file, she did not use misleading tactics in order to obtain information under ss. 231.1(1) and 231.2(1) for the purpose of advancing an investigation into penal liability. Moreover, there seems to have been but minor contact between Goy-Edwards and Chang from the moment when the file was transferred to Special Investigations on May 4, 1994. In brief, Goy-Edwards should undoubtedly have been truthful when asked about the status of the appellant's file, but there is no evidence to show that she used her audit powers to obtain

Digitized by Google

information for prosecutorial purposes.

102 We do not think it was improper for Goy-Edwards to have brought her supervisor to the April 11 meeting in order to provide a "second opinion" as to whether the file should be sent to the investigative section. The auditor should not have asked if the appellant felt comfortable with the attendance of an "assistant" when that person was in fact a supervisor, but this did not change the fact that the referral to Special Investigations was the auditor's determination. So long as there has been no crystallization of the adversarial relationship, there is, in our view, nothing wrong with an auditor seeking the counsel of another before completing the transfer paperwork.

103 The record indicates that very little new information came to light as a result of the April 11 meeting. Goy-Edwards was seeking confirmation of a suspicion that she held that tax evasion may have occurred, but her goal in this was to determine whether to refer the file. There is no suggestion that she was seeking information to be used in an eventual prosecution, which fact is borne out by the conclusions of the Court of Queen's Bench and the Court of Appeal: much of the material that was relied upon in the Information to Obtain was already in Revenue Canada's possession. In this respect, as previously stated, it is clear that, although an investigation has been commenced, the audit powers may continue to be used, though the results of the audit cannot be used in pursuance of the investigation or prosecution.

104 We conclude that, on the facts of this case, the April 11 meeting did not constitute an investigation into Jarvis's penal liability under s. 239 of the ITA. It follows that, other than the paragraphs struck from the Information by the trial judge as being erroneous, nothing should have been omitted from the application for the search warrant, and the warrant was therefore validly issued. Based on the application of the relevant factors as discussed above, we differ with the courts below and find that there was no investigation into penal liability prior to May 4, 1994, when Goy-Edwards filled out the Form T134 and referred her file to Special Investigations. The record establishes that Chang's efforts to determine whether reasonable grounds to obtain a search warrant commenced upon her receipt of the file, and that she concluded shortly thereafter that such grounds existed.

105 The searches of the appellant's residence, his accountant's residence, and Revenue Canada's Calgary office were therefore conducted pursuant to a valid warrant. The evidence obtained therefrom should be admissible in a new trial, if one is held. We point out, however, that some banking information was obtained pursuant to s. 231.2(1) requirement letters in early 1995. On the above analysis, this usage violated the appellant's s. 7 rights, since the investigation was at that point well underway. The respondent did not argue that the trial judge had erred in his application of s. 24(2) of the *Charter*, and we would therefore order that the banking records be excluded from any subsequent criminal proceedings against the appellant.

VII. Disposition

106 Accordingly, we would dismiss the appeal, and uphold the Alberta Court of Appeal's judgment and order for a new trial.

Appeal dismissed.

Solicitors for the appellant: Macleod Dixon, Calgary.

Solicitor for the respondent: The Department of Justice, Vancouver.

Solicitor for the intervener the Attorney General for Ontario: The Ministry of the Attorney General, Toronto.

Solicitor for the intervener the Attorney General of Quebec: The Department of Justice, Sainte-Foy.

Digitized by Google

Solicitor for the intervener the Criminal Lawyers' Association (Ontario): Scott K. Fenton, Toronto.

See also R. v. DiGiuseppe[74] when the local police were actively involved in the securing of documentary evidence while CRA conducting an audit, with the argued intent of having all the evidence brought together to prosecute tax evasion. It was held:

> Overview
>
> [1] By Notice of Application and Constitutional Issue dated September 23, 2005, as further refined by Mr. Irving's September 24, 2007 correspondence with the Crown, the applicant Riccardo DiGiuseppe seeks an order excluding the evidence tendered during the course of the trial and a further order setting aside the guilty verdict. Alternatively the applicant requests declaration of a mistrial or a stay of proceedings.
>
> [2] In the event the aforementioned relief is not granted, leave is sought to adduce further evidence to address alleged improprieties by the police during the course of their investigation of the applicant.
>
> The Issues Issue # 1
>
> [3] The applicant submits the York Regional Police Service contemplated the laying of tax evasion charges from the outset of the investigative initiative "Project Northern Greed". As particularized in paragraph 121 of the application's factum:
>
> "…the York Regional Police intended from the outset to use Project Northern Greed as a venue to collapse the business operations of Fantasia and Bunnies and to gather evidence to support charges of tax evasion and the eventual prosecution of the applicant for the very charge upon which he was convicted".
>
> [4] In effect the applicant contends the York Regional Police Service acted as Revenue Canada's "proxy" with the intention of assisting the tax authority to secure evidence in support of anticipated tax evasion charges.
>
> [5] During the execution of a series of *Criminal Code* search warrants by the police on September 10, 1998 documentation and financial information were seized. This information was ultimately secured by the revenue agency and that material formed the evidentiary foundation for Revenue Canada's successful prosecution of the applicant.
>
> [6] The failure of Revenue Canada to seek search warrants, at the outset of the project, in furtherance of their own investigation of the applicant's personal tax liability is submitted as undermining the legality of the search warrants that were secured and executed by the police. As a consequence the legitimacy of Revenue Canada's receipt and reliance on the documents seized has been compromised.
>
> Issue # 2
>
> [7] The applicant summits Revenue Canada personnel were actively engaged in a tax evasion investigation from the outset. This initiative was intentionally concealed under the guise of a tax compliance audit. While acting in complicity with the York Regional Police Service, Revenue Canada is alleged to have instituted and exercised investigative authority without regard to the applicant's constitutional entitlement to be free from unreasonable search and seizure. As a consequence the applicant contends a section 8 violation has occurred as incriminating information was obtained under the false pretence of an audit for tax assessment purposes.
>
> [8] By "recourse" to the provisions of subsection 231.1 (1) and section 231.2 (1) of the *Income Tax Act* and, while under the guise of a compliance audit, the tax department invalidly gathered and reviewed information in accordance with the tax auditor's inspection

[74] 2008 ONCJ 126

Digitized by Google

and requirement powers. As Revenue Canada investigators must secure a search warrant to lawfully advance their investigations the materials ultimately obtained and relied upon by the tax investigators ought to be excluded as evidence in the applicant's trial.

Issue # 3

[9] Finally, the applicant submits the undercover police investigators engaged in illicit and illegal conduct, without lawful authority or justification, in order to gather evidence which ultimately resulted in bawdy house and other prostitution related offences and proceeds of crime charges.

[10] The illegal activities of the investigating officers were not subsequently fully disclosed to the judges who issued wiretap authorizations and the September 10, 1998 search warrants. Failure to disclose such activities is contended to constitute an abuse of process as such authorizations require that the issuing justice have full disclosure of all relevant facts in order to insure the discretion to issue process is exercised judicially.

[11] By engaging in and permitting illegal acts of sexual touching the evidentiary base for the lawful issuance of the September 10, 1998 search warrants has been compromised and the administration of justice called into disrepute.

[12] As a result the fairness of the applicant's trial has been affected. The unseemly methods employed to gather evidence of sexual activity at the clubs controlled by the applicant is viewed as having "tarnished" the judicial process. The evidence thus obtained ought therefore be excluded.

[13] In order for this concern to be fully explored the applicant seeks leave to cross-examine the various undercover officers who participated in the gathering of evidence by posing as patrons at the Fantasia and Bunnies strip clubs.

The Crown's Position

[14] In the view of the Crown the historical involvement and interest of the York Regional Police and other government agencies in the applicant's business operations serves to undermine the Applicant's assertion that the initiative known as "Project Northern Greed" was actually a tax evasion investigation concealed as a large scale police action into alleged bawdy house activities.

[15] The genesis, development, and timing of Project Northern Greed does not support the applicant's contention that Revenue Canada illegally "piggy-backed" it's tax evasion inquiry on the York Regional Police Services bawdy house investigation.

[16] The fact the accused and/or the business operations he is alleged to have controlled had been prosecuted for morals offences on two previous occasions adds further support to the legitimacy of the declared *Criminal Code* offence based objectives of Project Northern Greed.

[17] The Crown asserts Revenue Canada officials, who were initially involved in an audit of the applicant and his related business enterprises, properly secured all necessary legal authorizations prior to reviewing the documents seized by the police on September 10, 1998.

[18] As the documentation was lawfully obtained at the time of the initial seizure by the police there was a substantially "reduced expectation of privacy" in the seized materials thereafter.

[19] Once an investigation was commenced to determine the applicant's penal tax liability the Revenue Canada investigators relied on information that had been lawfully obtained by the auditors in accordance with a section 490 (15) of the *Criminal Code* and the powers of inspection pursuant to section 231.1 (1) and section 231.2 (1) of the *Income Tax Act*.

[20] The applicant's expressed desire to widen the scope of the abuse of process motion by exploring allegations of alleged sexual misconduct by certain undercover officers is viewed as an unwarranted and irrelevant consideration given the applicant's

Digitized by Google

primary contention that the police were carrying out a tax evasion inquiry under the guise of a bawdy house investigation.

[21] In summary, the respondent submits this application is without merit with any infraction or transgression, in either the audit or tax investigation of the applicant, arising as a consequence of inadvertence, "honest" mistake or unintended procedural irregularity.

Summary of the Evidence on the Motion

[22] On April 24, 1998 the Operational Plan for the proposed investigation of the applicant's alleged criminal enterprise was approved for funding by the Criminal Intelligence Service of Ontario.

[23] The "Investigative Objectives" of the project were noted to include the establishment of a data base of potential "targets", their assets, properties and businesses; elimination of the applicant as a "criminal element" within the communities affected and collection of intelligence information in order to conduct a criminal investigation of the applicant's "syndicate" with the intention of ultimately securing the closure of both the Major Mack Hotel (Fantasia) and Bunnies.

[24] Upon successful completion of the project twenty charges were expected to be laid. These charges were anticipated to include morals offences, other *Criminal Code* offences including assault, extortion, intimidation, possession of stolen property, money laundering, obstruction of justice and conspiracy; drug offences; *Liquor Licence Act* infractions; *Immigration Act* charges; municipal bylaw infractions and *Income Tax Act* violations. [25] Constable Purves of the York Regional Police Service, the officer responsible for the drafting of the operational plan, advised the inclusion of anticipated charges under the Income Tax Act was speculative and based on his assumption that evidence of such offences would be secured as a consequence of the proposed investigations and information provided by Integrated Proceeds of Crime (IPOC) investigator Dan Corbeil.

[26] No evidence was presented during the hearing of the application to indicate Revenue Canada had any input or involvement in the decision to include Income Tax Act charges in the list of anticipated offences in the projects Operational Plan. This inclusion was acknowledged by Constable Purves as being a product of his own expectations.

[27] On implementation of Project Northern Greed the police investigators set about to gather evidence relating to the stated objects of the investigative plan with the focus of the initiative on the applicant's alleged bawdy house operations.

[28] The investigation employed undercover operatives, surveillance teams, wiretaps and informants.

[29] The project culminated with the execution of a number of search warrants on September 10, 1998 and seizure of voluminous documentation and financial information.

[30] In due course the analysis of this information by Revenue Canada officials would form the evidentiary basis for the prosecutions case in the applicant's fraud trial.

Revenue Canada's Involvement

[31] During the course of the application most of the Revenue Canada personnel who had dealings with either the audit or investigative initiatives relating to the Applicant's business affairs were called to testify.

[32] The first confirmed contact between the police and Revenue Canada in relation to the applicant appears to have occurred on July 10, 1998 when Tracy Gualberto, who was at that time a Revenue Canada forensic auditor seconded to the Newmarket based "I.P.O.C. section of the R.C.M.P. pursuant to a Memorandum of Understanding, was asked by one of the I.P.O.C. investigators Dan Corbeil to assist in Project Northern Greed.

[33] Following a July 16, 1998 meeting between Constable Corbeil, Tracy Gualberto and the Assistant Director of Investigations with the Toronto North office of Revenue Canada, Don Renaud, it was agreed Revenue Canada would endeavour to lend computer

Digitized by Google

expertise to assist with evidence recovery when the contemplated search warrants were executed at the culmination of the Project Northern Greed investigation. [34] Ron Allen, the co-ordinator for Revenue Canada's Computer Search and Evidence Recovery (C.S.E.R.'s) assumed responsibility for securing and assigning Revenue Canada personnel to assist with the anticipated computer searches.

[35] Ron Allen also lent his technical expertise and previous litigation experience by assisting in the drafting of portions of the Information to Obtain related to computerized information.

[36] On September 10, 1998 several Revenue Canada C.S.E.R.'s participated in the searches of the accused's residence, business offices and related business operations.

[37] Tracey Gualberto was also present and participated in the September 10, 1998 search warrant initiative. [38] During the September 10, 1998 searches Ron Allen secured a copy of the New Views accounting program from the offices of the Applicant's financial controller Peter Fuller which he retained. This program contained detailed financial records of the Applicant's various business enterprises.

[39] A copy of this program was installed in a computer that was provided to Tracey Gualberto on November 13, 1998. At that time Instructions were provided to enable Tracy Gualberto to operate the program and access the financial data it contained. The installation of a further computer program took place on November 17, 1998. This program was required to facilitate computer access to the Newviews Program which Ms. Gualberto indicated she did not attempt until after an access order was obtained.

[40] On November 18, 1998, Tracey Gualberto applied for and secured an order under section 490 (15) of the *Criminal Code* authorizing access to the records for audit purposes.

[41] In January 1999 Revenue Canada auditors Neil Reine and Zahur Jiwa were assigned, at the request of Tracy Gualberto, to # 5 Division Headquarters of the York Regional Police Service where over two hundred boxes of seized documentary items, secured during the execution of the September 10, 1998 search warrant, were to be reviewed. The auditors and the York Regional Police investigators were provided with spread sheets Tracey Gualberto had prepared based on her review of the Daily Revenue Summary Sheets. [42] At the direction of Angelo Villella, Special Enforcement Program Team Leader at Revenue Canada, Reine was to perform a Goods and Services Tax audit with Jiwa directed to consider the documentation to be reviewed for a potential Income Tax audit.

[43] Jiwa and Reine continued their review of the seized documentation until August 1999.

[44] During the timeframe of this review Tracy Gualberto advised she had no further involvement in the audit procedures with the auditors conducting their work without direction or involvement by other Revenue Canada personnel or the police.

[45] At the direction of Dan Renaud, Revenue Canada Investigator Gail McNeil variously met with Dan Corbeil, Angelo Villella and Tracy Gualberto in late March 1999 to assess the file for a potential G.S.T. investigation.

[46] McNeil prepared a written report of her assessment of the files investigative potential. In that report McNeil concluded the file had potential noting that "all procedures for a normal investigation are still required and a civil audit has not yet commenced".

[47] In her oral testimony on the application McNeil observed she had intended to indicate the audit had not yet been completed. Reine testified he and Jiwa spent most of their time "vouching" or verifying Gualberto's work product. He recalled dovetailing the time devoted to the discharge of their audit function while at #5 District to the general IPOC Code and not a designated audit file.

[48] The audit review was completed in August 1999 at which time Reine and Jiwa met with Angelo Villella their immediate supervisor on the Special Enforcement Program team. Villella directed that a proposal letter not be forwarded to the applicant detailing the results of the audit. Following a subsequent meeting with Don Renaud on August 24, 1999 the

Digitized by Google

auditors prepared three referrals (one for Fantasia, two for Bunnies) to Special Investigations. During the months of August and September 1999 Reine issued bank requirements relating to the audit.

[49] On October 8, 1999 Villella approved the referrals for transmission to Special Investigations based on his assessment of the results of the audit. The referrals were accepted by Investigations on October 29,1999.

[50] By the end of October 1999 Special Investigators, Frank Menniti and Don Lee, had reviewed the auditors working papers, Gualberto's financial analysis, the audit file and related documentation. On confirmation of the reliability of the internal financial controls employed in the operation of both Fantasia and Bunnies notification of the tax reassessment and a legal caution was delivered in written form to the applicant's corporate controller Peter Fuller.

[51] On November 17, 1999 a Prosecution Report prepared by Menniti and Lee was forwarded to the Department of Justice. This report included a summary of the proposed tax evasion prosecution, anticipated offences, a description of the alleged fraud, a list of proposed witnesses and a summary of the testimonial evidence anticipated to be adduced.

[52] On June 21, 2000 a *Criminal Code* search warrant was served by Menniti on Dan Corbeil in order to secure copies of the records that had been seized during the September 10, 1998 investigation.

[53] These records had been previously secured by Gualberto pursuant to a section 490 (15) *Criminal Code* search warrant on November 18, 1998. These were the same records that were reviewed by Reine and Jiwa during the months of January to August 1999. Items secured included daily summary sheets, bar reports, cash register tapes, drop envelopes, computer accounting records and corporate documentation.

[54] In February 2001, Menniti issued requirements to obtain his own records for use in the investigation.

[55] On November 4, 2003 a subsequent section 487 warrant was obtained by Menniti in order to secure the original documentation seized during the course of the September 10, 1998 searches. This action was prompted by a concern that the withdrawal of certain *Criminal Code* charges against the applicant at that time might lead to the return of the original seized documentation to Mr. DiGiuseppe.

[56] The Information to Obtain filed by Menniti in support of the November 3, 2003 warrant differed from that employed in securing the June 21, 2000 warrant as the initial Information to Obtain indicated that Neil Reine and Zahur Jiwa had been assigned to perform audits of a number of companies controlled by the applicant. The 2003 version asserted, in part, that Reine and Jiwa had been assigned to assist Tracy Gualberto in her review of the records she had seized pursuant to an access order obtained under section 490 (15) of the *Criminal Code*. The 2003 Information to Obtain indicates audits for G.S.T. and Income Tax Act purposes were "performed" by Reine and Jiwa respectively in "August 1999".

[57] Menniti accounted for the noted changes as having arisen based on additional information he received in consultation with the Crown at the time and information reportedly contained in Villella and Renaud's will say statements that the audit did not commence until August 1999.

Applicable Legal Principles Stay of Proceedings

[58] In *O'Connor v. The Queen* 103 C.C.C. (3d) 1 affirming 89 C.C.C. (3d) 109 (S.C.C.), L'Heureux Dube J,. for the majority, adopted the Ontario Court of Appeals conclusion in *R. v. Young* and affirmed that [at page 31]:

"there is a residual discretion in a trial court judge to stay proceedings where compelling an accused to stand trial would violate those fundamental principles of justice which underlie the community's sense of fair play and decency and to prevent the abuse of a court's

Digitized by Google

process through oppressive and vexatious proceedings".
[59] This power is subject to the additional directive that it is to be exercised only in the "clearest of cases", (paragraph 59 and 62) as "a last resort, to be taken when all other acceptable avenues of protecting the accused's right to full answer and defence are exhausted" (paragraph 77) and where "the accused's right to make full answer and defence cannot be remedied or where irreparable prejudice would be caused to the integrity of the judicial system if the prosecution were continued" (paragraph 82).
[60] Principles of fundamental justice including consideration of trial fairness require "a balancing of societal and individual interests".
[61] In *O'Connor* L'Heureux Dube J. sets down guidelines to evaluate whether there has been a violation of the *Charter* invoking analagous concerns to those traditionally raised under the doctrine of abuse of process at common law and situations under which a remedy of a judicial stay of proceedings will be "appropriate and just in the circumstances" as required by section 24 (1) of the *Charter* (para 72).
[62] The criteria in which a stay of proceedings is warranted are noted in circumstances where:
the prejudice caused by the abuse in question will be manifested, perpetuated or aggravated through the conduct of the trial, or by its outcome; and
no other remedy is reasonably capable of removing that prejudice (para 75)
[63] Factors to be considered in applying this criteria include, but are not limited to, the seriousness of the violation; the conduct and intention of the Crown; and, the societal interests in obtaining a determination of guilt or innocence with the interests of society increasing "commensurately to the seriousness of the charges against the accused" (para 81).
[64] Despite "shoddy and inappropriate" conduct by the Crown in failing to effect full and timely disclosure the Supreme Court of Canada concluded in *O'Connor* that the accused's ability to make full answer and defence had not been compromised or prejudiced to the point a stay of proceedings was warranted.
[65] In the Supreme Court of Canada decision *Canada (Minister of Citizenship and Immigration) v. Tobias*
118 C.C.C. (3d) 443 the court considered the consequences arising from the fact an Assistant Deputy Attorney General in the Department of Justice had contact with the Chief Justice of the Federal Court, without notice to other parties, regarding a matter before that court involving the Justice Department.
[66] In concluding there was no persuasive evidence of bad faith on the part of any of the officials involved, or actual interference with judicial independence, the Supreme Court of Canada affirmed the decision of the Federal Court of Appeal that the damage to judicial independence in this case was not sufficient to warrant a stay of proceedings. The societal interest in the proceedings was held to outweigh any affront to the appearance of interference or infringement of judicial independence.
[67] In *Tobias* the Court concludes the two criteria referenced in *O'Connor* must be satisfied before a stay arising from the unfair conduct of a prosecution by the state or other damage to the integrity of the judicial system is granted. These considerations are repeated in summary form as follows:
the prejudice caused by the abuse in question will be manifested, perpetrated or aggravated through the conduct of the trial, or by its outcome;
no other remedy is reasonably capable of removing the prejudice (para 90 *Tobias*; para 75 *O'Connor*). [68] In *Tobias* a third factor for consideration is specified in circumstances "where the affront to fair play and decency is disproportionate to the societal interest in the effective prosecution of criminal cases, then the administration is best served by staying

Digitized by Google

the proceedings" "L'Heureux Dube J. *R., v. Conway* [1989] 1 S.C.R. 1659 at p. 1667, 49 C.C.C. (3d) 289 (para 92, *Tobias*).

Summary

[69] Applying these considerations to this application the applicant must establish on the balance of probabilities:

misconduct by the state amounting to an abuse of process affecting either trial fairness or the integrity of the judicial process;

irreparable prejudice arising from the abusive conduct alleged that is manifest during the conduct of the trial, or the verdict, resulting in a circumstance where no lesser remedy, other then a stay of proceedings, is appropriate;

circumstances where the "affront" to the applicant's individual fair trial interests favouring the granting of a stay outweigh the societal interest in seeing serious criminal cases effectively prosecuted to their conclusion and, finally;

that this is one of the "clearest of cases" where the discretionary power to grant a stay of proceedings should be granted even if a section 7 *Charter* violation is established.

Revenue Canada's Audit and Investigative Authority

[70] Section 231.1 (1) of the *Income Tax Act* R.S.C. 1985 C. 1(5th Supp) provides that authorized representatives of the Minister of National Revenue may "inspect, audit and examine the books and records of any taxpayer" for any purpose related to the administration of the *Income Tax Act*.

[71] Section 231.2 grants authority to an "authorized person" (defined as a person authorized by the Minister of National Revenue for the purposes of sections 231.1 to 231.5) to require that a tax payer produce requested information or documentation within a specified time frame for any purpose related to the administration or enforcement of the *Income Tax Act.*

[72] Section 231.3 details the criteria that govern the application for a search warrant in circumstances where there are i) reasonable and probable grounds to believe an offence has been committed under the *Act*; ii) a document or "thing" to be seized that is likely to be found may provide evidence of the commission of the offence alleged; iii) the building, receptacle or place specified in the application is likely to contain the document or thing.

[73] The distinction between Revenue Canada's audit and investigative functions was reviewed in detail by the Supreme Court of Canada in the case of *Regina v. Jarvis* (2002), 169 C.C.C. (3d) 1 (S.C.C.).

[74] In *Jarvis* the court endeavoured to delineate the bounds between a compliance audit and an investigation where the predominant purpose of the inquiry is the determination of penal liability (paras 88- 94).

[75] When exercising their audit function revenue officials are lawfully entitled to use the inspection and requirement powers under section 231.1(1) and section 231.2 (1). In circumstances where the "predominant purpose of a particular inquiry is the determination of penal liability" these powers must be relinquished. (para 88).

[76] Factors indicated as bearing on the determination of the nature of the inquiry and whether the predominant purpose of the inquiry is the determination of the tax payers penal liability include but are not limited to the following:

the presence of reasonable grounds to lay charges and/or confirmation of a decision to proceed with a criminal investigation;

general conduct of the tax authorities consistent with the pursuit of a criminal investigation;

transfer of files from the auditor to the investigator;

conduct consistent with the auditor performing an agency role for the investigation;

evidence to support a finding that the investigators were using the auditors as their agents for the purpose of collecting evidence;

Digitized by Google

the nature of the information being sought from the tax payers and its relevance to taxpayer liability generally (the audit function) on the taxpayer's intention or *mens rea* (a consideration that is only of importance in an inquiry relating to the taxpayer's penal liability); the presence of any other factors, or consideration of the totality of the evidence, that could lead to the conclusion that a compliance audit had become a criminal investigation. (para 94).

[77] Factors that are not necessarily determinative of the existence of an investigation are also canvassed in

Jarvis (para's 89-92). In summary form these non-determinative considerations include:

the "mere existence of reasonable grounds that an offence has occurred" (para 89) Even when there are reasonable grounds to believe an offence has occurred "the courts must guard against creating procedural shackles on regulating officials" by restricting or removing the possibility of a lesser regulatory sanction in circumstances "mere culpable" conduct might reasonably be believed to exist;

The "mere suspicion that an offence has occurred" is similarly an insufficient basis to distinguish an audit from an investigation. Mere suspicion of taxpayer wrong doing by an auditor during an audit is an insufficient reason to "freeze auditorial fact finding". (para 90).

As indicated in Jarvis supra at para 30:

Whether a matter has been sent to the investigations section is another factor that is not determinative of whether an adversarial relationship exists between the taxpayer and the tax department. As the possibility exists the file may be returned to the auditor and may not be accepted for criminal prosecution a referral for investigation is, by itself, not determinative of the audit/investigation issue. (para 92)

All relevant factors must be considered on the totality of circumstances, and considered in context, in order to determine whether the inquiry in issue "engages the adversarial relationship between the state and the individual". (para 93)

[78] In *R. v. Norway Insulation Inc*. [1995] O.J. No. 1073 a decision of Justice Laforme then of the Ontario Court (General Division) the trial judge's decision to exclude evidence secured by Revenue Canada during the course of an audit and an order quashing two search warrants secured on the basis of the audit findings was upheld.

[79] In *Norway Insulation*, following referral to Special Investigations by a Revenue Canada auditor, the investigators directed the auditor to gather further information in order that charges could be laid.

[80] In *Norway* both the trial judge and the summary conviction appeal court concluded factors such as the transfer of files from the auditor to the investigator; conduct by the auditor consistent with the auditor acting in an agency capacity for the investigation; and, evidence to support the contention the investigators use of the auditor for the purpose of collecting evidence relating to the taxpayers penal liability, infringed the taxpayers section 8 *Charter* right as an unreasonable search and seizure.

Improper Conduct by the Police

[81] In *R. v. P (N.M)* 188 D.L.R. (4th) 350 the Nova Scotia Court of Appeal considered the circumstances of a seventeen year old accused who alleged her rights under section 7 and section 15 of the *Charter* had been violated as a result of the touching of her pubic hair by a police officer during the course of a prostitution related investigation. Citing *R. v. Sharose* (1999), 133 C.C.C. (3d) 257, 171 D.L.R. (4th) 193 (S.C.C. and *R. Regan* (1999), 179 N.S.R. (2d) 45, 137 C.C.C. (3d) 449 (N.S.C.A.) the court concluded each case must be determined on a case by case basis with the "drastic remedy" of a stay of proceedings only being available in "the clearest of cases".

[82] Where the fairness of the accused's trial is not in issue the applicant must show "the fundamental principles that underlie the community's sense of fair play and decency were violated".

Digitized by Google

[83] In *R. v. P (N.M.)* the act of touching by the undercover officer in the circumstances in which it occurred was held to be justified as falling "in the category of situational police conduct" (page 9). The court noting "undercover police operatives would be of little value if officers were expected to make full disclosure to all and sundry of their true purpose". The legislation relating to the offence of sexual assault being directed to the protection of "dignity, bodily integrity and safety of the person" not the facilitation "for law breakers to circumvent legitimate undercover police operatives". (page 11).

[84] The effect of alleged police misconduct on an application for a stay of proceedings was considered by the Alberta Court of Appeal in *R. v. Bond* (1993), 135 A.R. 329 (leave to appeal refused) [1993] 3 S.C.R.v. at p. 333:

"illegal conduct by the police during an investigation, while wholly relevant to the issue of abuse of the court's processes, is not per se fatal to prosecutions which may follow: Mack; supra at 558. Frequently it will be, but situational police illegality happens. Police involve themselves in high speed chases, travelling beyond posted speed limits. Police pose as prostitutes and communicate for that purpose in order to gather evidence. Police buy, possess, and transport illegal drugs on a daily basis during undercover operations. In a perfect world this would not be necessary but, patently, illegal drug commerce is neither successfully investigated, nor resisted, by uniformed police peering through hotel room transoms and keyholes or waiting patiently at police headquarters to receive the confessions of penitent drug-traffickers".

Project Northern Greed as a Tax Fraud Investigation

[85] The applicant submits the investigative initiative Project Northern Greed was an elaborately disguised tax evasion investigation.

[86] The facts viewed as supportive of this conclusion include the following:

reference to "Income Tax Act violations" as one of the "anticipated charges" in the Operational Project Plan for Project Northern Greed ;

the inclusion of the offence of income tax evasion contrary to section 239 (1) of the Income Tax Act and the related factual assertions referenced in Appendix "A" in Constable Kirk Dickson's September 10, 1998 Information to Obtain Search Warrant;

the involvement of certain Department of Justice and Revenue Canada personnel in Project Northern Greed prior to the execution of the search warrants and the arrest of the Applicant on September 10, 1998;

the continuing interest of Revenue Canada auditors, investigators and management personnel in the financial documentation seized during the course of the September 10, 1998 searches of the applicant's residence, office and businesses.

The fact all *Criminal Code* charges were ultimately withdrawn against the applicant with the sole exception of a single count of fraud over $5000, section 380 (1) (a), founded on the applicant's evasion of payment of both G.S.T. and Income Tax.

[87] A review of the application record and the exhibits filed on this application confirm the historic involvement of the York Regional Police Service with Fantasia. Previous bawdy house investigations occurred in 1992 and 1995. The facility had attracted previous regulatory enforcement from the Town of Richmond Hill and the Liquor Licence Board or Alcohol and Gaming Commission.

[88] While the Operational Plan for Project Northern Greed referenced a new investigative focus, with an emphasis on proceeds of crime, the object of the investigation was directed at the elimination of the applicant's continuing operation of both Fantasia and Bunnies as alleged bawdy houses.

[89] The application record demonstrates that efforts were made by the investigators to encourage Revenue Canada to take part in the project. On July 7, 1998, Constable Dickson spoke to Rosemary Warren, a prosecutor with the Department of Justice, to

Digitized by Google

advise he suspected the investigation might yield evidence of tax evasion. As a consequence of the meeting Constable Purves met with Dan Renaud and Tracy Gualberto to further define the role Revenue Canada would play as the police investigation drew to a close.
[90] Notes of these meetings and related CISO bi-weekly reports confirm Revenue Canada's awareness, interest and involvement in the project.
[91] The limited scope of that involvement is reflected in the record of Dan Corbeil's September 15, 1998 meeting with Rosemary Warren where it is agreed Revenue Canada will be requested to perform a net worth analysis and financial inquiry of the applicant.
[92] In furtherance of that initiative Tracey Gualberto secured an access order on November 18, 1998 authorizing Revenue Canada personnel to review the financial material seized by the police on September 10, 1998.
[93] In due course charges were laid under the Income Tax Act and Excise Tax Act on March 9, 2001. A further charge of fraud over $5000. was laid by Revenue Canada investigator Frank Menniti on July 9, 2001. [94] While bawdy house charges were withdrawn on November 2, 2003, I conclude, based on consideration of the totality of the evidence presented on this application, that the primary focus of the police initiative Project Northern Greed was the investigation of bawdy house and proceeds of crime offences as detailed in the projects Operational Plan.
[95] Revenue Canada or Justice Department personnel had no involvement in the formulation of the Operational Plan and very limited peripheral input prior to the execution of the search warrants on September 10, 1998. Apart from the provision of technical expertise during the searches the evidence establishes involvement of a significant degree by the tax department did not begin until after the access order was secured by Tracy Gualberto in November 1998.
[96] The applicant's assertion that the York Regional Police Service exercised Revenue Canada's investigative "proxy" from the genesis of Project Northern Greed through to the culmination of that investigation is concluded to be unfounded in fact.
[97] Speculation aside, the suggestion Revenue Canada and the York Regional Police Service wilfully conspired, one with the other, to subvert the judicial process through a series of fraudulent representations leading to the issuance of wiretap and search warrant authorizations with the ultimate intention of securing evidence to support a charge of tax evasion, the logical extension of the argument advanced on this issue, is not supportable on the facts presented here.
[98] The fact the applicant was ultimately prosecuted on a single Criminal Code charge of fraud relating to the evasion of income tax and GST is not, in itself, proof or confirmation that prosecution on this charge was the prosecutorial goal of both the York Regional Police Service and Revenue Canada from the outset of Project Northern Greed.
[99] As noted, the charge of fraud upon which the applicant was ultimately convicted was not laid until July 9, 2001. There is no evidence to suggest the "proxy" or "piggy back" theory advanced on behalf of the applicant was even contemplated by any of the law enforcement agencies involved in this investigation let alone intentionally implemented.
[100] The evidence on this application supports the charge of fraud being laid after an extensive review and independent assessment of the seized documentary materials and financial information by Revenue Canada investigators.
[101] At its highest the evidence establishes Constable Purves and Corbeil were aware, at the outset of the planning process for Project Northern Greed that undeclared income might reasonably be anticipated as being generated as a consequence of the observed conduct of the dancers at Fantasia and Bunnies.
[102] As the police had reasonable and probable grounds to support their belief that these establishments were bawdy houses it was not unreasonable for them to assume income tax

Digitized by Google

was not being fully reported on income that had not been lawfully earned.

[103] The contention that the York Regional Police Service and/or Revenue Canada planned to carry out a tax fraud investigation and prosecute that offence from the outset is concluded to be speculative at best and without any factual substance or support. While one of the investigative goals of Project Northern Greed may have been to "collapse the business operations of Bunnies and Fantasia" there is no evidence to suggest the police and/or Revenue Canada planned from the outset of the project to resort to the offence of tax evasion in order to do so.

Investigation or Audit

[104] Having concluded the applicant has failed to establish proof on a balance of probabilities that the York Regional Police Service planned "from the outset of Project Northern Greed to carry out their investigation with the focus on prosecuting the applicant for tax evasion or "tax fraud" (para 107 Applicant's factum), consideration turns to the assertion Revenue Canada initiated certain "paths of investigation under the guise of an audit" contrary to the Supreme Court of Canada ruling in *R. v. Jarvis*, supra.

[105] Having reviewed the Application Record in its entirety, the documentation presented and the testimony offered by the various tax officials, I conclude there is no merit to the allegation Revenue Canada officials misused the requirement and inspection authority sections 231.1 and 231.2 of *The Income Tax Act*.

[106] As previously noted Revenue Canada's involvement during the planning and implementation stages of Project Northern Greed was limited. While technical assistance was provided by Revenue Canada CSER's on September 10, 1998 and Revenue Canada's Special Enforcement Program was kept informed of the investigative initiative, no involvement by Revenue Canada personnel, of any meaningful consequence, took place until November 1998.

[107] Following the obtaining of an access order by Tracy Gualberto the documentation seized by the police on September 10, 1998 was subject to review by Revenue Canada auditors Reine and Jiwa.

[108] Reflecting on the nature of the work they performed rather than Revenue Canada's designation or description of that work I conclude there is no evidentiary support for the applicant's submission Reine and/or Jiwa, or any other Revenue officials, were in fact conducting an investigation to determine the applicant's penal liability without lawful authority.

[109] Applying the distinguishing considerations referenced in *Jarvis* I conclude as follows:

Revenue officials did not have reasonable grounds to lay charges prior to August 1999 at the earliest when Reine and Jiwa completed their review of the seized business records.

The fact the audit report disclosed evidence of unreported income and unpaid income tax and GST does not in itself support the conclusion that the "predominant purpose" of Reine and Jiwa's efforts was the determination of the applicant's penal liability. Their activities and the resultant report are consistent with an audit.

Based on the results of the audit it may be fairly concluded the auditors had reason to suspect an offence had occurred but there is no evidentiary support to suggest this conclusion was reached prior to the completion of their review in August 1999. As stated in *Jarvis* the "whiff of suspicion" of taxpayer wrong doing is not enough to "freeze auditorial fact finding" (para 90).

The reference to a Revenue Canada "investigation" in Tracey Gualberto's November 18, 1998 access order application, which may well be attributable to an error based on her stated lack of awareness of the legal import of that term, and the initial posting of Jiwa and Reine's time to "IPOC" rather than on assigned audit file notwithstanding, I conclude the determination of the Applicants penal liability did not become the "predominant purpose" of

Digitized by Google

Revenue Canada's inquiry until August 1999 at the earliest. It is at this time, following completion of the audit process by Reine and Jiwa, that reasonable grounds to lay charges were developed.

The evidence establishes a further independent assessment of the auditors report was subsequently conducted by investigator Frank Menniti to confirm the auditors assessment and to prepare the case for prosecution. The fact reasonable grounds to support the offence of fraud may have existed prior to the formalization of charges in March 2001 is not in itself a sufficient basis to conclude that the predominate purpose of the Reine/Jiwa inquiry was the determination of penal liability.

As stated in Jarvis:

"Even where reasonable grounds to suspect an offence exists, it will not always be true that the predominant purpose of an inquiry is the determination of penal liability".

(R. v. Jarvis, supra at para 89)

[110] Further, there is no evidentiary basis for the applicant's assertion that the auditors were performing an investigation function simply as a result of their review of documentation originally seized by the police and accessed by Revenue Canada personnel through a section 490(15) *Criminal Code* order.

[111] Based on the evidence of Tracy Gualberto I am satisfied that the reference to the word "investigation" in paragraph 6 of the November 4, 1988 affidavit filed in support of the section 490(15) order must be read in context by reference to the "inquiry" into the applicant's financial affairs detailed in paragraph 5 of the affidavit. Tracy Gualberto's limited involvement in the file following the securing of the access order and the subsequent August 1999 audit report of Reine and Jiwa are factors that offer strong support for the Crown's assertion that a Revenue Canada investigation did not commence until the fall of 1999 at the earliest.

[112] Finally, I am not persuaded that the inquires made by the police and/or revenue officials into the applicant's banking records prior to the formalization of the penal focus of Revenue Canada's inquiry render the evidence secured inadmissible. There is no evidence of bad faith by the requesting officials, the procedure employed complied with the law as it was understood and applied at the time and warrants were subsequently secured to access the information which was discoverable by other means in any event. *R. v. Bjellebo* [2003] O.J. No. 3946 (CA) paras 8-9; *R. v. Zuk* [2004] O.J. No. 4379 (CJ) paras 31-33, 42-43.

Characterization of the Conduct of the Revenue Canada Personnel

[113] The evidence presented on the application establishes that a strict protocol existed within the administrative organization of Revenue Canada in order to maintain separation of the audit and investigation departments of that organization.

[114] I conclude that protocol was followed in this case as demonstrated by the stated and confirmed reluctance of Don Renaud, to involve the Special Investigators Department in the applicant's file unless and until independently assessed factual information was secured to support the suspicion of revenue offences harboured by the police.

[115] The cautious approach taken by Renaud; his insistence on the maintenance of Revenue Canada's investigation protocols; his awareness of the potential conflict in Tracy Gualberto's role with IPOC and the fact she remained a Revenue Canada employee and his efforts to ensure her activities complied with the Memorandum of Understanding between Revenue Canada and the R.C.M.P. IPOC unit; his direction to investigators Pat Pope (in November 1998) and Gail McNeil (in March 1999) to assess the applicant's file for potential as an investigative file, and the directive that ultimately led to the involvement of Special Enforcement Program auditors Reine and Jiwa to review the file, are all actions that are consistent with the implementation of a cautious, measured procedurally based and

Digitized by Google

lawful consideration of the applicant's financial affairs by the tax department.

[116] While McNeil determined potential existed for the GST investigation based on her brief review and assessment of the applicant's file as at March 1999 there is no evidence to suggest the normal procedures associated with the audit process did not continue through to the fall of 1999.

[117] In the absence of express authorization from Don Renaud to commence an investigation and in view of an assessment of the actions of the Revenue Canada personnel from July 1998 through to August 1999, I conclude the general conduct of the tax authority was not consistent with the pursuit of a criminal investigation. It is acknowledged suspicions of criminal wrong doing by the applicant in relation to tax or revenue issues existed but that fact alone is not a sufficient basis to characterize Revenue Canada's actions as being consistent with a tax evasion investigation.

[118] The actions of the Revenue Canada officials who dealt with the applicant's file thorough to the fall of 1999 are viewed as being consistent with the actions one might reasonably attribute to the determination of tax liability and not the determination of penal liability.

Transfer of Files

[119] There is no evidentiary basis to suggest files were ever transferred from either Reine or Jiwa to the investigators at Revenue Canada prior to the formal referral to investigation in the fall of 1999.

[120] The McNeil inquiry in March 1999 took place when the audit was continuing but there is no evidence to suggest she accessed any of the work product of the auditors relying instead, in large measure, on the financial analysis performed by Tracy Gualberto in her capacity as a forensic accountant at IPOC.

The Auditors as Agents for Special Investigations

[121] There is no evidence any contact took place between either Jiwa or Reine and any member of the investigative staff at Revenue Canada until after their audit file was transferred to the Special Investigations Program for a prosecution viability assessment.

Collection of Investigative Evidence By the Auditors

[122] The audit was conducted on financial information originally secured by the police pursuant to search warrants and accessed by Reine and Jiwa under the authority of an access order. The application record does not contain any evidence to suggest Revenue Canada investigations had any contact with the auditors during the course of their documentary review (January to August 1999), requested any information, were given any information, initiated any inquiries, or gave any directions to the auditors.

Assessment of Tax Payer Liability Generally or Criminal Intent and Penal Liability

[123] The auditors work product reflects and confirms the focus of their review as being directed to the assessment of tax liability only.

[124] The conclusions referenced in each of the three audit referrals (Treesann Management Inc. (Fantasia), 1038345 and 1246434 Ontario Limited (Bunnies I and II) variously confirm under - reporting of sales, taxable income and GST. Each referral proposes issuance of civil assessments. The result of the auditors inquiries are consistent with an assessment of the applicant's compliance with the reporting requirements of both the *Income Tax Act* and *Excise Tax Act*. The determination that the results of the audit might form the basis for an investigative or "penal liability" inquiry and the determination to provide evidence to assist in the establishment of *mens rea* occurred only after the audit report was subject to further review and independent assessment by Revenue Canada investigators according to the evidence presented.

Compliance Audit as a Criminal Investigation

[125] Having heard from almost every Revenue Canada official who had even peripheral

Digitized by Google

involvement with the applicant's tax file I conclude there is no evidence to suggest Reine and Jiwa ever engaged in any investigative actions or performed any functions that were not consistent with their roles as auditors. There is no evidence they shared any information with anyone else or had contact with any potential witnesses or the police. The information they accessed was indicated as being limited to the materials in the #5 District police exhibit room, the Newviews accounting records and Tracy Gualberto's preliminary financial review.

Conclusion

[126] For the foregoing reasons I conclude the applicant has failed to establish any contravention of the guidelines established in *R. v. Jarvis*.

[127] There is no evidence to support the contention that Revenue Canada's review of the applicant's financial records was predominantly directed to the determination of penal liability at any point prior to August 1999 at the earliest.

Leave to Call Evidence of Alleged Sexual Misconduct by the Police

[128] This request has been the subject of previous consideration and the subject of submissions and an interim ruling on October 1, 2007.

[129] The applicant has consistently asserted that reliance on evidence secured as a consequence of the actions of the police in securing evidence of sexual misconduct in the clubs he operated would tend to bring the administration of justice into disrepute. In the applicant's view consideration of this evidence should be excluded and the search warrants issued as a result of this evidence set aside.

[130] I have reviewed and considered the detailed notes of the various undercover officers who participated in gathering evidence in support of bawdy house charges during the course of Project Northern Greed.

[131] It is evident that a number of these officers both touched dancers and were touched by dancers in a sexual manner.

[132] The applicant's complaint pre-supposes standing exists to challenge the actions of these officers and is predicated on the absence of any lawful justification of the officers actions in such circumstances, as has been recognized by the Nova Scotia Court of Appeal in *R. v. P. (N.M.)* supra.

[133] In the circumstances of this prosecution and this application I am not persuaded any inquiry into the allegations of sexual misconduct by the police is warranted.

[134] In my view, this proposed area of inquiry is not relevant to the charge upon which the applicant has been convicted and the availability of legal standing to challenge the actions of the police within the context of this prosecution is dubious at best.

[135] The assertion the officers conduct might establish a serious violation of the communities sense of fair play and decency disproportionate to societies interest in the effective prosecution of a serious criminal case, is undermined by the fact that a significant factual basis justifying the issuance of the search warrants sought to be impugned by the applicant remains even if the applicant successfully addresses issues of relevance, standing and investigative justification and succeeds in excluding consideration of the offending conduct alleged.

[136] In the context of this prosecution, the applicant's unrealized expectations that this issue would be litigated notwithstanding, I conclude the proposed inquiry is unwarranted and without practical import. Leave to further explore this issue is therefore refused.

Conclusion

[137] The Applicant has failed to establish the police acted as Revenue Canada's "proxy" during the course of Project Northern Greed or violated the principles specified by the Supreme Court of Canada in *Jarvis*. [138] The applicant has not established a violation of his rights under section 7 or section 8 of the *Charter*.

[139] In the absence of any misconduct by the state amounting to an absence of process,

Digitized by Google

either through conduct that affects the fairness of the trial or the integrity of the judicial system the application in its entirety fails and is therefore dismissed.

Mere Potential for Situation Leading to Special Investigations Not Enough to Prevent Response

In Paul S. Bining et al. V. Her Majesty The Queen[75] the Trial Ct. had to also deal with the Charter issue when, while there no special investigations started by CRA, the taxpayer attempted to argue that the mere possibility of such applying to large bank deposits with possible inference of hidden income and thus tax evasion was enough to prompt his Charter protections against self-incrimination when CRA made a RFI of the bank account. The Court held:

> [7] On May 21, 2003, the Applicants filed an application under section 18 and 18.1 of the *Federal Court Act* for a declaration that the Requirements are an abuse of process and constitute an infringement of section 7 and 8 of the *Canadian Charter of Rights and Freedoms* and should be set aside pursuant to subsection 24(1) of the *Charter*, and a declaration that the Requirements are otherwise invalid and unlawful and should be set aside in accordance with paragraph 18.1(a) and 18.1(3)(b) of the *Federal Court Act*. The Applicants are now requesting an order for a stay of the May 1, 3003 Requirement to Provide Information on the basis that this application raises a serious issue, that the Applicants will suffer irreparable harm if the Requirement is not stayed, and that the balance of convenience favours the Applicants.
>
> …
>
> [9] The Applicants suggest that responding to the Requirement would have the purpose of eliminating any non-income source for the unidentified bank deposits and to lead to the conclusion that the unidentified deposits are unreported income. The Applicants suggest that the purpose of the Requirement is only to eventually proceed with a criminal investigation based on the unexplained bank deposits found in the audit, and that the Requirement in this context is used with the objective of a criminal investigation and that the Applicants should not be in a position to self-incriminate with responses to those Requirements.
>
> [10] The Applicants rely on recent Supreme Court of Canada decisions *R. v. Jarvis* 2002 SCC 73 and
> *R. v. Ling* 2002 SCC 74 where "the Court found that the predominant purpose of a particular enquiry is to determine penal liability, CCRA officials must relinquish the authority to use the statutory compulsion powers in section 231.2 of the *Income Tax Act*."
>
> [11] On the other side, the Respondent suggests that it is in possession of bank statements of the Applicants and that those statements show unidentified deposits.
>
> [12] The Respondent suggests that this Requirement is totally reasonable in the circumstances, and that "the May 1, 2003 Requirements request legitimate information regarding non-taxable sources of income to the Applicants, such as gambling winnings, lottery winnings, loans, inheritance, etc." The Respondent also disagrees with the suggestion by the Applicants that the Respondent has only to reassess the Applicants and it will be up to the Tax Court to decide on whether those deposits eventually would be considered as revenues and could be taxable.
>
> [13] The Respondent finally mentioned that the possibility that the Applicants should be the object of criminal prosecution is there anyway, and that the answers that would be

[75] 2003 FCT 689

Digitized by Google

provided to the Requirements would allow the Respondent to make a more accurate assessment.

…

[17] The Applicants suggest that they will suffer irreparable harm if a stay is not granted because they will be compelled under criminal penalty to provide potentially incriminating evidence that could eventually be used against them in a criminal prosecution for tax evasion and, at the same time, if the Applicants fail to comply with the Requirements, they may be liable to criminal prosecution for such failure to comply suggesting that they are in a catch-22 situation.

[18] The Respondent reacts to those allegations by saying that if the Minister is not provided with an answer within a reasonable time-frame the Minister will be statute-barred from reassessing, and also argues that if the information that is requested is provided and it is decided later that the information was collected in violation of the Applicants' constitutional rights**, it will not be possible to use that information in any subsequent criminal proceedings anyway.**

[20] As I mentioned at the hearing, as it is suggested by the Applicants, if the majority of the responses to the Requirement would be rendered in the negative, I don't see how the natural inference could be drawn that the amount of deposits in the bank account should be considered as revenue and could imply criminal prosecution for tax evasion.

[21] How could one suggest that by providing no information on the origin of bank deposits, it could be seen as self-incriminating? The wording of the Act would have to be stretched considerably to arrive at such conclusions, which I am not ready to do.

In Roger Ellingson v. The Minister Of National Revenue[76] the Trial Ct. had to consider whether to prevent a RFI when it had been sent pursuant to CRA';s Special Enforcement Program that acts in conjunction with the R.C.M.P. to counter organized crime. The tax auditor had heard about a drug arrest in the US and sent out the request for income tax returns and net worth statements, as "an auditor for the SEP auditor" and the court had to decide whether to allow it when the taxpayer objected. It provided:

[4] The Applicant refuses to answer the Requirement on the basis that, in the circumstances, its issuance is beyond the jurisdiction of the Auditor. Therefore, it is agreed that the standard of review of the decision to issue the Requirement is correctness.

[5] The jurisdictional issue arises from the Supreme Court of Canada decision in *R. v. Jarvis*, [2002] 3 S.C.R. 757. *Jarvis* stands for propositions of law respecting protection from self-incrimination; a taxpayer is required to comply with a Requirement when its "predominant purpose" (the "Purpose") is determining the taxpayer's tax liability, however, a Requirement is not to be used for the investigation of penal liability. Therefore, when the Purpose changes from determining tax liability to the investigation of penal liability under the *Act*, the taxpayer need not answer the Requirement. Of course, this result follows if the Purpose from the outset was the investigation of penal liability. With respect to the use of evidence obtained from an answer to a Requirement, if it was obtained before a penal liability investigation is commenced, the answer is admissible evidence which can be used in the penal liability investigation and potential prosecution, but once the penal liability investigation is commenced, any information obtained thereafter will only be admissible if the taxpayer's rights are protected under the *Charter*.

[6] It is agreed that, in the present case, the sole question for determination is as follows: **"When the Auditor made the decision to issue the Requirement, was a penal liability investigation under way?" If the answer is "yes", on the authority of**

[76] 2005 FC 1068

Digitized by Google

***Jarvis*, it is agreed that the Auditor acted beyond his jurisdiction.**

[7] The standard of proof for coming to the answer to the question is low. In *Jarvis*, certain factors for consideration are suggested in determining the Purpose, the first of which includes this question: "Does it appear from the record that a decision to proceed with a criminal investigation *could* have been made?". The Federal Court of Appeal has determined that this text "is cast in terms of a mere possibility as opposed to a probability" (Létourneau J.A. in *Kligman v. Canada (M.N.R.)*, [2004] F.C.J. No. 639 at para. 31).

[8] **In the present case, the answer depends on an analysis of an evidentiary contest between the Auditor's own stated understanding and intention in issuing the Requirement versus the institutional obligation and intention within which he was operating.**

The contest in the evidence

[9] It is agreed that the whole of the evidence with respect to the issuance of the Requirement must be considered in order to determine the Purpose. **That is, the Auditor's opinion on the Purpose is not determinative; the Purpose must be derived from an "objective" analysis of the evidence, being an analysis of *all* of the evidence (see *Capital Vision v. M.N.R.*, [2002] F.C.J. 1797 (T.D.)).**

The Auditor's understanding and intention

[10] The Auditor's evidence is found in his affidavit filed for the purposes of the present Application as follows:

I am employed as a Special Enforcement Program Auditor in the Investigations Division of the Southern Interior B.C. Tax Services Office ("SITSO") of the Canada Customs and Revenue Agency ("CCRA").

I have made a diligent search of CCRA's records and have made appropriate inquiries of others to inform myself in order to make this Affidavit.

I have personal knowledge of the facts and matters deposed to in this Affidavit except where they are stated to be on information and as to those facts and matters, I believe them to be true.

I currently have conduct of the audit of the Applicant. I have reviewed the files carefully and this Affidavit is based on the information in the file as well as my own personal knowledge.

I have been a Special Enforcement Program ("SEP") auditor in SITSO since December 2001. Prior to that, I was an auditor in the Verification and Enforcement Division of SITSO.

The SEP Unit is a separate audit unit within the Investigations Division. In the same that business audit deals with audits of legal businesses, the SEP Unit deals with audits of taxpayers where there is an indication they may have earned income from illegal activities. The SEP Unit does not conduct investigations. Where, during the course of a SEP audit, it is determined that an offence may have been committed, the file is referred to an investigator within the Investigations Division.

My duties within SEP are to gather information necessary to determine whether an audit should be commenced and to conduct audits of non-filers where there is an indication that income may have been earned from illegal activities. I do not conduct criminal investigations as a member of SEP.

Since December 2001, I have done several dozen SEP audits. I have never referred any of my files to an investigator within the Investigations Division. Since beginning with Investigations in December 2001, all of my files have concluded by either assessments being issued by me or in no action being taken.

On or about April 16, 2004, the Investigations Division of SITSO received a copy of a Suspicious Transaction Referral Form (the "Referral") received by FINTRAC from the HSBC Bank, which detailed a deposit to the Applicant's account of $5,000 all in $20 bills. Attached

Digitized by Google

as Exhibit A to this Affidavit is a copy of the Referral.
The Referral came to the SEP Unit of the CCRA from the RCMP Proceeds of Crime Unit and was initially received by [JL], the liaison between the CCRA and the RCMP Proceeds of Crime Unit.
The Referral then went to [DW], a SEP investigator in the Investigations Division of the CCRA. [DW] is also located in SITSO.
[DW] found a newspaper article published in the April 7, 2004 edition of the Penticton Herald (the "Article"). The Article is attached as Exhibit D to the Affidavit of [RW] sworn September 1, 2004 and filed in these proceedings.
[DW] then conducted an "Option I" search of the CCRA electronic database to determine what tax returns the Applicant had filed with the Respondent. Attached as Exhibit B to this Affidavit is a copy of the Option I printout (the "Printout").
The Printout shows the Applicant did not file any tax returns for the years 1997 to 2003.
Once [DW] determined that the Applicant was a non-filer, the Referral, Article and Printout were given to me for action.
Had there not been any hint that the Applicant's income may be from illegal activities, the Applicant's file would have gone to the Non-Filer Non-Registrant Unit of the Collections Division of the CCRA.
On July 20, 2004, I issued the letter dated July 20, 2004 (the "Requirement") to the Applicant.
The first and, to date, only action taken by me with respect to the Applicant has been to issue the Requirement.
The Requirement contained standard requests in situations where the taxpayer has not filed tax returns and we have no, or very little, financial information on them:
As the Applicant was a non-filer, paragraph (A) of the Requirement was inserted in the Requirement to require the Applicant to file a tax return, which could be reviewed and verified by me.
As it is my experience that many of these audits do not turn up sufficient information regarding income sources but rather, end of with assessments being issued on a net worth basis, paragraphs (B) and (C) of the Requirement were inserted in the Requirement to gather the type of information necessary to determine whether a net worth assessment is warranted and, if so, the amount of such assessment.
The Respondent issued the Requirement to the Applicant for purposes related to the administration and enforcement of the Income Tax Act (the "Act") and not for the purpose of further a criminal investigation of the Applicant.
The Applicant is not under criminal investigation.
The Applicant is being audited to determine his correct tax liability under the Act.
Prior to being shown the Affidavit of [RW] sworn September 1, 2004, I had never seen the documents attached as Exhibits A, B and C to the Affidavit of [RW].
I make this Affidavit in opposition to an application by the Applicant for an Order quashing the Requirement.
[11] Thus, when the Requirement was issued, the Auditor did not have knowledge of the Grand Jury decision or the Attorney General's news release. **However, he did have some greater knowledge of suspicious conduct than that precisely stated in his affidavit. The complete statement under the heading "Description of Suspicious Activity" in the Referral is as follows:**
(STR 9584804) Description of suspicious activity*
Client brought in $5000.00 in cash all in 20s to be applied to two car loans he has with HSBC. The CSR noticed that the money had the distinct odor of marijuanna [sic]. A further review of the loans revealed that client consistently makes payments

Digitized by Google

to the loans by way of cash.
Loan #1 opened Aug 30/02-original amount was $50,084.00- current loan balance is $23,799.73. Has paid off over $25M in 15 months.
Loan #2 opened June 10/03-original amount was $19,218.00- current loan balance is $7,769.42. Has paid off over $10M in 6 months.
It is certainly not difficult to understand why the Applicant would be of interest to the SEP as a potential target for pursuing earned income from illegal activities.
[12] In any event, during the course of oral hearing of the Application, Counsel for the Applicant agreed that the Auditor was acting on an honest belief and intention that the issuance of the Requirement was for tax liability purposes only.
[13] Counsel for the Respondent argues that the Auditor's evidence should be accepted as conclusive proof that the Purpose of issuing the Requirement was with respect to tax liability:
There is nothing but speculation on the part of the Applicant that the purpose of the Requirement was to further a criminal investigation of the Applicant (whether it be for tax or other offences). The unequivocal evidence of the Auditor was that the sole purpose was for audit. This stated purpose is in accord with common sense given no evidence of any contact between anyone involved in the US indictment and the CCRA, the lack of material in the possession of the CCRA at the time of the Requirement and the very preliminary type of information being sought in the Requirement.
There is no question the CCRA is at a very early stage of its look (to use neutral language) into the tax affairs of the Applicant. The problem with hindering the CCRA at such an early stage was recognized by the SCC in *Jarvis* at para. 90:
90. All the more, the test cannot be set at the level of mere suspicion that an offence has occurred. Auditors may, during the course of their inspections, suspect all manner of taxpayer wrongdoing, but it certainly cannot be the case that, from the moment such suspicion is formed, an investigation has begun. On what evidence could investigators ever obtain a search warrant if the whiff of suspicion were enough to freeze auditorial fact-finding? The state interest in prosecuting those who wilfully evade their taxes is of great importance, and we should be careful to avoid rendering nugatory the state's ability to investigate and obtain evidence of these offences.
As well as thwarting any criminal prosecution, prohibiting the Minister from using its requirement powers to gather the very preliminary type of information requested in the Requirement may lead to the Applicant's tax affairs being immune from scrutiny because it is far from certain that the Minister could satisfy the requirements necessary to obtain a search warrant given the Minister's lack of knowledge.
(Respondent's Memorandum at paras. 29-31)
[14] Relying on the affidavit of the Auditor, Counsel for the Respondent also submits that the function of the SEP is to conduct audits and that it does *not* conduct criminal investigations. **That is, the preliminary information being requested, and the scant information in the possession of the Auditor, is indicative of a gathering of information to determine whether or not to commence an audit.**
[15] Counsel for the Applicant argues that, effectively, the Auditor's belief and intention is irrelevant to the true Purpose of issuing the Requirement, being the institutional obligation and intention.

The institutional obligation and intention
[16] Counsel for the Applicant argues that the Purpose of issuing the requirement is proved by the nature of the institutional framework within which the Requirement was issued. **That is, regardless of the Auditor's personal belief and intention, the**

Digitized by Google

institutional obligation and intention within which he was operating, was, from the outset, to investigate the Applicant for penal liability.

[17] The Requirement was issued by the Auditor as an employee of the Special Enforcement Program ("the SEP"), being part of the Special Investigations Division ("SID") of the **Canada Customs and Revenue Agency ("the CCRA"), and operating according to a 1992 Taxation Operations Manual, and a 1992 Working Arrangement ("the Arrangement") (AR, pp. 136-144) between the Royal Canadian Mounted Police ("RCMP") and the predecessor of the CCRA. The Arrangement details the governing of the SEP as follows:**

The various activities which are carried out under these Working Arrangements will be categorized by the RCMP as the Tax Program and by the RCT as the Special Enforcement Program.

The parties acknowledge that their overall objective is:

"In order to address more effectively the accumulation of unreported illicit wealth amassed by Organized Crime and increase the effectiveness of criminal law enforcement and thus cause maximum disruption to Organized Crime, stem the infiltration of legitimate business by criminal elements, and reduce the activities of Organized Crime on society, RCT and the RCMP agree to act in concert with one another in combatting [sic] Organized Crime through enforcement under the Income Tax Act."

[Emphasis added] (AR, p. 136)

[18] Thus, Counsel for the Applicant characterizes the SEP as a "quasi criminal investigatory program" and argues that "members of the SEP are either directly or indirectly involved (as agents of the RCMP or agents of other officers of the Special Investigations Division) in the advancement of criminal investigations" (Applicant's Memorandum, para. 33).

[19] In support of this characterization, Counsel for the Applicant relies on the decision in *R. v. Harris*, [1995] B.C.J. No. 1467, in which Justice Oliver of the British Columbia Supreme Court upheld a judicial stay of proceedings where the accused was charged with failing to meet the very same type of Requirement as was issued to the Applicant in the present case. Justice Oliver had this to say about the functioning of the SEP:

9. It is uncontradicted that Mr. Anderson, in serving Mr. Harris with the Requirements pursuant to s.231.2(1), was doing so in his capacity as an officer advancing the goals and objectives of the Program. Clearly, the function of the Income Tax Act here as it was used with the "assistance and support of the Department of the Solicitor General, represented by the R.C.M.P." in all fairness cannot be said to be solely regulatory or administrative. Indeed the first step in Anderson's procedure is to identify persons earning income from illegal activities and determine their position in the criminal community. The appellant would have the Court turn a blind eye to the close working relationship between the Department of National Revenue and the R.C.M. Police existing under the Special Enforcement Program. With respect, I am not prepared to do that. It is not the function of the Income Tax Act alone which must be considered in this case (as it was in McKinlay); rather, it is the function of the Income Tax Act in conjunction with the Special Enforcement Program which must be considered. I am in agreement with the Court below which found that McKinlay is distinguishable, and further, that in the context of this case there is a criminal or quasi-criminal function apparent in the procedures and methods which were followed.

[Emphasis added]

[20] Counsel for the Respondent does not dispute that, at the time the Requirement was issued, the Arrangement was still in effect, but in the following argument advances the proposition that its application has changed significantly:

The Applicant fails to refer to the subsequent 2002 publication by the CCRA

Digitized by Google

(Applicant's Application Record, pages 149-163) dealing specifically with the Special Enforcement Program, however. The very first paragraph of that publications casts doubt on the relevance of the older material, and the relevance of the case *R. v. Harris*, [1993] B.C.J. No. 3140 (B.C. Prov. Ct.) aff'd [1995] B.C.J. No. 1467 (B.C.S.C.), as it states "This [SEP] program has evolved through the years and its focus has shifted from a criminal to a mainly civil approach." Whatever was the situations in 1992, 1993 or 1995, the program clearly had changed by 2002 into one focusing on civil audits rather than criminal investigations. It would appear the focus since 2002 has shifted yet again as it was the evidence of [the Auditor] that currently SEP only conducts audits and not criminal investigations.

This shift is understandable given the Supreme Court of Canada decision in *Jarvis* and *Ling* rendered on November 21, 2002. It would strain credulity to argue that, after the clear decision of the SCC in *Jarvis* and *Ling*, the CCRA would leave in place an entire program that would use requirement powers to conduct criminal investigations.

...

[21] Counsel for the Applicant responds that, in effect, no measure of self serving statements in the 2002 Guidelines can change the fact that the Arrangement, and actions taken thereunder, are all about prosecution. That is, regardless of the stated purpose in the 2002 Guidelines that "SEP audits are carried out to determine, as accurately as possible, the taxes, duties, interest and penalties payable under the law by those persons earning income from illegal activities", by the Arrangement, the purpose of this action is the investigation of penal liability.

Conclusion on the contest

[22] I find I agree with the Applicant's arguments. In particular, I find that the comments of Justice Oliver in *Harris* are applicable to the Requirement issued in the present case.

[23] In my opinion, the Arrangement is the most important piece of evidence from which to conclude that the Purpose of issuing the Requirement was to investigate the Applicant's penal liability. The Arrangement provides cogent evidence that this was the CCRA's institutional obligation and intention. A stated purpose of the Arrangement is to "stem the infiltration of legitimate business by criminal elements, and reduce the activities of Organized Crime on society". In addition, by its terms, the RCMP and the CCRA agree to "*act in concert with one another in combating organized crime through enforcement under the Income Tax Act*". I find it is difficult to understand how stemming the infiltration of, and reducing the activities of, organized crime through "enforcement" can be conducted by the RCMP and the CCRA in any other way but prompt concerted effort to investigate for the Purpose of attempting to ultimately impose penal sanction.

[24] During the course of oral argument, I asked whether there is any doubt that any answer the Applicant might provide to the Requirement would be immediately sent to the RCMP. There was no debate on the point. Acting in concert with the RCMP is to be expected of the CCRA under the Arrangement, and there is no doubt about the RCMP's intention under the Arrangement: the imposition of criminal sanction for wrongdoing. By the same token, as a obliged partner in the Arrangement, I cannot find that the CCRA's institutional Purpose in gathering information, that both partners to the Arrangement might use, is anything but the imposition of penal tax sanction.

[25] I give no weight to the evidence that inside the SEP there is a bureaucratic division between "audit" and "investigation" functions. In my opinion, on an objective examination of all the evidence, the whole of the activity of the SEP is dedicated to the investigation of penal liability, with different roles being performed by different persons. In this respect, I find that the Auditor, in fact, took a preliminary investigative step in issuing the

Digitized by Google

Requirement.

[26] I also give no weight to the statements in the 2002 Guidelines that SEP "has evolved through the years and its focus has shifted from a criminal to a mainly civil approach" as proof of the Purpose of issuing the Requirement. It might very well be that a "civil approach" is ultimately adopted in many cases, but this does not mean that the obligation and intention when first approaching a given case is not the imposition of penal sanctions.

The Trial court found for the taxpayer and the RFI was quashed. On Appeal[77], however, the court looked into the issues with a finer eye and held:

[11] Mr. Matheson's first task was to gather information to determine whether an audit should be undertaken. Having the sole conduct of this file, Mr. Matheson issued the Requirement on July 20, 2004. This is the only activity undertaken by Mr. Matheson. There is no evidence of any criminal investigation by the Investigations Division nor was Mr. Ellingson ever interviewed by any CRA official.

IV. ANALYSIS

[12] In *Jarvis,* the Supreme Court of Canada was called upon to settle the line of demarcation between audits and criminal investigations for income tax purposes pursuant to subsection 231.2(1) of the Act. Writing for a unanimous court, Iacobucci and Major JJ. wrote as follows:

Although the taxpayer and the CCRA [now CRA] are in opposing positions during an audit, when the CCRA exercises its investigative function they are in a more traditional adversarial relationship because of the liberty interest that is at stake. It follows that there must be some measure of separation between the audit and investigative functions within the CCRA.

…

…where the predominant purpose of a particular inquiry is the determination of penal liability, CCRA officials must relinquish the authority to use the inspection and requirement powers under ss. 231.1(1) and 231.2(1). In essence, officials "cross the Rubicon" when the inquiry in question engages the adversarial relationship between the taxpayer and the state. There is no clear formula that can answer whether or not this is the case. Rather, to determine whether the predominant purpose of the inquiry in question is the determination of penal liability, one must look to all factors that bear upon the nature of that inquiry.

…

…Apart from a clear decision to pursue a criminal investigation, no one factor is necessarily determinative in and of itself, but courts must assess the totality of the circumstances, and make a determination as to whether the inquiry or question in issue engages the adversarial relationship between the state and the individual. [emphasis added]

….

…the test cannot be set at the level of mere suspicion that an offence has occurred. Auditors may, during the course of their inspections, suspect all manner of taxpayer wrongdoing, but it certainly cannot be the case that, from the moment such suspicion is formed, an investigation has begun. [emphasis added]

(See *Jarvis*, paragraphs 84, 88, 93 and 90)

[13] This predominant purpose test is not a bar to the Minister conducting parallel criminal investigations and audits (see *Jarvis* at paragraph 97). However, the timing of such processes is important. Auditors can share information they obtain with CRA investigators, provided that the information was gleaned prior to the start of the criminal investigation. At that stage, the adversarial relationship arises and Charter protections are engaged. At

[77] 2006 FCA 202

Digitized by Google

paragraph 103 of *Jarvis*, the Supreme Court of Canada summarized the law in the following words:

…as previously stated, it is clear that, although an investigation has been commenced, the audit powers may continue to be used, though the results of the audit cannot be used in pursuance of the investigation or prosecution. (See also *R. v. Ling,* [2002] 3 S.C.R. 814 at paragraph 30)

[14] *Jarvis* requires a reviewing court to consider what the dominant purpose in issuing a requirement was: the conduct of an audit or the pursuit of an investigation. This is a two step test. The first step is to determine whether there is a clear decision to pursue a criminal investigation based on the evidence. If the answer to the first step is yes, the inquiry ends there and the power to issue a requirement can no longer be exercised by the Minister (see for example *Kligman v. Canada (Minister of National Revenue*), 2004 FCA 152).

[16] In the present case, there is no evidence of a clear decision by either the RCMP or the Investigations Division of the CRA to embark on a criminal investigation. The record is silent on this point. Accordingly an inquiry in accordance with step two of Jarvis must be conducted. Instead of proceeding in that fashion, the Applications Judge chose to state the issue in the following words:

…the sole question for determination is as follows. "When the Auditor made the decision to issue the Requirement, was a penal liability investigation under way?" If the answer is 'yes', on the authority of *Jarvis*, it is agreed that the Auditor acted beyond his jurisdiction.

[17] That is clearly an error of law. As indicated in *Jarvis* at paragraphs 97 and 103, audits and investigations are permissible on parallel tracks. The issue of whether the Applications Judge correctly applied the relevant case law to whether the CRA had the jurisdiction to send the Requirement is a question of law, which suggests the least deferential standard of review (see *Zenner v. Prince Edward Island College of Optometrists*, 2005 SCC 77*)*.

[18] I turn now to an analysis of the *Jarvis* factors relevant to the Requirement issued to Mr. Ellingson; the key question being whether its predominant purpose was to further a criminal investigation against him. In this analysis, the standard of proof as to whether his Charter rights have been engaged is on a balance of probabilities (see *R. v. Collins*, [1987] 1 S.C.R. 265).

Factor A – Reasonable Grounds to Lay Charges

[19] At the time the Requirement was issued, the inquiry by the CRA through its audit function was responding to mere suspicion of unreported income from illegal activity. While it was open to the CRA to conduct both a criminal investigation and audit, the evidence does not show that the CRA were doing both. Rather the evidence is that the pre-audit inquiry was but a first step in determining whether Mr. Ellingson was a non-filer for the taxation years 1999 to 2003. Accordingly, I can see no basis on the present evidence to conclude that the CRA had reasonable grounds to lay criminal charges under the Act at this early stage.

Factor B – Basis to Proceed with Criminal Investigation

[20] While Mr. Matheson was unaware of the indictment at the time he issued the Requirement, presumably the Referral and the grand jury indictment could provide a basis upon which an investigation under the Act could be commenced by the RCMP or criminal investigators within the CRA. This factor favours Mr. Ellingson.

Factor C – General Conduct

[21] The general conduct of the CRA with respect to Mr. Ellingson is also not consistent with the pursuit of a criminal investigation, in that the CRA did not issue a search warrant or conduct an interview. Rather its conduct is consistent with simply gathering information to

Digitized by Google

determine whether to commence an audit.

Factor D – Have the Files Been Transferred to Investigators

[22] Whether a file has been transferred to an investigator is yet another factor in determining whether an adversarial relationship exists. However, by itself it is not conclusive (see *Jarvis* at paragraph 92). The present case does not involve a situation where the file is first transferred from the audit to investigation section and then returned to the auditor who then issues a requirement for documents. In such circumstances, the Supreme Court of Canada has directed that courts must pay close attention to determine whether an investigations section has truly declined to pursue the case or whether the auditor is merely collecting information on its behalf.

[23] Here, the file relating to Mr. Ellingson has only been acted upon by Mr. Matheson. It is his undisputed evidence that while the file could have been transferred to the Investigations Division if he had determined that an offence had been committed, that was not done in this case. While it is true that Mr. Matheson does work as an auditor in the SEP unit, which is part of the Investigations Division, the current policy indicates that the SEP unit only conducts audits and Mr. Matheson said that he had never conducted a criminal investigation. Accordingly, there is nothing in this record to suggest that information was exchanged that could give rise to an adversarial relationship.

Factors E and F – Auditor as Agent of Investigators

[24] There is also no evidence of any conduct by Mr. Matheson which could suggest that in his audit function he was being used as an agent of the Investigations Division or the RCMP in the collection of evidence. Rather, the record suggests that there was no contact once Mr. Matheson assumed conduct of the file.

Factor G – Evidence Sought Relevant to Penal Liability Only

[25] *In my analysis, the information sought in the Requirement is relevant to Mr. Ellingson's tax liability* ***generally*** *and is not only relevant to penal liability. It contains what can only be viewed as a normal CRA request in a situation where the taxpayer has not filed any tax returns and little or no financial information is available*. For example, it sought the actual tax returns for the relevant years so as to be reviewed or verified by Mr. Matheson. It also sought information regarding income sources, assets, liabilities and personal expenditures also necessary so as to determine whether a net worth assessment was warranted. Again, in and of itself, this factor does not point to an adversarial relationship.

Factor H – Other Circumstances – The 1992 Working Arrangement

[26] Key to the Applications Judge's order was his determination that regardless of Mr. Matheson's personal intention, his role as auditor was tainted by the 1992 Working Arrangement. That document obliges the RCMP and the CRA to act in concert to disrupt and combat organized crime in the enforcement of the Act. This, according to the Applications Judge, can only mean cooperative investigations and a sharing of information with the ultimate purpose to impose penal sanctions. Respectfully, I do not read the 1992 Working Arrangement and the surrounding exhibits in that light, especially when the unrefuted evidence of Mr. Matheson is considered.

[27] As early as 1972, the Department of National Revenue, Taxation and the Department of the Solicitor General had a signed protocol in place with the stated objective to disrupt and combat organized crime through criminal prosecutions only. That protocol was replaced by the 1992 Working Arrangement with the same objective, but with a methodology expanded beyond criminal prosecutions to include: identifying those earning income from illegal activities and determining their position in the criminal community, carrying out preliminary investigations in relation to case development, carrying out audits towards assessment/re- assessment where the criteria for tax evasion prosecution is not met and providing the maximum information to the Collections Division in order to

Digitized by Google

maximize actual collection of taxes, penalties and interest.

[28] The Applications Judge found it difficult to understand how stemming the activities of organized crime could be carried out other than by investigations for the purpose of imposing criminal sanctions. However, it is self-evident that auditing those involved and issuing a reassessment for taxes, interest and penalties is also highly disruptive to organized crime.

[29] The Applications Judge also gave no weight to a subsequent 2002 publication by the CRA dealing specifically with the Specific Enforcement Program (SEP Manual). While that publication does not have the force of an act or regulation, it can be used to provide legal context and inform decisions. Here, the SEP Manual is a helpful source for discerning the operation of the SEP and should be accorded some weight.

…

[33] This change in focus of the SEP unit is also evident from Mr. Matheson's evidence that since at least the time when he joined the SEP unit in 2001, it only conducts audits and not criminal investigations. Accordingly, there is no evidentiary basis for the Applications Judge's conclusion that at the time that the Requirement was issued in 2004 the SEP unit could only conduct criminal investigations. In reaching that conclusion, the Applications Judge chose to marginalize and ignore Mr. Matheson's evidence and the above provisions of the SEP Manual.

[34] Accordingly, considering the Jarvis Factors, as well as the 1992 Working Arrangement and the SEP Manual and based on a balance of probabilities, *I am unable to conclude that Mr. Matheson was acting in any way beyond mere suspicion when he issued the Requirement. On the present facts, an adversarial relationship simply does not arise.*

In Hugh Stanfield et al v. The Minister of National Revenue[78] the court had to ascertain whether "the rubicon had been crossed" when a massive audit send-out of RFIs that resulted from SI's involvement with a potential tax loss scheme that was being promoted and there was some seemingly integration between Audit and SI on the matter. It held:

[1] On 17 August 2002 the Minister of National Revenue (the "MNR"), had become concerned about what are characterized as "tax loss arrangements", being in the nature of currency and commodity transactions, spanning a year end, upon which various taxpayers had claimed losses. The MNR therefore sent to the Applicant, Hugh Stanfield, demand in the form of a questionnaire under cover of a letter dated 27 August 2002, the letter containing the statement:

Please be advised that a criminal investigation regarding the promotion of transactions of the type claimed on your income tax return has been undertaken. You are not under investigation at the present time but we wish to advise you that any information submitted may be provided to our Investigations Division for review.

The letter did not say that the recipient would never be under investigation. This uncertainty concerned Mr. Stanfield, who wondered why he should hand over information to the Minister if he was in fact under investigation. He was concerned enough that he sought review of the Minister's demand.

…

[3] The Applicants' position is based upon *Jarvis v. The Queen* [2002] 3 S.C.R. 757, the effect of which is summed up by Justices Iacobucci and Major, at pages 765-766:

Ultimately, we conclude that compliance audits and tax evasion investigations must be treated differently. While taxpayers are statutorily bound to co-operate with CCRA auditors

[78] 2004 FC 584

Digitized by Google

for tax assessment purposes (which may result in the application of regulatory penalties), there is an adversarial relationship that crystallizes between the taxpayer and the tax officials when the predominant purpose of an official's inquiry is the determination of penal liability. When the officials exercise this authority, constitutional protections against self-incrimination prohibit CCRA officials who are investigating ITA offences from having recourse to the powerful inspection and requirement tools in ss. 231.1(1) and 231.2(1). Rather, CCRA officials who exercise the authority to conduct such investigations must seek search warrants in furtherance of their investigation.

In essence, taxpayers must cooperate with Canada Customs and Revenue Agency (the "CCRA") audits for tax assessment purposes, even though the result may be a regulatory penalty, but an adversarial relationship crystallizes when the predominant purpose of the inquiry is the determination of a penal liability: when this line is crossed the CCRA no longer has recourse to inspection and requirement procedures under the *Income Tax Act*, but must obtain search warrants in order to further their investigation.

…

[8] In April 2001 members of the CCRA Investigations Division met with the auditors from the Tax Avoidance Division, who included Ms. Pumple, to share information. As a result of a request by the Investigations Division Ms. Pumple referred various of her files to them and created a chronology for their assistance. At about this point the Investigations Division instructed the Tax Avoidance Division to cease auditing the 1998 and 1999 returns.

[9] The Investigations Division was involved for the purpose of evaluating whether the Applicants were involved in criminal activities. From time to time Ms. Pumple received requests for and forwarded additional information to the Investigations Division. This seems to have been an ongoing process, with Ms. Pumple from time to time taking or seeking directions from the Investigations Division.

[10] Some time after April of 2001 a Mr. Kuhn, of Tax Avoidance in Vancouver, was seconded to work for the Investigations Division in Vancouver. He was a member of what was called the Global Prosperity Group Team in the Investigations Division, working directly with its members, although he held himself out as belonging to Tax Avoidance. From the transcript of the examination of Ms. Pumple it is clear that he at least acted as the liaison person between the Tax Avoidance and the Investigations groups.

11] About a year after the Investigations group became involved, March 2002, the Investigations Division told the Tax Avoidance Division to recommence the audit for 1998, the result being a Notice of Reassessment for 1998.

[12] In July 2002 Investigations told Tax Avoidance to recommence auditing the Applicants for their 1999 and 2000 taxation years. This resulted in Ms. Pumple and various other Tax Avoidance officers sending out letters and attached questionnaires, the subject of the present judicial review application.

[13] Between June 2002 and September 2002 there was a regular exchange of information between Investigations and Tax Avoidance. Examples of the exchange of information show up in a series of emails from Mr. Kuhn, the liaison person between Investigations and Tax Avoidance, instructing CCRA officers as to the audit approach to be taken upon resumption of audit activities. As an example of the interrelationship of the two groups, at the time of the cross-examination of Ms. Pumple, in January of 2003, the tax returns of many of the Applicants were still in the possession of Investigations.

[14] The Applicants set out in the material that Ms. Pumple did not always have personal knowledge and this is reasonable enough given the magnitude of the project. To inform herself Ms. Pumple communicated with other Tax Avoidance officers. She determined where various of the tax returns were located. However she did not make any

Digitized by Google

inquiries of the head office of the CCRA or speak with anyone at Investigations. Counsel for the Applicants goes on to make a case that Ms. Pumple had really only limited knowledge, for she knew nothing about internal communication within the CCRA, the communications path between head office and Investigations, the concept of a tax shelter, and the role of Investigations. She was unable to speak for Investigations. Further, Ms. Pumple did not prepare the letter or questionnaire at issue, although she did sign the letter. The discovery does indicate that Investigations had some input in drafting the letter, specifically I think the advice of the criminal investigation and that the recipient was not at that point under investigation. From the point of view of the Applicants, the evidence of Ms. Pumple and the documents that she brought with her to the cross-examination do not, in their view, make clear the predominant purpose of the investigation itself, the concept of predominant purpose demonstrating, in some instances, in the crystallization of an adversarial relationship. Thus the Applicants submit they are unable to determine both whether an adversarial situation has crystalized and the clear line between provision of information in an audit setting and the right to refuse information, except as against a search warrant, in an investigation setting.

…

Minister's Predominant Purpose

[30] Before turning to the requests for individual documents, answers to specific questions and the matter of re-attendance for further cross-examination, I should consider the nature of the predominant purpose test referred to in *Jarvis* (*supra*). The propriety of a requested document or answer may depend on their relevancy in the context of the predominant purpose test. More specifically, the Supreme Court of Canada has suggested an open-ended list of factors which may go to indicate whether the line, between a cooperative audit for tax assessment purposes and the crystallization of an adversarial relationship when the predominant purpose of an investigation is a determination of penal liability, has been crossed.

[31] In *Jarvis* the Supreme Court of Canada speaks of the necessary balance required between the principle against self-crimination and the need to make all evidence available in order to do fundamental justice, in essence a tension between privacy and state interest (see pages 795 and 797). In *Jarvis*, just as in the present instance, a liberty issue is at stake, there being no presumption of confidentiality, for once an auditor has information or documents, that material may go to the Investigations Division.

[32] The predominant purpose test is not satisfied by a mere suspicion raised by minor contact between auditor and investigator: that does not signify a cross of the Rubicon between the section 231 requirement that documents be produced to an auditor and a clear adversarial relationship between the taxpayer and the Minister.

[33] *Jarvis* teaches that there is no crystallization until there has been a formal referral of a file to the Investigations Division, however in the present instance, there was such a referral followed by a return of the file to the Audit Division, where upon the Audit Division sent out the 27 July 2002 letter to which was attached the very pointed investigation type questionnaire, raising more than a mere suspicion relating to the predominant purpose.

[34] Certainly, applying *Jarvis*, where a file has been sent to the Investigations Division, that is a factor going to define the relationship between the taxpayer and the CCRA, just as is the reason for the return of the file from the Investigations Division to the Audit Division. As the Supreme Court of Canada observed at page 806 in *Jarvis*, one must consider whether the return of the file is because the Investigations Division has declined to take part on the basis there should merely be an audit, or because there is another agenda, that of allowing the Audit Division to use their easy entry into the taxpayer's records to obtain evidence to support a later prosecution and penal liability. Included in the factors to

Digitized by Google

examine which may bear on determination of the one dominant purpose of the CCRA are:
Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation could have been made?
Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?
Had the auditor transferred his or her files and materials to the investigators?
Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?
Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?
Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea*, is the evidence relevant only to the taxpayer's penal liability?
Are there any other circumstances or factors that can lead the trial judge to the conclusion that the compliance audit had in reality become a criminal investigation?
[*Jarvis* at 806-807] This list contains a broad range of factors and moreover is, as I have said, open-ended.
…
[36] Just as there may be no clear and absolute line between a CCRA investigation and a CCRA audit there is, in the present instance, no clear and absolute evidence indicating whether the predominant purpose has gone from an initial audit intent, to an investigative and penal intent and whether it reverted to an audit purpose when the file subsequently went from the Investigations Division to the Audit Division, for there is no clear indication that the audit process will be the final disposition. As I read the transcript of the cross-examination of Ms. Pumple, who signed the 27 August 2002 letter, it is, as set out in that letter, that the Applicants are not presently under investigation, although "... a criminal investigation regarding the promotion of transactions of the type claimed on your income tax return has been undertaken.". The 27 August 2002 letter is thus far from an assurance that the Applicants are not at risk of a very real criminal investigation. Moreover, the cross-examination of Ms. Pumple establishes that she had no direct personal knowledge that the Applicants were not under criminal investigation and that she had made no inquiries of the Investigations Division personnel who might have personal or direct knowledge as to what the Investigations Division intended of the criminal investigation.
[37] Here I accept various indicia, as submitted by counsel for the Applicants, that those individuals reasonably believed that they had been and perhaps continue to be under investigation by the Investigations Division for a number of reasons including:
The files of the Applicants went to the Investigations Division in April of 2001.
From that time until at least January of 2003 there was regular contact between the Audit Division and the Investigations Division as to the 1998 through 2001 taxation years.
An Audit Division's employee, Mr. Kuhn, worked with the Investigations Division for some time, although still maintaining, or holding himself out as a member of the Audit Division.
In March 2002 the Investigations Division instructed the Audit Division to recommence gathering information for the 1998 taxation year.
In July of 2002 the Investigations Division instructed the Audit Division to recommence gathering information in respect of the 1999 and 2000 taxation years and at that point the Audit Division sent out letters and questionnaires, the questionnaire being a point to which I will shortly return.
Between June of 2002 and September of 2002 there was a regular exchange of information and emails between the Investigations Division and the Audit Division as to the approach to be taken on resumption of audit activities.

Digitized by Google

All of this reasonably raises alarm, on the part of the Applicants, that they may still be under investigation, or at least that there may be a clearly contemplated investigation and that for practical purposes there has been a crystallization of an adversarial relationship between the applicant taxpayers and the tax officials, with the predominant purpose of the inquiry being the determination of penal liability, once documents have been gathered from the Applicants by the Audit Division through the so-called cooperative approach with the taxpayers.

[38] Counsel for the Applicants urged a thoughtful reading of the questionnaire sent out by the CCRA with the 27 August 2002 letter. The letter itself calls upon the taxpayers to produce a very thorough and comprehensive package of documents and information. In effect it is a letter requesting books and records: the questionnaire clearly goes far beyond being a request for books and records, but seeks a good deal of information which either was clearly not covered in the extensive production request in the letter and indeed, looks for information which one might be hard pressed to justify merely on the basis of an audit. A thoughtful reading of the questionnaire can easily lead one to the conclusion that the questionnaire was not something dictated by the needs of and drafted by the Audit Division, but rather is a far more pointed and searching request for information which could well have bearing on the criminal investigation. Finally, and this has direct bearing on the provision of answers and production of documents well before June of 2002, Ms. Pumple did agree, in cross-examination, that the review by the CCRA of the 1998 taxation year was connected to an ongoing review of the taxation years 1999 through 2001, and that investigations undertaken by the CCRA dealt not only with the 1998 taxation year, but also with the 1999 through 2001 taxation years. Indeed, it is fair to say that investigations as to the 1998 taxation year were relevant to the subsequent three taxation years, all being a part of one investigation over a number of years.

At Trial on the issue[79] the Trial Ct. further held:

[1] This is an application for judicial review in respect of a request for audit information by the Minister of National Revenue ("Minister") contained in letters and questionnaires sent to each of the Applicants between August and October 2002. The Applicants have opposed responding to these letters and questionnaires on the basis that the request was not done for audit purposes but rather, for criminal investigation purposes. The Applicants seek an Order declaring that the letters, including the questionnaires, requesting the information are invalid or unlawful, and furthermore, an Order prohibiting or restraining the Minister from taking any action or proceedings against the Applicants for their failure to respond to the letters and questionnaires.

ISSUES

[2] Was the issuance of the letters and questionnaires within the parameters of the audit functions as contained in subsection 231.1(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "*Act*")?

[3] If necessary, does this action by the Minister then engage the Applicants' rights pursuant to section 7 of the *Canadian Charter of Rights and Freedoms*, s. 7, Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c. 11 (the "*Charter*")?

…

[10] From April 4 to 6, 2001, Rod Jamieson ("Mr. Jamieson") and Chris Fleming ("Mr. Fleming"), investigators with the investigations division in Vancouver ("Investigations"), met

[79] Hugh Stanfield et al v. The Minister of National Revenue, 2005 FC 1010

Digitized by Google

with some of the Audits personnel, including Ms. Pumple and Larry Kuhn ("Mr. Kuhn"), an auditor in the Vancouver office, in order to discuss commodities trading losses and the financing of these losses by some of the taxpayers by means of loans from a certain Yukon company. Specifically, CCRA had learned from a newspaper article that some people had been arrested in the U.S. in relation to a similar tax evasion scheme. Also, a taxpayer's lawyer in Penticton, British Columbia, had told an auditor that his client wished to meet with CCRA officers in order to discuss why these commodities trading and financing schemes were considered frauds. The taxpayer met with Mr. Kuhn and Mr. Fleming. As a result of this interview, Mr. Jamieson announced on April 6th, 2001 to all auditors during a conference call that "the audit was now considered a criminal investigation ... [and] that no contact [should] be made by tax avoidance auditors with any taxpayers or their representatives on these files and that no further work [should] be done at the present time" (see memo to file dated April 6th, 2001, in volume 5 of the Applicants' Record at page 811).

[11] As a consequence, copies of the partially-audited tax return files of all the taxpayers (including the Applicants) were transferred to Investigations. On June 3rd, 2002, Mr. Fleming informed Audits that he wanted the original tax returns of all the taxpayers, promoters and any other relevant persons, including the returns of all of the Applicants, to be kept by Investigations for prosecution purposes in case such became necessary (such as forensic tests, original signatures of taxpayers for evidence purposes, etc.) (see email from Mr. Fleming to Ms. Pumple dated June 3rd, 2002, in volume 3 of the Applicants' Record at page 631). As of June 2nd, 2004, the control of the taxpayers' original returns was still with Mr. Fleming in Investigations. The information was maintained on 9 compact discs containing 18,000 pages of documents on the schemes and each individual taxpayer. As an example, about 500 of these pages concerned Mr. Stanfield's returns (see the affidavit of Ron D.F. Wilhelm dated June 18, 2004, counsel for the Department of Justice, in volume 1 of the Applicants' Record at pages 43 and 46-48).

[12] From the beginning of the investigation until late August 2002, Ms. Pumple kept in regular contact with Investigations by answering technical matters, giving advice, and supplying further information when needed. She even sought Mr. Fleming's consent for her 2002 holidays even though she was an auditor and not an investigator (see email from Ms. Pumple to Mr. Fleming dated June 3rd, 2002, in volume 3 of the Applicants' Record at page 630). As will be discussed later on in these reasons, Ms. Pumple kept in contact with Mr. Fleming even after August 2002 (see paragraph 20 of this decision).

[13] From November 28th, 2001 to September 9th, 2002, Mr. Kuhn, auditor of thirteen (13) Applicants, was seconded to work for Investigations in Vancouver. He also acted as "liaison" between Audits and Investigations. He was actively involved in all matters of the investigation and was of "tremendous help" to investigators (see email from Cheryl Hildebrand to Mr. Fleming dated August 29, 2002, in volume 4 of the Applicants' Record at page 710).

[14] In March 2002, Investigations gave the "green light" to Audits to recommence auditing the 1998 tax returns of the Applicants. Notices of Reassessment were forwarded to the Applicants in the spring and summer of 2002. These disallowed the commodity losses claimed and levied penalties pursuant to subsection 163(2) of the *Act*. The Applicants filed appeals against these reassessments.

…

[17] Early in July 2002, Investigations told Audits to recommence auditing the 1999-2000 returns of the Applicants. A verbal green light was given by Investigations. This

Digitized by Google

directive from Investigations was given by Mr. Kuhn (on secondment) to auditors at a meeting in Edmonton held on July 3rd and 4th, 2002. Mr. Kuhn advised that:

Vancouver SI had given the green light to go ahead on resuming contact with the investors for all years and all schemes ... should the taxpayer wish to provide any information on how the scheme works ... we should immediately refer the taxpayer to Vancouver SI and not take the information ourselves ... if we are able to arrange an interview ... we should advise Vancouver SI prior ... the taxpayer should be informed that they are NOT under investigation however, there is an investigation ongoing ...

…

SUMMARY OF THE SUBMISSIONS OF THE PARTIES

The Applicants

[23] The Applicants submit that the predominant purpose of the letters and questionnaires was to further a criminal investigation. Pursuant to ss. 231.1(1) and 231.2(1) of the *Act*, the Minister may exercise inspection and requirement powers, but this authority is not allowed where the predominant purpose of the inquiry is to determine penal liability.

[24] The Applicants claim that it is clear in the circumstances that Audits had transferred its files to Investigations, and that nothing in the file shows that Investigations ever actually ended their investigation of the Applicants. The auditor Ms. Pumple was therefore effectively acting as an agent for Investigations. Investigations and Audits were in regular communication regarding the Applicants' files. There was no reason for Audits to desire the information requested in the letters and questionnaires, other than to obtain information for Investigations, since, in the Applicants' submission, Audits already had determined the basis for the reassessment of the Applicants' 1999 taxation year.

[25] Finally, the Applicants submit that a number of other factors give the appearance that Investigations was using Audits as its agent in the collection of evidence, including the wording of the letters themselves, Mr. Kuhn's dual role within Investigations and Audits, Ms. Pumple's assertion that Investigations had given Audits a "green light" to continue its audits despite the fact that no such evidence is in the file, and the fact that many of the Applicants' files continued to be held by Investigations despite the resumption of the audits.

[26] The Applicants believe that allowing the Minister to proceed with its request for information at this point, two years after the normal reassessment period for the Applicants has expired, and in this manner, asking for information which can only be reasonably used for the purposes of investigation, would be an abuse of process by the tax authorities. The letters and questionnaires clearly promote a criminal tax investigation rather than a civil reassessment, and should be declared invalid or unlawful pursuant to s. 7 of the *Charter*.

The Respondent

[27] The Respondent claims that the letters and questionnaires are properly issued and a necessary tool to better determine the Applicants' tax liability for 1999 and 2000. Without an understanding of how the 1998 arrangements worked, Audits will be unable to properly reassess the Applicants' 1999 and 2000 taxation years.

[28] The purpose of the letter, issued pursuant to s. 231.1(1) of the *Act*, was to verify compliance by the Applicants with the duties and obligations imposed upon them by the *Act*, and in particular, to verify whether they correctly reported their taxable income under the *Act* for that year. The requests in the letter were standard. The questionnaire itself was developed in order to understand the tax aspect of the transactions as well as whether the Applicants had invested in non-qualified investments for RRSP purposes. Both were drafted by persons in Audits without input from Investigations, with the exception of the second paragraph of the letter dealing with the criminal investigation, which was drafted by Mr. Fleming.

Digitized by Google

[29] The Respondent further submits that none of the Applicants were under criminal investigation at the time Audits was told by Investigations that it could recommence its audits. It is standard practice that audits are not conducted while investigations are ongoing and that audits will only recommence once advised accordingly by Investigations. This sequence of events, of files moving from Audits to Investigations then back to Audits, is not uncommon. It is also not uncommon that personnel confer with each other as necessary, or that occasionally an auditor will be seconded to Investigations. None of these practices, in the particular circumstances of this case, can be shown to amount to abuse.

STANDARD OF REVIEW

[30] For the purpose of the present decision, the most relevant provisions of the *Act* are ss. 231.1(1), 231.2(1) and 239(1). These are attached to this decision as an annexe for reference.

[31] No explicit right of review is granted in s. 231.1(1). In determining the appropriate standard of review for decisions made pursuant to this section, Wilson J. for the Court in *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627, stated at page 648 that "the Minister of National Revenue must be given broad powers in supervising this regulatory scheme to audit taxpayers' returns and inspect all records which may be relevant to the preparation of these returns." These powers are explained further by Iacobucci and Major JJ. in *R. v. Jarvis*, [2002] 3 S.C.R. 757 at 788-89 (*Jarvis*):

The sections within Part XV of the ITA provide the Minister with "Administration and Enforcement" powers. They also impose reciprocal obligations upon taxpayers: for example, in furtherance of the overall reporting and verification scheme, s. 230(1) of the ITA requires all taxpayers, for various specified periods of time, to maintain books and records of account at their place of business or residence in Canada. These documents must be kept "in such form and containing such information as will enable the taxes payable under [the ITA] or the taxes or other amounts that should have been deducted, withheld or collected to be determined."

The provisions that are central to the instant appeal vest the Minister with extensive powers that may be used "for any purpose related to the administration or enforcement" of the ITA. Section 231.1(1) continues the inspection power that was introduced in *An Act to amend the Income War Tax Act*, S.C. 194, c. 43, s. 11. Paragraph (*a*) allows a person authorized by the Minister to "inspect, audit or examine" a wide array of documents, reaching beyond those that the ITA otherwise requires the taxpayer to prepare and maintain. In the course of the inspection, audit or examination, para. (*c*) provides that the authorized person may enter into any premises or place that is not a dwelling-house; furthermore, para. (*d*) imposes a correlative duty upon persons at the premises or place to provide "all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act.

[32] In *James Richardson & Sons, Ltd. v. Minister of National Revenue*, [1984] 1 S.C.R. 614 (*James Richardson*), the Supreme Court, in its review of a previous decision (*Canadian Bank of Commerce v. Attorney General of Canada*, [1962] S.C.R. 729) which was based on s. 231(3) of the *Act* (roughly the equivalent of today's s. 231.2(1), but with broader wording than s. 231.1(1)), outlined four criteria that serve to narrow the interpretation of that section:

(a) the test of whether the Minister is acting for a purpose specified in the Act is an objective one and has to be decided on the proper interpretation of the subsection and its application to the circumstances disclosed;

the obtaining of information relevant to the tax liability of some specific person or persons

Digitized by Google

whose liability to tax is under investigation is a purpose related to the administration or enforcement of the Act;
it is not necessary that the person from whom the information is sought be one whose liability to tax is under investigation;
the fact that giving of the information may disclose private transactions involving persons who are not under investigation and may not be liable to tax does not invalidate the requirement.
[My emphasis.]

[33] Relying on the jurisprudence reviewed above, especially factor a) outlined in *James Richardson*, and keeping in mind the Federal Court of Appeal's approach in *Kligman v. Canada (Minister of National Revenue)*, [2004] F.C.J. No. 639 (*Kligman*), the Court views the question before it as being one of applying facts to a particular legal situation. That is to say, the Court must look at the exact facts of this case in order to determine whether the predominant purpose of the letters and questionnaires was one of audits or investigations. Although this litigation is a fact-finding mission, it remains that it is a question of mixed fact and law - see *Jarvis*, *supra* at para. 100; *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235 at para. 27; *Kligman, supra*, at paras. 97-111 - and therefore the applicable standard of review is that of correctness.

THE GUIDING FACTORS

[34] The guiding factors to assess whether, at the time the letters and questionnaires were created and then issued, CCRA was exercising an audit function or an investigative one, were established by the Supreme Court in *Jarvis*, *supra*.

[35] We learn from the *Act* and the *Jarvis* decision that the process of tax collection relies on the assessment and reporting done by individual taxpayers. There is an obligation on taxpayers to estimate their yearly income and to assess and disclose the income tax consequently payable on their income tax return which they are obliged to file. The success of such a system depends fully on the honesty, integrity and collaboration of taxpayers. Only then do CCRA's audit powers, which permit auditors to examine and assess income tax returns within a certain period of time (according to ss. 152(3) and (4) of the *Act*, reassessments can be made within three years of filing) come into play ("the statute-bar problem"). Furthermore, the audit powers granted to CCRA provide for penalties where tax returns are not filed or are inaccurate. An audit is not a criminal process but an administrative one which does not trigger the implication of *Charter* rights.

[36] CCRA also has at its disposal investigative functions which are completely distinct from its audit functions. The purpose of these investigative functions is to investigate cases of importance which might divulge schemes of suspected tax evasion of a criminal nature which are punishable as criminal offences pursuant to s. 239 of the *Act*. The investigative functions include the collection of evidence for prosecutorial purposes. When exercising its investigative functions, CCRA and the taxpayer are in an "adversarial relationship", bringing into play the whole panoply of constitutional protections against self-incrimination, including the right to remain silent.

[37] Therefore, how should a trial judge assess a situation of an audit requirement to provide documents and information when there is evidence of a possible concurrent criminal investigation or an investigation that had begun but was later stopped?

In our view, where the predominant purpose of a particular inquiry is the determination of penal liability, CCRA must relinquish the authority to use the inspection and requirement powers under ss 231.1(1) and 231.2(1). In essence, officials "cross the Rubicon" when the inquiry in question engages the adversarial relationship between the taxpayer and the state.

Digitized by Google

[39] While indicating that CCRA can conduct parallel criminal investigations and administrative audits, the judges at para. 97 make the following precision:

However, if an investigation into penal liability is subsequently commenced, the investigators can avail themselves of that information obtained pursuant to the audit power prior to the commencement of the criminal investigation, but not with respect to information obtained pursuant to such powers subsequent to the commencement of the investigation into penal liability.

Thus, the transfer of information from Audits to Investigations is not forbidden as long as there is no "commencement of the investigation into penal liability." What is the situation if such an investigation has begun but later stopped, and then an audit requirement is made, such as is the situation in the present case? Subject to analysis later in these reasons, there must be a clear indication that the penal investigation has in reality stopped in order to permit the flow of information from Audits to Investigations.

[40] The judges in *Jarvis, supra*, also express, at para. 92, their thoughts on the location of a file (*i.e.*, whether it is held by Audits or Investigations) as a matter of inquiry, though this, in itself, is not determinative:

Still, if in an auditor's judgement a matter should be sent to the investigators, a Court must examine the following behaviour very closely. If the file is sent back, does it appear that the investigators have actually declined to take up the case and have returned the matter so that the audit can be completed? Or, does it appear rather, that they have sent the file back as a matter of expediency, so that the auditor may use ss. 231.1(1) and 231.2(1) to obtain evidence for a prosecution.

First, the Court notes that the word "appear" is used twice. Appearance is different from factual reality in that appearance must be assessed through the eyes of a neutral observer who has general knowledge of similar situations, and not through the eyes of one of the Applicants. A neutral, unbiased assessment must be done. Second, the situation is here further complicated since the originals of the Applicants' files were still being held by Investigations even though the criminal investigation had allegedly stopped. As the evidence shows, as of June 2004, the originals of most of the files (including Mr. Stanfield's own 500-page file) were under the control of team leader investigator Mr. Fleming. This is a full two (2) years after the criminal investigation had ended.

…

[44] Lastly, the Court has to look at the situation that would result should the Minister be deprived of the results of the letters' and questionnaires' requests for documents and information. Will that create an unacceptable situation, or will the Respondent still be in a position to achieve its audits objective? This last factor is not determinative of the issues but helps in assessing the prejudice alleged by the Respondent.

…

[46] In order to determine the answers to these questions, the evidence will be assessed according to the preponderance of proof as required in such a situation. That is to say, the Applicants do not have to prove that the Respondent issued the letters and questionnaires with the intention of furthering a criminal investigation; rather, they must show that the predominant purpose of the letters and questionnaires was to garner information for such an investigation. There need only be a preponderance of evidence which supports that finding: see, *e.g., Kligman, supra*, at paras. 11 and 13. This is also made clear by the wording of the factors enumerated in *Jarvis* above at paragraph 38, in that many of the criteria are worded in relative, not absolute, terms; *i.e.*, whether it "appears" from the record that a decision to proceed with criminal charges "could have been" made, whether the "general conduct" of the authorities was "consistent" with the pursuit of a criminal investigation, whether the auditor's "conduct" indicated he or she was "effectively

Digitized by Google

acting" as an agent for Investigations, whether it "appears" that Investigations was using Audits' powers for investigative purposes, etc.
Without getting into the particulars of the fact situation of what CRA had specifically done and asked here, the Ct. held:
CONCLUSION
[74] Therefore, having decided, based on the particular facts of this case, that the predominant purpose of the letters and questionnaires was to aid in the furtherance of a criminal investigation, it was not within the parameters of the audit functions as contained in section 231.1(1) of the *Act* for the Minister to issue the letters and questionnaires, at least at the time and in the manner this was done. Additionally, since the predominant purpose was a criminal investigation involving the Applicants, the Applicants' *Charter* rights were engaged, specifically the right to remain silent and to avoid self-incrimination.

In Les Plastiques Algar (Canada) Ltée, Modern Wood Fabricators (M.W.F.) Inc., Snapshot Theatrical Productions Inc. (Indexed as Kligman v. MNR) v. Minister Of National Revenue[80] the Appeal Ct. had to consider the taxpayer's argument as to whether a RFI was to be respected if it would lead to penal processes under the Act when CRA attempted to argue that even if it would, at that later stage, it would be argued, maybe successfully, that it would be excluded evidence. It held[81]:

[3] I do not accept the respondent's contention that the appellants should comply with the requirements and, as it was done in *R.* v. *Jarvis*, [2002] 3 S.C.R. 757, later oppose the admissibility into evidence of the information thus provided. In *Jarvis*, the documents had already been obtained and the only option left to the accused in his criminal trial for tax evasion was to object to their admissibility. The respondent's contention means that a taxpayer would be prohibited from asserting preventively his Charter right to protection against unreasonable searches and seizures and from impeding its imminent violation. He would only be entitled to apply for a discretionary remedy under section 24 (2) of the Charter. This would seriously undermine the beneficial and protective effect of the Charter.

[4] In *Hunter* v. *Southam Inc.*, [1984] 2 S.C.R. 145, at page 160, Dickson J. stressed the importance of prior authorization before a search is conducted:

If the issue to be resolved in assessing the constitutionality of searches under s. 10 were in fact the governmental interest in carrying out a given search outweighed that of the individual in resisting the governmental intrusion upon his privacy, then it would be appropriate to determine the balance of the competing interests after the search had been conducted. Such a *post facto* analysis would, however, be seriously at odds with the purpose of s. 8. That purpose is, as I have said, to protect individuals from unjustified state intrusions upon their privacy. That purpose requires a means of preventing unjustified searches before they happen, not simply of determining, after the fact, whether they ought to have occurred in the first place. This, in my view, can only be accomplished by a system of prior authorization, not one of subsequent validation.

(Emphasis in

[80] 2004 FCA 152
[81] I have quoted this case extensively since it shows the differing view-points of how CRA handles a file and what Charter protections are prompted thereby, after Jarvis.

Digitized by Google

original)
Wilson J. extended this rationale to seizures in *Thomson Newspapers Ltd.* v. *Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425. At paragraph 93, she wrote:
In my opinion, Dickson J.'s remarks with regard to searches are equally applicable to seizures. It makes no sense to say that s. 8 is only engaged once the private information becomes public. If that were the case, the protections afforded by s. 8 would be completely illusory. The fact that an individual can challenge the validity of the order before producing the documents goes, in my opinion, not to the question whether a seizure has occurred but to the question whether the seizure is a reasonable one.

(Emphasis added)

[5] Furthermore, I believe that the Supreme Court made it clear, in the *Jarvis* case, *supra*, that subsection 231.2(1) of the Act is not available for the purpose of criminal investigations, i.e. investigations whose predominant purpose is to establish the penal liability of the taxpayer. At pages 803-804 and 809, Iacobucci and Major JJ. wrote in this respect:
In our view, where the predominant purpose of a particular inquiry is the determination of penal liability, CCRA officials must relinquish the authority to use the inspection and requirement powers under ss. 231.1(1) and 231.2(1)...
Put another way, the requirement powers of ss. 231.1(1) and 231.2(1) cannot be used to compel oral statements or written production for the purpose of advancing the criminal investigation...

In summary, wherever the predominant purpose of an inquiry or question is the determination of penal liability, criminal investigatory techniques must be used. As a corollary, all Charter protections that are relevant in the criminal context must apply.

(My emphasis)
These conclusions of the Supreme Court mean that, in the context of a criminal investigation, barring exigent circumstances, searches and seizures are subject for their validity to prior judicial authorization. Their legality cannot be secured by an after-the-fact validation as it turned out to be the case in the present instance.
[6] I should add that the Supreme Court's conclusions relating to the availability of the requirement powers in subsection 231.2(1) of the Act do not distinguish between a physical and a corporate taxpayer: such powers are not available for the purpose of advancing a criminal investigation. I agree with my colleague that the motions judge, after having found that the investigation was a criminal investigation, could not use Charter considerations to authorize the use of the requirement powers. The Charter protections are a corollary to a finding that the investigation is a criminal investigation. They cannot be resorted to in order to undermine, or circumvent, the legal consequences of that finding.
The determination of a preliminary issue

[7] Whether the inquiry's predominant purpose was to establish the penal liability of the taxpayers was a key issue common to all five applicants before the motions judge. Two of the applicants were individuals who were the directors of the three other corporate

Digitized by Google

applicants. The conclusion of the judge was adverse to the Minister who did not appeal it with respect to the two individuals. However, the Minister attacked that conclusion in the context of this appeal by the corporate appellants.

[8] At the hearing, an issue arose as to whether the Minister could re-litigate this adverse conclusion without either appealing it or filing a cross-appeal in the present appeal. The Minister, having failed to appeal against the decision favourable to the two individuals on this issue, the argument goes, would be prohibited from seeking a reversal of that conclusion. Concerns were expressed about the possibility of conflicting decisions whereby the very same inquiry would receive two different and incompatible qualifiers: criminal in nature for two of the applicants and civil or administrative for the other three.

[9] Upon careful consideration of the matter, I have come to the conclusion that the doctrine of issue estoppel, which can arise when a party wants to re-litigate an issue that has been decided in an earlier case, does not apply in the present case because there is no identity of parties acting in the same qualities: *Toronto (City)* v. *Canadian Union of Public Employees Local 79 (C.U.P.E.)* 2003, S.C.C. 63, paragraph 23; *Blueberry River Indian Band* v. *Canada (Department of Indian Affairs and Northern Development)*, [2001] 4 F.C. 451, paragraph 45. The doctrine requires for its application that the parties to the earlier judicial decision on the issue be the same as the parties to the proceedings in which the estoppel is raised. The corporate applicants are legal entities and parties different from the individuals.

[10] I am also satisfied that the Minister did not have to file a cross-appeal under Rule 341 of the *Federal Court Rules, 1998* because he is not seeking a different disposition of the order appealed from. He is, in fact, simply submitting an additional reason for which the order should be maintained and, therefore, the appeal dismissed.

Whether the motions judge erred in finding that the investigation was a criminal investigation

[11] Unlike my colleague, I believe that the motions judge committed no error when he came to the conclusion that the appellants were the subject of a criminal investigation. The motions judge found that there was overwhelming evidence to that effect on the record. Unfortunately, he mentioned only one reason in support of his finding, namely, that investigator Faribault, whose function at the Special Investigation (SI) branch of the Canadian Customs and Revenue Agency (CCRA) was to investigate and gather evidence of a tax evasion offence (see his testimony at pages 113, 119-120 and 124 of the Appeal Book), admitted that such was the purpose of the investigation. At paragraph 90 of his reasons for order, he wrote:

The evidence on the record as a whole leads to the conclusion that the predominant purpose of the investigation of CCRA, from its outset, was prosecution of the applicants for tax evasion and eventual imposition of penal sanctions against them. The statements on discovery by Faribault are not the only indicia of this predominant purpose; they are simply among the most succinct elements of evidence which support this conclusion. Accordingly, I find that the predominant purpose of the investigation was prosecution of the applicants for tax evasion.

(My emphasis)

I will come back later to the impact of that witness' statement.

[12] In *Jarvis*, at paragraph 94, the Supreme Court gave a non-exhaustive list of

Digitized by Google

factors to be considered in determining whether the relationship between the state and a taxpayer has reached a point where it has become adversarial:

In this connection, the trial judge will look at all factors, including but not limited to such questions as:

À cet égard, le juge de première instance examinera tous les facteurs, y compris les suivants :

(a) Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation could have been made?

a) Les autorités avaient-elles des motifs raisonnables de porter des accusations? Semble-t-il, au vu du dossier, que l'on aurait pu prendre la décision de procéder à une enquête criminelle?

(b) Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?

b) L'ensemble de la conduite des autorités donnait-elle à croire que celles-ci procédaient à une enquête criminelle?

(c) Had the auditor transferred his or her files and materials to the investigators?

c) Le vérificateur avait-il transféré son dossier et ses documents aux enquêteurs?

(d) Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?

d) La conduite du vérificateur donnait-elle à croire qu'il agissait en fait comme un mandataire des enquêteurs?

(e) Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?

e) Semble-t-il que les enquêteurs aient eu l'intention d'utiliser le vérificateur comme leur mandataire pour recueillir des éléments de preuve?

(f) Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea*, is the evidence relevant only to the taxpayer's penal liability?

f) La preuve recherchée est-elle pertinente quant à la responsabilité générale du contribuable ou, au contraire, uniquement quant à sa responsabilité pénale, comme dans le cas de la preuve de la *mens rea*?

(g) Are there any other circumstances or factors that can lead the trial judge to the conclusion that the compliance audit had in reality become a criminal investigation?

g) Existe-t-il d'autres circonstances ou facteurs susceptibles d'amener le juge de première instance à conclure que la vérification de la conformité à la loi était en réalité devenue une enquête criminelle?

[13] These factors are designed to assist in the determination of the predominant purpose of an inquiry. They apply unless there is a clear decision to

Digitized by Google

pursue a criminal investigation. At paragraph 93, before listing the factors, the Supreme Court wrote:

To reiterate, the determination of when the relationship between the state and the individual has reached the point where it is effectively adversarial is a contextual one, which takes account of all relevant factors. In our opinion, the following list of factors will assist in ascertaining whether the predominant purpose of an inquiry is the determination of penal liability. Apart from a clear decision to pursue a criminal investigation, no one factor is necessarily determinative in and of itself, but courts must assess the totality of the circumstances, and make a determination as to whether the inquiry or question in issue engages the adversarial relationship between the state and the individual.

(My emphasis)

The evidence reveals that such a decision was made.

[14] In the present instance, the SI branch of the CCRA began, on November 12, 1998, a criminal investigation of a number of charitable organizations with respect to charitable donations. Targeted were the "Rabbinical College of Montreal", "Construit toujours avec Bonté", "Yeshiva Oir Hochaim", "L'Association Gimilis Chasodim Chava B'nei Levi" and others. It investigated tax evasion offences under section 239 of the Act which are criminal in nature: *Knox Contracting Ltd.* v. *Canada*, [1990] 2 S.C.R. 338, at pages 350 and 356. The appellants had made very substantial donations to the Rabbinical College of Montreal and, in one case, to Yeshiva Oir Hochaim. I reproduce the three lists of donations as they appear in the Appeal Book:

MODERN WOOD FABRICATORS (M.W.F.) INC.
LIST OF DONATIONS

Year ended February 28, 1993	
College Rabinique de Montreal	54 000 $
Year ended February 28, 1994	
College Rabinique de Montreal	212 000
Year ended February 28, 1995	
College Rabinique de Montreal	128 000
Year ended February 28, 1996	
College Rabinique de Montreal	200 000
Yeshiva Oir Hochaim	100 000
Year ended February 28, 1998	
College Rabbinique	50 000

* *

LES PLASTIQUES ALGAR (Canada) Ltée
LIST OF DONATIONS

Year ended May 31, 1994	
College Rabbinical de Montreal	86 000 $
Year ended May 31, 1995	
College Rabinique de Montreal	72 000
College Rabinique de Montreal	18 000
Year ended May 31, 1996	
College Rabbinique de Mtl	36 000

Digitized by Google

Year ended May 31, 1997
College Rabbinique de Mtl 100 000
Year ended May 31, 1998
College Rabbinique de Mtl 50 000

* *

SNAPSHOT THEATRICAL PRODUCTIONS
LIST OF DONATIONS

Year ended December 31, 1994
College Rabbinique de Montreal 36 000 $

[15] Therefore, in October 1999, in the context of that criminal investigation, the CCRA began an investigation of the appellants. It sent an informal requirement to one of them, Les Plastiques Algar (Algar), requesting various documents and informations, relative to donations made to the Rabbinical College of Montreal, including charitable donations receipts, with respect to taxation years 1994 to 1998. The following month, the CCRA informed Algar that the investigation against it was suspended. However, in the meantime, the criminal investigations continued against the targeted beneficiaries of the charitable donations.

[16] A charge of tax evasion under section 239 of the Act was laid against the charitable organization "Construit toujours avec Bonté" and the organization pleaded guilty on September 20, 2000 to that charge which consisted in the delivery of false charitable gift receipts. On September 21, 2000, the SI branch of the CCRA completed the investigation of the Rabbinical College of Montreal and, for reasons that were not provided to us, no criminal charges were laid against that institution.

[17] On October 18, 2000, the SI branch of the CCRA informed Algar that its file had been internally reassigned to another investigator by the name of Faribault. On January 12, 2002, investigator Faribault, on behalf of the Minister, sent letters to the three appellants requesting various documents and informations, such as cancelled cheques, bank statements, donation receipts and accounting books and records, all related to the donations to the Rabbinical College of Montreal.

[18] I have related these facts in chronological order because they shed a needed light on the context in which the appellants were summoned to provide information pursuant to subsection 231.2(1) of the Act. An investigation was actually undertaken with respect to false charitable donations and receipts. The investigation first looked at the recipients of the donations. Evidently, a fraudulent scheme of that nature requires, for success, the participation of accomplices, i.e. donors. I believe that the SI branch of the CCRA then turned its attention to the search and identification of the accomplices as well as to the search of evidence which could incriminate them and, by the same token, the charitable organizations which received the fraudulent donations. In fact, the investigation by Mr. Faribault was purely an extension of the so far unsuccessful criminal investigation directed initially towards the Rabbinical College of Montreal. Mr. Faribault was now trying to obtain evidence of fraud by looking at the same matter, but from a different perspective, i.e. that of the donors.

[19] Indeed, Mr. Faribault, at page 132 of the Appeal Book, admitted that much in his cross-examination under oath:

Q - [Me Rheault] Alors, votre objectif, donc... si je comprends bien, votre objectif principal à l'égard des requérants était d'établir qu'ils avaient commis une évasion fiscale, c'est ça?

R - [M. Faribault] Enquêter l'évasion fiscale, oui...

Digitized by Google

Q - [Me Rheault] Oui.
R - [M. Faribault] ... c'est...
Q - [Me Rheault] Mais si évidemment, ça arrivait pas en bout de ligne, vous avez toujours l'opportunité de cotiser au civil?
R - [M. Faribault] Voilà.
Q - [Me Rheault] O.K. O.K. Mais vous êtes pas en train de me dire que votre objectif principal dans le dossier ici, c'était simplement d'établir des cotisations d'impôt?
R - [M. Faribault] Non...

(My emphasis)

[20] Counsel for the respondent, in an effort to attenuate the adverse impact of that admission, contends that that statement of Mr. Faribault merely represents his personal views or motivation. He relies upon a decision of the Supreme Court of the United States in *United States* v. *La Salle National Bank*, 98 S.Ct. 2357, at page 2367, (1978), which held that while a special agent is an important actor in the process, his motivation is hardly dispositive of the issue. With respect, I think that, in the present factual context, it is an unfair and inaccurate characterization of Mr. Faribault's clear stated objective to view his testimony as a mere expression of his personal motivation.

[21] As I have already mentioned, Mr. Faribault resumed the suspended investigation against the appellants undertaken in the context of a broader criminal investigation of a fraudulent scheme involving charitable organizations and their donors. He was in charge of the file, autonomous and making the appropriate decisions to lead it to its ultimate admitted objective, i.e. the gathering of evidence of a tax evasion offence under section 239 of the Act. At page 120 of the Appeal Book, he admitted that such was his main responsibility and function:

Q - [Me Rheault] Dans le présent dossier... ici, on mentionne "*Où l'on soupçonne qu'il y ait eu évasion fiscale*", dans le présent dossier, vous aviez des soupçons qu'il y... qu'il y avait eu évasion fiscale au moment où vous avez émis les demandes péremptoires. C'est exact?
R - [M. Faribault] Des soupçons? Oui.
Q - [Me Rheault] Donc... et votre principale responsabilité comme enquêteur des enquêtes spéciales était de... d'enquêter dans ce cas qui occupe les requérants ici...
R - [M. Faribault] Oui.
Q - [Me Rheault] ... dans le but de recueillir des preuves de toute infraction criminelle, conformément au paragraphe 7, qui ont pu être commises, et si de telles preuves sont recueillies, de prendre les... des dispositions en vue de porter l'affaire devant les tribunaux en vertu de l'article 239 de la loi?
R - [M. Faribault] Oui.

(My emphasis)

This is consistent with paragraph 7 of Circulaire 73-10R3, dated February 13, 1987, entitled "Évasion fiscale" which reads:

"*La principale responsabilité des enquêtes spéciales est d'enquêter sur les cas importants où l'on soupçonne qu'il y a eu évasion fiscale, dans le but de recueillir des preuves de toute infraction criminelle qui a pu être commise, et si de telles preuves sont recueillies, de prendre des dispositions en vue de porter l'affaire devant les tribunaux en vertu de l'article*

Digitized by Google

239 de la loi. Les enquêtes spéciales ont aussi la responsabilité de faire connaître au public les condamnations judiciaires dans le but de décourager l'évasion fiscale chez les autres contribuables et de favoriser les divulgations volontaires."

If unsuccessful in that endeavour, it could still lead to a tax reassessment: see the excerpt from Mr. Faribault's testimony, at page 132 of the Appeal Book, previously cited.

[22] Moreover, the facts of our case are quite distinguishable from the facts in the *La Salle National Bank* case. In making its statement that the motivation of a special agent is hardly dispositive, the U.S. Supreme Court referred to the multilayered system of reviews of decisions in place and found that the motivation of a single agent attempting to build a criminal case, without regard to the enforcement policy of the Service as an institution, does not necessarily overturn the institutional responsibility of the Service to calculate and to collect civil fraud penalties. Obviously, the U.S. system is different from ours. In addition, in our case, the file was with the SI branch and assigned by that authority to a specific investigator to conduct a criminal investigation of a tax evasion offence. I would also point out that the *La Salle National Bank* case goes back some 26 years and contained strong dissenting views. No attempt has been made by counsel for the respondent to show that the ruling of the majority still represents the state of the law in this respect.

[23] Counsel for the respondent also argued that Mr. Faribault had no reasonable grounds to believe that an offence had been committed. The fact is that Mr. Faribault knew that between November 11, 1998 and September 22, 2000 a colleague of the SI branch had investigated the legitimacy and legality of donations made to the Rabbinical College of Montreal and to "Construit toujours avec Bonté". He knew that tax evasion charges had been laid successfully against "Construit toujours avec Bonté". He knew that the investigation against the Rabbinical College of Montreal had been so far inconclusive. Bearing in mind the context, I think that Mr. Faribault's testimony under cross-examination at the examination discovery dispels all my doubts as to what his real beliefs and objectives were when he resumed the investigation against the appellants.

[24] Counsel for the respondent finally argued that the investigator Faribault had no reasonable grounds to apply for a search warrant since he had no reasons to believe that a crime had been committed. I believe it is more accurate to say that he had suspicions that a crime had been committed, but not enough evidence at this stage to seek a warrant. That is why Mr. Faribault who, by his own admission, was conducting a criminal investigation, resorted to the requirement powers of subsection 231.2(1) which eliminate the hurdle of prior judicial scrutiny. A short review of his testimony is instructive in this respect.

[25] At pages 137 and 140 of the Appeal Book, Mr. Faribault testified as to what the policy was regarding his gathering of evidence of a tax evasion offence:

Q - [Me Rheault] Donc... mais il y a une... il y a une politique, là, qui est reflétée au paragraphe 13, applicable aux enquêtes spéciales, qui est celle à l'effet que... je... et je lis :

"*L'enquêteur doit donc obtenir tous les documents et registres en la possession ou sous le contrôle du contribuable qui peuvent servir d'éléments de preuve, et les conserver sous sa garde et son contrôle jusqu'à ce qu'ils soient présentés au Tribunal*."

C'est exact?

R - [M. Faribault] Oui, oui. Oui.

Q - [Me Rheault] Puis pour les fins de preuve, comme enquêteur, votre rôle c'est d'obtenir les originaux?

R - [M. Faribault] À un moment donné, oui. À un stade de l'enquête, oui.

Digitized by Google

[...]
Q - [Me Rheault] Puis la politique du ministère au moment des demandes péremptoires était exposée dans cette circulaire-là, ici, entre autres, et dans le cadre de cette politique-là, on demandait à l'enquêteur d'obtenir les documents et les registres en la possession ou sous le contrôle du contribuable qui peuvent... qui pourraient servir de... d'éléments de preuve, et de les conserver jusqu'à ce qu'ils soient présentés au Tribunal, c'est exact?
R - [M. Faribault] Dans la circulaire, oui, c'est indiqué, oui.
Q - [Me Rheault] Puis est-ce que c'était ça la politique du ministère à l'époque?
R - [M. Faribault] Bien, oui.

(My emphasis)

[26] Mr. Faribault explains at page 145 what he was trying to do to fulfill, as an investigator, his necessary obligation to gather the evidence of the tax evasion offence that he was investigating:

Q - [Me Rheault] Vous, comme enquêteur, vous deviez vous satisfaire que vous aviez des motifs raisonnables et probables de croire qu'une infraction avait été commise, avant d'aller demander l'émission d'un mandat de perquisition?
R - [M. Faribault] Oui.
Q - [Me Rheault] Puis dans le présent dossier comme vous l'avez mentionné tantôt, vous entreteniez des soupçons qui ont... qui ont résulté, là, à l'enquête que vous avez amorcée, mais vous nous dites que vous ne... n'aviez pas des motifs encore, là, raisonnables et probables de croire qu'une infraction d'évasion fiscale avait été commise?

R - [M. Faribault] Oui.
Q - [Me Rheault] Donc vous avez pas procédé, là, à... à demander un mandat de perquisition?
R - [M. Faribault] Non.
Q - [Me Rheault] Vous avez plutôt procédé par le biais de demandes péremptoires?
R - [M. Faribault] Oui.
Q - [Me Rheault] Selon l'article 231.2 de la loi?
R - [M. Faribault] Oui.

(My emphasis)

[27] In my respectful view, Mr. Faribault who was embarked upon a criminal investigation of the appellants attempted to do, indirectly, what he could not do directly, i.e. obtain the incriminating evidence without a warrant. The events go back to a time when the line between the use of the requirement powers and the search powers pursuant to a warrant was blurred and the decision in *Jarvis* had not yet been rendered: see the facts in *Jarvis* and in *R.* v. *Ling*, [2002] 3 S.C.R. 814 which attest to the blurring. In any event, both the admission and conduct of Mr. Faribault reveal that he was clearly engaged into the criminal investigation of the appellants and that a clear decision to that effect had been made.

[28] There would be no need for me to consider the factors identified by the Supreme Court. I will, nonetheless, do it and review the evidence on the record to ascertain whether the factors also establish that the respondent's investigation had crossed the Rubicon to

Digitized by Google

become a criminal investigation. The record before us is somewhat succinct, probably more so than it was before the motions judge. In any event, the transcript of the cross-examination of investigator Faribault of the SI branch has been included in the Appeal Book. I will analyse the first two factors together since the relevant facts already enumerated are intertwined.

Factor	Facteur
(a) Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation could have been made?	a) Les autorités avaient-elles des motifs raisonnables de porter des accusations? Semble-t-il, au vu du dossier, que l'on aurait pu prendre la décision de procéder à une enquête criminelle?
(b) Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?	b) L'ensemble de la conduite des autorités donnait-elle à croire que celles-ci procédaient à une enquête criminelle?

[29] Factor (a) addresses two different issues that may arise at different times in the process. A decision to proceed with a criminal investigation may be made early in the process and such investigation may eventually, at a later stage, provide the authorities with the required reasonable grounds to lay a charge. However, a criminal investigation does not cease to be a criminal investigation because, in the end, the authorities do not have reasonable grounds to lay charges or no charges are laid. It may be that the criminal investigation is inconclusive with respect to the commission of an offence or that, although conclusive in that respect, the offenders have yet to be identified. It is the very purpose of a criminal investigation to determine whether a crime has been committed and by whom so that charges can be laid. L'Heureux-Dubé J. said in *Starr* v. *Houlden*, [1990] 1 S.C.R. 1366, at page 1425, from a criminal law perspective, "specific individuals are targeted for the express and exclusive purpose of indicting them".

[30] The fact that the authorities have reached a stage in their inquiry where they have reasonable grounds to lay charges is not, in and of itself, sufficient to conclude that the threshold has been crossed and that the inquiry has become a criminal investigation: see *Jarvis, supra*, paragraph 93. It is, however, an important factor to be considered in the determination of the subsequent relationship between the parties. "In most cases", the Supreme Court writes, "if all ingredients of an offence are reasonably thought to have occurred, it is likely that the investigation function is triggered": *ibidem*, paragraph 89. This is no doubt the case when the situation has reached a stage where charges can be laid. Usually, the criminal investigation is over since the laying of charges is the outcome of the investigation.

[31] Conversely, the fact that there are yet no reasonable grounds to lay charges does not mean that the on-going inquiry is not a criminal investigation because, as I have already pointed out, the purpose of such investigation is to lead to a point where the prosecuting authorities acquire reasonable grounds to lay charges. As the second question in factor (a) indicates, it is important to look at the record to see if it appears "that a decision to proceed with a criminal investigation could have been made". I note that the test is cast in terms of a mere possibility as opposed to a probability and that the Supreme Court itself has underlined that fact.

[32] In the present instance, not only a decision to proceed with a criminal

Digitized by Google

investigation could have been made as factor (a) indicates, but such investigation was actually undertaken as evidenced by the facts and the admission and conduct of investigator Faribault of the SI branch.

(c) Had the auditor transferred his or her files and material to the investigators?	c) Le vérificateur avait-il transféré son dossier et ses documents aux enquêteurs?

[33] This factor as defined does not apply because the appellants' files were at all times with the SI branch of the CCRA which was conducting a criminal investigation of a fraudulent ring of charitable donations and receipts. The appellants were generous donors to one of the charitable organisation under criminal investigation and were part of that investigation.

(d) Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?	d) La conduite du vérificateur donnait-elle à croire qu'il agissait en fait comme un mandataire des enquêteurs?

[34] This factor does not apply in the case at bar.

(e) Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?	e) Semble-t-il que les enquêteurs aient eu l'intention d'utiliser le vérificateur comme leur mandataire pour recueillir des éléments de preuve?

[35] This factor does not apply directly *per se*. However, if what was really intended was a mere compliance audit and if the criminal investigation was really closed, why wasn't the file sent to the audit section to achieve that result. This would have had the advantage of dissipating any ambiguity as to the real objective of the investigation although, in my view, the testimony of investigator Faribault left none when he clearly stated the objective of the investigation that he had undertaken.

(f) Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea*, is the evidence relevant only to the taxpayer's penal liability?	f) La preuve recherchée est-elle pertinente quant à la responsabilité générale du contribuable ou, au contraire, uniquement quant à sa responsabilité pénale, comme dans le cas de la preuve de la *mens rea*?

(My emphasis)

[36] Factor (f), as worded, which states its objective in terms of mere relevancy of the evidence and exclusive relevancy with respect to penal liability, is difficult to apply in the present instance. By definition, an investigation with a predominant purpose is an investigation that has secondary or subsidiary purposes. Therefore, the evidence sought and obtained for the predominant or primary purpose may also be relevant and useful to the secondary purpose. Even if the evidence is sought to establish the penal liability of the taxpayer, such evidence will generally remain relevant to establish his tax liability and civil penalties. It may be, for example, that the evidence obtained in the context of a criminal investigation of a taxpayer falls short of proving a crime beyond a reasonable doubt, but still

Digitized by Google

reveals irregularities in that taxpayer's compliance with the Act which affect his tax liability. As the U.S. Supreme Court said in the *LaSalle National Bank* case *supra*, at page 2365, "the Government does not sacrifice its interest in unpaid taxes just because a criminal prosecution begins". Thus, it is difficult, if not impossible to say, that the evidence will be, or is relevant, *only* to the taxpayer's penal liability even though this was the primary reason why that evidence was sought and obtained and even though the taxpayer's penal liability was the predominant purpose of the investigation.

[37] All the evidence sought from the appellants, i.e. cancelled cheques, bank statements, accounting books and records, was in connection with their donations to the Rabbinical College of Montreal whose investigation led to the sending, on March 3, 2000, of a notice of revocation of its charitable registration for alleged numerous and serious irregularities relating to transfers of money and books and records keeping. That evidence was relevant to establish their penal liability. It could be used also to complement the unsuccessful criminal investigation of the Rabbinical College of Montreal and establish its involvement in the alleged organized fraud. The appellants' penal liability could not be proven solely with the evidence obtained from the College in the course of the criminal investigation that it was subject to.

(g) Are there any other circumstances or factors that can lead the trial judge to the conclusion that the compliance audit had in reality become a criminal investigation?	g) Existe-t-il d'autres circonstances ou facteurs susceptibles d'amener le juge de première instance à conclure que la vérification de la conformité à la loi était en réalité devenue une enquête criminelle?

[38] This factor does not apply in this case.

Conclusion

[39] Like the motions judge, I have come to the conclusion that the investigation of the appellants was a criminal investigation. It was led at all times by the SI branch of the CCRA whose primary function is to fight tax evasion and establish the penal liability of taxpayers in this respect. The investigator in charge of the file clearly stated that the investigation was a criminal investigation and that its purpose was to gather evidence of a tax evasion offence committed by the appellants. His evidence has remained uncontradicted. It is significant that none of his superiors came to testify that this was not the case. He testified that he resorted to the requirement powers of subsection 231.2(1) of the Act because he did not yet have reasonable grounds to apply for a warrant to obtain the evidence that he wanted. The events occurred at a time when the line between the requirement powers of subsection 231.2(1) and the search powers of subsection 231.3(1) was blurred.

[40] Furthermore, the investigation of the appellants was a resumption of the earlier criminal investigation that had been suspended. In addition, it was interconnected with other criminal investigations of charitable organizations. All these interconnected investigations were conducted by the SI branch of the CCRA. The evidence sought was relevant to the penal liability of the appellants as donors as well as that of the beneficiaries of the donations. The relevant factors, when analysed in their proper context, also point to an investigation whose predominant is criminal in nature. If this investigation of the appellants is not a criminal investigation, one is then left to wonder what is, and what will ever be, a criminal

Digitized by Google

investigation.

[41] For these reasons, I would allow the appeal with costs and set aside the decision of the motions judge. Rendering the judgment that he should have rendered, I would allow the application for judicial review with costs and quash the requirements for production of documents issued on behalf of the Minister on January 12, 2001 against the appellants, Les Plastiques Algar (Canada) Ltée, Modern Wood Fabricators (M.W.F.) Inc. and Snapshot Theatrical Productions Inc.

"Gilles Létourneau"

J.A.

NADON J.A. (concurring)

[42] For the reasons which my colleague Létourneau J.A. gives, I would also allow this appeal with costs. However, as I have reached this conclusion only after much hesitation, a few words are in order.

[43] I need not recite the facts, as they are clearly set out in the Reasons of my colleagues Desjardins and Létourneau JJ.A., which I have had the benefit of reading in draft.

[44] For their respective conclusions, my colleagues rely on the Supreme Court of Canada's decisions in *R. v. Jarvis*, [2002] 3 S.C.R. 757, and *R. v. Ling*, [2002] 3 S.C.R. 814. In *Jarvis*, the Supreme Court elaborated a test so as to determine the boundary between the audit and investigation functions of Revenue Canada. At paragraphs 93 and 94 of its Reasons in *Jarvis*, the Supreme Court directed trial judges to consider, absent a clear decision on the part of Revenue Canada to pursue a criminal investigation, a number of factors with a view to making the proper determination.

[45] In these Reasons, I wish to address one of the issues dealt with by both of my colleagues, namely whether, at the time the Requirements to provide information and documents were sent to the appellants, pursuant to paragraph 231.2(1)*(b)* of the *Income Tax Act*, R.S.C. 1996, ch. 1, 5th Supplement (the "Act"), Revenue Canada had made a clear decision to pursue a criminal investigation.

[46] At paragraph 27 of his Reasons, Létourneau J.A. concludes that, at the relevant time, the investigator, Mr. Faribault, was clearly "embarked upon a criminal investigation of the appellants". Although that conclusion is sufficient to dispose of the issue, Létourneau J.A. then goes on to examine, in light of the evidence, the factors set out in *Jarvis* at paragraph 94. That examination leads him to conclude that an adversarial relationship between the state and the appellants was in existence when the Requirements were sent.

[47] Desjardins J.A. arrives at a different conclusion. At paragraphs 112 to 122 of her Reasons, she deals with the issue of whether a clear decision to pursue a criminal investigation had been made at the time the Requirements were sent and, at paragraphs 118 and 122, she makes the following remarks:

[118] When Faribault's statements are analysed in context, it cannot be said, under the *Jarvis* test, that a clear decision had been made to pursue a criminal investigation. Nothing of that sort could have been decided at that stage. The directive given by CCRA to Faribault was an assignment to look principally for evidence of a penal nature. It cannot be drawn from that directive that CCRA had made the decision to pursue a criminal investigation. Such

Digitized by Google

decision could not be made. CCRA had no evidence on which to base such a decision and no search warrant could have been issued to implement it.
[...]
[122] It is my view that "a clear decision to pursue a criminal investigation" had not been made and could have been made at that preliminary stage. Paragraphs 88 and 93 of *Jarvis* stand for the proposition that it is for the judge to objectively assess the nature of the inquiry and determine whether a clear decision is made to pursue the taxpayer for a criminal offence. If a clear decision is made, an analysis of the enumerated factors is not necessary. A contextual analysis of circumstances and attitudes is superfluous, because the evidence is clear. I do not understand *Jarvis* to say, however, that from a mere directive to conduct principally a penal investigation in circumstances where there is not one iota of evidence and where no search warrant can be issued, one can draw the conclusion that a decision to pursue a criminal investigation has been made.

[48] As I understand Desjardins J.A.'s Reasons, the fact that the investigator believed that he was conducting a criminal investigation, or that he had been so instructed by his superiors, is not determinative of the issue. As she states at paragraph 122, it is for the trial judge to determine whether, in a given case, a criminal investigation has been undertaken. In order to make that decision, the judge must examine all of the evidence and decide whether there was a proper basis or foundation to justify the commencement of a criminal investigation. That approach appears to be the one which the Supreme Court instructs judges to take when assessing the factors listed at paragraph 94 of *Jarvis* and, in particular, when assessing factor (a):
(a) Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation could have been made?
[49] I repeat that the Supreme Court, at paragraphs 93 and 94 of its Reasons, instructed trial judges to have recourse to the enumerated factors only when a clear decision to pursue a criminal investigation has not been made. However, that approach is not applicable here, because the issue is whether a clear decision to proceed with a criminal investigation has been made, and not whether a criminal investigation ought to have been commenced.

[50] In order to properly understand paragraphs 93 and 94 of *Jarvis,* it must be remembered that the conduct of the inquiry in both *Jarvis* and *Ling* was, at all times, in the hands of the auditors and not in the hands of the investigators. That is the context which drives both decisions and, in particular, the discussion commencing at paragraph 85 of *Jarvis*, the sub-title of which is "Delineating the Bounds Between Audit and Investigation: Nature of the Inquiry".
[51] In *Jarvis* and *Ling*, the Supreme Court sought to elaborate a test which would allow judges to determine whether an inquiry conducted by auditors had, in fact, become a criminal investigation, even though the matter remained at all times in their hands. The discussion which commences at paragraph 85 and which concludes at paragraph 99 can only be understood in that context. That is why, at paragraphs 88 and 89 of its Reasons in *Jarvis*, the Supreme Court speaks of crossing the Rubicon and determining the predominant purpose of an inquiry.
[52] Of the seven factors listed in paragraph 94 of *Jarvis*, three of these factors, (c), (d) and (e), have in mind the investigative branch. They are as follows:
(c) Had the auditor transferred his or her files an materials to the investigators?

Digitized by Google

(d) Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?
(e) Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?
[53] These factors must be read in the light of what the Supreme Court states at paragraph 92:

[92] Whether a matter has been sent to the investigations section is another factor in determining whether the adversarial relationship exists. Again, though, this, by itself, is not determinative. An auditor's recommendation that investigators look at a file might result in nothing in the way of a criminal investigation since there is always the possibility that the file will be sent back. Still, if, in an auditor's judgment, a matter should be sent to the investigators, a court must examine the following behaviour very closely. If the file is sent back, does it appear that the investigators have actually declined to take up the case and have returned the matter so that the audit can be completed? Or, does it appear, rather, that they have sent the file back as a matter of expediency, so that the auditor may use ss. 231.1(1) and 231.2(1) to obtain evidence for a prosecution (as was found to be in the case in *Norway Insulation, supra*)?
[54] When factors (c), (d) and (e), and paragraph 92 are read in their proper context, it is clear that the Supreme Court, in elaborating its test, intended to prevent the audit section from conducting a disguised criminal investigation. That is why, at paragraph 92 of *Jarvis*, the Supreme Court states that whenever the audit section sends a matter to the investigative section, the judge must pay close attention. The purpose of the exercise is, as I have already indicated, to assess whether a criminal investigation has begun.
[55] In the various scenarios outlined at paragraph 92 of *Jarvis*, i.e. where the audit section has referred a matter to the investigative section, it is clear that the assumption which the Supreme Court makes is that no decision to commence a criminal investigation has yet been made. In directing judges to pay close attention, the Supreme Court is reminding judges that there is a line which the auditors cannot cross.
[56] At paragraph 97 of *Jarvis*, the Supreme Court outlines another scenario, i.e. where parallel investigations are being conducted by the audit and the criminal investigation sections. In such a situation, the Court states that the audit inquiry can continue to resort to subsections 231.1(1) and 231.2(1), but makes it clear that once a criminal investigation has been undertaken, a taxpayer cannot be forced by the investigators to comply with the Requirement powers of subsections 231.1(1) and 231.2(1). Specifically, the Court says at paragraph 97:

[...] It may well be that there will be circumstances in which the CCRA officials conducting the tax liability inquiry will desire to inform the taxpayer that a criminal investigation is also underway and that the taxpayer is not obliged to comply with the requirement powers of subsections 231.1(1) and 231.2(1) for the purpose of a criminal investigation.
[57] What is before us in this case is a situation quite different from that which prevailed in *Jarvis* and *Ling*. When the Requirements were sent, the matter was clearly in the hands of an investigator. On that part of the evidence, which Létourneau J.A. recites at paragraphs 14 to 17 of his Reasons, there cannot be much doubt that the matter had been sent to Mr. Faribault for the specific purpose of carrying out a criminal investigation. Whether or not, when the Requirements were sent, Revenue Canada and Mr. Faribault had sufficient information to commence a criminal investigation is, in my respectful view, irrelevant. The

Digitized by Google

plain fact is that Mr. Faribault had been directed to conduct a criminal investigation and that is what he was doing.

[58] Consequently, when no clear decision to commence a criminal investigation has been made, it is entirely proper to go to factor (a) so as to determine whether there were reasonable grounds to lay charges and whether the record was such as to justify the commencement of a criminal investigation. That approach has as its objective the determination of whether a matter in the hands of auditors has become a criminal investigation, even though it has not been referred to the investigative section with a mandate to commence a criminal investigation. However, when the matter is in the hands of the investigators, as is the case here, and they are clearly conducting a criminal investigation, there is no necessity of examining the factors set forth at paragraph 94 of *Jarvis*.

[59] For these reasons, I can only give an affirmative answer to the question of whether a clear decision to conduct a criminal investigation had been made when the Requirements were sent to the appellants. I would, therefore, dispose of the appeal in the manner proposed by Létourneau J.A.

"Marc Nadon"

J.A.

DESJARDINS J.A. (dissenting)

[60] Three corporate appellants, Les Plastiques Algar (Canada) Ltée., Modern Wood Fabricators (M.W.F.) Inc. and Snapshot Theatrical Productions Inc. appeal a decision of a Motions Judge of the Federal Court (reported at [2003] F.C.J. No. 70) holding that their rights under sections 7 and 8 of the *Canadian Charter of Rights and Freedoms* (the Charter) were not violated when they were served with requirements to provide documents pursuant to paragraph 231.2(1)(*b*) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act).

[61] In the Federal Court, two individuals, Messrs Sam Kligman and Allan Sandler, directors of the corporate appellants, were also parties to the proceedings. The Motions Judge held in their favour under section 7 of the Charter. Consequently, they are not parties to this appeal.

[62] At issue are the scope of the Minister's powers to conduct an inquiry into the affairs of the three corporate taxpayers and the determination of the moment at which the predominant purpose of the inquiry became an investigation, as a consequence of which their rights under the Charter were allegedly violated.

I. The Facts

[63] Before the Motions Judge, the two individuals and the three corporations challenged, by way of judicial review, letters issued on January 12, 2001, by the Special Investigations division (SI) of the Canada Customs and Revenue Agency (CCRA) titled Requirements to Provide Information and Documents (the requirements). The letters addressed to the three corporations
were sent pursuant to paragraph 231.2(1)(*b*) of the Act while those addressed to the two individuals were sent pursuant to paragraphs 231.2(1)(*a*) and (*b*) of the Act.

[64] CCRA stated in those letters that it required information from the five taxpayers with respect to donations made to four charitable organizations, being the Montreal Rabbinical College, the Yeshiva Oir Hochaim, l'Association Gimilis Chasodim Keren Chava

Digitized by Google

B'Nei Levi and Les Amis Canadiens des Institutions de la Terre Sainte.

[65] CCRA required information for various periods between 1994 to 1998 inclusive. The relevant periods differed for each party. Les Plastiques Algar (Canada) Ltée was required to produce documents regarding six charitable donations all made to the Montreal Rabbinical College between 1994 and 1998 totalling $362,000. Modern Wood Fabricators (M.W.F.) Inc. was required to produce documents related to six charitable donations made from 1995 to 1998 totalling $744,000 to the Montreal Rabbinical College and Yeshiva Oir Hochaim. Snapshot Theatrical Productions Inc. was asked to produce documents in connection to a $36,000 charitable donation made to the Montreal Rabbinical College in 1994.

[66] The information required from Kligman and Sandler, the two individuals, consisted of account numbers (and the identification of the banks and branches at which the accounts were held) from which cheques were drawn to pay the donations and the cancelled cheques related to these donations. The material requested from the three corporations included cancelled cheques, bank statements and donation receipts related to donations to the organizations mentioned in the letters. Also requested were the cash disbursements journal, general ledger, adjusting entries and trial balance for the periods specified in the letters.

[67] Each of the five letters concluded with the following:

Your attention is directed to subsections 238(1) and (2) of the *Income Tax Act* for default in complying with this requirement.

[68] At the time the requirements were issued, two registered charities had been investigated by Gaétan Ouelette, an SI investigator, for falsely issuing tax receipts. The first, Construit Toujours avec Bonté, had pleaded guilty to an offence under paragraph 239(1)(*d*) of the Act. The other, the Montreal Rabbinical College, was not charged and no further charges would be laid against it (see the affidavit of the SI investigator André Faribault, A.B. p. 75, p. 77, par. 17).

[69] The appellants claimed deductions in respect of donations to the Montreal Rabbinical College but not in respect of donations to Construit Toujours avec Bonté.

[70] The five taxpayers challenged by way of judicial review the requirements of the Minister on the basis that their constitutional rights under sections 7 and 8 of the Charter had been violated. A notice under section 57 of the *Federal Courts Act* (R.S. 1985, c. F-7) was given.

II. The decision of the Motions Judge

[71] Relying on the decisions of the Supreme Court of Canada in *R. v. Jarvis*, [2002] 3 S.C.R. 757 (*Jarvis*), and *R. v. Ling,* [2002] 3 S.C.R. 814 (*Ling*), the Motions Judge stated that while taxpayers are bound to cooperate with CCRA auditors for tax assessment purposes, an adversarial relationship crystalizes between CCRA and the taxpayer when the predominant purpose of the inquiry is the determination of a taxpayer's penal liability.

[72] At that stage, he said at paragraphs 74 and 75 of his reasons, the fundamental protection against self-incrimination guaranteed by the Charter comes into play. As a matter of statutory construction, the inspection and requirement powers granted by subsections 231.1(1) and 231.2(1) cannot be used for the purpose of criminal investigations. Rather, search warrants must be obtained pursuant to section 231.3 of the Act. He reiterated the non-exhaustive list of factors set out by the Supreme Court of Canada to assist in the determination of whether the taxpayer's penal liability had become the predominant purpose

Digitized by Google

of the inquiry. He concluded, based on his reading of the evidence, that there was "from the outset" an investigation where penal sanctions were sought by CCRA. He stated, at paragraph 90 of his reasons:

[90] The evidence on the record as a whole leads to the conclusion that the predominant purpose of the investigation of CCRA, from its outset, was prosecution of the applicants for tax evasion and eventual imposition of penal sanctions against them. The statements on discovery by Faribault are not the only indicia of this predominant purpose; they are simply among the most succinct elements of evidence which support this conclusion. Accordingly, I find that the predominant purpose of the investigation was prosecution of the applicants for tax evasion.

[Emphasis added.]

[73] The Motions Judge concluded, at paragraphs 91 and 92 of his reasons, that the section 7 Charter rights of the two individuals concerned would be in jeopardy if the requirements were maintained. He wrote:

[91] In Jarvis, the Supreme Court noted that where the s. 7 requirements of fundamental justice are engaged by a finding that the predominant purpose of an investigation is penal in nature, self-incrimination is the primary principle of fundamental justice on which the determination will be based. However, the Court added that protection against self-incrimination does not mean an absolute ban on requirements to provide information. The right of a person not to provide information adverse to his liberty interest must be balanced against the opposing principle of fundamental justice which posits that relevant evidence should be available to the trier of fact in the search for the truth.

[92] With these conflicting principles in mind, I am inclined to follow the findings in Jarvis and Ling that CCRA cannot expect taxpayers to provide information that has the effect of assisting the state in its efforts to deprive them of their liberty. Accordingly, I find that the rights of Kligman and Sandler would be compromised by requirements to provide information to further an investigation which is geared mainly toward assessing criminal liability.

[Emphasis added.]

[74] With regard to the three corporations involved, the Motions Judge concluded at paragraphs 95, 103 and 104 of his reasons that section 7 did not apply to corporations, and that their privacy interests in the requested records were minimal under section 8 of the Charter. He wrote:

[95] A corporation cannot enjoy life, liberty or security of the person. Accordingly, s. 7 of the Charter does not apply to corporations. The Supreme Court has held that a corporation cannot invoke this right in order to shield itself from criminal investigation or prosecution. This rule was originally stated in Irwin Toy Ltd. v. Québec (Attorney General), [1989] 1 S.C.R. 927. The rule has been reiterated in Thomson and British Columbia Securities Commission, supra. It therefore remains only to be determined whether s. 8 can be applied in respect of the corporate applicants.

[...]

[103] Although the corporate applicants in the case at bar are not publicly traded companies like the company in question in British Columbia Securities Commission, they still have records that they must maintain for regulatory purposes, including purposes related to the ITA. The privacy interest in these records will be minimal.

[104] The privacy interests of corporate entities are substantially limited compared to those of individuals. The values on which the privacy interests of individuals include recognition of,

Digitized by Google

and respect for, the physical and psychological integrity of human beings, are simply not present in the case of corporate entities. Accordingly, I find that neither s. 7 nor s. 8 of the Charter would be violated by compelling the corporate applicants to comply with the Requirements as issued by the CCRA.

[75] The Motions Judge then applied subsection 24(1) of the Charter and, in doing so, he quashed the requirements received by the individuals but upheld those received by the corporate appellants. He said, at paragraphs 110 and 111 of his reasons:

[110] Subsection 24(1) allows me to provide "such remedy as the court considers appropriate and just in the circumstances" in the event of a breach of the Charter. Technically, a Charter breach has not yet occurred since the evidence has not yet been delivered. However, I have found that the Charter rights of Kligman and Sandler will be violated if they are compelled to provide the materials sought by CCRA. It is possible to order that they provide what they have been told to provide by the Requirements, and leave it to the presiding judge to make a decision as to the exclusion or admission of that evidence in the event that Kligman and Sandler are charged with tax evasion. However, Iacobucci and Major JJ. addressed this hypothesis in Jarvis at para. 91:

Although the respondent argued that such situations could be remedied by the courts, we view it as preferable that such situations be avoided rather than remedied.

[111] I agree. Accordingly, I exercise my discretion under subsection 24(1) of the Charter to quash the Requirements issued personally to Sandler and Kligman. As I have found no breach of the Charter in respect of the Requirements issued to the corporate applicants, these Requirements shall be upheld.

III. The position of the parties

[76] The three corporate appellants claim that, having made the finding that the predominant purpose of the inquiry conducted by the SI division was to determine the corporate appellants' penal liability, the full panoply of their rights under sections 7 and 8 of the Charter applied and that, as a result, the requirements should have been quashed.

[77] The respondent claims that the reviewing judge exceeded his jurisdiction in finding that the *Jarvis* and *Ling* analyses, which were developed in the context of a criminal trial, applied to pre-charge proceedings such as a judicial review application to quash the requirements to produce tax records. The respondent further claims that the Motions Judge erred in finding that the predominant purpose of CCRA's requirements was to determine the corporate appellants' penal liability. He submits that, notwithstanding these errors, the reviewing judge correctly held

that section 7 of the Charter does not apply to corporate entities and that the use of the requirements to compel the corporate appellants to produce pre-existing banking and business records did not violate their rights under section 8 of the Charter.

IV. The relevant statutory provisions

[78] The Act provides the following:

Part XV - Administration and Enforcement

Digitized by Google

231.1: Inspections

(1) An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act,

(*a*) inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act, and

(*b*) examine property in any inventory of a taxpayer and any property or process of, or matter relating to, the taxpayer or any other person, an examination of which may assist the authorized person in determining the accuracy of the inventory of the taxpayer or in ascertaining the information that is or should be in the books or records of the taxpayer or any amount payable by the taxpayer under this Act,

and for those purposes the authorized person may

(*c*) subject to subsection 231.1(2), enter into any premises or place where any business is carried on, any property is kept, anything is done in connection with any business or any books or records are or should be kept, and

(*d*) require the owner or manager of the property or

231.1: Enquêtes

(1) Une personne autorisée peut, à tout moment raisonnable, pour l'application et l'exécution de la présente loi, à la fois:

a) inspecter, vérifier ou examiner les livres et registres d'un contribuable ainsi que tous documents du contribuable ou d'une autre personne qui se rapportent ou peuvent se rapporter soit aux renseignements qui figurent dans les livres ou registres du contribuable ou qui devraient figurer, soit à tout montant payable par le contribuable en vertu de la présente loi;

b) examiner les biens à porter à l'inventaire d'un contribuable, ainsi que tout bien ou tout procédé du contribuable ou d'une autre personne ou toute matière concernant l'un ou l'autre dont l'examen peut aider la personne autorisée à établir l'exactitude de l'inventaire du contribuable ou à contrôler soit les renseignements qui figurent dans les livres ou registres du contribuable ou qui devraient y figurer, soit tout montant payable par le contribuable en vertu de la présente loi;

c) sous réserve du paragraphe (2), pénétrer dans un lieu où est exploitée une entreprise, est gardé un bien, est faite une chose en rapport

Digitized by Google

business and any other person on the premises or place to give the authorized person all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act and, for that purpose, require the owner or manager to attend at the premises or place with the authorized person.

Prior authorization

(2) Where any premises or place referred to in paragraph 231.1(1)(c) is a dwelling-house, an authorized person may not enter that dwelling-house without the consent of the occupant except under the authority of a warrant under subsection 231.1(3).

Application

(3) Where, on ex parte application by the Minister, a judge is satisfied by information on oath that

(*a*) there are reasonable grounds to believe that a dwelling-house is a premises or place referred to in paragraph 231.1(1)(c),

(*b*) entry into the dwelling-house is necessary for any purpose relating to the administration or enforcement of this Act, and

(*c*) entry into the dwelling-house has been, or there are reasonable grounds to believe that entry will be, refused,

the judge may issue a warrant authorizing an authorized person to enter the dwelling-house subject to such conditions as are specified in the warrant but, where the judge is not satisfied that entry into the dwelling-house is necessary for any purpose

avec une entreprise ou sont tenus ou devraient l'être des livres ou registres;

d) requérir le propriétaire, ou la personne ayant la gestion, du bien ou de l'entreprise ainsi que toute autre personne présente sur les lieux de lui fournir toute l'aide raisonnable et de répondre à toutes les questions pertinentes à l'application et l'exécution de la présente loi et, à cette fin, requérir le propriétaire, ou la personne ayant la gestion, de l'accompagner sur les lieux.

Autorisation préalable

(2) Lorsque le lieu mentionné à l'alinéa (1)c) est une maison d'habitation, une personne autorisée ne peut y pénétrer sans la permission de l'occupant, à moins d'y être autorisée par un mandat décerné en vertu du paragraphe (3).

Mandat d'entrée

(3) Sur requête ex parte du ministre, le juge saisi peut décerner un mandat qui autorise une personne autorisée à pénétrer dans une maison d'habitation aux conditions précisées dans le mandat, s'il est convaincu, sur dénonciation sous serment, de ce qui suit:

a) il existe des motifs raisonnables de croire que la maison d'habitation est un lieu mentionné à l'alinéa (1)c);

b) il est nécessaire d'y pénétrer pour l'application ou l'exécution de la présente loi;

c) un refus d'y pénétrer a été opposé, ou il existe des motifs raisonnables de croire qu'un tel refus sera opposé.

Dans la mesure où un refus

Digitized by Google

relating to the administrationde pénétrer dans la maison
or enforcement of this Act, thed'habitation a été opposé ou
judge may pourrait l'être et où des
(*d*) order the occupant of thedocuments ou biens sont
dwelling-house to provide togardés dans la maison
an authorized persond'habitation ou pourraient
reasonable access to anyl'être, le juge qui n'est pas
document or property that isconvaincu qu'il est nécessaire
or should be kept in thede pénétrer dans la maison
dwelling-house, and d'habitation pour l'application
(*e*) make such other order asou l'exécution de la présente
is appropriate in theloi peut ordonner à l'occupant
circumstances to carry out thede la maison d'habitation de
purposes of this Act, permettre à une personne
to the extent that access wasautorisée d'avoir
or may be expected to beraisonnablement accès à tous
refused and that thedocuments ou biens qui sont
document or property is orgardés dans la maison
may be expected to be kept ind'habitation ou
the dwelling-house. devraient y être gardés et

Requirements to provide rendre tout autre ordonnance
documentation or indiquée en l'espèce pour
information **231.2** (1) l'application de la présente loi.
Notwithstanding any other Production de documents ou
provision of this Act, the fourniture de renseignements
Minister may, subject to **231.2** (1) Malgré les autres
subsection (2), for any dispositions de la présente loi,
purpose related to the le ministre peut, sous réserve
administration or enforcement du paragraphe (2) et, pour
of this Act, including the l'application et l'exécution de
collection of any amount la présente loi, y compris la
payable under this Act by any perception d'un montant
person, by notice served payable par une personne en
personally or by registered or vertu de la présente loi, par
certified mail, require that any avis signifié à personne ou
person provide, within such envoyé par courrier
reasonable time as is recommandé ou certifié,
stipulated in the notice, exiger d'une personne, dans
(*a*) any information or le délai raisonnable que
additional information, précise l'avis:
including a return of income or *a*) qu'elle fournisse tout
a supplementary return; or renseignement ou tout
(*b*) any document. renseignement
[...] supplémentaire, y compris
Search warrant une déclaration de revenu ou
231.3 (1) A judge may, on ex une déclaration
parte application by the supplémentaire;
Minister, issue a warrant in *b*) qu'elle produise des
writing authorizing any person documents.
named therein to enter and [...]

Digitized by Google

search any building, receptacle or place for any document or thing that may afford evidence as to the commission of an offence under this Act and to seize the document or thing and, as soon as practicable, bring it before, or make a report in respect of it to, the judge or, where the judge is unable to act, another judge of the same court to be dealt with by the judge in accordance with this section.

Evidence in support of application

(2) An application under subsection 231.3(1) shall be supported by information on oath establishing the facts on which the application is based.

Evidence

(3) A judge may issue the warrant referred to in subsection 231.3(1) where the judge is satisfied that there are reasonable grounds to believe that

(*a*) an offence under this Act was committed;

(*b*) a document or thing that may afford evidence of the commission of the offence is likely to be found; and

(*c*) the building, receptacle or place specified in the application is likely to contain such a document or thing.

[...]

Offences and punishment

238. (1) Every person who has failed to file or make a return as and when required by or under this Act or a regulation or who has failed to comply with subsection 116(3), 127(3.1) or 127(3.2), 147.1(7) or 153(1), any of

Requête pour mandat de perquisition

231.3 (1) Sur requête ex parte du ministre, le juge saisi peut décerner un mandat écrit qui autorise toute personne qui y est nommée à pénétrer dans tout bâtiment, contenant ou endroit et y perquisitionner pour y chercher des documents ou choses qui peuvent constituer des éléments de preuve de la perpétration d'une infraction à la présente loi, à saisir ces documents ou choses et, dès que matériellement possible, soit à les apporter au juge ou, en cas d'incapacité de celui-ci, à un autre juge du même tribunal, soit à lui en faire rapport, pour que le juge en dispose conformément au présent article.

Preuve au soutien de la requête

(2) La requête visée au paragraphe (1) doit être appuyée par une dénonciation sous serment qui expose les faits au soutien de la requête.

Preuve

(3) Le juge saisi de la requête peut décerner le mandat mentionné au paragraphe (1) s'il est convaincu qu'il existe des motifs raisonnables de croire ce qui suit:

a) une infraction prévue par la présente loi a été commise;

b) des documents ou choses qui peuvent constituer des éléments de preuve de la perpétration de l'infraction seront vraisemblablement trouvés;

c) le bâtiment, contenant ou endroit précisé dans la requête contient vraisemblablement de tels

Digitized by Google

sections 230 to 232 or a
regulation made under[...]
subsection 147.1(18) or with
an order made under
subsection 238(2) is guilty of
an offence and, in addition to
any penalty otherwise
provided, is liable on
summary conviction to
(*a*) a fine of not less than
$1,000 and not more than
$25,000; or
(*b*) both the fine described in
paragraph 238(1)(*a*) and
imprisonment for a term not
exceeding 12 months.

documents ou choses.

Infractions et peines

238. (1) La personne qui ne produit ou ne présente pas ou ne remplit pas une déclaration de la manière et dans le délai prévus à la présente loi ou à son règlement ou qui contrevient au paragraphe 116(3), 127(3.1) ou (3.2), 147.1(7) ou 153(1) ou à l'un des articles 230 à 232 ou à une disposition réglementaire prise en vertu du paragraphe 147.1(18) ou encore qui contrevient à une ordonnance rendue en application du paragraphe (2) commet une infraction et encourt, sur déclaration de culpabilité par procédure sommaire et outre toute pénalité prévue par ailleurs:

a) soit une amende de 1 000 $ à 25 000 $;

b) soit une telle amende et un emprisonnement maximal de 12 mois.

Compliance orders

Where a person has been convicted by a court of an offence under subsection 238(1) for a failure to comply with a provision of this Act or a regulation, the court may make such order as it deems proper in order to enforce compliance with the provision.

Saving

(3) Where a person has been convicted under this section of failing to comply with a provision of this Act or a regulation, the person is not liable to pay a penalty imposed under section 162 or 227 for the same failure unless the person was assessed for that penalty or that penalty was demanded from the person before the information or complaint giving rise to the conviction was laid or made.

Ordonnance d'exécution

(2) Le tribunal qui déclare une personne coupable d'une infraction prévue au paragraphe (1) peut rendre toute ordonnance qu'il estime indiquée pour qu'il soit remédié au défaut visé par l'infraction.

Réserve

(3) La personne déclarée coupable, par application du présent article, d'avoir contrevenu à une disposition de la présente loi ou de son règlement n'est passible d'une pénalité prévue à l'article 162 ou 227 pour la même contravention que si une cotisation pour cette pénalité a été établie à son égard ou

Other offences and punishment

239. (1) Every person who has

(*a*) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements in a

Digitized by Google

return, certificate, statement or answer filed or made as required by or under this Act or a regulation,

(*b*) to evade payment of a tax imposed by this Act, or destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,

(*c*) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,

(*d*) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act, or

(*e*) conspired with any person to commit an offence described in paragraphs 239(1)(a) to 239(1)(d),

is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

(*f*) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or

(*g*) both the fine described in paragraph 239(1)(*f*) and imprisonment for a term not exceeding 2 years.

[...]

[Emphasis added.]

que si le paiement en a été exigé d'elle avant que la dénonciation ou la plainte qui a donné lieu à la déclaration de culpabilité ait été déposée ou faite.

Autres infractions et peines

239. (1) Toute personne qui, selon le cas:

a) a fait des déclarations fausses ou trompeuses, ou a participé, consenti ou acquiescé à leur énonciation dans une déclaration, un certificat, un état ou une réponse produits, présentés ou faits en vertu de la présente loi ou de son règlement;

b) a, pour éluder le paiement d'un impôt établi par la présente loi, détruit, altéré, mutilé, caché les registres ou livres de comptes d'un contribuable ou en a disposé autrement;

c) a fait des inscriptions fausses ou trompeuses, ou a consenti ou acquiescé à leur accomplissement, ou a omis, ou a consenti ou acquiescé à l'omission d'inscrire un détail important dans les registres ou livres de comptes d'un contribuable;

d) a, volontairement, de quelque manière, éludé ou tenté d'éluder l'observation de la présente loi ou le paiement d'un impôt établi en vertu de cette loi;

e) a conspiré avec une personne pour commettre une infraction visée aux alinéas a) à d),

commet une infraction et, en plus de toute autre pénalité prévue par ailleurs, encourt, sur déclaration de culpabilité par procédure sommaire:

Digitized by Google

f) soit une amende de 50 % à 200 % de l'impôt que cette personne a tenté d'éluder;
g) soit à la fois l'amende prévue à l'alinéa f) et un emprisonnement d'au plus 2 ans.
[...]
[Non souligné dans l'original.]

[79] Sections 7, 8 and subsection 24(1) of the Charter provide:

7. Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.	**7.** Chacun a droit à la vie, à la liberté et à la sécurité de sa personne; il ne peut être porté atteinte à ce droit qu'en conformité avec les principes de justice fondamentale.
8. Everyone has the right to be secure against unreasonable search or seizure.	**8.** Chacun a droit à la protection contre les fouilles, les perquisitions ou les saisies abusives.
24. (1) Anyone whose rights or freedoms, as guaranteed by this Charter, have been infringed or denied may apply to a court of competent jurisdiction to obtain such remedy as the court considers appropriate and just in the circumstances.	**24.** (1) Toute personne, victime de violation ou de négation des droits ou libertés qui lui sont garantis par la présente charte, peut s'adresser à un tribunal compétent pour obtenir la réparation que le tribunal estime convenable et juste eu égard aux circonstances.

V. Was a cross-appeal necessary?

[80] A preliminary matter was raised as to whether the respondent had the obligation to file a cross-appeal if he wished to attack the finding of the Motions Judge that the predominant purpose of the inquiry conducted by CCRA was the determination of the penal liability of the corporate appellants for tax evasion.

[81] This query may be summarized along the following lines.

[82] The finding of the Motions Judge that the predominant purpose of the inquiry was penal in nature was binding on the corporate appellants, on the individuals and on the respondent. The respondent, not having cross-appealed, is prevented from reopening the judge's finding *vis-à-vis* the corporate appellants since by doing so, he is making a collateral attack on a vital point of the Motions Judge's reasons in a proceeding where he was a party. The corporate appellants could reasonably expect that the only issue on appeal would be related to the application of sections 7 and 8 of the Charter. By not cross-appealing, the respondent takes the corporate appellants by surprise.

[83] I hold that the respondent is entitled to question, as he does, the finding of the

Digitized by Google

Motions Judge that the dominant purpose of the inquiry was penal in nature, although he has not filed a cross-appeal.

[84] The statutory source for an appeal in this Court lies in section 27 of the *Federal Courts Act*, which reads:

27. (1) An appeal lies to the Federal Court of Appeal from any of the following decisions of the Federal Court: (*a*) a final judgment, [...] (4) For the purposes of this section, a final judgment includes a judgment that determines a substantive right except as to any question to be determined by a referee pursuant to the judgment. [Emphasis added.]	**27.** (1) Il peut être interjeté appel, devant la Cour d'appel fédérale, des décisions suivantes de la Cour fédérale : *a*) jugement définitif; [...] (4) Pour l'application du présent article, est assimilé au jugement définitif le jugement qui statue au fond sur un droit, à l'exception des questions renvoyées à l'arbitrage par le jugement. [Non souligné dans l'original.]

[85] Subsection 2(1) of the *Federal Courts Act,* defines "final judgment" as follows:

"final judgment" means any judgment or other decision that determines in whole or in part any substantive right of any of the parties in controversy in any judicial proceeding;	« jugement définitif » Jugement ou autre décision qui statue au fond, en tout ou en partie, sur un droit d'une ou plusieurs des parties à une instance.

[86] Rule 341(1) of the *Federal Court Rules*, 1998, [SOR/98-106] makes it clear that a respondent who intends to participate in an appeal shall, within 10 days after service of the notice of appeal, serve and file a notice of appearance; or where he seeks a different disposition of the order appealed from, a notice of cross-appeal.

[87] Rule 341(1)(*a*) and (*b*) reads:

341. (1) A respondent who intends to participate in an appeal shall, within 10 days after service of the notice of appeal, serve and file (*a*) a notice of appearance in Form 341A; or (*b*) where the respondent seeks	**341.** (1) L'intimé qui entend participer à l'appel dépose et signifie, dans les 10 jours suivant la signification de l'avis d'appel : *a*) soit un avis de comparution établi selon la formule 341A; *b*) soit, s'il entend demander la

Digitized by Google

a different disposition of the order appealed from, a notice of cross-appeal in Form 341B. [Emphasis added.]	réformation de l'ordonnance portée en appel, un avis d'appel incident établi selon la formule 341B. [Non souligné dans l'original.]

[88] A cross-appeal is only appropriate where the respondent seeks a disposition different from that of the judgment under appeal. (See *Roberts v. Canada,* [1999] F.C.J. No. 1529; *Air Canada v. Canada (Commissioner of Competition)*, [2002] F.C.J. No. 424, at paragraphs 32 and 33).

[89] In the case at bar, the respondent could not have filed a cross-appeal against the corporate appellants since that part of the disposition of the case which dealt with the corporate appellants was favourable to him. The cross-appeal is directed at the decision under appeal and not at the reasons for judgment (*Redpath Industries Ltd. v. Fednav Ltd.* (F.C.A.), [1994] F.C.J. No. 397). The respondent was under no obligation to cross-appeal that part of the decision that dealt with the individuals in order to reach the corporate appellants.

[90] The corporate appellants appealed the decision. This gave the respondent the opportunity to raise all issues that were before the Motions Judge. In *Devinat v. Canada* (*Immigration and Refugee Board*) (*C.A.*), [2000] 2 F.C. 212, leave to appeal to the S.C.C. refused [2000] 2 S.C.R. vii) this Court held, at paragraph 12, that "an appeal from the judgment by the appellant allows the respondent to make all the arguments it considers relevant and which have a bearing on the questions of law or fact that were before the Motions Judge or that led to the judgment". It is open to the respondent therefore to try to convince this Court that the Motions Judge erred on some issues, although he may have come to the right conclusion in the end.

[91] John Sopinka and Mark A. Gelowitz state at page 7 of their book *The Conduct of an Appeal*, 2nd ed. (Toronto: Butterworths, 2000):

The importance of a lower court's reasons for judgment should not, of course, be understated. As mentioned above, those reasons often contain the foundation upon which an appellate court will draw its conclusions concerning whether the judgment or order below was based upon a reviewable error, and those reasons are generally the focus of an appeal.

[92] The corporate appellants were not taken by surprise. Appellants generally know or ought to know that an appeal of a judgment opens for scrutiny the grounds on which it is based. In casting doubt on the Motions Judge's finding that the predominant purpose of the inquiry was penal in nature, the respondent is not making a collateral attack on the decision rendered below. A collateral attack presupposes that a party attacks in the wrong forum a decision which could have been attacked directly but was not. In *Toronto (City) v. Canadian Union of Public Employees, Local 79 (C.U.P.E.),* [2003] S.C.J. No. 64, 2003 S.C.C. 19, Arbour J. for the Court cited, at paragraph 33, the case of *Wilson v. The Queen*, [1983] 2 S.C.R. 594 at page 599, where it was said that the rule against collateral attack:

has long been a fundamental rule that a court order, made by a court having jurisdiction to make it, stands and is binding and conclusive unless it is set aside on appeal or lawfully quashed. It is also well settled in the authorities that such an order may not be attacked collaterally - and a collateral attack may be described as an attack made in proceedings

Digitized by Google

other than those whose specific object is the reversal, variation, or nullification of the order or judgment.

The respondent is in the proper forum. He was taken here by an appeal process lodged by the corporate appellants who, by doing so, took all the risks inherent to an appeal.

[93] I conclude that the respondent does not seek a different disposition than the one arrived at by the Motions Judge and, consequently, that it would have been inappropriate for him to cross-appeal. Since the corporate taxpayers are appealing the decision of the Motions Judge, it is open to the respondent to oppose those reasons which he finds in error. The decision of the Motions Judge has become *res judicata* between the respondent and the individuals but not between the respondent and the corporate appellants.

VI. Issues

[94] The issues before us are the following:

(1) Whether the Motions Judge exceeded his jurisdiction in finding that the *Jarvis* and *Ling* analyses apply not only to criminal proceedings but also to pre-charge proceedings, such as a judicial review directed at the requirements;

(2) Whether the Motions Judge erred in finding that the letters issued under section 231.1 of the Act were requirements issued for the predominant purpose of determining the corporate appellants' penal liability;

(3) Whether the Motions Judge erred in deciding that the requirements did not infringe the corporate appellants' rights against self-incrimination under section 7 of the Charter and their rights against unreasonable search and seizure pursuant to section 8 of the Charter.

VII. Analysis

(1) Charter protection and pre-charge proceedings

[95] The Motions Judge made no error in applying *Jarvis* and *Ling* to the case at bar.

[96] It is uncontested that the issues examined in both *Jarvis* and *Ling* were raised during criminal trials for tax evasion. But as recognized by Iacobucci and Major JJ. in *Jarvis*, at paragraph 91, "[i]t would be a fiction to say that the adversarial relationship only comes into being when charges are laid". The adversarial relationship may appear at an earlier stage. It is at this stage that the taxpayer needs the protection of the Charter. It is then that he should obtain it. Iacobucci and Major JJ. have explained that situations where Charter rights are violated should be avoided rather than remedied (paragraph 91 of their reasons). The Motions Judge was therefore justified in applying the analyses developed in those two cases in order to determine the validity of the requirements on a judicial review application.

(2) The letters issued under section 231.1 of the Act

[97] In *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627 (*McKinlay*), Wilson J. qualified the Act as "essentially a regulatory statute" since it controls the manner in which federal income tax is calculated and collected (at paragraph 20). In the same decision at paragraph 37, La Forest J. in concurring reasons described the Act as "essentially of an administrative nature."

[98] Based on self-assessment and self-reporting characteristics, the success of the administration of the tax scheme depends primarily upon a taxpayer's honesty. As Cory J. noted in *Knox Contracting*, "[t]he entire system of levying and collecting income tax is dependent upon the integrity of the taxpayer in reporting and assessing income." (*Knox Contracting Ltd. v. Canada,* [1990] 2 S.C.R. 338 at paragraph 18). To short-circuit the possibilities that taxpayers may omit to report revenues, "a system of random monitoring

Digitized by Google

may be the only way in which the integrity of the tax system can be maintained." (*McKinlay*, at paragraph 33).

[99] To achieve such an end, the Minister is granted broad supervisory powers to audit and inspect relevant documents to the productions of those returns. However, to be effective, the self-enforcing regulatory scheme that is the Act requires resort to adequate investigation and the existence of effective penalties (*Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425).

[100] In *Del Zotto v. Canada*, [1997] F.C.J. No. 795, r'ved [1999] 1 S.C.R. 3 (*Del Zotto*) Strayer J.A., dissenting, but confirmed by a unanimous panel of the Supreme Court of Canada, noted at paragraph 50 of his reasons that, when trying to label the Act as 'regulatory' or 'criminal', "one must look at the total context of the particular process in question." Strayer J.A. stated at paragraph 51 that "the nature and the purpose of the legislative scheme whose administration or enforcement is in question" constitute contextual elements to be considered in the interpretation of provisions related to mandatory production of documents.

[101] The Act already requires from the taxpayer to disclose an important amount of information. As found by Strayer J.A. at paragraph 62 of his reasons:

[62] [...] The Act requires all manner of disclosure. The taxpayer must, for example, disclose: his place of residence; his age; his social insurance number; his marital status or whether he is living common law; his sources and amounts of income; his dependants, their ages and possible physical conditions if handicapped; the amounts and objects of his charitable or political donations, if he is to claim tax credits; whom he employs and entertains if he seeks to deduct the costs as business expenses; and details of his pension arrangements. If he is employed he must disclose many of these details not only to Revenue Canada but also to his employer so that mandatory tax deductions can be made.

[102] Subsection 238(1) of the Act sets out a summary conviction offence that is triggered by non-compliance with the filing requirements or with other of the Act's provisions - including subsections 231.1(1) and 231.2(1) and the documentary retention rules imposed by subsection 230(1) (see *Jarvis*, paragraph 55).

[103] For its part, section 239 creates a number of additional offences. In *Del Zotto, supra*, Strayer J.A., at paragraph 61, described section 239 as a section "designed to ensure compliance with the self-reporting requirements of the *Income Tax Act*". The existence in the Act of section 239 does nothing to alter its regulatory or administrative nature but rather ensures that taxpayers act in conformity with its requirements. Non-compliance with the mandatory provisions of the Act can, however, lead to criminal charges being laid under section 239, which bears the formal hallmark of criminal legislation.

[104] At that stage, the Charter must receive contextual application (*Jarvis*, at paragraph 63). The powers of the Minister, under subsections 231.1(1) and 231.2(1), which are available "for any purpose related to the administration or enforcement" of the Act, do not include the prosecution of offences under section 239 (*Jarvis*, at paragraph 78). Recourse must be had to subsection 231.3(1), which sets out an *ex parte* application process for a warrant to search "for any document or thing that may afford evidence [of] the commission of [the] offence [under this Act]" (*Jarvis*, at paragraph 81).

Digitized by Google

[105] The Court in *Jarvis* noted, at paragraph 88, that "where the predominant purpose of a particular inquiry is the determination of penal liability, CCRA officials must relinquish the authority to use inspection and requirement powers under ss. 231.1(1) and 231.2(1)" of the Act. The Minister must then apply to the court for a search warrant pursuant to section 231.3 of the Act. At that stage, officials have crossed the Rubicon. The adversarial relationship between the taxpayer and the state is engaged and the inquiry has become an investigation (paragraph 88).

[106] An analysis is required to determine whether the Rubicon has been crossed (*Jarvis*, at paragraph 88). The predominant purpose of the inquiry in question may be found in a clear decision to pursue a criminal investigation. Apart from that clear decision, one must weigh all the factors that have a bearing on the nature of the inquiry in order to characterize the inquiry. A finding on the predominant purpose of an inquiry is a question of mixed fact and law. In *Jarvis*, at paragraphs 88, 93 and 94, the Court sets the test in the following manner:

[88] [...] In essence, officials "cross the Rubicon" when the inquiry in question engages the adversarial relationship between the taxpayer and the state. There is no clear formula that can answer whether or not this is the case. Rather, to determine whether the predominant purpose of the inquiry in question is the determination of penal liability, one must look to all factors that bear upon the nature of that inquiry.

[Emphasis added.]

[...]

[93] To reiterate, the determination of when the relationship between the state and the individual has reached the point where it is effectively adversarial is a contextual one, which takes account of all relevant factors. In our opinion, the following list of factors will assist in ascertaining whether the predominant purpose of an inquiry is the determination of penal liability. Apart from a clear decision to pursue a criminal investigation, no one factor is necessarily determinative in and of itself, but courts must assess the totality of the circumstances, and make a determination as to whether the inquiry or question in issue engages the adversarial relationship between the state and the individual.

[Emphasis added.]

[94] In this connection, the trial judge will look at all factors, including but not limited to such questions as:

[Emphasis added.]

(a) Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation could have been made?

(b) Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?

(c) Had the auditor transferred his or her files and materials to the investigators?

(d) Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?

(e) Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?

(f) Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea*, is the evidence relevant only to the taxpayer's penal liability?

(g) Are there any other circumstances or factors that can lead the trial judge to the conclusion that the compliance audit had in reality become a criminal investigation?

[Emphasis in original.]

Digitized by Google

[107] The Minister acknowledged that criteria (*c*), (*d*), (*e*) and (*g*) of the analysis did not apply since at no time was the Audit Section of CCRA ever involved. The Motions Judge noted, at paragraph 84 of his reasons, that although the list of factors was not exhaustive, his analysis would focus on factors (*a*), (*b*) and (*f*).

[108] The Motions Judge did not, however, proceed with an analysis of the three factors he mentioned. He quoted an excerpt from Faribault's testimony in examination for discovery and then promptly concluded that, "from the outset", the predominant purpose of the investigation
was the determination of penal liability. He said at paragraph 90, which I repeat, that:
The evidence on the record as a whole leads to the conclusion that the predominant purpose of the investigation of CCRA, from its outset, was prosecution of the applicants for tax evasion and eventual imposition of penal sanctions against them. The statements on discovery by Faribault are not the only indicia of this predominant purpose; they are simply among the most succinct elements of evidence which support this conclusion. Accordingly, I find that the predominant purpose of the investigation was prosecution of the applicants for tax evasion.
Yet, the Motions Judge pointed to not even one of the indicia he found, "on the record as a whole", to support his conclusion.
[109] The Supreme Court of Canada in *Jarvis*, at paragraph 100, stated:
Whether or not a given inquiry is auditorial or investigatory in nature is a question of mixed fact and law. It involves subjecting the facts of a case to a multi-factored legal standard (Canada (Director of Investigation and Research) v. Southam Inc., [1997] 1 S.C.R. 748, at para. 35) and, accordingly, Judge Fradsham's finding is not immune from appellate review.
[110] That same Court observed in *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235, that questions of law can sometimes be mistaken for questions of mixed fact and law. Iacobucci and Major JJ. wrote at paragraph 27:

[27] Once it has been determined that a matter being reviewed involves the application of a legal standard to a set of facts, and is thus a question of mixed fact and law, then the appropriate standard of review must be determined and applied. Given the different standards of review applicable to questions of law and questions of fact, it is often difficult to determine what the applicable standard of review is. In Southam, supra, at para. 39, this Court illustrated how an error on a question of mixed fact and law can amount to a pure error of law subject to the correctness standard:
... if a decision-maker says that the correct test requires him or her to consider A, B, C, and D, but in fact the [page258] decision-maker considers only A, B, and C, then the outcome is as if he or she had applied a law that required consideration of only A, B, and C. If the correct test requires him or her to consider D as well, then the decision-maker has in effect applied the wrong law, and so has made an error of law.
Therefore, what appears to be a question of mixed fact and law, upon further reflection, can actually be an error of pure law.
[111] The absence of a proper application of the legal test to the facts in the case at bar would justify this Court to intervene if an error of law or of mixed fact and law is committed. The standard of review on appeal is one of correctness.
[112] Before I go into the detailed examination of factors (*a*) (*b*) and (*f*) of the list in *Jarvis* which were mentioned by the Motions Judge, I must examine whether there was, in the words of the Supreme Court of Canada, at paragraph 93 of *Jarvis*, "a clear decision to

Digitized by Google

pursue a criminal investigation".
[113] The evidence is clear that Faribault suspected that a tax evasion had occurred and was mandated by CCRA to investigate the matter.
[114] Faribault explained in his cross-examination the principal purpose of his investigation (A.B., p. 120, questions 72 to 74):

72. Q- Dans le présent dossier. . . ici, on mentionne "Où l'on soupçonne qu'il y ait eu évasion fiscale", dans le présent dossier, vous aviez des soupçons qu'il y. . . qu'il y avait eu évasion fiscale au moment où vous avez émis les demandes péremptoires, c'est exact ?
R- Des soupçons ? Oui.
73. Q- Donc. . . et votre principale responsabilité comme enquêteur des enquêtes spéciales était de. . . d'enquêter dans ce cas qui occupe les requérants ici. . .
R- Oui.
74. Q- . . . dans le but de recueillir des preuves de toute infraction criminelle, conformément au paragraphe 7, qui ont pu être commises, et si de telles preuves sont recueillies, de prendre les. . . des dispositions en vue de porter l'affaire devant les tribunaux en vertu de l'article 239 de la loi ?
R- Oui.
[Emphasis added.]
[115] He admitted that, while the principal objective of his investigation was to look for evidence of tax evasion, special investigations do not always lead to such a finding and may result in a reassessment. He stated (A.B., p. 132, questions 129-132):
129. Q- Alors, votre objectif, donc. . . si je comprends bien, votre objectif principal à l'égard des requérants était d'établir qu'ils aient commis une évasion fiscale, c'est ça ?
R- Enquêter l'évasion fiscale, oui. . .
130. Q- Oui.
R- . . . c'est. . .
131. Q- Mais si évidemment, ça arrivait pas en bout de ligne, vous avez toujours l'opportunité de cotiser au civil ?
R- Voilà.
132. Q- O.K. O.K. Mais vous êtes pas en train de me dire que votre objectif principal dans le dossier ici, c'était simplement d'établir des cotisations d'impôt ?
R- Non. . .

[Emphasis added.]
[116] The following specific questions were later put to him and the following answers were given (A.B., p. 145, questions 164-167):
164. Q- Puis dans le présent dossier, comme vous l'avez mentionné tantôt, vous entreteniez des soupçons qui ont. . . qui ont résulté, là, à l'enquête que vous avez amorcée, mais vous nous dites que vous ne. . . n'aviez pas des motifs encore, là, raisonnables et probables de croire qu'une infraction d'évasion fiscale avait été commise ?
R- Oui.
165. Q- Donc vous avez pas procédé, là, à. . . à demander un mandat de perquisition ?
R- Non.
166. Q- Vous avez plutôt procédé par le biais de demandes péremptoires ?
R- Oui.
167. Q- Selon l'article 231.2 de la loi ?
R- Oui.

Digitized by Google

[Emphasis added.]

[117] The characterization of whether "a clear decision to pursue a criminal investigation" was made, is not to be considered with a pure criminal law perspective in mind. Quite the contrary, it flows from the nature and purpose of the Act which is essentially administrative and regulatory.

[118] When Faribault's statements are analysed in context, it cannot be said, under the *Jarvis* test, that a clear decision had been made to pursue a criminal investigation. Nothing of that sort could have been decided at that stage. The directive given by CCRA to Faribault was an assignment to look principally for evidence of a penal nature. It cannot be drawn from that directive that CCRA had made the decision to pursue a criminal investigation. Such decision could not be made. CCRA had no evidence on which to base such a decision and no search warrant could have been issued to implement it.

[119] The principle applicable in income tax cases is that the Minister must be capable of exercising his broad supervisory powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act (*Jarvis*, at paragraph 89). Faribault's firm intent and directive did not act as shackles. No adversarial relationship had yet crystalized between the parties (*Jarvis*, at paragraph 88, *Ling*, at paragraph 30). CCRA had not yet crossed the Rubicon.

[120] The gathering of evidence, through the administrative process, could therefore legally continue. The request to produce documents, which taxpayers are required to keep under section 230 of the Act, is in order. The gathering of evidence must cease when the collaboration of the taxpayer could cause his auto-incrimination. CCRA has then the duty to warn the taxpayer of such a potential consequence. The taxpayer may in turn invoke the protection of the Charter.

At that stage, either through a clear decision or *de facto*, CCRA chooses to pursue a criminal investigation. Before that stage has been reached, and when only a directive to look principally for evidence of a penal nature has been given, it cannot be said that a criminal investigation has begun. Faribault entertained suspicion. He had a clear mandate, a strong intent but no evidence whatsoever. At paragraph 90 of *Jarvis* it is said:

[...] On what evidence could investigators ever obtain a search warrant if the whiff of suspicion were enough to freeze auditorial fact-finding? The state interest in prosecuting those who wilfully evade their taxes is of great importance, and we should be careful to avoid rendering nugatory the state's ability to investigate and obtain evidence of these offences.

[121] The absence of evidence is not an irrelevant consideration. It goes to the essence of the making of a "clear decision to pursue a criminal investigation". A clear decision must be distinguished from the appearance of a decision. What is the reality of a decision if the decision-maker knows from the start that he cannot implement it?

[122] It is my view that "a clear decision to pursue a criminal investigation" had not been made and could have been made at that preliminary stage. Paragraphs 88 and 93 of *Jarvis* stand for the proposition that it is for the judge to objectively assess the nature of the inquiry and determine whether a clear decision is made to pursue the taxpayer for a criminal offence. If a clear decision is made, an analysis of the enumerated factors is not necessary. A contextual analysis of circumstances and attitudes is superfluous, because the evidence is clear. I do not understand *Jarvis* to say, however, that from a mere directive to conduct principally a penal investigation in circumstances where there is not one iota of evidence and where no search warrant can be issued, one can draw the conclusion that a decision to

Digitized by Google

pursue a criminal investigation has been made.
[123] I now turn to a detailed analysis of factors (*a*), (*b*) and (*f*) of *Jarvis*. This will allow me to further explain my position.

(a) Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation could have been made?
[124] Faribault, at paragraph 22 of his affidavit, made it clear that:
[...] au moment de l'émission de cette demande préemptoire, je n'avais aucun motif raisonable et probable de croire à la commission d'une infraction d'évasion fiscale par la requérante.
[125] He repeated that proposition during his testimony (A.B., page 145).
[126] The evidence shows that at the time the requirements were issued, the authorities did not have reasonable grounds to lay charges. It is clear from the record that a decision to proceed with a criminal investigation could not have been made at that point.
(b) Was the general conduct of the authorities consistent with a criminal investigation?
[127] The fact that Faribault had a long experience with CCRA, that he was the sole person assigned to the inquiry directed at the corporate appellants, that he suspected that a tax evasion
had occurred, that his main responsibility was to gather evidence of a criminal offence and that, if found, he was to bring the matter before the court under the penal provision of section 239 of the Act, do not lead to the conclusion that a criminal investigation is in process as these words are to be understood in an income tax context. In *Jarvis*, the Supreme Court of Canada accepted that criminal investigations and administrative audits may be conducted in parallel (paragraph 97). It said that the mere existence of reasonable grounds that an offence may have occurred is by itself insufficient to support the conclusion that the predominant purpose of an inquiry is the determination of penal liability (*Jarvis*, at paragraph 89). All the more, the test cannot be set at the level of mere suspicion that an offence has occurred. Even where reasonable grounds to suspect an offence exist, it will not always be true that the inquiry has become an investigation. The Minister must be capable of exercising his broad supervisory powers whether or not he has reasonable grounds for believing a particular taxpayer has breached the Act. The existence of reasonable grounds is not a sufficient indicator that CCRA is conducting a *de facto* investigation. In most cases, if all ingredients of an offence are reasonably thought to have occurred, it is likely that the investigation function is triggered. Paragraphs 88 to 90 of *Jarvis* set the tests in the following manner:
[88][...] In essence, officials "cross the Rubicon" when the inquiry in question engages the adversarial relationship between the taxpayer and the state. There is no clear formula that can answer whether or not this is the case. Rather, to determine whether the predominant purpose of the inquiry in question is the determination of penal liability, one must look to all factors that bear upon the nature of that inquiry.

[89] To begin with, the mere existence of reasonable grounds that an offence may have occurred is by itself insufficient to support the conclusion that the predominant purpose of an inquiry is the determination of penal liability. Even where reasonable grounds to suspect an offence exist, it will not always be true that the predominant purpose of an inquiry is the determination of penal liability. In this regard, courts must guard against creating procedural shackles on regulatory officials; it would be undesirable to "force the regulatory hand" by removing the possibility of seeking the lesser administrative penalties on every occasion in

Digitized by Google

which reasonable grounds existed of more culpable conduct. This point was clearly stated in McKinlay Transport, supra, at p. 648, where Wilson J. wrote: "The Minister must be capable of exercising these [broad supervisory] powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act." While reasonable grounds indeed constitute a necessary condition for the issuance of a search warrant to further a criminal investigation (s. 231.3 of the ITA; Criminal Code, s. 487), and might in certain cases serve to indicate that the audit powers were misused, their existence is not a sufficient indicator that the CCRA is conducting a de facto investigation. In most cases, if all ingredients of an offence are reasonably thought to have occurred, it is likely that the investigation function is triggered.

[90] All the more, the test cannot be set at the level of mere suspicion that an offence has occurred. Auditors may, during the course of their inspections, suspect all manner of taxpayer wrongdoing, but it certainly cannot be the case that, from the moment such suspicion is formed, an investigation has begun. On what evidence could investigators ever obtain a search warrant if the whiff of suspicion were enough to freeze auditorial fact-finding? The state interest in prosecuting those who wilfully evade their taxes is of great importance, and we should be careful to avoid rendering nugatory the state's ability to investigate and obtain evidence of these offences.

[Emphasis added.]

[128] The Rubicon is crossed when the inquiry in question engages the adversarial relationship between the taxpayer and the state (*Jarvis*, at paragraph 88).

[129] At paragraph 97, the Court further explains in *Jarvis* that if an investigation into penal liability is subsequently commenced, the investigators can avail themselves of the information obtained pursuant to the audit powers prior to the commencement of the criminal investigation but not with respect to information obtained pursuant to the commencement of the investigation into penal liability. This is no less true where the investigations into penal liability and tax liability are in respect of the same tax period.

[130] The test set by the Supreme Court to determine when an administrative audit has become a criminal investigation is a demanding one. The evidence in the case at bar shows that the general conduct of the authorities was not consistent with a criminal investigation under the *Jarvis* test at the time the requirements were issued because the Rubicon had not and could not be crossed.

(f) Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea*, is the evidence relevant only to the taxpayer's penal liability?

[131] Faribault's affidavit indicates that he was given the principal responsibility to gather evidence of a criminal offence and, if found, to bring the matter before the court under the penal provision of section 239 of the Act. Faribault did not indicate, however, whether that was the

only evidence sought except to say that if no evidence of a penal nature was found, he had jurisdiction to reassess and impose a penalty under section 163 of the Act (see A.B. at p. 76, paragraphs 10 and 11, and p. 119, question 68).

[132] The record does not allow a calculation that would determine if a reassessment could be done in a timely fashion since we have no evidence of the date of mailing of the various notices of assessments. It may be that the Minister would still be in time for a reassessment for the 1998 taxation year in the cases of Les Plastiques Algar (Canada) Ltée and Modern Wood Fabricators (M.W.F.) Inc., but one can only speculate. Faribault's mandate was however clear. He was definitely looking for evidence relevant to the appellants' penal liability. This was the principal evidence he was looking for.

[133] The statement of Faribault, mentioned in the above paragraph, read in the light of

Digitized by Google

the two other relevant factors, does not detract however from the fact that CCRA did not and could not make a clear decision to cross the Rubicon when the letters were issued. The superior interest of the income tax system must therefore prevail.

[134] The fact that CCRA started the inquiry after the Montreal Rabbinical College was cleared of the charges against it does not alter my conclusion. The Motions Judge erred by misapplying the legal tests elaborated in *Jarvis.*

VII. Conclusion

[135] I conclude from the evidence that the Minister is still capable of exercising these broad supervisory powers given to him under subsections 231.1(1) and 231.2(1) of the Act.

[136] The requirements are valid and I need not consider the third issue raised in this appeal, namely whether the appellants' Charter rights were violated.

[137] I must stress, however, that the Motions Judge made another error in the context of his reasons for judgment. Having concluded that the predominant purpose of the inquiry had become criminal in nature, a conclusion I do not share, he nevertheless concluded in the end that the requirements directed at the corporate appellants were valid under the Charter. That, he could not do.

[138] In *Jarvis*, Iacobucci and Major JJ. stated at paragraph 78 that by their express terms, both subsections 231.1(1) and 231.2(2) of the Act are available "for any purpose related to the administration or enforcement" or, in French, "pour l'application et l'exécution" of the Act. And that although these terms are, at first glance, extremely broad, they do not include the prosecution of section 239 offences. At paragraph 88, they observed that "where the predominant purpose of a particular inquiry is the determination of penal liability, CCRA officials must relinquish the authority to use the inspection and requirement powers under ss. 231.1(1) and 231.2(1)" of the Act. Search warrants under section 231.3 of the Act or section 487 of the *Criminal Code* are then required (paragraph 83).

[139] Having found that a criminal investigation had begun, a conclusion, I repeat, I do not share, the Motions Judge could not have concluded to the validity of the requirements under the Charter. As a matter of statutory construction, search warrants would have been required if such a situation had arisen.

VIII. Disposition

[140] For the above reasons, I would dismiss this appeal with costs.

"Alice Desjardins"

J.A.

Jean Breau v. The Minister Of National Revenue, 2013 FCA 215, Appeal Court Disagreeing to Interfere with RFI Due to PURPORTED CRIMINAL Investigation

REASONS FOR JUDGMENT OF THE COURT

(Delivered from the Bench at Toronto, Ontario, on September 16, 2013).

STRATAS J.A.

[1] Mr. Breau appeals from the judgment dated October 17, 2012 of the Federal Court (*per* O'Reilly J.): 2012 FC 1207.

[2] In the Federal Court, Mr. Breau applied for judicial review of the respondent Minister's decision under the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1 to require Mr. Breau and others to provide information concerning a particular tax plan. The Federal Court dismissed the application for judicial review.

[3] Before the Federal Court, Mr. Breau submitted that the Minister issued the requirement

Digitized by Google

for the improper purpose of gathering evidence for a criminal investigation, contrary to section 7 of the Charter and the Supreme Court of Canada's decision in *R. v. Jarvis*, 2002 SCC 73, [2002] 3 S.C.R. 757.

[4] Examining the interactions between the Canadian Revenue Agency's audit and enforcement branches and applying *Jarvis* (especially paragraph 97), the Federal Court rejected Mr. Breau's submission. It held that the Minister's predominant purpose in issuing the requirement was civil in nature.

[5] In this Court, Mr. Breau accepts *Jarvis* as the controlling authority. In Mr. Breau's view, the Federal Court mischaracterized certain matters, thereby wrongly concluding the requirement was civil in nature. In particular, Mr. Breau that submitted the audit branch was acting as an agent for the enforcement branch in collecting evidence, the evidence gathered by the audit branch was relevant to penal liability, and the contact between the audit and enforcement branches while the criminal investigation was ongoing was important and significant.

[6] In our view, the Federal Court's rulings on these matters are questions of mixed fact and law suffused by fact. Therefore, in this Court, Mr. Breau must demonstrate palpable and overriding error in order to set them aside.

[7] This he has not done. In our view, the Federal Court examined the particular constellation of evidence before it, which included some isolated incidents of contact between the audit and enforcement branches after the criminal investigation started. Based on this constellation of evidence, it made defensible findings.

[8] In this Court, Mr. Breau also challenged the Federal Court's overall conclusion that the Minister's predominant purpose in issuing the requirement was civil in nature under the *Jarvis* test. We see no reversible error on the part of the Federal Court based on the particular evidence before it.

[9] In rejecting Mr. Breau's submissions, we do not foreclose a court in any later criminal proceedings from reaching a different conclusion if, based on the evidence then available, a different light is cast on the matter.

[10] For the foregoing reasons, we shall dismiss the appeal, with costs.

"David Stratas"

J.A.

Supporting Documents to Arrive at Stated Amounts

Since any type of document pertaining to a taxpayer's statements or transactions can be requested, it should come as no surprise that such would include any supporting documents used in arriving at the stated amounts, be they in the tax return itself, or in any statement made to the tax authorities.

This was the case in Javed Ahmad, Naheed Surrya Ahmad, Tahira Parveen Chaudhry, Khush B.R. Chaudhry V. The Minister Of National Revenue[82] where the taxpayers had supplied net worth statements to CRA on preliminary request, but CRA further asked for the supporting calculations that led to the amounts being presented. When contested the Ct. held:

PURPOSE OF THE REQUEST

[16] The evidence reveals that the Minister is auditing each applicant on his/her tax liability.

[17] The tax system is a self-reporting and self-assessing one and the Minister of National Revenue has the task of administering and enforcing the *Income Tax Act*. To achieve this purpose, Parliament enacted several provisions, among which section 231.2 of the *Income*

[82] T-2570-96

Digitized by Google

Tax Act, empowering the Minister to investigate and audit taxpayers.

[18] Pursuant to the demand made under paragraph 231.2(1)(a) of the Act, the applicants did provide signed statements of their net worth for the years 1991, 1992 and 1993. The respondent is not seeking, in these proceedings, to obtain information for 1989 and 1990.

[19] The respondent is seeking, under paragraph 231.2(1)(b) of the Act, the supporting documents and working papers relative to the preparation of the net worth statements which were signed and provided by the applicants through their accountant on July 10, 1995.

[20] To establish the tax position of each applicant, authorized officers of Revenue Canada are seeking to review the supporting documents and working papers relative to the preparation of the statements of net worth already provided to Revenue Canada in July 1995.

[21] The test to be applied in determining whether the Minister is acting for a purpose related to the administration and enforcement of the *Income Tax Act* was stated by the Supreme Court of Canada in *Canadian Bank of Commerce v. Attorney General of Canada*, [1962] S.C.R. 729 and applied by that same Court in *James Richardson & Sons, Ltd. v. M.N.R.*, [1984] 1 S.C.R. 614 at 623 as follows:

The Canadian Bank of Commerce case, however, makes it clear that the subsection is not to be construed that broadly. It establishes through the majority judgment written by Mr. Justice Cartwright as:

the test of whether the Minister is acting for a purpose specified in the Act is an objective one and has to be decided on the proper interpretation of the subsection and its application to the circumstances disclosed;

the obtaining of information relevant to the tax liability of some specific person or persons whose liability to tax is under investigation is a purpose related to the administration or enforcement of the Act;

it is not necessary that the person from whom the information is sought be one whose liability to tax is under investigation;

the fact that the giving of the information may disclose private transactions involving persons who are not under investigation and may not be liable to tax does not invalidate the Requirement.

[22] At this point, a tax audit is underway and the furnishing of the documents serves the purpose of continuing the audit of each of the applicants' taxable income for the years under review.

In Fraser Milner Casgrain LLP et al. v. MNR[83] the Minister served a RFI on the tax planning notes of a law firm in attempt to determine the rationale by which a set of transactions had been structured. They thought that GAAR (s. 245) applied and by obtaining the information they could better assess the situation. When contested the Trial Court held:

[5] Three of the Requirements ("Sale Strategy Memorandum Requirements") demand production of a Sale Strategy memorandum referred to in certain Fraser & Beatty invoices.

[6] The remaining six Requirements ("Tax Planning Requirements") demand production of certain documents relating to tax planning. The tax planning information is subject to a claim of solicitor-client privilege which is being adjudicated upon by the British Columbia Supreme Court.

[83] 2002 FCT 912

Digitized by Google

[7] The applicants also submit that:
The purpose of the Requirements was to determine whether there was an avoidance transaction as defined in subsection 245(3) of the Act, thereby attracting the potential application of the general anti-avoidance rule ("GAAR").
Other than the documents demanded by the Requirements, the Minister has been provided with access to all documents relating to the reorganization.
[8] Those facts are not admitted by the Minister. The Minister submits that the purpose of the Requirements was not only to determine whether there was an avoidance transaction, but also to verify the audit subjects' compliance with the Act.
…
[10] Two issues are raised with respect to the Requirements:
Should the purported Sale Strategy Memorandum Requirements be quashed because the invoices to which they refer do not contain any reference to a "Sale Strategy memorandum"?
Should the Tax Planning Requirements be quashed on the ground that they were not requested for any purpose related to the administration or enforcement of the Act?

ANALYSIS
Sales Strategy Memorandum Requirements

[12] The Minister admits that the Sale Strategy Memorandum Requirements cannot be complied with because no "Sale Strategy memorandum" is referred to in any of the invoices referred to in the Sale Strategy Memorandum Requirements.
[13] Therefore, the application will be allowed in respect of these requirements.

Tax Planning Requirements
[14] The applicants argue that the Tax Planning Requirements should be quashed because the Requirements only seek tax planning information, and that information is irrelevant to the issue of whether any of the transactions under investigation are avoidance transactions as defined in subsection 245(3) of the Act.
…
[15] More particularly, the applicants say that a requirement to provide information under section
of the Act is valid only if it is issued for a purpose related to the administration or enforcement of the Act. See: *James Richardson & Sons Ltd. v. Minister of National Revenue*, [1984] 1 S.C.R. 614 at page 623; *AGT Limited. v. Canada (Attorney General)*, [1997] 2 FC 878 (CA), leave to appeal to the Supreme Court of Canada denied [1997] SCC No 314.
[16] The applicants assert that while the Tax Planning Requirements were issued to determine if the reorganization is an avoidance transaction as described in subsection 245(3) of the Act, the purpose test contained in subsection 245(3) is objective, not subjective. See: *OSFC Holdings Ltd. v. The Queen*, 2001 FCA 260 at paragraph 46, leave to appeal to the Supreme Court of Canada refused [2001] SCC No. 522; *The Queen v. Canadian Pacific Limited*, 2001 FCA 398 at paragraph 16.
[17] Therefore, the applicants say that GAAR's applicability depends upon objective criteria and not upon the thoughts of a particular taxpayer. If it were otherwise, identical transactions and circumstances could lead to different tax results, depending solely upon the thoughts of a taxpayer. It is said that GAAR is not about thought, but rather applies equally whether a taxpayer consulted a tax lawyer or took no advice at all. It follows, it is said, that the tax planning information requested in the Requirements cannot be relevant. [18] Moreover, the applicants say that by making imprisonment a potential consequence of

Digitized by Google

the failure to comply with a requirement issued pursuant to section 231.2 of the Act, Parliament indicated its intention that such a requirement is to be issued sparingly and judiciously, and only where there is a purpose related to the administration or enforcement of the Act. Examining a taxpayer's thoughts is not such a purpose.

[19] In response to those submissions, the Minister says that, first, in order for a requirement issued under subsection 231.2(1) to be valid, it is not necessary that the information or documents requested be relevant for a particular issue. Second, the Minister says that the purpose of the Tax Planning Requirements was not merely to determine whether the transactions in the reorganization are avoidance transactions as defined in subsection 245(3) of the Act.

[20] Proper consideration of these submissions begins with subsection 231.2(1) of the Act which provides that the Minister may issue a requirement under this section "for any purpose related to the administration or enforcement of this Act".

[21] The scope of the Minister's power under the predecessor to this subsection was considered by the Supreme Court of Canada in *James Richardson & Sons, supra*, where it was determined that the scope of the Minister's power was not so broad as would appear on the face of the provision. Justice Wilson, writing for the Court at pages 622 and 623, wrote as follows:

The language of s. 231(3) of the *Income Tax Act* is unquestionably very broad and on its face would cover any demand for information made to anyone having knowledge of someone else's affairs relevant to that other person's tax liability. It would, in other words, if construed broadly, authorize an exploratory sortie into any taxpayer's affairs and require anyone having anything to contribute to the exploration to participate. It would not be necessary for the Minister to suspect non-compliance with the Act, let alone to have reasonable and probably grounds to believe that the Act was being violated as required in s. 231(4). Provided the information sought had a bearing (or perhaps even could conceivably have a bearing) on a taxpayer's tax liability it could be called for under the subsection.

The *Canadian Bank of Commerce* case, however, makes it clear that the subsection is not to be construed that broadly. It establishes through the majority judgment written by Mr. Justice Cartwright (as he then was) that:

the test of whether the Minister is acting for a purpose specified in the Act is an objective one and has to be decided on the proper interpretation of the subsection and its application to the circumstances disclosed;

the obtaining of information relevant to the tax liability of some specific person or persons whose liability to tax is under investigation is a purpose related to the administration or enforcement of the Act;

it is not necessary that the person from whom the information is sought be one whose liability to tax is under investigation;

the fact that the giving of the information may disclose private transactions involving persons who are not under investigation and may not be liable to tax does not invalidate the requirement.

[22] Justice Wilson went on, at page 624, to further clarify that a prerequisite to the statutory purpose is that someone's tax liability be the subject of investigation.

[23] This decision was referred to with approval by the Supreme Court of Canada in *R. v. McKinlay Transport Limited*, [1990] 1 S.C.R. 627, where the Court upheld the constitutionality of the predecessor to section 231.2. There, Justice Wilson, writing for the majority, observed at paragraph 38 that:

In my opinion, subsection 231(3) provides the least intrusive means by which effective monitoring of compliance with the *Income Tax Act* can be effected. It involves no invasion of a taxpayer's home or business premises. It simply calls for the production of records which

Digitized by Google

may be relevant to the filing of an income tax return. A taxpayer's privacy interest with regard to these documents *vis-a-vis* the Minister is relatively low. The Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them. At the same time, the taxpayer's privacy interest is protected as much as possible since section 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies.
[underlining added]

[24] In her analysis, Justice Wilson concluded, at paragraph 36, that the criteria established in the criminal context to be met in order for a search to be reasonable were not applicable to regulatory provisions under the Act. In particular, Justice Wilson found no requirement that there be reasonable grounds to believe that a requirement will lead to disclosure of something related to a particular assessment, or that only documents strictly relevant to the assessment may be authorized to be seized.

[25] In *AGT Ltd. v. Canada (Attorney General)*, [1996] 3 FC 505 (TD) Justice Rothstein, as he then was, considered the validity and enforceability of notices of requirements issued under subsection 231.2 (1) of the Act in circumstances where, among others, it was asserted by the taxpayer that much of the information sought by the Minister was irrelevant and where there were admissions in the cross-examination of the Minister's deponent to that effect. Justice Rothstein summarized the guiding principles with respect to subsection 231.2(1) as follows, at paragraph 17:

Having considered *Richardson* and *McKinlay*, I conclude:

The expectation of privacy in relation to business records is relatively low.

As long as the Minister's purpose is related to the administration and enforcement of the *Income Tax Act*, relevance of the material sought to a particular issue is not a prerequisite to a requirements notice under subsection 231.2(1).

Documents may be compelled even if they are not required to be prepared or kept under the *Income Tax Act*.

It is not necessary that a requirements notice set out the grounds or particulars for which the documents sought are required.

As long as the documents pertain to a genuine inquiry into the tax liability of a person, they may be the subject of a requirements notice under subsection 231.2(1).

[underlining added]

[26] Justice Rothstein's decision was upheld by the Federal Court of Appeal, [1997] 2 F.C. 878. At paragraphs 23 and 24 of that decision, Justice Desjardins for the Court wrote:

Under the *Income Tax Act*, the Minister is concerned with verifying the tax liability of the taxpayer which is first revealed in the taxpayer's return. It will often be "impossible to determine from the face of the return whether any impropriety has occurred in its preparation". Because of the nature of the conduct regulated by the *Income Tax Act*, there are, in many cases, no ways of determining whether proscribed conduct has been engaged in, short of studying the process by which a suspected corporation or business has made and implemented its decision. Investigatory mechanisms which force corporations and other businesses to divulge what they and only they can know about their internal affairs are part of the state's interest in the enforcement of the Act.

While an individual or a corporation's interest in having business strategies kept in confidence is recognized, the balancing no doubt favours the state. Wilson J. in *McKinlay* recognizes that the "Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them". There is an ultimate safeguard. Not all of those documents are necessarily admissible against the taxpayer in a court of law or in another proceeding. Only those in accord with the rules of evidence shall be admissible.

Digitized by Google

[underlining added] [27] I accept that from this jurisprudence the following principles emerge:

The determination of a taxpayer's tax liability is a purpose related to the administration and enforcement of the Act.

In order for a requirement to produce records to be valid, the Minister need not show the records will be relevant, he need merely show the records requested may be relevant.

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

[28] It follows, in my view, that even if the sole purpose of the Requirements was to determine whether there was an avoidance transaction, this does not impair the validity of the Requirements. Relevance to a particular issue is not a prerequisite, it is sufficient that the material may be relevant to the determination of a taxpayers' tax liability.

[29] Here, the Tax Planning Requirements were served upon a director, officer or agent for the audit subjects, and the tax planning documents sought pertain to their tax liability.

[30] Moreover, while without doubt the purpose test found in subsection 245(3) of the Act is objective, that does not necessarily make irrelevant the factual matrix which led to the transactions at issue, or preclude evidence as to what motivated certain actions. In applying the purpose test, the Court will look to all of the relevant facts and circumstances, determining intent at the time the transactions in question were carried out. Looking to what a party expected to receive from a transaction may be relevant, and a comparison of the amount of the estimated tax benefit to the estimated business earnings may be helpful. See, for example, the comments of the Federal Court of Appeal in *OSFC Holdings, supra*, at paragraph 58. [31] By way of further example, in *Duncan v. Canada* [appeal by *Water's Edge Village Estates (Phase II) Limited*] 2002 FCA 291, when considering whether the impugned transactions reasonably could be considered to have been undertaken primarily for a purpose other than to obtain a tax benefit, the Federal Court of Appeal had regard to the taxpayers' evidence as to their motivations and to the findings of fact made below with respect to that evidence. This evidence of motive was not excluded or considered irrelevant or inadmissible.

[32] Therefore, I am not satisfied that tax planning information is *per se* irrelevant to a proper subsection 245(3) analysis. In any event, even if such information is in the end found not to be relevant, as Justice Desjardins noted for the Federal Court of Appeal in *AGT Ltd., supra*, the ultimate safeguard is that the documents are not necessarily admissible against the taxpayers in another proceeding.

Accountant's Files While No Accountant-Client Privilege

Further, in Leslie Tower et al v. MNR et al[84] the Trial court had to consider whether there was accountant- client privilege over the tax files of a client when CRA issued a RFI in respect of them. It held:

[1] This is an application under section 18.1 of the *Federal Court Act*, R.S.C. 1985, c. F-7, for judicial review of two decisions of the Minister of National Revenue to issue two "Requirements to Provide Information", dated July 11, 2001 and July 18, 2001 respectively, requiring the applicants' accountants BDO Dunwoody LLP to provide all the tax files, tax planning documents and all other files relating to the applicants.

[84] 2002 FCT 929

Digitized by Google

[2] The issues in this application are (a) whether the documents and information in the possession of the applicants' accountants (the respondent BDO Dunwoody LLP) are subject to a privilege protecting them from disclosure, and (b) whether the Requirements are within the legal scope of subsection 231.2(1) of the *Income Tax Act* (the "*Act*").
[12] On July 11, 2001, the Minister prepared a 'Requirement to Provide Information' pursuant to paragraphs 231.2(1) of the *Act*. The Requirement was served on BDO Dunwoody's Kelowna BC office. The three- page Requirement requests a broad range of documents, including:
[...all documents in your possession for the period January 1, 1997 to July 10, 2001, relating to [the applicants], and any corporation the shares of which were owned by any of them, directly or indirectly at any time [...], including but not limited to:
All Working Paper files...]

All tax files and planning documents relating to, but not limited to, the taxpayers listed above.
All correspondence files including:
all correspondence in any form, including electronic, to or from any of the taxpayers above,
[...]

The reasons each individual sought financing through BDO as opposed to a lending institution.
The reason financing was required by each individual....]
[13] On July 18, 2001, a second Requirement was prepared and subsequently served on BDO Dunwoody's Calgary office. This document is similar to the first Requirement.
[14] The Requirements called for BDO Dunwoody to provide documents and information to the Minister, pertaining to the applicants' CIBC interest deductions and other business and tax matters related to the 1997 and subsequent taxation years. Both Requirements' due dates have been extended indefinitely pending the outcome of this matter.

ANALYSIS WITH RESPECT TO PRIVILEGE
[17] The applicants submit that their communications with their accountants should be protected by either a "class privilege", by virtue of the relationship akin to that between a solicitor and client, or by virtue of a "case- by-case privilege" if the party seeking the privilege meets the four-part test of *Wigmore* (*Wigmore, Evidence in Trials at Common Law*, vol. 8, McNaughton Revision, para. 2285).The Respondent BDO Dunwoody takes no position on whether a privilege applies.
[18] Privilege was discussed by by Lamer C.J. (as he then was) in *R.* v. *Gruenke* [Man. C.A. Indexed as: *R.* v. *Fosty*], [1991] 3 S.C.R. 263, [1991] S.C.J. No. 80 (S.C.C.). Part of this discussion is useful to clarify the issue here:
¶ ¶ 26 Before delving into an analysis of the issues raised by this appeal, I think it is important to clarify the terminology being used in this case. The parties have tended to distinguish between two categories: a "blanket", prima facie, common law, or "class" privilege on the one hand, and a "case-by-case" privilege on the other. The first four terms are used to refer to a privilege which was recognized at common law and one for which there is a prima facie presumption of inadmissibility (once it has been established that the relationship fits within the class) unless the party urging admission can show why the communications should not be privileged (i.e., why they should be admitted into evidence as an exception to the general rule). Such communications are excluded not because the evidence is not relevant, but rather because, there are overriding policy reasons to exclude this relevant evidence. Solicitor-client communications appear to fall within this first category (see: Geffen v. Goodman Estate, [1991] 2 S.C.R. 353 and Solosky v. The

Digitized by Google

Queen, [1980] 1 S.C.R. 821). The term "case-by-case" privilege is used to refer to communications for which there is a prima facie assumption that they are not privileged (i.e., are admissible). The case-by-case analysis has generally involved an application of the "Wigmore test" (see above), which is a set of criteria for determining whether communications should be privileged (and therefore not admitted) in particular cases. In other words, the case-by-case analysis requires that the policy reasons for excluding otherwise relevant evidence be weighed in each particular case.

Proposed Accountant-Client Class Privilege

[19] There is a high threshold for finding a class privilege. Solicitor-client privilege, the standard to which the applicant seeks to draw an analogy, is ensconced in the common law and is a fundamental and necessary aspect of the dealings between lawyers and their clients.

[20] BDO Dunwoody has a "client confidentiality policy", which reads, in part:

Client Confidentiality [...]

All information concerning the affairs of any client of the Firm must be held under strict confidence and will not be released or disclosed to any other party outside the office unless required by law or other specific written request by the client, and in all cases, it can be released only by a Partner.

[21] It is well established that accountants and their clients do not have a class privilege with respect to income tax litigation. The Federal Court of Appeal in *Baron* v. *Canada*, [1991] 1 F.C. 688 (F.C.A.), varied at [1993] 1 S.C.R. 416 (but not on this point) stated:

¶ ¶ 64 As far as the claim for accountant/client privilege is concerned, a claim based on a number of provisions of Quebec law, the Trial Judge said [at pages 292-293]:

Even if I accept that the law of Quebec provides for an accountant-client privilege in the context of litigation, I am not persuaded that such a rule has been adopted with respect to federal income tax litigation. If such a rule were intended to apply one would expect to find it expressly so provided in either the Canada Evidence Act [R.S.C., 1985, c. C-5] or the Income Tax Act.

and again [at pages 293-294]:

It is not at all strange that solicitor-client communications are privileged in so far as compellable evidence before the courts is concerned, while those between an accountant and client are not. The purpose of the solicitor-client privilege is to ensure free and uninhibited communications between a solicitor and his client so that the rendering of effective legal assistance can be given. This privilege preserves the basic right of individuals to prosecute actions and to prepare defences. As Mr. Justice Lamer indicated, in Descôteaux et al. v. Mierzwinski, [1982] 1 S.C.R. 860; (1982), 141 D.L.R. (3d) 590; 70 C.C.C. (2d) 385; 28 C.R. (3d) 289;1 C.R.R. 318; 44 N.R. 462 at page 883 S.C.R., the privilege is recognized because it is necessary for the proper administration of justice. I do not think there is an overriding policy consideration, of this nature, in the case of accountant-client communication. An accountant may, as a matter of professional ethics, be required to keep communications and other information concerning his or her client confidential. But this is not founded upon a need to ensure an effective system of the administration of justice.

¶ ¶ 65 We could see nothing to criticize in her treatment of either matter and accordingly did not require to hear from the respondents.

[emphasis added]

[22] Further, in 1997 this Court in *Vancouver Trade Mart Inc. (Trustee of)* v. *Canada (Minister of National Revenue - M.N.R.)*, [1997] F.C.J. No. 1467 (F.C.T.D.) reiterated that

Digitized by Google

communications between an accountant and his client are not privileged unless the communication was directed by a lawyer:

¶ 35 Jackett P. [in In Susan Hosiery Ltd. v. Minister of National Revenue, (1969) 69 D.T.C. 5278 (ex. ct.), following a discourse on the nature of solicitor client privilege] then went on to examine the application of the solicitor/client privilege to "accountant's materials". At 5283, he put it as follows:

Applying these principles, as I understand them, to materials prepared by accountants, in a general way, it seems to me

that no communication, statement or other material made or prepared by an accountant as such for a business man falls within the privilege unless it was prepared by the accountant as a result of a request by the business man's lawyer to be used in connection with litigation, existing or apprehended; and

that, where an accountant is used as a representative, or one of a group of representatives, for the purpose of placing a factual situation or a problem before a lawyer to obtain legal advice or legal assistance, the fact that he is an accountant, or that he uses his knowledge and skill as an accountant in carrying out such task, does not make the communications that he makes, or participates in making, as such a representative, any the less communications from the principal, who is the client, to the lawyer; and similarly, communications received by such a representative from a lawyer whose advice has been so sought are none the less communications from the lawyer to the client.

[emphasis mine]

[23] Counsel for the applicants rely upon *R.* v. *McClure,* [2001] S.C.J. No. 13, 2001 SCC 14 (S.C.C.) to show that there can be identified a new "class privilege" on a principled basis if the privilege is essential to the effective operation of the legal system. Major J. wrote:

¶ 28 For a relationship to be protected by a class privilege, thereby warranting a prima facie presumption of inadmissibility, the relationship must fall within a traditionally protected class. Solicitor-client privilege, because of its unique position in our legal fabric, is the most notable example of a class privilege. Other examples of class privileges are spousal privilege (now codified in s. 4(3) of the Canada Evidence Act,
R.S.C. 1985, c. C-5) and informer privilege (which is a subset of public interest immunity).

¶ 29 Other confidential relationships are not protected by a class privilege, but may be protected on a case-by-case basis. Examples of such relationships include doctor-patient, psychologist-patient, journalist-informant and religious communications. The Wigmore test, containing four criteria, has come to govern the circumstances under which privilege is extended to certain communications that are not traditionally-recognized class privileges (Wigmore, supra, at p. 527):

The communications must originate in a confidence that they will not be disclosed.

This element of confidentiality must be essential to the full and satisfactory maintenance of the relation between the parties.

The relation must be one which in the opinion of the community ought to be sedulously fostered.

The injury that would inure to the relation by the disclosure of the communications must be greater than the benefit thereby gained for the correct disposal of litigation.

[emphasis mine]

Digitized by Google

[24] Therefore *McLure* does not extend the protection of a class privilege, however, leaves open the possibility of a case-by-case privilege following the *Wigmore* test.
[25] The applicants submit that tax advice from an accountant with respect to the *Income Tax Act* is no different than tax advice from a lawyer and, accordingly, ought to be accorded the same class privilege. I cannot agree for the reasons referred to by Mr. Justice Lamer (as he then was) in *Descôteaux, supra*. Privilege for lawyer-client communications is necessary for the proper administration of justice as it preserves the basic right of individuals to prosecute actions and to prepare defences. None of this applies to a client's communications with an accountant because the accountant does not represent the client with respect to the administration of justice.
[26] Therefore, no class privilege attaches to the material set out in the Requirements.
Case-by-Case Privilege
[27] I deal next with the alternative claim of "case-by-case privilege" as set out in *Wigmore*, based on the analogy of advice from a tax accountant as being akin to advice from a tax lawyer, and entitled to similar protection. The Wigmore test was set out by Lamer C.J. in *R.* v. *Gruenke, supra.*:
¶ ¶ 22 Given that the Wigmore criteria play a central role in this case, I will set out the "test" below for ease of reference (Wigmore, Evidence in Trials at Common Law, vol. 8, McNaughton Revision, para. 2285):
The communications must originate in a confidence that they will not be disclosed.
This element of confidentiality must be essential to the full and satisfactory maintenance of the relation between the parties.
The relation must be one which in the opinion of the community ought to be sedulously fostered.
The injury that would inure to the relation by the disclosure of the communications must be greater than the benefit thereby gained for the correct disposal of litigation.
[28] In my view, the applicants fail the *Wigmore* test. The relationship between a client and his tax accountant is not one which in the opinion of the community ought to be sedulously fostered. The *Income Tax Act* is complicated and individuals rely upon their accountants to prepare their returns and to deal with the tax department about their returns. The records which a client provides his accountants are his income tax records, and must be produced upon demand so that the tax department can verify or question an individual's tax return. Clients understand that information must be produced to the tax department upon demand.
[29] Moreover, the "community" of North America is currently experiencing a crisis of confidence in the accounting of financial information with respect to many public companies, and public outrage over accounting misdeeds (such as with Enron Corporation and Worldcom Inc.). Such events, and the resulting outcry, are illustrative of the view of the "community" that a client-accountant privilege is not to be "sedulously fostered" as per Wigmore.

The taxpayer further argued that the legal scope of the RFI was at issue, that it was beyond the limits of what the ITA allows for which is the securing of any information that relates to the tax affairs of the taxpayer. The court held:

ANALYSIS WITH RESPECT TO THE LEGAL SCOPE OF THE REQUIREMENTS
[30] The applicants and the respondent BDO Dunwoody challenge the legal scope of the Requirements as being too broadly drawn and authorizing "an exploratory sortie" or "fishing expedition" into the applicants' affairs beyond the subject of the Minister's "genuine and serious inquiry" with respect to the loans from the CIBC and the deduction of the

Digitized by Google

interest costs of these loans in the applicants' last two tax years prior to leaving Canada. Moreover, the Requirements demand that BDO Dunwoody not only provide documents and information with respect to the applicants, but "subjective" explanations as to the purpose and intention of the applicants with respect to the loan transactions and their decision to emigrate from Canada. In the applicants' submission, this is beyond the scope of the Requirements.

[31] The case law is clear that the Requirements under subsection 231.2(1) of the *Income Tax Act* cannot be construed, as the Supreme Court of Canada held in *Richardson* v. *Minister of National Revenue*, [1984] 1 S.C.R. 614, to "authorize an exploratory sortie into any taxpayer's affairs and require anyone having anything to contribute to the exploration to participate". The Court stated that it would be necessary for the Minister to suspect a taxpayer's non-compliance with the *Act* and to require information which had a bearing on the taxpayer's tax liability.

Evidence from the Minister's Representative

[32] The Minister's representative, Mr. S.M. Marischuk, deposed at paragraph 13 of his affidavit that the applicants are the subject of audits to determine their correct tax liability. He testified that the Requirements relate to this general audit, as well as the only "serious and genuine inquiry" identified to date: whether the applicants are entitled to the interest expense deduction on the loan transactions, which the Minister characterizes as a "Departure Trade".

Test of Relevancy and Reasonableness under Subsection 231.2(1)

[33] In *AGT Limited v. The Attorney General of Canada* (1997) 97 D.T.C. 5189, [1997] F.C.J. No. 398 (F.C.A.), the Federal Court of Appeal held that the requirement to provide information under subsection 231.2(1) is drafted in broad language but has been "reduced through the rules of interpretation" to situations where the information sought by the Minister is relevant to the tax liability of a specific person and the tax liability of such person is the subject of a "genuine and serious inquiry". The Court found that it is often impossible to determine whether an impropriety has occurred in the preparation of a tax return without studying the process by which a suspected business or person has made and implemented a decision. The Court held at page 5193:

"....[I]nvestigatory mechanisms which force corporations and other businesses to divulge what they and only they can know about their internal affairs are part of the state's interest in the enforcement of the Act. While an individual or a corporation's interest in having business strategies kept in confidence is recognized, the balancing [sic] no doubt favours the state..."

[34] The Court of Appeal further stated that the Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them.

[35] In the case at bar, the general tax liability of the applicants is the subject of an audit. This is a genuine and serious inquiry as required in *AGT, supra*.

[36] Under the *Act*, the Minister is entitled to require the production of "information" for the purpose of studying "the process by which a suspected corporation or business has made and implemented its decision". The applicants seek to restrict the Requirements to only information relevant to the loans from the CIBC to the applicants at the end of the 1997 tax year. I cannot unduly restrict the Minister's right to require the production of information to only these loans. These loans triggered a concern with verifying the general tax liability of the applicants. The tax liability of the applicants is the subject of a genuine and serious audit and the Requirements thereby meet the test of relevancy and reasonableness.

[37] When the applicants decided to emigrate from Canada and undertake sophisticated multi-million dollar loans to obtain income tax deductions to off-set off capital gains on

Digitized by Google

leaving Canada, it is reasonable to expect that the Minister may audit the applicants not only with respect to the loan transactions, but also with respect to their total income tax liability.

Subjective Information

[38] The applicants and BDO Dunwoody object to the parts of the Requirements that BDO Dunwoody create and produce documents and information which does not exist. The Requirements ask individuals at BDO prepare new documents with their subjective understanding of the intention of the applicants and BDO. [39] The broad powers of subsection 231.2(1) require the production of documents and information in existence. It is not framed so broadly that accountants can be required to respond to written interrogatories. This subsection does not authorize the Minister to demand responses to written interrogatories. If subsection 231.2(1) of the *Act* were intended to be so broad as to provide the Minister with the option to conduct a written examination for discovery, Parliament would have so provided. Accordingly, the parts of the Requirements which require the creation of responses to questions are outside the legal scope of subsection 231.2(1) of the *Act*, and will be set aside.

[40] In *R.* v. *McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627, [1990] S.C.J. No. 25 (S.C.C.), the Supreme Court considered the nature of the Requirement to Provide Information. That Court's findings were summarize by the Federal Court of Appeal in *Bisaillon* v. *Canada*, [1999] F.C.J. No. 1477 (F.C.A.) at paragraph 3, as follows:

the Act is essentially a regulatory measure;

s. 231(3) (the predecessor of s. 231.2(1)) is not criminal or quasi-criminal law; [...]

in a taxation system based on the principle of self-reporting and self-assessment, the Minister of National Revenue has to have broad powers to audit taxpayers' returns and inspect records which may have been used to prepare those returns;

the Minister of National Revenue must be able to exercise these powers whether or not he has reasonable grounds to believe that a particular taxpayer has breached the Act;

s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the Act can be carried out; and

the taxpayer's privacy interest with regard to documents which may be relevant in income tax returns is relatively low in relation to the Minister.

[41] Implicit in the Supreme Court's decision is the concept that a Requirement to Provide Information under the *Act* only applies to documents and other records already in existence.

[42] Any ambiguity as to the information subject to a Requirement under subsection 231.2(1) shall be resolved in favour of the taxpayer. See *Seaspan International Ltd.* v. *Canada,* [2002] F.C.J. No. 911(F.C.T.D.) as per Blais J.:

¶ ¶ 40 [... The Supreme Court of Canada has already repeated many times that any ambiguities found in the taxing statutes shall be resolved in favour of the taxpayer as per Mr. Justice Estey in Johns-Manville Canada Inc. v. The Queen, 85 D.T.C. 5373 (SCC) at 5384 where he stated:

Such a determination is, furthermore, consistent with another basic concept in tax law that where the taxing statute is not explicit, reasonable uncertainty or factual, ambiguity resulting from lack of explicitness in the statute should be resolved in favour of the taxpayer.

¶ ¶ 41 In addition, Justice Sopinka of the Supreme Court of Canada held in Fries v. The Queen, 90

D.T.C. 6662 (SCC) said that:

We are not satisfied that the payments by way of strike pay in this case come within the definition of 'income... from a source' within the meaning of s. 3 of the Income Tax Act. In these circumstances the benefit of the doubt must go to the taxpayers.

[43] Therefore, the scope of the Minister's power in a Requirement to Provide

Digitized by Google

Information under 231.2(1) extends to documents and records already in existence. The power does not provide the Minister with the right to conduct a written examination for discovery.

Right to Redaction to Expunge Names of Any Person Unrelated to the Applicants
[44] If any of the documents or information to be produced under the Requirements refer to a client of BDO Dunwoody unrelated to the applicants, BDO Dunwoody has the right to redact the documents to expunge that person's name before the document or information is submitted.

On appeal[85] the Appeal Ct. had to consider 4 issues raised by the taxpayer:

- *Whether the RFI could be made in such a way as to compel the taxpayers tax accountants to actually create relevant documents (answer questions posed to them by CRA),*
- *Whether the taxpayer's tax accountants had a right of redaction of non-related party identities,*
- *Whether there existed a class-privilege over the communications between the taxpayer and his tax accountants that would prevent the documents from being released, and*
- *Whether the RFI was based on the legality of administration and enforcement of the Act.*

The judgment is well worth reading as an Appeal case that speaks of so many issues regarding this important instance and it provided:

[2] In his Requirements, dated July 11 and July 18, 2001, the Minister required BDO Dunwoody (Dunwoody), the accountants for Bruce Kitsch, Leslie Tower and Robert Tower (the Taxpayers) to deliver up all the tax files, tax planning documents and all of the files relating to the Taxpayers, and to provide written responses to certain questions. The Applications Judge ordered the Taxpayers to comply with the Minister's Requirements, except for those parts which required written responses to questions, or which compelled Dunwoody to create new documents; these latter demands being said to be outside the scope of subsection 231.2(1).
<u>On Appeal</u>

- does subsection 231.2(1) allow Dunwoody to refuse to answer the Minister's written questions or to create new documents?
- does subsection 231.2(1) permit Dunwoody to redact, that is, remove, confidential references and information in respect of persons other than the Taxpayers from the documents to be delivered in response to the Minister's Requirements?

<u>On Cross-appeal</u>
were the Requirements issued for the purpose of the administration and enforcement of the Act within the meaning of section 231.2?
was certain of the requested material that was prepared by Dunwoody for the purpose of providing tax advice to the Taxpayers privileged?
[11] The Requirements required production of numerous documents, including all tax files, planning documents, working paper files, permanent files, records, minutes or notes of all conversations or meetings, detailed billings, detailed telephone records, promotional material, and correspondence relating to the Taxpayers. In addition, they required

[85] Minister of National Revenue v. Bruce Kitsch et al, 2003 FCA 307

Digitized by Google

answers to a number of questions to be answered by Mr. Hughes, the Taxpayers' accountant at the Kelowna office of Dunwoody, and Mr. Butalia. The questions would appear to be designed to elicit facts that were likely to be within the knowledge of Mr. Hughes and Mr. Butalia. There has been no suggestion that Mr. Hughes and Mr. Butalia did not possess the knowledge required to answer the questions. However, the Minister conceded that if they did not possess the information, an answer to that effect would have complied with the Requirements.

[12] The Taxpayers and Dunwoody commenced an application for judicial review challenging the validity of the Requirements, and also making a claim of privilege with respect to the required documents and information. The Applications Judge allowed the application in part. He found that the general tax liability of the Taxpayers was the subject of a genuine and serious inquiry by the Minister, and that the Requirements met the tests of relevance and reasonableness established by this Court in *AGT Limited v. Canada (Attorney General) (C.A.)*, [1997] 2 F.C. 878. However, he interpreted subsection 231.2(1) as giving the Minister the right to require the production of documents, but not the right to require the answers to questions, and on that basis he held that the Requirements were invalid with respect to the questions asked of Mr. Hughes and Mr. Butalia.

[13] The Applications Judge also indicated that if any of the documents or information to be produced under the Requirements referred to a client of Dunwoody unrelated to the appellants, Dunwoody had the right to redact the documents to expunge that person's name before the document or information was submitted to the Minister. Dunwoody did not redact any information from the requested material which it prepared but did not deliver to the Minister, pending the ultimate outcome of these proceedings.

Analysis

Issue a): *Does subsection 231.2(1) allow Dunwoody to refuse to answer the Minister's written questions or to create new documents?*

[14] The Applications Judge held that the powers of subsection 231.2(1) require the production of documents and information in existence, but that it is not framed so broadly that accountants can be required to respond to written interrogatories. He reasoned that if subsection 231.2(1) of the Act were intended to be so broad as to provide the Minister with the option to conduct a written examination for discovery, Parliament would have so provided. It is my respectful opinion that the learned Applications Judge erred in his interpretation of subsection 231.2(1). His error, in my view, lies in his failure to give a meaning to paragraph 231.2(1)(a).

[15] In statutory interpretation there is a presumption against redundancy. The governing principle has been described in Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes,* 4th ed. (Markham: Butterworths, 2002) at 158:

It is presumed that the legislature avoids superfluous or meaningless words, that it does not pointlessly repeat itself or speak in vain. Every word in a statute is presumed to make sense and to have a specific role to play in advancing the legislative purpose.

[16] The same principle is expressed as follows by Iacobucci J. in *Communities Economic Development Fund v. Canadian Pickles Corp.*, [1991] 3 S.C.R. 388 at paragraph 36:

It is a principle of statutory interpretation that every word of a statute must be given meaning: "A construction which would leave without effect any part of the language of a statute will normally be rejected" (see also *Maxwell on the Interpretation of Statutes* (12th ed. 1969), at p. 36).

[17] Applied in this case, that principle dictates that meaning must be given to both

Digitized by Google

paragraphs (*a*) and (*b*) of the subsection 231.2(1), and unless there is good reason to the contrary, a different interpretation must be given to both paragraphs, and different meanings to the words "information" and "document".

[18] The word "information", used in paragraph 231.2(1)(*a*), is not defined in the Act. Referring to the *The Concise Oxford English Dictionary*, 10th ed., "information" is defined as "facts or knowledge provided or learned as a result of research or study" or "what is conveyed or represented by a particular sequence of symbols, impulses, etc." The French version of paragraph 231.2(1)(*a*) uses the word "renseignement". In *Collins Robert Unabridged French-English Dictionary* (5th ed.), "renseignement" is defined as "information, piece of information".

[19] Turning to paragraph 231.2(1)(*b*), it provides the Minister with the power to compel production of "any document". Again, referring to *The Concise Oxford English Dictionary*, 10th ed., "document" is defined
as "a piece of written, printed, or electronic matter that provides information or evidence or that serves as an official record." However, the word "document", as used in the Act, is not restricted to writings. It is defined in section 231 to include "money, a security and a record". "Record" in turn is defined in subsection 248(1) as including "an account, an agreement, a book, a chart or table, a diagram, a form, an image, an invoice, a letter, a map, a memorandum, a plan, a return, a statement, a telegram, a voucher, and any other thing containing information, whether in writing or in any other form".

Issue b):

Does subsection 231.2(1) of the Act permit Dunwoody to redact, that is, remove, confidential references and information in respect of persons other than the Taxpayers from the documents to be delivered in response to the Minister's Requirements?

[21] In preparing to disclose the requested material to the Minister, Dunwoody was concerned that some material might contain the names of or information concerning other clients not legally associated with or related to the Taxpayers. Accordingly, during the course of argument, Dunwoody asked the Applications Judge for permission to redact such names or information from the material if it became necessary to protect confidential third party information. The Applications Judge agreed with this proposal.

[22] Once Dunwoody assembled the required documents, it was discovered that there was nothing to be redacted. It is argued for the Taxpayers that this issue should not be dealt with at all because it is moot, in the sense that there is no live controversy between the parties on the question of redaction of the documents. The Crown argues that this is an appropriate case in which to deal with the issue despite its mootness (see *Borowski v. Canada (Attorney General of Canada)*, [1989] 1 S.C.R. 342 at 353. In my view, it is appropriate to deal with the Applications Judge's conclusion on the redaction issue, despite its mootness, because of the likelihood of uncertainty and confusion that could result from the Applications Judge's comments, and also because the issue is amenable to a simple resolution.

[24] That is sufficient to dispose of the redaction issue in this case. I recognize that this resolution of the matter leaves unanswered theoretical questions. For example, it is debatable whether there is a right of redaction at all with respect to documents that fall within the scope of a valid requirement under subsection 231.2(1). In this regard, there is jurisprudence from the Supreme Court of Canada that supports the proposition that a requirement is not invalid merely because it results in the disclosure of private transactions involving persons who are not under investigation and may not be liable to tax (see *Canadian Bank of Commerce v. Attorney General of Canada* (1962), 35 D.L.R. (2d) 49 at

Digitized by Google

54; *James Richardson & Sons v. Minister of National Revenue*, 9 D.L.R. (4th) 1 at 7; and *R. v. McKinlay Transport*, [1990] 1 S.C.R. 627 at paragraph 16.)

[25] If a right of redaction exists in theory, there is an issue as to who ought to determine whether the right should be exercised in a particular case, the person to whom the requirement is directed, or the Minister, or the Court. If a dispute should arise in future about the right to redact a document that is within the scope of a valid requirement but contains third party information that for some reason the Minister ought not to have, I have no doubt that the parties will find a way to have the issues debated in an appropriate forum. Meanwhile, I prefer to express no opinion on issues that do not arise in this case.

[26] For these reasons, the Minister's appeal is well founded and should be allowed, subject only to the resolution of the issues raised in the cross-appeal.

Issue c):

Were the Requirements issued for the purpose of the administration and enforcement of the Act within the meaning of section 231.2?

[27] The evidence establishes that the Requirements are intended to test the Taxpayers' entitlement to the interest deduction. Broadly speaking, entitlement to the interest deduction depends upon whether the statutory conditions in paragraph 20(1)(c) of the Income Tax Act are met, and if not, whether the general anti-avoidance rule in subsection 245(2) applies.

[28] The position of the Taxpayers is that the Requirements would result in the disclosure of tax planning documents and information about their subjective intention in entering into the transactions that gave rise to the claim for the interest deduction. They argue that the Minister cannot possibly require tax planning documents and evidence of subjective intention for the purpose of the administration and enforcement of the Income Tax Act, because those matters are not relevant to the applicability of paragraph 20(1)(c) or subsection 245(2). I am unable to accept this argument. The scope of subsection 231.2(1) is not as limited as the Taxpayers suggest.

[29] A number of cases have dealt with the scope of subsection 231.2(1) (see *R. v. McKinlay Transport, supra*; *James Richardson & Sons v. Minister of National Revenue, supra*; *AGT Limited v. The Attorney General of Canada, supra*; and *R. v. Jarvis,* 2002 D.T.C. 7547 (S.C.C.) at paragraph 51). The relevant principles from these authorities establish that the determination of a taxpayer's tax liability is a purpose related to the administration and enforcement of the Act. A requirement is valid if the requested information may be relevant in the determination of the tax liability of the named taxpayer. This is a low threshold. Subsection 231.2(1) gives the Minister a broader authority to obtain information than would be the case if, for example, the Minister were conducting pre-trial examinations for discovery in the context of an income tax appeal.

[30] In my view, the information which the Taxpayers object to producing may be relevant to determining their tax liability under the Act. As Desjardins J.A. stated at paragraph 23 for an unanimous panel of this Court in *AGT Limited v. The Attorney General of Canada, supra*:

Because of the nature of the conduct regulated by the *Income Tax Act*, there are, in many cases, no ways of determining whether prescribed conduct has been engaged in, short of studying the process by which a suspected corporation or business has made and implemented its decision.

[31] First of all, tax planning information can shed light on intention and therefore may be important in interpreting contracts or determining whether persons are acting at arm's length. Further, it may be relevant in determining the residency of the Taxpayers, which is an issue in the present case, since a relevant factor is whether they intended to sever their

Digitized by Google

ties to Canada permanently or only temporarily. Finally, the subjective intention of the Taxpayers may be relevant in determining interest deductibility or the applicability of the general anti-avoidance provision. The purpose test may be an objective one, but a taxpayer's intention is certainly a relevant consideration (see *Ludco Enterprises Ltd. v. Canada*, [2001] 2 S.C.R. 1082 at paragraphs 54-55; and *Fraser Milner Casgrain v. Minister of National Revenue*, 2002 D.T.C. 7310, [2002] 4 C.T.C. 210 (F.C.T.D.)).

[32] The Taxpayers also assert that the Requirements, which are intended to elicit information about the 1997 and 1998 taxation years, were issued more than three years after the initial assessment of those years, and thus after the expiry of the normal limitation period for those years. They argue that because the Minister cannot reassess those years, they need not produce any documents covered by the Requirements. I cannot agree. First, there is no statutory time limit for requirements. Second, the record does not establish that the Minister cannot reassess the Taxpayers for 1997 and 1998. Assuming, without deciding, that the Requirements relate only to those years, there are numerous statutory provisions that permit the Minister to reassess within three years after the expiry of the normal limitation period. There are also statutory exceptions that remove all time limitations.

[33] Finally, the Taxpayers argue that the Requirements improperly subvert the *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a, relating to pre-trial discovery. The simple answer to this argument is no income tax appeal has been commenced in this case. In any event, the Minister's right to investigate the affairs of a taxpayer is not necessarily limited by the commencement of an appeal (see *Canada v. Imperial Oil Limited and Inco Limited*, 2003 FCA 289). There may be situations where the exercise of a statutory power of investigation is abusive, but this is not such a case.

[34] For the foregoing reasons, in my analysis, the Applications Judge correctly determined that the Requirements were issued for the purpose of the administration and enforcement of the Act.

Issue d):

Was certain of the requested material that was prepared by Dunwoody for the purpose of providing tax advice to the Taxpayers privileged?

[35] This issue raised the question as to whether tax memoranda, notes of tax advice, or other documents which set out or show the tax advice given by a tax accountant to a client and the reasoning or analysis behind the tax advice are privileged communications. If so, such communications would not be subject to disclosure under Canadian law even though the subject matter may be relevant to an income tax audit or Tax Court proceeding.

[36] The Supreme Court of Canada has recognized that there are two types of legal privilege - "class" privilege and "case-by-case" privilege (see *R. v. Gruenke,* [1991] 3 S.C.R. 263 at paragraph 26). The Taxpayers urge that their confidential communications with Mr. Butalia, when properly understood, can fit within either category of privilege. They assert that the evidence establishes that they dealt with Dunwoody, and Mr. Butalia in particular, on the understanding that the tax advice they received was confidential. They argue that had they known that tax advice could only be shielded by solicitor-client privilege they would not have discussed the matters with Dunwoody.

[37] In 1990, this Court confirmed that an accountant-client privilege does not exist in relation to advice given by an accountant in connection with the search and seizure provisions of the Act (see *Baron v. Canada*, [1991] 1 F.C. 688, (1990) 91 D.T.C. 5055, [1991] 1 C.T.C. 125). The Taxpayers say it is now time to recognize a class privilege for communications between tax accountants who provide professional tax advice to their clients in the course of a professional relationship and such privilege should extend to all types of tax advice; income tax, excise tax, goods and services tax, sales tax and real property tax. It is

Digitized by Google

urged that the categories of privilege are not static and can evolve over time, with the identification of a new class on a principled basis (see Lamer C.J. in *R. v. Gruenke, supra*, at paragraph 35).

[38] I see nothing in the submissions of the Taxpayers that militates against the earlier ruling rendered by this Court in *Baron v. Canada, supra*. Solicitor-client privilege is rooted in the proper administration of justice, made necessary by the need for confidential advice in prosecuting one's rights and preparing defences against improper claims (see *R. v. McClure*, [2001] 1 S.C.R. 445 at 457-459). Lawyers are legally and ethically required to uphold and protect the public interest in the administration of justice (see *Fortin v. Chrétien*, [2001] 2 S.C.R. 500 at paragraph 49). In contrast, accountants are not so bound. Nor do they provide legal advice, as to do so would constitute a breach of provincial and territorial laws governing the legal professions. In my analysis, no overriding policy consideration exists so as to elevate the advice given by tax accountants to the level of solicitor-client privilege.

[39] As for case-by-case privilege, the Supreme Court of Canada has directed that the principles set out by Professor Wigmore in his American treatise on evidence provide a general framework to determine whether or not a communications is privileged. Within this framework, policy considerations and the requirements of fact-finding can be weighed and balanced on the basis of their relative importance in each case. Consequently, a principled approach to the question of case-by-case privilege should always be employed, taking into account each of the four factors, and the particular circumstances of each case (see *R. v. Gruenke, supra*, at paragraph 35).

[40] The four Wigmore principles are these:

The communications must originate in a *confidence* that they will not be disclosed.

This element of *confidentiality must be essential* to the full and satisfactory maintenance of the relation between the parties.

The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*.

The *injury* that would inure to the relation by the disclosure of the communications must be *greater than the benefit* thereby gained for the correct disposal of litigation.

(see John Henry Wigmore, *Evidence in Trials at Common Law*, vol. 8. (Boston: Little, Brown, 1961) at 527.) [41] In discussing the first Wigmore principle, the Supreme Court of Canada has stated that "it is absolutely crucial that the communications originate with an expectation of confidentiality . . .. Without this expectation of confidentiality, the *raison d'être* of the privilege is missing" (see *R. v. Gruenke, supra*, at paragraph 39). While a chartered accountant, as a matter of professional ethics, is required to keep his communications with clients confidential, the accountant knows, or should know, that this confidentiality is restricted by the power of the Minister to require disclosure. Therefore, Dunwoody and the Taxpayers have not discharged their onus of showing that the relationship in issue carried with it an expectation of confidentiality sufficient to meet this first Wigmore principle.

[42] The Taxpayers have also not shown that confidentiality was essential to the full and satisfactory maintenance of their relationship with Mr. Butalia so as to satisfy Wigmore's second principle. Confidentiality may be desired, as with all personal and professional relationships, but the relationships here did not depend on confidentiality for their existence. Indeed, according to his evidence, had Mr. Kitsch believed that there was no confidentiality involved, he would have still used the same firm of accountants for business and financial advice.

[43] Further, the Taxpayers have not shown that the tax accountant-client relationship is one that in the opinion of the community ought to be sedulously fostered to the degree that

Digitized by Google

would attract privilege. While confidentiality may be preferred, the tax accountant-client relationship is in no way as fundamental to society and the administration of justice as the solicitor-client relationship.

[44] The rare situations where case-by-case privilege has been extended to certain specifically identified communications have included clients and their doctors, sexual assault therapists and clergy. These relationships are sedulously fostered to the extent that privilege may apply to them in certain limited circumstances. The reason is obvious. Canadian society puts a much higher value on the physical, mental and spiritual integrity of a person than on personal wealth. It is recognized that unnecessary harm and suffering could result from deterring an individual from consulting a doctor, a sexual assault therapist, or a member of the clergy. The worst that could happen if a person is discouraged from seeking income tax advice is that the person might fail to take advantage of a tax saving opportunity, unfortunate perhaps, but not a threat to one's physical, mental or spiritual well being.

[45] In considering the fourth Wigmore principle, it must be determined whether the interests served by protecting the communications from disclosure outweigh the interest in getting at the truth and correctly disposing of the matter (see *M.(A.) v. Ryan,* [1997] 1 S.C.R. 157 at paragraphs 16 and 31). The balancing of the injury to the relationship against the benefit of the correct disposal of the matter involves purely public policy considerations. As Chief Justice McLachlin held, at this stage of analysis, an occasional injustice should not be accepted as the price of extending privilege from disclosure. While it is true that the traditional categories of privilege necessarily run the risk of occasional injustice, "that does not mean that courts, in invoking new privileges, should lightly condone its extension." (*M.(A.) v. Ryan, supra*, at paragraph 32). In that case, the potential injury to be suffered due to the disclosure of the disputed information was described, at paragraph 30, as one that:

perpetuates the disadvantage felt by victims of sexual assault, often women. The intimate nature of sexual assault heightens the privacy concerns of the victim and may increase ... the difficulty of obtaining redress for the wrong. The victim of a sexual assault is placed in a disadvantaged position as compared with the victim of a different wrong... She is doubly victimized, initially by the sexual assault and later by the price she must pay to claim redress - redress which in some cases may be part of her program of therapy.

Nonetheless, the Court affirmed the disclosure of all documents except the personal notes of a person who would not be called as a witness at trial and whose opinion was of no consequence. The unsuccessful claim of privilege in that case illustrates the high threshold of injury necessary to overcome the benefit of correctly disposing of the matter.

[46] The Taxpayers have not shown that any public injury would occur should these tax accountant- client communications continue to be subject to review by the Minister. Innumerable tax accountant-client relationships have functioned fully in the past notwithstanding the Minister's opportunity to review their communications. Whatever the public injury feared by the Taxpayers may be, it has not precluded the full and satisfactory maintenance of those past relationships despite the Minister's powers of review. If tax accountant-client communications are subject to the spectre of case-by-case privilege, the harm done to the verification and enforcement of the Act would be considerable, and would outweigh whatever injury, if any, that would inure to such relationships. Overall, in my analysis, the balancing of public interests favours disclosure.

[47] The disputed communications in this appeal and cross-appeal do not meet any of Wigmore's four principles and are therefore not covered by case-by-case privilege. The Applications Judge correctly held that the documents requested in the Requirements are not subject to either class or case-by-case privilege. [48] It was drawn to the courts attention

Digitized by Google

that since July 22, 1998, the United States, pursuant to I.R.C.
§ 7525 (1986), has afforded a class privilege to federally authorized tax practitioners with respect to tax advice given to their clients. Except for criminal matters, the scope of that privilege, where the tax advice given involves either the Internal Revenue Service or United States Federal Court proceedings, is the same as for attorney-client privilege. While a matter of policy interest, it is of no consequence to the task at hand. In addition, a review of the content of that legislation undoubtedly reveals that enactment of the class privilege for accountants is better left with Parliament.

143471 Canada Inc. v. Quebec (Attorney General); Tabah v. Quebec (Attorney General), [1994] 2 S.C.R. 339, Impounding Seized Documents under a Provincial Tax Act

Present: Lamer C.J. and La Forest, L'Heureux-Dubé, Sopinka, Cory, McLachlin and Iacobucci JJ.
on appeal from the court of appeal for quebec

Procedure -- Interlocutory relief -- Documents seized pursuant to provisions of tax legislation -- Motions for orders impounding seized documents granted -- Documents sealed until final judgment rendered on legality of search warrants -- Whether impounding orders should be set aside.

Commercial documents were seized at the places of business of the corporate respondents and the homes of the respondents Arcuri and Tabah. In both cases the respondents challenged the legality of the search warrants by means of motions in evocation, *certiorari* and mandamus in which they sought to quash the warrants and attacked the constitutionality of ss. 40 and 40.1 of the *Act respecting the Ministère du Revenu* ("*AMR*"), which authorize searches, alleging *inter alia* that these sections infringe ss. 7 and 8 of the *Canadian Charter of Rights and Freedoms*. By way of interlocutory relief the respondents appended to their actions motions to have all the seized documents impounded pending a final judgment on the legality of the search warrants. In *143471 Canada Inc.*, the Superior Court allowed the motion to impound but dismissed the motion in evocation, *certiorari* and mandamus 15 months later, concluding that s. 40 *AMR* was constitutional. The respondents appealed that decision. In the meantime the Court of Appeal allowed their motion to impound the seized documents for the duration of the appeal. While this Court's judgment on the appeal from that decision was still under reserve, the Court of Appeal dismissed the appeal with respect to the motion in evocation, *certiorari* and mandamus. In *Tabah*, the Superior Court allowed the motion to impound and the Court of Appeal dismissed the appellants' appeal from that judgment. This appeal raises the question whether interlocutory relief in the form of an impounding order should be granted until the validity of the provisions in the *AMR* authorizing searches has been determined under the *Charter*.

Held (La Forest, L'Heureux-Dubé and McLachlin JJ. dissenting): The appeal should be dismissed.

Per Sopinka, Cory and Iacobucci JJ.: In considering an interim measure in the context of a *Charter* challenge to the validity of the underlying law, a court must consider three criteria: (1) the seriousness of the question to be tried; (2) the possibility of irreparable harm to the applicant if the interim order is refused; and (3) the balance of inconvenience caused to the parties by the interim order. A consideration of these three criteria in this case leads to the conclusion that the impounding orders should be maintained.

First, there is a serious question of law raised in this case.

Second, if the respondents are successful in the main applications, they would

Digitized by Google

suffer irreparable harm if the impounding orders were to be set aside. The searches were made pursuant to the provisions of a regulatory statute dealing with a highly regulated business and the expectation of privacy in the commercial documents seized was thus relatively low. However, there is still some measure of privacy in commercial documents. Since the purpose of the impounding orders is to preserve the rights of the respondents pending a final determination of a legal question which will affect those rights, if the orders are not maintained and the warrants are quashed, the loss of that privacy interest, small as it may be, would in itself constitute irreparable harm. But there is a more significant aspect in this case. The documents were obtained by means of intrusive searches of residential and business premises and so long as the documents are held by or on behalf of the government there is a continuing violation of the respondents' very real and significant privacy interest in those premises. There would thus clearly be irreparable harm to the respondents if the warrants are quashed. The government will have had the continuing possession of these documents in the absence of any authority and in violation of the *Charter*. The intrusive nature of the searches cannot be isolated from the taking of the documents. Section 69 *AMR* does not adequately protect the respondents' privacy interests. It prohibits the public release of information contained in the documents but does not protect the respondents from having their privacy interests in their homes and offices violated by the state -- the very interest that s. 8 of the *Charter* is aimed at protecting. Finally, it is highly speculative to expect that a breach of privacy interests, not only in the documents, but also in the homes and offices of the respondents, could be compensated in damages.

Third, and most importantly, the balance of inconvenience favours the respondents. The impounding orders protect both the integrity of the documents and the privacy interest of the respondents, and this sensible interlocutory measure does not harm the public interest. The evidence clearly establishes that the granting of impounding orders will not paralyse the enforcement of taxation laws in the province of Quebec, even if in every case where searches were carried out, impounding orders were in fact issued. The Minister of Revenue is still at liberty to carry out searches and effect seizures and can still investigate and proceed under other sections of the Act. An impounding order does no more than delay the Minister viewing the documents seized. Further, the statistics do not disclose a problem of a flood of impounding orders and there is nothing to indicate that there is a probability, or even a real possibility, that there would be a flood of similar requests as a result of granting these applications. There are so few searches and seizures carried out each year under taxation statutes in the province that this case is still one of exemption and not of suspension. Since there is no serious interference with the enforcement of taxation statutes resulting from the granting of the impounding orders, there is no interference with the public interest and, on this basis, the impounding orders should be granted. Moreover, even if it can be said that the irreparable harm the respondents would suffer from the refusal of the impounding orders is small, the impounding orders should be upheld since there is no significant interference with the public interest.

Per Lamer C.J.: Cory J.'s reasons were generally agreed with, subject to one comment. Since the scope of a right guaranteed by the *Charter* must be assessed in context, it is necessary to take into account all the relevant factors which indicate the importance of a right to the person who enjoys it. This means that one should avoid creating rigid categories that will be used to determine the scope of a constitutional guarantee in a mechanical fashion. The "licensing" theory is therefore of no value in determining the extent of the respondents' expectations of privacy. While the distinction between criminal acts and regulatory offences is a useful and very real one, it should not be used to obscure other aspects of the context of a given case. Yet that is precisely what is likely to happen if one presumes that those who engage in "regulated" activities have accepted a lower level of constitutional protection. The

Digitized by Google

licensing theory is based on an erroneous factual premise since it cannot be said, in a general and abstract manner, that any person engaging in a regulated activity, whatever it may be, automatically acquiesces in a limited application of the *Charter* to him- or herself. Here, when all the relevant factors are taken into account, it can be concluded that the respondents had reasonable expectations of privacy with respect to the documents seized and that they are sufficiently important to justify upholding the impounding orders.

Per La Forest, L'Heureux-Dubé and McLachlin JJ. (dissenting): A *prima facie* case, irreparable harm and the balance of convenience are the three criteria relevant in determining whether interlocutory relief should be granted. This analytical framework permits the reconciliation of the rights and freedoms guaranteed in the *Charter* with the conduct of governmental affairs.

In the present case the first criterion has been met. In view of the serious arguments raised by the respondents against the constitutionality of ss. 40 and 40.1 *AMR*, it cannot be concluded that the motions in evocation, *certiorari* and mandamus are frivolous or vexatious. The dismissal of the motion by the Superior Court in *143471 Canada Inc.* is a relevant factor, but is not sufficient to alter the fact that serious questions have been raised. Moreover, the precedents regarding stay of proceedings should not be applied without qualification when the constitutionality of legislation is challenged under the *Charter*, in view of the importance and complexity of the rights and freedoms it guarantees.

With respect to the second criterion, it cannot be concluded that the respondents will suffer irreparable harm if the impounding orders are set aside. The existence of irreparable harm cannot be inferred simply because a breach of a right protected by the *Charter* is alleged or because the main proceeding itself involves the infringement of a guaranteed right. Both the right and the alleged infringement must be placed in context. In the present case the harm claimed by the respondents relates solely to the fact that the tax authorities will learn the content of the documents seized. Any reasonable expectations of privacy the respondents may have regarding the content of those documents are considerably reduced owing to their relevance in establishing the tax profile of their business and the responsibilities they assume as agents of the government. The search warrants and the seizures were directed only at the respondents' business documents, production of which may be required under the *AMR*. By allowing a person to object to the production or seizure of documents containing information protected by professional privilege, and prohibiting disclosure of the information obtained in the course of the investigation, the *AMR* minimizes the risk that the respondents may suffer harm as a result of the implementation by the tax authorities of the investigative scheme provided by that Act. Finally, the possibility that the seized documents may contain information of a personal nature is not sufficient to alter the reasonable expectations of privacy of taxpayers in respect of such documents. On the one hand, the *AMR* itself does not permit the seizure of documents containing personal information; on the other hand, the respondents themselves have never claimed that such documents were in fact seized. It can therefore not be concluded that the respondents will suffer irreparable harm if the tax authorities examine the contents of the documents seized.

With respect to the third criterion, an assessment of the balance of convenience does not favour the respondents. As the existence of irreparable harm has been ruled out, it is hard to see how the respondents could suffer significant hardship if they were denied the impoundment. Since the only effect of the impounding order is to delay the examination of the documents, it can be assumed that at some point or other the respondents will suffer the hardships associated with an investigation by the Ministère du Revenu, whether or not the sections are declared unconstitutional. On the other hand, if the impoundment is upheld, the delays imposed on the appellants in examining the contents of the seized documents are likely to jeopardize proof of the offences. Even if it is admitted that impoundment does not have the

Digitized by Google

effect of suspending the Minister's investigative powers, there is nothing to suggest that he could make significant progress with his investigation if the impoundment were upheld.

Be that as it may, the present case has ramifications that go beyond the immediate interests of the parties, if only because of the mandate underlying the action of the Ministère -- namely the implementation and execution of tax legislation. It is thus necessary to take the public interest into account in determining the balance of convenience. Because the *AMR* is based on the principle of self-declaration and self-assessment, the implementation of the investigative provisions contained in ss. 40 and 40.1 *AMR* is essential if the integrity of the collection system is to be maintained and these investigative powers form the principal tool available to the Ministère to fight tax evasion. Although it is not possible to speak of a "flood of actions", the systematic nature of recent impounding orders cannot be ignored. Since the Ministère must adduce proof beyond a reasonable doubt and in view of the difficulties of proof inherent in the nature of offences against the tax laws, even temporarily watering down investigative powers has more than a symbolic effect on the public interest.

Cases Cited

By Cory J.

Applied: *Manitoba (Attorney General) v. Metropolitan Stores Ltd.*, [1987] 1 S.C.R. 110; *RJR -- MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311; **referred to:** *Hadmor Productions Ltd. v. Hamilton*, [1982] 1 All E.R. 1042; *Aetna Financial Services Ltd. v. Feigelman*, [1985] 1 S.C.R. 2; *Friends of the Oldman River Society v. Canada (Minister of Transport)*, [1992] 1 S.C.R. 3; *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425; *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627; *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154; *Baron v. Canada*, [1993] 1 S.C.R. 416; *Ameublement Jeanne Inc. v. Québec (Procureur général)*, Sup. Ct. Montréal, No. 500-05-003335-872, April 15, 1987; *Brochetterie Tino Inc. v. Québec (Procureur général)*, [1989] R.D.F.Q. 98; *Restaurant le Gourmet grec Inc. v. Séguin*, [1989] R.D.F.Q. 80; *Courrier grec du Canada Ltée v. Québec (Procureur général)*, Sup. Ct. Montréal, No. 500-05-002016-895, February 24, 1989; *Cuisines Multiform internationales Inc. v. Angers*, [1992] R.D.F.Q. 46; *Cuisines Multiform internationales Inc. v. Angers*, [1992] R.D.F.Q. 126; *Électro Marine Diesel Inc. v. Québec (Procureur général)*, [1992] R.D.F.Q. 125; *Groupe Shakiba Inc. v. Québec (Procureur général)*, [1993] R.D.F.Q. 70; *Zeppetelli v. Canada*, [1990] 2 C.T.C. 354.

By Lamer C.J.

Referred to: *Edmonton Journal v. Alberta (Attorney General)*, [1989] 2 S.C.R. 1326; *Rocket v. Royal College of Dental Surgeons of Ontario*, [1990] 2 S.C.R. 232; *Kindler v. Canada (Minister of Justice)*, [1991] 2 S.C.R. 779; *R. v. Généreux*, [1992] 1 S.C.R. 259; *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154.

By La Forest J. (dissenting)

Manitoba (Attorney General) v. Metropolitan Stores Ltd., [1987] 1 S.C.R. 110; *RJR -- MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311; *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627; *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425; *Zeppetelli v. Canada*, [1990] 2 C.T.C. 354; *Baron v. Canada*, [1993] 1 S.C.R. 416, aff'g [1991] 1 F.C. 688; *Re B.C. Motor Vehicle Act*, [1985] 2 S.C.R. 486; *Hunter v. Southam Inc.*, [1984] 2 S.C.R. 145; *Kourtessis v. M.N.R.*, [1993] 2 S.C.R. 53; *R. v. Dyment*, [1988] 2 S.C.R. 417; *United States of America v. Cotroni*, [1989] 1 S.C.R. 1469; *Edmonton Journal v. Alberta (Attorney General)*, [1989] 2 S.C.R. 1326; *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154; *Air Canada v. British Columbia*, [1989] 1 S.C.R. 1161; *Fafard Buildings System Inc. v. R.*, J.E. 90-1187; *Ameublement Jeanne Inc. v. Québec (Procureur général)*, Sup. Ct. Montréal, No. 500-05-003335-872, April 15, 1987; *Brochetterie Tino Inc. v. Québec (Procureur général)*,

Digitized by Google

[1989] R.D.F.Q. 98; *Restaurant le Gourmet grec Inc. v. Séguin*, [1989] R.D.F.Q. 80.

Statutes and Regulations Cited

Act respecting the Ministère du Revenu, R.S.Q., c. M-31, ss. 34(1) [rep. 1983, c. 49, s. 40], 38(*a*) [am. 1986, c. 95, s. 190], 39, 40 [rep. 1986, c. 95, s. 191; am. 1988, c. 21, s. 104], 40.1 [ad. 1986, c. 95, s. 191], 40.2 [ad. 1986, c. 95, s. 191], 46 [rep. 1990, c. 4, s. 587], 53 [*idem*, s. 589], 69, 78 [am. 1982, c. 38, s. 28].

Canadian Charter of Rights and Freedoms, ss. 7, 8.

Charter of Human Rights and Freedoms, R.S.Q., c. C-12, s. 24.1 [ad. 1982, c. 61, s. 1].

Criminal Code, R.S.C., 1985, c. C-46.

Meals and Hotels Tax Act, R.S.Q., c. T-3.

APPEAL from judgments of the Quebec Court of Appeal (1992), 32 A.C.W.S. (3d) 226 and [1992] R.D.F.Q. 44, granting the motion to impound seized documents brought by the respondents 143471 Canada Inc. et al., and affirming a judgment of the Superior Court, [1991] R.D.F.Q. 90, granting the motion to impound seized documents brought by the respondents Tabah et al. Appeal dismissed, La Forest, L'Heureux-Dubé and McLachlin JJ. dissenting.

Michel Dansereau, *Judith Kucharsky* and *Pierre Gonthier*, for the appellants.

Guy Du Pont, *Basile Angelopoulos* and *Ariane Bourque*, for the respondents.

English version of the reasons delivered by

LAMER C.J. -- I am generally in agreement with the reasons of Justice Cory. With respect, however, I would like to add a comment concerning the factors he takes into account in assessing the respondents' expectations of privacy.

It is now well settled that the scope of a right guaranteed by the *Canadian Charter of Rights and Freedoms* must be assessed in context. This method was first explained by Wilson J. in *Edmonton Journal v. Alberta (Attorney General)*, [1989] 2 S.C.R. 1326, at pp. 1352-55, and again applied by the Court in *Rocket v. Royal College of Dental Surgeons of Ontario*, [1990] 2 S.C.R. 232; *Kindler v. Canada (Minister of Justice)*, [1991] 2 S.C.R. 779; and *R. v. Généreux*, [1992] 1 S.C.R. 259. It is thus necessary to take into account all the relevant factors which indicate the importance of a right to the person who enjoys it. This also means that we should avoid creating rigid categories that will be used to determine the scope of a constitutional guarantee in a mechanical fashion.

I am concerned about the fact that Cory J. relies on the so-called "licensing" theory in determining the extent of the respondents' expectations of privacy. This theory, which he explained in detail in his reasons in *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154, at pp. 227-33, essentially holds that persons engaging in "regulated" activities are presumed to have accepted the existence of such regulation, greater intervention by the state in their activities, and a lower measure of constitutional protection.

In my humble opinion this theory is open to two kinds of criticism.

First, it tends to give credence to the idea that there is a clear distinction between regulatory offences and truly criminal acts, and that there are two different definitions of the rights guaranteed by the *Charter* corresponding to these two categories of offences. This approach reflects a formalism alien to the contextual method. The distinction between criminal acts and regulatory offences is a useful and very real one, but it should not be used to obscure other aspects of the context of a given case. That is precisely what is likely to happen if we presume that those who engage in "regulated" activities have accepted a lower level of constitutional protection. If there were such a waiver there would be no need to examine the other aspects of the context.

Second, with respect, I am of the view that the licensing theory is based on an erroneous factual premise. It cannot be said, in a general and abstract manner, that persons engaging in regulated sectors of life in society expect a lower level of constitutional protection. It is true that intervention by government officials is generally accepted in certain areas and that

Digitized by Google

accordingly the expectations of privacy of persons working in those areas may be lower. However, this observation cannot be transformed into a general rule presuming that any person engaging in a regulated activity, whatever it may be, automatically acquiesces in a limited application of the *Charter* to him- or herself. In the present case I cannot say that the respondents agreed to allow the state to search their homes when they set up their restaurant and hotel businesses. In my opinion, there is no factual foundation for such a proposition. We may also take the example of driving an automobile, a highly regulated activity. Can it be said that people who obtain a driver's licence thereby accept that they will not have the full benefit of the rights set forth in the *Charter*? I do not think so.

In reality the only factual proposition that can be taken as valid is the one set out by Cory J. at p. 377: "Those who enter a regulated field must accept regulations as an integral part of their business operations". The same can be said about the criminal law: anyone who lives in society must accept the rules laid down in the *Criminal Code*, R.S.C., 1985, c. C-46. There is nothing surprising in this: the validity of legislation does not depend on the consent of those to whom it applies. Accordingly, although the statement by Cory J. is correct, it cannot be used as the basis for a valid distinction between various types of offences, depending on whether or not the individuals concerned "accept" the rules in question. All things considered, I do not feel that the "licensing" theory can be of any value in determining the scope of the rights guaranteed by the *Charter*.

I have nevertheless come to the same conclusion as Cory J. regarding the extent of the respondents' expectations of privacy. Cory J. notes the following factors.

1. The *Act respecting the Ministère du Revenu*, R.S.Q., c. M-31, does not create criminal offences in the strict sense. Its purpose is instead to set up an administrative mechanism for the collection of taxes.
2. The Minister may seize a considerable number of documents whose connection with enforcement of the Act may be tenuous.
3. The Act allows for searches at the premises of third parties who are not the subject of an investigation and who may have been in compliance with the Act.
4. Certain searches took place at the respondents' private homes, not their commercial establishments.
5. Searches involve a greater intrusion into individual privacy than a mere demand for production of documents.

From factors 2, 3, 4 and 5 it can be concluded that the respondents had reasonable expectations of privacy with respect to the documents seized by the appellants. The first factor suggests that the scope of these expectations should be treated as relative, but like Cory J. I am of the view that they are sufficiently important to justify upholding the impounding orders.

I would dismiss the appeal with costs.

English version of the reasons of La Forest, L'Heureux-Dubé and McLachlin JJ. delivered by

LA FOREST J. (dissenting) -- This case raises the question whether interlocutory relief in the form of an impounding order should be granted until the validity of the provisions authorizing searches in the *Act respecting the Ministère du Revenu*, R.S.Q., c. M-31, has been determined under the *Canadian Charter of Rights and Freedoms*.

Facts

The facts in the two cases giving rise to these appeals are similar and may be summarized as follows. Judges of the Court of Quebec issued written authorizations to conduct searches pursuant to s. 40 of the *Act respecting the Ministère du Revenu* (hereinafter the "Act"), based on sworn informations that the respondents had *inter alia* attempted to avoid the payment of sums of money pursuant to the *Meals and Hotels Tax Act*, R.S.Q., c. T-3. These authorizations were executed at the places of business of the corporate respondents

Digitized by Google

and the homes of the respondents Arcuri and Tabah. Several documents were seized.

In both cases the respondents challenged the legality of the search warrants by means of motions in evocation, *certiorari* and mandamus, seeking to quash the seizure authorizations and their execution and to attack the constitutionality of ss. 40 and 40.1 of the Act in light of ss. 7 and 8 of the *Canadian Charter of Rights and Freedoms* (hereinafter the "*Charter*") and s. 24.1 of the Quebec *Charter of Human Rights and Freedoms*, R.S.Q., c. C-12. By way of interlocutory relief the respondents appended to their actions motions to have all the seized documents impounded so they could be sealed and given into the custody of a third party pending a final judgment on the legality of the search warrants.

In the *143471 Canada Inc.* case, on November 7, 1990, Hannan J. of the Quebec Superior Court allowed the motion to impound the seized documents, until such time as judgment was rendered at trial on the legality of the search warrants: [1990] R.D.F.Q. 104. On February 10, 1992 Croteau J. of the Quebec Superior Court dismissed the motion in evocation, *certiorari* and mandamus and concluded that s. 40 of the Act was constitutional: [1992] R.D.F.Q. 48. The respondents appealed that decision and asked the Court of Appeal to issue an order impounding the seized documents for the duration of the proceedings. On March 9, 1992, the Court of Appeal allowed the motion to impound the seized documents: (1992), 32 A.C.W.S. (3d) 226. While this Court's judgment on the appeal from that decision was still under reserve, the Quebec Court of Appeal dismissed the appeal with respect to the action in evocation, *certiorari* and mandamus, on May 18, 1994: J.E. 94-934.

In the *Tabah* case, on June 18, 1991, Marquis J. of the Quebec Superior Court allowed the motion to impound the seized documents until a judgment was rendered on the legality of the search warrants: [1991] R.D.F.Q. 90. The appellants appealed that judgment. On March 9, 1992, the Court of Appeal dismissed their appeal: [1992] R.D.F.Q. 44.

Judgments of the Courts Below

Quebec Superior Court, 143471 Canada Inc. Case, [1990] R.D.F.Q. 104

Hannan J. characterized the motion to impound as an exemption case since it applied only to the respondents, was confined to the documents seized, and related to the offences alleged. In ruling on the validity of the motion he considered the three criteria set out in *Manitoba (Attorney General) v. Metropolitan Stores Ltd.*, [1987] 1 S.C.R. 110, namely, whether there was a serious question to be tried, the irreparable harm the respondents might suffer if the motion was dismissed and the balance of convenience.

Hannan J. noted that the first criterion was difficult to apply at the interlocutory stage. He referred to the opinion expressed by Beetz J. in *Metropolitan Stores* that the courts are reluctant to grant an interlocutory injunction unless the public interest is weighed in the balance of convenience. Relying on *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627, and *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425, Hannan J. noted that the distinction between the criminal and regulatory contexts with regard to what constitutes a reasonable invasion of privacy was likely to increase that reluctance to order interlocutory relief. He concluded, however, that it was difficult to assess if a *prima facie* case was made out and proposed to review the other criteria.

In determining whether irreparable harm existed, Hannan J. relied on the Quebec Court of Appeal's decision in *Zeppetelli v. Canada*, [1990] 2 C.T.C. 354. In that case the court noted that impoundment was an essential preventive measure for the constitutional protection of privacy against a seizure that might eventually be declared unreasonable. In the court's view refusing the impoundment would cause irreparable harm since the disclosure would be an invasion of privacy and would render the protection conferred by the *Charter* meaningless. Hannan J. considered he was bound by this decision and concluded as follows (at p. 109):

[TRANSLATION] In this unanimous judgment in *Zeppetelli* it is possible to draw

Digitized by Google

the inference that once protection of privacy is sought in a case where the intrusion is allegedly unconstitutional (or at least anti-constitutional), the Court of Appeal considered that the criterion of irreparable harm has been met and, apparently, that the judgment in *Dyment* would support such a conclusion.

With respect to the balance of convenience criterion, Hannan J. pointed out that the exemption sought by the respondents was very limited in its application and did not have the effect of paralysing any other investigation or prosecution for other offences relating to different periods. He noted the comments made by Baudouin J.A. in *Zeppetelli*, *supra*, who pointed out that [TRANSLATION] "as between inconveniences of an essentially administrative nature and those involving a constitutionally protected fundamental right, the balance must tip in favour of the latter" (p. 357). Hannan J. came to the following conclusion (at p. 110):

> [TRANSLATION] In the present case, where the exceptional stay is restricted to the items already seized, and does not suspend the application of the tax legislation, except in this regard, and where the irreparable harm and balance of convenience are in favour of the applicants until this Court renders a judgment on the motion in evocation, and although the merits of the case are not crystal clear, there is a good basis for granting the present motion to impound.

Quebec Superior Court, Tabah Case, [1991] R.D.F.Q. 90

Like Hannan J., Marquis J. of the Quebec Superior Court relied on *Metropolitan Stores* and *Zeppetelli*, *supra*, in deciding whether to grant the impounding order. He characterized the case as one of exemption since the effect of the motion to impound was only to suspend *pendente lite* the application of the impugned provisions of the Act as they affected the respondents. Marquis J. proceeded to apply the three relevant criteria in determining whether to grant the respondents' motion.

Marquis J. concluded that the respondents met the *prima facie* case criterion since the case raised a serious question. In his view the contention put forward by the appellants was not so immediately obvious as to exclude from consideration that put forward by the respondents. In support of this conclusion he relied on the reasons of Hugessen J.A. of the Federal Court of Appeal in *Baron v. Canada*, [1991] 1 F.C. 688.

Regarding the irreparable harm criterion, Marquis J., after referring to the Court of Appeal's decision in *Zeppetelli*, *supra*, concluded (at p. 96):

> [TRANSLATION] While it is true that the seizures have already been made, the evidence shows that the examination of the documents seized is far from being complete. The very purpose of that examination is to identify evidence which might eventually lead to the prosecution of one or more of the [respondents]. It is also this examination of the seized documents which is an invasion of privacy: if the seizures were eventually quashed, irreparable injury would be caused to the [respondents] which could have been prevented by the impoundment.

With respect to the balance of convenience criterion, Marquis J. also relied on the foregoing passage from the Court of Appeal's decision in *Zeppetelli*, which noted that [TRANSLATION] "as between inconveniences of an essentially administrative nature and those involving a constitutionally protected fundamental right, the balance must tip in favour of the latter" (p. 357). On the question of the public interest, he noted that although the public is entitled to have the law respected and to have offenders prosecuted, the appellants' fear -- that applications to impound would become so numerous as to paralyze the operation of the Act -- was not based on any factual evidence. Accordingly, since the exemption was limited to specific persons and documents and the case raised a serious question, Marquis J. ordered that the documents be impounded until a final judgment was rendered on the legality of the searches.

Digitized by Google

Quebec Court of Appeal

The Quebec Court of Appeal allowed the motion to impound in the *143471 Canada Inc.* case, relying on the principles set out in *Zeppetelli* and the reasons given in the judgment it rendered the same day in the *Tabah* case. In the latter the Court of Appeal dismissed the appellants' appeal, being of the view that the purpose of the motion to impound was not to suspend the effect of the Act but simply to delay temporarily access to the seized documents, which might also contain information of a personal nature. The judgment was as follows:

> [TRANSLATION] Whereas in the present case the purpose of the respondents' motion was not to suspend the effect of the Act, since according to its terms the investigations and other measures undertaken against the respondents can continue and have in fact continued;
>
> Whereas the purpose of the motion was only to suspend, on a purely temporary basis, the appellants' access to documents, books and registers which might contain personal items of information and so contravene the protection of privacy guaranteed by law;
>
> Whereas, although this Court is not ruling on the reality or existence of the other criteria, the respondents have both in the Superior Court and in this Court demonstrated a *prima facie* case and so met the first condition set out above;
>
> Whereas further the Supreme Court of Canada recently heard two cases on not exactly identical but similar points of law in *Baron v. Canada* and *Kourtessis v. M.N.R.* and those cases are currently reserved;
>
> In view of *Attorney General of Manitoba v. Metropolitan Stores Ltd.*; *Hunter v. Southam Inc.*; *Bâtiments Fafard inc./Fafard Building System Inc. v. R.* [J.E. 91-1611] and *Zeppetelli v. R.*
>
> For these reasons:
>
> Dismisses the appeal with costs.
>
> ([1992] R.D.F.Q. 44, at p. 45.)

Analysis

In *Metropolitan Stores*, *supra*, this Court expressly rejected the presumption of constitutional validity of legislation, understood in its literal sense, as it considered it to be "not compatible with the innovative and evolutive character" of the *Charter* (p. 124). The presumption of constitutional validity of legislation is at variance with the flexible and generous interpretation that should be given to the *Charter* in view of the nature of the rights and freedoms entrenched in it: see *Re B.C. Motor Vehicle Act*, [1985] 2 S.C.R. 486. Interlocutory relief was refused in *Metropolitan Stores*, however, and the disputed provisions continued to apply while their constitutionality was being determined. That decision indicates that interlocutory orders suspending the application of legislation will not be granted automatically.

A cautious approach is all the more necessary as the government's activities have ramifications throughout all aspects of life in society. There is much other legislation, in addition to taxation statutes, that includes inspection or investigation systems the implementation of which might give rise to applications designed to impede their operation: legislation on the environment, the professions, labour, health and safety and securities transactions are some examples. The orchestration of a large number of activities regulated by the government might be compromised if litigants could easily avoid the application of legislation adopted by democratically elected legislatures, presumably in the public interest.

In addition there is the problem of systemic delays in court challenges. This cannot be ignored in deciding whether to grant interlocutory relief suspending the application of legislation for the duration of the proceedings. In the present appeal the search authorizations were issued in June 1990 in the *143471 Canada Inc.* case and in March 1991 in the *Tabah* case. In the former case the appeal from the motion in evocation, *certiorari* and mandamus

Digitized by Google

was dismissed by the Quebec Court of Appeal on May 18, 1994. In the latter the motion has not yet been dealt with at first instance. A final ruling on the validity of these motions, if it were to be made by this Court, is not to be expected for some time.

In this light, it is necessary to adopt an analytical framework that permits the reconciliation of the rights and freedoms entrenched in the *Charter* with the conduct of governmental affairs. Although this point was not expressly made by the parties, it seems to me entirely appropriate to use the analytical framework developed in *Metropolitan Stores*, even though this appeal does not raise the question of a stay of proceedings or an injunction. If granted, the remedy sought will exempt the respondents for all practical purposes from the application of the provisions of the Act regarding investigations until the legality of the searches has been determined.

The three criteria set out in *Metropolitan Stores* -- *prima facie* case, irreparable harm and balance of convenience -- have recently been revisited by this Court in *RJR -- MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311. My colleagues Sopinka and Cory JJ. there made an analysis of the principles with which I entirely agree. There is no need to repeat it except as necessary to explain its application to the present case.

Prima Facie Case

The requirement of a *prima facie* case is explained by the concern with preventing a litigant from avoiding the application of legislation by simply arguing that it is unconstitutional. There must be a mechanism to ensure that frivolous or vexatious actions will not systematically result in interlocutory relief intended to impede the application of legislation. In cases involving a constitutional challenge, particularly when it is based on the *Charter*, the application of this criterion will be more flexible if the public interest is considered in the analysis of the balance of convenience. It will then be sufficient to note that there is a serious question to be tried. This greater flexibility is necessary in view of the inherent difficulties of determining, at the interlocutory stage, the validity of the constitutional challenge, given the limited evidence and the effect that an exemption from or suspension of the application of a statute can have not only on the parties but also on the public interest.

The appellants argue that the provisions authorizing the searches are in accordance with the principles set out in *Hunter v. Southam Inc.*, [1984] 2 S.C.R. 145. They criticize the Court of Appeal for relying on the fact that *Baron v. Canada*, [1993] 1 S.C.R. 416, and *Kourtessis v. M.N.R.*, [1993] 2 S.C.R. 53, were still reserved at the time it rendered its decision concluding that there was a *prima facie* case. In this Court they argued that there is no longer a *prima facie* case in view of the Court's conclusions in *Baron*.

In the *143471 Canada Inc.* case, although the issue is limited to the constitutionality of ss. 40 and 40.1 of the Act, the respondents put forward other arguments that s. 40 of the Act is unconstitutional, in addition to those dealt with by this Court in *Baron*. They concede that the latter are now academic. The respondents rely *inter alia* on the fact that there is no requirement to allege the commission of an offence, or the identification of the premises or the things to be seized; on the argument that s. 40 of the Act is unconstitutional since it is the Minister who technically issues the search warrant; on the fact that there is no express requirement that the judge's authorization be given before the warrant is issued or even before the seizure is carried out; and on the combined effect of ss. 40 and 40.1 of the Act and the legality of "fishing expeditions".

The respondents also plead the unconstitutionality of s. 40.1 of the Act, which refers to the "plain view" doctrine, in support of the motion in evocation, *certiorari* and mandamus in the *Tabah* case. This practice has been approved on several occasions by Canadian courts. However, this Court has never ruled on its constitutionality under s. 8 of the *Charter*. Finally, in addition to the argument that the provision authorizing the seizures is unconstitutional, the respondents argue that the information was inadequate and the seizures were unreasonable.

Digitized by Google

Since this Court has taken a liberal approach to the application of the first criterion, I am prepared to conclude that there is in both cases a *prima facie* case. I hasten to add that the Quebec Court of Appeal could not have come to any other conclusion at the time it dealt with the matter since its decision was rendered when *Baron* and *Kourtessis*, *supra*, were under reserve.

One can certainly question whether the fact that the Quebec Superior Court dismissed the motion in evocation, *certiorari* and mandamus in the *143471 Canada Inc.* case imposes a heavier burden in meeting the first criterion. This argument was made by the appellants, who objected that the Court of Appeal had not applied its own case law on stays of proceedings, by virtue of which a stay will very seldom be ordered when there is no apparent defect in the lower court judgment. The dismissal of the motion in evocation, *certiorari* and mandamus by the Superior Court is certainly a relevant factor, but is not, in this case, sufficient to alter the fact that serious questions have been raised by the respondents. I do not think that the precedents regarding stay of proceedings should be applied without qualification when the constitutionality of legislation is challenged under the *Charter*, in view of the importance and complexity of the rights and freedoms it entrenches.

Having thus not been persuaded that the respondents' motions in evocation, *certiorari* and mandamus are frivolous or vexatious, I propose to analyse the other two steps of the test set forth in *Metropolitan Stores*.

Irreparable Harm

The irreparable harm criterion refers to the harm the applicant may suffer if the interlocutory relief is not granted. If there is no harm or it can be adequately compensated for by an award of damages, there will be little reason to exempt the applicant from the application of the law. In *RJR -- MacDonald*, *supra*, this Court noted that this view of harm is of limited application when a breach of the *Charter* is alleged. The concept of "irreparable harm" is often associated with that of damages. However, a monetary remedy is not always contemplated in cases where the *Charter* is invoked. This results from the nature of the rights it guarantees and of the parties. That is why the Court held that in most situations the existence of irreparable harm must be presumed. But when the alleged harm itself takes the form of a breach of a right protected by the *Charter*, as it does here, the judge who has the responsibility for ruling on the merits of the interlocutory motion is in the best position to determine its nature and extent and whether it is irreparable.

Harm is generally viewed from the standpoint of the person seeking to benefit from the interlocutory relief. Others view it from the standpoint of the person against whom the motion is directed. Although one could at this stage consider the type of harm the Ministère du Revenu might incur if an impounding order were upheld, in my view it is preferable to consider this issue when the balance of convenience is being determined. The same is true of irreparable harm to the public interest. This was the approach taken by this Court in *RJR -- MacDonald*, and, as I see it, it is the right one.

The respondents contend that if no impounding order is made they will suffer harm since the examination of the contents of the seized documents by the tax authorities will result in an infringement of their right to privacy. Such harm, they say, would by its very nature be irreparable. The respondents argue that if individuals have the right to be protected against state intrusions and to have the legality of such intrusions tested, it follows that the courts have the power -- and the duty -- to protect the privacy of the documents seized and preserve the *status quo* by ordering that the documents be impounded until the legality of the searches has been determined. The appellants, on the other hand, argue that the respondents would suffer no harm because any reasonable expectations of privacy they might have are limited or perhaps even non-existent.

The conclusion that the respondents will suffer irreparable harm seems at first sight

Digitized by Google

irrefutable, since they are relying on a breach of a constitutionally protected right, the infringement of which is itself an extension of that resulting from the search. This was the view taken by the Quebec Court of Appeal in *Zeppetelli*, *supra*, relied on by Hannan and Marquis JJ. in the case at bar, in concluding that there was irreparable harm. In that case Baudouin J.A. relied on the following passage from this Court's decision in *R. v. Dyment*, [1988] 2 S.C.R. 417, at p. 430, in support of the conclusion that if there was no impounding the respondents would suffer irreparable harm:

> One further general point must be made, and that is that if the privacy of the individual is to be protected, we cannot afford to wait to vindicate it only after it has been violated. This is inherent in the notion of being secure against unreasonable searches and seizures. Invasions of privacy must be prevented, and where privacy is outweighed by other societal claims, there must be clear rules setting forth the conditions in which it can be violated. This is especially true of law enforcement, which involves the freedom of the subject. [Emphasis in original.]

In *Zeppetelli* Baudouin J.A. concluded as follows, at p. 356:

> [TRANSLATION] In this case, therefore, impounding is a preventive measure inherent in the constitutional protection of privacy from a seizure which might eventually be found to be unreasonable. According to the rule stated by the Supreme Court, the injury caused would thus be irreparable, as disclosure would be an invasion of privacy and make the protection afforded by the Charter meaningless.

However, the present case can be distinguished from *Dyment*, where the respondent was challenging the seizure of a bodily fluid without prior authorization. The respondents are objecting here to the examination by the tax authorities of the contents of business documents the seizure of which was previously authorized. The existence of irreparable harm cannot be inferred simply because a breach of a right protected by the *Charter* is alleged or because the main proceeding itself involves the infringement of an entrenched right. In the present case not only have the courts not yet made a final ruling on whether the searches are unreasonable, but the Quebec Superior Court dismissed the motion in evocation, *certiorari* and mandamus in the *143471 Canada Inc.* case. It seems wrong to conclude as a matter of principle that the right to privacy must in all circumstances take priority over any other interest, for example over giving effect to legislation adopted in the public interest. Both the right and the alleged infringement must be placed in context: see *United States of America v. Cotroni*, [1989] 1 S.C.R. 1469, and *Edmonton Journal v. Alberta (Attorney General)*, [1989] 2 S.C.R. 1326. Accordingly, before concluding that the harm is "irreparable", as required by the second criterion, the existence and extent of the harm must be determined, something which the Court of Appeal seems to have failed to do in the case at bar since it simply said that the seized documents might [TRANSLATION] "contain personal items of information and so contravene the protection of privacy guaranteed by law" (p. 45 R.D.F.Q.).

There is considerable merit in the proposition that persons who decide to engage in activities regulated by the government are subject to a diminution of their expectations of privacy. In that case, it can be presumed that they have agreed to be subject to the obligations imposed by the legislature that are inherent in the conduct of such activities; see *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154. While in *McKinlay Transport*, *supra*, this Court was of the view that power given by s. 231(3) of the *Income Tax Act*, R.S.C. 1952, c. 148, came within the ambit of s. 8 of the *Charter*, it held that the criteria laid down in *Hunter v. Southam Inc.* could be applied more flexibly in a regulatory context. After analysing several lower court decisions, Wilson J. wrote, at p. 647:

> I refer to these cases not to approve or disapprove the results achieved but rather as evidence of the need to take a flexible and purposive approach to s. 8 of the *Charter*. It is consistent with this approach, I believe, to draw a distinction between

Digitized by Google

seizures in the criminal or quasi-criminal context to which the full rigours of the *Hunter* criteria will apply, and seizures in the administrative or regulatory context to which a lesser standard may apply depending upon the legislative scheme under review.

McKinlay Transport dealt with the constitutionality of a provision authorizing the tax authorities to require the production of documents. Such a power, though it was characterized as a "seizure" within the meaning of s. 8 of the *Charter*, was nonetheless different from the power to "search". This distinction was the basis for the qualification to the application of the criteria set out in *Hunter v. Southam Inc.* In *Thomson Newspapers*, I underlined that the more invasive character of a search was referable to the importance individuals attached to the inviolability of their homes, and of their workplaces. I added, at p. 522 of the judgment:

> The requirement to submit to a search of business premises by agents of the state can therefore amount to a requirement to reveal aspects of one's personal life to the chilling glare of official inspection. It seriously invades the right to be secure against unreasonable search and seizure. This is not the case with a power to order the production of records and documents relevant to the investigation of anti-competitive offences; there the eyes of the state can see no further than the business records it is entitled to demand. [Emphasis in original.]

The reasons of L'Heureux-Dubé J. were essentially to the same effect, at p. 594:

> Although they are functional equivalents, a requirement to produce documents impairs considerably less on a corporation's or an individual's privacy than the actual entry into, and search of, its place of business or home. This is especially so, in the case of corporations, since, for the reasons given above, a corporation's privacy interest with respect to a request for documents is relatively low.

Wilson J. also made the point in *McKinlay Transport*, at p. 649:

> Thus, when the tax officials seek entry onto the private property of an individual to conduct a search or seizure, the intrusion is much greater than a mere demand for production of documents. The reason for this is that, while a taxpayer may have little expectation of privacy in relation to his business records relevant to the determination of his tax liability, he has a significant privacy interest in the inviolability of his home.

In the case at bar the warrants have already been executed. The question whether the searches were unreasonable is currently before the Quebec courts. In the context of the present appeal the harm claimed by the respondents relates solely to the fact that the tax authorities will learn the content of the documents seized. Any reasonable expectations of privacy the respondents may have regarding the content of those documents are considerably reduced owing to their relevance in establishing the tax profile of their business and the responsibilities they assume as agents of the government in collecting the meals and hotels tax. In this regard, the keeping of several documents seized by the appellants is required by the Act. Section 34(1) provides:

> **34.** (1) Every person who carries on a business or is bound under a fiscal law to deduct, withhold or collect an amount must keep registers and books of account, including an annual inventory in the prescribed manner, at his place of business or residence or at any other place designated by the Minister.
>
> The registers and books shall be kept in the appropriate form and contain information enabling the establishment of the amount that must be deducted, withheld, collected or paid under a fiscal law.

The Act gives the Minister of Revenue certain powers to audit books and registers. Section 38(*a*) of the Act provides:

> **38.** Any person authorized to do so by the Minister may, for every purpose dealing with the

Digitized by Google

application or enforcement of a fiscal law, enter at any suitable time the premises or places in which a business is carried on or property is kept or in which anything is done relating to any business or where books or registers in accordance with a fiscal law are or must be kept.

The person so authorized by the Minister may:

(*a*) audit or examine the books and registers and any account, voucher, letter, telegram or other document which may relate to the information contained or that should be contained in the books or registers or to the amount of any duty that must be paid, deducted, withheld or collected under a fiscal law;

Section 39 of the Act gives the Minister of Revenue power to require the production of information and documents:

39. The Minister may, by a formal demand delivered by registered or certified mail or personal service require from any person that he file by registered or certified mail or personal service, within a reasonable delay fixed in the demand:

(*a*) information or additional information, including a return, report or supplementary return or report exigible under a fiscal law, or

(*b*) books, letters, accounts, invoices, financial statements or other documents.

The constitutionality of a similar provision has already been determined by this Court in *McKinlay Transport*, *supra*, as it relates to the expectation of privacy of a taxpayer. In any event, it does not arise in the present case. The way in which the tax authorities obtained copies of the documents does not alter the nature of the information they contain. In either case the same documents are in question. The search warrants in the case at bar and the seizures resulting from their issuance were directed only at the respondents' business documents, production of which may be required under the Act.

The Act further provides that a person may object to the production or seizure of documents containing information protected by professional privilege: see ss. 46 and 53 of the Act respectively. Some of the respondents raised this objection in the present case, and documents seized in the accountants' offices were sealed and entrusted to the prothonotary of the Superior Court pursuant to s. 46 of the Act.

Finally, disclosure of the information contained in the seized documents is itself prohibited by the Act: the tax authorities may not disclose information obtained in the course of their investigation. The first paragraph of s. 69 of the Act provides:

69. All information obtained in the application of a fiscal law is confidential. No public servant shall use such information for any purpose not provided for by law, communicate such information or allow it to be communicated to a person not legally entitled thereto or allow such a person to examine a document containing such information or have access to it.

These provisions minimize the risk that the respondents may suffer harm as a result of the implementation by the tax authorities of the investigative scheme provided by the Act. Their significance cannot be disregarded. They echo the concerns I expressed in *Dyment*, *supra*, at pp. 429-30:

> Finally, there is privacy in relation to information. This too is based on the notion of the dignity and integrity of the individual. . . . In modern society, especially, retention of information about oneself is extremely important. We may, for one reason or another, wish or be compelled to reveal such information, but situations abound where the reasonable expectations of the individual that the information shall remain confidential to the persons to whom, and restricted to the purposes for which it is divulged, must be protected.

Similarly, in *McKinlay Transport*, *supra*, Wilson J. noted at p. 650:

A taxpayer's privacy interest with regard to these documents *vis-à-vis* the Minister is relatively

Digitized by Google

low. The Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them. At the same time, the taxpayer's privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies.

Some may be concerned that the seized documents may contain information of a personal nature. However, that possibility is not, in my view, sufficient to alter the reasonable expectations of privacy of taxpayers in respect of such documents. On the one hand, the Act itself does not permit the seizure of documents containing personal information. Sections 38 and 40 of the Act, as well as s. 39 which authorizes a demand for the production of documents, are directed only at documents the contents of which have some connection with the application of tax legislation to taxpayers. In the highly unlikely event that documents containing information of a personal nature were seized in the course of exercising investigative powers, a taxpayer could always apply to the courts, seeking their exclusion and any other appropriate relief on the ground, for example, that this went beyond the investigators' statutory authority. On the other hand, the respondents themselves have never claimed that documents of that kind were in fact seized in the case at bar. Indeed, the appellants submitted uncontradicted evidence that all the documents seized, including those seized in the private homes of some of the respondents, were covered by the search warrants and related to their business affairs, in particular to the application of the Act to them. This can be seen by examining the written authorizations and the inventory of the documents seized. In the *143471 Canada Inc.* case, for example, the written authorization of the Deputy Minister of Revenue limited the search as follows:

> [TRANSLATION] . . . to search for documents, books, registers, papers or things described in the said written authorization from the judge of the Court of Quebec, namely documents, books, registers, papers or things concerning the operation by 143 471 Canada Inc. of its establishment . . . and the collection by it of the tax provided for in the Meals and Hotels Tax Act (R.S.Q., c. T-3) during the period from June 26, 1985 to June 30, 1988, in particular:
>
> (a)general ledger, sales journal, purchases journal, cash receipts journal, cash disbursements journal, subsidiary journals, wages journal, general journal;
>
> (b)extra-accounting registers and work sheets, sales invoices, purchase invoices, financial statements, bank statements, cheques returned paid, deposit slips and other supporting documents, including contracts concluded with its customers and all documents appended thereto;
>
> (c)lists, notebooks or other documents containing information relating or that may be related to the sales of 143 471 Canada Inc. or to the collection by it of the meals and hotels tax;
>
> which may serve as evidence of the offence mentioned in the said written authorization by the judge of the Court of Quebec . . .

The documents seized in the search made in the *143471 Canada Inc.* case correspond to those identified in the search warrant: bank statements, journal entries, purchase invoices, cheque stubs, cheques debited, financial statements, wages book, receipt contracts and so on. The same is true of the documents seized in the *Tabah* case, though the written authorizations and corresponding seizures are more detailed since the information indicated several breaches of the Act. In any event both the authorizations to search and the documents seized related only to the respondents' business affairs, in particular those required to conform with the Act, and did not concern any document likely to contain personal information. Further, unless a party complains of the seizure of information of a personal nature I do not think it is desirable for the judge who has the responsibility to rule on the motion to

Digitized by Google

impound to examine the contents of the documents seized in order to determine whether the order is appropriate. That would make his task more onerous in view of the difficulties inherent in determining whether the information contained in the documents seized is personal.

Accordingly, I find it difficult to see how the respondents will suffer irreparable harm if the tax authorities examine the contents of the documents seized. Since the respondents have not established any other harm, I now propose to consider the final stage of the *Metropolitan Stores* test.

The Balance of Convenience

The balance of convenience, which constitutes the third criterion relevant in determining whether interlocutory relief should be granted, is designed to weigh the respective hardships the parties may incur depending on whether or not the interlocutory relief is granted.

As the existence of irreparable harm has been ruled out, it is hard to see how the respondents could suffer significant hardship if they were denied the impoundment. As they themselves argue, the only effect of the impounding order is to delay the examination of the documents. It can thus be assumed that at some point or other the respondents will suffer the hardships associated with an investigation by the Ministère du Revenu, whether or not the sections are declared unconstitutional. It should be added that under s. 40.2 of the Act the respondents may obtain copies of the documents seized.

The hardships the appellants are likely to suffer if the impoundment is upheld derive from the delays imposed on the examination of the contents of the seized documents. We may immediately dispose of their effect on the limitations against penal remedies under the Act. Although the impoundment for all practical purposes suspends the investigative proceedings, the actions against the respondents are not jeopardized -- at least in theory -- since the Act provides that the five-year limitation period may be extended to one year from the date the Minister of Revenue learns of evidence sufficient to justify prosecution; see s. 78 of the Act. In the circumstances it is hardly surprising that the appellants placed no great emphasis on the existence of such harm at the hearing; sufficient proof probably could not come to the knowledge of the Minister of Revenue until he had the documents covered by the order in his possession, after the impounding order was lifted.

The appellants added that if the impounding orders are upheld the resulting delays would jeopardize proof of the offences. In this connection they note the difficulties associated with gathering information, the credibility of witnesses, even with the recovery of fees, interest and fines, in view of the risks that the corporate vehicle might be altered or cease to exist. The respondent 143471 Canada Inc. made an assignment of its property on September 1, 1992. While at the present stage of the proceedings this is speculative, the Court can nevertheless take note of the probable occurrence of such hardships. In *Zeppetelli*, Baudouin J.A. acknowledged that impoundment would prevent the Minister of Revenue [TRANSLATION] "from having access for the moment to a great deal of information which might allow him to build his case and achieve substantive progress on the matter" (p. 357).

The respondents argued that in any case impoundment does not have the effect of suspending the Minister of Revenue's investigative powers: he can complete his evidence by other means. However, this option, which appreciably moderates the effect of the measure, disregards the fact that the Minister of Revenue must adduce proof beyond a reasonable doubt. Not only is this a weighty burden, but the proof of offences is complicated here by the very nature of tax evasion, which requires a comprehensive analysis of the accounting system of the respondent companies. In the circumstances there is nothing to suggest that the Minister of Revenue could make significant progress with his investigation if the impoundment were upheld. Further, if the measure had the negligible effect suggested by the respondents, then the applicability of the test set forth in *Metropolitan Stores* would be open to question.

Even if we admit that these hardships are negligible and of a purely administrative

Digitized by Google

nature, the fact remains that the present case has ramifications that go beyond the immediate interests of the parties, if only because of the mandate underlying the action of the Ministère du Revenu. In such a situation *Metropolitan Stores* invites the courts to take the public interest into account in determining the balance of convenience. In the case at bar the Court of Appeal is not only silent on the point but specifically refused to rule on [TRANSLATION] "the reality or existence" of this criterion, which is strange to say the least since in the *143471 Canada Inc.* case it was not sitting in appeal from the judgment of Hannan J. In *Zeppetelli* Baudouin J.A. simply stated that [TRANSLATION] "as between inconveniences of an essentially administrative nature and those involving a constitutionally protected fundamental right, the balance must tip in favour of the latter" (p. 357).

In this regard the appellants rely essentially on the public interest in having the Act observed and enforced. The importance of tax legislation clearly needs no elaboration; see *Air Canada v. British Columbia*, [1989] 1 S.C.R. 1161, and *McKinlay Transport*, *supra*. Because such legislation is based on the principle of self-declaration and self-assessment, the existence of mechanisms making it possible to verify whether taxpayers are subject to the Act is essential. The imposition of such controls is all the more necessary for individuals who act as agents of the government. In Quebec the Act imposes on the Ministère du Revenu the duty of supervising the implementation and execution of tax legislation and confers on it all the powers necessary for this purpose. The implementation of the investigative provisions contained in ss. 40 and 40.1 of the Act is essential if the integrity of the tax collection system is to be maintained. These considerations alone are sufficient to meet the public interest criterion. In *RJR -- MacDonald* the Court wrote (at p. 346):

> In our view, the concept of inconvenience should be widely construed in *Charter* cases. In the case of a public authority, the onus of demonstrating irreparable harm to the public interest is less than that of a private applicant. This is partly a function of the nature of the public authority and partly a function of the action sought to be enjoined. The test will nearly always be satisfied simply upon proof that the authority is charged with the duty of promoting or protecting the public interest and upon some indication that the impugned legislation, regulation, or activity was undertaken pursuant to that responsibility. Once these minimal requirements have been met, the court should in most cases assume that irreparable harm to the public interest would result from the restraint of that action.

The respondents added, however, that the delay in examining the contents of the documents seized causes no injury to the public interest since the interlocutory relief is limited to the present case. The argument in this Court centred on proof of a "flood of actions" since the judgments of the Quebec Court of Appeal in *Zeppetelli* and *Fafard Buildings System Inc. v. R.*, C.A. Montréal, No. 500-10-000409-894, July 10, 1990, J.E. 90-1187. Such proof was viewed as important by both sides in demonstrating the real effect of the impounding order on the public interest.

In my view proof of a flood of actions -- or the lack of it -- is not determinative of whether or not interlocutory relief should be granted. Depending on the nature and scope of the measure contemplated, as well as the particular circumstances of each case, the court might take note of the impact of a decision exempting a party from the application of a statute on future litigants, who would be tempted to rely on it. In *Metropolitan Stores* Beetz J. wrote (at p. 146):

> The reason why exemption cases are assimilated to suspension cases is the precedential value and exemplary effect of exemption cases. Depending on the nature of the cases, to grant an exemption in the form of a stay to one litigant is often to make it difficult to refuse the same remedy to other litigants who find themselves in essentially the same situation, and to risk provoking a cascade of

Digitized by Google

stays and exemptions, the sum of which make them tantamount to a suspension case.

It is not desirable to impose on the party arguing that an interlocutory application should be dismissed a requirement that he prove the harmful effect of previous orders. How could the threshold of such evidence be determined? Such a burden would not only be likely to trivialize the public interest considerations underlying the balance of convenience test, it would be at odds with the preventive purpose of interlocutory relief.

The parties drew the Court's attention to about ten decisions on applications to impound documents incidental to a constitutional challenge based on ss. 40 and 40.1 of the Act. Clearly these few decisions are far from suggesting the existence of a "flood of actions". It is significant, however, that all motions to impound subsequent to the decision of the Court of Appeal in *Zeppetelli*, *supra*, have been granted. Needless to say, the orders expressly cited the reasons given by Baudouin J.A. By way of contrast, the applications to impound prior to that decision were denied (except the one in *Ameublement Jeanne Inc. v. Québec (Procureur général)*, Sup. Ct. Montréal, No. 500-05-003335-872, April 15, 1987, which was granted on consent). For example, in *Brochetterie Tino Inc. v. Québec (Procureur général)*, Sup. Ct. Montréal, No. 500-05-008861-898, July 17, 1989, [1989] R.D.F.Q. 98, Lesyk J. wrote (at pp. 3-4):

> [TRANSLATION] Granting impoundment of the documents seized would set a precedent in enforcement of the Act that might be followed in seizures of the same kind and might accordingly render ss. 40 and 40.1 of the Act respecting the Ministère du Revenu inoperative for a more or less extended period, with the consequences that might follow for the obligations and duties imposed on the operators of the establishments subject to the Meals and Hotels Tax Act.
>
> Granting the application to impound without extremely sound and exceptional grounds, which do not exist in the present case, would also amount to suspending the application of ss. 40 and 40.1 of the Act respecting the Ministère du Revenu adopted by the democratically elected National Assembly in the common interest. Such impoundment would be likely to temporarily frustrate pursuit of the common interest and would have the effect of preventing the Minister of Revenue from carrying out the duty imposed on him by law, namely of applying tax legislation.
>
> When a Minister of the Crown is prevented from exercising the powers conferred on him by law the public interest of which the Minister is the guardian suffers irreparable harm.

This approach seems to me to be consistent with the above-cited passages from *RJR -- MacDonald* and *Metropolitan Stores*. See also *Restaurant le Gourmet grec Inc. v. Séguin*, Sup. Ct. Montréal, No. 500-05-004272-892, April 5, 1989, [1989] R.D.F.Q. 80, where Brassard J. refused to order impoundment on the ground that the harm alleged by the applicant could not override the public interest.

In any event, although it is not possible to speak of a "flood of actions", the systematic nature of the impounding orders since *Zeppetelli* cannot be ignored, and this can only be enhanced by the Court of Appeal decisions in the present case. To the extent that trial courts are bound by decisions of the Quebec Court of Appeal, it is doubtful whether they have much real manoeuvring room in the exercise of their discretion. Under the present case law it appears that any well-informed litigant can have an investigation suspended by attaching to his motion for evocation, *certiorari* and mandamus a motion to impound the documents seized.

The marginal nature of motions to impound is best explained by the limited number of searches conducted each year. As an indication of the impact of impoundment on the public interest the number of searches is certainly a better yardstick than the total of Quebec taxpayers. The evidence shows that implementation of the investigative powers set out in

Digitized by Google

ss. 40 and 40.1 of the Act is likely to lead to the recovery of large sums estimated at about a hundred million dollars in fees, interest and fines, just for the period from April 1, 1988 to March 31, 1992. The amounts involved in the present cases are also non-negligible since they exceed $250,000, not including, in the *Tabah* case, an amount of some one million dollars which was allegedly not included in calculating income. Further, if we are to believe certain studies estimating at several hundred million dollars the annual losses resulting from tax evasion, the amounts recovered through the implementation of investigative powers are only the tip of the iceberg. That being the case, we cannot minimize the importance of ss. 40 and 40.1 of the Act, which form the principal tool available to the Ministère du Revenu to fight tax evasion, not only in dealing with ongoing offences but especially for its deterrent value. In view of the burden of proof -- beyond a reasonable doubt -- and the difficulties of proof inherent in the nature of offences against the tax laws, even temporarily watering down investigative powers has more than a symbolic effect on the public interest.

The respondents made no arguments regarding the public interest in maintaining impounding orders. It is clear that there is also a public interest in having the government respect the fundamental rights of taxpayers, including the right to privacy and protection against unreasonable intrusions by the government. However, bearing in mind that in the present case the courts have not yet found the intrusion to be unreasonable -- a question which will be decided in the principal action, with the appropriate relief if necessary -- this aspect cannot have much weight here, especially when considered in light of the comments I have made regarding irreparable harm. In other words, to paraphrase the reasons of my colleagues in *RJR -- MacDonald*, the respondents have not persuaded me of the advantages to the public interest of granting impoundment of the documents seized.

Conclusion

For these reasons I would allow the appeal with costs, set aside the decisions of the Court of Appeal and quash the impounding orders.

The judgment of Sopinka, Cory and Iacobucci JJ. was delivered by

CORY J. -- In this matter I have had the pleasure of reading the careful reasons of my colleague La Forest J. I am in complete agreement with his view that the governing principles to be applied in this case are set out in the reasons of this Court in *Manitoba (Attorney General) v. Metropolitan Stores Ltd.*, [1987] 1 S.C.R. 110, and in *RJR -- MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311. These decisions indicate that in considering an interim measure such as an injunction or an impounding order in the context of a *Charter* challenge to the validity of the underlying law a court must consider three factors. The first, is whether a serious question of law is raised. The second, is whether irreparable harm will be occasioned to the applicant if the interim order is refused. The third, requires the court to consider and weigh in the balance the inconveniences caused to the parties by the interim order.

Further, I am in agreement with my colleague that there is a serious question of law raised in this case. It is in the application of the factors pertaining to irreparable harm and the balance of inconvenience that I differ with his views.

The facts giving rise to this appeal are set out in the reasons of La Forest J. and need not be repeated.

The Nature of the Questioned Orders

At the outset I would observe that the orders in issue on this appeal are discretionary in nature. Like all discretionary decisions, they should be accorded a measure of deference. See, for example, *Hadmor Productions Ltd. v. Hamilton*, [1982] 1 All E.R. 1042; *Aetna Financial Services Ltd. v. Feigelman,* [1985] 1 S.C.R. 2, at p. 37; *Metropolitan Stores*, *supra*, at pp. 154-56; and *Friends of the Oldman River Society v. Canada (Minister of Transport)*, [1992] 1 S.C.R. 3, at pp. 76-77. Since I am of the view that the decisions of the judges hearing the original

Digitized by Google

motions were correct, I need not consider the question of deference.

Irreparable Harm

There are a number of matters that must be conceded at the outset. The documents seized in this case are commercial in nature. It follows that there cannot be the same privacy interest in those documents that there would be in personal papers. The expectation of privacy in business records is necessarily low. They do not ordinarily contain the type of personal information that lies at the heart of the constitutional protection of privacy. Further, it must be recognized that the state must have the power to regulate business, both for economic reasons and in order to provide protection to the vulnerable individual against private power. This was set out with great cogency by La Forest J. in *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425, at pp. 517-18. It follows that since the search in this case was made pursuant to a regulatory statute in the highly regulated field of restaurants and hotels the expectation of privacy must of necessity be diminished.

Those who enter a regulated field must accept regulations as an integral part of their business operations. It has been recognized that there is a significant distinction between searches and seizures effected pursuant to a regulatory statute and searches and seizures made pursuant to the *Criminal Code,* R.S.C., 1985, c. C-46, or statutes of a quasi-criminal nature. This was the view of four of five judges in both *Thomson Newspapers* and in *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627.

In *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154, although there was disagreement as to its application, eight of nine judges affirmed the principle enunciated in *Thompson Newspapers* and *McKinlay Transport* that there is a relevant and significant distinction to be drawn between a statute that is criminal and one which is regulatory in nature when the application of the *Canadian Charter of Rights and Freedoms* to those statutes is to be considered.

In *Wholesale Travel Group*, I attempted to indicate the basis for the distinction. The distinction can properly be based upon both the licensing concept and the need to protect the vulnerable. In today's complex society, individuals are frequently placed in vulnerable situations. An individual often does not and cannot have the requisite knowledge or training to determine what may be safe and what is dangerous. For example, it is essential that there be regulations to protect the environment from poisonous effluent; to protect individuals from the sale of dangerous products or patent medicines; to ensure there is a reasonable standard of safety in mines, factories, construction sites and all workplaces; to ensure that food is prepared in sanitary conditions and that public and commercial buildings are constructed in a reasonably safe manner. The protection of all, and particularly the vulnerable, by regulation requires that government agencies be authorized to inspect premises and to review books and records. Those who enter a regulated field must be aware of those regulations. By entering that field they have accepted that their business will be regulated.

In *McKinlay Transport*, the majority of this Court held that the *Income Tax Act*, R.S.C. 1952, c. 148, is regulatory in nature, since in the words of Wilson J., at p. 641, "it controls the manner in which income tax is calculated and collected". There, it was held that the purpose of the investigation and enforcement provisions of the Act was not so much to penalize criminal conduct as to secure compliance with the provisions of the Act. The legislation at issue in this case (*An Act respecting the Ministère du Revenu*, R.S.Q., c. M-31) serves the same purpose as the *Income Tax Act* and like that statute is regulatory in nature. There is, then, a relatively low expectation of privacy in the documents seized in this case.

With all of that stated and accepted, there still remains some measure of privacy in commercial documents. They will inevitably reveal aspects of the business that the operator would rather have kept private. For example, one supplier may be paid on a COD basis and

Digitized by Google

another 90 days after delivery. These arrangements may have arisen from circumstances which prevailed years ago and have continued without thought of change to the present time. A business would never want to have those arrangements made public. Similarly, the record of wages paid to employees may reflect a higher wage rate to a particularly loyal and trusted employee than to another carrying out the same function. This information too is sensitive and something that the business operator would prefer to keep private. It is true that under the *Act respecting the Ministère du Revenu* the government employees are forbidden to disclose information obtained from the documents. However, the mere fact that the documents have been seized and must be reviewed by the government officers will be a cause for concern for the proprietor of the business.

It must be remembered that ss. 40 and 40.1 of this Act provide for searches and seizures of a wide range of documents ("books, registers, papers or other things that may be used as evidence of an offence against a fiscal law or a regulation made by the Government under such law"). Thus, the government may seize a far broader range of documents than those required by the Act and its regulations to be prepared and maintained by the business enterprise. As well, the Act allows for searches and seizures of documents in the possession of third parties who are not the subject of an investigation. It was these same factors that led four of the five judges sitting on *McKinlay Transport* to conclude that the compelled production of documents provided for in s. 231(3) of the *Income Tax Act* constituted a seizure for the purposes of s. 8 of the *Charter* because there was, for the proprietor, a privacy interest in the documents. That same reasoning is applicable to the facts presented by these cases.

The purpose of an interlocutory stay is to preserve the rights of applicants (the respondents before this Court) pending a final determination of a legal question which will affect those rights. Here, the respondents seek not the return of their documents, but simply the maintenance of the orders that they be held by the court pending the determination of this issue. If it is found that the respondents are correct and that the searches and seizures were unconstitutional, then the privacy right will have effectively been lost as a result of the unconstitutional provisions of the Act. Small as it may be, there is such a privacy interest. If it transpires that the respondents are correct in their constitutional contention, then I would think that the loss of that privacy interest would, in itself, constitute irreparable harm.

Yet there is another aspect which I consider to be far more significant in this case. Namely, that the documents were obtained by means of intrusive searches of residential and business premises.

In *Baron v. Canada*, [1993] 1 S.C.R. 416, at p. 444, it was recognized that although characterizations such as "regulatory" and "criminal" are useful for purposes of *Charter* analysis, they do not provide a complete answer. What must always be considered are the values which are at stake on the facts of the particular case. Here, it is true that the search was made pursuant to the provisions of a regulatory statute dealing with the highly regulated business; however, a court must still be concerned with the nature of the physical searches of private premises. Obviously, searches of private property are far more intrusive than a demand for production of documents. The greater the intrusion by the searchers into the business premises and private residences, the greater weight should be attached to the provisions of s. 8 of the *Charter*. Thus, although the privacy interest of an individual in business documents pertaining to a regulated field is relatively low, there remains a very real and significant privacy interest in maintaining the inviolability of residential premises, and to a lesser extent of business premises. This was recognized by Wilson J. in *McKinlay Transport*, *supra*, at p. 649:

> The greater the intrusion into the privacy interests of an individual, the more likely it will be that safeguards akin to those in *Hunter* will be required. Thus, when the tax officials seek entry onto the private property of an individual to conduct a search or seizure, the intrusion is much greater than a mere demand for production of documents.

Digitized by Google

> The reason for this is that, while a taxpayer may have little expectation of privacy in relation to his business records relevant to the determination of his tax liability, he has a significant privacy interest in the inviolability of his home.

It is on this issue that I find that I must take a position diametrically opposed to my colleague. The documents were seized from homes and business premises. The seizure of those documents cannot be divorced from the intrusion into private premises. The search and seizure of the documents are part and parcel of the same sequence of events. They are an integral part of the whole. It should not be said that once the documents are seized it is no longer necessary to consider the intrusion into homes and offices. The documents were obtained as a result of that intrusion. The violation of privacy interest resulting from that intrusion cannot end with the removal of the documents. So long as the documents are held by or on behalf of the appellants there is a continuing violation of the privacy interest of the respondents in their residences and business premises.

The constitutionality of ss. 40 and 40.1 of *An Act respecting the Ministère du Revenu* will be determined in the principal applications to quash the warrants. Should those sections eventually be found to be unconstitutional, then the searches and seizures will have violated the privacy interest of the respondents in their homes and offices. The government will, without authority, have entered the premises and searched for and seized the documents. Thus the government will have had the continuing possession of the documents in the absence of any authority and in violation of the *Charter*. This, it seems to me, would constitute irreparable damage to the respondents.

The provision for the impounding orders seems eminently fair for all parties. While the documents are impounded they cannot be altered or changed in any way by the respondents. The documents will thus remain protected while the court carries out the judicial function of determining the constitutionality of the legislation. There could be no question of the fairness and efficacy of such an order if the issue could be determined in a reasonable time; say two weeks or two months, or even six months. If the court cannot determine the issue within a reasonable time, then I wonder whether it is the respondents or the government that should suffer as a result of the delays.

In my view, it is irrelevant that the appellants could have lawfully gained possession of these documents by means of a demand made pursuant to ss. 38 or 39 of the Act. The fact remains that they were gained through searches and seizures conducted pursuant to ss. 40 and 40.1. The appellants chose the method of proceeding. They obtained the documents by means of intrusive searches of residential and business premises. The appellants cannot now rely on the fact the documents might have been obtained in some other way.

I cannot accept the appellants' argument that since s. 69 of the Act provides for the confidentiality of tax documents this section will protect the privacy interests of the respondents. Although s. 69 protects the respondents from public release of information contained in the documents, it does not protect them from having their privacy interests in their homes and offices violated by the state. This is the very interest that s. 8 of the *Charter* is aimed at protecting. Section 69 does not adequately protect the respondents' privacy interests in the documents. Nor can I accept that the breach of the privacy interest can be quantified and the respondents compensated in damages. There will always be problems in any attempt to quantify and to compensate the breach of a *Charter* right. The nature of the right to compensation for breaches of *Charter* rights is still highly uncertain. See *RJR -- MacDonald*, *supra*, at p. 342.

In summary then, there is some small privacy interest in commercial documents. The seizure by way of intrusive searches of business premises and private residences was and continues to be an integral part of the seizure. The intrusive nature of the search cannot be isolated from the taking of the documents. It is highly speculative to expect that a breach of

Digitized by Google

privacy interests, not only in the documents, but also in the homes and offices of the respondents, could be compensated in damages. Thus, if the respondents are successful in the principal motions, they would suffer irreparable damage if the impounding orders, which constitute a very fair disposition of the matter, were to be set aside. It is then necessary to consider whether the public interest would be harmed by this apparently fair solution.

Balance of Inconveniences

It is under the balance of inconveniences branch of the *Metropolitan Stores* test that this case should really be decided. Obviously, the public interest is a very important consideration in determining whether an interlocutory impounding order should be set aside. What is being considered is a regulatory scheme dealing with the restaurant and hotel business. All who enter this field must be aware of the governmental regulations and know that they must comply with them. Those regulations are of great importance for the health and safety of the public. Thus, there clearly is a public good derived from the regulations. That public good must weigh heavily in the public interest in considering whether the interlocutory impounding orders should be set aside. Further the public good which results from the collection of revenues derived from taxation statutes is obviously a factor that should weigh heavily in assessing the balance of convenience. There is no question that to ensure compliance with any taxation legislation powers of investigation and enforcement are essential. These are all factors to be taken into account and considered to be favourable to the position of the Ministère du Revenu.

With all that recognized, it still must be determined whether the holding in escrow of the documents seized pending the determination of the constitutional validity of the search provisions of the Act should be upheld in light of the remaining privacy interest in those documents and in the homes and offices of the respondents. My colleague begins his analysis of the balance of inconveniences by observing that the impounding orders will merely delay the appellants' opportunity to look at the documents seized. Therefore, he continues, it can be presumed that the respondents will at one time or another suffer the inconveniences related to the investigation by the Ministère du Revenu (i.e., the appellants seeing the documents seized). With respect, I disagree. His approach assumes that the respondents will lose the main applications to quash the warrants. Any remedy in the nature of an interlocutory stay or impounding order is predicated on the possibility that the party applying for the stay will eventually be successful. Obviously, if the respondents are successful in the main applications, then they will not suffer a violation of their privacy interests. As I have observed, the impounding orders protect both the integrity of the documents and the privacy interest of the respondents. The impounding order is an eminently sensible interlocutory measure, provided that it does not harm the public interest.

What then is the detriment that the Ministère du Revenu will suffer if the impounding orders are upheld? After a review of the evidence provided in this case, I have come to the conclusion that the Ministère du Revenu and the public interest in the enforcement of taxation statutes would suffer little, if at all, from the granting and maintaining of these orders.

Quite simply, the evidence does not support the appellants' submission that the orders in these cases will paralyse the enforcement of taxation statutes in the province. The appellants are still at liberty to carry out searches and effect seizures. The appellants can still investigate and proceed under other sections of the Act, specifically ss. 38 and 39. Accepting, for the purpose of argument, the appellants' contention that this case will act as a precedent, it must be observed that there are so few searches and seizures carried out each year under taxation statutes in the province that this case is still one of exemption and not of suspension. In *RJR -- MacDonald*, *supra*, it was held that the onus of demonstrating harm to the public interest is a relatively low one for government authorities opposing interlocutory orders. The following appears at p. 346:

Digitized by Google

> The test will nearly always be satisfied simply upon proof that the authority is charged with the duty of promoting or protecting the public interest and upon some indication that the impugned legislation, regulation, or activity was undertaken pursuant to that responsibility. Once these minimal requirements have been met, the court should in most cases assume that irreparable harm to the public interest would result from the restraint of that action. [Emphasis added.]

However, the public interest will not always be harmed by granting a stay, particularly where the case in one of exemption rather than suspension (at p. 346):

> Consideration of the public interest may also be influenced by other factors. In *Metropolitan Stores*, it was observed that public interest considerations will weigh more heavily in a "suspension" case than in an "exemption" case. The reason for this is that the public interest is much less likely to be detrimentally affected when a discrete and limited number of applicants are exempted from the application of certain provisions of a law than when the application of the law is suspended entirely.

The sole adverse effect of the impounding orders is that the appellants will not be able to see the documents seized until the constitutionality of the legislation is determined. The evidence indicates that this may delay the investigation in two ways. First the documents seized may well contain evidence which can be used in the prosecution. Secondly, the documents seized may enable the investigators to find additional evidence in the form of witnesses and other documents. The evidence does support the appellants' submission that the delay caused by the impounding orders may make it more difficult for the investigators to find more evidence in the form of other documents and witnesses when the orders are lifted.

However, the evidence also establishes that there are some avenues of investigation which can still be pursued while the impounding orders are in place. Further, it is clear that very few searches are conducted in a year. Quebec has approximately 4.2 million individual taxpayers, 240,000 corporate taxpayers, 223,000 employers, and 302,000 "agents". Despite the large base of taxpayers, the Ministère du Revenu of Quebec, carries out only some 45 investigations per year under all taxation legislation. Further, only some 25 searches and seizures are carried out in these 45 annual investigations. These statistics clearly indicate that the impounding orders will not curtail the investigative process.

The appellants further allege that it is confronted with a problem by the systematic granting of impounding orders with respect to documents seized pursuant to s. 40 of the Act. The appellants refer to eight cases, including the two which are the subject of this appeal.

Those cases are as follows: *Ameublement Jeanne Inc. v. Québec (Procureur général)*, Sup. Ct. Montréal, No. 500-05-003335-872, granted April 15, 1987; *Brochetterie Tino Inc. v. Québec (Procureur général),* Sup. Ct. Montréal, No. 500-05-008861-898, denied July 17, 1989, [1989] R.D.F.Q. 98; *Restaurant le Gourmet grec Inc. v. Séguin,* Sup. Ct. Montréal, No. 500-05-004272-892, denied April 5, 1989, [1989] R.D.F.Q. 80; *Courrier grec du Canada Ltée v. Québec (Procureur général)*, Sup. Ct. Montréal, No. 500-05-002016-895, denied February 24, 1989; the present appeal *143471 Canada Inc.* and *Tabah*; *Cuisines Multiform internationales Inc. v. Angers*, granted January 31, 1992, [1992] R.D.F.Q. 46 (Sup. Ct.), and Sup. Ct. Montréal, No. 500-05-002049-920, granted April 14, 1992, [1992] R.D.F.Q. 126; *Électro Marine Diesel Inc. v. Québec (Procureur général)*, Sup. Ct. Montréal, No. 500-05-005278-922, granted April 28, 1992, [1992] R.D.F.Q. 125. The respondents also brought to the Court's attention *Groupe Shakiba Inc. v. Québec (Procureur général)*, Sup. Ct. Québec, No. 200-05-001644-934, granted June 3, 1993, [1993] R.D.F.Q. 70. These cases reveal that over a six year period, of nine motions, five were granted (one of these, *Ameublement Jeanne Inc.* was on consent), and four were refused.

It is true that these cases reveal that no applications for impounding orders have

Digitized by Google

been denied since the decision of the Court Appeal of Quebec in *Zeppetelli v. Canada*, [1990] 2 C.T.C. 354. However, it is also true that they do not disclose a problem of a flood of impounding orders. The figures reveal not a flood, but at most a very slow and irregular trickle. I cannot accept that the enforcement of taxation statutes in the province of Quebec will be paralysed by impounding orders when the scant number of searches and seizures is compared to the number of taxpayers in the province.

It is not without significance that the Superior Court judges who heard the initial applications for the impounding orders, specifically found that there was no evidence that these orders would paralyse the investigation and prosecution of offences. Marquis J. in the *Tabah* case, [1990] R.D.F.Q. 90, wrote (at p. 96):

> [TRANSLATION] The respondents argue that if the present application is granted there will be such an increase in this type of action that eventually enforcement of the Act will be paralyzed.
>
> It should be noted in this regard that this is a case concerning the meals and hotels tax. The evidence is that the Department conducts forty-five (45) investigations per year under this Act: twenty-five (25) of these result in searches. To date an impounding order has only been granted once. The fear of Department employees is understandable but is not based on any factual evidence adduced. [Emphasis added.]

Hannan J. in *143471 Canada Inc.*, [1990] R.D.F.Q. 104, wrote (at p. 109):

> [TRANSLATION] Clearly this affidavit indicates that the effect of a stay would not be to suspend any other investigation or prosecution of the applicants [respondents before this Court] for any other offence in respect of any other period. It would not have the effect of limiting the application of any tax legislation to any taxpayer or even to the applicants, except for use of the documents subject to the seizure.

Further, there cannot be any suggestion that the orders in these cases were granted on the basis of judicial "rubber stamping". The cases were argued extensively and careful reasons delivered. For example, the argument in the *Tabah* case lasted three days and that in *143471 Canada Inc.* lasted two days. In both cases the reasons given for the orders were careful and detailed.

The evidence clearly establishes that the granting of impounding orders will certainly not paralyse the enforcement of taxation laws in the province of Quebec. Even if in every case where searches were carried out, impounding orders were in fact issued, this would not have the effect of paralysing the enforcement of taxation legislation. It must be remembered that the impounding orders do not prevent searches. They do no more than delay the appellants viewing the documents seized. It cannot be said that the impounding orders in this case so interfere with the enforcement of taxation laws as to seriously harm the public interest. I think it unlikely that citizens will consider that they can break taxation laws with impunity when searches and seizures can still take place. Obviously, the balance of convenience would be very different if the respondents were seeking to have the carrying out of searches and seizures pursuant to ss. 40 and 40.1 of the Act enjoined. Here, the respondents seek no more than the maintenance of the impounding orders. Further, like La Forest J., I would conclude that the limitation period for laying charges will not run while the impounding orders are in effect. In the circumstances, I can reach no other conclusion than that the balance of convenience favours the respondents.

I agree with my colleague that the presence or absence of a flood of applications is not determinative in deciding whether an interlocutory order should be granted. The nature and scope of the order requested, as well as the circumstances of each case will determine whether the court hearing the application should be concerned about a flood of similar requests.

Digitized by Google

However, those concerns cannot be based on mere speculation. In my view, for a court to act based upon those concerns, there must be a substantial risk that there will be a flood of requests.

In this case, the evidence simply does not support the proposition that there is a probability, or even a real possibility, let alone a substantial risk, that there would be a flood of similar requests as a result of granting these applications.

My colleague suggests at the end of his reasons that there is an onus on an applicant for an interlocutory stay or impounding order (the respondents before this Court) to show that granting the stay or impounding order forwards the public interest. The discussion in *RJR -- MacDonald* at pp. 343-47 on which my colleague relies does not hold that in all cases an applicant for a stay must show that granting such an order is in the public interest. As a general rule all an applicant need show is that the public interest is not hurt by the order. What that passage considers is the situation where an applicant argues not only that its own private interest but also the public interest will be hurt by the refusal of a stay. In those circumstances, the private applicant has a higher threshold than the government respondent to establish that the public interest is served by its position. That is not this case. While in a general sense it can be said that there is a public interest in preventing unconstitutional searches, the respondents in this case do not rely on that public interest to support the impounding orders. Rather, they rely on their own privacy interests, and the fact that the public interest will not be harmed by granting the impounding orders. Thus, the respondents in this case only have to show that granting the orders will not harm the public interest, not that granting the orders will forward the public interest. This the respondents have done.

In summary, the evidence establishes that there is no serious interference with the enforcement of taxation statutes resulting from the granting of the impounding orders. There is then, no interference with the public interest and on this basis the impounding orders should be upheld. Further, even if it can be said that in a certain sense, the irreparable harm the respondents would suffer from the refusal of the impounding orders is small, since there is no significant interference with the public interest, the impounding orders should be upheld.

Delay

As I have indicated, if the judicial system could deal with the constitutional issue within a relatively short period, there would be no question that the impounding order would be the fairest and most reasonable method of proceeding. The prosecution would be protected, since the documents seized would be in safe keeping and could not be altered or changed. At the same time, the respondents' privacy interest in the documents, small though it may be, would be protected. How long is reasonable? Obviously, if the delay were a matter of weeks there would be no problem. Just as clearly, if the determination could be made within six months, there could be no significant prejudice suffered by anyone. It seems the delay will be longer than that in the province of Quebec. Judges of the Trial Division and the Court of Appeal work well and diligently under the pressure of an ever increasing case load. Courts and judges can do no more. Who then should bear the responsibility for that delay? Surely it should not be the individual, where as in this case, a serious question of law is raised as to the constitutional validity of search and seizure provisions of the legislation. The respondents should not suffer as a result of judicial delay. Ordinarily I would trust that this matter could be expedited and disposed of by the Court of Appeal of Quebec as expeditiously as possible. This Court has been advised that the Court of Appeal of Quebec granted the request of the respondent 143471 Canada Inc. to expedite the hearing of the appeal. The appeal was heard April 13, 1994. The Court of Appeal of Quebec dismissed the appeal on May 18, 1994, J.E. 94-934. I would expect that the application of Tabah would be bound by this decision. As a result it is not necessary to consider a direction to expedite the hearing of the appeal in *143471 Canada Inc.* or the application in *Tabah*.

Digitized by Google

Disposition

In the result, I would dismiss the appeal with costs.

Appeal dismissed with costs, LA FOREST, L'HEUREUX-DUBÉ *and* MCLACHLIN JJ. *dissenting*.

Solicitors for the appellants: Veillette & Associés, Montréal.
Solicitors for the respondents: Phillips & Vineberg, Montréal.
Solicitors for the respondent Hétu: Woods Brouillette Des Marais, Montréal.

Obtain Information On Unnamed Taxpayers From Third Parties

Subsections 231.2(2)-(6) provide the means by which the Minister can look into the tax affairs of unnamed persons via sending a request for information concerning them to third parties. There are, understandably, limits on this power that many defences have attempted, in some cases successfully, to call "a fishing expedition" into a taxpayer's affairs.

The Historic SCC on Unnamed Persons – Tempered Now

There is a considerable amount of jurisprudence examining the limits of this power, one of the founding cases of which is James Richardson & Sons v. M.N.R.[86] whereby the Minister went on a foray into a future broker's activities, including making requests of the customers' identities and activity, to gather information on whether, generally, there was proper tax reporting being done by this type of group. The Minister did acknowledge that no one was under investigation which is important since there must be a genuine tax enforcement intent when the RFI under this provision is affected. On appeal to the SCC the Court held:

> The Minister of National Revenue in a check on futures traders' compliance with the *Income Tax Act* demanded and received from the appellant confidential information about the trading activities of its customers in 1977 but was not given the means to identify individual accounts. Although the appellant had been told that other commodity brokers would also be approached to participate in the project, demands for information were made only on the appellant. On appellant's refusal to identify its customers' accounts, respondent served a formal demand under s. 231(3) of the Act. Later, similar demands were made with respect to 1978 and 1979. The Minister acknowledged that neither the broker nor any of its customers were the subject of investigation by the Department in respect of their tax liability. Appellant attacked the validity of these demands in *certiorari* and declaratory proceedings in the Federal Court. These actions, which were consolidated at trial, were dismissed by the trial judge. Appeals to the Federal Court of Appeal were also dismissed.
>
> *Held*: The appeals should be allowed.
> The Minister cannot under s. 231(3) of the Act conduct a "fishing expedition" into the trading activities of the customers of one broker. A demand can only be made for information relevant to the tax liability of a person or persons under that section if a genuine and serious inquiry is being conducted into the tax liability of such person or persons. The section does not authorize a general survey of compliance by a class of taxpayers. This can be effected under ss. 221(1)(*d*) and 233 but only if the Minister has obtained a

[86] [1984] 1 S.C.R. 614

Digitized by Google

regulation under s. 221(1)(*d*) requiring all traders to file returns of their futures activities.
Given the statutory interpretation of s. 231(3), it was not necessary to consider the constitutional questions arising out of this case.
The events leading up to the demand for information from the appellant are relatively complex but the most relevant ones can be stated fairly simply. The appellant is a commodities futures market broker in Winnipeg. In October 1974 the Department of National Revenue decided that it was necessary to check on compliance with the *Income Tax Act* by traders in the commodities futures market. In June 1979, after the appellant had queried the Department's legal authority to demand from it confidential information about its clients' affairs but had nevertheless participated in a feasibility study, the Department requested the appellant's magnetic tape file of their clients' commodity monthly statements for 1977 so that it could process the information on a test basis. The Department guaranteed confidentiality of the data during the test period and undertook to advise the appellant of any subsequent intention to use the information in an income tax compliance project. It also agreed to treat other Canadian commodity brokers in a similar way by inspecting their files for use in any such project.
The appellant supplied the information but with clients' account numbers only and no means of identifying them. In December 1979 the respondent requested the following information:
a complete listing of office locations identifying each by the office number; and
a complete listing of customers' names and addresses, identifying each by account number.

The Federal Court of Appeal

In the Federal Court of Appeal [reported at [1983] 1 F.C. 257] the appellant submitted, relying on the *Canadian Bank of Commerce* case, that a requirement for information under s. 231(3) was not for a purpose related to the administration or enforcement of the Act unless the purpose was to obtain information relevant to the tax liability of some specific person or persons whose tax liability was currently under investigation. It argued that the requirements in the present case did not meet this test. A requirement for information concerning all the customers of the appellant engaged in commodity trading was not, it submitted, a requirement related to some specific person or persons within the meaning of the *Canadian Bank of Commerce* decision.
Mr. Justice Le Dain, speaking for a unanimous Court, held that the judgment in the *Canadian Bank of Commerce* case presented no obstacle to the Minister in this case. The verification of compliance with the *Income Tax Act* by the commodity trading customers of the appellant was undoubtedly a purpose related to the administration and enforcement of the Act within the meaning of s. 231(3), and s. 231(3) was within the legislative authority of Parliament under s. 91(3) of the *Consitution Act, 1867.* Moreover, the Department was engaged in a genuine and serious inquiry into the tax liability of some specific person or persons. Mr. Justice Le Dain said, at p. 270:
The judgment in *Canadian Bank of Commerce* was based on the agreed fact that the requirement in that case related to a genuine and serious inquiry into the tax liability of some specific person or persons, but I do not read the judgment as purporting to treat that as the only valid purpose under what is now subsection 231(3). In any event I am far from certain that the present case is essentially distinguishable from that on which the majority of the Supreme Court based their conclusion. In the majority opinion of Cartwright J. (as he then was) the words "some specific person or persons" are obviously understood as referring not to named person but merely to existing identifiable persons. A reference to all of the commodity trading customers of the appellant comes within this meaning of the words.

Digitized by Google

Leave to appeal to this Court was granted and the following questions settled by order of the Chief Justice:

Is Section 231(3) of the *Income Tax Act,* S.C. 1970-71-72 C. 63 as amended, *intra vires* the Parliament of Canada under the provisions of Section 91(3) of the *Constitution Act, 1867*?

Are the Demands made upon the Appellant, James Richardson & Sons, Limited under Section 231(3) of the *Income Tax Act* S.C. 1970-71-72 C. 63 as amended, void under the provisions of the *Canadian Charter of Rights and Freedoms*?

Are the Demands made upon the Appellant, James Richardson & Sons, Limited under Section 231(3) of the *Income Tax Act,* S.C. 1970-71-72 C. 63 as amended, void under the provisions of the *Canadian Bill of Rights*?

The appellant appeals on four grounds, namely:

the requirements are not authorized by s. 231(3) of the Act;

section 231(3) of the Act is *ultra vires* the Parliament of Canada;

the requirements are void under the provisions of the *Canadian Charter of Rights and Freedoms*; and

the requirements are void under the provisions of the *Canadian Bill of Rights.*

If the appellant succeeds on the first ground as a matter of statutory interpretation then it is not necessary to consider the constitutional issues raised in the other three grounds.

The respondent counters these arguments by saying that what is required from the appellant is not the "information returns" mentioned in s. 221(1)(*d*). Nor have the demands for information in this case been made of a "class of persons" as s. 221(1)(*d*) requires. The respondent says that s. 22l(1)(*d*) contemplates the filing of information returns by a general class of persons on a regular basis whereas s. 231(3) is "part of the Department's investigating tools to obtain information". Such tools are vital, the respondent submits, to a self- assessment system. Nothing, he says, in either s. 221(1)(*d*) or s. 233 prevents the respondent from requiring under s. 231(3) information from a specific commodities broker regarding the tradings of a specific group of traders in commodities futures in respect of a specified period of time. The respondent submits that the case is squarely covered by this Court's decision in the *Canadian Bank of Commerce* case, *supra.*

The language of s. 231(3) of the *Income Tax Act* is unquestionably very broad and on its face would cover any demand for information made to anyone having knowledge of someone else's affairs relevant to that other person's tax liability. It would, in other words, if construed broadly, authorize an exploratory sortie into any taxpayer's affairs and require anyone having anything to contribute to the exploration to participate. It would not be necessary for the Minister to suspect non-compliance with the Act, let alone to have reasonable and probable grounds to believe that the Act was being violated as required in s. 231(4). Provided the information sought had a bearing (or perhaps even could conceivably have a bearing) on a taxpayer's tax liability it could be called for under the subsection.

The *Canadian Bank of Commerce* case, however, makes it clear that the subsection is not to be construed that broadly. It establishes through the majority judgment written by Mr. Justice Cartwright (as he then was) that:

the test of whether the Minister is acting for a purpose specified in the Act is an objective one and has to be decided on the proper interpretation of the subsection and its application to the circumstances disclosed;

the obtaining of information relevant to the tax liability of some specific person or persons whose liability to tax is under investigation is a purpose related to the administration or enforcement of the Act;

it is not necessary that the person from whom the information is sought be one whose

Digitized by Google

liability to tax is under investigation;
the fact that the giving of the information may disclose private transactions involving persons who are not under investigation and may not be liable to tax does not invalidate the requirement.
The respondent acknowledges that neither the appellant nor any of its customers is a person whose tax liability is under investigation within the meaning of the *Canadian Bank of Commerce* case. It submits however, that that is only one of the purposes contemplated by s. 231(3). The purpose in this case is to verify the accuracy of income tax returns made by the appellant's customers who were traders in commodities futures. This also, it submits, is a purpose related to the administration or enforcement of the Act.
I have some difficulty with the respondent's submission in relation to the *Canadian Bank of Commerce* case. If, indeed, the ratio of that case is that a demand for information which meets the test of being related to a genuine and serious inquiry into the tax liability of some specific person or persons is a demand made for purposes of the administration or enforcement of the Act, how can it be said, consistent with that decision, that a demand which does not meet such a test is also for a purpose related to the administration or enforcement of the Act? If this is so, it was pointless for the Court in the *Canadian Bank of Commerce* case to make a genuine and serious inquiry into the tax liability of some specific person or persons a prerequisite of the validity of the requirement in that case. Yet Mr. Justice Cartwright makes it clear that his judgment is premised on that prerequisite being there. After referring to certain paragraphs in the stated case he states at p. 738, that it is common ground "that the requirement addressed to the appellant relates to a genuine and serious inquiry into the tax liabilitity of some specific person or persons". **He then makes the point that the fact that the answer to the requirement may disclose private transactions involving a number of persons who are not under investigation and may not be liable to tax will not invalidate the requirement. He reiterates the purpose of the requirement at p. 739:**
The purpose of the requirement, then, is to obtain information relevant to the tax liability of some specific person or persons whose liability to tax is under investigation; this is a purpose related to the administration or enforcement of the Act.
Accordingly, while I agree with Le Dain J. that the Court in the *Canadian Bank of Commerce* case did not say that the purpose in that case, namely the obtaining of information relevant to someone's tax liability, was the only purpose for which a requirement could validly be made under s. 231(3), it did nevertheless insist on a prerequisite to that particular purpose, namely that the someone's tax liability be the subject of investigation, and it is that prerequisite which the appellant submits is missing in this case.
…
It seems to me that what the Minister is trying to do here, **namely check generally** on compliance with the statute by traders in the commodities futures market, cannot be done by conducting a "fishing exp edition" in to the affairs of one broker's customers under s. 231(3) of the Act. If the Minister seriously thinks that traders in the commodities futures market generally are not reporting their transactions properly for income tax purposes, then he has s. 221(1)(*d*) available to him. He can obtain a regulation under that subsection requiring all such traders to file returns of their transactions in the commodities futures market. Having obtained such a regulation, he is then in a position to demand such returns at large without regard to whether or not any specific person or persons are currently under investigation. The very presence of those provisions in the Act serves, in my view, to support the approach taken in the *Canadian Bank of Commerce* case that s. 231(3)

Digitized by Google

is only available to the Minister to obtain information relevant to the tax liability of some specific person or persons if the tax liability of such person or persons is the subject of a genuine and serious inquiry.

In Redeemer Foundation *v.* Canada (National Revenue)[87] the Minister asked a charity for the names of its donors as well as the recepients of its academic awards since he thought that the two were related in a tax avoidance scheme. The charity refused and argued to the Supreme Court it was held in the head-note:

> The appellant Foundation, a registered charity, operates a forgivable loan program that finances the education of students at an affiliated college. The Canada Revenue Agency ("CRA") was concerned that some donations to the program were not valid charitable donations because the donors' contributions were made solely to finance the education of their own children. **CRA served the Foundation with a requirement to record the identity of each donor and the name of the student who received credit for each donation. In a subsequent audit, CRA requested the donor information, which the Foundation provided. CRA advised the Foundation that there might be grounds to revoke its charitable status and to reassess its donors. Notices of reassessment were sent to some donors. The Foundation applied for judicial review of the CRA's request for donor information. The reviewing judge declared that the request was improper without prior judicial authorization, the donor information should be returned, and the Minister of National Revenue should be prevented from acting upon the information to reassess donors.** The Federal Court of Appeal set aside the reviewing judge's order and dismissed the application for judicial review.
>
> *Held* (Binnie, Deschamps and Rothstein JJ. dissenting in part): The appeal should be dismissed.

[87] [2008] 2 S.C.R. 643, 2008 SCC 46

Digitized by Google

Per McLachlin C.J. and LeBel, Fish and Charron JJ.: The Minister was entitled to the donor information through the combined effect of ss. 230(2)(*a*) and 231.1 of the *Income Tax Act*, and the Minister was not required to obtain judicial authorization before requesting the information. The Minister has a broad power under s. 231.1 to inspect, audit and examine taxpayers' records and any information that is or should be in the taxpayer's books**. The Foundation was required to collect the donor information pursuant to its record keeping obligations under s. 230(2)(*a*) because the information was necessary for determining whether to revoke its registration as a charity. Section 231.2 still serves a useful purpose if s. 231.1 is read as authorizing the Minister to obtain information on unnamed third parties during the audit of a taxpayer without judicial authorization, since s. 231.2 addresses circumstances where the Minister needs information about one or more taxpayers outside the context of a formal audit.** [1] [12-13] [15]

Regardless of whether the donor list was used by the CRA in pursuing its audits of the donors themselves, the CRA's request for the donor information was made for the legitimate purpose of investigating the validity of the Foundation's status as a registered charity. The CRA could not confirm whether the donors' contributions were valid charitable donations without the requested information. **The donor information is clearly the type of record that the Foundation is required to keep to verify the legitimacy of its donations and requiring the CRA to obtain judicial authorization before requesting it would be illogical and would serve no useful purpose. Furthermore, reassessment of donors is a logical consequence of a determination that a registered charity is not operating a valid charitable program. A donor can reasonably expect that his or her donation will be examined if the registered charity is audited and that his or her claimed tax credit will be non-compliant if the charitable program is not valid.** Requiring judicial authorization whenever an audit of a charity entails a possibility that its donors might be investigated and reassessed would be unworkable and, given the reciprocal nature of many tax arrangements, would potentially require judicial authorization in a variety of other circumstances. Lastly, there is minimal risk that the Minister will audit taxpayers who are not suspected of non-compliance solely to investigate unnamed taxpayers for non-compliance. [16-21] [26-27]

The Federal Court does not have the jurisdiction to order the Minister to vacate tax assessments.

Taxpayers should challenge evidence used for a reassessment before the Tax Court of Canada. [28]

Per Binnie, Deschamps and Rothstein JJ. (dissenting in part): The CRA is acting outside ss. 230 and 231.1 of the *Income Tax Act* when it seeks information other than to verify a taxpayer's compliance with the Act through an audit of the taxpayer, and judicial authorization is required under s. 230.2(2) if the information it seeks pertains to unnamed persons. While read in isolation ss. 230 and 231.1 might be interpreted as empowering the CRA to require a taxpayer to keep and provide information identifying unnamed persons, these provisions must be interpreted with regard to s. 231.2. In order for that section to be necessary and to have any meaning, it must provide the CRA with power in addition to what it is given under ss. 230 and 231.1. If the CRA could request information pertaining to unnamed persons under its audit powers, then it could

Digitized by Google

avoid the requirement for judicial authorization and s. 231.2(2) — a taxpayer protection provision — would be ineffective. This is not an issue of reading down s. 231.1(1) to avoid redundancy, but rather an issue of reading ss. 230, 231.1 and 231.2 coherently. Whereas ss. 230 and
focus on the taxpayer's compliance with the Act, s. 231.2 enhances the CRA's power and may be used for additional purposes such as dealing with non-payment and obtaining information about unnamed persons. [35-41]
Here, the CRA's request was improper without judicial authorization under s. 231.2(2). As early as July 2000, if not before, the CRA intended to reassess the Foundation's donors. This is not a case where its purpose was solely to audit the Foundation and the information was entirely within the Foundation's records. The CRA sought information pertaining to the compliance of specific but unnamed persons and nothing in the Act required the Foundation to keep that information other than the CRA's specific request under
s. 230(3). In the circumstances of this case, the CRA could not require the information under its power to audit the Foundation or under s. 230(3) without obtaining judicial authorization under s. 231.2(2), nor could it avoid s. 231.2(2) by making a verbal or informal request for the donor information. Furthermore, the CRA cannot justify bypassing s. 231.2(2) with arguments based on reciprocity of tax treatment or taxpayers' low expectations of privacy in their tax records. Because the authority of the CRA is so broad, it is required to follow the procedures provided in the Act rigorously. Section 231.2(2) was intended to provide some minimal restraint on the CRA's broad, unilateral authority and judicial authorization under s. 231.2(2) is required when, in the course of an audit of a taxpayer, the CRA forms the intention to obtain information pertaining to unnamed persons. [41] [43] [46-49] [54-56]

Discretion of Judge to Withhold Authorization

In The Minister of National Revenue and Nassereddin Derakhshani[88] the steps the Minister took to identify the taxpayers, and surrounding information that would allow them to be attended to, was at issue when a s. 231.2(2) request was made on a taxpayer. There was some issue as to whether the judge in the petitioning court had the discretion to withhold authorization to compel the taxpayer to release the information at the Appeal court held:

[1] This is an appeal from a decision by Justice Martineau (the Federal Court judge or the trial judge) refusing to give effect to the *ex parte* application filed by the Minister of National Revenue (the Minister) for authorization to issue a requirement to provide information relating to unnamed persons pursuant to section 231.2 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act).

…

Substantive issue

[15] In support of the Minister's appeal, counsel for the Minister alleges that the Federal Court judge should have granted the requested authorization since the evidence filed established that the two conditions provided at subsection 231.2(3) of the Act were met:

231.2 …

…

On *ex parte* application by the Minister, a judge may, subject to such conditions as

[88] 2009 FCA 190

Digitized by Google

the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection 231.2(1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") where the judge is satisfied by information on oath that the person or group is ascertainable; and the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act.
[Minister's emphasis.]

[16] According to counsel for the Minister, the record clearly establishes that the group of persons to whom the required information refers is ascertainable and that the provision of that information is necessary for the purposes of enforcing the Act. It follows that it was the duty of the Federal Court judge to issue the authorization; he had no discretion in the matter.

[17] That being said, counsel for the Minister is misreading subsection 231.2(3) of the Act. The judge hearing an application under this provision is the one who must be satisfied ("est convaincu" in the French text) that the required conditions are met. Clearly, such discretion must be exercised judicially, but, where it has been, the judge has the final say.

[18] Contrary to what counsel for the Minister asserts, I do not believe that the decision of our Court in
M.N.R. v. Greater Montréal Real Estate Board, 2007 FCA 346, [2008] 3 F.C.R. 366, supports the argument he advances (Memorandum, at paragraph 22). In that case, our Court began its analysis with the following statement (at paragraph 5):
This provision clearly states that the *ex parte* order will be made if the person or group referred to is ascertainable and if the information or documents are required to verify compliance with any duty or obligation under the Act.
[Double underlining added.]
In that case, it was not a matter of establishing whether the judge hearing an application under subsection 231.2(3) has any residual discretion. The dispute pertained to the contents of the two conditions under that provision and, more specifically, to the question of whether a "genuine and serious" inquiry remains one of the applicable conditions. After having explained that this criterion has its origins in case law dating from when the Act read differently, the Court ruled that it did not apply. That was the context in which the Court explained that an authorization "will be made" when the two conditions now found at subsection 231.2(3) are satisfied.

[19] It is useful to recall that the existence of judicial discretion is essential to the constitutional validity of this type of provision, which is comparable to a seizure even when used in a regulatory (or even non- criminal) context (*McKinlay Transport Ltd.*, above, at page 642). It is this discretion, conferred upon an independent judge, which protects individuals from the damaging use of this kind of power and brings it in line with the requirements of section 8 of the *Canadian Charter of Rights and Freedoms* (*Baron v. Canada*, [1993] 1 S.C.R. 416, at page 443). In this case, the wording of paragraph 231.2(3), according to which the judge ". . . may, subject to such conditions as the judge considers appropriate . . ." authorize the requirement ". . . where the judge is satisfied . . ." that the prescribed conditions are met, leaves no doubt as to the existence of this discretion.

[20] In the alternative, the Minister alleges that the Federal Court judge clearly misused his discretion. This brings into question the use that can be made of the oral "reasons" related by counsel for the Minister and reproduced at the beginning of this analysis (at paragraph 3).

Digitized by Google

[21] At the hearing, counsel for the Minister explained that he felt uneasy relying on the words of the judge that he himself had related and are not entered in the minutes. After being reminded by the Court that the respondent had not raised any objection in that regard, counsel for the Minister hinted at another problem. He explained that after having informed counsel for the Minister that his application would be dismissed, the Federal Court judge had given him a number of options, including that of dismissing his application with or without reasons. Counsel for the Minister had opted for dismissal without reasons, which explains why the reasons are not reported in the minutes.

[22] In the circumstances, I understand better why counsel for the Minister did not rely on the statements he related to attack the trial judge's exercise of discretion. In my opinion, it would have been inappropriate to do so.

[23] In the absence of reasons, we can only review the case as it was made to the trial judge by the Minister and ask ourselves whether, in light of that case, it was open to the trial judge to exercise his discretion as he did.

[24] The affidavit filed in support of the application is brief. It is signed by Francis Goulet, the Canada Revenue Agency auditor in charge of the respondent's file. The inquiry was part of an audit project aimed at taxi drivers. The affidavit reveals that the respondent does business under the legal name "Service d'impôt Bilan Enr." and prepares tax returns for others. The inquiry revealed that the returns of three taxi drivers prepared by the respondent between 2002 and 2006 were prepared [TRANSLATION] "without the necessary documentation and based on an estimation of earnings and expenditures" in two cases and [TRANSLATION] "without supporting documentation on income and by estimating expenditures from receipts" in the other case (Affidavit of Francis Goulet, at paragraphs 9, 10 and 11).

[25] At paragraph 13, the auditor explained having been unable to obtain the information sought because

[TRANSLATION]

[The respondent] did not send the CRA his clients' tax returns using the electronic filing system. I am unable to establish the identity or number of his clients because that information is not manually recorded in the CRA's databases.

[26] Lastly, the auditor explained that once the information is obtained, he will be able to conduct the necessary audits on the respondent's clients and determine, if applicable, the assessments and penalties that are required (*idem.* at paragraph 14).

[27] What is astounding, in reading this affidavit, is that it does not provide the judge with a single piece of information regarding the requirement to provide information that he is being asked to authorize. Accepting that the number of individuals affected by the requirement is unknown, the auditor in charge of the respondent's file still has knowledge of the respondent's business. In that respect, no reference is made to the respondent's tax returns or to the information likely to be found therein about his business, including the amount of income from the business. I must observe that the affidavit filed in support of the requirement does not point to any suspicion of inaccuracy in the information appearing on the respondents' tax returns.

[28] The affidavit also seems incomplete in another respect. Normally, the name of a professional who prepares a tax return on behalf of another person must appear on the return. That is part of the required information. The affidavit is silent on the subject. I clarify, in that respect, that nowhere is it stated in the affidavit that the

Digitized by Google

required information is not available, but indeed that such information is not manually recorded in the databases (see paragraph 13, quoted at paragraph 25, above). This implies, without it being possible to know for certain, that the required information could be obtained other than by a requirement to provide information.

[29] The fact that it may be possible to obtain the information using other means does not exclude the possibility that a requirement might be authorized, but that is information that must be provided to the judge. A judge must not be left in the dark on such an important point.

[30] In my view, the affidavit filed in support of the requirement shows a fundamental lack of rigour, and the Federal Court judge exercised his power appropriately in declaring that he was not satisfied.

The Inter-play of the Process

Whitewater Golf Club Inc. V. Minister Of National[89] illustrates exactly how a Trial court will handle a judicial review of a request for unnamed persons that stems from a general audit into a taxpayer's affairs. In this case a golf clubs members were the subject of a request for identity to further find out how they had handled the fees that they had paid to the club, while the club objected to their being identified. The Trial court held, giving a run-down of how the provisions were to play:

[1] By order dated July 24th, 2008, issued *ex parte* in Ottawa, Ontario, pursuant to subsection 231.2(3) of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supplement), as amended (the ITA), and paragraph 289(3) of the *Excise Tax Act,* R.S.C., 1985, c. E-15 (the ETA), I authorized the Minister of National Revenue (the Minister) to impose on the applicant, Whitewater Golf Club Inc. (Whitewater), a requirement that it provides the Minister with certain information and documents relating to a group of unnamed persons (the authorization).

[2] The required information is with regard to Whitewater's November 30, 2003 through November 30, 2005 taxation years, and includes: the names and addresses of persons or corporations to whom Whitewater supplied goods or services; sales journals, sales invoices or other supporting documentation; any and all accounting documents under Whitewater's control or in its possession concerning monies received with regard to the sale of goods or services; any and all documentation concerning monies received from the sale of goods or services to customers (members) including all bank statements, bank deposit books, and records of monies received from customers (members).

[3] The authorization and the notice to the respondent were served upon Whitewater's representative on July 31, 2008. Before me is an application by Whitewater for a review of the authorization pursuant to subsections 231.2(5) and (6) of the ITA and paragraph 289(5) of the ETA. Furthermore, Whitewater is seeking an order dismissing the Minister's originating application (T-1099-08). For the reasons that follow, the application for review will be dismissed.

[4] The Canadian income tax system is a self-reporting and self-assessing system (*R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627) (*McKinlay Tranport*). However, the Minister is given significant statutory powers to enable him to identify incidents of

[89] 2009 FC 739

Digitized by Google

non-compliance and to take corrective action. In this regard, it bears mentioning that taxpayers have a very low expectation of privacy in their business records relevant to the determination of their tax liability: *McKinlay Transport*, above and *Redeemer Foundation v. Canada (National Revenue)*, [2008] S.C.R. 643, (*Redeemer*) at para. 25.

[5] The powers of the Minister include a number of tools that permit the Minister to compel the production of information the Minister considers necessary to fulfil his mandate. One of those tools is found in subsection 231.2(1) of the ITA, and it permits the Minister, in certain circumstances, to compel the production of information about unnamed persons if the Minister first obtains the approval of a judge (defined in section 231 to mean a judge of the Federal Court or a judge of the superior court of the relevant province or territory). It reads in relevant part as follows:

(1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act (including the collection of any amount payable under this Act by any person), […] by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,

any information or additional information, including a return of income or a supplementary return; or

any document.

[6] Recourse to subsection 231.2(2) is made when the Minister wishes to verify whether an ascertainable class of persons has complied with the ITA and information relevant to that question is accessible by someone who has no statutory obligation to provide it to the Minister in the form of an information return or in the course of the Minister's examination of the person's own tax affairs. Subsection 231.2(2) reads as follows:

231.2 (2) The Minister shall not impose on any person (in this section referred to as a "third party") a requirement under subsection 231.2(1) to provide information or any document relating to one or more unnamed persons unless the Minister first obtains the authorization of a judge under subsection 231.2(3).

[7] The procedure to be followed when the Minister wishes to seek judicial authorization to compel the production of information about unnamed persons is set out in subsections 231.2(3) to (6). If the application is successful and the Minister acts on the authorization, the third party has an opportunity to apply to the same judge, or a judge of the same court, for a review of the authorization. That review may result in the authorization being cancelled, confirmed or varied. Subsections 231.2(3) to (6) read as follows:

231.2 (3) On ex parte application by the Minister, a judge may, subject to such conditions as the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection 231.2(1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") where the judge is satisfied by information on oath that

the person or group is ascertainable; and

the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act.

Where an authorization is granted under subsection 231.2(3), it shall be served together with the notice referred to in subsection 231.2(1).

Where an authorization is granted under subsection 231.2(3), a third party on whom a notice is served under subsection 231.2(1) may, within 15 days after the service of the notice, apply to the judge who granted the authorization or, where the judge is

Digitized by Google

unable to act, to another judge of the same court for a review of the authorization.
On hearing an application under subsection 231.2(5), a judge may cancel the authorization previously granted if the judge is not then satisfied that the conditions in paragraphs 231.2(3)(a) and 231.2(3)(b) have been met and the judge may confirm or vary the authorization if the judge is satisfied that those conditions have been met.

[8] At issue in the present proceedings is the Minister's compliance with the second condition for a judicial authorization under subsection 231.2(3) of the ITA that "the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act". Thus, the applicant submits that in the course of the audit being performed by the Canada Revenue Agency (CRA), the Minister requested the names of its corporate members in furtherance of that audit and not for the purpose of reviewing the compliance by said members with the provisions of the ITA or the ETA. The applicant further submits that the Minister, in making the *ex parte* application, did not provide full disclosure of all material facts and evidence it relied on in the material used to support its application.

[9] The CRA is conducting a full compliance audit of the applicant for income tax and GST/HST purposes. As part of this audit the CRA requested a copy of the financial statements, specifically working papers from the accountant and a copy of the electronic books and records of Whitewater. By exchange of correspondence during the months of December 2006 and January 2007 the applicant's counsel informed CRA that the applicant would only be providing paper copies of the records requested due to the fact that the electronic records contained the names of members of Whitewater. A letter, dated November 2007, from the Minister's counsel, Mr. MacPhee, to the applicant's counsel stated: "I have spoken with my client on this matter, and they have confirmed that Whitewater Golf Club Inc. is the only party under audit, and the records sought are necessary to properly complete their audit."

[10] Nonetheless, the Minister acknowledges that CRA's position on how to proceed on this matter changed somewhat from the time the information in issue was first sought. Although it was initially the position of the CRA audit that the members' names would only be used as part of the audit of Whitewater, the CRA later amended its position on this matter and assured the Court that the unnamed persons being sought would also be investigated to ensure compliance with the *ITA* and the *ETA*. This change of position was clearly set forth in the Minister's originating application (T-1099-08).

[11] The applicant submits that the Minister's assertion, following which the information is now sought to verify compliance with the legislation in question, is not *bona fide* and that this position was only adopted to bring it within the requirements of the *ITA* to obtain the authorization, in breach of the Minister's obligation to conduct a tax audit in good faith and to act judiciously in the exercise of its audit powers M.N.R. *v. Greater Montréal Real Estate Board*, 2007 FCA 346 , [2007] F.C.J. No. 1477 F.C.A. at para. 48).

[12] The Minister submits that at the outset of this audit the CRA was provided with "screener's comments" giving direction as to how to conduct the CRA audit. Based on said comments as well as CRA's review of this matter, it was determined that one of the purposes of the Whitewater audit was also to ensure the compliance of corporate members with regards to the limitation of the deductibility of golf membership by these corporate members.

[13] Nonetheless, the applicant further submits that while referred to by Ms. Mary Davies in her affidavit sworn on May 21, 2008 filed in support of the Minister's *ex*

Digitized by Google

parte initial application, the screener's comments were never filed as exhibits and thus the Minister failed to provide full disclosure of all material facts and evidence it relied on to support its application.

[14] The grounds of review of an authorization granted under subsection 231.2(3) of the *ITA* and paragraph 289(3) of the *ETA* have previously been stated. Thus, this Court will vary or cancel the authorization previously granted only if it is not satisfied that the conditions in subsections 231.2(3)(a) and 231.2(3)(b) have been met.

[15] The recent decision of the Supreme Court in *Redeemer* further confirmed at para. 27 that: [I]f an organization's charitable program is not valid, then both the charity
and any of its donors who claim tax credits are non-compliant. The CRA has a valid interest in investigating both. The same would be true of any other relationship involving reciprocal tax treatment. [...]

[16] The authorization at issue will be confirmed, as the Court is satisfied that the requirement is imposed in good faith by the Minister in order to verify compliance by Whitewater Gold Club members with their duties and obligations under the *ITA*. Moreover, the applicant has provided no compelling rationale for this Court to vary the authorization, and I see no sound reason for restricting today the requirement to corporate members since non-corporate members may have also claimed non-allowable deductions or GST refunds.

[17] The applicant has provided no objective evidence to support its allegation of bad faith. The Minister's change of position regarding the audit of the Whitewater members themselves, which resulted in the Minister seeking the authorization at issue, is not a sufficient ground by itself to annul the authorization. Indeed, this change of position was clearly stated in the material filed in support of the *ex parte* application. The case at hand is precisely that of a relationship involving reciprocal tax treatment as referred to in *Redeemer*. It appears to me that the Minister took the more prudent approach of seeking judicial authorization and followed the suggestion previously made by applicant's counsel that judicial authorization be obtained.

[18] In conclusion, the applicant's submissions regarding the Minister's failure to fully disclose the material in support of which the Whitewater members are not being audited has no legal or reasonable basis. Furthermore, there is no obligation under the *ITA* regarding the nature of the particular evidence that has to be filed in support of an application *ex parte* for an authorization. There was certainly no obligation in this case to produce protected material with the affidavit of Mary Davies. The only conditions to be satisfied are those set forth in subsections 231.2(3)(a) and 231.2(3)(b) of the *ITA* which have clearly been met. Again, there is sufficient proof on the record that the information was sought by the Minister to ensure the member's compliance under paragraph 18(1)(l) of the *ITA*. At the hearing of this application, other valid grounds to verify compliance, such as GST refunds, were also provided by Minister's counsel. Finally, the records of members exist and the applicant cannot simply refuse their access on the ground that it is not obliged by law to maintain such records.

Ascertainable Class Size Not a Limit

Digitized by Google

In MNR v. Greater Montréal Real Estate Board[90] the Appeal court had to ascertain the present RFI Unnamed person provisions when the taxpayer organization argued that its list of members was too broad (2,000) while at Trial the judge held against the MNR when it was seemingly settled that there was a "genuine and serious" inquiry into the third parties affairs. The case is very important since considerable amendments had occurred to these provisions in the Act following a few SCC. The Appeal court held:

> [1] The Minister of National Revenue (MNR) is appealing a decision by Madam Justice Johanne Gauthier (the judge) dated September 6, 2006. This decision set aside an earlier order dated June 28, 2005, which was made *ex parte* under subsection 232.2(3) of the *Income Tax Act*, R.S.C. 1985 (5th supp.), c. 1 (the Act). That order authorized the MNR to impose a requirement on the Greater Montréal Real Estate Board (the GMREB) to provide information and documents relating to a group of unnamed taxpayers.
>
> …
>
> [3] In the autumn of 2004, the Canada Customs and Revenue Agency serving the Montérégie/Rive- sud area set out to verify whether the real estate agents and licensed brokers living or carrying on business in that area were complying with the Act. This investigation was intended to determine, *inter alia*, whether the agents and brokers had completed their income tax returns properly and whether they had reported the commissions they had earned.
>
> …
>
> [5] This provision clearly states that the *ex parte* order will be made if the person or group referred to is ascertainable and if the information or documents are required to verify compliance with any duty or obligation under the Act.
>
> [6] In the order at issue, the judge upheld her initial finding that the group referred to by the MNR in its *ex parte* application constituted an ascertainable group within the meaning of paragraph 231.2(3)(*a*). She also set aside her previous order and determined that the "Minister has not established that, at this stage of the project, the request for information is intended to determine whether each and every one of the GMREB members (real estate agents and brokers) has complied with the Act by reporting all of their income": paragraph 58 of the order.
>
> The issues
>
> [7] The analysis of section 231.2 of the Act and its application to the facts of this case are at the heart of the dispute, as evidenced by the parties' submissions. The MNR contends that the first judgment is erroneous in that the judge found that t here was no "genuine and serious inquiry" about the agents and brokers referred to in the request for information. For its part, the GMREB argues that the judge erred in finding that the group was ascertainable.
>
> The identifiable group
>
> [9] The judge was correct in finding that the group referred to in the application was ascertainable under paragraph 231.2(3)(*a*) of the Act.
>
> [10] The GMREB argues that a group is ascertainable when the persons in the group have done something specific together in the pursuit of a common objective, which is not the case here [TRANSLATION] "because there is no reason to believe that there is a common link related to the administration of the Act": respondent's memorandum, paragraph 52. The GMREB refers to the decisions in: *Canada (M.N.R.) v. National Foundation for Christian Leadership*, 2004 FC 1753 (appeal dismissed: 2005 FCA 246), [*Christian Leadership*]; *Artistic Ideas Inc. v.*

[90] 2007 FCA 346

Digitized by Google

Canada (Customs and Revenue Agency), 2005 FCA 68, [*Artistic Ideas*]; *M.N.R. v. Sand Exploration Ltd. et al.*, [1995] 3 FC 44, [*Sand Exploration*]; and *Fédération des caisses populaires Desjardins du Québec, No: 200-00-000001-94*, [1997] 2 C.T.C. 159 (Sup. Ct.), [*Fédération des caisses*].

[11] These judgments are of no assistance in this case and do not support the GMREB's position on "ascertainable group". The reasons in these cases must be read with caution, bearing in mind the particular context of the legislation in effect at the time they were written since section 231.2 of the Act was significantly amended in 1996. The other legislative provisions on which the reasons were based must also be considered.

[12] Accordingly, in *Fédération des caisses*, the MNR made an arbitrary identification based on the nature of the transactions and not on the persons making those transactions. In that case, the individuals or companies had transferred sums of money out of Canada through the Fédération or one of the Caisses affiliated with it for a given period. This case required the analysis of section 231.2 prior to its amendment.

[13] In *Artistic Ideas*, our Court authorized the MNR to obtain the names of charitable organizations involved in "art flips" under subsection 231.2(1), not subsections (2) or (3). The Court ruled that there was no evidence that the MNR wanted to obtain the names of the charities to verify their compliance with the Act. In fact, their names were necessary solely for the Minister's investigation of the third party *Artistic Ideas*.

[14] The *Sand Exploration* and *Christian Leadership* cases also do not support GMREB's argument that the pursuit of a common objective is a prerequisite for a group to be ascertainable.

[15] Last, the GMREB contends that the group is not ascertainable because it numbers close to 2,000 people: respondent's memorandum, paragraph 52. This argument is not convincing. In *All Saints Greek Orthodox Church v. Canada (MNR)*, 2006 FC 374, at least 1300 donors made up the ascertainable group within the meaning of the Act.

[16] In this case, the audit involves the group composed of real estate agents and brokers living or carrying on business in the area served by the Canada Revenue Agency's Montérégie/Rive-Sud Tax Services Office. Gauthier J. correctly concluded that this was an ascertainable group for purposes of section 231.2 of the Act.

[17] I will now deal with the arguments about a genuine and serious inquiry.

The genuine and serious inquiry

[18] The judge accepted the GMREB's submission that the MNR was not conducting a genuine and serious inquiry about one or more individuals in the identified group. She ruled that a genuine and serious inquiry was a condition precedent for judicial authorization under subsection 231.2(3) of the Act.

[19] The judge suggested that any new application for authorization by the MNR would have to specify "that a genuine audit is under way in regard to each and every one of the members of this group and not only an investigation or project aimed at selecting the members of the group who are to be audited later": paragraph 59 of the order. Consequently, she was not satisfied with the evidence, ruling that the MNR was only conducting an audit project, and she set aside her previous order, concluding that there was no genuine and serious inquiry.

[20] The statutory provision under review does not mention "genuine and serious

Digitized by Google

inquiry." This expression, which originated in *The Canadian Bank of Commerce v. The Attorney General of Canada*, [1962] S.C.R. 729, [*Canadian Bank of Commerce*] and resulted from a simple admission by the parties (*ibidem*, p. 733), has since been repeated and argued as if it were an established legal principle.

[21] In my view, whether a "genuine and serious inquiry" exists is not the appropriate test in considering an application under subsection 231.2(3) of the Act. The question is not whether the MNR began a genuine and serious inquiry, let alone one involving every unnamed person of the group. Rather the question is: was the applications judge satisfied that the information or documents relating to one or more unnamed persons (forming an ascertainable group) was required to verify compliance with the Act?

The Richardson and Canadian Bank of Commerce decisions

[22] Over the years, the provision under review has been the subject of legislative amendments that must be borne in mind when analyzing the cases cited by the parties to support their arguments. I will spend more time discussing *Richardson (James Richardson & Sons) v. the Department of National Revenue*, [1984] 1 S.C.R. 614, [*Richardson*], which, together with *Canadian Bank of Commerce,* is cited as the leading case on the concept of serious and genuine inquiry.

[23] In *Richardson*, the Supreme Court of Canada reviewed the facts in light of section 231 of the Act [1970-71-72 (Can.), c. 63]; the relevant parts at that time read as follows:

231. …

…

The Minister may, for any purposes related to the administration or enforcement of this act, by registered letter or by a demand served personally, require from any person

any information or additional information, including a return of income or a supplementary return, or

production, or production on oath, of any books, letters, accounts, invoices, statements (financial or otherwise) or other documents.

within such reasonable time as may be stipulated therein.

…

Where the Minister has reasonable and probable grounds to believe that a violation of this act or a regulation has been committed or is likely to be committed, he may, with the approval of a judge of a superior or county court, which approval the judge is hereby empowered to give on ex parte application, authorize in writing any officer of the Department of national Revenue, together with such members of the Royal Canadian Mounted Police or other peace officers as he calls on to assist him and such other persons as may be named therein, to enter and search, if necessary by force, any building, receptacle or place for documents, books, records, papers or things that may afford evidence as to the violation of any provisions of this Act or a regulation and to seize and take away any such documents, books, records, papers or things and retain them until they are produced in any court proceedings.

An application to a judge under subsection (4) shall be supported by evidence on oath establishing the facts upon which the application is based.

[Emphasis added]

Digitized by Google

The section referred to the commission of a violation and authorized certain persons to enter and search for evidence of the violation.

[24] In that case, the MNR had decided that it was necessary to verify whether traders in the commodities futures market were complying with the Act. In order to do so, the Minister had asked Richardson to provide its clients' commodity monthly statements so that the information could be processed on a test basis. Richardson had supplied the information but with clients' account numbers only and no means of identifying them. The MNR had asked for additional information, including a complete list of customers and personal information about them. Richardson had refused, alleging, *inter alia*, that the MNR's demands were for "information returns respecting . . . [a] class of information" required in connection with assessments. Richardson added that these demands fell instead within the ambit of paragraph 221(1)(*d*) and section 233 of the Act, which provided:

[25] Richardson was successful before the Supreme Court of Canada, which confirmed that a demand could only be made for information relative to the tax liability of a person or persons under the former subsection 231(3) of the Act if a genuine and serious inquiry was being conducted into the tax liability of such person or persons. The section did not authorize a general survey of compliance by a class of taxpayers. The MNR was invited to use paragraph 221(1)(*d)* to "obtain a regulation . . . requiring all such traders to file returns of their transactions in the commodities futures market" (*ibidem*, p. 625).

[26] The *Richardson* decision must be read and applied with caution. In *Artistic Ideas*, Mr. Justice Rothstein, writing for the Federal Court of Appeal, was reserved about *Richardson* and *Bank of Commerce*. Rothstein J.A. wrote:

[9] …These authorities p re -date subsections 231.2(2) and (3), although it is apparent that their enactment was prompted, at least in part, by the *Richardson* case. While they provide useful background, the relevant legislation is different today than at the time of those decisions.

[27] In fact, subsection 231.2(1), as it currently reads, is the former subsection 231(3) *supra,* to which, in 1986, Parliament added the terms "notwithstanding any other provision of this Act" and "subject to subsection 2". This amendment to section 231.2 did not substantially change the earlier wording.

[28] At the same time, Parliament added subsections 231.2(2) to (6), which, in 1995, led Rothstein J., as he then was, to state that compliance with the procedure in subsections 231(2) and (3) of the Act addressed the "mischief" identified in *Richardson* (*Sand Exploration, supra*).

[29] I do not believe that *Richardson* and *Canadian Bank of Commerce* pose an obstacle to the MNR's submission in this case. In *Richardson*, as I indicated earlier, the MNR requested information in order to process it on a test basis. Furthermore, the judgment in *Canadian Bank of Commerce* was premised on the fact, acknowledged by the parties, that the requirement in that case was made in good faith and that it involved a genuine and serious inquiry about specific persons. Mr. Justice Cartwright wrote on page 738:

… it appears to be common ground, (i) that the requirement addressed to the appellant relates to a genuine and serious inquiry into the tax liability of some specific person or persons …

[Emphasis added]

[30] With respect, and unlike Madam Justice Wilson who wrote for the Court in

Digitized by Google

Richardson, I do not believe that Cartwright J. thereby "makes it clear that his judgment is premised on that prerequisite being there" (*ibidem*, p. 624), that is, that the requirement must relate to a genuine and serious inquiry.

[31] But there is more. Prior to 1996, subsection 231.2(3) of the Act required that the application for authorization be supported by information on oath addressing the following four conditions:

231.2 (3) …

the person or group is ascertainable;

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

it is reasonable to expect, based on any grounds, including information (statistical or otherwise) or past experience relating to the group or any other persons, that the person or any person in the group may have failed or may be likely to fail to provide information that is sought pursuant to the requirement or to otherwise comply with this Act; and

the information or documents is not otherwise more readily available.

[32] In 1996, the conditions in paragraphs (*c*) and (*d*) of subsection (3), i.e., reasonable grounds to believe that there has been non-compliance with the Act and the difficulty in obtaining the information otherwise, were repealed.

Section 231.2 of the Act currently in effect

[33] **According to the judge, the MNR had to establish that each and every one of the members of the GMREB identified in the application was the subject of a genuine and serious inquiry. Otherwise, the Minister was conducting a fishing expedition, which is prohibited by *Richardson*. I do not agree.** This finding perpetuates the reasoning in *Canadian Bank of Commerce* and *Richardson* without distinguishing the facts of the case and the statutory provision currently in effect.

[34] Generally, the MNR's powers of investigation and audit in the Act are the consideration for a self- reporting and self-assessing tax system that depends upon the honesty and integrity of taxpayers for its success (*R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627).

[35] It is recognized that the audit powers in section 231.2 of the Act are an intrusive measure affecting the right to the protection of private information and must be construed restrictively (*Sand Exploration*, *supra*, p. 52).

[36] These general principles are not being challenged, but it is nonetheless necessary to give meaning to the legislative amendments. Commenting on the 1995 Budget Papers, tax expert David M. Sherman wrote the following about the conditions in paragraphs (*c*) and (*d*)*:*

These restrictions [231.2(3)(*c)* and (*d)*], which make it difficult for Revenue Canada to obtain timely information in order to verify compliance with the Act, are being eliminated. This proposed measure will improve Revenue Canada's ability to verify compliance with the self- assessment system with respect to transactions where no information reporting is required. [*The Practitioner's Income Tax Act*, 32nd ed. (Toronto: Carswell, 2007)].

[37] I believe that removing conditions (*c*) and (*d*) from the former subsection

Digitized by Google

231.2(3) shows **Parliament's intention to ease the MNR's burden of proof in the sense suggested by tax expert Sherman because the MNR no longer has to establish reasonable grounds for believing that a violation has been committed or demonstrate that the information is not otherwise more readily available.**

[38] While I recognize that a strict interpretation is required, it must not have the effect of adding another condition to the provision—which occurs if we accept the respondent's argument—that is, that the MNR must prove that he or she is conducting a genuine and serious inquiry relating to unnamed persons referred to in the application. Nor can the provision be interpreted in such a way as to re-insert the conditions in paragraphs (*c*) and (*d*).

[39] Section 231.2 of the Act must be interpreted by considering all of its parts, including the headings and sub-headings, which are also part of the statute (Pierre-André Côté, *The Interpretation of Legislation in Canada*, 3rd ed. (Carswell: Scarborough, 2000) p. 79; *R. v. Lucas*, [1998] 1 S.C.R 439, 463). Headings may help to situate a provision within the general structure of the statute and determine the intention of Parliament.

[40] What about section 231.2 of the Act? This section is found in Part XV of the Act, entitled "Administration and Enforcement," under the heading "General". Subsections 231.1(1) and 231.2(1) explicitly state that they are intended to be used for "the administration and enforcement" of the Act.

[41] This general expression, which introduces the provision under consideration, allows us to situate section 231.2 of the Act in context; the section refers to the MNR's audit powers, as opposed to its investigative powers. As the Supreme Court of Canada pointed out in *R. v. Jarvis*, [2002] 3 S.C.R. 757 at 761, "a distinction can be drawn between the audit and investigative powers" under the Act.

[42] Administrative policy and interpretation, while not binding, can also be an important factor where there is doubt as to the meaning of legislation (*R. v. Nowegijick*, [1983] 1 S.C.R. 29). In the case before us, the respondent is relying on Information Circular IC71-14R3, entitled *The Tax Audit*, to establish that an "audit project" relating to certain members of the GMREB is not an audit within the meaning of the Act.

[43] This argument is without merit. On the one hand, I find that there was, in this case, an audit within the meaning of the Act. On the other hand, the circular describes the role, policies and practices of the tax audit; the audit project is only one of the methods available to the MNR in its "selection of files for audit" process (*ibidem*).

[44] In this case, the MNR asked the respondent to provide a list of its members in a given geographic area in order to compare the data with the information it already had. **The fact that the MNR was just beginning the audit in no way precludes the application of paragraph 231.2(3)(*b*). Clearly, the MNR** cannot argue that each and every one of the members were the subject of a "genuine and serious **inquiry", which was what the judge criticized: those members are still not identified. Imposing such a requirement on the MNR neutralizes the utility of subsections 231.2(2) and (3) of the Act, which permit, under judicial authorization, verification of the honesty of a tax return.**

[45] **Regardless of what the GMREB says on this point, it appears to me that in removing paragraphs (*c*) and (*d*) from subsection 231.2(3), Parliament permitted a type of fishing expedition, with the authorization of the Court and on conditions prescribed by the Act, all for the purpose of facilitating the M**

Digitized by Google

NR's access to information. It seems to me that the strict approach adopted by the judge in this case is not appropriate for the provision under review. This approach, borrowed from *Richardson*, was necessitated by the scope of the former statutory provision which, if interpreted too broadly, left open the possibility of abuse by tax enforcement officials (*Sand Exploration*, *supra*).

The applicable test

[46] Despite its penal sanctions, the Act is essentially and primarily regulatory and administrative. The MNR's audit powers, including the powers described in subsection 231.2(3), are necessary to achieve the objectives of the Act and to ensure compliance with it (*McKinlay*, *supra*; *Thomson Newspaper Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission*, [1990] 1 S.C.R. 425).

[47] In a tax system based on the principle of self-reporting and self-assessment, the MNR must **be given broad powers to audit taxpayers' returns and inspect all records that maybe relevant to the preparation of these returns (*Bisaillon et al v. The Queen*, 99 D.T.C. 5695 (FCA)).**

[48] It follows from my reading of paragraph 231.2(3)(*b*) that the MNR's *ex parte* application will be granted if the applications judge is satisfied that the information or documents are required for a tax audit conducted in good faith. This good faith guarantees that the MNR will act judiciously in the exercise of its audit power under section 231.2 to ensure the administration and enforcement of the Act.

[49] Having thus defined the applicable test on an application for judicial authorization under subsection 231.2(3), it is my view, based on the MNR's *ex parte* notice of application, supported by the affidavit of auditor Christiane E. Joly, that the tax audit in this case was conducted in good faith, that it had a genuine factual basis and that its objective was to ensure compliance with the Act.

[50] In this case, the MNR received documents from the GMREB in March 2005 while auditing a real estate agent who was a member of the organization. Several months later came the *ex parte* application at issue involving certain unnamed members of the GMREB. The affidavit in support of the application expressly states the objective: [TRANSLATION] "to determine whether the brokers who earned commissions following the sale of immovable property complied with all the duties and obligations under the Act" (appeal book, p. 39). The MNR therefore satisfied the requirements in the Act and, more specifically, those in section 231.2.

Digitized by Google

Related to 3rd Party and Whether Access Through Other Route Relevant

In MNR v. Lordco Parts Ltd[91] the Minister was attempting to verify that winners of a contest for the taxpayer's customers had reported their fringe benefits as a result of employment properly with the taxpayer's customers and had no way to identify them except to make a Sec. 231.2 request. The taxpayer contested and the Trial court held:

> [1] This is an application brought pursuant to subsection 231.2(3) of the *Income Tax Act*[1] for an order authorizing the Minister of National Revenue to impose on the respondent, Lordco Parts Ltd., a requirement to produce information and documents relating to certain persons whose identities are unknown to the Minister. The Minister seeks the identity of these persons to verify their compliance with the *Income Tax Act*. For the reasons specified below, the Court is in accord with the position of the Minister.
>
> [2] This application is made without notice as permitted by subsection 231.2(3) of the *Income Tax Act*.
>
> II. Background
>
> [3] Lordco Parts Ltd. is a company incorporated pursuant to the laws of British Columbia, having a registered and records office at 22866 Dewdney Trunk Road, Maple Ridge, British Columbia. Lordco is a distributor and retailer of automotive parts and accessories (Affidavit of B. Wong at para. 5).
>
> [4] In 2008, the CRA completed a corporate business audit of Lordco with respect to its 2005 and 2006 taxation years. In the course of the corporate business audit, CRA noted that Lordco had established an incentive program which includes a bi-annual promotional cruise for its customers. The bi-annual cruises are organised and hosted by Lordco. Concerns were raised regarding the reporting and taxation of any of the benefits arising from these bi-annual cruises for those individuals who participated in the cruises (Affidavit of B. Wong at paras. 6 and 7).
>
> [5] In July 2009, CRA commenced an employer compliance audit for Lordco with respect to the 2006 and 2007 calendar years. The employer compliance audit was expanded to include the 2008 and 2009 calendar years in January 2011 (Affidavit of B. Wong at paras. 8 and 20).
>
> [6] The employer compliance audit included the consideration of the issue of whether individuals received and reported a taxable benefit on their 2007 and/or 2009 returns for the non-business portion of the cruises, organized and hosted by Lordco, which took place in 2007 and 2009 in furtherance of its incentive program (Affidavit of B. Wong at para. 8 and 23).
>
> A. *Lordco's Cruise in 2007*
>
> [7] Based on information obtained by CRA regarding the promotional cruise organized and hosted by Lordco in 2007, the cruise promotion operates generally as follows: Lordco customers earn rebates based on the volume of their purchases of Lordco products. A customer may purchase tickets for the promotional cruise with these rebates. If the value of the customer's rebates were not sufficient to cover the price of the cruise, Lordco permitted the customer to pay the balance of the price with cash (Affidavit of B. Wong at para. 10).
>
> [8] Customers were permitted to purchase tickets for the 2007 cruise with customer rebates earned between November 1, 2005 and June 30, 2007. As many of these customers were companies, not specific individuals, the companies nominated individual employees to

[91] 2011 FC 209

Digitized by Google

attend the cruise as representatives (Affidavit of B. Wong at para. 11).

[9] Based on a review of the 2007 cruise itinerary, CRA determined that 30% of the cruise was for business purposes while 70% of the cruise was for non-business. As such, an individual attending the 2007 cruise may have had obligations to report a taxable benefit under the *Income Tax Act* with respect to the non-business portion of the cruise (Affidavit of B. Wong at para. 12).

[10] CRA takes the position that Lordco was required to issue and file T4A slips for individuals who attended the cruise because it was the primary payer for the 2007 cruise through the rebates. T4A slips are issued by a payer to an individual who has received what is commonly referred to as "other income", such as lump-sum payments, research grants, and non-cash gift benefits. CRA uses the T4A slips to verify that the individual has properly reported the taxable benefit on his or her tax return. Lordco failed to issue and file T4A slips for the individuals who attended the 2007 cruise (Affidavit of B. Wong at para. 13).

[11] CRA wishes to verify whether the individuals attending the 2007 cruise reported the taxable benefit relating to the non-business portion of the cruise. In order to do so CRA must identify the individual taxpayers who attended the 2007 cruise. As Lordco did not issue any T4A slips for the cruise, CRA cannot identify these individuals to begin the process of verifying whether they received a taxable benefit and properly reported it so that CRA may accurately determine the amount of tax payable (Affidavit of B. Wong at para. 14).

[12] On August 10, 2010, CRA issued a named requirement to provide information and documents under subsection 231.2(1) of the *Income Tax Act* seeking, among other things, a list of individuals who attended the 2007 cruise along with the companies they represented, the individuals' addresses and the registration forms (Affidavit of B. Wong at para. 17).

[13] By letter dated September 9, 2010, Lordco declined to provide the names, addresses, and registration forms of the individuals who attended the cruise. Citing subsection 231.2(2) of the *Income Tax Act*, Lordco asserted that the requirement could not compel such information as the information sought for the individuals related to unnamed persons (Affidavit of B. Wong at para. 18).

[14] Lordco did provide with its letter a list of the companies which purchased cruise packages (the Reconciliation List). The Reconciliation List shows that 516 companies purchased cruise packages and that a total of 1059 cruise packages were sold (Affidavit of B. Wong at para. 19).

B. *Lordco's Cruise in 2009*

[15] The CRA auditor, Mr. Bernie Wong, was advised by Lordco's controller, Mr. Rick Sayers, that Lordco also organized and conducted a cruise in 2009 further to its bi-annual travel incentive promotion (Affidavit of B. Wong at para. 21).

[16] Lordco's cruise in 2009 was organized in a similar manner as the 2007 cruise in that customers purchased cruise tickets with rebates earned from Lordco. Based on the cruise in 2007, the companies which purchased cruise tickets for 2009 may have nominated individuals to attend the cruise as representatives. As such, an individual who attended the 2009 cruise may have obligations to report a taxable benefit under the *Income Tax Act* with respect to any non-business portion of the cruise (Affidavit of B. Wong at para. 22).

[17] To verify Lordco's tax obligations with respect to 2009, Mr. Wong requested information and documents from Lordco with respect to the 2009 cruise in order to verify whether Lordco was required to issue T4A slips to individuals who attended the 2009 cruise, and if so, whether the individuals who attended the cruise received and reported a taxable benefit on their 2009 tax return (Affidavit of B. Wong at para. 23).

[18] Mr. Sayers responded on behalf of Lordco, to the request for the information by letter dated February 8, 2011. With respect to the 2009 cruise information, Mr. Sayers advised that "as with prior years, I am unable to supply a list of the actual attendees as we

Digitized by Google

consider this third party information" (Affidavit of B. Wong at para. 25).

[19] CRA does not know the identities of the individuals who attended the cruises. CRA is unable to complete the employer compliance audit and verify whether the individuals who attended the cruises have any tax obligations arising under the tax legislation, and the amount of that obligation. As well, CRA is unable to issue information slips to the individuals who attended the cruises on behalf of Lordco, if required (Affidavit of B. Wong at para. 26).

[20] Lordco organized the cruises and in doing so, received information about each individual who attended the cruise by way of the registration forms. Lordco would also have information regarding the company customer each individual attended on behalf of. As such, obtaining the list of individuals who attended the 2007 and 2009 cruises from Lordco appears to be the most efficient and reasonable way of identifying these individuals (Affidavit of B. Wong at para. 27).

[21] The CRA seeks to determine if the unnamed persons, that is, the unidentified individuals who attended the cruises, are complying with their duties and obligations under the *Income Tax Act.* The CRA specifically seeks to identify the individuals who attended the cruise, and verify that such individuals correctly reported for tax purposes any taxable benefit gained on the cruises and paid the required taxes that may have arisen. Once the individuals are identified, the CRA intends to issue T4A slips to the individuals showing the amount of the cruise as a taxable benefit (Affidavit of B. Wong at para. 28).

[22] Therefore, to determine whether the individuals who attended the cruises have complied with their obligations under *the Income Tax Act*, the CRA seeks judicial authorization to send a requirement to provide information and documents relating to unnamed persons to Lordco, pursuant to subsection 231.2(2) of the ITA, for the following information and documents:

a. A list of the names of the individuals who attended the 2007 cruise along with the company that they represented.
b. A list of the addresses of the individuals who attended the 2007 cruise.
c. The registration forms for the individuals who attended the 2007 cruise.
d. A list of the names of the individual who attended the 2009 cruise along with the company that they represented.
e. A list of the addresses of the individuals who attended the 2009 cruise.
f. The registration forms for the individuals who attended the 2009 cruise.

(Affidavit of B. Wong at para. 31)

[23] The CRA intends to address the requirement to the attention of Mr. Sayers who is the controller for Lordco (Affidavit of B. Wong at Exhibit "I").

[24] The individuals are an identifiable group because the information and documents sought are limited to those individuals who attended the cruises hosted and organized by Lordco in 2007 and 2009 (Affidavit of B. Wong at para. 32).

[25] As the 2007 cruise relates to the 2007 taxation year, any reassessments issued to the individuals who attended the cruise may be statute-barred as early as the end of February 2011 (Affidavit of B. Wong at para. 33).

[26] The documents and information sought by the CRA in the unnamed requirement are not for the purposes of any criminal investigation (Affidavit of B. Wong at para. 35).

III. Issue

[27] The only point in issue is whether the evidence proffered by the Minister satisfies the criteria set out in subsection 231.2(3) of the *Income Tax Act* such that an order be granted imposing on the respondent, Lordco Parts Ltd., a notice to produce information and documents in the form sought by the Minister.

IV. Analysis

A. *The statutory framework*

Digitized by Google

[28] The Canadian income tax system is a self-reporting and self-assessing system that depends on the honesty and integrity of taxpayers for its success.[2] However, situations occur where this self-reporting system is contravened to avoid paying their full share of tax as required under the *Income Tax Act* by failing to comply with the rules set out in the Act.[3]

[29] The Minister has the task of administering and enforcing the Act and has been given broad powers to carry out this mandate. One of the provisions enacted by Parliament to assist the Minister is section 231.2 of the *Income Tax Act*.[4]

[30] Subsection 231.2(1) of the Act provides that the Minister may, for any purpose related to the administration or enforcement of the Act, require a person to provide any information or additional information or any documents to the Minster within a reasonable time from the service of a written notice requiring the same. Such a notice is colloquially known as a "requirement to provide information and documents" or an "RFI".

[31] In *R. v. McKinlay Transport Ltd.*, the Supreme Court of Canada held that subsection 231.2(1) of the *Income Tax Act* provides the "least intrusive means by which effective monitoring of compliance with the *Income Tax Act* can be effected".[5] The Court upheld the constitutionality of requirements for information and documents, holding that such requirements did not violate section 8 of the *Charter of Rights and Freedoms*.[6]

[32] The obtaining of information relevant to the tax liability of some specific person or persons whose tax liability is under review by the Minister is recognized as a purpose related to the administration or enforcement of the *Income Tax Act*.[7]

[33] The Minister is also permitted to request from a third party information and documents relating to one or more persons unknown to him through the issuance of a requirement;[8] however, the Minister must first seek and obtain the authorization of a judge before he may issue the requirement.[9] The Act allows the Minister to make the application for the judicial authorization on a without notice basis.[10]

[34] Subsection 231.2(3) of the *Income Tax Act* sets out two criteria that are to be satisfied before a judge may authorize the Minister to impose on a third party a requirement relating to one or more unnamed persons. First, pursuant to subsections 231.2(3)(a) of the *Income Tax Act*, the judge is to be satisfied on the evidence that the person or group is ascertainable. Second, pursuant to subsections 231.2(3)(b) of the *Income Tax Act*, the judge is to be satisfied on the evidence that the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under the Act.

[35] The Minister's application is to be granted if the judge is satisfied that the information or documents are required for a tax audit conducted in good faith.[11]

[36] Where judicial authorization is granted, the Minister is required by subsections 231.2(4) of the *Income Tax Act* to serve the order together with the requirement upon the respondent.

[37] Pursuant to subsections 231.2(5) of the *Income Tax Act*, the respondent may apply to the court for a review of the authorization within 15 days of service of the notice. Subsections 231.2(6) of the *Income Tax Act* permit the court to cancel, confirm, or vary the authorization upon review.

B. *Statutory conditions for judicial authorization are met*

[38] It is submitted that the evidence presented by the Minister on this application satisfies the two criteria necessary for judicial authorization allowing the Minister to issue an unnamed person requirement:

a. the person or group referred to is ascertainable; and
b. the requirement is made to verify compliance by persons in the group with any duty or obligation under the Act.

C. *The person or group is ascertainable*

[39] The Minister is attempting to ascertain the identity of the group of unnamed

Digitized by Google

persons who attended the 2007 and/or 2009 cruise organized and hosted by Lordco.

[40] The group of unnamed persons is ascertainable because each member of the group was an individual who attended the 2007 and/or 2009 cruise organized and hosted by Lordco.

[41] As such, the group of unnamed persons is finite and is ascertainable.

[42] The Minister has ascertained a group of taxpayers, which the CRA is unable to identify, in order to verify their income, particularly with respect to taxable benefits, and ensure the accuracy of the amount of tax payable.

[43] The Minister needs the information and documents sought in the requirement to be imposed upon the respondent to permit the Minister to identify the unnamed persons who comprise this group. Upon identifying these persons, the Minister intends to verify that the each person has complied with their obligations under the *Income Tax Act* for the 2007 and/or 2009 calendar year.

[44] As such, the information and documents are required in good faith for the purpose of verifying compliance by the unnamed persons with their respective obligations under the *Income Tax Act*.

Minister of National Revenue v. RBC Life Insurance Company, 2011 FC 1249, A Case of Incomplete Disclosure on ex parte Application that Does Not Necessarily Cause Order to be Set Aside, But Ulterior Motive to Proper Tax Enforcement and Analysis of the Nature of the Court's Process

[1] These are four motions, brought by the respondents RBC Life Insurance Company, Industrial Alliance Pacific Insurance and Financial Services Inc., Industrielle Alliance Assurance et Services Financiers Inc. and BMO Life Assurance Company [collectively the Insurers], to cancel *ex parte* orders of this Court dated October 6, 2009, April 12, 2010 and June 7, 2010. The orders were issued pursuant to section 231.2(3) of the *Income Tax Act*, RSC 1985, c 1 (5th Supp) [the Act], and authorize the Minister of National Revenue to impose on the Insurers requirements to produce certain information and documents.

[2] For the reasons that follow, the motions will be granted.

Part I – Background Facts

[3] On October 6, 2009, Justice Yvon Pinard granted the Minister of National Revenue [the Minister] *ex parte* authorization to issue the requirement to RBC Life Insurance Company [RBCI]. The requirement, which was served on November 5, 2009, seeks "all information and documents relating to RBC Life Insurance Company's 10-8 plan holders," including names and social insurance numbers, business numbers, or trust numbers. The requirement was issued following claims by the Minister that this information was required in order to verify that these persons are in compliance with the Act. On November 19, 2009, RBCI moved to challenge Justice Pinard's order.

[4] On April 12, 2010, I granted two *ex parte* applications brought by the Minister for authorization to issue similar requirements to Industrial Alliance Pacific Insurance and Financial Services Inc. and Industrielle Alliance Assurance et Services Financiers Inc. [collectively IA]. The first of these requirements seeks "A listing of all loans outstanding [...] contracted by individuals, corporations and/or trusts" relating to IA's 10-8 plan in a specified period, including: names; policy numbers; social insurance numbers, business numbers or trust numbers; amounts owing on any loans; the cash surrender value of their policies; and the interest on the loans for each 10-8 plan holder. The second requirement seeks "Une liste de tous les prêts [...] souscrit par toute personne physique, fiducie et/ou compagnie, faisant

Digitized by Google

l'objet de la Stratégie 10-8" in a specified period. On April 30, 2010, IA moved to challenge both of my orders.

[5] Justice Richard Mosley issued an order authorizing a requirement to BMO Life Assurance Company [BMO] on June 7, 2010. The requirement seeks "all information and documents" in a specified period pertaining to BMO's 10-8 plan holders. On July 14, 2010, BMO moved to challenge Justice Mosley's order.

[6] At the same time that BMO was served with the requirement authorized by Justice Mosley's order, it was also served with a requirement issued without judicial authorization which sought "all information and documents [...] relating to BMO Life Assurance Company's (formerly AIG Life Insurance Company of Canada) 10-8 Investment Plans" during a specified period. This requirement was challenged by way of an application for judicial review which BMO commenced on July 12, 2010. Although the parties' joint submissions address this application together with the four motions described above, the application will be dealt with in separate reasons.

[7] All of the requirements concern insurance leveraging strategies for high net worth individuals referred to as "10-8 plans." A 10-8 plan involves two essential elements: a life insurance policy that includes an investment account, and a loan which is secured by the life insurance policy in an amount equal to the balance of the investment account. The term "10-8 plan" refers to the interest rates applicable to these elements, as the policy-holder pays 10% interest on the loan and receives an 8% return on the investment in the life insurance policy. The 10-8 plan creates a tax benefit because the 8% interest paid to the client is tax-exempt as part of a life insurance policy, and the 10% interest payable on the loan may be tax-deductible if it is used to produce income.

[8] Each of the Insurers provided the Minister with information and documents relating to their 10-8 plans, although BMO did not provide this information until after it was served with the two requirements. Each of the Insurers also refused to provide the Minister with names or other identifying information relating to its 10-8 plan holders. The Minister therefore initiated the *ex parte* applications described above to seek authorization to issue the various requirements in an effort to obtain information relating to the identities of 10-8 plan holders. I note, however, that each of the requirements is considerably more broad than merely seeking the identifies of the Insurers' 10-8 plan holders in a given period.

[9] On February 24, 2010, Prothonotary Martha Milczynski issued an order pursuant to Rule 54 of the *Federal Courts Rules* requiring the Minister to produce all relevant documents related to Justice Pinard's order. Prior to Prothonotary Milczynski's order, the Minister had refused to produce anything other than certain documents that RBCI had created and provided to the Minister, as well as a news article and a publicly available presentation about 10-8 plans. The Minister refused to disclose any other documents on the basis that they were privileged or irrelevant, failing even to produce the documents to her counsel for review. Prothonotary Milczynski disagreed, finding that "The Court, [sic] and RBCI need to know all the facts that were within the Minister's knowledge at the time of the hearing. [...] The information sought is relevant to the issue of whether the Minister made full and frank disclosure at the time the *ex parte* application was made." Prothonotary Milczynski therefore ordered the Minister to produce her file to RBCI and awarded RBCI its costs of the motion.

[10] Following Prothonotary Milczynski's order, the Minister made further disclosure to RBCI. However, the Minister continued to refuse to produce certain documents – namely, documents surrounding an Advanced Income Tax Ruling Request [ATR] made by another insurer regarding its 10-8 plan and internal discussions relating to the consideration of the ATR by the General Anti-Avoidance Rule Committee [GAAR Committee], as well as the questionnaire which the Minister had developed to send to 10-8 plan holders. The Minister

Digitized by Google

refused to produce these documents, again claiming privilege and that they were not relevant to the motion.

[11] An ATR is a publicly available document issued by CRA. Generally, the purpose of an ATR is to seek guidance from CRA as to how it will apply the provisions of the Act in a specific context. This ATR, which was submitted by a third party insurer in 2007, provided detailed information about the submitter's proposed 10-8 plan and sought to determine whether the proposed plan complied with the Act. In contrast to a technical interpretation in which CRA addresses a hypothetical scenario, an ATR provides a specific and concrete scenario for the CRA to consider.

[12] This particular ATR was considered by the GAAR Committee, a specialized committee within CRA Rulings. The GAAR Committee assesses the potential application of the GAAR, an exceptional provision that allows CRA and the Minister to address abusive tax avoidance behaviour. GAAR can only be used as a last resort where no other provisions of the Act apply. After examining the ATR, the GAAR Committee concluded that the proposed 10-8 plan was likely in compliance with the Act and did not believe that the GAAR could be successfully applied.

[13] In light of the Minister's continued refusal to produce documents relating to the GAAR Committee's consideration of the ATR, the Insurers brought a second disclosure motion. On January 13, 2011, Prothonotary Roza Aronovitch ordered the Minister to produce the above described documents, finding that "The Minister may wish to argue at the hearing on the merits that the documents sought to be produced by way of the direction to attend are not relevant, however, it is not open for argument at this juncture, as that determination has already been made."

[14] Following Prothonotary Aronovitch's order, the Minister produced the documents in question and from these documents a different picture emerges. For the reasons set out below, these documents establish that the Court was not in a position to appreciate the full context in which the Minister brought the *ex parte* applications and the orders must therefore be cancelled.

[15] The four motions were consolidated along with BMO's application on January 13, 2011. The hearing was based on a joint record and joint written submissions from both parties. These reasons will address the four motions brought by the Insurers.

Part II – The Evidence

[16] The evidence in each of the *ex parte* applications consisted of the following:

- In the RBCI application, an affidavit of Randy Jacobs, CRA officer, stating that "CRA is seeking to verify the compliance with the obligations and duties under the *Income Tax Act* of certain taxpayers who are clients of [RBCI] and who participate in [...] the '10-8 plan'" and that "The CRA is not aware of the identity of the RBC Insurance policyholders who have participated in the [10-8 plan]. The Minister seeks to determine whether the RBC Insurance policyholders who have participated in the [10-8 plan] have complied with their duties and obligations under the *Income Tax* [sic];"
- In the IA applications, two nearly identical affidavits of Michel Lévesque, CRA officer, both stating that "Depuis 2008, l'ARC a entrepris de vérifier si les contribuables qui ont souscrit comme clients aux produits généralement connus sous le nom de « programmes 10/8 » auprès de compagnies d'assurance ont respecté quelque devoir ou obligation prévu par la *Loi de l'impôt sur le revenu*" and that "les informations recherchées et décrites au paragraphe 11 de ma dénonciation serviront à vérifier si chacune des personnes physiques, fiducies ou compagnies ayant participé à la Stratégie 10/8 décrite aux sous-paragraphes 9I, 9II, 9III A. à J. inclusivement ont

Digitized by Google

respecté quelque devoir ou obligations prévu par la LIR;"

- And, in the BMO application, an affidavit of Linda Szeto, CRA officer, stating that "I am seeking to verify the compliance with the obligations and duties under the *Income Tax Act* of certain taxpayers who are clients of BMO Life who participate in the 10-8 program," that "The CRA is currently examining the 10-8 program offered by certain insurance companies, including BMO Life, to their policyholders," and that "In order to verify if the unknown policyholders [...] who have participated in the 10-8 program have complied with their duties and obligations under the *Income Tax Act*, the Minister requires BMO Life to provide [the information listed in the requirement]."

[17] However, a significant amount of additional evidence was disclosed following the orders of Prothonotary Milczynski and Prothonotary Aronovitch.

[18] The following evidence was disclosed in response to Prothonotary Milczynski's order:

- A ruling dated December 6, 2004 in response to an inquiry regarding the deductibility of the interest paid on the loan, which concluded that "Apart from the issue of reasonableness [of the interest rate], as it would seem that this type of arrangement is not in accord with the purpose and spirit of the provisions in the Act related to exempt insurance policies we have referred this matter to the Department of Finance for their consideration;"
- E-mail correspondence between various individuals at the Canada Revenue Agency, including the following statements:
  - While discussing the strategy of using targeted audits to alert the insurance industry to its concerns regarding 10-8 plans, "We should make sure we have some technical basis supporting our concerns before we embark on this project, otherwise we could look pretty bad. [...] we better back up our concerns with real effective and timely action" and that "Finance has been aware that there are a number of issues with the policyholder legislation. About 8-9 years ago they started to look into revamping policyholder tax policy (we attended the meetings) but it didn't get off the ground (too big a project) [...] it looks like policyholder reform in [sic] now being reconsidered." [my emphasis]
  - Upon learning that insurance governance bodies were receiving inquiries from insurers seeking clarification as to the Canada Revenue Agency's interest in and concerns with 10-8 plans, "This is all good. In fact, I'm delighted. Policyholder taxation is an area long overdue for attention;"
  - In instructions to front-line auditors at the launch of the 10-8 plan audit program, "You should put together all the facts. You must be able to answer the following questions. You will notice that this does not require knowing the names of the participants;" and
  - In an update on the progress of the 10-8 plan audit project, "[redacted] did provide the names of the participants and we chose 20 files and started a test audit."

[19] The following additional evidence was disclosed following Prothonotary Aronovitch's order on the second disclosure motion:

- A memorandum from F. Lee Workman, manager of the Charitable and Financial Institution Sectors, to the GAAR Committee which states the following:
  - "any loans under the [collateral loan facility] will not be 'policy loans' as defined in subsection 148(9), the assignment of the policy as security for the loans under the [collateral loan facility] will not be a disposition of an interest in the policy by virtue of paragraph (f) of the definition of 'disposition' in

Digitized by Google

subsection 148(9), and provided the loans to be advanced by the insurer to the policyholder under the [collateral loan facility] will be borrowed money for the purposes of paragraph 20(1)(c) the interest paid on the [loan] advances will be deductible by the policyholder;"

- "the only manner in which the tax benefits to be realized the [sic] proposed transactions might be challenged is by denying a portion of the interest the policyholder claims under paragraph 20(1)(c) on the basis that the interest rate of 10% is not reasonable;"
- "the exempt policy can reasonably be said to have been purchased primarily for insurance purposes (and investment purposes to the extent permitted by the 'exempt policy' rules);"
- "The entering into of the [collateral loan facility], in order to obtain a loan from the insurer, can reasonably be said to have been undertaken by the policyholder, primarily to obtain financing;"
- "It is the fact that the borrowing is at an annual rate of 10% that might be said to have not been undertaken for a bona fide non-tax purpose as the rate is probably higher than the policyholder would likely be willing to pay on a borrowing [sic] from a bank where a policy has been assigned as collateral. The reasonability of the 10% rate is not a GAAR issue however;"
- "the collateral assignment of the policy to the insurer as security for the loan is an ordinary commercial transaction;"
- "given that whether a transaction or a series of transactions were arranged primarily for a non-tax purpose is a question of fact, it may be difficult to convince a court that the series of transactions is an avoidance transaction;"
- "the Department of Finance Explanatory Notes that were released with section 245, state that 'Subsection 245(3) does not permit the "re-characterization" of a transaction for the purposes of determining whether or not it is an avoidance transaction. In other words, it does not permit a transaction to be considered an avoidance transaction because some alternative transaction that might have achieved an equivalent result would have resulted in higher taxes.'"
- "the fact that the 8% rate of return being earned on the [collateral loan account] balance will be tax deferred is consistent with the words, object, spirit and purpose of section 12.2 and section 306 of the Regulations;"
- "the proposed series of transactions is not a misuse of the definition of 'policy loan' nor an abuse of the scheme of the Act with respect to policy loans;"
- "If the loan in question is not a 'policy loan' at law, then it would be difficult to argue that the proposed transactions are an abuse of the provisions of the Act dealing with policy loans;" and
- "we do not believe that the GAAR can be successfully applied to redetermine the implications of these transactions but it is our view that there are policy concerns that should be considered with a view to proposing amendments." [My emphasis]

- A memo from Margaret McCreary, Insurance Specialist, to the Manager of the GAAR & Technical Support Section stating that "Insurance policy tax legislation is out of date and has not kept up with the innovations in insurance products. [...] For years, insurance companies took a conservative approach and tailored their products to fit the intent, if not the exact wording, of the legislation. [...] the largest insurers are starting to lose a bit of their market share and they are concerned that the designs of the new products being offered by their competitors are no longer within the spirit of

Digitized by Google

the legislation," and concluding that "a limited number of targeted audits will be extremely effective in putting the industry on notice that CRA is concerned about the direction they are headed;" and

- Additional email correspondence between individuals at the Canada Revenue Agency which contains the following statements:
  - Following a GAAR Committee meeting at which 10-8 plans were discussed, "The discussion was interesting and the decision was that CRA would not provide a ruling. It would send a message to the insurance industry that we are troubled with the arrangement. Finance certainly was concerned by the 10/8 arrangement from a policy perspective …" and "That response [to the ATR] is that we will not provide a ruling, that both the CRA and Finance believe this product to be contrary to tax policy with regard to exempt policies, it is not clear that the 10% interest meets the reasonable test in paragraph 20(1)(c) and we are leaving the door open to the possible application of GAAR until we have audited a specific case;"
  - In an update regarding the audit strategy for dealing with 10-8 plans, "I said we would be starting an audit blitz early next year on a number of insurers know [sic] to be offering the product with the objective of obtaining sample contracts to review the 20(1)(c) interest deductions and to consider the application of GAAR;" [My emphasis]

Part III – Relevant Statutory Provisions

[20] These motions concern section 231.2 of the Act:

231.2 (3) On ex parte application by the Minister, a judge may, subject to such conditions as the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection 231.2(1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") where the judge is satisfied by information on oath that	231.2 (3) Sur requête ex parte du ministre, un juge peut, aux conditions qu'il estime indiquées, autoriser le ministre à exiger d'un tiers la fourniture de renseignements ou production de documents prévue au paragraphe (1) concernant une personne non désignée nommément ou plus d'une personne non désignée nommément — appelée « groupe » au présent article —, s'il est convaincu, sur dénonciation sous serment, de ce qui suit :
(*a*) the person or group is ascertainable; and	*a*) cette personne ou ce groupe est identifiable;
(*b*) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act.	*b*) la fourniture ou la production est exigée pour vérifier si cette personne ou les personnes de ce groupe ont respecté quelque devoir ou obligation prévu par la présente loi;
[…]	
(5) Where an authorization is granted under subsection 231.2(3), a third party on whom a notice is served	

Digitized by Google

under subsection 231.2(1) may, within 15 days after the service of the notice, apply to the judge who granted the authorization or, where the judge is unable to act, to another judge of the same court for a review of the authorization.	**[…]** (5) Le tiers à qui un avis est signifié ou envoyé conformément au paragraphe (1) peut, dans les 15 jours suivant la date de signification ou d'envoi, demander au juge qui a accordé l'autorisation prévue au paragraphe (3) ou, en cas d'incapacité de ce juge, à un autre juge du même tribunal de réviser l'autorisation.
(6) On hearing an application under subsection 231.2(5), a judge may cancel the authorization previously granted if the judge is not then satisfied that the conditions in paragraphs 231.2(3)(*a*) and 231.2(3)(*b*) have been met and the judge may confirm or vary the authorization if the judge is satisfied that those conditions have been met.	(6) À l'audition de la requête prévue au paragraphe (5), le juge peut annuler l'autorisation accordée antérieurement s'il n'est pas convaincu de l'existence des conditions prévues aux alinéas (3)*a*) et *b*). Il peut la confirmer ou la modifier s'il est convaincu de leur existence.

Part IV – Issues

[21] There are three issues before the Court on these motions:

1. Did the Minister fail to make full and frank disclosure in the *ex parte* applications?
2. Were the requirements obtained for the purpose of verifying compliance with the Act?
3. Does section 231.2(3) of the Act unjustifiably infringe section 8 of the *Charter of Rights and Freedoms*?

Part V – Discussion

1. *Full and Frank Disclosure*

i. The law

[22] Given the *ex parte* nature of the applications, the Applicant had a duty to make full and frank disclosure to the Court. It is well established that this burden requires the party in an *ex parte* hearing to present all material facts, even if those facts are adverse to its case.

[23] This Court was faced with a similar statutory provision in *Canada (Commissioner of Competition) v Labatt Brewing Co et al*, 2008 FC 59, 323 FTR 115. In that context, Justice Anne Mactavish noted that, in *ex parte* proceedings, the "normal checks and balances of the adversary system" are absent, and that the Court is therefore "at the mercy" of the party seeking *ex parte* relief (at paras 23 to 24). She also noted that "There is no situation more fraught with potential injustice and abuse of the Court's powers than an application for an *ex parte* injunction" (*Watson v Slavik*, in *Labatt*, above, at para 24). This potential injustice is the reason why the party seeking *ex parte* relief "must inform the Court of any points of fact or law known to it which favour the other side" (*Friedland* in *Labatt*, above, at para 25).

[24] As Justice Mactavish noted in *Labatt*, above, this duty of full and frank disclosure

Digitized by Google

is crucial to the proper exercise of judicial discretion:

> Section 11 of the *Competition Act* provides for independent judicial oversight with respect to the extensive investigative powers granted to the Commissioner under the *Competition Act*. To this end, section 11 does not mandate that the Court act as a mere "rubber stamp" […]
>
> I agree that the Court must indeed be satisfied that the two statutory conditions precedent to the granting of a production order have been met […] However, in order to properly exercise the discretion conferred on the Court by section 11 of the *Competition Act*, and for the Court to be able to control its own processes, and to guard against the abuse of those processes, the Court must also be fully apprised of the relevant circumstances surrounding the request. [At paras 50-51]

[25] My colleague Justice Luc Martineau also considered a jeopardy order issued pursuant to the Act in *Canada (National Revenue) v Robarts*, 2010 FC 875, 374 FTR 87. In that decision, Justice Martineau noted that:

> In all *ex parte* matters the applicant is obliged to draw to the attention of the Court all facts in issue, even those which it considers unhelpful or inconvenient, and all relevant caselaw. […] Indeed, full and frank disclosure requires that the Minister disclose "what might reasonably be regarded as [known] weaknesses". […]
>
> While the omission [in the Minister's disclosure] was apparently made with no malicious intent, it severely undermines the *ex parte* application that was made by the Minister. [At paras 35 and 41]

[26] The Federal Court of Appeal considered the disclosure obligation in section 231.2 proceedings in *R v Derakhshani*, 2009 FCA 190, 2010 DTC 5043. In that decision, the unanimous Court noted the importance of full and frank disclosure to the judicial discretion captured in subsection 231.2(3):

> It is useful to recall that the existence of judicial discretion is <u>essential</u> to the constitutional validity of this type of provision, which is comparable to a seizure even when used in a regulatory (or even non-criminal) context […] It is this discretion, conferred upon an independent judge, which protects individuals from the damaging use of this kind of power and brings it in line with the requirements of section 8 of the *Canadian Charter of Rights and Freedoms* […]
>
> The fact that it may be possible to obtain the information using other means does not exclude the possibility that a requirement might be authorized, but that is information that must be provided to the judge. <u>A judge must not be left in the dark on such an important point</u>. [At paras 19 and 29, my emphasis]

[27] It seems to me that the most basic element of the duty to make full and frank disclosure is the disclosure to the Court of any information that has already been provided (see *Labatt*, above, at paras 93 and 94).

[28] Pursuant to Rule 399 of the *Federal Courts Rules*, the Court can quash an *ex parte* order where it was issued based on "misleading, incomplete, or incorrect" facts (see *Canada (Commissioner of Competition) v Air Canada*, [2001] 1 FC 219, 186 FTR 48 at para

Digitized by Google

14). Although the *ex parte* applications were brought under section 231.2(3) of the Act, Rule 399 nonetheless applies (see *Air Canada*, above, at para 5).

[29] However, an order will not automatically be cancelled because of any breach of this duty. An *ex parte* order will only be disturbed where non-disclosure is material and must be such that, had the information been disclosed, it would have affected the exercise of the *ex parte* judge's discretion (see *Labatt*, above, at paras 31 and 98).

[30] The Court retains the discretion to continue an *ex parte* order despite flawed disclosure:

> [I]t is important to keep in mind that the reason for the disclosure requirement is firstly to deprive the person who has not observed the rule of an advantage improperly obtained and secondly to act as a deterrent to ensure that persons who make *ex parte* applications realize that they have a duty of disclosure and that they appreciate the consequences if they fail in that duty.
>
> [...] In exercising its discretion, the court should consider the extent of the culpability with regard to the non-disclosure, and the importance and significance of the matters that were not disclosed to the court to the outcome. [*Sherwood Dash Inc v Woodview Products Inc*, [2005] OTC 1061, 2005 at paras 39-40]

ii. Parties' Submissions

[31] The Insurers submit that the Minister failed to make full and frank disclosure in the *ex parte* applications. She was required to present a balanced view to the Court and to disclose any facts which could operate against her, citing several decisions including *Robarts*, above, at para 35 and *Labatt*, above, at paras 25-26.

[32] Further, the Minister cannot justify the lack of disclosure on the basis that the information is immaterial,

> The duty extends to placing before the court all matters which are relevant to the court's assessment of the application, and it is no answer to a complaint of non-disclosure that if the relevant matters had been placed before the court, the decision would have been the same. The test as to materiality is an objective one, and it is not for the applicant or his advisers to decide the question; hence it is no excuse for the applicant subsequently to say that he was genuinely unaware, or did not believe, that the facts were relevant or important. [Steven Gee, *Mareva Injunctions and Anton Piller Relief*, 3rd ed. (London: FT Law & Tax, 1995) at p 98, in *Labatt*, above, at para 31]

[33] The Insurers also note that it is no excuse for a party to say that it did not intend to mislead the Court with its flawed disclosure, citing *R v Morelli*, 2010 SCC 8, [2010] 1 SCR 253 at para 59.

[34] The Insurers compare the orders under review to the power of the Commissioner of Competition to compel disclosure with judicial authorization, noting that this Court has held that,

> [T]he Court must indeed be satisfied that the two statutory conditions precedent to the granting of a production order have been met – namely that there is a section 10 inquiry under way, and that the respondent has information that is relevant to the inquiry – prior to granting a production order under the Act. However, in order to properly exercise the discretion conferred on the Court by section 11 of the *Competition Act*, and for the Court

Digitized by Google

> to be able to control its own processes, and to guard against the abuse of those processes, the Court must also be fully apprised of the relevant circumstances surrounding the request. [*Labatt*, above, at para 51]

[35] Finally, the Insurers argue that the Court's discretion to continue the *ex parte* orders despite the flawed disclosure is exceptional and limited, and that it should not be exercised simply because the orders would probably have been granted had the disclosure been complete, citing *Sherwood Dash*, above, at paras 37-39.

[36] Thus the four *ex parte* orders must be cancelled because the Minister failed to make full and frank disclosure. In particular, the Minister had a duty to disclose the documents and emails surrounding the GAAR Committee's consideration of the ATR and the Canada Revenue Agency's plan to audit 10-8 plan holders, as well as the significant volume of information about 10-8 plans that had already been disclosed to the Minister before the *ex parte* applications.

[37] The Minister, on the other hand, claims that the *ex parte* orders were sought for the purpose of verifying whether the 10-8 plan holders are in compliance with the Act, and that the GAAR Committee documents and internal discussions are immaterial to this end.

[38] The Minister further submits that, in order for the *ex parte* orders to be set aside, the Insurers must demonstrate that the disclosure made at the hearing was "misleading, inaccurate or incomplete," citing *Labatt*, above, at para 34. She also claims that the Insurers must show that, but for the lack of disclosure, the orders would not have been made, citing *Re Papa*, 2009 FC 49, [2009] 4 CTC 93 at paras 21-23. Therefore the Insurers have not met this high burden and that I should therefore decline to exercise my discretion to cancel the orders.

iii. Analysis

[39] In my opinion, the Minister fell short of her obligation to make full and frank disclosure in two respects. First, she did not disclose the significant volume of information that the Insurers had already provided to her before the *ex parte* applications were commenced. These documents provided a great deal of information about the Insurers' 10-8 plans, and with the exception of the identities and personal information of the Insurers' 10-8 plan holders, responded fully to the requirements for which the Minister sought *ex parte* authorization.

[40] The second, and more troubling, omission is the Minister's failure to disclose internal documents and information suggesting that the 10-8 plans comply with the letter of the Act, if not with its spirit. These documents – the bulk of which were only disclosed to the Insurers after two separate motions – are undoubtedly material and, had they been disclosed to the Court, could certainly have affected the outcome of the *ex parte* applications.

[41] More specifically, the evidence disclosed following the Prothonotaries' orders include the following material facts which were not disclosed to the Court on the *ex parte* applications:

a) The fact that the Department of Finance had refused to amend the Act to address the outdated policyholder provisions;
b) The ATR, which provided a great deal of information regarding a specific 10-8 plan for the express purpose of determining whether the plan complied with the Act;
c) The fact that the GAAR Committee had determined that the 10-8 plan likely complied with the letter of the Act, if not with its spirit; and
d) The decision to "send a message to the industry" by refusing to answer the ATR and to take measures to "chill" 10-8 plan business, in part by undertaking an "audit blitz".

Digitized by Google

[42] The fact that the Minister decided to undertake an "audit blitz" to "send a message to the insurance industry" is clearly relevant to the balancing exercise that the Court has to undertake in deciding whether or not the orders should be granted. For the Court to be able to control its own processes and to guard against any abuses, it must be fully apprised of all relevance circumstances surrounding the request (see *Labatt*, above, at paras 47 and 51 to 52).

[43] Although subsection 231.2(6) of the Act does not explicitly state that the Court can cancel an authorization previously issued based on a lack of disclosure, I find that Rule 399 of the *Federal Courts Rules* gives me the inherent power to do so (see *Air Canada*, above, at para 5). The Court must retain the authority to control its own processes and to remedy any abuse that results from an *ex parte* order granted based on incomplete or misleading disclosure.

[44] I note as well that, had the Minister disclosed these material facts on the *ex parte* applications, the orders might still have been granted. However, I would have had many questions for the Minister about the information she had already received and CRA's position on the 10-8 plans and her goal in auditing 10-8 plan holders. As was the case in *Derakhshani*, above, the evidence omitted from the *ex parte* applications does not exclude the possibility that the requirements might be authorized, but the information must be before the judge. Otherwise the *ex parte* applications become a rubber stamp exercise and the Court cannot effectively exercise its discretion.

[45] I am satisfied that this information was material and that, because of its omission from the *ex parte* applications, the Court was not in a position to make an informed decision. As a result, the orders must be cancelled.

2. *Purpose of the Requirements*

i. The law

[46] Section 231.2(3)(*b*) requires that the Minister's purpose in seeking to issue a requirement concerning unnamed persons be to "verify compliance by the person or persons in the group with any duty or obligation under this Act." This purpose requirement is one of two conditions of which the presiding judge must be satisfied in order for the authorization to be granted, the other condition being that the group must be ascertainable.

[47] The purpose requirement in subsection 231.2(3)(*b*) of the Act has not been the subject of much adjudication. It appears that this dearth of judicial consideration results from the Minister's broad audit powers under the Act:

> Accordingly, the Minister of National Revenue must be given broad powers in supervising this regulatory scheme to audit taxpayers' returns and inspect all records which may be relevant to the preparation of these returns. The Minister must be capable of exercising these powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act. Often it will be impossible to determine from the face of the return whether any impropriety has occurred in its preparation. A spot check or a system of random monitoring may be the only way in which the integrity of the tax system can be maintained. [*McKinlay*, above, at para 36]

[48] The most direct ruling on the purpose requirement in subsection 231.2(3)(*b*) comes from Justice Johanne Gauthier in *Minister of National Revenue v Greater Montréal Real Estate Board*, 2006 FC 1069, 303 FTR 29: "The language of the Act is clear. The information and documents requested must be for the purpose of verifying whether the persons being investigated have complied with some duties or obligations set out in the Act. The courts have held that the information must be "relevant" to the inquiry" (at para 61).

Digitized by Google

[49] In *Nadler Estate v Canada (Attorney General)*, 2005 FC 935, [2005] 4 CTC 7, Justice Johanne Gauthier noted that "The Act does not require that the third party from whom the information is sought be given any details as to the purpose of the Requirement" (at para 9) and was satisfied that the Requirement at issue was valid because "The Requirement properly indicates the name of the taxpayer concerned, refers to the appropriate enabling provision and gives a description of the information required which is sufficient to enable Canada-Israel Securities Ltd. to prepare its response" (at para 9).

[50] Similarly, I held in *Ministre du Revenu national v Banque Toronto Dominion*, 2004 FC 169, 253 FTR 90 that:

> It is not the function of a financial institution to which the requirement is sent to decide on the relevance of the information sought under that requirement. It noted [sic] that the procedure created under subsections 231.2(2) and (3) of the I.T.A. has the twofold function of requiring the Canada Customs and Revenue Agency to justify the obtaining of the information required when the requirement relates to unnamed persons and allowing the financial institution to which the requirement is sent to comply with its obligations to its clients. [At para 15]

[51] However, the Minister may have more than one purpose in issuing requirements. Where a secondary purpose such as the audit of a named taxpayer is sufficiently connected to the enforcement purpose relating to the unnamed persons, subsection 231.2(3)(b) is still satisfied (see *Whitewater Golf Club Inc v Minister of National Revenue*, 2009 FC 739, [2009] 6 CTC 51 at paras 15 to 16).

ii. Parties' Submissions

[52] The Insurers submit that the requirements were issued for an improper purpose: namely, a fishing expedition intended to chill their 10-8 plan business. They claim that the Minister failed to establish in the *ex parte* applications that the requirements were necessary to verify compliance with the Act and note that the Minister has not alleged any specific breach of the Act.

[53] The Insurers argue that the Minister was required to act in good faith in exercising her powers under section 231.2 of the Act, citing *Greater Montréal Real Estate Board*, above, at para 48.

[54] Further, section 231.2(3) requires the Minister to show that the requirements are necessary to ensure compliance, again citing *Greater Montréal Real Estate Board*, above. They claim that the requirements were not actually necessary to verify that the 10-8 plans were in compliance with the Act, and that they had already provided enough information to allow the Minister to determine that their 10-8 plans comply with the Act without conducting any audits.

[55] The Minister submits that nothing in the record contradicts the evidence in the *ex parte* applications that the requirements are needed to conduct targeted audits of 10-8 plan holders and ensure their compliance with the Act. She is not required to justify her decision to audit, and that an audit program that targets 10-8 plan holders is not evidence of bad faith.

iii. Analysis

[56] As stated above, I am satisfied that the orders must be quashed solely because of the incomplete disclosure. However, I will make the following comments about the question of the Minister's true purpose in issuing the requirements since the issue was fully argued before me.

[57] There is no merit to the Insurers' claim that the Minister was required to identify a specific section of the Act that she believed had been breached. The Supreme Court held in *McKinlay*, above, that "The Minister must be capable of exercising these [audit] powers

Digitized by Google

whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act. Often it will be impossible to determine from the face of the return whether any impropriety has occurred in its preparation" (at para 36). The Minister was not, therefore, required to give more detail as to the purpose of the Requirements as long as the information is "relevant" to the verification of compliance with a duty of obligation under the Act. Subsection 231.2(3) does not require the Minister to show that there are reasonable grounds to believe that there is failure to comply with a provision of the Act.

[58] At the hearing, the Insurer's conceded that the Minister had a valid audit purpose in issuing the requirements, but argued that this valid purpose was extraneous to her primary goal, which was to chill their 10-8 plan business. I agree.

[59] I do not believe that the Minister's central purpose in issuing the requirements is sufficiently tied to her valid audit purpose. Contrary to the Minister's pretension, I did find evidence that the targeted audit of specific 10-8 plan holders was not only done to test the reasonableness of the 10% payable interest rate or the possible application of the GAAR but to send a message to the industry. I am not satisfied that the Minister's attempt to "send a message" is a valid enforcement purpose such that subsection 231.2(3)(*b*) of the Act is satisfied or that this goal is sufficiently connected to the Minister's valid audit purpose.

[60] Moreover, I am not satisfied that the requirements are actually necessary for the Minister to verify compliance with the Act. The only evidence in the *ex parte* applications to the effect that the requirements were necessary consisted of bald assertions by the Minister's affiants, who apparently were not apprised of the context in which the applications were brought. Not only have the Insurers provided the Minister with a substantial amount of information, but RBCI has also provided her with the identities of certain of its 10-8 plan holders. Of course, it is not the role of the Court to question the Minister's decision to audit someone (see *Greater Montréal Real Estate Board*, above, at para 28). However the Minister cannot pretend that she is unable to audit any of the Insurers' 10-8 plan holders or to otherwise determine whether the 10-8 plans comply with the Act because that is simply not the case. Further, the ATR, although made by another insurer, provided sufficient concrete information to allow the Minister to make a determination – and, in fact, she determined that the 10-8 plan likely complies with the Act.

[61] The Minister therefore was already in a position to assess the 10-8 plans and their compliance with the Act. Again, this begs the question of her true purpose in bringing the *ex parte* applications.

[62] If, as the Minister's delegates claimed in the internal emails, "Policyholder taxation is an area long overdue for attention," then the manner in which it should receive this attention is through legislative amendment. It is a misuse of the Minsiter's powers – powers which the Courts have repeatedly called "intrusive" – to use section 231.2 to pursue policy objectives rather than to enforce tax obligations. It was not open to the Minister to seek *ex parte* authorization under the pretence of verifying compliance with the Act when her true purpose was to achieve through audits what the Department of Finance refused to do through legislative amendment.

3. *Constitutionality of Section 231.2(3) of the Act*

[63] The Charter issue is raised in the specific context of these motions and is intertwined with the first two issues. In light of my above conclusion that ex parte orders must be cancelled, it is unnecessary for me to address this issue.

Part VI – Conclusion

[64] As a result of the incomplete disclosure in the *ex parte* motions, these motions are allowed and the *ex parte* orders are cancelled with costs.

Digitized by Google

The Minister Of National Revenue v. Cormark Securities Inc., 2011 FC 1472, Purported Vagueness of Class of Identities, Purported Ability to Realize Info. from Other CRA Source, All Not Conclusive

[1] Cormark Securities Inc. seeks to set aside an *ex parte* Order of this Court made pursuant to section 231.2 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp) (the "Requirement Order"). The Order authorized the Minister of National Revenue to impose a Requirement on Cormark to provide information and documents relating to one or more unnamed persons involved in a specified form of transaction. In these transactions, companies engaged in one industry were attempting to deduct losses generated by companies that had been engaged in a different industry.

[2] Cormark alleges that the Minister failed to make full and frank disclosure in its *ex parte* application, with the result that the Requirement Order should be set aside. It further asserts that the affidavit evidence provided in support of the motion was vague, confusing and showed a fundamental lack of rigour. As such, Cormark says that it cannot comply with the Order.

[3] Cormark also argues that the evidence provided by the Minister in support of the *ex parte* application did not include the type of information that the Federal Court of Appeal has held to be essential to this type of application.

[4] Cormark further submits that the unnamed person or group of persons is not ascertainable and that the purpose of the Requirement Order is not to verify an unnamed person's or group of persons' compliance with any duty or obligation under the Act.

[5] For the reasons that follow, I have concluded that the Minister did provide full and frank disclosure in support of its *ex parte* application. Cormark has also not persuaded me that the evidence provided in support of the Minister's *ex parte* motion was vague or confusing, or that the group targeted by the Requirement Order is not ascertainable. As a consequence, Cormark's motion will be dismissed.

Background

[6] Cormark Securities Inc. (formerly known as Sprott Securities Inc.) is an investment management company carrying on business in Alberta.

[7] According to the evidence provided by the Minister in support of the *ex parte* application for a Requirement Order, the Canada Revenue Agency [CRA] is currently working on a project known as the "Tech Wreck" project. The Tech Wreck project is focussed on verifying the compliance with the *Income Tax Act* of certain unnamed persons involved in a particular kind of transaction with the assistance of investment management companies in Alberta, including Cormark.

[8] In the transactions in question, investors acquire a minority of shares in a corporation that has become insolvent, bankrupt or otherwise unable to continue, but which has significant pools of tax losses ("Losscos"). The investors then cause a change to the directors of the Lossco to favour the interests of the investors. The new directors cause the Lossco to involve itself in a new business. Income from the new business is then offset against the losses generated by the Lossco's previous business. For the purpose of these reasons, such transactions will be referred to as "Lossco Transactions".

[9] The ability of a business to deduct losses may be restricted if there has been a change in control of the business. The CRA is concerned that through these types of transactions, there has been an effective change in control of the Lossco, and that investors are trying to avoid the change of control restrictions in the Act.

[10] The Tech Wreck project started after the CRA's Calgary office noted that businesses with oil and gas assets were trying to deduct losses incurred by businesses engaged in research and development. An investigation revealed that certain investment management companies in Alberta, including Cormark, were promoting or facilitating these

Digitized by Google

transactions.

[11] The unnamed persons who are the targets of the Requirement are clients of Cormark, or are otherwise known to Cormark, who have entered into or promoted, or attempted to enter into or promote Lossco Transactions. According to the CRA, these individuals are thus ascertainable.

[12] The purpose of the Requirement Order was thus to verify compliance by these unnamed persons with the duties and obligations imposed upon them by the *Income Tax Act*, and to determine whether these individuals had correctly computed and reported their taxable income.

The Requirement Order

[13] By Order dated March 21, 2011, Justice Kelen authorized the CRA to impose a Requirement on Cormark to provide information and documents under the authority of subsection 231.2(1) of the Act relating to one or more unnamed persons. A copy of the Requirement Order is attached as Annex A to these reasons.

[14] The Requirement was served on Cormark on July 14, 2011, following which Cormark brought this motion seeking to have the Requirement set aside.

The Relevant Statutory Provisions

[15] These motions relate to section 231.2 of the *Income Tax Act*. The provisions that are relevant to this motion state that:

231.2 (1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act (including the collection of any amount payable under this Act by any person), of a comprehensive tax information exchange agreement between Canada and another country or jurisdiction that is in force and has effect or, for greater certainty, of a tax treaty with another country, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as stipulated in the notice, (a) any information or additional information, including a return of income or a supplementary return; or (b) any document.	**231.2** (1) Malgré les autres dispositions de la présente loi, le ministre peut, sous réserve du paragraphe (2) et pour l'application ou l'exécution de la présente loi (y compris la perception d'un montant payable par une personne en vertu de la présente loi), d'un accord général d'échange de renseignements fiscaux entre le Canada et un autre pays ou territoire qui est en vigueur et s'applique ou d'un traité fiscal conclu avec un autre pays, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne, dans le délai raisonnable que précise l'avis : a) qu'elle fournisse tout renseignement ou tout renseignement supplémentaire, y compris une déclaration de revenu ou une déclaration supplémentaire; b) qu'elle produise des

Digitized by Google

[…]
(3) On ex parte application by the Minister, a judge may, subject to such conditions as the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection 231.2(1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") where the judge is satisfied by information on oath that
(a) the person or group is ascertainable; and
(b) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act.
(c) and (d) [Repealed, 1996, c. 21, s. 58(1)]
[…]
(5) Where an authorization is granted under subsection 231.2(3), a third party on whom a notice is served under subsection 231.2(1) may, within 15 days after the service of the notice, apply to the judge who granted the authorization or, where the judge is unable to act, to another judge of the same court for a review of the authorization.
(6) On hearing an application under subsection 231.2(5), a judge may cancel the authorization previously granted if the judge is not then satisfied that the conditions in paragraphs 231.2(3)(a) and 231.2(3)(b) have been met and the judge may confirm or vary

documents.
[…]
(3) Sur requête ex parte du ministre, un juge peut, aux conditions qu'il estime indiquées, autoriser le ministre à exiger d'un tiers la fourniture de renseignements ou production de documents prévue au paragraphe (1) concernant une personne non désignée nommément ou plus d'une personne non désignée nommément — appelée « groupe » au présent article —, s'il est convaincu, sur dénonciation sous serment, de ce qui suit :
a) cette personne ou ce groupe est identifiable;
b) la fourniture ou la production est exigée pour vérifier si cette personne ou les personnes de ce groupe ont respecté quelque devoir ou obligation prévu par la présente loi;
c) et d) [Abrogés, 1996, ch. 21, art. 58(1)]
[…]
(5) Le tiers à qui un avis est signifié ou envoyé conformément au paragraphe (1) peut, dans les 15 jours suivant la date de signification ou d'envoi, demander au juge qui a accordé l'autorisation prévue au paragraphe (3) ou, en cas d'incapacité de ce juge, à un autre juge du même tribunal de réviser l'autorisation.
(6) À l'audition de la requête prévue au paragraphe (5), le juge peut annuler l'autorisation accordée antérieurement

Digitized by Google

the authorization if the judge is satisfied that those conditions have been met.	s'il n'est pas convaincu de l'existence des conditions prévues aux alinéas (3)a) et b). Il peut la confirmer ou la modifier s'il est convaincu de leur existence.

Did the Minister Provide Full and Frank Disclosure?

[16] There is no dispute that the Minister must provide full and frank disclosure of all of the relevant facts when seeking *ex parte* relief from the Court under subsection 231.2(1) of the *Income Tax Act*.

[17] As Justice Sharpe noted in *United States of America v. Friedland*, [1996] O.J. No. 4399 (Q.L.), [*Friedland*] both the judge hearing an *ex parte* motion and the party against whom the order is sought are literally "at the mercy" of the party seeking the relief in issue. As a consequence, the law requires that a party seeking *ex parte* relief must do more than simply present its own case in the best possible light, as would be the case if the other side were present. Rather, the person seeking *ex parte* relief must:

> [S]tate its own case fairly and must inform the Court of any points of fact or law known to it which favour the other side. The duty of full and frank disclosure is required to mitigate the obvious risk of injustice inherent in any situation where a Judge is asked to grant an order without hearing from the other side: *Friedland*, above at para. 27.

[18] The Court did, however, observe at paragraph 31 of *Friedland* that the duty to make full and frank disclosure is not to be imposed in a formal or mechanical manner. That is, a party should not be deprived of a remedy because of "mere imperfections in the affidavit or because inconsequential facts have not been disclosed". Rather, the defects complained of must be relevant and material to the discretion to be exercised by the Court: see *Friedland*, above at para. 31, and *Canada (Commissioner of Competition) v. Labatt Brewing Co.*, 2008 FC 59, 323 F.T.R. 115 at para. 27.

[19] That being said, court orders - even those made without notice to the opposing party - are not lightly to be set aside. As Justice Reed observed in *Canada (Commissioner of Competition) v. Air Canada*, [2001] 1 F.C. 219, [2000] F.C.J. No. 1177 (Q.L.) at para. 13, "[t]he non-disclosure or errors, in the evidence placed before the issuing judge, must be such as to have caused the issuing judge, had he or she known of them, to have refused to grant the order".

[20] In seeking to have the Requirement set aside, Cormark's first argument is that the Minister failed to provide full and frank disclosure of relevant and material information in its *ex parte* application. In particular, Cormark asserts that the Minister failed to disclose that he could have obtained the information being sought by other means.

[21] According to Cormark, the Minister could have obtained the information sought through the Requirement Order by mining its own databases. Each unnamed Lossco is a corporation which would have had to file a T-2 return each year. As a result, each company would have had to disclose whether it was claiming any kind of losses or scientific research and experimental expenditures, and whether it was inactive. Each company would also have to disclose whether its major business activity has changed since it filed its last return, and the nature of the business now carried on by the company.

[22] The Minister could also have obtained information from the System for Electronic Document Analysis and Retrieval [SEDAR]. According to Cormark's affiant, the Minister should have been able use SEDAR to identify any Lossco that was a reporting issuer in

Digitized by Google

Canada without the need for the Requirement Order.

[23] Finally, Cormark points out that the Minister has been able to obtain information with respect to at least one oil and gas company involved in a Lossco-type transaction as evidence that the Requirement Order is not necessary here. In support of this contention, Cormark has produced documents with respect to the reassessment of Fortress Energy Inc. and the CRA's disallowance of non-capital losses claimed by that company.

[24] In support of its argument, Cormark relies on the decision in *R. v. Derakhshani*, 2009 FCA 190, 323 F.T.R. 115. There the Federal Court of Appeal observed that the fact that the Minister may obtain the information sought using other means "does not exclude the possibility that a requirement might be authorized, but that is information that must be provided to the judge. A judge must not be left in the dark on such an important point": at para. 29. See also *Canada (Minister of National Revenue - M.N.R.) v. RBC Life Insurance Co.*, 2011 FC 1249, [2011] F.C.J. No. 1537 (Q.L.) at para. 29.

[25] Having failed to disclose to Justice Kelen that the information being sought was available elsewhere, Cormark says that the Minister failed to make full and frank disclosure with the result that the Requirement Order should be set aside.

[26] I am not persuaded that the information sought by means of the Requirement would be available to the CRA by other means. Cormark has not demonstrated that the CRA would be able to identify a Lossco by reviewing its T-2 and SEDAR filings without first knowing the name of the company in question.

[27] Moreover, it is clear that the type of Lossco Transactions that are of concern to the Minister involve the acquisition of a minority of the shares of the Lossco by investors. In response to questions from the Court, counsel for Cormark conceded that information regarding such acquisitions would not be available to the CRA, either through the company's own tax filings or through SEDAR.

[28] It is also clear from the evidence of Derek Carroll, a Team Leader in the Audit Division of the CRA, that agreements entered into by the minority investors which give them effective control of the Lossco play a central role in the tax schemes in question. Without these agreements, investors acquiring a minority interest in Losscos would not be able to cause a change to the directors of the Lossco to favour the interests of the investors and to involve the Lossco in a new business. In response to questions from the Court, Cormark conceded that neither the existence nor the content of these agreements would be discoverable by the Minister through SEDAR or through the Lossco's T-2 filings.

[29] Finally, the information provided with respect to the Fortress Energy Inc. does not assist Cormark, as there is nothing in the evidence to indicate how the company's potential involvement in a Lossco Transaction came to the attention of the CRA.

[30] As a consequence, I am not persuaded that the Minister breached the duty of full and frank disclosure in this case.

Is the Group Ascertainable?

[31] Cormark submits that the affidavit evidence provided by the Minister in support of the motion was both confusing and misleading and that it showed a fundamental lack of rigour, with the result that the unnamed persons or entities identified in the Requirement Order are not ascertainable.

[32] In particular, Cormark says that the language used in Mr. Carroll's affidavit was imprecise. By way of example, Cormark points to Mr. Carroll's statement in his affidavit that Losscos are not entitled to deduct losses if there has been a change in control of "the *business*", noting that "corporation" and "business" are each defined terms in the *Income Tax Act*. Cormark noted that Mr. Carroll admitted in cross-examination that this statement was imprecise, and that it would have been more precise to say that the ability of a corporation to deduct losses may be restricted if there has been a change in the control of "the *corporation*"

Digitized by Google

and not "the *business*". However, when read in context, it is clear that the two terms were being used interchangeably.

[33] Cormark also points out that Mr. Carroll's affidavit states that in accordance with the *Income Tax Act*, a business can deduct losses for the purposes of computing its taxable income "*in certain circumstances*". Cormark contends that this statement was misleading. In support of this contention, Cormark points out that Mr. Carroll conceded in his cross-examination that *the general rule* under subsection 3(d) of the Act is that a business can deduct losses in calculating its income.

[34] In addition, Cormark takes issue with Mr. Carroll's failure to define various terms used in his affidavit and in the Requirement.

[35] I agree with Cormark that the language used by Mr. Carroll in his affidavit is not as precise as one may have liked. That said, I am not persuaded that the affidavit was misleading or confusing when the statements in issue are read in context.

[36] Indeed, when the affidavit that was provided by Mr. Carroll in support of the Minister's *ex parte* application is read as a whole, it is quite clear which type of transactions were of concern to the CRA, and what kind of information Cormark would need to look for in order to comply with the Requirement Order. This is especially so when regard is had to the step-by-step example of a Lossco Transaction contained in the Requirement letter which is attached as Schedule "A" to the Requirement Order.

[37] Cormark also takes issue with the reference in Mr. Carroll's affidavit and the Requirement letter to the "acquisition of tax attributes" of one taxpayer by another. "Tax attributes" are defined in the Requirement letter as "undepreciated capital cost balances, capital losses, non-capital losses, unused Scientific Research and Experimental Development ("SRED") expenditures, and/or unused SRED tax credits".

[38] Lou D'Souza, Cormark's Chief Compliance officer, deposes that he does not know how a taxpayer can make an "acquisition" of the tax attributes of another taxpayer, with the result that Cormark cannot identify the taxpayers who engaged in the types of transactions in issue.

[39] Cormark further contends that this aspect of Mr. Carroll's evidence was misleading, as Mr. Carroll himself conceded on cross-examination that one taxpayer cannot technically acquire the tax attributes of another taxpayer.

[40] However, as the Minister points out, Mr. Carroll went on to explain that in the course of work done on the Tech Wreck project, the CRA had seen a series of transactions that had been designed to get around the "acquisition of control" rules. These transactions resulted in the effective acquisition of one taxpayer's tax losses by another taxpayer. In light of this, I am not persuaded that there was anything misleading about this aspect of Mr. Carroll's evidence.

[41] Cormark also argues that the Requirement Order is vague, and that the unnamed person or group of persons is not ascertainable.

[42] The Minister submits that the unnamed persons are ascertainable, in that they were made up of clients of Cormark who either participated in one of the Lossco Transactions or attempted to enter into such a transaction. In addition, some members of the group are promoters known to Cormark who promoted or attempted to promote Lossco Transactions.

[43] I agree with the Minister that Cormark would know which of its clients entered into a Lossco Transaction and which of its clients attempted to enter into a Lossco Transaction with the assistance of Cormark. Cormark would also be in a position to advise the CRA as to those entities known to it that had promoted or attempted to promote Lossco Transactions.

[44] Moreover, Cormark is not being required to speculate as to whether specific Lossco Transactions were actually concluded, given that the Minister is only seeking the

Digitized by Google

names of those individuals and companies known to Cormark who attempted to enter into or promote a Lossco Transaction. As a consequence, I am satisfied that the individuals and companies targeted by the Requirement Order constitute an ascertainable group.

Is the Purpose of the Requirement to Verify Compliance with the Act?

[45] Finally, Cormark challenges Mr. Carroll's statement that "the purpose of the Requirement [...] is to verify compliance by the unnamed persons who have entered into or promoted, or attempted to enter into or promote, a Transaction with the duties and obligations imposed under the *Income Tax Act*, and whether they have correctly calculated their taxable income".

[46] Cormark asserts that the Minister has failed to demonstrate that promoting, attempting to promote, or attempting to enter into a Lossco Transaction would avoid a duty or obligation imposed under the Act, as required by paragraph 231.2(3)(b) of the *Income Tax Act*.

[47] Cormark notes that in cross-examination, Mr. Carroll admitted that, other than promoter fees (which are not the subject of the Requirement Order), there is no impact on a taxpayer's tax liability where the taxpayer merely considered a transaction of the type described in Mr. Carroll's affidavit. Similarly, there is no impact on a promoter or intended promoter's tax liability where the promoter or intended promoter merely promoted or considered promoting a Lossco transaction.

[48] It is true the audit powers in section 231.2 of the *Income Tax Act* are an intrusive measure affecting the right to the protection of private information. As a consequence, the statutory provision must be construed restrictively: *M.N.R. v. Sand Exploration Ltd. et al.*, [1995] 3 FC 44 at 52.

[49] That said, in *Canada (Minister of National Revenue - M.N.R.) v. Greater Montréal Real Estate Board*, 2007 FCA 346, [2008] 3 F.C.R. 366 at para. 45 [*Greater Montreal*] the Federal Court of Appeal held that as long as the conditions prescribed by the Act are complied with, the effect of the 1996 amendments to section 231.2 of the *Income Tax Act* is to permit "a type of fishing expedition ... for the purpose of facilitating the MNR's access to information".

[50] Moreover, the Minister no longer needs to show that the Requirement Order relates to a "genuine and serious inquiry" into the tax liability of a specific person or persons, or, for that matter, each and every person or entity targeted by the Order. Rather, it is appropriate to grant an *ex parte* application for a Requirement Order where the judge is satisfied that the information or documents relating to one or more unnamed persons is required to verify compliance with the *Income Tax Act* through a tax audit that is conducted in good faith: see *Greater Montreal*, above at paras. 21 and 48.

[51] I am satisfied that the Minister has met this test in this case. Mr. Carroll stated under oath that the Minister has reason to believe that promoters of a Lossco Transaction may also have participated in that transaction, thereby affecting the promoter's duties and obligations under the *Income Tax Act*. Moreover, Mr. Carroll believes that entities who attempted to participate in a Lossco Transaction through Cormark may have gone on to conclude the transaction through a separate investment management company with the attendant consequences for the entities' duties and obligations under the Act.

Conclusion

[52] For these reasons, Cormark's motion to set aside the March 21, 2011 *ex parte* Requirement Order of this Court is dismissed. The Minister is entitled to his costs, which are fixed at $3,500.

Digitized by Google

Inquiries by CRA/Justice

It some instances it is paramount to question parties on their knowledge of a taxpayer's affairs to fathom out exactly what is going on with them and in determining their tax aspects. In some instances in can lead to merely administrative action such as financial penalties, and, in others, penal tax evasion charges may be appropriate. It obviously depends on the outcome of the findings of the inquiry.

Inquiry - S. 231.4

231.4 (1) The Minister may, for any purpose related to the administration or enforcement of this Act, authorize any person, whether or not the person is an officer of the Canada Revenue Agency, to make such inquiry as the person may deem necessary with reference to anything relating to the administration or enforcement of this Act.

Appointment of hearing officer

(2) Where the Minister, pursuant to subsection 231.4(1), authorizes a person to make an inquiry, the Minister shall forthwith apply to the Tax Court of Canada for an order appointing a hearing officer before whom the inquiry will be held.

Powers of hearing officer

(3) For the purposes of an inquiry authorized under subsection 231.4(1), a hearing officer appointed under subsection 231.4(2) in relation thereto has all the powers conferred on a commissioner by sections 4 and 5 of the *Inquiries Act* and that may be conferred on a commissioner under section 11 thereof.

When powers to be exercised

(4) A hearing officer appointed under subsection 231.4(2) in relation to an inquiry shall exercise the powers conferred on a commissioner by section 4 of the *Inquiries Act* in relation to such persons as the person authorized to make the inquiry considers appropriate for the conduct thereof but the hearing officer shall not exercise the power to punish any person unless, on application by the hearing officer, a judge of a superior or county court certifies that the power may be exercised in the matter disclosed in the application and the applicant has given to the person in respect of whom the applicant proposes to exercise the power 24 hours notice of the hearing of the application or such shorter notice as the judge considers reasonable.

Rights of witness at inquiry

(5) Any person who gives evidence in an inquiry authorized under subsection 231.4(1) is entitled to be represented by counsel and, on request made by the person to the Minister, to receive a transcript of the evidence given by the person.

Rights of person whose affairs are investigated

(6) Any person whose affairs are investigated in the course of an inquiry authorized under subsection 231.4(1) is entitled to be present and to be represented by counsel throughout the inquiry unless the hearing officer appointed under subsection 231.4(2) in relation to the inquiry, on application by the Minister or a person giving evidence, orders otherwise in relation to the whole or any part of the inquiry on the ground that the presence of the person and the person's counsel, or either of them, would be prejudicial to the effective conduct of the inquiry.

Digitized by Google

The principal case that deals with the issues of the scope of the inquiry and whether it can be challenged on Charter grounds are the set of cases of Del Zotto where the taxpayer attempted to argue his s. 7-8 charter rights were infringed on when a colleague was about to be compelled to give testimony. Taking a long route the Federal Appeal Ct. did find for the taxpayer, even with consideration of the processes that would come into play with respect to the admissibility of the fact-finding results, while the Supreme Court found, thankfully, the opposite. In many instances taxpayer knowledge cannot be obtained through various RFI's or warrants since it resides only in the minds of the parties to be subpoenaed and while not necessarily leading to a criminal prosecution it needs to be realizable in some form for the thorough application of the Act. Taken a few steps to get it there, the Supreme Court thankfully thought so.

Del Zotto v. Canada, [1997] 3 FC 40, A-55-97

Legislation cited (available on CanLII)
Constitution Act, 1982, The, Schedule B to the Canada Act 1982 (UK), 1982, c 11 — 1; 7; 8; 11; 13; 17; 52(1); 231.4; 231(14); 231(15); 239; 239(1)
Criminal Code, RSC 1985, c C-46 — 535
Federal Courts Act, RSC 1985, c F-7 — 28
Inquiries Act, RSC 1985, c I-11 — 4; 5; 11; 239(1)
Public Inquiries Act, RSO 1990, c P.41
Securities Act, RSBC 1996, c 418
Tobacco Tax Act, RSO 1990, c T.10 — 24
Decisions cited

- Baron v. Canada, 1993 CanLII 154 (SCC)
- Baron v. Canada (C.A.), reflex
- British Columbia Securities Commission v. Branch, 1995 CanLII 142 (SCC)
- Del Zotto v. Canada, 1997 CanLII 6325 (FC)
- Guay v. Lafleur, 1964 CanLII 45 (SCC)
- Hunter v. Southam Inc., 1984 CanLII 33 (SCC)
- Knox contracting ltd. v. Canada, 1990 CanLII 71 (SCC)
- Norway Insulation Ltd. v. R., 1995 CanLII 7439 (ON SC)
- Phillips v. Nova Scotia (Commission of Inquiry into the Westray Mine Tragedy), 1995 CanLII 86 (SCC)
- R. v. Colarusso, 1994 CanLII 134 (SCC)
- R. v. Dyment, 1988 CanLII 10 (SCC)
- R. v. Eddy (T.), 1994 CanLII 5274 (NL SCTD)
- R. v. Mckinlay transport ltd., 1990 CanLII 137 (SCC)
- R. v. Plant, 1993 CanLII 70 (SCC)
- R. v. S. (R.J.), 1995 CanLII 121 (SCC)
- Schreiber v. Canada (Attorney General), 1997 CanLII 6333 (FCA)
- Starr v. Houlden, 1990 CanLII 112 (SCC)
- Thomson newspapers ltd. v. Canada (Director of investigation and research, restrictive trade practices commission), 1990 CanLII 135 (SCC)
- Yang v. R., 1996 CanLII 8230 (ON SC)

A-55-97
Angelo Del Zotto and **Herbert B. Noble** (*Appellants*) (*Plaintiffs*)
v.
Her Majesty the Queen in Right of Canada, the Minister of National Revenue, John Edward Thompson and **D. Reilly Watson** (*Respondents*) (*Defendants*)
Indexed as: Del Zotto v.Canada (C.A.)

Digitized by Google

Court of Appeal, Strayer and MacGuigan JJ.A. and Henry D.J."Toronto, May 12, 13 and 14; Ottawa, June 10, 1997.

Constitutional law " Charter of Rights " Criminal process " Appeal from dismissal of actions for declarations Income Tax Act, s. 231.4 contravening Charter, s. 8 " S. 231.4 permitting Minister to authorize inquiry into anything relating to administration, enforcement of Act " After indicating intention to charge Del Zotto with tax evasion under s. 239(1)(a), (d), Revenue Canada commencing s. 231.4 inquiry " Only Noble subpoenaed " Appeal allowed " S. 8 right evolving into right to reasonable security of one's privacy " Intrusiveness of search, gathering of evidence for prosecution of taxpayer determining whether preconditions for search established in Hunter et al. v. Southam Inc. apply " S. 231.4 inherently oriented towards criminal prosecution " Trial Judge not giving sufficient weight to fact inquiry criminal investigation " Search involving order to appear for examination under oath with documents sufficient for violation of s. 8 " Any threatened seizure bringing s. 8 into play " Since s. 8 protecting privacy rights of people, not places, Del Zotto having reasonable expectation of privacy over documents, information held by others at different places " Right to privacy protected prior to actual physical search, i.e. as soon as any government action threatens security of individual's privacy interest " S. 231.4 struck down as violating Charter, s. 8.

Income tax " Seizures " Appeal from trial judgment dismissing actions for declarations Income Tax Act, s. 231.4 contravening Charter, ss. 7, 8 " S. 231.4 permitting Minister to authorize inquiry into anything relating to administration, enforcement of Act " Revenue Canada proposing to charge Del Zotto with tax evasion under s. 239(1)(a),(d) " S. 231.4 inquiry commenced " Only Noble summoned as witness " Appeal allowed " S. 231.4 inquiry inherently oriented towards criminal prosecution " Trial Judge not giving adequate weight to fact inquiry criminal investigation " Possibility Del Zotto could be subpoenaed " Reasonable expectation of privacy in peril from beginning of inquiry " Given inherent orientation of s. 231.4, any threatened seizure sufficient to bring s. 8 into play " Unlimited investigation into financial affairs over six years revealing many aspects of private life " Revenue Canada must have reasonable, probable cause to set up criminal inquiry into financial affairs of taxpayer " As violating Charter, s. 8, s. 231.4 struck down.

This was an appeal from a Trial Division judgment dismissing actions for declarations that *Income Tax Act*, section 231.4 contravened Charter, sections 7 and 8. Section 231.4 permits the Minister to authorize an inquiry into anything relating to the administration or enforcement of the Act. A hearing officer appointed to conduct an inquiry has all the powers conferred on a commissioner by the *Inquiries Act*, sections 4 and 5, i.e. the power to summon witnesses, including the same power as a court of record to enforce the attendance of witnesses and to compel them to give evidence. The appellant, Del Zotto, was suspected of tax evasion. In 1986 Revenue Canada began an investigation into his financial affairs and in 1991 departmental officials advised him that they proposed to charge him with tax evasion under paragraphs 239(1)(*a*) and (*d*). In late 1992 National Revenue appointed an inquiry officer and obtained the appointment of a hearing officer. Del Zotto was advised that an inquiry would be made into his financial affairs for the years 1979 to 1985 inclusive. The inquiry got under way but Del Zotto was not summoned as a witness, although it was acknowledged that he might be. The appellant, Noble, was summoned to appear with all documents in his possession or control relating to the financial affairs of Del Zotto for the taxation years in question.

Charter, section 7 guarantees the right not to be deprived of life, liberty or security of the person except in accordance with the principles of fundamental justice. Section 8 guarantees the right to be secure against unreasonable search or seizure.

Held, (Strayer J.A. dissenting), the appeal should be allowed.

Per MacGuigan J.A. (Henry D.J. concurring): An inquiry under section 231.4 is inherently oriented towards criminal prosecution, based not on the labels used but on what is really in

Digitized by Google

question in such a proceeding, i.e. on the values of criminality or innocence in play.
The right to be secure against unreasonable searches and seizures under Charter, section 8 has evolved into a right to the reasonable security of one's privacy. The *locus classicus* for section 8 is *Hunter et al. v. Southam Inc.* wherein it was held that section 8 must be broadly and liberally construed to effect its purpose, which is to secure a person's right to a reasonable expectation of privacy against governmental encroachments. In the absence of exigent circumstances, section 8 requires prior authorization by a judicial officer as a precondition to a criminal law seizure, on a standard of reasonable and probable grounds both as to the commission of an offence and as to the evidence to be afforded by the search.
What determines whether the principles and guidelines in *Hunter* apply is the intrusive nature of the search in question and the gathering of evidence for the prosecution of the taxpayer. The Trial Judge correctly concluded that "a full weighing of all the circumstances [was] required", but he did not give adequate weight to the focussed criminal investigation in the case at bar, and was unduly influenced by *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)* in relation to the lesser form of intrusion and the low degree of expectation of privacy for business affairs which he had analyzed to exist. It was enough for a violation of section 8 if the proposed search involves an order to appear for examination under oath with documents (subpoena *duces tecum*), under the principle that section 8 confers an entitlement to a reasonable expectation of privacy. It was unnecessary to wait for Del Zotto to be subpoenaed. His right to a reasonable expectation of privacy was in peril from the time the inquiry began. A trigger is needed for the invocation of Charter, section 8, which does not apply in the absence of a search or seizure. Given the inherent orientation of section 231.4 towards criminal prosecution, any threatened seizure is sufficient to bring section 8 into play.
Since section 8 protects the privacy rights of people, not places, Del Zotto had a reasonable expectation of privacy over documents and information held by other people at different places. An investigation into all cash received and all cash spent is necessarily, in today's modern world, a window into most of a person's private life. The combination of forced documentary production and forced oral testimony can be particularly intrusive. The right to privacy is protected in advance of any physical search, that is, as soon as any government action threatens the security of the individual's privacy interest. National Revenue has no right to conduct a criminal investigation into the financial affairs of taxpayers merely by setting up an inquiry under section 231.4, a procedure which establishes no safeguards for the taxpayer. What is required for validity is a judicial inquiry based upon reasonable and probable cause, the normal standard for criminal investigation.
No justification under Charter, section 1 having been advanced, section 231.4 violated Charter, section 8 and had to be struck down.
Per Strayer J.A. (*dissenting*): Characterization as a criminal process did not mean that the preconditions for a search as established by the Supreme Court in *Hunter et al. v. Southam Inc.* had automatically to be met before an inquiry under section 231.4 could be commenced. It is only when particular uses of the subpoena power by such an inquiry, or particular subsequent uses of evidence obtained through such subpoenas threaten to endanger Charter, section 7 or 8 rights that those rights should be invoked.
A subpoena issued to Noble would not *per se* invade Del Zotto's right to know the Crown's "case to meet". In the absence of evidence as to the relationship between Del Zotto and Noble, there was no reason for the Court to assume that any question put to, or document demanded from Noble, would disclose Del Zotto'Ñ defence to a charge which had not yet been laid. There is a proper time and method for protecting an accused's rights against self-incrimination, but this was not it.
The rights in section 8 apply differently depending on the reasonable expectation of privacy

Digitized by Google

in respect of the subject-matter and the nature of the intrusion on such privacy. Such factors go to the reasonability of any seizure.

One had to look at the total context of the process to determine whether a statutory scheme is "regulatory" or "criminal". The "context" in which these matters must be judged involves a number of factors: the nature and the purpose of the legislative scheme whose administration or enforcement is in question; the mechanism for discovery or mandatory production employed and the degree of its potential intrusiveness; and the availability of judicial supervision. All of these factors must be considered in determining whether a seizure, real or potential, would be unreasonable within section 8. The predominant purpose of the inquiry was to seek evidence for possible prosecution of Del Zotto under paragraphs 239(1)(*a*) and (*d*). Those paragraphs were designed to ensure compliance with the self-reporting requirements of the *Income Tax Act* and those paragraphs have been characterized as part of what is really a regulatory scheme.

In comparison with a search, a subpoena *duces tecum* does not result in a major intrusion upon one's privacy. Furthermore, the only subpoena *duces tecum* issued herein was directed to Noble. Any documents which he may have had concerning Del Zotto's financial affairs were presumably no longer private to Del Zotto; but whether they were, because of some relationship between him and Noble, was a matter to be explored on evidence before the hearing officer. Further, a subpoena *duces tecum* can be attacked generally or in respect of a particular document either before the hearing officer or, if necessary, on judicial review, if it can be demonstrated that in the particular circumstances someone's constitutional right is about to be violated. Objections could then be raised as to the relevance of a particular document to the legitimate purposes of the inquiry.

There was no basis for declaring section 231.4 invalid. Theoretical and potential invalid uses or consequences of the use of section 231.4 do not justify a declaration of total invalidity. Nothing had as yet happened in this inquiry to justify a declaration of its invalidity. Although the terms of reference of the inquiry were unnecessarily broad, it was open to Noble or Del Zotto to insist that these terms be confined in their application to the scope of subsection 231.4 so that personal documents having nothing to do with the collection of income tax would not need to be produced. The time for a witness to object is when the Crown seeks to use his own evidence against him. Thus the time for raising the objection was not at the inquiry, but at any subsequent trial of Del Zotto. If a person is called at an inquiry, he can successfully object to testify if the predominant purpose is to obtain evidence to incriminate him. Here that predominant purpose in respect of Del Zotto has been admitted, but Del Zotto has not yet been called and may never be called.

statutes and regulations judicially considered

Canadian Charter of Rights and Freedoms, being Part I of the *Constitution Act, 1982*, Schedule B, *Canada Act 1982*, 1982, c. 11 (U.K.) [R.S.C., 1985, Appendix II, No. 44], ss. 1, 7, 8, 11, 13.

Combines Investigation Act, R.S.C. 1970, c. C-23 , ss. 17, 34 (as am. by S.C. 1974-75-76, c. 76, s. 16).

Constitution Act, 1982, Schedule B, *Canada Act 1982*, 1982, c. 11 (U.K.) [R.S.C., 1985, Appendix II, No. 44], s. 52(1).

Criminal Code, R.S.C., 1985, c. C-46.

Federal Court Act, R.S.C., 1985, c. F-7 , s. 28.

Income Tax Act, R.S.C. 1952, c. 148 (as am. by S.C. 1970-71-72, c. 63, s. 1), ss. 231(3),(7),(8),(12), (13),(14),(15), 231.4 (as enacted by S.C. 1986, c. 6, s. 121), 239 (as am. by S.C. 1988, c. 55, s. 182; c. 61, s. 25).

Income Tax Act (The), S.C. 1948, c. 52, s. 115(4).

Income War Tax Act, 1917 (The), S.C. 1917, c. 28, s. 8(3).

Digitized by Google

Inquiries Act, R.S.C., 1985, c. I-11 , ss. 4, 5.
Public Inquiries Act, R.S.O. 1980, c. 411.
Securities Act, S.B.C. 1985, c. 83.
Tobacco Tax Act, R.S.O. 1990, c. T.10.
cases judicially considered
applied:
Baron v. Canada, 1993 CanLII 154 (SCC), [1993] 1 S.C.R. 416; (1993), 99 D.L.R. (4th) 350; 78 C.C.C. (3d) 510; 18 C.R. (4th) 374; 13 C.R.R. (2d) 65; [1993] 1 C.T.C. 111; 93 DTC 5018; 146 N.R. 270; affg reflex, [1991] 1 F.C. 688; (1991), 91 DTC 5055; 122 N.R. 47 (C.A.); *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, 1990 CanLII 135 (SCC), [1990] 1 S.C.R. 425; (1990), 65 D.L.R. (4th) 161; 54 C.C.C. (3d) 417; 29 C.P.R. (3d) 97; 76 C.R. (3d) 129; 47 C.R.R. 1; 106 N.R. 161; 39 O.A.C. 161; *Starr v. Houlden*, 1990 CanLII 112 (SCC), [1990] 1 S.C.R. 1366; (1990), 68 D.L.R. (4th) 641; 55 C.C.C. (3d) 472; 110 N.R. 81; 41 O.A.C. 161; *Schreiber v. Canada (Attorney General)*, 1997 CanLII 6333 (FCA), [1997] 2 F.C. 176 (C.A.).
distinguished:
British Columbia Securities Commission v. Branch, 1995 CanLII 142 (SCC), [1995] 2 S.C.R. 3; (1995), 123 D.L.R. (4th) 462; [1995] 5 W.W.R. 129; 4 B.C.L.R. (3d) 1; 60 B.C.A.C. 1; 97 C.C.C. (3d) 505; 7 C.C.L.S. 1; 38 C.R.R (4th) 133; 27 C.R.R. (2d) 189; 180 N.R. 241; 99 W.A.C. 1.
considered:
Yang v. R. 1996 CanLII 8230 (ON SC), (1996), 31 O.R. (3d) 66 (Gen. Div.); *Del Zotto v. Canada (Minister of National Revenue " M.N.R.)*, [1993] F.C.J. No. 885 (C.A.) (QL); *Hunter et al. v. Southam Inc.*, 1984 CanLII 33 (SCC), [1984] 2 S.C.R. 145; (1984), 55 A.R. 291; 11 D.L.R. (4th) 641; [1984] 6 W.W.R. 577; 33 Alta. L.R. (2d) 193; 27 B.L.R. 297; 14 C.C.C. (3d) 97; 2 C.P.R. (3d) 1; 41 C.R. (3d) 97; 9 C.R.R. 355; 84 DTC 6467; 55 N.R. 241; *R. v. McKinlay Transport Ltd.*, 1990 CanLII 137 (SCC), [1990] 1 S.C.R. 627; (1990), 68 D.L.R. (4th) 568; 55 C.C.C. (3d) 530; 76 C.R. (3d) 283; 47 C.R.R. 151; [1990] 2 C.T.C. 103; 90 DTC 6243; 106 N.R. 385; 39 O.A.C. 385; *R. v. S. (R.J.)*, 1995 CanLII 121 (SCC), [1995] 1 S.C.R. 451; (1995), 121 D.L.R. (4th) 589; 96 C.C.C. (3d) 1; 36 C.R. (4th) 1; 26 C.R.R. (2d) 1; 177 N.R. 81; 78 O.A.C. 161; *R. v. Dyment*, 1988 CanLII 10 (SCC), [1988] 2 S.C.R. 417; (1988), 73 Nfld. & P.E.I.R. 13; 55 D.L.R. (4th) 503; 229 A.P.R. 13; 45 C.C.C. (3d) 244; 66 C.R. (3d) 348; 38 C.R.R. 301; 10 M.V.R. (2d) 1; 89 N.R. 249; *R. v. Plant*, 1993 CanLII 70 (SCC), [1993] 3 S.C.R. 281; (1993), 145 A.R. 104; [1993] 8 W.W.R. 287; 12 Alta. L.R. (3d) 305; 84 C.C.C. (3d) 203; 24 C.R. (4th) 47; 17 C.R.R. (2d) 297; 157 N.R. 321; 55 W.A.C. 104; *Cock v. Attorney-General* (1909), 28 N.Z.L.R. 405 (C.A.); *R. v. Colarusso*, 1994 CanLII 134 (SCC), [1994] 1 S.C.R. 20; (1994), 110 D.L.R. (4th) 297; 87 C.C.C. (3d) 193; 26 C.R. (4th) 289; 19 C.R.R. (2d) 193; 49 M.V.R. (2d) 161; 162 N.R. 321; 69 O.A.C. 81.
referred to:
R. v. Norway Insulation Inc. 1995 CanLII 7439 (ON SC), (1995), 28 O.R. (3d) 432; [1995] 2 C.T.C. 451; 29 C.R.R. (3d) 163; 95 DTC 5328 (Gen. Div.); *R. v. Harris, R.* (1995), 95 DTC 5653 (B.C.S.C.); *R. v. Jarvis*, [1997] A.J. No. 214 (Alta. Prov. Ct.) (QL); *R. v. Soviak*, [1997] O.J. No. 1215 (Prov. Div.) (QL); *Guay v. Lafleur*, 1964 CanLII 45 (SCC), [1965] S.C.R. 12; (1964), 47 D.L.R. (2d) 226; [1964] C.T.C. 350; 64 DTC 5218; *Phillips v. Nova Scotia (Commission of Inquiry into the Westray Mine Tragedy)*, 1995 CanLII 86 (SCC), [1995] 2 S.C.R. 97; (1995), 124 D.L.R. (4th) 129; 31 Admin. L.R. (2d) 261; 39 C.R. (4th) 141; 180 N.R. 1; *R. v. Kabbebe*, [1997] A.Q. No. 273 (Que. C.A.) (QL).
APPEAL from the Trial Division judgment (*Del Zotto v. Canada*, 1997 CanLII 6325 (FC), [1997] 2 F.C. 428; (1997), 143 D.L.R. (4th) 340 (T.D.)) dismissing actions for declarations that *Income Tax Act*, section 231.4 contravened Charter, sections 7 or 8. Appeal allowed.

Digitized by Google

counsel:
Edward L. Greenspan, Q.C. and *David W. Stratas* for appellant Angelo Del Zotto.
Mahmud Jamal and *Alan D. Gold* for appellant Herbert B. Noble.
Ivan S. Bloom, Q.C. and *Gordon S. Campbell* for respondent Her Majesty the Queen in right of Canada.
Graham F. Pinos, Q.C. for respondent D. Reilly Watson.
solicitors:
Greenspan & Associates, Toronto, and *Osler, Hoskin & Harcourt*, Toronto, for appellant Angelo Del Zotto.
Osler, Hoskin & Harcourt, Toronto and *Gold & Fuerst*, Toronto, for appellant Herbert B. Noble.
Deputy Attorney General of Canada for respondent Her Majesty the Queen in right of Canada.
Graham F. Pinos, Q.C., Toronto, for respondent D. Reilly Watson.
The following are the reasons for judgment rendered in English by
Strayer J.A. (*dissenting*): I have had the opportunity to read a draft of the reasons of my colleague MacGuigan J.A. and I regret that I am unable to agree with him. Instead I would dismiss the appeal because I am in agreement with the reasoning of the learned Trial Judge [1997 CanLII 6325 (FC), [1997] 2 F.C. 428].
The Trial Judge rejected the appellants' action for declarations, based on section 7 and section 8 of the Charter [*Canadian Charter of Rights and Freedoms*, being Part I of the *Constitution Act, 1982*, Schedule B, *Canada Act 1982*, 1982, c. 11 (U.K.) [R.S.C., 1985, Appendix II, No. 44]]. With respect to section 7 his conclusions were essentially to the effect that any guarantees under that section related to self-incrimination and as Del Zotto, the "target" of the inquiry and the person the Crown hopes to prosecute, has not been subpoenaed it is at best premature to invoke section 7. With respect to section 8 he concluded that having regard to the context in which the subpoena *duces tecum* is being used, the regulatory context of the inquiry, and the limited intrusiveness of such a subpoena, there is no unreasonable seizure involved at the stage of the issue of the subpoena. I adopt his reasoning and the comments which follow are simply an elaboration of certain aspects considered by him.
Briefly put I am unwilling to accept that because some might characterize this as a criminal process the preconditions for a search as proclaimed by the Supreme Court in *Hunter et al. v. Southam Inc.*[1] must automatically be met before an inquiry under section 231.4 of the *Income Tax Act* [S.C. 1970-71-72, c. 63 (as enacted by S.C. 1986, c. 6, s. 121)] can be commenced. If particular uses of the subpoena power by such an inquiry, or particular subsequent uses of evidence obtained through such subpoenas threaten to endanger section 7 or 8 rights, it is only then that those rights should be invoked.
The appellants' case suffers from verbal excess: the inflation of language which detracts from precise consideration of what is involved here. The factum tells us that:
Such Inquiries are a hallmark of the worst of the police states that the world has seen.[2]
Much was heard of the Star Chamber, now dead some 350 years but still the stuff of legal rhetoric. Revenue Canada was said to have "passed" (*sic*) the Rubicon.[3] Counsel argued that this whole process would destroy the "Golden Thread" of the common law, a familiar[4] but unhelpful metaphor in the application of finely balanced Charter guarantees. The possible prosecution of Del Zotto was equated to an ordinary criminal prosecution, and the requirement that any witness be obliged to appear in private before a hearing officer (where he would be represented by counsel) was equated to anyone being obliged to face and respond to a police interrogation.
As I understand it, the appellants' proposition is essentially as follows. No process whereby

Digitized by Google

any person (whether or not connected in any way to a potential accused) might be compelled to testify or produce documents concerning that potential accused, can be initiated unless the Crown first meets the conditions laid down in *Hunter et al. v. Southam Inc.*[5] for the issuance of a search warrant involving the search of business or private premises. For these purposes it is irrelevant what the nature of the document sought or the questions put may be; nor is the fact that such evidence and such testimony will be given in private with counsel for the witness and the potential accused present before a hearing officer appointed by a judge of the Tax Court. It is equally irrelevant that an inquiry of this type has been held[6] to be an administrative process where there are no findings of guilt or responsibility, that oral evidence taken there cannot be used directly in a subsequent trial, and that various protections exist under sections 7 and 13 of the Charter with respect to the use of original or derivative self-incriminatory evidence should such a situation arise.

I am unable to accept this proposition nor do I think it is consistent with the Supreme Court jurisprudence most relevant to the statutory provisions in question here, namely sections 231.4 and 239 [as am. by S.C. 1988, c. 55, s. 182; c. 61, s. 25] of the *Income Tax Act*.

Section 7 of the Charter

I agree with the analysis of the Trial Judge on this matter. I would only add that I find it particularly difficult to understand how the appellants can argue at this time that a subpoena issued to Noble will *per se* invade the right of the potential accused, Del Zotto, to know the Crown's "case to meet". It was explained that the real meaning of this requirement is that the accused should not be obliged to disclose his defence until after he has been charged, a trial ensues, and the Crown has closed its case. While I do not in any way question that right, I do not understand why this automatically presents a barrier to anyone"whether in any way connected to the potential accused or not"from being the object of a subpoena *duces tecum* . It is common ground that there is no evidence on the record as to what relationship Noble has to Del Zotto if any. Why then should this Court assume that any question put to, or document demanded from, Noble will disclose the defence of Del Zotto to a charge which has not yet even been laid? This would mean that no one could be subpoenaed even to produce public records concerning Del Zotto or to testify as to his public movements or public utterances. With respect, I think the appellants overreach when they make this argument. As I will suggest below, there is a proper time and method for protecting an accused's undoubted rights against self-incrimination, but this is not it.

Section 8 of the Charter

I find the appellants' argument that the inquiry is simply evidence gathering for a criminal prosecution to be overly simplistic, leading to the premature and unnecessary conclusion that all rules applicable to a *Criminal Code* [R.S.C., 1985, c. C-46] prosecution apply including the principles in *Hunter et al. v. Southam Inc.* No doubt many Charter guarantees, including all of section 11 (applying to anyone "charged with an offence") would apply at the appropriate time. However the rights in section 8 apply differently depending on the reasonable expectation of privacy in respect of the subject-matter and the nature of the intrusion on such privacy. Such factors go to the reasonability of any seizure.

Thus while the "full panoply" of constitutional rights are of course available to the appellants, one must consider, in the specific context, what are the relevant constitutional rights. I agree with my colleague on the importance of the privacy interest, but it is an interest which is conditioned in many ways by conflicting public interests.

I should say first, in addressing the requirements of section 8 in the present case, that I find those decisions of the Supreme Court on mandatory production of documents not involving searches to be much more relevant than those involving the conditions for issuing search warrants. I also distinguish cases such as *Starr v. Houlden*[7] on the basis that they involved the criminal nature of potential and public findings of fact or law. An inquiry such as we are

Digitized by Google

concerned with makes no findings and is conducted in private.

In my view the two most pertinent cases are the *Thomson* case[8] and *R. v. McKinlay Transport Ltd.*[9] both decided on March 29, 1990. The *McKinlay* case is particularly relevant since it involved a form of discovery under the *Income Tax Act*. The *Thomson* case involved the compulsory production of evidence to determine whether an offence under section 34 [as am. by S.C. 1974-75-76, c. 76, s. 16] of the *Combines Investigation Act* had been committed by those ordered to testify and to produce documents. Neither case involved a search warrant. In both cases the processes were held not to infringe on section 8 rights. On the other hand, cases such as *Hunter*[10] and *Baron v. Canada*[11] involved the preconditions for the issue of search warrants.

Like my colleague MacGuigan J.A. I take guidance from what was said by Sopinka J., on behalf of a unanimous Court in *Baron*,[12] that labels as to whether a statutory scheme is "regulatory" or "criminal" are not determinative in deciding whether an unreasonable search or seizure is authorized. Instead he affirmed that one must look at the total context of the particular process in question. *Baron* involved the use of search warrants issued under the *Income Tax Act* without the issuing judge being allowed any discretion once reasonable grounds were established. While acknowledging that the Court had found the *Income Tax Act* to be regulatory in *McKinlay*, Sopinka J. concluded that because a "physical entry and search" would be authorized in the case before him the issue of the search warrants should meet the preconditions as defined in *Hunter* . He went on to say, however:

Physical search of private premises . . . is the greatest intrusion of privacy short of a violation of bodily integrity. It is quite distinct from compelling a person to appear for examination under oath and to bring with them certain documents, under a *subpoena duces tecum* (*Thomson Newspapers, supra*), or to produce documents on demand (*McKinlay Transport, supra*). Both La Forest and L'Heureux-Dubé JJ. acknowledged in *Thomson Newspapers, supra*, at pp. 520 and 594, respectively, that the power to search premises is more intrusive of an individual's privacy than the mere power to order the production of documents. [Emphasis added.]

Clearly, then, Sopinka J. was not prepared to say that section 8 precludes any mandatory production of documents where a prosecution is potentially involved.

It appears to me from the jurisprudence that the "context" in which these matters must be judged involves a number of factors: the nature and the purpose of the legislative scheme whose administration or enforcement is in question; the mechanism for discovery or mandatory production employed and the degree of its potential intrusiveness; and the availability of judicial supervision. One must consider all of these factors in determining whether a seizure, real or potential, would be unreasonable within the meaning of section 8.

The *Thomson* case involved the validity of orders to testify and to produce documents, issued by a member of the Restrictive Trade Practices Commission under section 17 of the *Combines Investigation Act*.[13] There was no judicial involvement in the issue of such orders and no preconditions as to their issue. For all practical purposes these orders were like a subpoena *duces tecum*. The orders in question made it clear that the purpose of the inquiry was to determine whether the objects of the orders had committed an offence of predatory pricing under the *Combines Investigation Act*, an offence punishable with imprisonment. Similarly in the present case, although no such order exists stating a purpose of prosecution, the Crown acknowledges that the predominant purpose of the inquiry is to seek evidence for possible prosecution of Del Zotto under paragraphs 239(1)(*a*) and (*d*) of the *Income Tax Act*.

A majority of a five-member court in *Thomson* held that section 17 did not violate section 8 of the Charter. While there are five-separate judgments it appears that the three who upheld section 17 *vis-à-vis* section 8 of the Charter looked at various of the contextual factors mentioned above. La Forest J. stated that expectations of privacy are different in respect of

Digitized by Google

regulatory and criminal matters. He said that the fact that there was possible imprisonment involved as a sanction for this offence under the *Combines Investigation Act* did not necessarily make the matter criminal for purposes of a reasonable expectation of privacy. He then analyzed the nature and purpose of the *Combines Investigation Act* and found that it was a scheme of economic regulation concerning matters of concern for the economy, but did not involve the control of acts morally or socially reprehensible within the normal scope of the criminal law. He pointed out the importance for business to observe the requirements of free competition and to conform to the law without regular inspection. Because the effectiveness of the law was so dependent on self-regulation in areas not normally open to official surveillance it was important that there be an effective system of penalties for its non-observance. Thus the penalties related to the regulatory purpose of the Act. He stated that the conduct for which a penalty was imposed

. . . is made criminal for strictly instrumental reasons.[14]

He went on to make comparisons with the *Income Tax Act* in this respect, in particular section 239 which is one of the sections in issue in the present case. He observed:

As a final comment, I would point out that the *Combines Investigation Act* is not, as regards sanctions, unlike the *Income Tax Act*. Under section 239 of the latter Act, a taxpayer can be liable to imprisonment to a term "not exceeding 5 years", provided he is, at the election of the Attorney General of Canada, proceeded against by way of indictment. The offences in relation to which this punishment can be imposed are defined in s. 239(1). They include making "false or deceptive statements in a return, certificate, statement or answer filed or made as required by or under this Act" (s. 239(1)(*a*)); destroying, altering or secreting records or books "to evade payment of a tax imposed by this Act" (s. 239(1)(*b*)); making or acquiescing in the omission of "a material particular" from the "records or books of account of a taxpayer" (s. 239(1)(*c*)); evading "wilfully, in any manner . . . compliance with this Act or payment of taxes imposed by this Act" (s. 239(1)(*d*)); and conspiring "with any person to commit an offence described by paragraphs (*a*) to (*d*)" (s. 239(1)(*e*)). All of these offences relate to conduct that might well be discovered by the exercise of the power to order the production of documents which s. 231(3) confers on the Minister of National Revenue. This has not prevented this Court from characterizing s. 231(3) as a regulatory or administrative power of investigation; see *R. v. McKinlay Transport Ltd., supra*. I do not see why we should regard the possibility of imprisonment as having a different effect in the case of s. 17 of the *Combines Investigation Act.*[15]

While it might be said that his comments on the *Income Tax Act* in the context of the *Thomson* case were *obiter dicta*, it should be noted that this case, and the *McKinlay* case which actually involved the *Income Tax Act*, were decided on the same day and he makes reference to *McKinlay* in this passage. Further, in his concurring judgment in *McKinlay* he adopts his reasons in *Thomson* in support of his conclusion in *McKinlay* that the *Income Tax Act*, though supported by penal sanctions, is essentially of an administrative nature.[16] The two decisions are therefore interrelated.

La Forest J. went on to conclude that in this kind of regulatory context the expectations of privacy are much less in respect to enforcement for the purpose of section 8. This led him to conclude that the procedure in question in *Thomson*, which was much like a subpoena *duces tecum*, did not involve any unreasonable seizure within the meaning of section 8 of the Charter.

L'Heureux-Dubé J. agreed in *Thomson* that both the *Combines Investigation Act* and the *Income Tax Act* are regulatory in nature and she cited this as an important reason for the expectations of privacy being somewhat less.

Sopinka J. in *Thomson* concluded that section 17 did not violate section 8 of the Charter, but he did not rely on section 17 being part of a regulatory scheme. He decided the matter

Digitized by Google

instead on the basis of the nature of an order under section 17 compelling the production of documents. He found this not to be a "seizure" within the meaning of section 8. He therefore did not have to address the question of whether it was "reasonable". His decision is however important in underlining the modest degree of intervention involved with an order such as a subpoena *duces tecum* . Even if, as now seems to be the predominant view, one treats such orders as "seizures", the limited degree of intervention involved, as underlined by the reasoning of Sopinka J., is an important factor in determining the reasonability of a "seizure".

Wilson J. with whom Lamer J. [as he then was] concurred in a separate opinion in *Thomson*, agreed with the general principles set out above but characterized the *Combines Investigation Act* as being of a criminal nature and therefore she thought more stringent controls were appropriate with respect to seizures. This does not much concern our analysis of the *Income Tax Act*, however, because as noted below, in the *McKinlay* case she characterized that Act as regulatory and upheld the relevant provisions.

In *McKinlay* the same five-member Court upheld subsection 231(3) of the *Income Tax Act* which authorized the conduct of an income tax audit by service on behalf of the Minister of letters on taxpayers demanding information and the production of documents. Again this scheme was attacked under section 8 of the Charter because it did not involve any preconditions for the issue of such letters as set out in the *Hunter* case. Wilson J. with whom Lamer, La Forest, and L'Heureux-Dubé JJ. concurred, analyzed the nature and purpose of the *Income Tax Act*. She noted that it is [at page 636] "[a] chief source of revenue for the federal government". (It might be observed in passing that it is also a chief source of revenue for all provincial governments except that of Quebec.) The Act operates on a self-reporting basis. It is necessary that the Minister have some adequate powers of inspection because there will always be those who do not comply with reporting requirements. She stated that:

The Minister must be capable of exercising these powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act.[17]

She concluded that the demands for information in question violated no reasonable expectation of privacy, given the general nature and purpose of the Act. Further she emphasized that this kind of demand was "the least intrusive means" for monitoring compliance. Sopinka J., while concurring in the result did so on the same basis as adopted by him in *Thomson* , namely that there was no seizure involved and therefore section 8 was not engaged. Again this at least underlines the lack of intrusiveness of a mere demand for documents.

The *McKinlay* case is very pertinent because, although it did not involve a potential prosecution (except for non-compliance with the demand for information) it involved a form of compulsion not very different from a subpoena *duces tecum*. Further, in one way it was more intrusive in that the information was simply provided to the Minister without an administrative process such as an inquiry under section 231.4 where the target of an investigation can be represented by counsel and where objections can be made to relevancy.

Drawing on these cases which are most pertinent because they directly or indirectly support the regulatory nature of the *Income Tax Act* and the contextual approach to what is a reasonable seizure, I will refer to a few salient features of the present case.

First it should be observed that section 8 of the Charter does not apply to the compulsion of testimony. As observed by L'Heureux-Dubé J. in the *Thomson* case:

To hold that an order to testify constitutes a "seizure", presumably a "seizure" of one's thoughts, would be to stretch that word beyond any meaning.[18]

Secondly, instead of dwelling on generalities concerning section 239 of the *Income Tax Act*, it is important to see just what it provides.

239. (1) Every person who has

(*a*) made, or participated in, assented to or acquiesced in the making of, false or deceptive

Digitized by Google

statements in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation,
(*b*) to evade payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,
(*c*) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,
(*d*) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by the Act, or
(*e*) conspired with any person to commit an offence described in paragraphs (*a*) to (*d*),
is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to
(*f*) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or
(*g*) both the fine described in paragraph (*f*) and imprisonment for a term not exceeding 2 years.
(2) Every person who is charged with an offence described in subsection (1) may, at the election of the Attorney General of Canada, be prosecuted upon indictment and, if convicted, is, in addition to any penalty otherwise provided, liable to
(*a*) a fine of not less than 100%, and not more than 200%, of the amount of the tax that was sought to be evaded; and
(*b*) imprisonment for a term not exceeding 5 years.
In the present case Revenue Canada has advised Del Zotto that he may be charged under paragraphs 239(1)(*a*) and (*d*), all part of the same scheme. What is striking about the offences described in paragraphs 239(1)(*a*) to (*e*) is that they all involve possible tax evasion through false returns, falsified documents, wilful evasion or conspiracy to commit any of the foregoing. This is not a typical criminal law but is a law designed to ensure compliance with the self-reporting requirements of the *Income Tax Act* and was characterized as part of what is really a regulatory scheme by La Forest J. in the passage from *Thomson* quoted above. As he said in connection with the *Combines Investigation Act*, such conduct
. . . is made criminal for strictly instrumental reasons.
There cannot be the exaggerated claims to privacy connected with the administration of the *Income Tax Act* which the appellants assert. The Act requires all manner of disclosure. The taxpayer must, for example, disclose: his place of residence; his age; his social insurance number; his marital status or whether he is living common law; his sources and amounts of income; his dependants, their ages and possible physical conditions if handicapped; the amounts and objects of his charitable or political donations, if he is to claim tax credits; whom he employs and entertains if he seeks to deduct the costs as business expenses; and details of his pension arrangements. If he is employed he must disclose many of these details not only to Revenue Canada but also to his employer so that mandatory tax deductions can be made.
A subpoena *duces tecum* is not a major intrusion of privacy as compared to a search. This has been recognized on several occasions.[19] It should further be noted that in the present case the only subpoena *duces tecum* which has ever been issued has been directed not to Del Zotto, the supposed "target", but to Noble, a person whose status is unknown to the Court. It is not irrelevant that any documents which Noble may have about Del Zotto are presumably no longer private to Del Zotto: if they are because of some relationship between him and Noble that is a matter to be explored on evidence before the hearing officer.
Further, a subpoena *duces tecum* can be attacked generally or in respect of a particular document either before the hearing officer or if necessary on judicial review, if it can be

Digitized by Google

demonstrated that in the particular circumstances someone's constitutional right is about to be violated.[20] Objections could also be raised then as to the relevance of a particular document to the legitimate purposes of the inquiry.

Section 231.4 under which this inquiry is held guarantees both the witness and the "target" of the inquiry the right to be "represented" by counsel save in exceptional circumstances. Notwithstanding the suggestions of counsel for the appellants, I can find no authority for the proposition that counsel representing a witness or a target would not be allowed to raise objections as to relevance or constitutionality in respect of a particular subpoena or a particular document. The natural meaning of "represented" must include that right.

All of these factors when taken together lead me to conclude, as did the learned Trial Judge, that the holding of an inquiry and the issuing of subpoenas *duces tecum* cannot *per se* be seen as inevitably leading to an unreasonable seizure within the meaning of section 8 so as to justify its termination at this point.

Remedies

The learned Trial Judge emphasized that the mere establishment of the inquiry and the issue of a subpoena to Noble did not violate section 8. On the appeal the appellants, who had asked in their original relief for a declaration that section 231.4 is invalid or in the alternative that this particular inquiry is invalid, criticized the learned Trial Judge for deciding only the last question. I think it is obvious from his judgment that he considered there to be no basis for declaring the whole section to be invalid. With this I agree.

This is not a case such as *Hunter* or *Baron* where the section can have little or no valid application because it lacks an essential ingredient. The gravamen of the appellants' complaint is that in certain circumstances an inquiry established under this section, or a particular subpoena issued by such an inquiry, or the production of a particular document, or the use in subsequent proceedings of evidence gleaned by the inquiry, could violate someone's constitutional rights under sections 7 or 8 of the Charter. The same could be said of an inquiry established under the federal *Inquiries Act*[21] and the various comparable provincial statutes which authorize in the broadest possible terms the establishment of commissions of inquiry with powers of subpoena, etc. There have been many instances of successful attacks on particular terms of reference of such commissions or on particular actions or findings of commissioners, some relating to constitutional rights similar to those in question here. But just because the *Inquiries Act* could on occasion be used for unconstitutional purposes, this would not justify a declaration of its total invalidity. Nor in my view do theoretical and potential invalid uses or consequences of the use of section 231.4 justify a declaration as to its invalidity.

Nothing has as yet happened in this particular inquiry to justify a declaration of its invalidity.

It is true that the terms of reference of the inquiry are very broad and, I think, unnecessarily so. They authorize an inquiry

. . . into the financial affairs of the said Angelo Del Zotto, for the taxation years 1979 to 1985 inclusive.

But it is surely open to Noble or Del Zotto to insist that these terms be confined in their application to the scope of subsection 231.4(1) which authorizes an inquiry

231.4 (1) . . . relat[ing] to the administration or enforcement of this Act.

Therefore personal documents having nothing to do with the collection of income tax need not be produced. As noted earlier, objections can be taken before the hearing officer and if necessary judicial review may be sought, but all at the time the problem actually arises. At most, a particular subpoena could be attacked instead of waiting to dispute specific documents. But the appellants have not sought this remedy.

As for concerns about self-incrimination, these too should be raised and dealt with before the inquiry or even later if the Crown seeks to use self-incriminating evidence or documents, or

Digitized by Google

evidence derived therefrom, at a subsequent trial. As was held in *R. v. S. (R.J.)*,[22] a witness may be compelled to testify in a trial of another for a crime in which the witness may be implicated, but may object later in his own trial to any evidence derived from his own testimony in the first trial. That is, the time for a witness to object is when the Crown seeks to use his own evidence against him. The same may be true where it is sought to use evidence against an accused at trial derived from compelled evidence from his wife at an earlier proceeding.[23] But that is because she, like the accused, would not be a compellable witness at the trial. This means that the time for raising the objection is not at the inquiry in this case, but at any subsequent trial of Del Zotto. Again, as held by the Supreme Court in *British Columbia Securities Commission v. Branch*[24] if a person is called at an inquiry (the first proceeding) he can successfully object to testify if the predominant purpose is to obtain evidence to incriminate him. In the present case that predominant purpose in respect of Del Zotto has been admitted. But Del Zotto has not been called yet and may never be called.

In short if there are circumstances in which the use of this inquiry power, or the subsequent use of evidence derived from it, may impinge on constitutional rights there will be opportunities to assert those rights at the time when an intrusion is imminent and demonstrable. So far the Court has only been treated to hypothetical possibilities.

For these reasons I am of the view that the appeal should be dismissed and that no declaration should be made at this time of invalidity of either the Act or the inquiry.

The following are the reasons for judgment rendered in English by

MacGuigan J.A.: This case involves a constitutional challenge to the "inquiry provision," section 231.4 of the *Income Tax Act* , R.S.C. 1952, c. 148, as amended (the Act), on the basis of sections 7 and 8 of the *Canadian Charter of Rights and Freedoms* (the Charter).

I

The appellant Del Zotto fell under suspicion of tax evasion following a 1985 audit by the Audit Branch of Revenue Canada. In 1986 an investigation into his financial affairs was begun by the Special Investigations Branch (SI) of Revenue Canada, which led in turn to the initiation of an inquiry into his financial affairs for the years 1979 through 1985, authorized by section 231.4, which reads as follows:

231.4 (1) The Minister may, for any purpose related to the administration or enforcement of this Act, authorize any person, whether or not he is an officer of the Department of National Revenue, to make such inquiry as he may deem necessary with reference to anything relating to the administration or enforcement of this Act.

(2) Where the Minister, pursuant to subsection (1), authorizes a person to make an inquiry, the Minister shall forthwith apply to the Tax Court of Canada for an order appointing a hearing officer before whom the inquiry will be held.

(3) For the purposes of an inquiry authorized under subsection (1), a hearing officer appointed under subsection (2) in relation thereto has all the powers conferred on a commissioner by sections 4 and 5 of the *Inquiries Act* and that may be conferred on a commissioner under section 11 thereof.

(4) A hearing officer appointed under subsection (2) in relation to an inquiry shall exercise the powers conferred on a commissioner by section 4 of the *Inquiries Act* in relation to such persons as the person authorized to make the inquiry considers appropriate for the conduct thereof but the hearing officer shall not exercise the power to punish any person unless, on application by the hearing officer, a judge of a superior or county court certifies that the power may be exercised in the matter disclosed in the application and the applicant has given to the person in respect of whom he proposes to exercise the power 24 hours notice of the hearing of the application or such shorter notice as the judge considers reasonable.

(5) Any person who gives evidence in an inquiry authorized under subsection (1) is entitled to be represented by counsel, and, on request made by him to the Minister, to receive a

Digitized by Google

transcript of the evidence given by him.
(6) Any person whose affairs are investigated in the course of an inquiry authorized under subsection (1) is entitled to be present and to be represented by counsel throughout the inquiry unless the hearing officer appointed under subsection (2) in relation to the inquiry, on application by the Minister or a person giving evidence, orders otherwise in relation to the whole or any part of the inquiry on the ground that the presence of the person and his counsel, or either of them, would be prejudicial to the effective conduct of the inquiry.
Pursuant to subsection 231.4(3) above, a hearing officer appointed to conduct an inquiry has all the powers conferred on a commissioner by sections 4 and 5 of the *Inquiries Act*, R.S.C., 1985, c. I-11, which state:
4. The commissioners have the power of summoning before them any witnesses, and of requiring them to
(*a*) give evidence, orally or in writing, and on oath or, if they are persons entitled to affirm in civil matters on solemn affirmation; and
(*b*) produce such documents and things as the commissioners deem requisite to the full investigation of the matters into which they are appointed to examine.
5. The commissioners have the same power to enforce the attendance of witnesses and to compel them to give evidence as is vested in any court of record in civil cases.
The first predecessor provision of section 231.4 was enacted in 1917 but allowed inquiries only into "the income of any taxpayer": *The Income War Tax Act, 1917* , S.C. 1917, c. 28, subsection 8(3). In 1948 that wording was changed to allow inquiries "relating to the administration or enforcement of this Act: *The Income Tax Act* , S.C. 1948, c. 52, subsection 115(4). The inquiry provision was further amended by providing for the inclusion of certain procedural protections for the taxpayer, such as the appointment of an independent hearing officer: S.C. 1970-71-72, c. 63, subsections 231(7), 231(8), 231(12), 231(13), 231(14), 231(15). Section 239 of the Act is also relevant, since it is common ground that the inquiry provision is used for the investigation of tax evasion offences under that provision, which reads as follows:
239. (1) Every person who has
(*a*) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation,
(*b*) to evade payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,
(*c*) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,
(*d*) wilfully, in any manner, evaded or attempted to evade, compliance with this Act or payment of taxes imposed by this Act, or
(*e*) conspired with any person to commit an offence described by paragraphs (*a*) to (*d*),
is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to
(*f*) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or
(*g*) both the fine described in paragraph (*f*) and imprisonment for a term not exceeding 2 years.
(2) Every person who is charged with an offence described in subsection (1) may, at the election of the Attorney General of Canada, be prosecuted on indictment and, if convicted is, in addition to any penalty otherwise provided, liable to
(*a*) a fine of not less than 100%, and not more than 200%, of the amount of the tax that was

Digitized by Google

sought to be evaded; and
(*b*) imprisonment for a term not exceeding 5 years.
On April 19, 1991, at a meeting with officials of SI, counsel for the appellant Del Zotto was advised that Revenue Canada proposed to charge him with income tax evasion under paragraphs 239(1)(*a*) and (*d*) of the Act (Case on Appeal, Vol. XV, at page 2495). The amount of federal taxes sought to be evaded was stated to be $1,669,062 (Case on Appeal, Vol. VII, at page 1058).
Sections 7 and 8 of the Charter are as follows:
7. Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.
8. Everyone has the right to be secure against unreasonable search or seizure.
In the latter part of 1992 National Revenue appointed an inquiry officer and obtained the appointment of a hearing officer from the Chief Judge of the Tax Court. The appellant Del Zotto was advised on 21 April 1993 that an inquiry would be made into his financial affairs for the taxation years 1979 to 1985 inclusive and that the calling of evidence would begin on 6 May 1993 (Case on Appeal, Vol. VII, at page 1089). The appellant Del Zotto was not himself initially called as a witness, though the letter of 30 September 1992 from the Assistant Deputy Minister to the Deputy Minister of the Department requesting the setting up of the commission of inquiry admitted that "it is a possibility that Angelo Del Zotto may also be subpoenaed before the Inquiry" (Case on Appeal, Vol. VII, at page 1059). The witness subpoenaed to appear on 6 May was the appellant Noble, who was summoned to appear with all documents in his possession or control relating to the financial affairs of the appellant Del Zotto for the taxation years 1979 to 1985 inclusive, including documents relating to five named corporations (Case on Appeal, Vol. VII, at pages 1090-1091).
On 6 May counsel for both appellants requested an adjournment to allow the inquiry's powers to be tested by this Court (Case on Appeal, Vol. VII, at page 1044 *ff*). The adjournment was granted the next day.
The section 28 challenge brought before this Court was to the appointment of the hearing officer to preside over the inquiry. This Court held, following *Guay v. Lafleur*, 1964 CanLII 45 (SCC), [1965] S.C.R. 12, that the inquiry was a purely administrative matter which can neither decide nor adjudicate upon anything, and that the application for judicial review had therefore to be dismissed: [*Del Zotto v. Canada (Minister of National Revenue"M.N.R.)*, [1993] F.C.J. No. 885 (C.A.) (QL)]. However, the Court (*per* Hugessen J.A.) added (at page 6 (QL)):
In his argument counsel for the applicant expressly declined to make any Charter-based attack on section 231.4. In light of the fate suffered by adjacent and related sections of the *Income Tax Act* [he referred to *Baron v. Canada*, 1993 CanLII 154 (SCC), [1993] 1 S.C.R. 416; and to *Minister of National Revenue v. Kruger Inc.*, [1984] 2 F.C. 535], such an attack cries out to be made.
It is that attack which is before us in the case at bar, following a decision on the merits by the Trial Division on 24 January 1997 [1997 CanLII 6325 (FC), [1997] 2 F.C. 428].
II
What is the character of an investigation launched by SI?
First, it should be noted that the objective of Special Investigations is "to plan and administer criminal investigation programs": Taxation Operations Manual (T.O.M.) of Revenue Canada, subsection 1111(1), Case on Appeal, Vol. VIII, at page 1252. Moreover, "only cases with a prosecution potential will be selected for full-scale investigation": T.O.M., subsection 1112(3), Case on Appeal, Vol. VIII, at page 1253.
In the case at bar, on 26 January 1986 the Audit Department made a T-124 fraud referral concerning the appellant Del Zotto to SI. On 24 April SI formally decided to keep the Del

Digitized by Google

Zotto matter for preliminary investigation and opened a file. A full-scale investigation was decided on in 1989.

I have already related the setting up of the inquiry in 1992. A section 231.4 inquiry is an investigative tool in the criminal process. In the words of T.O.M. (Case on Appeal, Vol. VII, at page 1172):

11(12)01 INQUIRIES UNDER
SECTION 231.4 OF
THE INCOME TAX ACT

11(12)1.1 **When Use is Justified**

(1) An Inquiry may be conducted as a means of strengthening our case in either of two areas of the investigation.

(2) Firstly, witnesses whose evidence is material to our case in an anticipated prosecution are examined under oath to determine what they will say in Court. Even then, the story might later be varied but, should any witness give contradictory evidence from that given under the Inquiry, this can be put to the witness. Unless a justifiable reason can be given for the change in his sworn testimony, it can leave him open to a charge of perjury. In any event, it definitely weakens the value of his testimony, especially concerning any statements he might make that would otherwise be damaging to the Crown's case. The evidence is admissible but has little probative value.

(3) Secondly, the following types of witness may be questioned under oath to draw out facts not otherwise obtainable:

(A) Witnesses known to have information material to the case, who have not and will not divulge it in voluntary interview or interrogation, but who are believed to be of the type that, if questioned under oath, will tell the truth.

(B) Witnesses"perhaps friendly to the tax evader"who will not reveal what they know in an interview but who infer or admit that, if they were put under oath, they would tell the truth.

(C) Witnesses who are impartial but who are most reluctant to become involved.

(D) Witnesses whose evidence is required to fill in major gaps in the documentary evidence available.

(4) Witnesses appearing in an Inquiry will normally have been interviewed at an earlier stage in the investigation, but there is no point in doggedly questioning, under oath, a subject who has lied persistently in voluntary interview. He is no doubt lying because he feels his own best interests are served by so doing and he can be expected to lie under oath just as readily as he would in other circumstances.

11(12)1.2 **Timing**

(1) An Inquiry is not normally implemented until the more conventional methods of investigation have been exhausted.

There can be no doubt from reading the Department's own understanding of what an inquiry is about that it can be thought of only in a criminal investigatory context: note, for instance, the references to "an anticipated prosecution," "perjury," and "the tax evader". Departmental witness McCarney admitted that, absent settlement, a prosecution always followed an inquiry (Case on Appeal, Vol. II, at page 354). For good measure, T.O.M. acknowledged that "An Inquiry is never irrevocably closed; in practice, its proceedings are simply adjourned sine die" (Case on Appeal, Vol. VII, at page 1176).

National Revenue's own interpretation of its mandate cannot, of course, be taken as definitive of the purpose of section 231.4. It does, however, reveal its breadth, and, more important, its effects on a taxpayer.

It can hardly be a surprise that lower courts have consistently held that, when a case is put in the hands of SI, even if the statute is otherwise a regulatory one, the case at that moment becomes a criminal investigation: *R. v. Norway Insulation Inc.* (1995), 28 O.R. (3d) 432 (Gen.

Digitized by Google

Div.); *R. v. Harris, R.* (1995), 95 DTC 5653 (B.C.S.C.); *Yang v. R.* 1996 CanLII 8230 (ON SC), (1996), 31 O.R. (3d) 66 (Gen. Div.); *R. v. Jarvis*, [1997] A.J. No. 214 (Alta. Prov. Ct.) (QL), decided 25 February 1997; *R. v. Soviak*, [1997] O.J. No. 1215 (Prov. Div.) (QL), decided 24 March 1997. Typical is the decision of LaForme J. in *Yang*, which dealt with the seizure of tobacco under the *Tobacco Tax Act* [R.S.O. 1990, c. T.10]. After stating that in his view the provisions of the Act in question were quasi-criminal law, LaForme went on to add (at page 76):

Even if I am wrong in my general comments respecting the potential nature of the provisions, namely s. 24 of the *Tobacco Tax Act*, Special Investigations transformed the purpose of the provisions from merely regulatory to quasi-criminal when it relied on the section to undertake a full-scale investigation for purposes of laying charges against targeted individuals and businesses.

In a case such as that at bar, the conclusion as to the existence of a criminal investigation must be *a fortiori.*

I believe the words of Hugessen J.A. for this Court, relating to a neighbouring provision of the Act in *Baron v. Canada,* reflex, [1991] 1 F.C. 688, at pages 693-694, which the Supreme Court did not disagree with in arriving at the same conclusion, are highly persuasive:

As a preliminary matter, it is as well to make clear at the outset that in my opinion we are dealing with procedures that are criminal in their nature. It is not necessary at this stage to characterize in constitutional terms the source of Parliament's legislative power, a question on which the Supreme Court has recently divided and which awaits a definitive resolution by a majority of the members of that Court (see *Knox Contracting Ltd. v. Canada,* 1990 CanLII 71 (SCC), [1990] 2 S.C.R. 338).

It is enough simply to read the section under attack and its repeated reference to "offence" to realize that the section is concerned with the detection and prosecution of crime, albeit a limited category of crime, namely offences under the *Income Tax Act* . This makes the legislation different in kind from the type of administrative enforcement mechanisms found in adjacent sections of the *Income Tax Act* such as were upheld by the Supreme Court in *R. v. McKinlay Transport Ltd.*, 1990 CanLII 137 (SCC), [1990] 1 S.C.R. 627.

The requirements of a self-reporting and self-assessing income tax system may justify an easing of Charter [*Canadian Charter of Rights and Freedoms*, being Part I of the *Constitution Act 1982,* Schedule B, *Canada Act, 1982*, 1982, c. 11 (U.K.) [R.S.C., 1985, Appendix II, No. 44]] standards where the primary purpose of a search is simply to ensure that taxes are paid as and when due. Where as here, however, we are dealing with provisions whose stated aim is the discovery and preservation of evidence "for the purpose of a criminal proceeding" nothing less than the full panoply of Charter protection is appropriate.

It is true, as La Forest J. has pointed out in *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, 1990 CanLII 135 (SCC), [1990] 1 S.C.R. 425, at pages 515-516, that one cannot conclude from the sanctions alone, that a particular provision is criminal or regulatory,[25] and that the Supreme Court held in *R. v. McKinlay Transport Ltd.*, 1990 CanLII 137 (SCC), [1990] 1 S.C.R. 627, that a provision of the Act was regulatory in nature, though obviously it was of a different frame of mind on the appeal from this Court's decision in *Baron v. Canada*, 1993 CanLII 154 (SCC), [1993] 1 S.C.R. 416, where it held that the same provision violated section 8 of the Charter.

In *Baron*, Sopinka J. held for a unanimous Court that what is ultimately important are not labels but the values at stake in a particular context. The Court had held in *McKinlay Transport, supra*, that in the context of a mere income tax audit, the *Income Tax Act* was a regulatory statute, and no Charter issue was raised by compulsion to produce information and documents. Sopinka J. distinguished that case as involving merely the effective monitoring of compliance with the Act. In *Baron* "[t]he purpose of the search is to provide

Digitized by Google

evidence to be used in the prosecution of *ITA* offences" (at page 444).
Justice Sopinka put the result in *Baron* (striking down the provision of the Act as unconstitutional) on two grounds (at page 445):
Given the intrusive nature of searches and the corresponding purpose of such a search to gather evidence for the prosecution of a taxpayer, I see no reason for a radical departure from the guidelines and principles expressed in *Hunter* [*v. Southam*].
The intrusive nature of the power to search premises in *Baron* is, of course, not matched by the subpoena *duces tecum* in the case at bar, but it seems to me that the equally important factor of gathering information for the prosecution of a taxpayer is present with greater force in this case. Later, Sopinka J. disapproved of fishing expeditions by the state, and went on to say (at page 448):
This Court established in *Hunter* that a standard of credibly based probability rather than mere suspicion should be applied in determining when an individual's interest in privacy is subordinate to the needs of law enforcement.
We have it from the mouth of National Revenue that such a standard was intended to be short-circuited in the case at bar.
In the words of the respondent's witness McCarney, who drafted the memorandum to the Deputy Minister recommending that an inquiry be established, "In my personal opinion, from my vantage point at Head Office, I do not think we had grounds for a search warrant on Del Zotto" (Case on Appeal, Vol. II, at pages 224-225). In other words, the Department lacked reasonable and probable cause for a proper criminal investigation, and moved to an inquiry as a back-door alternative, since that procedure did not require any showing of reasonable and probable cause.
I can conclude only that an inquiry under section 231.4 is inherently oriented towards criminal prosecution, based not on the labels used but on what is really in question in such a proceeding, in other words, on the values of criminality or innocence in play. I regard such a conclusion as *a fortiori* in the case at bar.
III
The right to be secure against unreasonable searches and seizures under section 8 of the Charter has evolved into a right to the reasonable security of one's privacy.
The *locus classicus* for section 8 law is *Hunter et al. v. Southam Inc.*, 1984 CanLII 33 (SCC), [1984] 2 S.C.R. 145, where Dickson J. (as he then was) held for the Court that section 8 must be broadly and liberally construed to effect its purpose, which is to secure a person's right to a reasonable expectation of privacy against governmental encroachments. In the absence of exigent circumstances, section 8 requires prior authorization by a judicial officer as a precondition to a criminal-law seizure, on a standard of reasonable and probable grounds both as to the commission of an offence and as to the evidence to be afforded by the search. In analyzing section 8, Dickson J. said for the Court (at page 158), "There is, further, nothing in the language of the section to restrict it to the protection of property or to associate it with the law of trespass."
In *R. v. Dyment*, 1988 CanLII 10 (SCC), [1988] 2 S.C.R. 417, La Forest J. (with whom Dickson C.J. concurred), penned concurring reasons for decision which put a great deal of emphasis on privacy under section 8 (at pages 427-428):
The foregoing approach is altogether fitting for a constitutional document enshrined at the time when, Westin tells us, society has come to realize that privacy is at the heart of liberty in a modern state; see Alan F. Westin, *Privacy and Freedom* (1970), pp. 349-50. Grounded in man's physical and moral autonomy, privacy is essential for the well-being of the individual. For this reason alone, it is worthy of constitutional protection, but it also has profound significance for the public order. The restraints imposed on government to pry into the lives of the citizen go to the essence of a democratic state.

Digitized by Google

Claims to privacy must, of course, be balanced against other societal needs, and in particular law enforcement, and that is what s. 8 intended to achieve.
Justice La Forest continued [at pages 429-430]:
Finally, there is privacy in relation to information. This too is based on the notion of the dignity and integrity of the individual. As the Task Force [on *Privacy and Computers*, Information Canada, 1972] put it (p. 13): "This notion of privacy derives from the assumption that all information about a person is in a fundamental way his own, for him to communicate or retain for himself as he sees fit." In modern society, especially, retention of information about oneself is extremely important. We may, for one reason or another, wish or be compelled to reveal such information, but situations abound where the reasonable expectations of the individual that the information shall remain confidential to the persons to whom, and restricted to the purposes for which it is divulged, must be protected. Governments at all levels have in recent years recognized this and have devised rules and regulations to restrict the uses of information collected by them to those for which it was obtained; see, for example, the *Privacy Act,* S.C. 1980-81-82-83, c. 111.
One further general point must be made, and that is that if the privacy of the individual is to be protected, we cannot afford to wait to vindicate it only after it has been violated. This is inherent in the notion of being secure against unreasonable searches and seizures. Invasions of privacy must be prevented, and where privacy is outweighed by other societal claims, there must be clear rules setting forth the conditions in which it can be violated. This is especially true of law enforcement, which involves the freedom of the subject.
In *R. v. Plant*, 1993 CanLII 70 (SCC), [1993] 3 S.C.R. 281, at pages 292-293, Sopinka J. (for 6 of 7 members of the Court) also fastened on the significance of informational privacy under section 8:
Some indication of the parameters of the protection afforded by s. 8 with respect to informational privacy can be derived from the following passage from the reasons of La Forest J. in *Dyment, supra,* at pp. 429-30, commenting on the Report of the Task Force on Privacy and Computers:
In modern society, especially, retention of information about oneself is extremely important. We may, for one reason or another, wish or be compelled to reveal such information, but situations abound where the reasonable expectations of the individual that the information shall remain confidential to the persons to whom, and restricted to the purposes for which it is divulged, must be protected.
Consideration of such factors as the nature of the information itself, the nature of the relationship between the party releasing the information and the party claiming its confidentiality, the place where the information was obtained, the manner in which it was obtained and the seriousness of the crime being investigated allow for a balancing of the societal interests in protecting individual dignity, integrity and autonomy with effective law enforcement. It is, then, necessary to apply this contextual approach to the facts of the case at bar.
The United States Supreme Court has limited application of the Fourth Amendment (the right against unreasonable search and seizure) protection afforded by the United States Constitution to situations in which the information sought by state authorities is personal and confidential in nature: *United States v. Miller*, 425 U.S. 435 (1976). That case determined that the accused's cheques, subpoenaed for evidence from a commercial bank, were not subject to Fourth Amendment protection. While I do not wish to be taken as adopting the position that commercial records such as cancelled cheques are not subject to s. 8 protection, I do agree with that aspect of the *Miller* decision which would suggest that in order for constitutional protection to be extended, the information seized must be of a "personal and confidential" nature. In fostering the underlying values of dignity, integrity and

Digitized by Google

autonomy, it is fitting that s. 8 of the *Charter* should seek to protect a biographical core of personal information which individuals in a free and democratic society would wish to maintain and control from dissemination to the state. This would include information which tends to reveal intimate details of the lifestyle and personal choices of the individual.

In *Plant* the police action was merely to check the electrical consumption at the address in question, and this was held to reveal very little about the personal lifestyle or private decisions of the occupant. It is significant, however, that Justice Sopinka specifically reserved the Court's decision as to an accused's cheques subpoenaed for evidence from a commercial bank. (This issue surfaced recently in this Court in *Schreiber v. Canada (Attorney General)*, 1997 CanLII 6333 (FCA), [1997] 2 F.C. 176, to which I shall return in a moment.)

Subsequently in *R. v. Colarusso*, 1994 CanLII 134 (SCC), [1994] 1 S.C.R. 20, at page 60, La Forest J., writing for the majority of the Court, said:

This really goes to the underlying reason for the protection afforded by s. 8; one must not overemphasize the purely physical aspects of the seizure. In both *Hunter* and *Dyment*, the Court emphasized that what is protected by s. 8 is people, not places or things. The principal right protected by s. 8 is individual privacy, and the provision must be purposively applied to that end.

He then proceeded to quote the paragraph above relating to privacy in relation to information.

This Court's most recent consideration of section 8 occurred in *Schreiber, supra*, where a majority held that the Canadian standard for the issuance of a search warrant was required to be satisfied for a letter of request to a foreign country to search and seize a citizen/resident's banking documents and records. Linden J.A. rested this holding squarely on *Hunter* (at page 235):

On the facts in *Hunter*, Dickson J. held that the provision of the statute authorizing certain broad-ranging searches was inconsistent with section 8 of the Charter. He did this on the basis that the authorization did not have to be granted by an impartial and judicial arbiter and because authorization did not depend on evidence of reasonable and probable grounds, established upon oath, to believe that an offence had been committed.

He emphasized the guarantee of "security" in section 8. Stone J.A. in dissent took a different point of view on this (at pages 207-208):

It would be wrong, in my view, to emphasize the word "secure" at the expense of the remaining language of section 8, when that section guarantees the right to be secure against "unreasonable search and seizure" by Canadian state actors. In the present case, as I understand the facts, the Canadian authorities neither possessed the ability to carry out a search or seizure in Switzerland nor requested that the Swiss authorities should do so as their agents.

This difference of opinion is not relevant to the case at bar.

As I have already suggested, I believe the Trial Judge, was misled by his reliance on *Thomson*. The Supreme Court had no difficulty in unanimously distinguishing *Thomson* as well as *McKinlay* in *Baron*. Whether one conceives of the Act as regulatory legislation whose application is not in all instances governed by that fact, or, as seems better to me, as legislation with a regulatory side (audit and payment) and a criminal investigatory side, makes no difference to the realism of the judicial scrutiny as to what is really underway. In the opinion of the Court in *Baron* what mattered was the intrusive nature of the search in question and the gathering of evidence for the prosecution of the taxpayer.

I am strengthened in my approach by the conclusions advanced by the Supreme Court in *Starr v. Houlden*, 1990 CanLII 112 (SCC), [1990] 1 S.C.R. 1366. That case involved a commission of inquiry pursuant to the Ontario *Public Inquiries Act* [R.S.O. 1980, c. 411] (with

Digitized by Google

powers similar to those under the federal *Inquiries Act* and under section 231.4 of the *Income Tax Act*) to inquire into the facts surrounding the relationships between Patty Starr and other persons. The issue that fell for decision by the Supreme Court was whether such a provincial inquiry was *ultra vires* the province as an infringement of the federal criminal law power.

In the course of his reasons for decision Lamer J. (as he then was) wrote for six of seven judges (at pages 1407-1409):

Second, it is not necessary for the Commissioner to make findings of guilt in the true sense of the word for the inquiry to be *ultra vires* the province. It suffices if the inquiry is in effect a substitute police investigation and preliminary inquiry into a specific allegation of criminal conduct by named, private citizens. In my view, the investigation the Commissioner is asked to undertake, and the findings of fact he will make as a result of his investigation, place him in a similar position as a judge conducting a preliminary inquiry under s. 535 of the *Criminal Code*.

. . .

In essence the inquiry is entering into the preliminary stages of the judicial criminal process by taking evidence, determining its sufficiency and ultimately deciding whether a *prima facie* case exists . . . .

The foregoing description is very like what is proposed by the respondents in the case at bar: a substitute police investigation into a specific allegation of criminal conduct, viz., the making of false or deceptive statements in a tax return under paragraph 239(1)(*a*) of the Act, by a named private citizen. It does not seem to be forbidden to the inquiry even to pass over to being a preliminary inquiry, in which the hearing officer would determine the sufficiency of the evidence, and ultimately decide whether a *prima facie* case exists, though I am aware of no duty on the hearing officer to go so far.

Because of the different circumstances of *Starr*, the sanction there was quite different, the unconstitutionality of the provincial action as transgressing on criminal law, from what is needed in the case at bar. But from Justice Lamer's embrace of the New Zealand Court of Appeal decision in *Cock v. Attorney-General* (1909), 28 N.Z.L.R. 405, at page 425, where an inquiry was held to be "virtually a trial for the offence without the protection that the law gives to accused persons," it is obvious that the vice of a substitute police investigation has a broader meaning for him. (In New Zealand, with no issues of federalism, the governmental excess led to a writ of prohibition at common law.)

The Supreme Court's decision in *British Columbia Securities Commission v. Branch*, 1995 CanLII 142 (SCC), [1995] 2 S.C.R. 3, which was particularly urged on us by the respondents, allowed company officers to be required to testify and to produce documents, on a holding that the British Columbia *Securities Act* [S.B.C. 1985, c. 83] is regulatory in nature and indeed forms part of a much larger framework which regulates the securities industry throughout Canada. The primary goal of securities legislation was said to be the protection of the investor, the secondary goals capital market efficiency and ensuring public confidence in the system. Given this background, it was not surprising that the Court found a low expectation of privacy. In particular, Sopinka and Iacobucci JJ. held for the Court that "[d]ocuments produced in the course of a business which is regulated have a lesser privacy right attaching to them than do documents that are, strictly speaking, personal" (at page 41, emphasis added). Such business records, dedicated to a special regulated purpose, are a long way from the general records of a taxpayer in the course of administering his/her affairs. These general records cannot be swept into the kind of narrow category appropriate under securities legislation.

The Trial Judge acknowledged that "it is not in dispute that subsection 231.4(3) provides for warrantless seizures contrary to the *Hunter* criteria" (at page 462). He was correct, I believe,

Digitized by Google

in his conclusion that "[a] full weighing of all the circumstances is required" (at page 463). He does not, however, in my view give adequate weight to the focussed criminal investigation in the case at bar, and was unduly influenced by *Thomson* in relation to the lesser form of intrusion and the low degree of expectation of privacy for business affairs which he analyzed to exist.

Is it enough for violation of section 8 if the proposed search is less intrusive than that in *Hunter* and *Baron*, involving rather an order to appear for examination under oath with documents (under a subpoena *duces tecum*)? I believe it is, under the principle asserted by Dickson J. in *Hunter* that section 8 confers an entitlement to a reasonable expectation of privacy (at page 159). Moreover, as Linden J.A. said of *Hunter* in *Schreiber* (at page 235), "the existence of an actual illegal search conducted under the statute was apparently not of importance to the holding of unconstitutionality."

The whole inquiry is aimed at the financial affairs of the appellant Del Zotto over a six-year period. Although he is not at present under subpoena, there is a possibility that he will be summoned himself. On the facts of this case, it is not enough to wait for the appellant Del Zotto to be subpoenaed. His right to a reasonable expectation of privacy is in peril from the time the inquiry begins.

As I see it, the section 231.4 process is inherently oriented towards criminal prosecution, a conclusion that is particularly obvious in the present case, where the appellant Del Zotto is not only subject to being summoned but has even been told under what paragraphs of subsection 239(1) he will eventually be prosecuted. In respect of its inherent orientation, section 231.4 is like the inquiry in *Starr*, and not at all like the normal commission inquiry under the *Inquiries Act*, which has a general public purpose.

Of course, a trigger is needed for the invocation of section 8 of the Charter. Section 8 does not apply in the absence of a search or seizure. In my view, given the inherent orientation of section 231.4, any threatened seizure is sufficient to bring section 8 into play.

Since section 8 protects the privacy rights of people, not places, the appellant Del Zotto has a reasonable expectation of privacy over documents and information held by other people at different places. Anything to do with his financial affairs over six years may include many items of a very personal or private nature such as personal expenditures (e.g. gifts to friends and relatives, reading materials), donations (e.g. to churches, charities or political parties), personal tastes (e.g. food, clothes), his relationship with family members (what he buys for them, what they give to him), and so on. Documents and information concerning his financial affairs over six years, without limitation, could reveal incredibly intimate and personal details about his preferences, habits, opinions, hopes and activities. The same is true for witnesses who have knowledge of his financial affairs during 1979-1985"their own personal preferences may become relevant to the terms of reference of the inquiry. Simply put, as the appellants emphasized, an investigation into all cash received and all cash spent is necessarily, in today's modern world, a window into most of a person's private life.

Although, as I have noted, Sopinka J. withheld judgment in *Plant* as to cheques subpoenaed for evidence, the matter has now been settled in this Court by *Schreiber* where Linden J.A. held (at page 232):

In contrast, the bank records sought in the letter of request, unlike electricity consumption records, reveal important and personal details about an individual. The heightened privacy interest in banking records was described by Puddester J. in *R. v. Eddy (T.)* as a "substantially greater expectation of privacy relating to the records of an individual's personal financial position, and the pattern of the individual's operating on his or her bank account" (1994 CanLII 5274 (NL SCTD), (1994), 119 Nfld. & P.E.I.R. 91 (S.C.T.D.), at p. 126). Puddester J. found in that case that warrantless inquiries by the police at a bank regarding the identity of a bankbook holder and about a major transaction which took place on that

Digitized by Google

account did interfere with a reasonable expectation of privacy.

The combination of forced documentary production and forced oral testimony can be particularly intrusive, if an invoice leads to questions about the activity which gave rise to the invoice and all the context surrounding it. As a result, in the words of Linden J.A. in *Schreiber*, "the right to privacy is protected in advance of any physical search, that is, as soon as any government action threatens the security of the individual's privacy interest" (at page 218).

None of this is to say that National Revenue has no right to conduct a criminal investigation into the financial affairs of Del Zotto or anyone else. It is rather to say that it has no special right to do so merely by setting up an inquiry under section 231.4, a procedure which establishes no safeguards for the taxpayer. The hearing officer appointed is not a judicial officer, nor are there any rules for the inquiry, except such guidance (see T.O.M.) as suits the Crown. Although the taxpayer is entitled to counsel, "unless the hearing officer . . . orders otherwise," there is some doubt whether in such an administrative proceeding the counsel would be entitled to question witnesses. As the Supreme Court held in *Guay v. Lafleur , supra*, and this Court reiterated in the judicial review hearing in this case, such an inquiry is a purely administrative one. In my opinion what is rather required for validity is a judicial inquiry based upon reasonable and probable cause, the normal standard for criminal investigation.

Since the respondent advanced no justification under section 1 of the Charter, I am of the view that section 231.4 of the Act violates section 8 of the Charter, and that striking the provision down under subsection 52(1) of the *Constitutional Act, 1982* [Schedule B, *Canada Act 1982*, 1982, c. 11 (U.K.) [R.S.C., 1985, Appendix II, No. 44]] is an appropriate remedy. Reading the statute down would have been a much simpler matter in *Baron* than here, but the Court was not disposed to do so. I am equally disinclined. As the section 231.4 process is in my opinion vitiated from the outset, with the issuance of a subpoena *duces tecum* to the appellant Noble, it is unnecessary to await further actual infringements.

IV

Since I have resolved the matter under section 8 of the Charter, I find no need to deal with the arguments advanced under section 7.

I would allow the appeal with costs here and below, set aside the decision of the Trial Division, and declare that section 231.4 of the *Income Tax Act* and subpoenas issued under it are of no force or effect under subsection 52(1) of the *Constitution Act, 1982*.

Henry D.J.: I agree.

[1] 1984 CanLII 33 (SCC), [1984] 2 S.C.R. 145.

[2] Appellants' factum, at para. 150.

[3] *Id.*, at para. 50.

[4] See e.g. Mortimer, J. *Rumpole and the Golden Thread* (N.Y.: Penguin, 1983), at pp. 55-96, *passim*.

[5] *Supra*, note 1.

[6] *Guay v. Lafleur*, 1964 CanLII 45 (SCC), [1965] S.C.R. 12. See also *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, 1990 CanLII 135 (SCC), [1990] 1 S.C.R. 425, at p. 457 where Wilson J. stated that a hearing under s. 17 of the *Combines Investigation Act* [R.S.C. 1970, c. C-23] set up specifically to determine if there was evidence that certain named parties had committed an offence "does not determine any rights or impose any liabilities".

[7] 1990 CanLII 112 (SCC), [1990] 1 S.C.R. 1366.

[8] *Supra*, note 6.

[9] 1990 CanLII 137 (SCC), [1990] 1 S.C.R. 627.

[10] *Supra*, note 1.

[11] 1993 CanLII 154 (SCC), [1993] 1 S.C.R. 416.

Digitized by Google

[12] *Id.*, at pp. 444-445.
[13] R.S.C. 1970, c. C-23.
[14] *Supra*, note 6, at p. 510.
[15] *Id*, at pp. 515-516.
[16] *McKinlay, supra*, note 9, at p. 650.
[17] *Id.*, at p. 648.
[18] *Supra*, note 6, at p. 569.
[19] See e.g. *McKinlay, supra*, note 9, at pp. 649-650; *Thomson, supra*, note 6, at pp. 522, 594.
[20] See e.g. *Thomson, supra*, at pp. 532, 534-535, 594-595 and 613.
[21] R.S.C., 1985, c. I-11.
[22] 1995 CanLII 121 (SCC), [1995] 1 S.C.R. 451. See also *Phillips v. Nova Scotia (Commission of Inquiry into the Westray Mine Tragedy)*, 1995 CanLII 86 (SCC), [1995] 2 S.C.R. 97, at pp. 152-153.
[23] *R. v. Kabbebe*, [1997] A.Q. No. 273 (Que. C.A.).
[24] 1995 CanLII 142 (SCC), [1995] 2 S.C.R. 3.
[25] With respect to La Forest J's comparison of the *Combines Investigations Act* and the *Income Tax Act* as to sanctions, I respectfully believe that the learned Trial Judge [at p. 467] overextended the comparison when he stated that the "explicit link between sanctions . . . tends to reinforce the application of *Thomson* to the present case." In my view the comparison does not have any significance beyond sanctions.
La Forest J. did not see the *Combines Investigation Act* as dealing with "real crimes" (at p. 510), but with "the preservation of the competitive conditions which are crucial to the operation of a free market economy" (at p. 510), "far removed from what is the typical concern of the criminal law system, i.e. the underlining (of) crucial social values, (emphasis added) where "(t)he sort of things prohibited"acts of violence, dishonesty and so on"are acts violating common sense standards of humanity' which we regard as meriting disapprobation and punishment" (at p. 509). But, of course, the sanctions provision (viz. s. 239) relating to s. 234.1 deals primarily with fraud and dishonesty, the heartland of criminal behaviour for La Forest J.

Del Zotto *v.* Canada, [1999] 1 S.C.R. 3
Her Majesty The Queen in right of Canada,
the Minister of National Revenue
and John Edward Thompson *Appellants*
v.
Angelo Del Zotto and Herbert B. Noble *Respondents*
and
The Attorney General for Ontario,
the Attorney General of Quebec and
the Attorney General for Alberta *Interveners*
Indexed as: Del Zotto *v.* Canada
File No.: 26174.
1999: January 20; 1999: January 21.
Present: Lamer C.J. and L'Heureux-Dubé, Gonthier, McLachlin, Major, Bastarache and Binnie JJ.
on appeal from the federal court of appeal
Constitutional law -- Charter of Rights -- Search and seizure -- Inquiry under Income Tax Act -- Whether s. 231.4 of Income Tax Act infringes s. 8 of Canadian Charter of

Digitized by Google

Rights and Freedoms.

Constitutional law -- Charter of Rights -- Fundamental justice -- Inquiry under Income Tax Act -- Whether s. 231.4 of Income Tax Act infringes s. 7 of Canadian Charter of Rights and Freedoms.

Taxation -- Income tax -- Inquiry -- Whether s. 231.4 of Income Tax Act constitutional -- Canadian Charter of Rights and Freedoms, ss. 7, 8.

Statutes and Regulations Cited

Canadian Charter of Rights and Freedoms, ss. 7, 8.

Income Tax Act, R.S.C. 1952, c. 148 [now R.S.C., 1985, c. 1 (5th Supp.)], s. 231.4 [ad. 1986, c. 6, s. 121].

APPEAL from a judgment of the Federal Court of Appeal, [1997] 3 F.C. 40, 215 N.R. 184, 147 D.L.R. (4th) 457, 97 D.T.C. 5328, [1997] 3 C.T.C. 199, 46 C.R.R. (2d) 324, 116 C.C.C. (3d) 123, [1997] F.C.J. No. 795 (QL), setting aside a judgment of the Trial Division, [1997] 2 F.C. 428, 125 F.T.R. 161, 143 D.L.R. (4th) 340, 97 D.T.C. 5145, [1997] 2 C.T.C. 103, 41 C.R.R. (2d) 63, [1997] F.C.J. No. 85 (QL), dismissing the respondents' constitutional challenge of s. 231.4 of the *Income Tax Act*. Appeal allowed.

Ivan S. Bloom, *Q.C.*, and *Gordon S. Campbell*, for the appellants.

Edward L. Greenspan, *Q.C.*, and *David Stratas*, for the respondent Del Zotto.

Alan D. Gold and *Mahmud Jamal*, for the respondent Noble.

Michel Y. Hélie, for the intervener the Attorney General for Ontario.

Monique Rousseau and *Gilles Laporte*, for the intervener the Attorney General of Quebec.

Robert C. Maybank and *Christine L. Enns*, for the intervener the Attorney General for Alberta.

The following is the judgment delivered by

//*The Court*//

1 The Court -- The appeal is allowed with costs throughout for the reasons given by Strayer J.A. of the Federal Court of Appeal. The judgment of the Court of Appeal is set aside and the trial judgment is restored. The constitutional questions are answered as follows:

1. Does s. 231.4 of the *Income Tax Act*, R.S.C. 1952, c. 148, as amended, restrict rights guaranteed by s. 7 of the *Canadian Charter of Rights and Freedoms*?
   The answer is no.
2. If so, can these restrictions be demonstrably justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?
   Given the answer to the first question, the second question does not arise.
3. Does s. 231.4 of the *Income Tax Act*, R.S.C. 1952, c. 148, as amended, restrict the right guaranteed by s. 8 of the *Canadian Charter of Rights and Freedoms*?
   The answer is no.
4. If so, can these restrictions be demonstrably justified in a free and democratic society under s. 1 of the *Canadian Charter of Rights and Freedoms*?
   Given the answer to the third question, the fourth question does not arise.

Appeal allowed with costs.

Solicitor for the appellants: The Department of Justice, Ontario Regional Office, Toronto.

Solicitors for the respondent Del Zotto: Greenspan, Nenein & White, Toronto.

Solicitors for the respondent Noble: Gold & Fuerst, Toronto.

Solicitor for the intervener the Attorney General for Ontario: The Attorney General for Ontario, Toronto.

Solicitor for the intervener the Attorney General of Quebec: The Department of

Digitized by Google

Justice, Sainte-Foy.

Solicitor for the intervener the Attorney General for Alberta: The Attorney General for Alberta, Edmonton.

Spencer v. The Queen, [1985] 2 S.C.R. 278, Compellable Witness Notwithstanding Conflict with International Disclosure Laws

Spencer v. The Queen, [1985] 2 S.C.R. 278
Date: October 10, 1985
Docket: 17603
Other formats: PDF WPD

Printer Friendly

Spencer *v.* The Queen, [1985] 2 S.C.R. 278
Robert Spencer *Appellant*;
and
Her Majesty The Queen *Respondent*.
File No.: 17603.
1985: March 26; 1985: October 10.
Present: Dickson C.J. and Beetz, Estey, McIntyre, Chouinard, Lamer, Wilson, Le Dain and La Forest JJ.
on appeal from the court of appeal for ontario

Evidence -- Witnesses -- Compellability -- Canadian resident refusing to disclose information received while working as bank manager in Bahamas -- Disclosure of such information constituting criminal offence under Bahamian law -- Whether witness should be compelled to testify.

Constitutional law -- Charter of Rights -- Liberty and security of the person -- Compellability of witness -- Canadian resident refusing to disclose information received while working as bank manager in Bahamas -- Disclosure of such information constituting criminal offence under Bahamian law -- Charter of Rights inapplicable -- Infringement of liberty or security not resulting from operation of Canadian law -- Canadian Charter of Rights and Freedoms, s. 7.

Appellant, a crown witness in a prosecution against a person charged under the *Income Tax Act*, refused to testify about his knowledge relating to specific customers and transactions of the Royal Bank in the Bahamas because s. 10 of the Bahamian *Banks and Trust Companies Regulation Act, 1965*, as amended, makes it a summary conviction offence punishable by a fine or a term of imprisonment to reveal such knowledge. Appellant, a resident and citizen of Canada, acquired this knowledge while he was manager of the main Freeport Branch in the Bahamas. He has not returned there since 1974. The Provincial Court ordered the appellant to testify but the order was quashed by a judge of the Supreme Court of Ontario. On appeal, the Court of Appeal restored the Provincial Court judge's order.

Held: The appeal should be dismissed.

Per Dickson C.J. and Beetz, McIntyre, Chouinard, Lamer, Wilson, Le Dain and La Forest JJ.: For the reasons given by the Court of Appeal, appellant is a compellable witness in Canada and must testify notwithstanding the Bahamian statute.

Furthermore, to compel appellant to testify does not constitute an infringement of s. 7 of the *Canadian Charter of Rights and Freedoms* which guarantees "everyone...the right to life, liberty and security of the person...." That section has no application in the present case.

Digitized by Google

The infringement of liberty or security, if any, does not result from the operation of Canadian law, but solely from the operation of Bahamian law in the Bahamas. To allow the appellant to refuse to give evidence in the present circumstances would permit a foreign country to frustrate the administration of justice in this country in respect of a Canadian citizen in relation to what is essentially a domestic situation.

Per Estey J.: Canadian courts are not prevented from compelling a witness by the fact that giving the evidence sought may constitute a crime in another country. Our courts, however, should not lightly make orders which may result in a violation or an unnecessary circumvention of the laws or procedures of a friendly state. Here, a preferable alternative at trial would have been to grant a stay of proceedings to allow the appellant sufficient time to apply to a Bahamian court for an order permitting disclosure, which would exempt him from criminal liability under s. 10 of the Bahamian *Banks and Trust Companies Regulation Act, 1965*. If no such order had been sought or obtained within a reasonable time, our courts would have had no option but to compel the appellant to testify.

Cases Cited

Re Application of Chase Manhattan Bank, 297 F.2d 611 (1962); *Hilton v. Guyot*, 159 U.S. 113 (1895); *Re International Bank of Washington*, Supreme Court of the Bahamas, No. 38 of 1980; *Re Nassau Bank and Trust Co.*, Supreme Court of the Bahamas, No. 95 of 1975, referred to.

Statutes and Regulations Cited

Banks and Trust Companies Regulation Act, 1965, Bahamas, No. 64 of 1965, s. 10 [am. No. 3 of 1980, s. 2].

Canadian Charter of Rights and Freedoms, s. 7.

Income Tax Act, R.S.C. 1952, c. 148.

APPEAL from a judgment of the Ontario Court of Appeal (1983), 145 D.L.R. (3d) 344, 2 C.C.C. (3d) 526, setting aside a judgment of Montgomery J.[1], quashing a decision of a Provincial Court judge ordering the appellant to testify. Appeal dismissed.

[1] Summarized at (1982), 8 W.C.B. 111.

John Sopinka, Q.C., and *Donald Houston*, for the appellant.

Michael R. Dambrot, Mark L. Jewett and *Robert W. Hubbard*, for the respondent.

The judgment of Dickson C.J. and Beetz, McIntyre, Chouinard, Lamer, Wilson, Le Dain and La Forest JJ. was delivered by

1. LA FOREST J.--In this case the Crown seeks to compel the appellant Mr. Spencer, who is a crown witness in a prosecution against one Robert McGregor for contravening the *Income Tax Act*, R.S.C. 1952, c. 148, as amended, to testify about his knowledge relating to specific customers and transactions of the Royal Bank in the Bahamas. Mr. Spencer, who is a resident and citizen of Canada, acquired this knowledge while he was a manager of the main Freeport Branch in the Bahamas where, subject to certain exceptions, s. 10 of the Bahamian *Banks and Trust Companies Regulation Act, 1965*, as amended, makes it a summary conviction offence punishable by a fine not exceeding $15,000 or a term of imprisonment not exceeding two years, or by both, to reveal such knowledge.

2. His Honour Judge Parker of the Ontario Provincial Court, who heard the case, ordered that Mr. Spencer must testify notwithstanding the Bahamian statute, but this order was quashed by Montgomery J. of the Supreme Court of Ontario. On appeal to the Ontario Court of Appeal (1983), 145 D.L.R. (3d) 344, 2 C.C.C. (3d) 526, that court set aside Montgomery J.'s judgment and restored the order of Judge Parker. In its view, the public and the courts have a right to Mr. Spencer's evidence whether or not the giving of this evidence constituted a crime in the Bahamas. I agree with this conclusion substantially for the reasons given by MacKinnon, A.C.J.O. Under these

Digitized by Google

circumstances it becomes unnecessary to consider whether or not the Bahamian statute had extra-territorial effect.

3. In this Court counsel for Mr. Spencer raised, though somewhat feebly, an argument not dealt with by the Ontario Court of Appeal, namely, that compelling Mr. Spencer either to breach Bahamian law or be found in contempt for not testifying constitutes an infringement of s. 7 of the *Canadian Charter of Rights and Freedoms*, which guarantees that everyone has a right not to be deprived of life, liberty or security of the person. This provision, he argued, afforded Mr. Spencer a protection similar to that given by the Fifth Amendment to the Constitution of the United States.

4. This argument raises the interesting question whether the *Charter* applies to a result flowing from the interplay of a common law principle (as opposed to a federal or provincial statute) and a foreign statute. I do not, however, find it necessary to comment on this point because, assuming the application of the *Charter* to common law principles, I do not think Mr. Spencer can successfully rely on s. 7. The Canadian law in no way deprives him of his liberty or security. To the extent that these may be interfered with, it is the foreign law that does so. Nor does the operation of the Canadian law substantially put him in jeopardy of prosecution under the law of the Bahamas, where he has not returned since 1974. Only if he decides to go there will he be in jeopardy of prosecution.

5. The infringement of Mr. Spencer's liberty or security, if any, does not result from the operation of Canadian law, but solely from the operation of Bahamian law in the Bahamas. Under these circumstances the *Charter* has no application. To allow Mr. Spencer to refuse to give evidence in the circumstances of this case would permit a foreign country to frustrate the administration of justice in this country in respect of a Canadian citizen in relation to what is essentially a domestic situation. Indeed such an approach could have serious repercussions on the operation of Canadian law generally.

6. I would dismiss the appeal.

The following are the reasons delivered by

7. ESTEY J.--I am in respectful agreement with the law as expressed in the judgment of La Forest J. and the disposition there proposed. The fact that the giving of the evidence sought in this case may constitute a crime in another country cannot prevent the Canadian courts from compelling a witness to testify. However, the threat arising in a foreign jurisdiction of criminal proceedings against a Canadian resident for revealing information in a Canadian judicial proceeding is a serious consideration to be borne in mind in a proceeding such as this. Thus any course by which such a serious consequence may be avoided must be carefully considered by our courts. In these proceedings it is therefore relevant to take note of the fact that under Bahamian law an appropriate order releasing the appellant may be obtained from a Bahamian court. Section 10 of the *Banks and Trust Companies Regulation Act, 1965*, as amended, provides:

> **10.**--(1) No person who has acquired information in his capacity as
>
> (a) director, officer, employee or agent of any licensee or former licensee;
>
> ...
>
> shall, without the express or implied consent of the customer concerned, disclose to any person any such information relating to the identity, assets, liabilities, transactions, accounts of a customer of a licensee or relating to any application by any person under the provisions of this Act, as the case may be, except--
>
> ...
>
> (iii) when a licensee is lawfully required to make disclosure by any court of competent

Digitized by Google

jurisdiction within The Bahamas, or under the provisions of any law of The Bahamas.

...

(3) Every person who contravenes the provisions of subsection (1) of this section shall be guilty of an offence against this Act and shall be liable on summary conviction to a fine not exceeding fifteen thousand dollars or to a term of imprisonment not exceeding two years or to both such fine and imprisonment.

8. This Bahamian legislation was passed in order to ensure that the Bahamas remained an attractive location for foreign banks and other financial institutions. According to the Bahamian Chief Justice, "the secrecy provisions is one of the pillars of this part of our economic structure, the destruction of which would lead to the collapse of the whole structure which it supports" (*Re Nassau Bank and Trust Co.*, Supreme Court of the Bahamas, No. 95 of 1975, unreported). The provisions are of equal importance to the Canadian and other foreign companies doing business in the Bahamas. In this context, international comity dictates that Canadian courts should not lightly disregard the Bahamian provisions by requiring the appellant in this case to testify. " `Comity' in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws": *Hilton v. Guyot*, 159 U.S. 113 (1895), at pp. 163-64.

9. It therefore would have been a preferable alternative at the trial level to have granted a stay of these proceedings so as to allow the appellant sufficient time to make application to a Bahamian court of competent jurisdiction for an order permitting disclosure of the evidence sought to be compelled. Such an order was asked for and granted in the case of *Re International Bank of Washington*, Supreme Court of the Bahamas, No. 38 of 1980, unreported, in circumstances substantially similar to those existing in this case, and in *Re Application of Chase Manhattan Bank*, 297 F.2d 611 (2nd Cir. 1962), a subpoena *duces tecum* was modified to permit application to be made to the appropriate Panamanian authorities for permission to disclose information covered by Panama's secrecy provisions. Moore J. spoke at p. 613 in the latter case of the "obligation to respect the laws of other sovereign states even though they may differ in economic and legal philosophy from our own. As we recently said ... `upon fundamental principles of international comity, our courts dedicated to the enforcement of our laws should not take such action as may cause a violation of the laws of a friendly neighbor, or, at the least, any unnecessary circumvention of its procedures'."

10. If an authorizing order had not been sought or obtained within a reasonable time, the Canadian courts would have had no option, having regard to the subject matter of these proceedings, but to proceed in the manner indicated by the Ontario Court of Appeal below.

Appeal dismissed.

Solicitors for the appellant: Stikeman, Elliott, Toronto.

Solicitor for the respondent: Roger Tassé, Ottawa.

Copies - S. 231.5

231.5 (1) Where any document is seized, inspected, audited, examined or provided under any of sections 231.1 to 231.4, the person by whom it is seized, inspected, audited or examined or to whom it is provided or any officer of the Canada Revenue Agency may make,

Digitized by Google

or cause to be made, one or more copies thereof and, in the case of an electronic document, make or cause to be made a print-out of the electronic document, and any document purporting to be certified by the Minister or an authorized person to be a copy of the document, or to be a print-out of an electronic document, made pursuant to this section is evidence of the nature and content of the original document and has the same probative force as the original document would have if it were proven in the ordinary way.

Compliance
(2) No person shall, physically or otherwise, interfere with, hinder or molest an official (in this subsection having the meaning assigned by subsection 241(10)) doing anything that the official is authorized to do under this Act or attempt to interfere with, hinder or molest any official doing or prevent or attempt to prevent an official from doing, anything that the official is authorized to do under this Act, and every person shall, unless the person is unable to do so, do everything that the person is required to do by or under subsection (1) or sections 231.1 to 231.4.

Foreign Based Information and Treaty Interaction
The Act clearly provides extensive powers to CRA to obtain relevant documentary material to legitimately assess a taxpayer's tax position in s. 231.6.

Definition of "foreign-based information or document" - S. 231.6
231.6 (1) For the purposes of this section, "foreign-based information or document" means any information or document that is available or located outside Canada and that may be relevant to the administration or enforcement of this Act, including the collection of any amount payable under this Act by any person.

Requirement to provide foreign-based information
(2) Notwithstanding any other provision of this Act, the Minister may, by notice served personally or by registered or certified mail, require that a person resident in Canada or a nonresident person carrying on business in Canada provide any foreign-based information or document.

Notice
(3) The notice referred to in subsection 231.6(2) shall set out

- **(*a*) a reasonable period of time of not less than 90 days for the production of the information or document;**
- **(*b*) a description of the information or document being sought; and**
- **(*c*) the consequences under subsection 231.6(8) to the person of the failure to provide the information or documents being sought within the period of time set out in the notice.**

Review of foreign information requirement
(4) The person on whom a notice of a requirement is served under subsection 231.6(2) may, within 90 days after the service of the notice, apply to a judge for a review of the requirement.

Powers on review

Digitized by Google

(5) On hearing an application under subsection 231.6(4) in respect of a requirement, a judge may

(*a*) confirm the requirement;

(*b*) vary the requirement as the judge considers appropriate in the circumstances; or

(*c*) set aside the requirement if the judge is satisfied that the requirement is unreasonable.

Idem

(6) For the purposes of paragraph 231.6(5)(*c*), the requirement to provide the information or document shall not be considered to be unreasonable because the information or document is under the control of or available to a non-resident person that is not controlled by the person served with the notice of the requirement under subsection 231.6(2) if that person is related to the non-resident person.

Time during consideration not to count

(7) The period of time between the day on which an application for review of a requirement is made pursuant to subsection 231.6(4) and the day on which the review is decided shall not be counted in the computation of

(*a*) the period of time set out in the notice of the requirement; and

(*b*) the period of time within which an assessment may be made pursuant to subsection 152(4).

Consequence of failure

(8) If a person fails to comply substantially with a notice served under subsection 231.6(2) and if the notice is not set aside by a judge pursuant to subsection 231.6(5), any court having jurisdiction in a civil proceeding relating to the administration or enforcement of this Act shall, on motion of the Minister, prohibit the introduction by that person of any foreign-based information or document covered by that notice.

Unlike the primary document-acquisition sections (231.1-231.2) **this section has a reasonableness test** that can allow a judge to set-aside, vary or all-together cancel the request depending on the circumstances.

The RFI can also only be phrased in respect documents that are held by a related party to the Canadian-resident taxpayer, or who must be carrying on business in Canada, regardless of whether they are controlled by the taxpayer or not. If the non-resident party is merely related, it is possible to obtain their records as well, and if any of their records are relevant, as to be determined by the Minister's representatives, they must lend themselves to examination.

This was the case in Saipem Luxembourg S.A. v. CRA[92] where the Minister made a request of a non- resident, the taxpayer's parent corporation, though who did do business in Canada through its subsidiary. The Minister made a request for ALL of the parent's financial records to determine the tax position of the party doing business in Canada while the taxpayer argued that the scope was too broad and was unreasonable. On appeal the Court held:

> [1] In the course of assessing Saipem Luxembourg S.A.'s (Saipem) liability for income tax, the Canada Customs and Revenue Agency (the Agency) served upon it a notice of requirement (the Requirement) pursuant to subsection 231.6(2) of the *Income Tax Act*, R.S.C. 1985, c. 1, (5th Supp.) as amended from time to time (the Act). The Requirement demands that Saipem produce for the Agency's inspection the whole of its corporate records for its fiscal years ending July 31, 1999 and 2000. **The issue in this appeal is whether the**

[92] 2005 FCA 218

Digitized by Google

Requirement is so broad as to be unreasonable and therefore liable to be set aside pursuant to subsection 231.6(5) of the Act.

FACTS AND PROCEDURAL HISTORY

[2] Saipem is incorporated under the laws of Luxembourg and maintains its head office in that country. It owns and operates very specialized vessels which are used for marine construction. In 1998 and 1999, Saipem contracted to employ one of its vessels, the S7000, the most powerful heavy lift vessel in the world, in the procurement, transportation and installation of the Venture, Thebaud, and Triumph jackets and topsides for the Sable Offshore Energy Project (the Sable Project). The 1998 work was done pursuant to a contract dated August 4, 1998, between Saipem and Saipem UK Limited, a related company, which had in turn contracted with the owners of the Sable Project, Mobil Oil Canada Properties. The work itself was done over a period of 53 days in September and October 1998. At the completion of the contract, the S7000 left Canadian waters to carry out contracts in other parts of the world.

[3] The contract for the work done in 1999 is dated December 14, 1998. The work itself was done in Canadian waters between August 15, 1999 and September 16, 1999. Given Saipem's July 31 fiscal year end, the 1998 work fell into the fiscal year ending July 31, 1999, and the work done in 1999 fell into the fiscal year ending July 31, 2000, hence the notice of requirement to produce documents for those two fiscal years.

[4] The Canada-Luxembourg Tax Convention provides that a resident of one contracting state is not liable to pay tax on business income earned in the other contracting state, unless the business in question is carried on through a permanent establishment in the other state. **Saipem filed income tax returns for each of the taxation years in which it had business income in Canada, but claimed that since it had no permanent establishment, it was not taxable on its Canadian business income. The Minister has not yet issued notices of assessment in respect of those taxation years, insisting that he is unable to do so until he can make an independent determination as to whether or not Saipem had a permanent establishment in Canada during the relevant period.**

[5] Saipem has offered to produce to the Agency all of the documents relevant to its Canadian operations. The Agency's position is that this makes Saipem the judge of the relevance of the documents it produces. It argues that it has no means of verifying information provided by Saipem other than by carrying out an audit of Saipem's books and records. In its Memorandum of Fact and Law, the Agency says:

> **29. ...the Minister seeks information in order to carry out a general audit of the Appellant's affairs for 1999 and 2000 with a view to determining its Canadian tax liability, if any.**

[6] Saipem also offered to have the Tax Court of Canada decide whether it had a permanent establishment in Canada. Section 173 of the Act authorizes the Tax Court of Canada to decide any question of fact, law or mixed fact and law as a preliminary proceeding. The Agency rejected Saipem's offer on the basis that it does not have the necessary facts to submit such a question to the Court.

[7] According to subsection 231.6(4) of the Act, the person who has been served with a notice of requirement may, within 90 days, apply to a judge of the Federal Court for a review of the requirement. Subsection 231.6(5) authorizes the judge to confirm, vary or, if the judge is satisfied that it is unreasonable, set aside the notice of requirement. Saipem brought such an application. In a decision reported at (2004) D.T.C. 6068, 2004 FC 113 (*Saipem Luxembourg S.A. v. Canada (Customs and Revenue)*), Mr. Justice Rouleau of the Federal

Digitized by Google

Court dismissed Saipem's application, relying on the decision of the Federal Court in *Merko v. Canada (Minister of National Revenue - M.N.R.) (T.D.)*, [1991] 1 F.C. 239 (*Merko*).

[8] Rouleau J. found that the test to be applied is not whether the information requested will be relevant in determining the applicant's liability to pay tax in Canada, but rather whether the information is relevant to the administration of the Act. He concluded that the Agency's duty to verify Saipem's tax liability necessarily required the production of its books and records:

[24] In the present case, the respondent seeks information in order to carry out a general audit of the applicant's affairs for the 1999 and 2000 fiscal years with a view to determining its Canadian tax liability. It is trite law that one of the purposes of an audit is to verify information. The fact that some information has been provided by the taxpayer or may be available from another source is irrelevant.

[25] It is the CCRA's duty to verify the applicant's tax liability which necessarily requires the production of the applicant's books and records. If, after being examined, they have no impact on Canadian tax liability and if some information gleaned from the audit proves to be irrelevant it shall be treated as such but, before such a determination can be made, the books and records must be made available.

[26] In conclusion one need only refer to the summary of *Merko v. Canada (Minister of National Revenue-M.N.R.), supra*:

> **"Parliament intended to give the Minister far-reaching powers under section 231.6 to obtain information available outside of Canada. The Minister need only show that it is relevant to the administration or enforcement of the Act. The taxpayer is protected from abusive use of the provision through the power of a judge to review the requirement. The respondent's requirement was not an abuse of the process nor was the request unreasonable."**

Accordingly, the learned applications judge dismissed the application.

[9] Saipem appeals from the decision of the Federal Court.

THE SCHEME OF THE ACT

[10] It is helpful to situate the notice of requirement in its statutory context. Subsection 230.(1) requires every person carrying on business in Canada to maintain books and records at its place of business:

230.(1) Every person carrying on business and every person who is required, by or pursuant to this Act, to pay or collect taxes or other amounts shall keep records and books of account (including an annual inventory kept in prescribed manner) at the person's place of business or residence in Canada or at such other place as may be designated by the Minister, in such form and containing such information as will enable the taxes	230.(1) Quiconque exploite une entreprise et quiconque est obligé, par ou selon la présente loi, de payer ou de percevoir des impôts ou autres montants doit tenir des registres et des livres de comptes (y compris un inventaire annuel, selon les modalités réglementaires) à son lieu d'affaires ou de résidence au Canada ou à tout autre lieu que le ministre peut désigner, dans la forme et renfermant les renseignements qui permettent d'établir le

Digitized by Google

payable under this Act or the taxes or other amounts that should have been deducted, withheld or collected to be determined.	montant des impôts payables en vertu de la présente loi, ou des impôts ou autres sommes qui auraient dû être déduites, retenues ou perçues.

[11] As a person carrying on business in Canada, Saipem was under an obligation to maintain, at its place of business in Canada, the books and records required to enable the Minister to determine its liability for tax. The Agency can take advantage of this obligation by attending at the taxpayer's premises and conducting an inspection of those books and records. Thus, the Agency is in a position to independently verify, at the taxpayer's place of business, the taxpayer's income and expenses, and thus his or her liability for income tax.

231.1(1) An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act, (*a*) inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act, and (*b*) examine property in an inventory of a taxpayer and any property or process of, or matter relating to, the taxpayer or any other person, an examination of which may assist the authorized person in determining the accuracy of the inventory of the taxpayer or in ascertaining the information that is or should be in the books or records of the taxpayer or	231.1(1) Une personne autorisée peut, à tout moment raisonnable, pour l'application et l'exécution de la présente loi, à la fois : *a*) inspecter, vérifier ou examiner les livres et registres d'un contribuable ainsi que tous documents du contribuable ou d'une autre personne qui se rapportent ou peuvent se rapporter soit aux renseignements qui figurent dans les livres ou registres du contribuable ou qui devraient y figurer, soit à tout montant payable par le contribuable en vertu de la présente loi; *b*) examiner les biens à porter à l'inventaire d'un contribuable, ainsi que tout bien ou tout procédé du contribuable ou d'une autre personne ou toute matière concernant l'un ou l'autre dont l'examen peut aider la personne autorisée à établir l'exactitude de l'inventaire du contribuable ou à contrôler soit les

Digitized by Google

any amount payable by the taxpayer under this Act, and for those purposes the authorized person may (*c*) subject to subsection 231.1(2), enter into any premises or place where any business is carried on, any property is kept, anything is done in connection with any business or any books or records are or should be kept, and (*d*) require the owner or manager of the property or business and any other person on the premises or place to give the authorized person all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act and, for that purpose, require the owner or manager to attend at the premises or place with the authorized person.	renseignements qui figurent dans les livres ou registres du contribuable ou qui devraient y figurer, soit tout montant payable par le contribuable en vertu de la présente loi; à ces fins, la personne autorisée peut : *c*) sous réserve du paragraphe (2), pénétrer dans un lieu où est exploitée une entreprise, est gardé un bien, est faite une chose en rapport avec une entreprise ou sont tenus ou devraient l'être des livres ou registres; *d*) requérir le propriétaire, ou la personne ayant la gestion, du bien ou de l'entreprise ainsi que toute autre personne présente sur les lieux de lui fournir toute l'aide raisonnable et de répondre à toutes les questions pertinentes à l'application et l'exécution de la présente loi et, à cette fin, requérir le propriétaire, ou la personne ayant la gestion, de l'accompagner sur les lieux.

[12] The Minister can also issue a notice of requirement pursuant to subsection 231.2(1):

231.2(1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act, including the collection of any amount payable under this Act by any person, by notice served personally or	231.2(1) Malgré les autres dispositions de la présente loi, le ministre peut, sous réserve du paragraphe (2) et, pour l'application et l'exécution de la présente loi, y compris la perception d'un montant payable par une personne en vertu de la présente loi, par avis signifié à personne ou

Digitized by Google

by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice, (*a*) any information or additional information, including a return of income or a supplementary return; or (*b*) any document. (2) The Minister shall not impose on any person (in this section referred to as a "third party") a requirement under subsection (1) to provide information or any document relating to one or more unnamed persons unless the Minister first obtains the authorization of a judge under subsection (3).	envoyé par courrier recommandé ou certifié, exiger d'une personne, dans le délai raisonnable que précise l'avis : *a*) qu'elle fournisse tout renseignement ou tout renseignement supplémentaire, y compris une déclaration de revenu ou une déclaration supplémentaire; *b*) qu'elle produise des documents. (2) Le ministre ne peut exiger de quiconque -- appelé "tiers" au présent article -- la fourniture de renseignements ou production de documents prévue au paragraphe (1) concernant une ou plusieurs personnes non désignées nommément, sans y être au préalable autorisé par un juge en vertu du paragraphe (3).

[13] If the Minister proposes to issue a Requirement with respect to unnamed persons, he or she must obtain the prior approval of a judge. See subsection 231.2(2).

[14] Where a non-resident taxpayer is carrying on business in Canada, the Minister may require it to produce documents or records which are located outside Canada:

231.6(1) For the purposes of this section, "foreign-based information or document" means any information or document that is available or located outside Canada and that may be relevant to the administration or enforcement of this Act, including the collection of any amount payable under this Act by any	**231.6(1) Pour l'application du présent article, un renseignement ou document étranger s'entend d'un renseignement accessible, ou d'un document situé, à l'étranger, qui peut être pris en compte pour l'application ou l'exécution de la présente loi, y compris la perception d'un montant**

Digitized by Google

person. **(2) Notwithstanding any other provision of this Act, the Minister may, by notice served personally or by registered or certified mail, require that a person resident in Canada or a non-resident person carrying on business in Canada provide any foreign-based information or document.**	**payable par une personne en vertu de la présente loi.** **(2) Malgré les autres dispositions de la présente loi, le ministre peut, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne résidant au Canada ou d'une personne n'y résidant pas mais y exploitant une entreprise de fournir des renseignements ou documents étrangers.**

[15] The person who is subject to the obligation to produce foreign-based information or document may challenge the notice of requirement's reasonableness before the Federal Court:

231.6(4) The person on whom a notice of a requirement is served under subsection 231.6(2) may, within 90 days after the service of the notice, apply to a judge for a review of the requirement. (5) On hearing an application under subsection 231.6(4) in respect of a requirement, a judge may (*a*) confirm the requirement; (*b*) vary the requirement as the judge considers appropriate in the circumstances; or (*c*) set aside the requirement if the judge is satisfied that the requirement is unreasonable.	231.6(4) La personne à qui l'avis est signifié ou envoyé peut, dans les 90 jours suivant la date de signification ou d'envoi, contester, par requête à un juge, la mise en demeure du ministre. (5) À l'audition de la requête, le juge peut : *a*) confirmer la mise en demeure; *b*) modifier la mise en demeure de la façon qu'il estime indiquée dans les circonstances; *c*) déclarer sans effet la mise en demeure s'il est convaincu que celle-ci est déraisonnable.

[16] If the person in question does not produce the foreign-based information or document when required to do so, then no

Digitized by Google

use may be made of that information by the person in any subsequent proceedings:

231.6(8) If a person fails to comply substantially with a notice served under subsection(2) and if the notice is not set aside by a judge pursuant to subsection (5), any court having jurisdiction in a civil proceeding relating to the administration or enforcement of this Act shall, on motion of the Minister, prohibit the introduction by that person of any foreign-based information or document covered by that notice.	231.6(8) Si une personne ne fournit pas la totalité, ou presque, des renseignements ou documents étrangers visés par la mise en demeure signifiée conformément au paragraphe (2) et si la mise en demeure n'est pas déclarée sans effet par un juge en application du paragraphe (5), tout tribunal saisi d'une affaire civile portant sur l'application ou l'exécution de la présente loi doit, sur requête du ministre, refuser le dépôt en preuve par cette personne de tout renseignement ou document étranger visé par la mise en demeure.

[17] By way of contrast, if a person fails to comply with a Requirement issued pursuant to section 231.2, the Minister may apply to a judge for a compliance order pursuant to section 231.7 which, in the event of non-compliance, may give rise to contempt proceedings.

ISSUE

[18] The issue to be decided is whether the Minister's notice of requirement which requires Saipem to produce all of its corporate books and records for the 1999 and 2000 fiscal years is unreasonable.

ANALYSIS

[19] After dealing with the issue of standard of review, I propose to begin by examining the limited jurisprudence on section 231.6 to see if it provides any guidance as to what constitutes an unreasonable notice of requirement. As we shall see, it provides very little assistance. In the absence of such guidance, I propose to apply the test of reasonableness found in the recent Supreme Court decision, *Law Society of New Brunswick v. Ryan*, [2003] 1 S.C.R. 247, 2003 SCC 20 (*Law Society of New Brunswick*), in assessing whether the notice of requirement in this case is reasonable.

[20] What is the standard of review? This Court is sitting in appeal of a decision of an applications judge whose task it was to determine whether the notice of requirement issued to Saipem is reasonable. The role of this Court is as described by the Supreme Court of Canada in *Dr. Q. v. College of Physicians and Surgeons of British Columbia*, [2003] 1 S.C.R. 226, 2003 SCC 19:

[43] ...The role of the Court of Appeal was to determine whether the reviewing judge had chosen and applied the correct standard of review, and in the event she had not, to assess the administrative body's decision in light of the correct standard of review,

Digitized by Google

reasonableness. At this stage in the analysis, the Court of Appeal is dealing with appellate review of a subordinate court, not judicial review of an administrative decision. As such, the normal rules of appellate review of lower courts as articulated in *Housen, supra*, apply. The question of the right standard to select and apply is one of law and, therefore, must be answered correctly by a reviewing judge.

[21] In this case, the standard of review to be applied by the reviewing judge is defined by the statute: reasonableness. It is only if the reviewing judge has made a palpable and overriding error in the application of that standard, that this Court is entitled to intervene.

[22] Before turning to the applications judge's reasons, a brief review of the jurisprudence is in order. The jurisprudence dealing with subsection 231.6(5) is not extensive, but nonetheless provides some examples of notices of requirement which the Courts have found to be reasonable. On the other hand, it provides little guidance as to the basis on which a court might find a notice of requirement unreasonable. The first case to consider the issue was *Merko* where the notice of requirement was served on the taxpayer after his notice of objection had been filed. The documents which it required Merko to produce related to certain investments in respect of which he had claimed large losses. **The major issue in the case was whether the serving of a notice of requirement after a notice of objection had been filed was an abuse of process. Cullen J. held that there was no temporal limitation on when a notice of requirement could be served and dismissed the abuse of process claim. The learned judge then turned to the question of reasonableness:**

> **[24] Is the demand reasonable? Parliament, through the wording of the Act, leaves no room for doubt that the demand for the foreign-based information or document is *prima facie* reasonable given the far-flung nature of the business of the limited partnership and the large loss claimed by this applicant. The applicant must clearly make an attempt to secure the foreign-based information or document unless it is his contention that the request/demand is unreasonable in which case a procedure is in place to make his case, and hence the application to this Court. I cannot find the request unreasonable. *There is no requirement that any information or document be provided but there is the sanction of subsection 231.6(8) i.e., the taxpayer, if he withholds any such required information or document, cannot use it at a subsequent civil proceeding.* The requirement puts the taxpayer on notice about the kind of information being sought, not only from him but others. He can choose to seek out all the data possible, and tender it to National Revenue or he can indicate that some or all of the information sought cannot be produced, or will not be produced. If he takes the latter position, there is the sanction of subsection 231.6(8) mentioned earlier.**
>
> [25] Accordingly, there being no abuse of the process provided in the Income Tax Act, and in the circumstances here the requirement is reasonable, I will confirm the said requirement. The respondent is entitled to its costs of this motion in any event of the cause.
>
> [*Merko* at p. 249-250]

[Emphasis added.]

[23] The learned judge said two things about the reasonableness of the notice of requirement. He began by commenting that the language of the legislation left no doubt that the requirement was *prima facie* reasonable given the far-flung nature of the limited partnership and the large losses claimed by the taxpayer. If the judge was saying that it was not unreasonable for the Minister to request further information, given the large losses

Digitized by Google

claimed, there is little with which to quarrel. Presumably, the learned judge was not saying that the language of the legislation made every notice of requirement *prima facie* reasonable.

[24] The learned judge also concluded that the notice of requirement was reasonable because it did not compel the taxpayer to produce any information. It simply stipulated the consequences of non-production of the information. With respect, this is an erroneous reading of the legislation. Subsection 231.6(2) clearly empowers the Minister to demand production of foreign-based documents. Furthermore, the recipient of a notice of requirement is not free to choose which of the documents demanded he will produce, as suggested in the learned judge's reasons. Subsection 231.6(8) is explicit that if the notice of requirement is not "substantially complied with", the court may make an order which "prohibit[s] the introduction by that person of *any foreign-based information or document covered by that notice*" [emphasis added]. Consequently, even if the taxpayer partially complies with the Requirement, the court can order than none of the material covered by the notice can be tendered, not even those documents which have been produced. Thus, the broader the demand, the more drastic the consequences of non-compliance.

[25] There have been few other cases which have considered the question of reasonableness in the context of subsection 231.6(5) of the Act. In *Bernick v. Her Majesty The Queen*, 2002 D.T.C. 7167 (Ont. S.C.J.) (*Bernick*), the taxpayer challenged a notice of requirement which called upon him to disclose the names and partnership interests of other members of an offshore partnership of which he was a member. Bernick refused to provide the information on the ground that the Minister should have proceeded under subsection 231.2(3) which requires the Minister to obtain court authorization before issuing a notice of requirement relating to "one or more unnamed persons". Swinton J. decided that subsection 231.2(3) did not apply as the Minister was not investigating the unnamed persons; he was investigating Bernick. Citing *Merko,* the learned judge went on to find that the notice of requirement was reasonable as the Minister was seeking information about the operation of the partnership from those involved in it in an effort to determine whether Bernick was entitled to claim partnership losses. I take this to mean that the learned judge was satisfied that there was a rational connection between the information sought and the issue in respect of which the information was sought.

[26] *Merko* and *Bernick* appear to apply a body of jurisprudence dealing with a notice of requirement issued pursuant to section 231.2 (or its predecessor) which holds that a notice of requirement which seeks to obtain information relevant to the tax liability of some specific person or persons whose liability to tax is under investigation is a purpose related to the administration or enforcement of the Act. See *Canadian Bank of Commerce v. Canada (Attorney General)*, [1962] S.C.R. 729 (*Canadian Bank of Commerce*), per Cartwright J. This is so even if much of the information requested turns out to be irrelevant. *Canadian Bank of Commerce* per Kerwin C.J. Since foreign-based document is defined as information or a document which is maintained outside Canada and "that may be relevant to the administration or enforcement of this Act", this test is, to that extent, relevant to a notice of requirement issued pursuant to subsection 231.6(2).

[27] The element which is present in section 231.6, and which is lacking in section 231.2, is the availability of judicial review of the notice of requirement on the ground of unreasonableness. Such a review lacks any substance if a notice of requirement is reasonable simply because the information requested is, or may be, relevant to the administration and enforcement of the Act. Given that Parliament took

Digitized by Google

the trouble to provide for a review on the basis of reasonableness, I conclude that Parliament intended that a notice of requirement in respect of a foreign-based document must not only relate to a document which is relevant to the administration and enforcement of the Act but that it must also not be unreasonable.

[28] When one turns to the decision of the Federal Court in this case, one notes that the issue of reasonableness is not addressed. The judge takes care to point out that the verification of the taxpayer's information is a purpose relevant to the administration and enforcement of the Act:

> [23] Thus, the test to be applied is not whether the information requested will be relevant in determining the applicant's Canadian tax liability, but rather whether the information is relevant to the administration of the Act.

[29] This is the test which is applied in the cases dealing with a notice of requirement delivered under section 231.2 of the Act which contains no provision for review of the notice of requirement on the basis of reasonableness. The judge goes on to cite the Federal Court Reports head note from *Merko*:

...The taxpayer is protected from abusive use of the provision through the power of a judge to review the requirement. The respondent's requirement was not an abuse of the process nor was the request unreasonable.

[30] The learned judge never does say why he found the notice of requirement in this case reasonable. To the extent that he adopted the reasoning in *Merko*, the difficulty is that there is no issue of abuse of process in this case, as there was in *Merko*. If he meant to say that a notice of requirement is reasonable if it is not otherwise an abuse of process, I must say, with respect, that he conflated the two issues in *Merko* into a single issue and, to that extent, he failed to appreciate the test to be applied under subsection 231.6(5), and consequently, he did not apply it. This is a palpable and overriding error, as a result of which this Court is called upon to apply the proper test.

[31] What does "reasonable" (and by extension, "unreasonable") mean in these circumstances? In *Law Society of New Brunswick*, the Supreme Court said at paragraph 47:

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

Given that the reviewing Court under subsection 231.6(5) is reviewing a decision (the content of the notice of requirement) on a standard of reasonableness, I find that this is an appropriate statement of the test to be applied. To apply that standard to this case, one needs some understanding of the extent of the demand and the reasons for which it is made.

[32] In *Merko* and *Bernick*, the notices of requirement called for the production of records relating to a specific transaction in respect of which the taxpayer was claiming a tax benefit. The link between the documents whose production was sought and the individual's tax liability is obvious and reasonable. In this case, the notice of requirement requires Saipem to produce the whole of its corporate documentation for two fiscal years. **The link between the documents to be produced and Saipem's liability for tax is more remote.**

[33] **The Agency justifies the breadth of the notice of requirement on the basis that it requires production of all of Saipem's documents in order to conduct an audit for the purpose of verifying information submitted by Saipem. This position is well summarized at paragraph 29 of the Agency's Memorandum of Fact and Law:**

In the present case the Minister seeks information in order to carry out a general audit of the Appellant's affairs for 1999 and 2000 with a view to determining its Canadian tax

Digitized by Google

liability, if any. As stated in *McKinlay*, one of the purposes of an audit is to verify information. The fact that information has been provided by the taxpayer or is possibly available from another source is irrelevant. It is the CCRA's interest in verifying the Appellant's tax liability that compels the production of the Appellant's books and records. All of the Appellant's books and records are relevant to an audit even if some of them only serve to verify, after being examined, that they have no impact on its Canadian tax liability.

[34] The issue before the reviewing Court is not the reasonableness of the Agency's intention to conduct an audit, but the reasonableness of the notice of requirement in light of the Agency's determination that an audit is required. Saipem's argument that the Agency could have obtained the documents it seeks by issuing a notice of requirement with respect to specific classes of documents seeks to question the reasonableness of conducting an audit. In the absence of some evidence of bad faith or other improper motive, the appropriateness of an audit is outside the mandate of the Court under subsection 231.6(5).

[35] The question therefore is whether the Agency's intention to conduct an audit of Saipem supports the need for a notice of requirement in respect of the whole of Saipem's corporate records. A "somewhat probing examination" leads to an inquiry as to whether one can truly conduct an audit solely on the basis of material provided by the person being audited, without the possibility of verification that no further records exist. In practice, the issue seldom arises as I have no doubt that most businesses confronted with a notice of requirement of the sort in issue here, accept the Agency's offer to treat their consent to an on-site audit as sufficient compliance with the notice of requirement. But the reasonableness of the notice of requirement is to be assessed according to its terms, not according to some alternate method of compliance.

[36] It is the Agency's prerogative as to whether it will conduct an audit, and what form that audit will take. Given that the records in question are, by definition, maintained outside Canada, the Agency can do little more to gain access to the records than issue the notice of requirement which it issued here. If the result is an audit which does not meet the Agency's usual standards, it is nonetheless the best audit the Agency can conduct in the circumstances. As a result, I conclude that the Agency's determination to conduct an audit supports the scope of the notice of requirement served upon Saipem by the Minister.

[37] For those reasons, applying the test which the applications judge should have applied, I find that the notice of requirement issued to Saipem is not unreasonable, and therefore, I would dismiss the appeal with costs and, pursuant to paragraph 231.6(5)(*a*) of the Act, confirm the notice of requirement.

"J.D. Denis Pelletier"
J.A.

"I concur
Alice Desjardins J.A."

"I agree
M. Nadon J.A."

In Fidelity Investments Canada Limited And CRA[93] at issue was whether the reasonableness

[93] 2006 FC 551

Digitized by Google

test was upset with the possibility that CRA would not be able to **guarantee** that the information requested of foreign-resident parents would not be made public. At issue was whether fees charged by a parent to its sub. were reasonable. The court held:

I. Introduction

[1] Fidelity Investments Canada Limited (the "Applicant") brings two applications for judicial review, pursuant to the *Federal Courts Act*, R.S.C. 1985, c. F-7, as amended, relative to two Notices of Requirement ("Notice" or "Notices"), issued by the Canada Revenue Agency (the "CRA" or the "Respondent"), under section 231.6 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), as amended (the "Act"). The relief sought by the Applicant is an order varying or setting aside the Notices.

II. Facts

[2] The Applicant is a body corporate, incorporated in 1987 under the laws of Canada and continued, under the laws of Ontario, in 1989. It was amalgamated under the laws of Ontario in 1994. It has filed the affidavit of Mr. Kevin Ross Barber, Vice-President, Finance, with the Applicant, as evidence in these proceedings. By a Notice dated July 12, 2004, the Applicant was required to provide information and production of the financial statements of Fidelity Investments Money Management, Inc. ("FIMMI") for the taxation years ended 1999, 2000, 2001 and 2002. If the financial statements are not prepared, then the Respondent seeks production of schedules or summaries that reflect year-end, income, expense, assets and liabilities. The Applicant's challenge to that Notice is the subject of proceeding T-1807-04.

[3] By another Notice dated July 12, 2004 and issued by the CRA, the Applicant was required to provide information and financial statements of Fidelity Management and Research Co. ("FMR Co.") for the taxation year 1998. That Notice is the subject of proceeding T-1808-04.

[4] According to the evidence, the Applicant is the subject of an audit by the CRA for the taxation years 1998 to 2002, inclusive. The audit began in February 2002. Prior to receipt of the Notices, the Applicant received a letter, dated March 22, 2004, from the CRA, requesting it to provide certain information and documents. It has complied with the request with the exception of providing the financial statements of FIMMI and FMR Co. to the Respondent.

[5] The Applicant is a wholly-owned subsidiary of FMR Corp. FMR Corp. is an American corporation, based in Boston, Massachusetts. It is the parent of a group of companies, collectively known as the "FMR Group" that also includes FIMMI. The FMR Group manages mutual funds and provides other services, including brokerage, life insurance, retirement, human resources and benefits outsourcing services. It provides investment management services to retail and institutional investors in Canada through the Applicant. FMR Corp., and each of its subsidiaries, including FIMMI, are private corporations and their shares are not traded on any public stock exchange.

[6] FIMMI, a wholly-owned subsidiary of FMR Corp., is a registered investment advisor in the United States of America. It provides related investment services relative to certain portfolios of funds distributed by the Applicant. It is a private corporation and its shares are not traded on any public stock exchange.

[7] Mr. Barber deposed that the Applicant has subcontracted some of its responsibilities to FIMMI and FIMMI has contracts with FMR Co. to manage the portfolios of certain funds. He further deposed that he had been informed by Mr. Gregory Wass, Vice-President, Taxation, FMR Corp., that FIMMI provides various services for other members of the FMR Group but not to non-members of the FMR Group.

[8] Further, Mr. Barber deposed that the Applicant paid FIMMI and FMR Co. for the advisory services provided by them. The reasonableness of those fees is under review by

Digitized by Google

the CRA. In that regard, FMR Corp. hired the accounting firm of Ernst & Young who "benchmarked" the fees using investment advisory fee dates provided by an independent third party for the Applicant's 1998 taxation year. A copy of that report was provided to the CRA. An earlier report had been prepared in 1996 by Coopers and Lybrand; that document was also provided to the Respondent.

[9] The Applicant received further correspondence from Ms. Donna O'Connor, Auditor, International Audit Section, CRA, dated June 8, 2004. In that letter, attached as an exhibit to the affidavit of Mr. Barber, Ms. O'Connor attempted to respond to the concerns expressed by the Applicant in connection with the provision of the information and documents requested in the March 8, 2004 letter. She reviewed certain provisions of the Act that authorize the CRA to request information and documents. She advised that the CRA was unable to give a guarantee that the information obtained will not be used in any other audit or for any other purpose than the audit of the Applicant.

[10] Further, Ms. O'Connor rejected the suggestion that the CRA attend to review the financial statements in Boston without copies being made. Finally, she referred to a "Transfer Pricing Memorandum", TPM-04, a document generated by the CRA, and advised that the CRA would use the requested information as a "secret comparable" in another file only as a last resort, as a basis of assessment, if it was unable to use publicly available documents.

[11] The Applicant's concerns about the use of the requested information and documents, respecting both FIMMI and FMR Co., were again addressed in correspondence dated June 25, 2004, from its solicitors to Ms. Maria Praulins, Director of CRA. The Applicant offered to provide the financial information contained in the FIMMI and FMR Co. financial statements in a specific manner. First, the Applicant proposed that the CRA review FIMMI and FMR Co.'s financial information that specifically dealt with transactions with the Applicant. If this information was inadequate, the Applicant was prepared to discuss what further information would be required. Alternatively the Applicant proposed that the CRA agree to enter into a confidentiality agreement concerning its review of FIMMI and FMR Co. financial statements. The Applicant says that the information requested bears no relationship to the reasonableness of the fees that it paid to FIMMI and FMR Co.

[12] The CRA responded to these proposals by letter dated June 30, 2004. It refused to grant an undertaking that the information requested from FIMMI and FMR Co. would be protected from being used for purposes other than the audit of the Applicant or that the information would not be made public as the result of being used in the audit of another Canadian taxpayer. The CRA took the position that such an approach, that is an undertaking to protect confidential material, is governed by section 241 of the Act and the relevant treaty.

[13] Mr. Barber deposed in his affidavit that he had been advised by Mr. Gregory Wass that the financial information of FIMMI and FMR Co. that is the subject of the Notices is "an extremely confidential trade or business secret" and that public release of this information could be prejudicial to the competitive position of FMR Group in the marketplace. Finally, Mr. Barber deposed that he had been informed by Mr. Wass that FIMMI and FMR Co. will provide the information requested to the Applicant if appropriate protection is provided by the CRA upon the loss of confidentiality and the use of that information for other purposes. The Applicant is not in a position to compel FIMMI and FMR Co. to disclose the requested information.

[14] For its part, the CRA filed the affidavit of Ms. Donna O'Connor. In her affidavit, Ms. O'Connor reviewed the history of the audit, the delivery of correspondence and documents pursuant to the Notices, and the rationale for the issuance of the Notices. The CRA takes the position that the information contained in the financial statements of FMR Co. and FIMMI is necessary in order to complete its audit. She deposed that the CRA is not

Digitized by Google

satisfied that the transfer-pricing studies prepared relative to the fees paid by the Applicant to FMR Co. and FIMMI are reliable. She also questioned whether these reports relied on adequate methodology.

[15] In cross-examination upon her affidavit, Ms. O'Connor said that the CRA was looking for the financial statements in order to advance its work relative to review of the transfer-pricing, that is the fees paid by the Applicant to FIMMI and FMR Co. She said that the 1996 study prepared by Coopers and Lybrand was neither relevant nor helpful since it had been prepared for the American tax authorities. Similarly, she said that the 1999 study, prepared by Ernst and Young was not acceptable because the CRA could not determine the relationship between the parties for the purpose of establishing the best comparables. That issue, that is the best comparables, is important to the Respondent for the purposes of assessing the reasonableness of the fees in issue.

[16] As well, according to Ms. O'Connor, the two studies that were provided by the Applicant do not contain sufficient quality information to support a proper application of the CUP method, that is "comparable uncontrolled price". She said that the CRA does not believe that the CUP method submitted by the Applicant is reliable for the purpose of assessing the transfer pricing. Further, she said that it is part of a regular audit to "review the financial position of related party services to establish if their financial results are consistent with that other party charged for such services regardless of the transfer pricing methodology used".

[17] Ms. O'Connor expressed doubt about the reliance of both Coopers and Lybrand and Ernst and Young upon Lipper data in carrying out their respective studies of transfer-pricing relative to the fees paid by the Applicant to FIMMI and FMR Co.

III. Submissions

[18] The Applicant argues that according to the Act, the Notices are to be reviewed by this Court upon the standard of reasonableness. It submits that the Notices are unreasonable on several grounds. First, it says that the Notices are too broad and relate to companies that are separate companies. Then, it submits that the CRA has not shown why it needs this information or that it is relevant for the purpose of administering the Act.

[19] The Applicant argues that these Notices are in conflict with the provisions of the *Convention Between Canada and the United States of America With Respect to Taxes on Income and Capital*, 31 August 1984, Can. T.S. 1984 No. 15, as amended (the "Treaty"). Finally, it submits that the lack of any guarantee of protection of confidential information leads to the inference that the Notices are unreasonable.

[20] For its part, the Respondent takes the position that it can request information for ensuring that taxpayers comply with the principles of self-reporting and self-assessing income, as authorized by the Act. It argues that the Applicant has failed to provide acceptable evidence that the information sought is confidential information. It submits that the applicable standard of review in this case is unreasonableness and says that, in any event, the Notices are not unreasonable, having regard to the statutory authority for production of information or documents that are relevant to the administration or enforcement of the Act.

[21] The Respondent argues that section 231.6 is not inconsistent with the requirements of the Treaty. It notes that pursuant to subsection 3(c) of Article XXVII of the Treaty, there is no obligation to provide information that would disclose trade secrets, the disclosure of which is not contrary to public policy. It submits that subsection 3(c) of that Article limits, but does not prohibit, a contracting state's obligation to comply with section 1 of that Article. Article XXVII provides that contracting states shall exchange information concerning taxes. The Respondent argues that the Applicant has failed to show that the

Digitized by Google

information contained in the financial statements comes within the terms of subsection 3(c) and if it does, that its disclosure would be contrary to public policy.

[22] Second, the Respondent submits that the affidavits of Mr. Barber constitute inadmissible hearsay evidence because they are based on information and belief, not personal knowledge. It argues that the affidavits should be stricken out.

[23] Finally, the Respondent alleges that the Applicant has improperly named the CRA as the respondent to this proceeding. It says that the Minister of National Revenue (the "Minister") is the appropriate respondent since the Minister, not the CRA, is authorized to issue notices pursuant to section 231.6 of the Act.

IV. Discussion and Disposition

[24] This proceeding arises under section 231.6 of the Act which provides as follows:

231.6. (1) For the purposes of this section, "foreign-based information or document" means any information or document that is available or located outside Canada and that may be relevant to the administration or enforcement of this Act, including the collection of any amount payable under this Act by any person.	231.6. (1) Pour l'application du présent article, un renseignement ou document étranger s'entend d'un renseignement accessible, ou d'un document situé, à l'étranger, qui peut être pris en compte pour l'application ou l'exécution de la présente loi, y compris la perception d'un montant payable par une personne en vertu de la présente loi.
(2) Notwithstanding any other provision of this Act, the Minister may, by notice served personally or by registered or certified mail, require that a person resident in Canada or a non-resident person carrying on business in Canada provide any foreign-based information or document.	(2) Malgré les autres dispositions de la présente loi, le ministre peut, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne résidant au Canada ou d'une personne n'y résidant pas mais y exploitant une entreprise de fournir des renseignements ou documents étrangers.
(3) The notice referred to in subsection 231.6(2) shall set out	(3) L'avis doit:
(a) a reasonable period of time of not less than 90 days for the production of the information or document;	a) indiquer le délai raisonnable, d'au moins 90 jours, dans lequel les renseignements ou documents étrangers doivent être fournis;
(b) a description of the information or document being sought; and	b) décrire les renseignements ou documents étrangers recherchés;
(c) the consequences under subsection 231.6(8) to the person of the failure to provide the information or	c) préciser les conséquences prévues au paragraphe (8) du

Digitized by Google

documents being sought within the period of time set out in the notice.

(4) The person on whom a notice of a requirement is served under subsection 231.6(2) may, within 90 days after the service of the notice, apply to a judge for a review of the requirement.

(5) On hearing an application under subsection 231.6(4) in respect of a requirement, a judge may

(a) confirm the requirement;

(b) vary the requirement as the judge considers appropriate in the circumstances; or

(c) set aside the requirement if the judge is satisfied that the requirement is unreasonable.

(6) For the purposes of paragraph 231.6(5)(c), the requirement to provide the information or document shall not be considered to be unreasonable because the information or document is under the control of or available to a non-resident person that is not controlled by the person served with the notice of the requirement under subsection 231.6(2) if that person is related to the non-resident person.

(7) The period of time between the day on which an application for review of a requirement is made pursuant to subsection 231.6(4) and the day on which the review is decided shall not be counted in the computation of

(a) the period of time set out in the notice of the requirement; and

(b) the period of time within which an assessment may be

défaut de fournir les renseignements ou documents étrangers recherchés dans le délai ci-dessus.

(4) La personne à qui l'avis est signifié ou envoyé peut, dans les 90 jours suivant la date de signification ou d'envoi, contester, par requête à un juge, la mise en demeure du ministre.

(5) À l'audition de la requête, le juge peut:

a) confirmer la mise en demeure;

b) modifier la mise en demeure de la façon qu'il estime indiquée dans les circonstances;

c) déclarer sans effet la mise en demeure s'il est convaincu que celle-ci est déraisonnable.

(6) Pour l'application de l'alinéa (5)c), le fait que des renseignements ou documents étrangers soient accessibles ou situés chez une personne non-résidente qui n'est pas contrôlée par la personne à qui l'avis est signifié ou envoyé, ou soient sous la garde de cette personne non-résidente, ne rend pas déraisonnable la mise en demeure de fournir ces renseignements ou documents, si ces deux personnes sont liées.

(7) Le délai qui court entre le jour où une requête est présentée conformément au paragraphe (4) et le jour où il est décidé de la requête ne compte pas dans le calcul:

a) du délai indiqué dans l'avis correspondant à la mise en demeure qui a donné lieu à la requête;

Digitized by Google

made pursuant to subsection 152(4).	b) du délai dans lequel une cotisation peut être établie conformément au paragraphe 152(4).
(8) If a person fails to comply substantially with a notice served under subsection 231.6(2) and if the notice is not set aside by a judge pursuant to subsection 231.6(5), any court having jurisdiction in a civil proceeding relating to the administration or enforcement of this Act shall, on motion of the Minister, prohibit the introduction by that person of any foreign-based information or document covered by that notice.	(8) Si une personne ne fournit pas la totalité, ou presque, des renseignements ou documents étrangers visés par la mise en demeure signifiée conformément au paragraphe (2) et si la mise en demeure n'est pas déclarée sans effet par un juge en application du paragraphe (5), tout tribunal saisi d'une affaire civile portant sur l'application ou l'exécution de la présente loi doit, sur requête du ministre, refuser le dépôt en preuve par cette personne de tout renseignement ou document étranger visé par la mise en demeure.

[25] I will first address the applicable standard of review. Contrary to the submissions of the Respondent, the standard of review here is the standard of reasonableness. That standard of review is identified in the Act, in paragraph 231.6(5)(c). In light of the language of this statutory provision**, it is not necessary to engage in a pragmatic and functional analysis to determine the appropriate standard of review.** In *Saipem LuxembourgS.V. v. Canada(Customs and Revenue Agency)*, [2005] 3 C.T.C. 294 (F.C.A.),leave to appeal to S.C.C. refused, [2005] S.C.C.A. No. 368 (Q.L.) at paragraph 21, the Federal Court of Appeal confirmed this standard of review.

[26] The standard of reasonableness was discussed in *Canada(Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 where the Supreme Court of Canada said the following at paragraph 56:

> **56. ... An unreasonable decision is one that, in the main, is not supported by any reasons that can stand up to a somewhat probing examination. Accordingly, a court reviewing a conclusion on the reasonableness standard must look to see whether any reasons support it. The defect, if there is one, could presumably be in the evidentiary foundation itself or in the logical process by which conclusions are sought to be drawn from it. An example of the former kind of defect would be an assumption that had no basis in the evidence, or that was contrary to the overwhelming weight of the evidence. An example of the latter kind of defect would be a contradiction in the premises or an invalid inference.**

[27] The question, then, is whether it was reasonable for the CRA to seek production, pursuant to section 231.6, of the financial statements of FMR Co. and FIMMI, having regard to the purposes of the Act and the known facts. I need address only the issue of production

Digitized by Google

of the financial statements of FMR Co. and FIMMI since the evidence of Mr. Barber, to the effect that the Applicant has provided all documents and information requested with the exception of the financial statements, is corroborated by Ms. O'Connor in the transcript of her cross-examination upon her affidavit.

[28] The purpose of the Act, broadly stated, is to allow the federal government to collect funds that will be spent by the Government of Canada. The Canadian income tax system is based upon self-reporting of income. The purpose of the Act and its reliance upon self-assessment of income is discussed in *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627 at pp. 636 and 637.

[29] In *McKinlay*, the Supreme Court also discussed the availability to the Minister of broad investigatory powers, including the authority to require the production of information and documents; see *AGT Ltd v. Canada (Attorney General)*, [1997] 2 F.C. 878. Section 231.6 is one of those far-ranging provisions that authorizes the Minister to seek the production of information and documents. Section 231.6 is directed to the production of foreign-based information or documents, as defined in subsection 231.6(1).

[30] Section 231.6 speaks to the general criterion that the information and documents requested "may be relevant to the administration or enforcement" of the Act. In *AGT*, the Federal Court of Appeal commented upon this requirement of relevance as follows:

> **27. Subsection 231.2(1) is drafted in broad language, but its scope has been reduced through the rules of interpretation to situations where the information sought by the Minister is relevant to the tax liability of some specific person or persons, and when the tax liability of such person or persons is the subject of a genuine and serious inquiry. ... [Notes omitted]**

[31] In the present case, the Respondent argues that the financial statements are relevant for the purposes of conducting an audit of the Applicant. That audit must relate to the tax liability of the Applicant. There is no question that such liability relates to the enforcement and administration of the Act. There is no challenge made to the initiation of the audit.

[32] Specifically, the Respondent says that the financial statements of FMR Co. and FIMMI, two American corporations that are related to the Applicant, are necessary because it is unable to assess the reasonableness of fees paid by the Applicant to FIMMI and to FMR Co. In light of subsection 231.6(6), the fact that the Applicant is related to FMR Co. and FIMMI does not make the requirement to produce information and documents unreasonable. In my opinion, however, the relationship alone does not make the requirements "reasonable". The factor of relevance must also be satisfied. In my view, there must be evidence that the documents requested are relevant for the purposes of the Act.

[33] The Applicant challenges the Respondent's dismissal of the two transfer pricing studies that it provided, on the grounds that the Respondent's employees were unfamiliar with the Lipper methods and did not adequately investigate the bases upon which Coopers and Lybrand and Ernst and Young, respectively, reached their conclusions. The Applicant argues that the Respondent did not understand the two studies.

[34] As noted above, the decision of the Respondent to issue the Notices is reviewable on the standard of reasonableness. The concept of reasonableness includes relevance, relative to the Act. Although the Applicant argues that the information sought is not relevant and that its principal concern here is with the protection of confidential material, I am not persuaded that the material in question is not relevant. I draw this conclusion from the Applicant's offer to disclose the information to the CRA, albeit in a protected environment where no copies would be made and subject to the provision of an undertaking to maintain

Digitized by Google

confidentiality.

[35] In view of the evidence submitted by the Respondent, I am satisfied that the information sought to be produced, that is the financial statements of FIMMI and FMR Co., is relevant to the conduct of an audit of the Applicant. The conduct of an audit pursuant to the Act is relevant for the administration and enforcement of the Act.

[36] It is not necessary for me to address, in detail, the Applicant's submissions concerning the Treaty. In my opinion, the existence of the Treaty does not overrule or limit the Minister's right to pursue the requested information by means of notices issued pursuant to section 231.6 of the Act. That is the course of action chosen in this case.

[37] I am satisfied that the financial statements in question are essentially confidential materials. In this regard, I refer to *Montana Band of Indians v. Canada* (1988), 51 D.L.R. (4th) 306 (F.C.T.D.) at 315. I am also satisfied that the evidence submitted by the Applicant is sufficient to support the claim to confidential status of the financial statements of privately held corporations, that is FIMMI and FMR Co., notwithstanding the fact that the affidavit of Mr. Barber is based on information and belief and that he has no personal knowledge of the contents of those documents. Mr. Barber's evidence is the "best evidence" available.

[38] I agree with the Applicant's submissions concerning the admissibility of hearsay evidence on a principled basis, as discussed in *R. v . Khan*, [1990] 2 S.C.R. 531 and *R. v. Smith*, [1992] 2 S.C.R. 915. As well, in *P.S. Partsource Inc. v. Canadian Tire Corp.* (2001), 11 C.P.R. (4th) 386 (F.C.A.), the Federal Court of Appeal discussed the applicability of the common law principles concerning the admissibility of hearsay evidence.

[39] The production of an affidavit from Mr. Wass would have potentially exposed that individual to cross-examination or, alternatively, to the risk of having the affidavit stricken out if he failed to submit to cross-examination. The cross-examination of Mr. Wass may well have destroyed any claim for non-disclosure of the financial statements on the grounds of confidentiality. Any order striking out his affidavit may have impacted upon the evidentiary basis of the Applicant's application for judicial review.

[40] The Respondent relies on section 241 of the Act in response to the Applicant's concerns with the protection of confidential information. The correspondence exchanged between employees of the CRA and the Applicant clearly shows that the Respondent is not prepared to accord to the Applicant any guarantee of confidentiality, other than is provided by section 241 of the Act. Generally, that section provides that taxpayer information shall not be "knowingly" disclosed to any person, except as authorized by this section.

[41] The status of the information sought here as "taxpayer information", relative to the Applicant, was not addressed in this proceeding. However, Ms. O'Connor, as the representative of the Respondent, said in her cross-examination that the Respondent would support a request by the Applicant for an *in camera* proceeding if such request was made in relation to future judicial proceedings. As well, she stated that the Respondent would give the requisite notice if any request was made for the disclosure of the financial statements, in order to allow the Applicant to pursue its legal remedies.

[42] Section 231.6 does not identify the confidential nature of information as a basis for non-disclosure when a notice is issued pursuant to this provision. There is no evidence to suggest that the Respondent is engaged in a "fishing trip" for the purpose of using the financial statements of FIMMI and FMR Co. other than in the conduct of an audit of the Applicant. In general, the Minister is subject to the obligation of acting in good faith. That obligation has been recognized by the Courts in respect of notices issued pursuant to section 231.2 of the Act; see *M.N.R. v. Sand Exploration Ltd.*, [1995] 3 F.C. 44 (T.D.). I see no reason in principle why the same obligation of good faith would not exist with respect to notices issued pursuant to section 231.6 of the Act.

[43] That being so, I conclude that the Applicant's concerns about the confidential

Digitized by Google

nature of the financial statements in issue do not establish that the request for their production is unreasonable. Having regard to the evidence before me, including the cross-examination of Ms. O'Connor, I am satisfied that the Notices are reasonable.

[44] There is a final issue to be addressed. The Respondent argues that it is not the most appropriate respondent in this proceeding, that the Minister should have been named in that capacity. In this regard, the CRA refers to subsection 231.6(2) and says that this provision authorizes the Minister, not the CRA, to issue the Notices. It submits that the situation is not remedied by the *Canada Customs and Revenue Agency Act*, S.C. 1999, c. 17, s. 69 (now called the *Canada Revenue Agency Act*) that allows the CRA to be named in judicial proceedings only "in respect of any right or obligation acquired or incurred by the Agency".

[45] The Applicant's response to this argument is that the Notices were issued by the CRA, not by the Minister. Further it submits that in *Saipem*, the CRA was named as the Respondent, without comment by the Federal Court of Appeal.

[46] According to Rule 303(1) of the *Federal Courts Rules*, SOR/98-106 (the "Rules"), an applicant in a judicial review proceeding shall name, as respondent, every person "directly affected"
by the order sought or "required to be named as a party under an Act of Parliament" under which the proceeding is brought. It is clear that the Minister is a person "directly affected" since the order sought here if granted, would result in the non-disclosure of information sought by him. The Minister would certainly be an appropriate Respondent.

[47] The Act is silent as to the identification of the respondent in an application for review of a Notice, pursuant to subsection 231.6(2). The general rule is that set out in Rule 303(1). In my opinion, it may be more appropriate for the Minister to be named as the respondent but in this case, the absence of the Minister as a party caused no prejudice or confusion. The failure to name the Minister had no material effect.

V. Conclusion

[48] These applications for judicial review are dismissed. The Respondent shall have its taxed costs on the basis of Column III of Tariff B, counsel fees for one counsel only and for one proceeding only.

ORDER

These applications for judicial review are dismissed. The Respondent shall have its taxed costs on the basis of Column III of Tariff B, counsel fees for one counsel only and for one proceeding only. This Order shall be filed in T-1807-04 and placed on the file in T-1808-04.

"E. Heneghan"
Judge

SOFT-MOC INC. v. MNR/AG of Canada, 2013 FC 291, Judicial Review of S. 231.6 Foreign Information Request

Date: 20130320
Citation: 2013 FC 291

Digitized by Google

Ottawa, Ontario, March 20, 2013
PRESENT: The Honourable Mr. Justice Russell
BETWEEN:

SOFT-MOC INC.

Applicant

and

THE MINISTER OF NATIONAL REVENUE AS REPRESENTED BY THE ATTORNEY GENERAL OF CANADA

Respondent

REASONS FOR JUDGMENT AND JUDGMENT

INTRODUCTION

[1] This is an application for judicial review pursuant to subsection 18.1 of the *Federal Courts Act*, RSC, 1985, F-7, and subsections 231.6(4) and 231.6(5) of the *Income Tax Act*, RSC, 1985, c 1 (5th Supp) (ITA). The Applicant seeks review in respect of a decision (Decision) of the Assistant Director, Toronto East Tax Services Office, Canada Revenue Agency (Director), dated 21 December 2011, to issue a Foreign-Based Information Requirement (Requirement) requiring the Applicant to obtain and provide to the Canada Revenue Agency (CRA) certain foreign-based information and documents.

BACKGROUND

[2] The Applicant is a Canadian resident corporation that sells footwear. Mr. Bryan Bardocz is the President of the Applicant and owns 10% of the Applicant's common shares. Mr. Bert Krista owns, directly or indirectly, 90% of the Applicant's common shares. In 2004, Mr. Krista took up residence in the Bahamas and incorporated the other four corporations involved in this application: ITPC Inc. (ITPC), Manser Inc. (Manser), MWF Inc. (MWF) and SoftPOS Inc. (SoftPOS). Mr. Krista wholly owns these four corporations.

[3] During the course of its operations, the Applicant received services from ITPC, Manser, MWF and SoftPOS, all of whom have their centers of operation in Nassau, Bahamas. During 2005 and 2006, the Applicant paid substantial amounts to these four corporations for a variety of services, such as merchandising services, information technology consulting services, business development services and software licensing fees.

[4] In April 2009, the Minister undertook an audit of the Applicant (Transfer Pricing Audit or TPA). Part of the TPA included a review of the payments made by the Applicant to ITPC, Manser, MWF and SoftPOS as consideration for the services provided by them to the Applicant. The TPA also aimed to determine whether the services said to be provided by the four companies were provided in the Bahamas or in Canada and, if the services were provided in the Bahamas, how they were provided.

[5] The Minister also sought to determine whether the consideration paid by the Applicant to the four companies benefited the Applicant. This determination was to assist in ascertaining whether the transfer price paid by the Applicant was an "arm's length transfer price."

[6] On 6 October 2009, the Applicant received an audit query from the Minister. The

Digitized by Google

Applicant provided a binder of material in response. The Applicant received a second audit query on 28 January 2010, to which it responded on 26 March 2010. On 21 December 2011, the Minister issued the Requirement to the Applicant for foreign-based information pursuant to subsection 231.6(2) of the ITA.

[7] In addition to the Requirement, the Applicant was served with a request to provide certain domestic information dated 16 January 2012. On 20 March 2012, the Applicant provided the Minister with a binder of material in response to this request.

[8] On 24 January 2012, Mr. Bardocz wrote to Terry North, counsel for Mr. Krista, Manser, ITPC, MWF and SoftPOS in the Bahamas, informing him of the Requirement. On 5 March 2012, Mr. North responded to a portion of the 74 questions issued in the Requirement. MWF, ITPC, SoftPOS and Manser declined to provide some of the requested information on the basis that such information did not exist or was confidential and proprietary, or that the release of such information would detrimentally affect the competitive advantage of each corporation.

[9] The following information was not provided by the Applicant in response to the Requirement:

a. Minute books, personnel charts, information relating to the organizational structure and financial statements of ITPC, Manser, MWF and SoftPOS;
b. The names of independent buyers and purchasing agents with whom ITPC networked and any correspondence exchanged with them;
c. The names of industry experts contacted by ITPC in 2005 and 2006;
d. The names of information technology specialists who were involved in providing services, and documents supporting payments made to these specialists;
e. Documents to support payments to a U.S.-based company from Manser, and correspondence exchanged between it and Manser;
f. Whether Manser and SoftPOS provided services to other arm's length or non-arm's length customers and, if so, the names of those customers and a detailed description of the services provided; and
g. The names of employees or external computer contractors hired by Manser and their telephone numbers.

[10] Mr. Bardocz, on behalf of the Applicant, says that he does not know why the information is confidential or proprietary in nature, or how it would affect the competitive advantage of the four companies. Upon receiving the answers provided by the four companies, the Applicant commenced this judicial review.

DECISION UNDER REVIEW

[11] The Decision under review in this application is the Requirement issued by the Director on 21 December 2011. Pursuant to subsection 231.6(2) of the ITA, the Director lays out 74 questions to which the Applicant's previously provided responses from the audit queries were considered incomplete or lacking in detail.

[12] The questions in the Requirement ask for a variety of detailed information about the four Bahamian companies. Employees' names and phone numbers are requested, as is the personal information of external contractors and specialists. There are also questions about service contracts, how business relationships were built up, details about manufacturers, independent buyers and purchasing agents, merchandising agents, marketing and advertising allowances, new retail stores and their images, new products, and sales and customer programs.

[13] The Requirement requests specific details of some of the services provided by Manser to the Applicant. It also requests expenses incurred by Manser, and the cost and profit allocated to the Applicant by Manser. There are also a variety of questions about tradeshows attended by ITPC.

Digitized by Google

ISSUES

[14] The Applicant raises forward the following issues:

a) Whether the Requirement should be entirely set aside as being unreasonable on account of the following:

i. It is overly broad in scope;

ii. It requires the production of information and documents that are not relevant to the administration or enforcement of the ITA; and

iii. It requests certain information that cannot be obtained or provided by the Applicant because such information is confidential and proprietary, non-existent, or otherwise unavailable; or

b) Whether the Requirement should be varied so as to delete all questions relating to information that cannot be obtained or provided by the Applicant by virtue of such information being confidential and proprietary, non-existent, or otherwise unavailable.

STANDARD OF REVIEW

[15] The Supreme Court of Canada in *Dunsmuir v New Brunswick*, 2008 SCC 9 held that a standard of review analysis need not be conducted in every instance. Instead, where the standard of review applicable to a particular question before the court is well-settled by past jurisprudence, the reviewing court may adopt that standard of review. Only where this search proves fruitless must the reviewing court undertake a consideration of the four factors comprising the standard of review analysis.

[16] In *Saipem Luxembourg S.A. v Canada (Customs and Revenue Agency)*, 2005 FCA 218 [*Saipem*], the Federal Court of Appeal held that the standard of review applicable to a requirement under subsection 231.6 of the ITA is reasonableness. This was also the finding of the Federal Court in *Fidelity Investments Canada Ltd. v Canada (Revenue Agency)*, 2006 FC 551 [*Fidelity*] at paragraph 27.

[17] The Applicant points out that in the context of subsection 231.6, the Requirement may be found to be unreasonable even if all the requested information is relevant to the administration of the ITA. The Federal Court of Appeal said at paragraph 27 of *Saipem*:

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

[18] When reviewing a decision on the standard of reasonableness, the analysis will be concerned with "the existence of justification, transparency and intelligibility within the decision-making process [and also with] whether the decision falls within a range of possible, acceptable outcomes which are defensible in respect of the facts and law." See *Dunsmuir*, above, at paragraph 47, and *Canada (Minister of Citizenship and Immigration) v Khosa*, 2009 SCC 12 at paragraph 59. Put another way, the Court should intervene only if the Decision was unreasonable in the sense that it falls outside the "range of possible, acceptable outcomes which are defensible in respect of the facts and law."

Digitized by Google

STATUTORY PROVISIONS

[19] The following provisions of the ITA are applicable:

Definition of "foreign-based information or document"	**Sens de « renseignement ou document étranger »**
231.6 (1) For the purposes of this section, "foreign-based information or document" means any information or document that is available or located outside Canada and that may be relevant to the administration or enforcement of this Act, including the collection of any amount payable under this Act by any person.	**231.6** (1) Pour l'application du présent article, un renseignement ou document étranger s'entend d'un renseignement accessible, ou d'un document situé, à l'étranger, qui peut être pris en compte pour l'application ou l'exécution de la présente loi, y compris la perception d'un montant payable par une personne en vertu de la présente loi.
Requirement to provide foreign-based information	**Obligation de fournir des renseignements ou documents étrangers**
(2) Notwithstanding any other provision of this Act, the Minister may, by notice served personally or by registered or certified mail, require that a person resident in Canada or a non-resident person carrying on business in Canada provide any foreign-based information or document.	(2) Malgré les autres dispositions de la présente loi, le ministre peut, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne résidant au Canada ou d'une personne n'y résidant pas mais y exploitant une entreprise de fournir des renseignements ou documents étrangers.
[…]	[…]
Review of foreign information requirement	**Révision par un juge**
(4) The person on whom a notice of a requirement is served under subsection 231.6(2) may, within 90 days after the service of the notice, apply to a judge for a review of the requirement.	4) La personne à qui l'avis est signifié ou envoyé peut, dans les 90 jours suivant la date de signification ou d'envoi, contester, par requête à un juge, la mise en demeure du ministre.
Powers on review	**Pouvoirs de révision**
(5) On hearing an application under subsection 231.6(4) in respect of a requirement, a judge may	(5) À l'audition de la requête, le juge peut :
(*a*) confirm the requirement;	*a*) confirmer la mise en
(*b*) vary the requirement as the judge considers	

Digitized by Google

appropriate in the circumstances; or

(*c*) set aside the requirement if the judge is satisfied that the requirement is unreasonable.

Idem

(6) For the purposes of paragraph 231.6(5)(*c*), the requirement to provide the information or document shall not be considered to be unreasonable because the information or document is under the control of or available to a non-resident person that is not controlled by the person served with the notice of the requirement under subsection 231.6(2) if that person is related to the non-resident person.

[…]

Consequence of failure

(8) If a person fails to comply substantially with a notice served under subsection 231.6(2) and if the notice is not set aside by a judge pursuant to subsection 231.6(5), any court having jurisdiction in a civil proceeding relating to the administration or enforcement of this Act shall, on motion of the Minister, prohibit the introduction by that person of any foreign-based information or document covered by that notice.

demeure;

b) modifier la mise en demeure de la façon qu'il estime indiquée dans les circonstances;

c) déclarer sans effet la mise en demeure s'il est convaincu que celle-ci est déraisonnable.

Précision

(6) Pour l'application de l'alinéa (5)*c*), le fait que des renseignements ou documents étrangers soient accessibles ou situés chez une personne non-résidente qui n'est pas contrôlée par la personne à qui l'avis est signifié ou envoyé, ou soient sous la garde de cette personne non-résidente, ne rend pas déraisonnable la mise en demeure de fournir ces renseignements ou documents, si ces deux personnes sont liées.

[…]

Conséquences du défaut

(8) Si une personne ne fournit pas la totalité, ou presque, des renseignements ou documents étrangers visés par la mise en demeure signifiée conformément au paragraphe (2) et si la mise en demeure n'est pas déclarée sans effet par un juge en application du paragraphe (5), tout tribunal saisi d'une affaire civile portant sur l'application ou l'exécution de la présente loi doit, sur requête du ministre, refuser le dépôt en preuve par cette personne de tout renseignement ou document étranger visé par

Digitized by Google

la mise en demeure.

ARGUMENTS

The Applicant

The Requirement is Overly Broad in Scope

[20] The Applicant says that the information relating to MWF, ITPC, SoftPOS and Manser was requested by the CRA in order to assist in determining:

a) Whether the services were provided in the Bahamas or in Canada, and if provided in the Bahamas how they were provided; and

b) What is the most appropriate transfer pricing methodology for consideration paid by the Applicant to the four Bahamian companies, and whether the services were paid for at an "arm's length transfer price."

The Applicant submits that the information requested by the CRA goes well beyond what is necessary to enable the CRA to make determinations on the above issues.

[21] The Requirement requested the following information in questions 1-5, 8, 14, 23, 24, 29, 32 and 52:

a. The names of IT specialists involved in the services provided by Manser and documents supporting the payments made thereto;

b. Extensive details about a United States-based computer company that provided services to Manser, such as copies of emails and other correspondences, the name of the contact person, dates and details of services performed, the applicable service contract and documentation supporting payment for services;

c. Information about services Manser provided to any customers besides the Applicant;

d. Minute books, financial statements and a list of directors and employees for all four companies;

e. The names and telephone numbers of anyone hired by Manser to perform services for the Applicant;

f. A breakdown and details of the costs and profits allocated to the Applicant by Manser;

g. The names of independent buyers and purchasing agents with whom ITPC networked, as well as correspondences with these parties;

h. The names of industry experts contacted by ITPC; and

i. The names of other buyers with whom ITPC networked to discuss upcoming trends.

[22] The Applicant says that it has already provided the CRA with a significant amount of information for purposes of the Requirement. Specifically, it has provided:

a. Details of the processes whereby each of the four companies provided services to the Applicant; and

b. Background documentation such as correspondence, names and contact information supporting the services performed by each of the four companies for the Applicant.

[23] In *Saipem*, above, the requirement at issue sought "information, and production of all invoices, correspondence, agreements, contracts with amendments, financial statements, books and records of account, reports, memoranda, schedules, working papers, minutes of meetings, telexes, faxes or other documents…" The information was sought in order to carry out a general audit of the applicant's affairs with a view to determining its Canadian tax liability. The Federal Court of Appeal described the information sought by the CRA at paragraph 32 of *Saipem* as follows:

Digitized by Google

> In *Merko* and *Bernick*, the notices of requirement called for the production of records relating to a specific transaction in respect of which the taxpayer was claiming a tax benefit. The link between the documents whose production was sought and the individual's tax liability is obvious and reasonable. In this case, the notice of requirement requires Saipem to produce the whole of its corporate documentation for two fiscal years. The link between the documents to be produced and Saipem's liability for tax is more remote.

[24] The Applicant submits that the Requirement at issue in the present case requests the production of information even more remote than the information requested in *Saipem*. The CRA has essentially requested the whole of the corporate documentation of four separate foreign corporations. In addition, the purpose of the requirement in *Saipem* was to conduct a general audit. The purpose of the Requirement in the present case is not general; it is to determine the location from which ITPC, Manser, MWF and SoftPOS provided services to the Applicant, the manner in which those services were provided, and the appropriate transfer pricing methodology that should be applied.

[25] In *Maheux c Canada (Procureur général)*, 1999 CarswellQue 1176 [*Maheux*], the requirement was issued in order to allow the CRA to confirm certain deductions for business losses claimed by a group of investors in their Canadian income tax returns. Part of this involved the consideration of certain payments that had been made to the foreign company in exchange for services allegedly provided by the foreign company. The Requirement at issue in the present case demanded the production of information such as minute books, the general ledger, sales records, salary records, bank statements, financial statements, and information relating to the business carried on by that foreign company. The Court in *Maheux* found the requirement to be overly broad, and that it should have been limited to information concerning the deductions. The Court varied the requirement so that the applicant was only ordered to provide confirmation of certain expenses which led to the deductions that were claimed by the group of investors.

[26] The Applicant submits that, as in *Maheux*, the Requirement in the present case was issued for a specific purpose: to allow the CRA to determine the location from which ITPC, Manser, MWF and SoftPOS provided services to the Applicant, the manner in which those services were provided, and the appropriate transfer pricing methodology to be applied. The Applicant submits that the Requirement requests a variety of information that is not relevant to this purpose, and that the Requirement should be limited to information that is relevant to the Minister's stated purpose.

[27] Given the narrow parameters of the Minister's stated purpose in the present case, the Applicant says that the request to provide minute books, names of executive directors, minutes of board meetings, organization charts, personnel charts and financial statements is overly broad and amounts to a "fishing expedition" by the CRA. In addition, the request to provide highly specific business and trade information possessed by Manser and ITPC is overly broad, not necessary and/or irrelevant, and the Applicant submits it is unreasonable for the CRA to require the Applicant to provide this information.

[28] The Applicant further submits that it has already provided the CRA with detailed and substantive information that is sufficient to reach determinations on the issues identified as the purpose of the TPA. Had the CRA given proper consideration to these materials, the Requirement may not have been necessary, or the questions in the Requirement could have been substantially more focused and concise.

[29] Mr. Nick Yiu, the CRA auditor assigned to this matter, was unable to identify any other audits of retail businesses that he had conducted. The Applicant submits that this indicates that he lacked experience in conducting international audits of retail businesses. Prior

Digitized by Google

to the issuance of the Requirement, Mr. Yiu made no attempt to interview Mr. Krista, who Mr. Yiu states is a substantial shareholder of the Applicant. He briefly interviewed Mr. Bardocz once, as well as Mr. Matthew Wall, who was a short-term advisor to the Applicant.

[30] After Mr. Yiu's initial meeting with Mr. Bardocz, he did not request any additional follow-up meetings. Mr. Yiu admitted in his cross-examination that this was unusual in the context of a TPA. He also said in his testimony that to the date of cross-examination he had not completed a review of even the domestic materials that he received from the Applicant. The Applicant submits that had Mr. Yiu conducted further interviews with Mr. Bardocz, Mr. Krista or other high-level employees, and if he had completed a review of the materials already given, he could have significantly narrowed the scope of the Requirement.

The Requirement Demands the Production of Information and Documents that are not Relevant to the Administration or Enforcement of the ITA

[31] The test for relevance of foreign-based documents was described in *European Marine Contractors Ltd. v Canada (Customs and Revenue Agency)*, 2004 FC 114 [*European Marine*] at paragraph 23 as follows:

> Thus, the test to be applied is not whether the information requested will be relevant in determining the applicant's Canadian tax liability, but rather whether the information is relevant to the administration of the Act.

[32] The Respondent has taken the position that the four Bahamian companies are related to the Applicant, but this does not in itself make the Requirement reasonable. As the Federal Court said in *Fidelity,* above, at paragraph 32:

> …In light of subsection 231.6(6), the fact that the Applicant is related to FMR Co. and FIMMI does not make the requirement to produce information and documents unreasonable. In my opinion, however, the relationship alone does not make the requirements "reasonable". The factor of relevance must also be satisfied. In my view, there must be evidence that the documents requested are relevant for the purposes of the Act.

[33] In *Fidelity,* the only documents in dispute were the financial statements of two related corporations. The applicant in that case had also offered to disclose the documents subject to certain restrictions. Here, the information sought in the Requirement is far more extensive, and the Applicant has made no explicit or implicit concession of the relevance of any of the documents listed.

[34] The Applicant submits that even if all the information requested is relevant to the administration of the ITA, it is still unreasonable. The information requested by the CRA is not relevant to making determinations on the specific issues identified in the Affidavit of Mr. Yiu. The detailed information requested in the Requirement is entirely irrelevant to the administration of the ITA as it relates to the Applicant, and cannot assist the CRA in determining the location from which services were provided, the manner in which services were provided, or the appropriate transfer pricing methodology.

[35] The Applicant further submits that section 231.6 "pertains only to information as to a particular taxpayer in question." In *eBay Canada Ltd. v Canada (Minister of National Revenue – M.N.R.)*, 2007 FC 930 at paragraph 22 the Court provided as follows:

> The Applicants argue that since section 231.6 makes express provision whereby the Minister can seek information from foreign sources, section 231.2 must be read such that it contemplates only information resident in Canada. Counsel for the Minister argues that section 231.6 is more restrictive than section 231.2 in that section 231.6 pertains only to information as to a particular taxpayer in question whereas section 231.2 pertains to "any information" and to "any person" so long as the purposes

Digitized by Google

are genuinely those contemplated by the *Income Tax Act*.

[36] The Applicant submits that the information about MWF, ITPC, SoftPOS and Manser requested in the Requirement relates only to those corporations, and not to the Applicant. Therefore, such documents are outside the scope of subsection 231.6 of the ITA.

The Requirement Demands Information that Cannot be Obtained or Provided by the Applicant Because Such Information is Confidential and Proprietary, Non-existent, or Otherwise Unavailable

[37] In *Fidelity*, the requirement at issue sought the financial statements of two related foreign companies. The Court was satisfied the financial statements in question were essentially confidential, and held at paragraphs 42-43:

> Section 231.6 does not identify the confidential nature of information as a basis for non-disclosure when a notice is issued pursuant to this provision. There is no evidence to suggest that the Respondent is engaged in a "fishing trip" for the purpose of using the financial statements of FIMMI and FMR Co. other than in the conduct of an audit of the Applicant. In general, the Minister is subject to the obligation of acting in good faith. That obligation has been recognized by the Courts in respect of notices issued pursuant to section 231.2 of the Act; see *M.N.R. v. Sand Exploration Ltd.*, [1995] 3 F.C. 44 (T.D.). I see no reason in principle why the same obligation of good faith would not exist with respect to notices issued pursuant to section 231.6 of the Act.
>
> That being so, I conclude that the Applicant's concerns about the confidential nature of the financial statements in issue do not establish that the request for their production is unreasonable…

[38] The Applicant submits the issue of confidentiality in the present application can be distinguished from *Fidelity* in two respects. First, the information requested in this Requirement is far more extensive than that requested in *Fidelity*. The Requirement here demands the production of a significant amount of corporate information, as well as sensitive details regarding business practices and procedures of four foreign corporations.

[39] Secondly, the issue in *Fidelity* was the disclosure of the financial statements to the CRA. Here, the issue is the disclosure of the information to the Applicant. The four Bahamian corporations do not wish to provide this information to anyone, including the Applicant. In particular, Manser and ITPC do not want to provide the contact information of and correspondence with buyers and purchasing agents, industry experts, IT specialists, other customers, and employees.

[40] The value of the services performed by MWF, ITPC, SoftPOS and Manser derives from their specific industry knowledge. For these corporations to divulge the information requested, including to the Applicant itself, would undermine the value of the services. The CRA's attempt to value these services should not destroy their value in the process.

[41] The Applicant acknowledges that subsection 231.6(6) of the ITA says that a requirement shall not be considered unreasonable because the information requested is under the control of a non-resident person and the Applicant is related to that person. However, as established in *Fidelity*, the fact that the parties are related does not make the Requirement reasonable. The Applicant submits that the extent and nature of the information sought by the CRA is such that the Requirement is unreasonable and should be set aside.

Consequences of Failure to Comply

[42] The Federal Court of Appeal described the potential consequences of a failure to comply with a requirement at paragraph 24 of *Saipem*:

> …the recipient of a notice of requirement is not free to choose which of

Digitized by Google

> the documents demanded he will produce, as suggested in the learned judge's reasons. Subsection 231.6(8) is explicit that if the notice of requirement is not "substantially complied with", the court may make an order which "prohibit[s] the introduction by that person of any foreign-based information or document covered by that notice" [emphasis added]. Consequently, even if the taxpayer partially complies with the Requirement, the court can order than none of the material covered by the notice can be tendered, not even those documents which have been produced. Thus, the broader the demand, the more drastic the consequences of non-compliance.

[43] The Applicant says that the risk it faces from the potential application of subsection 231.6(8) is enhanced by the uncertainty of the application of the subsection, which is not definitively determined on a judicial review of a requirement but in the course of a future civil proceeding. As described in *1144020 Ontario Ltd. v Canada (Minister of National Revenue – M.N.R.)*, 2005 FC 813 at paragraph 78:

> In my view, it is not appropriate that this Court issue such a declaration of substantial compliance, at least in the circumstances of the present case. While the Court has the evidence of the applicant's deponents that the applicant has complied with the foreign-based requirements, there is no independent means of verifying the accuracy of this evidence. The proper time and forum for the determination of substantial compliance is when, in any civil proceeding relating to the administration or enforcement of the Act, the applicant attempts to introduce information or a document that the Minister believes was covered by the foreign-based requirements.

[44] The Applicant submits that it has already provided significant information to the CRA in response to the Requirement, and that the risk of holding that it has failed to substantially comply with the Requirement is unfairly prejudicial to the Applicant, considering its overly broad scope.

Conclusion and Relief Sought

[45] The Applicant reiterates that the Requirement is unreasonable because it is overly broad in scope, it requires production of information that is irrelevant to the administration of the ITA and the stated purpose of the Requirement, and it requires the production of confidential information from third parties which, if disclosed, would destroy the value of the services provided by those third parties. In addition, the broad scope of the Requirement creates a risk the Applicant will lose recourse to information legitimately provided in response to the Requirement. Accordingly, the Applicant submits the Requirement is unreasonable and should be set aside.

[46] In the alternative, the Applicant submits the Requirement should be varied to delete all questions relating to information that cannot be obtained or provided by the Applicant by virtue of such information being confidential and proprietary, non-existent or otherwise unavailable. Specifically, the Applicant requests the following questions in the Requirement be varied or deleted: 1-5, 8, 14, 15, 23, 24, 29, 32, 52.

The Respondent

[47] The Respondent points out that section 231.6 of the ITA gives the Minister strong, comprehensive and far-reaching powers to secure foreign based information or documents which "may be relevant to the administration or enforcement" of the ITA (*Merko v Canada (Minister of National Revenue – M.N.R.)*, [1991] 1 FC 239 at paragraph 24). The Respondent submits that the Requirement is reasonable as it seeks relevant and necessary information and documents, it is not overly broad, and the material sought is available.

Digitized by Google

The Material Sought is for a Purpose Related to the Administration and Enforcement of the ITA

[48] Obtaining information and documents relevant to the tax liability of a taxpayer through the issuance of a requirement is a purpose related to the administration and enforcement of the ITA. Subsection 231.6(1) says that foreign-based information includes any information or document "that may be relevant to the administration or enforcement of this Act" [emphasis added].

[49] The Respondent points out that a requirement issued under section 231.2 of the ITA is valid if the requested information may be relevant for the determination of the tax liability of a taxpayer. The case law establishes that the threshold for relevance is low (see *Tower v Canada (Minister of National Revenue – M.N.R.)*, 2003 FCA 307 at paragraph 29; *Fraser Milner Casgrain LLP and Gilbert Schmunk v The Minister of National Revenue*, 2002 DTC 7310 (FCTD) at paragraphs 20-27). The threshold for relevance for a requirement issued under subsection 231.6 is similarly low. Furthermore, the Minister has no way of knowing whether the material sought is relevant until she has had an opportunity to examine that material (*AGT Ltd. v Canada (Attorney General)*, [1997] 2 FC 878 (FCA) at paragraph 23).

The Material Sought is Relevant and Necessary

[50] The Affidavit of Mr. Yiu clearly sets out why this material is necessary and how it is relevant to the administration and enforcement of the ITA. He maintains that the information is required in order to determine from which location the services of the four Bahamian companies were provided, and to determine the proper transfer-pricing methodology. Mr. Yiu maintained on cross-examination that this information is required for him to properly perform the TPA.

[51] The Requirement seeks specific information and documents from the four companies related to the services they provide to the Applicant, how the services are provided, and who within the company provides the services. This material will enable the Minister to perform a functional analysis and determine where and how the services were provided. The Requirement also seeks corporate and financial materials to enable the Minister to determine the appropriate transfer pricing methodology to apply so that she can determine whether the transfer price paid by the Applicant was an arm's length transfer price.

[52] The Applicant says that the material sought is "entirely irrelevant" to the administration of the ITA as it relates to the Applicant, but the Respondent submits that this is incorrect. On cross-examination, Mr. Yiu said that he conducts interviews with the people who run companies as part of the audit. In order to conduct interviews, the CRA requires the names of executive directors and must have access to organizational and personnel charts.

[53] With respect to the other information, Mr. Yiu was clear that the material was sought in order to verify the answers previously provided by the Applicant. Mr. Yiu explained that he needs to verify that the services provided by the four companies exist, and who performs them (see page 196 of the Respondent's Record). Thus, the Respondent submits the information sought is relevant.

The Requirement is not Overly Broad

[54] Given that the information sought from the Applicant is necessary and relevant to the ongoing TPA, the Respondent submits that the Requirement is not overly broad. The Applicant characterizes the CRA's purpose as having "narrow parameters," and argues that the Requirement amounts to a "fishing expedition." The Respondent submits that this characterization is inaccurate and fails to appreciate the complex nature of a TPA and the type of information that is needed to verify that the transfer price paid by the Applicant to the four companies is an arm's length transfer price.

Digitized by Google

[55] Guidance as to the nature or type of information and documents to be obtained as part of a TPA is found in the CRA's Information Circular 87-2R as well as the 2010 Organization for Economic Co-operation and Development Transfer Pricing Guidelines for Multinational Enterprises and Administration (the Guidelines). The Guidelines explain the wide variety of documentation that ought to be considered in determining a transfer pricing methodology (page 44 of the Respondent's Record).

[56] Mr. Yiu explained in his affidavit and cross-examination that the first step is to review the function provided by the offshore entity. Function refers to what services are provided by the staff of the off-shore entity and the Canadian company. It is necessary to determine if the functions exist before the appropriate methodology can be selected. This is determined after a review of documents that would indicate that the services were in fact performed. Mr. Yiu explains in his affidavit that at this stage, the CRA does not have enough information to determine which pricing methodology to use (page 6 of the Respondent's Record).

[57] In *Saipem*, above, the Federal Court of Appeal held it was reasonable for the Minister to require production of the whole of the foreign company's corporate documentation for two fiscal years. The Applicant seeks to distinguish that case on the basis that the Minister's stated purpose was to perform a general audit, whereas here the Minister's purpose is to conduct a narrower TPA. The Respondent submits this is simply not the case. Part of the general audit in *Saipem* was to determine whether the company had a permanent establishment in Canada. To do so, production of the corporate documents was required. Here, the Minister seeks information to determine whether the services were performed in the Bahamas or in Canada, and if performed in the Bahamas how they were provided, in order to determine the appropriate transfer pricing methodology. The information sought from the Applicant is necessary to make those determinations.

[58] The Applicant also relies on the decision in *Maheux*. The evidence given by the principal of the foreign company in that case was that the requirement sought information that included business dealings of the foreign company that did not involve the Canadian taxpayers. The Court limited the requirement to the information in the possession of the foreign company that related to the Canadian taxpayers (*Maheux* at paragraphs 34-35).

[59] The Respondent submits that, unlike in *Maheux*, the Requirement in this case does not inadvertently capture the four companies' other business dealings. There is no evidence that these companies had any business dealings with any persons other than the Applicant at the material time. In fact, the evidence is that the Applicant is MWF, SoftPOS and ITPC's only client.

[60] The Applicant proposes that the scope of the Requirement can be narrowed and that Mr. Yiu should interview certain people. The Federal Court of Appeal made clear in *Saipem* that it is not up to the Applicant to say how the CRA should conduct its audit. The Federal Court of Appeal said at paragraph 36 of *Saipem* that "It is the Agency's prerogative as to whether it will conduct an audit, and what form that audit will take."

[61] The Applicant also suggests that the information and documents provided to date provide a response to the Requirement. The Respondent submits that there is no evidence before this Court to support this suggestion.

[62] Although the material sought is part of the records of the four companies, it is still relevant and necessary to determine the Applicant's tax liability, and whether the transfer price paid to the four companies for the services provided was at an arm's length transfer price. The Requirement is not overly broad in scope and should not be set aside in whole or in part as it seeks relevant and necessary information that is required in order to properly conduct the TPA of the Applicant's 2005 and 2006 taxation years.

The Information is not Confidential or Proprietary

[63] There is no evidence that the information sought is confidential and/or proprietary.

Digitized by Google

The only evidence before the Court is the affidavit of Mr. Bardocz. In cross-examination, he could not provide an explanation as to why the documents requested were confidential and/or proprietary, and he admitted he never asked any of the four companies for an explanation. He admitted on cross-examination that he never followed up with any of the companies as to why this information would be considered confidential or proprietary.

[64] In any event, the Respondent submits it is not unreasonable to require production of information pursuant to subsection 231.6 even if the information is confidential or proprietary. In *Fidelity*, above, it was found at paragraphs 42-43 that the confidential nature of information is not a basis for non-disclosure pursuant to a requirement issued under subsection 231.6 of the ITA.

[65] The Applicant suggests that the four Bahamian companies do not wish to disclose this information to anyone, including the Applicant, because disclosing the information could "destroy" the very value of the services the four companies provide. The Respondent submits that there is no evidence that disclosure would have any impact on the value of the services provided by the four companies. As previously stated, Mr. Bardocz was unable to explain why this information is confidential and/or proprietary, and there is no other evidence as to how disclosure would impact the value of the services provided by the four companies.

[66] The Applicant and the four companies are related. Mr. Krista owns 90% of the Applicant and 100% of the foreign companies. It is Mr. Krista who empowers Mr. Bardocz to run the Applicant in Canada. The Applicant is MWF, SoftPOS and ITPC's only client. The Respondent states that it is disingenuous to argue that, as owner of the four foreign companies, Mr. Krista refuses to disclose the information to the Applicant.

[67] The Respondent also questions whether the Applicant could or would use the information in any way to the detriment of the four companies. Given that the Applicant is MWF, SoftPOS and ITPC's only client, the only way the information could affect the services they provide would be if the Applicant chose to alter their arrangement.

[68] The ITA specifically prohibits this type of attempt to shelter information at subsection 231.6(6):

(6) For the purposes of paragraph 231.6(5)(*c*), the requirement to provide the information or document shall not be considered to be unreasonable because the information or document is under the control of or available to a non-resident person that is not controlled by the person served with the notice of the requirement under subsection 231.6(2) if that person is related to the non-resident person.	(6) Pour l'application de l'alinéa (5)*c*), le fait que des renseignements ou documents étrangers soient accessibles ou situés chez une personne non-résidente qui n'est pas contrôlée par la personne à qui l'avis est signifié ou envoyé, ou soient sous la garde de cette personne non-résidente, ne rend pas déraisonnable la mise en demeure de fournir ces renseignements ou documents, si ces deux personnes sont liées.

[69] The Respondent submits it is not open to the Applicant to argue that the Requirement is unreasonable because the information being sought is in the hands of the four companies, which are related to the Applicant.

[70] To the extent that the Applicant has concerns with disclosing the information to the Minister, the Court in *Fidelity* noted at paragraph 42 that the Minister is subject to an obligation

Digitized by Google

to act in good faith. As established in that case, concerns with providing information to the CRA do not establish that production is unreasonable.

[71] The Respondent submits there is no evidence that disclosing the information will impact the value of the services the four companies provide. Therefore, the confidential and/or proprietary nature of the information is no basis for limiting the information sought under the Requirement.

Consequences of the Failure to Comply

[72] Where the information sought by the Minister is both necessary and relevant to the TPA, subsection 231.6(8) operates as it should to prevent abuse. The Respondent submits that if individuals were permitted to pick and chose what information to provide, and then later during a civil proceeding they are permitted to rely on only what they choose to provide, there is potential for them to create a completely inaccurate representation of their tax affairs.

[73] The Respondent takes the position that the information in this case is both necessary and relevant to the TPA issues, and the potential consequences for failing to disclose are no basis for narrowing or setting aside the Requirement.

ANALYSIS

Broadness and the Relevance of the Information Requested in the Requirement

[74] The Applicant's position is that the information and documents requested by CRA go well beyond what is necessary to enable CRA to make determinations on the issues of concern under the TPA. Relying upon *Saipem*, above, the Applicant says that not only was the information and documentation requested not relevant to the administration and enforcement of the ITA, it amounted to a far-reaching fishing expedition.

[75] In the present case, it is true that the Requirement was issued for specific purposes:

a. To allow CRA to see or determine the location from which ITPC, Manser, MWF and SoftPOS provided services to the Applicant;

b. To allow CRA to determine the manner in which the services were provided; and

c. To allow CRA to determine the appropriate transfer pricing methodology.

[76] The Applicant's complaint is that, given these objectives, the requirement to produce minute books, organization charts, personnel charts, and financial statements for each of the four Bahamian companies is overly broad, and the requirement to produce information related to the highly specific business and trade information of the four companies is overly broad, unnecessary, irrelevant, and unreasonable. Due consideration to the materials provided to date, or an interview with Mr. Krista would have provided sufficient information for the specific purposes or would have significantly narrowed the scope of the Requirement.

[77] In his affidavit and on cross-examination, Mr. Yiu explains the analysis that is required to determine an appropriate transfer pricing methodology. As part of this process, it is necessary to document whether the services were in fact performed at the material time. It is also necessary to ascertain and confirm what functions were provided by the four Bahamian companies and the Applicant. However, before the appropriate transfer pricing methodology is selected CRA has to ascertain if the functions of all these companies exist and were performed. As Mr. Yiu explains in his affidavit, all of the documentation requested was needed to assess the arms-length issue because CRA needs to know the who, what, where and how of how the services were provided to the Applicant in a situation where the Applicant and the four Bahamian companies were owned and controlled by Mr. Krista. Any information already provided by the Applicant needs to be verified. Under this kind of TPA the quality of information provided cannot be ascertained without verification.

[78] In my view, the Applicant has not convincingly challenged Mr. Yiu's evidence that this was the best evidence for CRA to seek for the purposes of the TPA.

Digitized by Google

[79] In this case, CRA is conducting a TPA of the Applicant. In connection with that TPA, the Minister is reviewing the payments made by the Applicant to the four Bahamian companies for the services. The Minister seeks specific information related to those payments to determine whether the services were performed in the Bahamas or Canada and, if in the Bahamas, how the services were provided, and to determine the appropriate transfer pricing methodology to be applied so that the Minister can ascertain whether the transfer price paid was an arms-length transfer. In my view, the information sought from the Applicant is necessary to make these determinations and to verify information that has already been provided.

[80] Also, in my view, the link between the information and documentation requested and the purposes of the TPA is both obvious and reasonable. As in *Saipem*, at paragraph 36:

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

[81] Subsection 231.6 of ITA makes it clear that "foreign-based information or document" means any information or document that is available, or located outside of Canada and that "may be relevant" to the administration or enforcement of the Act, including the collection of any amount payable under the act by any person.

[82] The documents requested in the Requirement need to be both relevant and reasonable, but the cases say that the threshold is low and the powers of the Minister are wide-ranging. See *Tower*, above, at paragraph 29. As the Respondent points out, *Saipem*, above, also makes it clear that it is not for the Applicant to say what will suffice. See paragraph 35.

[83] Further, as the Respondent points out, unlike in *Maheux*, the Requirement issued to the Applicant is this case does not inadvertently capture irrelevant business dealings of the four Bahamian companies. This is because there is no evidence to indicate that these companies do business with anyone else except the Applicant. The Applicant is the only client of three of the companies. This justifies the scope of the documentation and information requested. Mr. Krista owns, either directly or indirectly, 90% of the Applicant's common shares. He ceased doing business in Canada in 2004 and took up residency in the Bahamas, whereupon he incorporated the four companies to provide services to the Applicant. Mr. Krista owns 100% of the common shares of the Bahamian companies. During 2005 and 2006, the Applicant paid substantial amounts of money to the four Bahamian companies as consideration for a variety of services to be provided to the Applicant.

[84] Given these arrangements, it is obvious that the information which the CRA seeks may well be part of the corporate and other documents requested in the Requirement, and it is not for the Applicant to say that such information could be ascertained by other means. See *Saipem*, above, at paragraph 36. Even an interview with Mr. Krista would not have provided the CRA with the objective confirmation it requires to complete the TPA. In my view, then, the Requirement is not overly broad in scope because it seeks relevant and necessary information to properly conduct the TPA for the 2005 and 2006 taxation years and assess the Applicant's tax liability and whether the transfer price paid by the Applicant to the four Bahamian companies for the services was an arms-length transfer price. Documentation and information requested in the Requirement are both relevant and reasonable.

Information in Confidential and Proprietary, Non-existent, or Otherwise

Digitized by Google

Unavailable

[85] The Applicant seeks to distinguish the present situation from that in *Fidelity*, above, in several ways. The Applicant says that, in *Fidelity*, the Court was only dealing with allegedly confidential financial statements for two related companies. In the present case, the Requirement seeks the production of significant corporate documentation, as well as sensitive details regarding business practices and procedures of the four Bahamian companies.

[86] The Applicant provides little in the way of evidence to establish that the corporate documentation and business practices and procedures in question are confidential or proprietary or sensitive. There is no reason to distinguish the present situation from the guidance given in *Fidelity* on point:

> In *Fidelity* the Applicant argued that the requirement at issue was unreasonable, in part because the documents sought by the CRA, being financial statements of two related foreign corporations, were confidential. The Court was satisfied that the financial statements in question were essentially confidential, but held:
>
> > Section 231.6 does not identify the confidential nature of information as a basis for non-disclosure when the notice is issued pursuant to this provision. There is no evidence to suggest that the Respondent is engaged in a "fishing trip" for the purpose of using the financial statements of FIMMI and FM Co. other than in the conduct of an audit of the Applicant. In general, the Minister is subject to the obligation of acting in good faith. That obligation has been recognized by the Courts in respect of notices issued pursuant to section 231.2 of the Act; see *Minister of National Revenue v. Sand Exploration Ltd.*, [1995] 3 F.C. 44 (Fed. T.D.). I see no reason in principle why the same obligation of good faith would not exist with respect to notices issued pursuant to section 231.6 of the Act.
> >
> > That being so, I conclude that the Applicant's concerns about the confidential nature of the financial statements in issue did not establish that the request for their production is unreasonable.
> >
> > […]

[87] The Applicant also says that the four Bahamian companies are, unlike in *Fidelity*, not refusing to disclose information to CRA; they are refusing to disclose the documentation and information to anyone, including the Applicant.

[88] Given the corporate relationship between the Applicant and the four Bahamian companies, and the control that resides in Mr. Krista, this is equivalent to saying that Mr. Krista refuses to divulge information to the Applicant — a company he controls — from four companies he also controls. In any event, the proprietary or sensitive character of information is not a reason for finding a notice of requirement unreasonable. See *Fidelity*, above, at paragraph 43.

[89] The rationale offered by the Applicant is that the value of the services performed by MWF, ITPC, SoftPOS and Manser derives from the specific industry knowledge, contact information, and other confidential business information possessed by those corporations. It is alleged that for any of these corporations to divulge such information to any person or corporation, including the Applicant itself, would undermine the value of the services to which such information relates.

[90] The Applicant argues that to the extent that the CRA seeks to determine the value of

Digitized by Google

the services performed by MWF, ITPC, SoftPOS and Manser, it would be entirely antithetical to such determination to destroy the value of such services by indirectly forcing MWF, ITPC, SoftPOS and Manser to divulge the very business strategies and practices that allow them to provide such value to the Applicant in the first place.

[91] There is no evidence to support these assertions.

[92] In my view, the relevance and reasonableness of the Requirement have nothing to do with the compellability of either the four Bahamian companies or Mr. Krista. As in *Saipem*, given that the documentation and information are maintained outside of Canada, CRA could do little more to gain access to the records than issue the Requirement. Subsection 231.6(6) of the Act provides as follows:

(6) For the purposes of paragraph 231.6(5)(*c*), the requirement to provide the information or document shall not be considered to be unreasonable because the information or document is under the control of or available to a non-resident person that is not controlled by the person served with the notice of the requirement under subsection 231.6(2) if that person is related to the non-resident person.	(6) Pour l'application de l'alinéa (5)*c*), le fait que des renseignements ou documents étrangers soient accessibles ou situés chez une personne non-résidente qui n'est pas contrôlée par la personne à qui l'avis est signifié ou envoyé, ou soient sous la garde de cette personne non-résidente, ne rend pas déraisonnable la mise en demeure de fournir ces renseignements ou documents, si ces deux personnes sont liées.

There is no evidence before me that it would require an extensive effort to provide the information requested or that providing it would destroy its value as alleged by the Applicant.

[93] The Minister's obligation to act in good faith under the ITA and the protection that this provides has not been challenged before me. There is no basis upon which to set aside this Requirement.

[94] Finally, the consequences of not providing the documentation and information requested as outlined in subsection 231.6(8) of the Act cannot, in my view, have anything to do with the relevance or reasonableness of the Requirement. Mr. Krista and the four Bahamian companies he controls are not compellable, but they have to realize that the Applicant's inability to substantially comply with the Requirement at this stage could lead to future negative consequences for the Applicant. This is, in essence, the purpose behind the issuance of a requirement under the ITA, and the consequences seem wholly appropriate in this case.

Digitized by Google

JUDGMENT

THIS COURT'S JUDGMENT is that

1. The application is dismissed with costs to the Respondent.

"James Russell"
Judge

Access to Information on Foreign Databases and What Constitutes Foreign-based Information Ebay Canada Limited And Ebay Cs Vancouver Inc. v. MNR[94] is an appeal case that perfectly speaks of the issue of whether information accessible in Canada through a computer terminal, generally, is foreign based information that would allow it to fall under the scope of Sec. 231.6. The issue was raised by the taxpayer's counsel since the Minister had made a request of the identity of Powersellers on the eBay network to determine their tax positions and eBay counsel attempted to argue that since the information "resided" on servers in the US it was not within the scope of the **Sec. 231.2** RFI request and since **s. 231.6 did not allow requests for unidentified taxpayers (foreign source info.)** it could also not be requested under that section. The appeal court held:

REASONS FOR JUDGMENT

EVANS J.A.

A. INTRODUCTION

[1] This is an appeal by eBay Canada Ltd. and eBay CS Vancouver Inc. (collectively, "eBay Canada" or "the appellants") from a decision of the Federal Court (2008 FC 180). In that decision, Justice Hughes affirmed his *ex parte* order authorizing the Minister of National Revenue to impose a requirement on the appellants to produce information identifying "PowerSellers" in Canada who have sold more than a certain volume of items on eBay, the world's largest global online marketplace. The Minister wants this information, as well their gross sales, in order to determine whether the PowerSellers have complied with their obligation under the *Income Tax Act*, R.S.C. 1985 (5th Supp.) c. 1 ("Act") to report their income.

[2] The requirement to produce information in this case was imposed under section 231.2 of the Act which confers broad and general powers on the Minister to require any person to produce information for any purpose related to the administration or enforcement of the Act. The appellants say that this section does not apply to the facts of this case because the information sought is "foreign-based information", which is the subject of a comprehensive code in section 231.6. It is important in this case, they argue, to determine which section the Minister may use because section 231.6 does not provide for the imposition of a requirement to produce foreign-based information relating to unnamed persons. In contrast, section 231.2 expressly empowers the Minister, with judicial authorization, to require the production of information relating to unnamed persons.

[3] The information identifying Canadian eBay sellers is stored as electronic records on servers in the United States owned by eBay Inc. ("eBay US"). The records are compiled and maintained by eBay International AG ("eBay International"), a Swiss corporation which is a wholly owned subsidiary of eBay US. The principal question to be decided in this appeal is whether the information sought by the Minister is "foreign-based" because it is "available or located outside Canada" for the purpose of subsection 231.6, despite the fact that the appellants, Canadian corporations, have been authorized to access it in Canada for use in their business, but do not download it to their computers.

---

[94] 2008 FCA 348

Digitized by Google

[4] In my view, Justice Hughes made no reversible error in concluding on the facts before him that the information sought was not "foreign-based information"; even though stored on servers outside Canada, it was also located in Canada because of its ready accessibility to and use by the appellants. Consequently, it was open to the Minister to seek its production by a requirement imposed on the appellants under section 231.2, without regard to any possible limitations on those powers flowing from the presence of section 231.6. Since the Judge properly authorized the imposition of the requirement under section 231.2, I would dismiss the appeal.

B. FACTUAL BACKGROUND

[5] eBay US operates an online marketplace ("eBay") in conjunction with its subsidiaries around the world. Registered users of eBay offer goods and services for sale on one of eBay's websites for purchase by the highest bidder. Sellers pay a fee for use of the eBay marketplace. Neither eBay US nor any of its subsidiaries is a party to the contracts of sale made by buyers and sellers on eBay.

[6] The appellant, eBay CS Vancouver Inc., is wholly owned by eBay US. The other appellant, eBay Canada Limited, is wholly owned by eBay International, the wholly owned subsidiary of eBay US.

[7] eBay International conducts most eBay activities outside the United States, including billing eBay users for fees and banking, the provision of a website platform directed at the eBay market in Canada, and a website with the domain name of eBay.ca, which is situated on servers outside Canada. eBay Canada uses the eBay.ca domain name and provides market assistance and research, and other administrative services, to eBay International, but has nothing to do with billing customers, receiving payments, or collecting fees.

[8] eBay US and eBay International grant eBay Canada secure online access to confidential information about Canadian users of eBay, which is stored on eBay US's servers in California. Under provisions in agreements with eBay US and eBay International, eBay Canada is required to keep confidential information provided to it "concerning the eBay system", except to the extent that its disclosure is ordered by law. eBay Canada says that these provisions include information concerning PowerSellers in Canada.

[9] The information sought from eBay Canada by the Minister comprises the names, addresses and other identifying information, and the gross sales for 2004 and 2005, of eBay PowerSellers who are registered as having a Canadian address. Registered eBay users earn the PowerSeller designation on the basis of the value of their eBay sales, the length of time that they have been selling, their financial record, and whether they have been the subject of complaints from other eBay users.

[10] PowerSellers' sales records vary widely. They may include, on the one hand, individuals who, on a casual basis, have sold goods or services for US$3,000 in one year and, on the other, corporations that have sold items for as much as US$450,000 in a similar period.

[11] Designation as a PowerSeller carries significant benefits. For instance, PowerSellers receive an enhanced level of eBay services, and potential purchasers are likely to have more confidence in the reliability and integrity of a seller with this designation. The PowerSellers program is an important part of the promotion of eBay and exists in many countries. Registered eBay users may join a program in their own country; residents of Canada may become PowerSellers on eBay.ca. The precise number of PowerSellers in the Canadian program is not known, but is estimated to be in the region of 10,000.

[12] There is no evidence that eBay Canada has either printed, or downloaded onto its computers in Canada, the information about PowerSellers sought by the Minister. However, it is conceded that eBay Canada has been granted access to and regularly uses this

Digitized by Google

information as an integral part of its business: see 2007 FC 930 at para. 12.

[13] The Minister did not know the names and contact information of Canadian PowerSellers or the value of the goods and services that they had sold on eBay. Accordingly, he applied *ex parte* to the Federal Court under subsection 231.2(3) for an order authorizing him to impose a requirement on eBay Canada to produce information and documents that would enable him to audit them. Justice Hughes granted the *ex parte* application on November 6, 2006, requiring the appellants to provide to the Minister

> … the following information and documents for any person having a Canadian address according to your records (including individual, corporation and joint venture) who qualified for the PowerSeller status under eBay's PowerSeller program in Canada at any time during the two calendar years 2004 and 2005:
>
> a) account information – full name, user id, mailing address, billing address, telephone number, fax number and email address; and
>
> b) merchandise sales information – gross annual sales
>
> Original documents in their original forms are required. Photocopies of information or documents will not be sufficient. Where these records exist in electronic format, I require that the records be provided in electronically readable format.

[14] After receiving notice of the *ex parte* order, the appellants made an application to Justice Hughes under subsection 231.2(5) to review it.

C. DECISION OF THE FEDERAL COURT

[15] Before issuing his final judgment, which is the subject of this appeal, Justice Hughes issued reasons and a partial judgment on September 18, 2007 (2007 FC 930), in which he rejected the appellants' principal argument. They had argued that the information and documents sought could not be the subject of a requirement under the Minister's general power in section 231.2, because they were stored on servers in California and therefore constituted "foreign-based information" for the purpose of section 231.6. Further, they said, section 231.6 does not authorize a requirement to be imposed for the production of foreign-based information relating to unnamed persons. The appellants alleged that, by resorting to section 231.2, the Minister had improperly tried to escape this and other limitations imposed by section 231.6 on requirements to produce records located outside Canada.

[16] The Judge noted the breadth of the power conferred on the Minister by subsection 231.2 to require the production of information, including the power to require a person to produce information relating to another person whose tax affairs the Minister wished to examine. Justice Hughes concluded that the scope of the power exercisable under section 231.2 in this case cannot be affected by section 231.6, because section 231.6 applies only to "foreign-based information", which, he found, did not include the information sought by the Minister from eBay Canada.

[17] In reaching this conclusion, Justice Hughes observed that, since electronically stored information relating to PowerSellers was readily, lawfully, and instantaneously available in a variety of places to eBay entities, including to the appellants in Canada, the location of the servers on which it was stored was irrelevant (2007 FC 930 at para. 23). He relied on judicial descriptions of telecommunications from a foreign state to Canada, and *vice versa*, as being "both here and there" (see *Society of Composers, Authors and Music Publishers in Canada v. Canadian Association of Internet Providers*, [2004] 2 S.C.R. 427 at para. 59 ("*SOCAN*")), and on the particular facts of this case concerning eBay Canada's permitted and actual use of the information.

[18] Justice Hughes delayed deciding the remaining issue (namely, whether there was sufficient evidence that the Minister required the information to audit Canadian PowerSellers for compliance with the *Income Tax Act*) until this Court released its decision in *Canada*

Digitized by Google

(Minister of National Revenue) v. Greater Montreal Real Estate Board, 2007 FCA 346, 2007 D.T.C. 5740, leave to appeal to S.C.C. refused, 32404 (April 24, 2008) ("*GMREB*"), and the parties had had an opportunity to make written submissions on it. In further reasons and final judgment, dated February 13, 2008 (2008 FC 180), Justice Hughes held that he was bound by *GMREB* on the applicable test (the "good faith audit" test) and concluded that on the basis of the evidence before him, the Minister had met it. He also said that, even if the more demanding test relied on by the appellants were applicable (the "genuine and serious inquiry" test), the evidence was sufficient to meet it too.

[19] Having also satisfied himself that the Minister had met the statutory preconditions in paragraphs 231.2(3)(*a*) and (*b*) to the imposition of a requirement under this section, Justice Hughes affirmed his *ex parte* order authorizing the requirement, but amended it to cover information concerning the identity of PowerSellers "registered as having a Canadian address", rather than those "having a Canadian address according to your records".

[20] This appeal is from the final judgment of Justice Hughes. However, since the issues raised are considered in both sets of the Judge's reasons, it will be necessary to refer to the reasons for the partial and the final judgments.

D. LEGISLATIVE FRAMEWORK

[21] It is important to situate the particular issues raised in this appeal within the wider context of the statutory powers from which they arise. The following general provision confers broad powers on the Minister to require the provision of information and documents.

231.2(1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act including the collection of any amount payable under this Act by any person by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as stipulated in the notice, (a) any information or additional information, including a return of income or a supplementary return; or (b) any document.	**231.2(1)** Malgré les autres dispositions de la présente loi, le ministre peut, sous réserve du paragraphe (2) et pour l'application ou l'exécution de la présente loi y compris la perception d'un montant payable par une personne en vertu de la présente loi, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne, dans le délai raisonnable que précise l'avis : a) qu'elle fournisse tout renseignement ou tout renseignement supplémentaire, y compris une déclaration de revenu ou une déclaration supplémentaire; b) qu'elle produise des documents.

[22] While subsection 231.2(1) is stated to operate "Notwithstanding any other provision of this Act", it is expressly made subject to subsection (2), which provides that prior judicial authorization is needed when, as in the present case, the requirement relates to information respecting unnamed persons.

231.2(2) The Minister shall not impose on any person (in this section referred to as a "third party") a requirement under subsection 231.2(1) to provide	**231.2(2)** Le ministre ne peut exiger de quiconque — appelé « tiers » au présent article — la fourniture de renseignements ou production de documents prévue

Digitized by Google

information or any document relating to one or more unnamed persons unless the Minister first obtains the authorization of a judge under subsection 231.2(3).

(3) On *ex parte* application by the Minister, a judge may, subject to such conditions as the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection 231.2(1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") where the judge is satisfied by information on oath that

(*a*) the person or group is ascertainable; and

(*b*) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act.

au paragraphe (1) concernant une ou plusieurs personnes non désignées nommément, sans y être au préalable autorisé par un juge en vertu du paragraphe (3).

(3) Sur requête *ex parte* du ministre, un juge peut, aux conditions qu'il estime indiquées, autoriser le ministre à exiger d'un tiers la fourniture de renseignements ou production de documents prévue au paragraphe (1) concernant une personne non désignée nommément ou plus d'une personne non désignée nommément — appelée « groupe » au présent article —, s'il est convaincu, sur dénonciation sous serment, de ce qui suit :

a) cette personne ou ce groupe est identifiable;

b) la fourniture ou la production est exigée pour vérifier si cette personne ou les personnes de ce groupe ont respecté quelque devoir ou obligation prévu par la présente loi.

[23] It is evident from paragraph 231.2(3)(*b*) that subsection 231.2(2) is intended to be used when the Minister wishes to verify whether the unnamed persons, not the person on whom the requirement is served, are in compliance with their obligations under the Act. See, for example, *Bernick v. Canada (Minster of National Revenue)*, 2002 D.T.C. 7167 at para. 10 (Ont. SCJ).

[24] A person on whom an *ex parte* order is served under subsection 231.2(3) must be served with notice of both it and the notice referred to in subsection 231.2(1) (see subsection 231.2(4)), and may request a review of the order by a judge, normally the judge who issued it.

(5) Where an authorization is granted under subsection 231.2(3), a third party on whom a notice is served under subsection 231.2(1) may, within 15 days after the service of the notice, apply to the judge who granted the authorization or, where the judge is unable to act, to another judge of the same court for a review of the authorization.

(5) Le tiers à qui un avis est signifié ou envoyé conformément au paragraphe (1) peut, dans les 15 jours suivant la date de signification ou d'envoi, demander au juge qui a accordé l'autorisation prévue au paragraphe (3) ou, en cas d'incapacité de ce juge, à un autre juge du même tribunal de réviser l'autorisation.

[25] In conducting the review, the judge must consider whether she or he is satisfied

Digitized by Google

that the conditions in paragraphs 231.2(3)(*a*) and (*b*) are met. If the judge is not so satisfied, the *ex parte* order may be cancelled, otherwise the order may be confirmed or varied: subsection 231.2(6).

[26] The sanctions for non-compliance with an order issued under section 231.2 are criminal prosecution (section 238) and contempt proceedings (subsection 231.7(4)).

[27] Section 231.6 was added to the Act in 1988 by S.C. 1988, c. 55, section 175, and deals with requirements for the production of "foreign-based information", which is defined as follows.

231.6 (1) For the purposes of this section, "foreign-based information or document" means any information or document that is available or located outside Canada and that may be relevant to the administration or enforcement of this Act, including the collection of any amount payable under this Act by any person.

231.6 (1) Pour l'application du présent article, un renseignement ou document étranger s'entend d'un renseignement accessible, ou d'un document situé, à l'étranger, qui peut être pris en compte pour l'application ou l'exécution de la présente loi, y compris la perception d'un montant payable par une personne en vertu de la présente loi.

[28] The scope of the power to require the production of any foreign-based information or document is defined as follows.

231.6 (2) Notwithstanding any other provision of this Act, the Minister may, by notice served personally or by registered or certified mail, require that a person resident in Canada or a non-resident person carrying on business in Canada provide any foreign-based information or document.

231.6 (2) Malgré les autres dispositions de la présente loi, le ministre peut, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne résidant au Canada ou d'une personne n'y résidant pas mais y exploitant une entreprise de fournir des renseignements ou documents étrangers.

[29] A person served with a notice of a requirement under subsection 231.6(2) may request a judge to review the requirement, including on the ground that it is unreasonable.

231.6 (4) The person on whom a notice of a requirement is served under subsection 231.6(2) may, within 90 days after the service of the notice, apply to a judge for a review of the requirement.

(5) On hearing an application under subsection 231.6(4) in respect of a requirement, a judge may

(*a*) confirm the requirement;

(*b*) vary the requirement as the judge considers appropriate in the circumstances; or

231.6 (4) La personne à qui l'avis est signifié ou envoyé peut, dans les 90 jours suivant la date de signification ou d'envoi, contester, par requête à un juge, la mise en demeure du ministre.

(5) À l'audition de la requête, le juge peut:

a) confirmer la mise en demeure;

b) modifier la mise en demeure de la façon qu'il estime indiquée dans les circonstances;

Digitized by Google

(*c*) set aside the requirement if the judge is satisfied that the requirement is unreasonable.

(6) For the purposes of paragraph 231.6(5)(c), the requirement to provide the information or document shall not be considered to be unreasonable because the information or document is under the control of or available to a non-resident person that is not controlled by the person served with the notice of the requirement under subsection 231.6(2) if that person is related to the non-resident person.

c) déclarer sans effet la mise en demeure s'il est convaincu que celle-ci est déraisonnable.

(6) Pour l'application de l'alinéa (5)c), le fait que des renseignements ou documents étrangers soient accessibles ou situés chez une personne non-résidente qui n'est pas contrôlée par la personne à qui l'avis est signifié ou envoyé, ou soient sous la garde de cette personne non-résidente, ne rend pas déraisonnable la mise en demeure de fournir ces renseignements ou documents, si ces deux personnes sont liées.

[30] Unlike section 231.2, section 231.6 contains no provisions specifically dealing with requirements for information relating to unnamed persons to enable the Minister to determine if they are in compliance with their obligations under the Act. However, under subsection 231.2(2) such a requirement may only be imposed with a judicial authorization, which itself is subject to judicial review. In contrast, *all* requirements under section 231.6 are subject to judicial review.

[31] On the other hand, section 231.6 contains its own sanction for non-compliance, in addition to the possibility of prosecution under section 238. However, the sanction of contempt proceedings, provided by section 231.7 when a person does not comply with a requirement imposed under section 231.2, is not available for a failure to comply with a section 231.6 requirement.

231.6 (8) If a person fails to comply substantially with a notice served under subsection 231.6(2) and if the notice is not set aside by a judge pursuant to subsection 231.6(5), any court having jurisdiction in a civil proceeding relating to the administration or enforcement of this Act shall, on motion of the Minister, prohibit the introduction by that person of any foreign-based information or document covered by that notice.

231.6 (8) Si une personne ne fournit pas la totalité, ou presque, des renseignements ou documents étrangers visés par la mise en demeure signifiée conformément au paragraphe (2) et si la mise en demeure n'est pas déclarée sans effet par un juge en application du paragraphe (5), tout tribunal saisi d'une affaire civile portant sur l'application ou l'exécution de la présente loi doit, sur requête du ministre, refuser le dépôt en preuve par cette personne de tout renseignement ou document étranger visé par la mise en demeure.

E. ISSUES AND ANALYSIS

Two preliminary matters

(i) *statutory interpretation*

Digitized by Google

[32] In order to interpret statutes consistently with legislative intent, courts must determine their meaning by reference to their text, context and purpose. Thus, while the ordinary and grammatical meaning of a statutory text is the point of departure for any interpretative exercise, it is rarely the end of the journey. The meaning of the text must also be found in the purpose of both the provision in question and the statute as a whole. Whenever possible, the text of the statute should be interpreted in a manner which furthers that purpose.

[33] As for context, a court should interpret a disputed provision in light of related statutory provisions in an attempt to give a coherent meaning to the group: *Redeemer Foundation v. Canada (National Revenue)*, 2008 SCC 46 at para. 15. In addition, a court should take into consideration external context when interpreting legislation. Thus, for example, Justice Binnie said in *SOCAN* (at para. 43) that courts had to "transpose" the provisions of a *Copyright Act* designed to cover works protected by the Berne Convention of 1886, as revised in 1908, " to the information age, and to technologies undreamt of by those early legislators."

[34] This "modern approach" to interpretation which takes account of statutory text, context and purpose also applies to the *Income Tax Act,* although particular weight may be given to the ordinary meaning of the text: *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601 at paras. 10-11; *Imperial Oil Ltd. v. Canada*, [2006] 2 S.C.R. 447 at para. 26. The Supreme Court of Canada has provided additional guidance which is relevant to the interpretation of the Act's enforcement powers. Thus, in *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627, a case involving a challenge under section 8 of the *Canadian Charter of Rights and Freedoms* to the Minister's power to require the production of documents, Justice Wilson noted (at 648) that the major drawback of a self-reporting tax system such as ours is that some taxpayers will attempt to evade tax, by failing to report income, for example. Accordingly, she said:

> [T]he Minister of National Revenue must be given broad powers in supervising this regulatory scheme to audit taxpayers' returns and inspect all books and records which may be relevant to the preparation of these returns. The Minister must be capable of exercising these powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act. … A spot check or a system of random monitoring may be the only way in which the integrity of the tax system can be maintained.

(ii) *standards of review*

[35] On an *ex parte* application by the Minister under subsection 231.2(3), the judge has discretion to authorize the imposition of a requirement, subject to such conditions as the judge considers appropriate, if satisfied that paragraphs (*a*) and (*b*) are met. On a request under 231.2(5) for a review of an authorization granted under subsection 231.2(3), the judge reviews a judicial order which, in most cases, will have been granted by that judge. In these circumstances, the standards of review to be applied by this Court on an appeal from a judge's decision under subsection 231.2(5) are those prescribed in *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235.

[36] Thus, questions of law, including questions of statutory interpretation and procedural fairness decided by Justice Hughes in this case, are subject to review on appeal on a standard of correctness. On the other hand, findings of fact are reviewable only for palpable and overriding error, as are applications of the law to the facts, unless the question is more legal than factual or a general question of law can readily be extrapolated, in which case correctness is the standard of review.

[37] With these considerations in mind, I turn to the issues in this appeal. The appellants' grounds of appeal can be reduced to four propositions: (i) the Application Judge

Digitized by Google

erred by holding that the requirement does not relate to "foreign-based information"; (ii) since the information in this case is "foreign-based" it can only be obtained in accordance with section 231.6, which does not extend to information relating to unnamed persons; (iii) if, contrary to the above, section 231.2 is applicable, a requirement may only be confirmed under subsection 231.2(3) if there is evidence that the Minister is conducting a "genuine and serious inquiry" as to whether specific members of the class of unnamed persons are in compliance with the Act; and (iv) the Application Judge breached the duty of fairness by failing to give notice to eBay US and eBay International before varying the terms of the requirement in a manner that adversely affected them.

Issue 1: Is the information which eBay Canada was required to produce "foreign-based information" for the purpose of section 231.6?

[38] Counsel for eBay Canada says that the Minister's general power to issue requirements under section 231.2 must be read in light of section 231.6, which specifically prescribes the circumstances in which the Minister may impose a requirement for the production of "foreign-based information". Counsel relies on the presumption that a general statutory provision should not be interpreted as derogating from a specific provision. However, this argument only comes into play if the information sought by the Minister in this case is indeed "foreign-based" for the purpose of section 231.6. In my view, it is not.

[39] Subsection 231.6 defines "foreign-based information or document" as "any information or document that is available or located outside Canada". What the Minister requires to be produced in this case is "information", not a "document". However, for the purposes of sections 231.1 to 231.7, section 231 defines "document" as including "a record". "Record", in turn, is defined by subsection 248(1) to include "any other thing containing information, whether in writing or in any other form", a definition broad enough to include information in electronic form stored on a server.

[40] Counsel for the appellants says that, as a matter of law, information in electronic form stored on a server is "located" where the server is situated and, until downloaded or printed, is not located anywhere else. He argues that the fact that information is "available" in another country to those who have access to the server through their computers is not sufficient to make it "located" in that other country for the purpose of section 231.6.

[41] Counsel could not relate the interpretation of "located" that he advanced to a statutory purpose served by section 231.6. He pointed out, however, that cases in which telecommunications had been described as being "here and there" (see especially, *SOCAN* at paras. 58 and 59) do not support a conclusion that information stored on a server is "located" both at the site of the server and wherever it is accessed. Counsel noted that, by their very nature, telecommunications have two end points: the location of the communicator and the location of the recipient of the communication. This is not true of information.

[42] I agree that neither *SOCAN* nor *Libman v. The Queen*, [1985] 2 S.C.R. 178, another telecommunications case, is directly analogous to the question in issue here. More important, however, *SOCAN* instructs courts to interpret legislation in light of contemporary technology and, if necessary, to "transpose" its terms to take into account the changed technological environment in which it is to be applied.

[43] Section 231.6 was enacted in 1988, when information technology was much less developed, and less widely used, than it is today. I can well understand that a written document may be "located" where it is physically situated, and nowhere else. Of course, a copy of the document may be located elsewhere, but that is a separate document with its own location. In order to determine the parameters of the concept of "location" on the present facts, it is helpful to consider whether the rationale for a separate statutory regime governing requirements to produce "foreign-based information or document" applies to information in electronic form which is accessible through computers situated far from the servers on which

Digitized by Google

the information is stored.

[44] Section 231.6 was enacted following the publication of the Department of Finance's *White Paper on Tax Reform* (Ottawa: Canadian CCH Limited, 1987), which recommended changes in the law to make it easier for the Minister to obtain information about cross-border transfer pricing: Annex 2, pp. 223 and 224. However, the language of section 231.6 deals with foreign-based information more generally and is not in terms limited to requiring the production of information concerning international transfer pricing. Because a requirement to produce documents cannot be served extraterritorially on the person in possession of them, subsection 231.6(2) enables the Minister to serve a notice on a person resident in Canada requiring the production of documents located outside Canada.

[45] The person on whom a notice is served under subsection 231.6(2) may apply for a review of the requirement on the ground, among others, that it is unreasonable: subsection 231.6(5). Subsection 231.6(6) provides that a requirement is not "unreasonable" for this purpose on the ground that the information or document in question is under the control of a non-resident person who is not controlled by, but is related to, the person to whom the requirement was issued.

[46] In order to induce compliance with a requirement, subsection 231.6(8) provides that a judge may prohibit a person who has failed to comply substantially with the requirement from relying on foreign-based information covered by it in a civil proceeding relating to the enforcement or administration of the Act.

[47] The scheme of section 231.6 suggests that Parliament was concerned that it could be unduly onerous for a person to be required to produce material located outside Canada and in the possession of another person, and that the section may operate in an unduly extraterritorial manner. While these concerns may be taken into account on a review by a judge for unreasonableness, they are largely irrelevant to the information (bulky as it may be) that is the subject of the requirement in the present case.

[48] This is because, with the click of a mouse, the appellants make the information appear on the screens on their desks in Toronto and Vancouver, or anywhere else in Canada. It is as easily accessible as documents in their filing cabinets in their Canadian offices. Hence, it makes no sense in my view to insist that information stored on servers outside Canada is as a matter of law located outside Canada for the purpose of section 231.6 because it has not been downloaded. Who, after all, goes to the site of servers in order to read the information stored on them?

[49] Nor is the extraterritorial application of the Act a significant issue on the present facts. For example, the agreements with eBay Canada expressly provide that they may disclose confidential "eBay System Information" (which the appellants say includes information about PowerSellers) which "is required to be disclosed by order of any court": Appeal Book, vol. II, pp. 295-96. Nor does the requirement oblige a person outside Canada to do anything.

[50] Counsel concedes that the information identifying PowerSellers registered as having an address in Canada would be located in Canada if the appellants had downloaded it to their computers. In my view, it is formalistic in the extreme for the appellants to say that, until this simple operation is performed, the information which they lawfully retrieve in Canada from the servers, and read on their computer screens in Canada, is not located in Canada.

[51] I would only add that, although Justice Hughes does not frame his reasons by reference to the statutory definition of "foreign-based information" in subsection 231.6(1), he clearly meant that the information in question could be "located" at places other than the site of the servers where it is stored. For example, he stated (2007 FC 930 at para. 23) that information stored electronically outside Canada "cannot truly be said to 'reside' only in one

Digitized by Google

place", and (*supra* at para. 25) the information required by the Minister "is not foreign but within Canada" for present purposes.

[52] Having concluded that information in electronic form stored on servers outside Canada is in law capable of being located in Canada for the purpose of section 231.6, I now consider whether Justice Hughes's application of the law to the particular facts of this case was vitiated by palpable and overriding error. In my view, it was not. In finding that the information in question was located in Canada within the meaning of section 231.6, Justice Hughes properly took into consideration the fact that eBay US and eBay International had granted the appellants access to information about Canadian PowerSellers for the purpose of their business, and that they indeed used it for this purpose. The facts support the following conclusion by Justice Hughes (*supra* at para. 25):

> For perhaps corporate efficiency the information is stored elsewhere, but its purpose is in respect of Canadian business. The information is not foreign but within Canada for the purposes of section 231.2 of the *Income Tax Act*.

[53] Since the facts of this case do not engage section 231.6, it is not necessary to consider whether the presence of that section in the statutory scheme reduces the Minister's powers under section 231.2 when the requirement relates to "foreign-based information".

Issue 2: Before authorizing the Minister to impose a requirement for information concerning unnamed persons pursuant to subsection 231.2(3), must a judge be satisfied that the Minister is conducting "a genuine and serious inquiry" into whether specific members of the group of persons identified are in compliance with the Act?

[54] The appellants first raised this issue before Justice Hughes in the course of oral argument. He delayed issuing final judgment until this Court had rendered its decision in *GMREB*, where the issue also was whether the Minister had to satisfy the judge that he was engaged in a "serious and genuine inquiry" of specific members of the group of persons to whom the information relates before a requirement could be imposed under subsection 231.2(3).

[55] In reasons written by Justice Trudel, the Court held that subsection 231.2(3) does not oblige the Minister to adduce evidence that he is conducting a "serious and genuine inquiry" into one or more specific individuals in the group of unnamed persons to whom a requirement relates. The Court concluded (at para. 21) that the judge authorizing the requirement had only to be satisfied that the information in question "was required to verify compliance with the Act by one or more of the unnamed persons in the group" or that "the information is required for a tax audit conducted in good faith" (at para. 48).

[56] Justice Hughes correctly regarded himself as bound by *GMREB*. Before this Court, counsel for the appellants argued that we should not follow *GMREB*. He argued that it was wrongly decided because it was inconsistent with an earlier decision of the Supreme Court of Canada, *James Richardson & Sons, Limited*, [1984] 1 S.C.R. 614 ("*James Richardson*"). Following its previous decision in *Canadian Bank of Commerce v. Attorney General of Canada*, [1962] S.C.R. 729, the Court in *James Richardson* applied the "serious and genuine inquiry" test to the provision of the Act in force at that time which was analogous to section 231.2.

[57] However, this Court has decided in *Miller v. Canada (Attorney General)*, 2002 FCA 270, 220 D.LR. (4th) 149, that only in unusual and limited circumstances should one panel of the Court decline to follow a decision of another panel. In particular, Justice Rothstein (then of this Court) stated that, in order to ensure a degree of certainty and stability in the law, a panel should not depart from a prior decision of another panel "merely because it considers that the first case was wrongly decided" (at para. 8). However, the Court in *Miller*

Digitized by Google

also said (at para. 10) that a panel was not bound to follow a prior decision which was "manifestly wrong" in one or more specified senses, which do not include inconsistency with a prior Supreme Court of Canada decision.

[58] Nonetheless, counsel for the appellants argued that it is fundamental to the due administration of justice in Canada that lower courts are bound by decisions of the Supreme Court of Canada. Hence, he said, it must always be open to this Court to decline to follow one of its previous decisions if that decision was inconsistent with previous Supreme Court jurisprudence.

[59] I do not agree. In my opinion, a determination by this Court of the legal effect of a Supreme Court decision is as subject to the general principle set out in *Miller* as a decision by this Court on any other question of law. It is clear that that general principle does not depend on the importance of the particular legal rule at issue, because it was applied in *Miller* to a prior decision of the Court on a question of constitutional law and the Constitution is the supreme law of the land. On the other hand, as *Miller* makes clear (at para. 20), it is open to counsel to argue that a decision of this Court should not be followed on the ground that it has been overruled, expressly or impliedly, by a subsequent decision of the Supreme Court.

[60] Parenthetically, in *Phoenix Bulk Carriers Ltd. v. Kremikovski Trade*, [2007] 1 S.C.R. 588, 2007 SCC 13, the Supreme Court of Canada noted (at para. 3) that the Federal Court of Appeal had allowed the appeal from the Federal Court in that case because the Federal Court of Appeal considered itself bound by one of its previous decisions, even though it would have reached a different result if it had not been for that previous decision. In allowing the appeal, the Supreme Court expressly left open "the merits of the practice that led the Federal Court of Appeal to allow the appeal".

[61] Even if Judges of this Court are not bound to follow colleagues' decisions which they are satisfied are manifestly wrong on grounds not listed in *Miller*, I am not persuaded that *GMREB* is such a case, even though, in the view of one commentator, "it may have come as a surprise to many tax practitioners" (see Margaret Nixon, "The Minister's Power to Issue Requirements: *Minister of National Revenue v. Greater Montreal Real Estate Board*" (2008), 15 *Tax Litigation*, 954).

[62] Section 231.2 was enacted in response to the problems created for the Minister by the decision in *James Richardson*: see the comments of Justice Rothstein in *Minister of National Revenue v. Sand Exploration Ltd.*, [1995] 3 F.C. 44 (T.D.) at 51-2. Of particular importance in this context is the fact that subsections 231.2(2) and (3) introduced the need for *ex parte* judicial authorization before the Minister can impose a requirement on a taxpayer to produce information relating to persons unnamed, and subsection 231.2(5) conferred a right of review of the judge's *ex parte* order. In addition, the repeal of the restrictions in paragraphs 231.2(3)(*c*) and (*d*) on the Minister's power to impose requirements lightened the Minister's burden: see 1996 S.C., c. 21, subsection 58(1).

[63] To oblige the Minister to prove that a genuine and serious inquiry was being conducted with respect to specific persons within the ascertained group of taxpayers would, in a case such as the present, rob subsections 231.2(2) and (3) of much of their efficacy. Moreover, the Supreme Court of Canada's refusal of leave to appeal the decision in *GMREB* does nothing to strengthen the appellants' argument that it was wrongly decided.

[64] In further support of his argument that we are not constrained by *GMREB* to relieve the Minister from having to show the existence of a serious and genuine inquiry before a judge may authorize a requirement under subsection 231.2(3), counsel brought to our attention the pre-*GMREB* decision of our Court in *AGT Ltd. v. Canada (Attorney General),* [1997] 2 F.C. 878 (F.C.A.). In that case, which was apparently not put before the panel which decided *GMREB*, Justice Desjardins, writing for the Court, said (at para. 27):

Digitized by Google

> Subsection 231.2(1) is drafted in broad language, but its scope has been reduced through the rules of interpretation to situations where the information sought by the Minister is relevant to the tax liability of some specific person or persons, and when the tax liability of such person or persons is the subject of a genuine and serious inquiry. Given these criteria, I find that no error was committed by the motions judge. (Emphasis added.)

[65] However, unlike *GMREB*, the issue of the appropriate test seems not to have been thoroughly canvassed before the Court in *AGT*, and the effects of the amendments to the *Income Tax Act* in response to the decision in *James Richardson* were not the subject of detailed analysis by the Court. Moreover, *AGT* concerned a requirement issued under subsection 231.2(1) in circumstances where judicial authorization was not required, because the information sought did not relate to unnamed persons, but to documents in the possession of a federal agency. Moreover, unlike the present case, the Minister was interested in auditing the person on whom the requirement was imposed.

[66] Finally, counsel relied on the public policy embodied in privacy legislation to buttress his argument that the "serious and genuine inquiry" test should be applied to requirements imposed under section 231.2. It was important, he said, to protect individuals from large scale and indiscriminate "fishing expeditions" of the kind being launched by the Minister to obtain personal details of Canadian PowerSellers, when he had not a shred of evidence that any of them were failing to report income.

[67] Given the purpose and terms of the statutory scheme, this line of argument does not, in my opinion, warrant our revisiting *GMREB*. In a self-reporting system of taxation, "[t]axpayers have a very low expectation of privacy in their business records relevant to the determination of their tax liability" (*Redeemer Foundation v. Canada (Minister of National Revenue*) 2008 SCC 46 at para. 25) and a requirement "provides the least intrusive means by which effective monitoring of compliance with the *Income Tax Act* can be effected" (*R. v. McKinlay Transport Ltd.*, *supra* at 649).

[68] In short, even if more than one view may reasonably be held on the issue decided by *GMREB*, this is an insufficient basis for the Court to re-examine it. Considerations of both judicial economy, and certainty and stability in the law indicate that we should depart from our previous decisions only when they are manifestly in error.

[69] Having properly rejected the "serious and genuine inquiry" test on the ground that he was bound by the decision of this Court in *GMREB*, Justice Hughes concluded, largely on the basis of an affidavit, that the information sought in the requirement was needed by the Minister to conduct a good faith audit of PowerSellers resident in Canada to ensure that they were complying with their obligations under Canada's tax laws: 2008 FC 180 at para. 7. There was ample evidence to support this conclusion; his application of the correct law to the facts did not constitute palpable and overriding error.

Issue 3: Did Justice Hughes breach the duty of procedural fairness when he amended the terms of his *ex parte* order without notice to eBay US and eBay International?

[70] The *ex parte* order issued by Justice Hughes confined the scope of the requirement which the Minister proposed to impose on eBay Canada to information relating to PowerSellers "having a Canadian address according to your records". (Emphasis added.) As counsel explained it, the appellants found this limitation to their liking because it enabled them to argue that since they (as opposed to eBay US or eBay International) owned no records relating to Canadian PowerSellers, the requirement did not oblige them to produce anything.

[71] At the *inter partes* hearing, Justice Hughes removed the reference to "your records" in these limiting words and substituted, "registered as having a Canadian address".

Digitized by Google

In the appellants' view, this amendment broadened the scope of the requirement by bringing within it records belonging to eBay International stored on servers owned by eBay US. If this amendment did not strictly make the requirement binding on these non-parties, the appellants maintain, it adversely affected them by exposing their records to disclosure. Consequently, they argue, Justice Hughes should have given notice to eBay US and eBay International that he proposed to amend his *ex parte* order in this respect, and afforded them an opportunity to make representations on the appropriate wording to define this aspect of the scope of the order.

[72] I do not agree. First, one person may not generally impugn a decision on the ground that it was made without giving a fair hearing to some other person. For the most part, a breach of the duty of procedural fairness may be relied on as a ground of review only by persons to whom the duty is owed. However, eBay US and eBay International, which counsel for the appellants was at pains to insist are separate legal entities from the appellants, have not sought intervener status in this appeal in order to raise the procedural fairness issue.

[73] Second, I am not persuaded that eBay US and eBay International were adversely affected by the amendment to the order. It seems to me fanciful to argue, as the appellants do, that the original limitation on the *ex parte* order meant that eBay Canada would not have to produce any information because the appellants "owned" no "records".

[74] I see little to commend an interpretation of a judge's order that would render it nugatory. A more plausible view of the restriction, in my view, is that it was intended to ensure that, regardless of who "owned" the information to which the appellants had access, they only had to produce information relating to PowerSellers in Canada. The further amendment made by Justice Hughes at the *inter partes* hearing, without objection by eBay Canada (see 2007 FC 930 at para. 14), does not seem to me materially different from the corresponding provision in the *ex parte* order which it replaced. Rather, it was probably intended by Justice Hughes simply to clarify his previous order.

F. CONCLUSIONS

[75] For these reasons, I would dismiss the appeal with costs.

"John M. Evans"

J.A.

Compliance order – 231.7(1)

(1) On summary application by the Minister, a judge may, notwithstanding subsection 238(2), order a person to provide any access, assistance, information or document sought by the Minister under section 231.1 or 231.2 if the judge is satisfied that

the person was required under section 231.1 or 231.2 to provide the access, assistance, information or document and did not do so; and

in the case of information or a document, the information or document is not protected from disclosure by solicitor-client privilege (within the meaning of subsection 232(1)).

Notice required – 231.7(2)

An application under subsection (1) must not be heard before the end of five clear days from the day the notice of application is served on the person against whom the order is sought.

Judge may impose conditions – 231.7(3)

A judge making an order under subsection (1) may impose any conditions in respect of the order that the judge considers appropriate.

Contempt of court – 231.7(4)

Digitized by Google

) If a person fails or refuses to comply with an order, a judge may find the person in contempt of court and the person is subject to the processes and the punishments of the court to which the judge is appointed.
Appeal – 231.7(5)
An order by a judge under subsection (1) may be appealed to a court having appellate jurisdiction over decisions of the court to which the judge is appointed. An appeal does not suspend the execution of the order unless it is so ordered by a judge of the court to which the appeal is made.

Compliance Orders and Contempt of RFIs

The mechanics of the ITA clearly allow CRA to apply to a court (s. 231.7) to have the RFI enforced, and if need be, after resilient resistance to supply, to have the taxpayer held in contempt of the founding court order and sentenced to either fine and/or incarceration. Generally, from the sentences that have been handed down, Crown counsel have simply asked for fine/incarceration plus costs, plus of course, the RFI to be respected, so by simply ignoring a RFI, given how sparingly they are in fact used, you run considerable risks.[95]

Compliance order - S. 231.7
231.7 (1) On summary application by the Minister, a judge may, notwithstanding subsection 238(2), order a person to provide any access, assistance, information or document sought by the Minister under section 231.1 or 231.2 if the judge is satisfied that

> **(*a*) the person was required under section 231.1 or 231.2 to provide the access, assistance, information or document and did not do so; and**
> **(*b*) in the case of information or a document, the information or document is not protected from disclosure by solicitor-client privilege**
> **(within the meaning of subsection 232(1)).**

Notice required
(2) An application under subsection (1) must not be heard before the end of five clear days from the day the notice of application is served on the person against whom the order is sought.

Judge may impose conditions
(3) A judge making an order under subsection (1) may impose any conditions in respect of the order that the judge considers appropriate.

Contempt of court
(4) If a person fails or refuses to comply with an order, a judge may find the person in contempt of court and the person is subject to the processes and the punishments of the court to which the judge is appointed.

Appeal
(5) An order by a judge under subsection (1) may be appealed to a court having appellate jurisdiction over decisions of the court to which the judge is appointed. An appeal does not suspend the execution of the order unless it is so ordered by a judge of the court to which

[95] See Minister of National Revenue And Linda Mae Marshall, 2006 FC 788, for the classic start-off. 125 2006 FC 455

Digitized by Google

the appeal is made.

In Minister Of National Revenue v. Kevin William Middleton[125] the actions were taken to the point of ordering a contempt of court using the following Federal Court Rules:

> I. Introduction
>
> [1] The Minister of National Revenue (the "Minister") seeks an Order, pursuant to the *Federal Courts Rules*, SOR/98-106 (the "Rules") that Mr. Kevin William Middleton (the "Respondent") is in contempt of Court.II. History of this Action
>
> [2] By Notice of Application filed on April 19, 2005, the Minister sought an Order pursuant to section 231.7 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "Act") that the Respondent provide certain information and documents to the Minister, pursuant to subsection 231.2(1) of the Act.
>
> [3] Following a hearing, an Order ("Compliance Order") was issued by Justice Kelen on May 9, 2005, requiring the Respondent to comply with a notice issued by the Minister pursuant to the Act. The Order provides as follows:
>
> > THIS COURT ORDERS pursuant to section 231.7 of the *Income Tax Act* that the Respondent shall comply with the notice issued by the Minister and shall forthwith, and in any event not later than 30 days after being served with this Order, provide the Information and Documents to a Canada Customs and Revenue Agency officer acting under the authority conferred by the *Income Tax Act* or other person designated by the Commissioner of Customs and Revenue.
> >
> > THIS COURT FURTHER ORDERS that the Minister is authorized to effect service of this Order on the Respondent by personal service pursuant to Rule 128 of the *Federal Court Rules, 1998*.
> >
> > THIS COURT FURTHER ORDERS that costs are awarded to the Minister in the amount of $400.00.
>
> [4] On December 5, 2005, upon the motion of the Minister, a further order was issued requiring the Respondent to appear February 14, 2006 at 9:30 a.m., before a judge of this Court to show cause why he should not be found in contempt of an Order of the Court, specifically the Order of May 9, 2005. By letter dated January 10, 2006, the Minister sought Directions from the Court concerning the manner of proving the contents of the Court file. On January 23, 2006, a Direction was issued by the Court, directing the Minister to prove the contents of the Court file by means of certified copies of the relevant documents, that is copies certified under the seal of the Court.
>
> [5] The Minister, by his counsel, submitted copies of documents purporting to be certified by a legal assistant with the office of counsel. Following two brief adjournments on February 14, 2006, counsel obtained certified copies of relevant documents from the Registry of the Court.
>
> III. The Evidence
>
> [6] As part of his case, the Minister submitted certified copies of certain documents maintained on the Court file in this proceeding as follows:
>
> 1. Exhibit 1 – certified copy of the Order of Justice Kelen dated May 9, 2005;
> 2. Exhibit 2 – certified copy of the Affidavit of Michael J. Lawless, swearing to personal service of the Order of May 9, 2005 upon the Defendant at the Victoria Sheriff's cells on August 5, 2005.
> 3. Exhibit 3 – certified copy of the Order of May 5, 2005,

Digitized by Google

requiring the Respondent to appear before a Judge of the Federal Court at Vancouver on Tuesday the 14th day of February, 2006, at 9:30 a.m. to hear proof of the charge that he is or may be guilty of contempt of the Order of Mr. Justice Kelen dated May 9, 2005;

4. Exhibit 4 – Certified copy of the affidavit of service of Jan Falkowski relative to personal service upon the Respondent at 3620 Munns Road, Victoria of the Order of December 5, 2005, together with a copy of the Order of May 9, 2005 and the affidavit of Tiziana Hespe sworn October 11, 2005.

[7] Following the entry of the above-referenced certified copies as Exhibits 1 to 4, Mr. Allan Tocher was called to testify on behalf of the Minister. Mr. Tocher, an employee with the Canada Revenue Agency, is a resource officer/complex case officer who handles the collection of complex "high dollar" files. He is responsible for the collection of taxes owed by the Respondent. He testified that the Respondent's tax debt is approximately $30,000.00.

[8] Mr. Tocher said that, in preparing himself to testify, he had reviewed approximately 50 pages of computer diary entries, as well as file folders containing Federal Court Certificates, asset searches and correspondence to and from the Respondent. The file materials reviewed by Mr. Tocher include a copy of a "Requirement to Provide Information and Documents" that was issued on September 17, 2004, addressed to the Respondent. According to Mr. Tocher, he attempted to serve this document upon the Respondent in the hallway of the Provincial Court in Victoria on September 17, but the document fell to the floor and the Respondent walked away. A copy of the Requirement was entered as Exhibit 5.

[9] The Respondent, after receipt of the Requirement, sent a note to the Canada Customs and Revenue Agency in Victoria on September 23, 2004. The Respondent apologized if he had "appeared rude to you on Friday the 17th of September". A copy of this note was entered as Exhibit 6.

[10] Mr. Tocher testified that he subsequently re-served the Requirement upon the Respondent on November 2, 2004. This service took place at the first meeting of creditors after the Respondent had assigned himself into bankruptcy. The Respondent did not provide the information and documents requested in the Requirement, although he did submit various correspondence to the Agency. This correspondence was not produced by the witness.

[11] However, Mr. Tocher said that recently the Respondent had forwarded two documents to the Tax Service Office in Victoria. The two documents were submitted together. The first is entitled "Registered Notice of Copyright Name Common Law Trademark Claim" and the second is entitled "User Agreement". The two documents, stapled together, were admitted as Exhibit 7.

[12] Mr. Tocher testified that apart from a couple of voicemails from the Respondent within the last several weeks, there has been no other communication with him. In concluding his evidence, Mr. Tocher said that the Respondent has not provided any response to the Compliance Order.

IV. Discussion and Disposition

[13] The issue in this motion is whether the Minister has met the burden of showing that the Respondent is in contempt of an Order of this Court, specifically the Compliance Order dated May 9, 2005. That Order was issued pursuant to section 231.7 of the Act which provides as follows:

231.7. (1) On summary application by the Minister,	231.7. (1) Sur demande sommaire du ministre, un

Digitized by Google

a judge may, notwithstanding subsection 238(2), order a person to provide any access, assistance, information or document sought by the Minister under section 231.1 or 231.2 if the judge is satisfied that

(a) the person was required under section 231.1 or 231.2 to provide the access, assistance, information or document and did not do so; and

(b) in the case of information or a document, the information or document is not protected from disclosure by solicitor-client privilege (within the meaning of subsection 232(1)).

(2) An application under subsection (1) must not be heard before the end of five clear days from the day the notice of application is served on the person against whom the order is sought.

(3) A judge making an order under subsection (1) may impose any conditions in respect of the order that the judge considers appropriate.

(4) If a person fails or refuses to comply with an order, a judge may find the person in contempt of court and the person is subject to the processes and the punishments of the court to which the judge is appointed.

(5) An order by a judge under subsection (1) may be appealed to a court having appellate jurisdiction

juge peut, malgré le paragraphe 238(2), ordonner à une personne de fournir l'accès, l'aide, les renseignements ou les documents que le ministre cherche à obtenir en vertu des articles 231.1 ou 231.2 s'il est convaincu de ce qui suit:

a) la personne n'a pas fourni l'accès, l'aide, les renseignements ou les documents bien qu'elle en soit tenue par les articles 231.1 ou 231.2;

b) s'agissant de renseignements ou de documents, le privilège des communications entre client et avocat, au sens du paragraphe 232(1), ne peut être invoqué à leur égard.

(2) La demande n'est entendue qu'une fois écoulés cinq jours francs après signification d'un avis de la demande à la personne à l'égard de laquelle l'ordonnance est demandée.

(3) Le juge peut imposer, à l'égard de l'ordonnance, les conditions qu'il estime indiquées.

(4) Quiconque refuse ou fait défaut de se conformer à une ordonnance peut être reconnu coupable d'outrage au tribunal; il est alors sujet aux procédures et sanctions du tribunal l'ayant ainsi reconnu coupable.

(5) L'ordonnance visée au paragraphe (1) est susceptible d'appel devant le tribunal ayant compétence pour entendre les appels des décisions du tribunal ayant rendu

Digitized by Google

over decisions of the court to which the judge is appointed. An appeal does not suspend the execution of the order unless it is so ordered by a judge of the court to which the appeal is made.	l'ordonnance. Toutefois, l'appel n'a pas pour effet de suspendre l'exécution de l'ordonnance, sauf ordonnance contraire d'un juge du tribunal saisi de l'appel.

[14] Contempt proceedings in this Court are governed by Rules 466 to 472. Rules 466(b), 467(1), (3) and (4), 469 and 470(2) are relevant to the present matter and provide as follows:

466. Subject to rule 467, a person is guilty of contempt of Court who ... (b) disobeys a process or order of the Court;	466. Sous réserve de la règle 467, est coupable d'outrage au tribunal quiconque : … b) désobéit à un moyen de contrainte ou à une ordonnance de la Cour;
467. (1) Subject to rule 468, before a person may be found in contempt of Court, the person alleged to be in contempt shall be served with an order, made on the motion of a person who has an interest in the proceeding or at the Court's own initiative, requiring the person alleged to be in contempt (a) to appear before a judge at a time and place stipulated in the order; (b) to be prepared to hear proof of the act with which the person is charged, which shall be described in the order with sufficient particularity to enable the person to know the nature of the case against the person; and (c) to be prepared to present any defence that the person may have.	467. (1) Sous réserve de la règle 468, avant qu'une personne puisse être reconnue coupable d'outrage au tribunal, une ordonnance, rendue sur requête d'une personne ayant un intérêt dans l'instance ou sur l'initiative de la Cour, doit lui être signifiée. Cette ordonnance lui enjoint : a) de comparaître devant un juge aux date, heure et lieu précisés; b) d'être prête à entendre la preuve de l'acte qui lui est reproché, dont une description suffisamment détaillée est donnée pour lui permettre de connaître la nature des accusations portées contre elle; c) d'être prête à présenter une défense.
... (3) An order may be made under subsection (1) if the Court is satisfied that there	.. (3) La Cour peut rendre l'ordonnance visée au paragraphe (1) si elle est

Digitized by Google

is a prima facie case that contempt has been committed.	d'avis qu'il existe une preuve prima facie de l'outrage reproché.
(4) An order under subsection (1) shall be personally served, together with any supporting documents, unless otherwise ordered by the Court.	(4) Sauf ordonnance contraire de la Cour, l'ordonnance visée au paragraphe (1) et les documents à l'appui sont signifiés à personne.
469. A finding of contempt shall be based on proof beyond a reasonable doubt.	469. La déclaration de culpabilité dans le cas d'outrage au tribunal est fondée sur une preuve hors de tout doute raisonnable.
470. (2) A person alleged to be in contempt may not be compelled to testify.	470.(2) La personne à qui l'outrage au tribunal est reproché ne peut être contrainte à témoigner.

[15] In *Lyons Partnership, L.P. v. MacGregor* (2000), 5 C.P.R. (4th) 157 (F.C.T.D.), the Court held that the Rules codify the common law of contempt. The moving party must prove beyond a reasonable doubt that the defendant had personal knowledge of the Court order; that the defendant was a primary actor, expressly or impliedly, in the conduct at issue; and that the defendant possessed the necessary *mens rea*.

[16] The Minister bears the burden of showing, first, that the Respondent was served with the Compliance Order of May 9, 2005. In that regard, he relies on the affidavit of Michael Lawless who deposed that he personally served the Respondent at the Victoria Sheriff's cells on August 2, 2005.

[17] Personal service upon an individual is governed by Rule 128. Rule 128(1) provides as follows:

128. (1) Personal service of a document on an individual, other than an individual under a legal disability, is effected	128. (1) La signification à personne d'un document à une personne physique, autre qu'une personne qui n'a pas la capacité d'ester en justice, s'effectue selon l'un des modes suivants :
(a) by leaving the document with the individual;	a) par remise du document à la personne;
(b) by leaving the document with an adult person residing at the individual's place of residence, and mailing a copy of the document to the individual at that address;	b) par remise du document à une personne majeure qui réside au domicile de la personne et par envoi par la poste d'une copie du document à cette dernière à la même adresse;
(c) where the individual is carrying on a business in Canada, other than a partnership, in a name or style other than the individual's own name, by	c) lorsque la personne exploite une entreprise au Canada, autre qu'une société de personnes, sous

Digitized by Google

leaving the document with the person apparently having control or management of the business at any place where the business is carried on in Canada;	un nom autre que son nom personnel, par remise du document à la personne qui semble diriger ou gérer tout établissement de l'entreprise situé au Canada;
(d) by mailing the document to the individual's last known address, accompanied by an acknowledgement of receipt form in Form 128, if the individual signs and returns the acknowledgement of receipt card or signs a post office receipt;	d) par envoi par la poste du document à la dernière adresse connue de la personne, accompagnée d'une carte d'accusé de réception selon la formule 128, si la personne signe et retourne la carte d'accusé de réception;
(e) by mailing the document by registered mail to the individual's last known address, if the individual signs a post office receipt; or	e) par envoi par courrier recommandé du document à la dernière adresse connue de la personne si la personne signe le récépissé du bureau de poste;
(f) in any other manner provided by an Act of Parliament applicable to the proceeding.	f) le mode prévu par la loi fédérale applicable à l'instance.

[18] Since there is no evidence that any attempt was made to serve the Respondent by any of the means addressed in Rule 128(1)(b) to (e), I must consider whether service upon him at the Victoria Sheriff's cells is valid personal service, for the purpose of Rule 467(4).

[19] The Rules provide no specific requirements as to the place of service. According to Rule 128(1)(a), personal service upon an individual may be effected by leaving the document with the individual. Rule 144(1) provides that service of a document under the Rules may be effected at any time. According to the affidavit of Michael Lawless, the Respondent was served with a copy of the Order of May 9, 2005, at the Victoria Sheriff's Cells on August 2, 2005 at 2:40 p.m. I am satisfied that the Respondent was personally served with the Order of which he is alleged to be in contempt. The requirements of Rule 467(4) have been met.

[20] The next question for consideration is whether the Minister has met his burden of showing that the Respondent, having knowledge of the Compliance Order, failed to comply with it. The Minister must establish this with proof beyond a reasonable doubt; see *Bhatnager v. Canada (Minister of Employment and Immigration)*, [1990] 2 S.C.R. 217.

[21] On the basis of the evidence of Mr. Tocher, I am satisfied that the Respondent has failed to produce the information and documents requested. Mr. Tocher gave his evidence in a straight-forward manner and there is no basis to disbelieve him. The documents submitted as Exhibits 6 and 7, that is a note and copies of a Copyright Agreement and a User Agreement, do not respond to the terms of the Compliance Order. There is no evidence that the Respondent submitted any other documents to the Minister or

Digitized by Google

his agents.

[22] The tenor of the documents sent by the Respondent to the Tax Service Office in Victoria, that is the "Registered Notice of Copyright" and "User Agreement", is that the Respondent is not subject to the provisions of the Act. On its face, the Act is a law of general application. There is no evidence that it does not apply to the Respondent.

[23] The Compliance Order was issued pursuant to section 237.1 of the Act. That provision allows the Minister to apply to a judge, on a summary basis, for the provision of any assistance, information or document that is sought pursuant to sections 231.1 or 231.2 of the Act. According to subsection 231.2(1), the Minister may require any person to provide information for "any purpose related to the administration or enforcement" of the Act, including collection purposes.

[24] Mr. Tocher testified that the Respondent has a tax debt of approximately $30,000.00. He also testified that his file contains various certificates from this Court. Although he did not elaborate on this, I understand his evidence to refer to certificates issued by the Minister pursuant to section 223 of the Act. Such Certificates, once deposited with the Court, enjoy the status of a judgment that may be enforced pursuant to the Rules; see *Canada v. Piccott* (2004), 326 N.R. 177 (F.C.A.).

[25] It appears to me that the Minister obtained the Compliance Order for purposes associated with the purposes of the Act. There is no evidence to explain non-compliance with the Order. The validity of the Compliance Order can only be challenged by legal process; see *Canada (Canadian Human Rights Commission) v. Taylor*, [1990] 3 S.C.R. 892.

[26] The Respondent alone was the subject of the Compliance Order. Upon the evidence before me, he failed to obey it. He was the principal actor. By his failure to comply, he has disobeyed that Order. The documents that he submitted to the CCRA, that is the so-called Copyright Agreement and User Agreement, indicate an intention to not comply with the Compliance Order. I infer from these documents an intention of non-compliance; that satisfies the required elements of *mens rea*.

[27] In these circumstances, I am satisfied that the Minister has met the burden and the legal test described in *Lyons Partnership*. An Order for Contempt will issue.

[28] The next matter is the appropriate penalty. Rule 472 governs the imposition of a penalty that may be imposed when the Court has found a person to be in contempt and provides as follows:

472. Where a person is found to be in contempt, a judge may order that	472. Lorsqu'une personne est reconnue coupable d'outrage au tribunal, le juge peut ordonner :
(a) the person be imprisoned for a period of less than five years or until the person complies with the order;	a) qu'elle soit incarcérée pour une période de moins de cinq ans ou jusqu'à ce qu'elle se conforme à l'ordonnance;
(b) the person be imprisoned for a period of less than five years if the person fails to comply with the order;	b) qu'elle soit incarcérée pour une période de moins de cinq ans si elle ne se conforme pas à l'ordonnance;
(c) the person pay a fine;	c) qu'elle paie une amende;
(d) the person do or refrain from doing any act;	d) qu'elle accomplisse un acte ou s'abstienne de
(e) in respect of a person	

Digitized by Google

referred to in rule 429, the person's property be sequestered; and	l'accomplir; e) que les biens de la personne soient mis sous séquestre, dans le cas visé à la règle 429;
(f) the person pay costs.	f) qu'elle soit condamnée aux dépens.

[29] The Minister seeks a fine of $3,000.00, costs in the amount of $2,000.00, together with the provision for a term of imprisonment if the Respondent fails to pay the fine and costs within a specified time. As well, the Applicant seeks the issuance of an order in the same terms as the Compliance Order, together with the imposition of a term of imprisonment if the Respondent fails to comply within a specified time. In effect, the Applicant is seeking the re-issuance of the May 9, 2005 Compliance Order with additional terms, that is the imposition of a prison term for failure to comply.

[30] In *Canadian Copyright Licensing Agency v. U-Compute*, 2005 FC 1644, the Court identified three factors to be considered in imposing a penalty for contempt, at paragraph 76:

> 76. In *Lyons Partnership, L.P. v. MacGregor*, [2000] F.C.J. No. 341, this Court summarized the relevant factors to be considered in framing a penalty. In assessing the penalty for contempt the Court should consider the gravity of the contempt, deterrence of similar conduct, any profit made from the contemptuous conduct, whether the contempt offence is a first offence, the contemptor's past conduct and the presence of any mitigating factors such as good faith or apology.

[31] In the circumstances outlined above, I am satisfied that a fine should be imposed upon the Respondent, as a sanction for his disobedience of the Court's Order of May 9, 2005. However, I am not persuaded that the fine should be as high as $3,000.00, in the absence of evidence to support that amount. Reference to other cases where a $3,000.00 fine was imposed does not mean that the same fine should be imposed here. I impose a fine of $2,000.00.

[32] The Minister seeks costs in the amount of $2,000.00. An award of costs is in the discretion of the Court; see Rule 400(1). In this case, I am satisfied that an award of costs in the amount of $1,000.00 is appropriate.

[33] I am not persuaded that a further Order should be issued, as sought by the Minister, requiring the Respondent to provide information and documents within a specified time period, failing which a term of imprisonment could be imposed. The Compliance order of May 9, 2005 remains in full force and effect.

Digitized by Google

ORDER

THIS COURT ORDERS THAT:

1. The Respondent is found to be in contempt of the Order dated May 9, 2005, pursuant to Rule 466(1)(b) of the *Federal Courts Rules*, SOR/98-106;
2. A fine of $2,000.00 is imposed upon the Respondent, payable within thirty (30) days of service upon him of this Order;
3. The Respondent is to pay costs in the amount of $1,000.00 within thirty (30) days of service upon him of this Order;
4. If the Respondent fails to pay the fine of $2,000.00 and costs of $1,000.00 within thirty (30) days of being served with this Order, the Court imposes a sentence of fifteen (15) days imprisonment for default of payment of the fine and a sentence of fifteen (15) days imprisonment for default of payment of the costs, such sentences to run consecutively.

"E. Heneghan"

Judge

…a lenient condition to satisfy.

In Minister Of National Revenue v. Sandra Bjornstad[126] Rule 472 of the Federal Court Rules was also applied in a court order when a s. 231.7 court order for a RFI was ignored. The justice held:

REASONS FOR ORDER

DAWSONJ.

[1] In these reasons I explain why I have found Ms. Bjornstad to be in contempt of the Court's order of February 21, 2006 and note that her continued failure to comply with that order may lead to her imprisonment.

APPLICABLE LEGAL PRINCIPLES

[2] Rule 466(*b*) of the *Federal Courts Rules*, SOR/98-106 (Rules) provides that a person is guilty of contempt of court who disobeys an order of the Court.

[3] Principles to be applied when considering whether to find a person in contempt of court are:

1. The party alleging contempt has the burden of proving such contempt, and the person alleged to be in contempt (the contemnor) need not present evidence to the Court.
2. The constituent elements of contempt must be proven beyond a reasonable doubt.
3. In the case of disobedience of an order of the Court, the elements which must be established are the existence of the Court order, knowledge of the order by the alleged contemnor, and knowing disobedience of the order.
4. Unless the Court otherwise directs, evidence to establish contempt shall be given orally.

See: Rules 469 and 470, and *Tele-Direct (Publications) Inc. v. Canadian Business Online Inc.* (1998), 151 F.T.R. 271.

[4] The fundamental purpose of the Court's contempt power is to ensure respect for the judicial process so as, in turn, to secure the proper and effective functioning of the judicial system. In short, the rule of law requires that court orders be complied with.

FINDINGS OF FACT

[5] Oral evidence in support of the allegation of contempt of court was given by: Mr. So, an auditor with the Canada Revenue Agency (CRA); Ms. Duff, a civil enforcement bailiff; and Mr. Ebeling, another civil enforcement bailiff. Each person testified in a straight-forward manner with no inconsistencies or inherent implausibilities in their evidence. Each answered questions I put to them directly and without hesitation. I find each witness to be credible and

Digitized by Google

accept their evidence.

[6] Additionally, certified copies of the Court's orders of January 23, 2006, February 21, 2006, and May 23, 2006 (all described below) were tendered and received as exhibits.

[7] Ms. Bjornstad did not attend in Court, nor did she otherwise respond to the application to find her to be in contempt of court.

[8] On the basis of the above described evidence, I am satisfied beyond a reasonable doubt of the following facts:

1. On July 19, 2005, Mr. So, accompanied by another auditor employed by the CRA, met with Ms. Bjornstad at her home in Stony Plain, Alberta. At that time Mr. So personally served Ms. Bjornstad with a Requirement to Provide Information and Documents (Requirement) issued pursuant to paragraphs 289(1)(*a*) and (*b*) of the *Excise Tax Act*, R.S.C. 1985, c. E-15 and paragraphs 231.2(1)(*a*) and (*b*) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.). Attached to the Requirement as Appendix A was a list of the documents Ms. Bjornstad was required to provide. Attached as Appendix B to the Requirement was a series of questions Ms. Bjornstad was required to answer in respect of the period from January 1, 2002 to December 31, 2004. Attached to these reasons as Appendices A and B are true copies of the appendices attached to the Requirement. The Requirement specified that the information and documents were to be provided within 30 days of receipt.

2. Ms. Bjornstad failed to make any response to the Requirement. No information or documents were provided by her, or on her behalf.

3. On January 30, 2006, Ms. Bjornstad's husband was personally served at Ms. Bjornstad's residence with a copy of the applicant's record filed in this proceeding by the Minister of National Revenue (Minister) in which he sought an order requiring Ms. Bjornstad to comply with the Requirement. Ms. Bjornstad's husband was also served with a copy of the Court's order of January 23, 2006 which permitted documents to be served upon Ms. Bjornstad by handing them to an adult person at her residence.

4. On February 21, 2006, the Court allowed the Minister's application and ordered that Ms. Bjornstad comply with the Requirement by March 23, 2006. This is the order she failed to obey.

5. On March 5, 2006, Ms. Bjornstad was personally served with the Court's order of February 21, 2006.

6. Ms. Bjornstad did not comply with the Requirement by March 23, 2006 as required by the Court's order, or at all. To date, neither the required documents nor information has been provided by Ms. Bjornstad.

7. On May 23, 2006, an order was made requiring Ms. Bjornstad to appear at the Court's general sitting in Edmonton on June 19, 2006 and to be prepared to answer the allegation of contempt of court made against her.

8. On May 24, 2006, Ms. Bjornstad was personally served with the Court's order of May 23, 2006.

[9] These facts establish, without doubt, the existence of the Court's order of February 21, 2006, Ms. Bjornstad's knowledge of that order, and Ms. Bjornstad's disobedience of that order. She is guilty of contempt of court because she has disobeyed the Court's order of February 21, 2006.

APPROPRIATE DISPOSITION

[10] The Minister seeks an order requiring Ms. Bjornstad to: provide the information and documents; pay a fine of $2000.00; and pay costs.

[11] Rule 472 deals with the penalty which may be ordered on a finding of contempt. The rule provides that:

472. Where a person is found472. Lorsqu'une personne est

Digitized by Google

to be in contempt, a judge may order that
(a) the person be imprisoned for a period of less than five years or until the person complies with the order;
(b) the person be imprisoned for a period of less than five years if the person fails to comply with the order;
(c) the person pay a fine;
(d) the person do or refrain from doing any act;
(e) in respect of a person referred to in rule 429, the person's property be sequestered; and
(f) the person pay costs.

reconnue coupable d'outrage au tribunal, le juge peut ordonner :
a) qu'elle soit incarcérée pour une période de moins de cinq ans ou jusqu'à ce qu'elle se conforme à l'ordonnance;
b) qu'elle soit incarcérée pour une période de moins de cinq ans si elle ne se conforme pas à l'ordonnance;
c) qu'elle paie une amende;
d) qu'elle accomplisse un acte ou s'abstienne de l'accomplir;
e) que les biens de la personne soient mis sous séquestre, dans le cas visé à la règle 429;
f) qu'elle soit condamnée aux dépens.

[12] I am prepared to order that:

1. The order that accompanies these reasons is to be personally served upon Ms. Bjornstad by leaving a copy of it with her.
2. Within 30 days of service of the order upon her, Ms. Bjornstad shall provide the information and documents which she was required to provide pursuant to the Requirement and the Court's order of February 21, 2006. As noted above, for ease of reference the information and documents are set out in Appendices A and B to these reasons.
3. Within 30 days of service of the order upon her, Ms. Bjornstad shall pay a fine of $2,000.00. I am satisfied that this amount reflects the gravity of the contempt and will deter similar conduct. But for the Minister's request at the oral hearing for a fine in this amount I would have been inclined to order payment of a larger fine. I reject the Minister's attempt to later seek an increased amount in the context of his submission on costs.
4. Within 30 days of service of the order upon her, Ms. Bjornstad shall pay costs to the Minister which I fix in the amount of $4,090.85. This amount represents reasonable costs calculated on a solicitor-client basis, recognizing that the services provided for in the previous order with respect to costs made by Justice Campbell should not be duplicated. I am satisfied this amount pays expenses reasonably incurred by the Minister. It includes an allowance of $440.85 on account of Court fees and disbursements. The award of costs on a solicitor-client basis reflects the policy of the Court that a party who assists the Court in the enforcement of its orders and in ensuring respect for its orders should not be put out of pocket. See, for example, *Coca-Cola Ltd. v. Pardham (c.o.b. Universal Exporters)*, 5 C.P.R. (4th) 333 (F.C.T.D.) aff'd on other grounds, (2003) 23 C.P.R. (4th) 173 (F.C.A.) and the authorities reviewed in the trial division by Associate Chief Justice Lutfy (as he then was).
5. In the event that Ms. Bjornstad does not comply with paragraph 2 above, the Minister may seek an order pursuant to Rule 471 requesting that the Attorney General of Alberta assist the Court by bringing Ms. Bjornstad before any judge of this Court to show cause why she should not be imprisoned for some period of time, or until she complies with the Court's order of February 21, 2006.

"Eleanor R. Dawson"
Judge

Digitized by Google

Ottawa, Ontario
June 28, 2006

REQUIREMENT TO PROVIDE INFORMATION AND DOCUMENTS
APPENDIX A:
The following documentation is to be provided for the period January 1, 2002 to December 31, 2004.
Business Records:
1) All source documents such as income & expense invoices.
2) All books of entry such as synoptic journal, cash receipts and disbursement journal, general journal, general ledgers and grouping schedules, if applicable.
3) Chart of accounts and a listing of vendors and suppliers
4) Accounts payable list, accounts receivable list and payroll ledgers, if applicable.
5) Bank statements, cancelled cheques and duplicate deposit books.
6) Credit card statements and source documents for business purchases
7) Contracts, loan and lease agreements
8) Details of drawings account
9) Copies of income tax returns for 2002, 2003 and 2004
10) List of fixed assets purchased and disposed; with date purchased, description and amount. Supporting documentation will be required as well.
11) Capital Cost Allowance (CCA) Schedule
12) Copies of year end financial statements
13) Sales invoices, sales summaries, work estimates, and work orders.
14) All backups of accounting software, if any, for the above stated audit period.
15) GST returns and the working papers used to prepare the GST returns.
16) Accountant's or Representative's working papers, grouping schedules and adjusting entries for the years under audit.
Personal Records:
1) All personal bank account statements/passbooks, transaction records, cancelled cheques and bank account reconciliation's.
2) All credit card statements, line of credit statements, and loan/mortgage documents including the repayment schedules and the purpose of the loans.
3) All insurance policy documents.
4) List of major personal assets (eg real estate, vehicles, equipment, recreational, etc.) along with the approximate costs/proceeds of disposition and year of acquisition/disposal.
5) Personal investment statements (eg. RRSP, mutual funds, term deposits, etc.).
6) If you have received any non-taxable sources of funds that would impact your financial situation during the audit period, please provide the details.

REQUIREMENT TO PROVIDE INFORMATION AND DOCUMENTS
APPENDIX B:
1. BUSINESS HISTORY:
A) When and how was the business started or acquired?
Organization type is:
Changes to business structure and/or ownership during the audit period are as follows:
List of Shareholders & Directors (and % shares) or partners (and % interest):
List of any related or associated businesses (or persons):
Is the taxpayer part of a group (for promotion purposes etc.):

Digitized by Google

B) Determine the nature of goods and services performed - including any secondary and/or by-products. (refer to specific guidelines for this type of business, if available, for common sources).

Description activity A: _____%
Description activity B: _____%
Description activity C: _____%

Most common activity or product sold currently and in the audit period:

	Main Goods/Services Sold/Provided
Major Customers	
i) 7% taxable	
ii) 0% taxable	
iii) Exempt	
iv) Major suppliers	

Days and hours of operation:
Are operations seasonal?
Peak and slack periods of operation.
D) Has there been any changes in the goods and services provided in recent years?
E) Major business asset acquisitions and dispositions:
Acquisitions/Dispositions:

Item acquired/ disposed of	Date	Cost	Proceeds	Percentage Commercial Use

2. MAINTENANCE OF BUSINESS BOOKS AND RECORDS:

A) List and describe the books and records maintained?

Business fiscal year end:
Bookkeeping System:
manual:
computerized:
type of software used:

B) Vending Licenses, municipal and/or provincial:
C) Who maintains the books and records?
Persons and responsibility:
Frequency of visits to the accountant:
Personal portions and how determined:
"Travel/Promotion" expenses:
"Vehicle" expenses
"Personal Consumption"
How involved is the owner in the handling of cash in the business?
What controls are in place in owner's absence?
D) Preparation of Income Tax and GST Returns:
Are the GST returns/elections prepared and filed by the taxpayer, staff (bookkeeper or controller) or an external accountant?
Are the Income Tax returns and financial statements prepared and filed by the taxpayer, staff (bookkeeper or controller) or an external accountant?
E) Accounting for Sales/Revenue and GST on Taxable Supplies

Digitized by Google

How are sales and accounts receivable recorded in the books and records?
How sales received and receivable recorded in the books and records?
How is GST received and receivable recorded in the books and records?
How is GST calculated (7% or 7/107)?
Is GST collected on all sales/services?
Are credit cards accepted? Are cheques accepted?
What is the percentage (%) of credit card sales?
What is the percentage (%) of cash sales?
Does the cash register total the GST collected?
What is the basis of the gross revenues income reported on the financial statements - ie. is gross reported revenue net of or does it include GST and PST?.
How is GST reported on the GST tax returns - ie. received or receivable?
F) Accounting for Expenses and GST Input Tax Credits
How are purchase and expense transactions recorded in the books and records?
How are purchases and expenses - paid and payable - recorded in the books and records?
How is GST - paid and payable - recorded in the books and records in respect of expenses?
What purchases make up your regular ITC's?
Who are your major suppliers?
Is an adjustment made for personal portions of expenses?
Is an adjustment made for personal portions of GST paid on "Travel/Promotion" expenses, "Vehicle" expenses and "Personal Consumption"?
Are purchases/expenses paid by cheque, cash or both?
Estimate the percentage (%) of cash purchases/expenses.
What is the basis of purchases and expenses claimed on the financial statements - ie. do expenses include or are they net of ITC's?.
How are ITC's claimed on the GST tax returns - ie. paid or payable?
G) Was a physical inventory count taken and how is the inventory valued?

3. BUSINESS BANKING

What are the business bank accounts and their location for the audit period and current year - details:

Financial Institution	Acct Numbers	Type of Account	Signing Authority

Who prepares the deposits?
How often are the deposits made?
Are all receipts deposited to the business account?
In which bank account(s)?
Are there any deposits to the business accounts other than sales:
ie. personal funds/loans etc?
Is there any cash withheld from the deposits?
For what purpose? (ie cash expenses/owner's draws).
Is a daily cash reconciliation done?
Is a cash float maintained - how much?
How are credit card receipt deposits handled? Is a separate bank account maintained for either Visa or MasterCard deposits?
Were there any business loans or lines of credit outstanding during the audit period - details:

3. PERSONAL BANKING

What are the personal bank accounts and their location for the audit period and current year - details:

Financial Institution	Acct Numbers	Type of Account	Signing Authority

Nature and source of deposits to personal accounts:
Drawings/wages/sale of personal assets:

Digitized by Google

Spouse's (or equivalent's) personal bank accounts:
Financial Institution Acct Numbers Type of Account Signing Authority
Nature and source of deposits to personal accounts:
Wages/sale of personal assets:
4. Any non-taxable sources of funds?
Inheritances/lottery winnings/gifts/gambling:
Cash-on-hand:
How much "cash" do you maintain outside of your personal and business bank accounts?
Have you ever maintained any extraordinary "cash" amount outside of your personal or business bank accounts?
Do you maintain one or more safe deposit boxes?

5. Other Personal Investments:

Determine existence of and details of the following:
Have you loaned or given money personally - i.e. family/friends, etc.?
List real property bought/sold or owned currently and during the audit period.
i.e. Principal/Primary Residence
Cottage/Time Shares/Vacation Properties
Rental Properties
Development Property
Vacant Land
Farm Land
List vehicles bought, sold or owned during the audit period. (Obtain details.)
i.e. Automobiles
Boats/Yachts/Planes
Motorbikes/All terrain vehicles
Recreation Vehicles/Trailers
List other personal asset acquisitions/dispositions.
i.e. Furniture/Appliances/Stereo/Video/TV
Antiques or Collectibles
Works of Art/Coins, etc.
Any individual or family vacations taken during the audit period? (Obtain details.)
6. Personal Loans/Mortgages/Lines of Credit
Mortgages (principal residence or rental property)
Vehicle Loans
Personal Loans
Lines of Credit
Credit Cards
Were there any non-institution loans made or outstanding during the audit period i.e. family/friends, etc.? (Obtain details.)
Have you received any money from family/friends, etc.? (Obtain details.)
Do you or have you ever held any money in trust for others? (Obtain details.)
7. International Information
Determine existence of and details of the following:
Offshore assets and liabilities.
Trust set-up offshore.
Business operations offshore.
Offshore banking information.
Offshore investment information and brokerage details.
Foreign pension income.

Digitized by Google

Foreign tax returns for all of the audit period.

See also MNR v. Alistair John Camplin[96] for the argument that the taxpayer was not bound by the compliance order since he felt that it didn't apply to his "natural person". The court held otherwise and disposed of the argument.[97]

Minister Of National Revenue v. The Money Stop Ltd And Tel Sutherland, 2013FC133, An Example of a S. 231.7 Contempt Proceeding

Date: 20130207
Docket: T-2045-11
Citation: 2013 FC 133
Ottawa, Ontario, February 7, 2013
PRESENT: The Honourable Mr. Justice Zinn
BETWEEN:

THE MINISTER OF NATIONAL REVENUE

Applicant

and

THE MONEY STOP LTD and TEL SUTHERLAND

Respondents

REASONS FOR ORDER AND ORDER

Mr. Sutherland and The Money Stop Ltd., his business, have had every opportunity to satisfy an Order of this Court, or to purge their contempt, but have not done so. They chose not to attend their sentencing hearing.

Background

[1] The Minister of National Revenue required certain financial records in order to conduct an audit of The Money Stop Ltd, a "payday lender" with three locations in Alberta and whose director is Tel Sutherland.

[2] The Canada Revenue Agency [CRA] requested this information in July and August 2011, and it further asked that it be provided by October 2011. The respondents failed to comply.

[3] The Minister initiated an application for an order of compliance pursuant to section

---

[96] 2006 FC 818
[97] 2007 FC 183

Digitized by Google

231.7 of the *Income Tax Act*, RSC 1985, c 1 (5th supp), which Justice Harrington granted on February 6, 2012. The respondents did not comply with Justice Harrington's Order.

[4] As a consequence of their failure to comply with Justice Harrington's Order, the Minister initiated contempt proceedings. By Order dated April 3, 2012, Justice Gleason directed that the respondents appear before this Court to answer the allegation that they were guilty of contempt.

[5] At the contempt hearing on July 3, 2012, the respondents admitted that they had not complied with Justice Harrington's Order. Based on that admission, and being satisfied that all other requirements had been met, on July 4, 2012 I issued an Order finding the respondents in contempt but permitted them a further period of 30 days to provide the following six items of information, failing which the Minister was at liberty to proceed with a request that this Court sentence the respondents for their contempt:

a. The password and username for the electronic version of the respondents' QuickBooks records previously provided on an USB key;
b. Individual cheque cashing transaction information in electronic format on a USB key, including password and username;
c. Bank statements, cancelled cheques, and duplicate deposit books for all business bank accounts;
d. Corporate Minute Book;
e. Completed RC59, *Business Consent Form*, to allow the Canada Revenue Agency to deal with the individual or firm who prepared the amended Corporate Tax Returns; and
f. Personal bank statements and cancelled cheques for 2006, 2007, 2008 and 2009.

[6] The Minister filed evidence that the respondents have failed to comply, they have failed to provide those six items, and accordingly the Minister asks that the respondents be sentenced now for their contempt.

[7] The sentencing hearing came on by way of videoconference between the Court in Ottawa, Ontario, and Edmonton, Alberta, on Tuesday, January 29, 2013. The respondents were properly served with notice of the hearing and, in fact, Mr. Sutherland had been in contact with the Court Registry prior to that date, making it clear that he was aware of the hearing. Nonetheless, and despite providing additional time for them to appear in case they were late, the respondents failed to appear before the Court on January 29, 2013. In addition to having been served with the notice of hearing, the respondents had previously been served and were aware of the sentence that the Minister was seeking for their contempt. Further, I also specifically asked the applicant and the Court Registry to inform me if the respondents contacted either of them subsequent to the sentencing hearing. As of this date, neither has so informed me nor have the respondents apparently attempted to communicate with the Court in any way.

[8] The Minister filed additional affidavit evidence on this hearing which proves that, although the respondents "delivered five boxes of documents to a hotel near the offices of the CRA," they failed to provide to the Minister with the following:

a. The password and username for the electronic version of the respondents' QuickBooks records previously provided on an USB key;
b. Individual cheque cashing transaction information in electronic format on a USB key, including password and username;
c. Corporate Minute Book;
d. Completed RC59, *Business Consent Form*, to allow the Canada Revenue Agency to deal with the individual or firm who prepared the amended Corporate Tax Returns; and

Digitized by Google

e. Personal bank statements and cancelled cheques for 2006, 2007, 2008 and 2009.

Further, although the respondents provided the Minister with some business bank statements and cancelled cheques, they did not provide those listed on Schedule A attached hereto.

[9] The respondents have provided no evidence either through affidavit or oral testimony to dispute the Minister's evidence, which the Court therefore accepts. I remain satisfied beyond a reasonable doubt that the respondents remain in contempt.

[10] The Minister submits that the following sanctions are warranted and appropriate:

(a) a fine of $5,000 plus solicitor-client costs, to be paid within 30 days, failing which Tel Sutherland is to be imprisoned for 30 days; and

(b) an order that the information set out in my Order dated July 4, 2012, other than that since provided, be provided to the Minister within 30 days of service of this Order, failing which Tel Sutherland is to be imprisoned until the respondents comply.

The Minister proposes other terms involving safeguards in case payment or disclosure is not possible, and the provision of warrants in the case of non-compliance.

[11] Rule 472 of the *Federal Courts Rules* outlines the Court's jurisdiction regarding penalties for contempt:

472. Where a person is found to be in contempt, a judge may order that	472. Lorsqu'une personne est reconnue coupable d'outrage au tribunal, le juge peut ordonner :
(a) the person be imprisoned for a period of less than five years or until the person complies with the order;	a) qu'elle soit incarcérée pour une période de moins de cinq ans ou jusqu'à ce qu'elle se conforme à l'ordonnance;
(b) the person be imprisoned for a period of less than five years if the person fails to comply with the order;	b) qu'elle soit incarcérée pour une période de moins de cinq ans si elle ne se conforme pas à l'ordonnance;
(c) the person pay a fine;	c) qu'elle paie une amende;
(d) the person do or refrain from doing any act;	d) qu'elle accomplisse un acte ou s'abstienne de l'accomplir;
(e) in respect of a person referred to in rule 429, the person's property be sequestered; and	e) que les biens de la personne soient mis sous séquestre, dans le cas visé à la règle 429;
(f) the person pay costs.	f) qu'elle soit condamnée aux dépens.

[12] The Federal Court of Appeal in *Canada (Human Rights Commission) v Winnicki*, 2007 FCA 52, at para 17, endorsed that the following factors are to be considered when determining an appropriate penalty for contempt:

1. the gravity of the contempt in the context of the particular circumstances of the case as they pertain to the administration of justice;
2. whether the contempt offence is the first offence;

Digitized by Google

3. presence of any mitigating factors such as good faith or an apology; and
4. deterrence of similar conduct.

[13] The Minister also points to this Court's decision in *Minister of National Revenue v Marshall*, 2006 FC 788, at para 16 [*Marshall*], wherein this Court considered the following factors relevant to determining a sentence for contempt of an Order of this Court to disclose information pursuant to section 231.7 of the *Income Tax Act*:

> i. The primary purpose of imposing sanctions is to ensure compliance with orders of the court. Specific and general deterrence are important to ensure continued public confidence in the administration of justice;
> ii. Proportionality of sentencing requires striking a balance between enforcing the law and what the Court has called "temperance of justice";
> iii. Aggravating factors include the objective gravity of the contemptuous conduct, the subjective gravity of the conduct (i.e. whether the conduct was a technical breach or a flagrant act with full knowledge of its unlawfulness), and whether the offender has repeatedly breached orders of the Court; and
> iv. Mitigating factors might include good faith attempts to comply (even after the breach), apologize or accept responsibility, or whether the breach is a first offence.

[14] In my view, ensuring compliance with orders made by the Court pursuant to the *Income Tax Act* is critical because most everyone in Canada pays tax, and reporting is largely self-reporting. If efforts by the Minister taken to ensure that taxpayers have complied and accurately reported income are ignored or thwarted, the taxation regime is seriously compromised and that affects every Canadian as we are dependant on tax revenue to fund most of our social and other programs, and indeed our government as a whole. In that sense, compliance with the *Income Tax Act* is a fundamental civic duty which cannot be taken lightly or ignored.

[15] Moreover, the breach here is not unintentional. The respondents have known for many months of this Court's Order and they have been provided, more than once, with an opportunity to comply or explain their non-compliance. They have done neither. The recent delivery of five boxes of documents, to a location other than the offices of the CRA, might be deserving of more positive consideration if those boxes contained most of the materials ordered to be produced. However, as the record indicates, these respondents have yet to produce the majority of the items ordered. I am particularly disturbed by the respondents' failure to produce the password and username for the electronic version of the respondents' QuickBooks records previously provided on an USB key, because this was specifically discussed when the respondents previously appeared before me. Mr. Sutherland not once suggested that it was unavailable; rather, despite my best efforts to obtain its disclosure in open Court, he claimed in the July 2012 hearing that he did not then recall it. This suggests, in particular, an intentional and deliberate flouting of the Court's Order.

[16] The Minister references the fact that Mr. Sutherland has appeared at each hearing as a mitigating factor. Had he also appeared at the sentencing hearing, it may well have weighed in his favour. Having failed to appear at this important and critical hearing to explain the respondents' actions or to dispute the Minister's evidence, however, I give it little weight.

[17] In *Marshall*, unlike this case, the respondents were not given a further opportunity to comply beyond the section 231.7 compliance order. These respondents were given a further opportunity to comply by virtue of my July 4, 2012 Order. The following penalty was ordered in

Digitized by Google

Marshall:

> 1. The respondent is guilty of contempt of this Court's order dated March 2, 2006, and shall pay a fine of $3,000.00 within 30 days from the date of service of this Order, and shall pay the applicant's legal costs in the amount of $2,000.00 within 30 days from the date of service of this Order. Failure to pay this fine and the legal costs within 30 days shall subject the respondent to 30 days' imprisonment.
> 2. The respondent shall also provide the information and documents set out in the Court's order dated March 2, 2006 within 30 days from the date of service of this Order, or provide the Minister with a full explanation why the respondent does not have this information and these documents, failing which the respondent shall be imprisoned for 10 days, such term to run consecutive to any other term of imprisonment imposed by this Order.
> 3. The respondent shall not be imprisoned for failure to pay the fine or the legal costs if within 30 days from the date of service of this Order the respondent arranges with the Minister for an oral examination under oath and provides evidence satisfactory to the Court that she is not able to pay the fine or the legal costs, or that she needs an extended time period in which to pay.
> 4. If the Minister informs the Court by affidavit that payment of either the fine or the legal costs has not been made within 30 days from the date of service of this Order, and that the respondent has not arranged with the Minister for an oral examination under oath with respect to her ability to pay the fine or the legal costs, the Court shall issue a warrant for the imprisonment of the respondent for 30 days.
> 5. If the Minister informs the Court by affidavit that the respondent has not provided the information and documents set out in the Court's order dated March 2, 2006, within 30 days from the date of service of this Order or provided the Minister with a full explanation why the respondent does not have this information and these documents, then the Court shall issue a warrant for the imprisonment of the respondent for a term of 10 days, such term to run consecutive to any other term of imprisonment imposed by this Order.

[18] These respondents have already had the benefit of lenience shown in the earlier Orders granting them time to comply and purge their contempt. Having failed to take advantage of that and having failed to either appear to explain their contempt or to provide evidence of compliance, they are deserving of little more. A swift and serious penalty is appropriate to compel compliance from these respondents, act as a general deterrent, and maintain the public's confidence in the administration of justice. Justice is tempered by ordering no more than is necessary to accomplish these legitimate ends; a balance I have considered in arriving at my Order.

[19] The Minister is also seeking solicitor-client costs and has provided a Bill of Costs showing a total of $19,905.74, being $18,200.95 in fees and $1,704.79 in disbursements. The amount appears to the Court to be reasonable and, in these circumstances, it is appropriate that the Minister not be out of pocket for having to enforce this Court's Orders.

Digitized by Google

ORDER

THIS COURT ORDERS that:

1. The respondents, having been found on July 4, 2012, guilty of contempt of this Court's Order dated February 7, 2012, and having failed to provide the Minister with the information and documents set out in the Court's Order dated July 4, 2012, and having provided no defence or explanation for having failed so to do, shall pay a fine of $5,000.00 within 30 days from the date of service of this Order, and shall also pay the applicant's legal costs in the amount of $19,905.74 within 30 days from the date of service of this Order. Failure to pay this fine and the legal costs within 30 days shall subject the respondent, Tel Sutherland, to 30 days imprisonment.

2. The respondents shall also provide the information and documents set out in the Court's Order dated July 4, 2012, except those described in these Reasons for Order as having been provided since that date, within 30 days from the date of service of this Order, failing which Tel Sutherland shall be imprisoned for three (3) years, such term to run consecutive to any other term of imprisonment imposed by this Order.

3. Tel Sutherland shall not be imprisoned for failure to pay the fine or the legal costs described in paragraph 1 of this Order if within 30 days from the date of service of this Order the respondents arrange with the Minister for an oral examination under oath and provide evidence satisfactory to the Court that they are not presently able to pay the fine or the legal costs, or that they need an extended time period in which to pay.

4. Tel Sutherland shall not be imprisoned for failure to produce the documents and information described in paragraph 2 of this Order if within 30 days from the date of service of this Order the respondents arrange with the Minister for an oral examination under oath, and provide evidence satisfactory to the Court that they are not able to produce those documents or information and that their inability to do so does not stem from their own intentional actions, recklessness, or negligence.

5. If the Minister informs the Court by affidavit that payment of either the fine or the legal costs described in paragraph 1 of this Order has not been made within 30 days from the date of service of this Order and that the respondents have not arranged with the Minister for an oral examination under oath with respect to their ability to pay the fine or the legal costs, and the respondents have not satisfied the Court in accordance with paragraph 3 of this Order, the Court shall issue a warrant for the imprisonment of Tel Sutherland for 30 days.

6. If the Minister informs the Court by affidavit that the respondents have not provided the information and documents set out in paragraph 2 of this Order within 30 days from the date of service of this Order and that the respondents have not arranged with the Minister for an oral examination under oath with respect to their ability to produce those documents and information, and the respondents have not satisfied the Court in accordance with paragraph 4 of this Order, then the Court shall issue a warrant for the imprisonment of Tel Sutherland until the Minister informs the Court by affidavit that the respondents have provided all of the information and documents set
out in paragraph 2 of this Order, or a term of three (3) years, whichever is earlier. Such term shall run consecutive to any other term of imprisonment imposed by this Order.

"Russel W. Zinn"
Judge

Digitized by Google

SCHEDULE "A"

Bank Note	Account #	2007	2008	2009
			All for the year (Y/N)	
BMO	Redacted	Y	Y	Y
TD Canada Trust	Redacted	Y	Y*3	N/A
TD Canada Trust	Redacted	Y	Y*1	N/A
ATB	Redacted	Y	Y	N*7
ATB	Redacted	Y	Y	N*6
ATB	Redacted	Y	Y	N*6
ATB	Redacted	Y	Y	N*6
Royal Bank				
^	Redacted	Y	Y	N*9
TD Canada Trust	Redacted	Y	Y*5	N/A
TD Canada Trust	Redacted	Y	Y*4	N/A
ATB	Redacted	Y	Y	N*6
ATB	Redacted	Y	Y	Y*8
ATB	Redacted	Y*	Y	N*6
BMO	Redacted	N/A	Y*2	Y

*Missing Feb, 2006 Stmt
*1- Account closed March 9, 2007
*2- Account opened March 28, 2007
*3- Account closed March 9, 2007
*4- Account closed March 9, 2007
*5- Account closed April 10, 2007
*6- Missing Jan 2008 Stmt
*7- Missing Dec 2008 & Jan 2009 Stmt
*8- Account closed June 11, 2008
*9- Missing all statements – Feb 2008 to Jan 2009
^ - Also require Jan 2006 & Feb 2009 bank statements as monthly bank statements do not go to end of month. i.e. Jan 31st.

There have been instances where a taxpayer was found not to be in contempt of a court order to respond to a RFI as was the case in MNR And Bernard Dropsy, As Representative Of Cd²l Coopérative De Services En Développement International, And As Administrator Of Warrington[98]. In this case the taxpayer was found not to have access to the records requested, was not a de facto representative of the taxpayer group, and the court found for him.
In Minister Of National Revenue V. Kocsis Transport Ltd.[99] a taxpayer's excuse that there had been hazardous water damage and mould growth that prevented him from complying with a

[98] 2009 FC 820
[99] 2009 FC 1216

Digitized by Google

ordered RFI "didn't hold water": the court held that every corporate taxpayer was responsible for maintaining accurate records and found for contempt.

Issues in Solicitor Client Privilege

There is an inherent limitation on trying to advocate that tax accountants and other types of accountants have a legitimate "client privilege" in refusing to disclose client records to CRA in any of the numerous instances where they may be asked to do. Such an issue arises in instances of seized documents and those requested under a RFI.[100]

Definitions - S. 232

232. (1) In this section,

"custodian" « *gardien* »
"custodian" means a person in whose custody a package is placed pursuant to subsection 232(3);

"judge" « *juge* »
"judge" means a judge of a superior court having jurisdiction in the province where the matter arises or a judge of the Federal Court;

"lawyer" « *avocat* »
"lawyer" means, in the province of Quebec, an advocate or notary and, in any other province, a barrister or solicitor;

"officer" « *fonctionnaire* »
"officer" means a person acting under the authority conferred by or under sections 231.1 to 231.5;

"solicitor-client privilege" « *privilège des communications entre client et avocat* »
"solicitor-client privilege" means the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional confidence, except that for the purposes of this section an accounting record of a lawyer, including any supporting voucher or cheque, shall be deemed not to be such a communication.

Solicitor-client privilege defence - S. 232(2)

(2) Where a lawyer is prosecuted for failure to comply with a requirement under section 231.2 with respect to information or a document, the lawyer shall be acquitted if the lawyer establishes to the satisfaction of the court

> **(*a*) that the lawyer, on reasonable grounds, believed that a client of the lawyer had a solicitor- client privilege in respect of the information or document; and**
> **(*b*) that the lawyer communicated to the Minister, or some person duly authorized to act for the Minister, the lawyer's refusal to comply with the requirement together with**

[100] See The Fragile Privilege: Establishing and Safeguarding Solicitor-Client Privilege by Gloria Geddes in the Canadian Tax Journal, (1999), Vol. 47, No. 4 / no 4 Pg. 799 for an older discussion.

Digitized by Google

a claim that a named client of the lawyer had a solicitor-client privilege in respect of the information or document.

Seizure of certain documents where privilege claimed - S. 232(3)

(3) Where, pursuant to section 231.3, an officer is about to seize a document in the possession of a lawyer and the lawyer claims that a named client of the lawyer has a solicitor-client privilege in respect of that document, the officer shall, without inspecting, examining or making copies of the document,

(*a*) seize the document and place it, together with any other document in respect of which the lawyer at the same time makes the same claim on behalf of the same client, in a package and suitably seal and identify the package; and

(*b*) place the package in the custody of the sheriff of the district or county in which the seizure was made or, if the officer and the lawyer agree in writing on a person to act as custodian, in the custody of that person.

Examination of certain documents where privilege claimed - S. 232(3.1)

(3.1) Where, pursuant to section 231.1, an officer is about to inspect or examine a document in the possession of a lawyer or where, pursuant to section 231.2, the Minister has required provision of a document by a lawyer, and the lawyer claims that a named client or former client of the lawyer has a solicitor-client privilege in respect of the document, no officer shall inspect or examine the document and the lawyer shall

(*a*) place the document, together with any other document in respect of which the lawyer at the same time makes the same claim on behalf of the same client, in a package and suitably seal and identify the package or, if the officer and the lawyer agree, allow the pages of the document to be initialed and numbered or otherwise suitably identified; and

(*b*) retain it and ensure that it is preserved until it is produced to a judge as required under this section and an order is issued under this section in respect of the document.

Application to judge

(4) Where a document has been seized and placed in custody under subsection 232(3) or is being retained under subsection 232(3.1), the client, or the lawyer on behalf of the client, may

(*a*) within 14 days after the day the document was so placed in custody or commenced to be so retained apply, on three clear days notice of motion to the Deputy Attorney General of Canada, to a judge for an order

(i) fixing a day, not later than 21 days after the date of the order, and place for the determination of the question whether the client has a solicitor-client privilege in respect of the document, and

(ii) requiring the production of the document to the judge at that time and place;

(*b*) serve a copy of the order on the Deputy Attorney General of Canada and, where applicable, on the custodian within 6 days of the day on which it was made and, within the same time, pay to the custodian the estimated expenses of transporting the document to and from the place of hearing and of safeguarding it; and

(*c*) if the client or lawyer has proceeded as authorized by paragraph 232(4)(*b*), apply at the appointed time and place for an order determining the question.

Disposition of application

Digitized by Google

(5) An application under paragraph 232(4)(*c*) shall be heard *in camera*, and on the application

(*a*) the judge may, if the judge considers it necessary to determine the question, inspect the document and, if the judge does so, the judge shall ensure that it is repackaged and resealed; and

(*b*) the judge shall decide the matter summarily and,

(i) if the judge is of the opinion that the client has a solicitor-client privilege in respect of the document, shall order the release of the document to the lawyer, and

(ii) if the judge is of the opinion that the client does not have a solicitor-client privilege in respect of the document, shall order

(A) that the custodian deliver the document to the officer or some other person designated by the Commissioner of Revenue, in the case of a document that was seized and placed in custody under subsection 232(3), or

(B) that the lawyer make the document available for inspection or examination by the officer or other person designated by the Commissioner of Revenue, in the case of a document that was retained under subsection 232(3.1), and the judge shall, at the same time, deliver concise reasons in which the judge shall identify the document without divulging the details thereof.

Order to deliver or make available

(6) Where a document has been seized and placed in custody under subsection 232(3) or where a document is being retained under subsection 232(3.1) and a judge, on the application of the Attorney General of Canada, is satisfied that neither the client nor the lawyer has made an application under paragraph 232(4)(*a*) or, having made that application, neither the client nor the lawyer has made an application under paragraph 232(4)(*c*), the judge shall order

(*a*) that the custodian deliver the document to the officer or some other person designated by the Commissioner of Revenue, in the case of a document that was seized and placed in custody under subsection 232(3); or

(*b*) that the lawyer make the document available for inspection or examination by the officer or other person designated by the Commissioner of Revenue, in the case of a document that was retained under subsection 232(3.1).

Delivery by custodian

(7) The custodian shall

(*a*) deliver the document to the lawyer

(i) in accordance with a consent executed by the officer or by or on behalf of the Deputy Attorney General of Canada or the Commissioner of Revenue, or

(ii) in accordance with an order of a judge under this section; or

(*b*) deliver the document to the officer or some other person designated by the Commissioner of Revenue

(i) in accordance with a consent executed by the lawyer or the client, or

(ii) in accordance with an order of a judge under this section.

Continuation by another judge

(8) Where the judge to whom an application has been made under paragraph 232(4)(*a*) cannot for any reason act or continue to act in the application under paragraph 232(4)(*c*), the application under paragraph 232(4)(*c*) may be made to another judge.

Digitized by Google

Costs
(9) No costs may be awarded on the disposition of any application under this section.

Directions
(10) Where any question arises as to the course to be followed in connection with anything done or being done under this section, other than subsection 232(2), 232(3) or 232(3.1), and there is no direction in this section with respect thereto, a judge may give such direction with regard thereto as, in the judge's opinion, is most likely to carry out the object of this section of allowing solicitor-client privilege for proper purposes.

Prohibition
(11) The custodian shall not deliver a document to any person except in accordance with an order of a judge or a consent under this section or except to any officer or servant of the custodian for the purposes of safeguarding the document.

Idem
(12) No officer shall inspect, examine or seize a document in the possession of a lawyer without giving the lawyer a reasonable opportunity of making a claim under this section.

Authority to make copies
(13) At any time while a document is in the custody of a custodian under this section, a judge may, on an *ex parte* application of the lawyer, authorize the lawyer to examine or make a copy of the document in the presence of the custodian or the judge by an order that shall contain such provisions as may be necessary to ensure that the document is repackaged and that the package is resealed without alteration or damage.

Waiver of claim of privilege
(14) Where a lawyer has, for the purpose of subsection 232(2), 232(3) or 232(3.1), made a claim that a named client of the lawyer has a solicitor-client privilege in respect of information or a document, the lawyer shall at the same time communicate to the Minister or some person duly authorized to act for the Minister the address of the client last known to the lawyer so that the Minister may endeavour to advise the client of the claim of privilege that has been made on the client's behalf and may thereby afford the client an opportunity, if it is practicable within the time limited by this section, of waiving the claim of privilege before the matter is to be decided by a judge or other tribunal.

Compliance
(15) No person shall hinder, molest or interfere with any person doing anything that that person is authorized to do by or pursuant to this section or prevent or attempt to prevent any person doing any such thing and, notwithstanding any other Act or law, every person shall, unless the person is unable to do so, do everything the person is required to do by or pursuant to this section.

Minister of National Revenue v. Welton Parent Inc., 2006 FC 67, a *Tax Lawyer's* files, though Substance Acutely Measured…

REASONS FOR ORDER AND ORDER

[1] **Welton Parent seeks an order cancelling or varying my order dated March**

Digitized by Google

31, 2004 authorizing the Minister of National Revenue to impose on it a requirement which seeks to produce information and documents relating to one or more unnamed persons under subsection 231.2(3) of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) (*ITA*).

[2] This order of March 31, 2004 was granted on an *ex parte* application. Pursuant to subsection 231.2(6) of the *ITA*, it may be cancelled if I am not satisfied that the conditions set out in paragraphs 231.2(3)a) and b) have been met, and it can be confirmed or varied even if I am satisfied that those conditions have been meet.

[3] In addition to challenging the validity of this order and the resulting requirement on the basis that the statutory conditions for issuing it were not met, Welton Parent challenges its validity on three additional grounds which it says are each independently sufficient to justify quashing it.

[4] It submits that:

i) the requirement imposed on it seeks information and documents that are protected by solicitor-client privilege;

ii) subsections 231.2(3), (5), (6) and section 232 of the *ITA* unjustifiably infringe sections 7 and 8 of the *Canadian Charter of Rights and Freedom*, Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c.11 (*Charter)*,by failing to provide for adequate protection of solicitor-client privilege and are, therefore, of no force and effect. In that respect, the Court should apply the reasoning of the Supreme Court of Canada in *Lavallee, Rackel & Heintz v. Canada (A.G.)*, [2002] 3 S.C.R. 209 in which section 488.1 of the *Criminal Code*, R.S.C. 1985, c. C-46, which mirrored section 232 of the *ITA*, was quashed. Alternatively, for the same reason, the order of March 31, 2004 unjustifiably infringes sections 7 and 8 of the *Charter* and should be quashed pursuant to subsection 24(1) of the *Charter* and subsection 231.2(6) of the *ITA*.

iii) the Minister failed to make a full and frank disclosure of all the facts and information within the knowledge of the Canada Custom Revenue Agency (CCRA) that would indicate that the information and documents sought by the requirement are privileged or potentially privileged.

BACKGROUND

[5] CCRA is conducting audits, for the taxation years of 1997 to 2003 inclusive, of various Canadian employers who have claimed expenses for salaries and wages incurred in respect of contributions to what those unnamed employers claim to be offshore "health and welfare trusts" for the benefit of their employees.

[6] The interpretation bulletin IT-85R2 defines "health and welfare trust" as a vehicle which allows special treatment for employers acting for the benefit of their employees. A health and welfare trust contribution that meets the criteria set out in the bulletin and the costs related to it may be deducted by an employer as a business expense.

[7] During the course of the audits referred to above, approximately twenty-five health and welfare trusts were identified and CCRA is of the view that these trusts did not in fact meet the criteria established in the interpretation bulletin because, among other things:

a) the employers have been contributing amounts to offshore trusts which could revert back to them in the future;

b) the contributions have been unreasonably high in light of the wages earned by the employees and in light of comparable insurance plans;

c) the funds available are used for other things than to provide health and welfare benefits;

d) the payments are not made enforceable by the trust; and

e) the employer and the trustee are not dealing at arm's length.

Digitized by Google

[8] On that basis, CCRA's position has been that contributions to such trusts will not be deductible in the year they are made.

[9] In the twenty-five cases referred to above, CCRA found an actuarial valuation prepared by the actuarial firm of the respondent, Welton Parent. In each case, it appears that CCRA was well aware that Welton Parent was providing those valuations to Ottawa lawyers. It also knew that the respondent did not deal directly with the unnamed employers.[1]

[10] Although at the time the authorization was sought, CCRA was only aware of the involvement of two lawyers, Gregory Sanders and William Johnston, it is clear that Welton Parent also provided similar services to a third Ottawa lawyer, Hari S. Nesathurai.[2] Each of these lawyers uses a slightly different legal structure to establish their respective group sickness and accident insurance plans, but these plans are essentially the same. A "group sickness and accident insurance plan" is one type of benefit plan that qualifies under the interpretation bulletin IT-85R2 as a "health and welfare trust". Hereinafter, I will refer to the arrangements set up by the three Ottawa lawyers as "the Plans".

[11] It is not contested that the three lawyers were retained to provide legal advice to their clients, the unnamed taxpayers. CCRA takes the position, however, that prior to the reply to its motion record, it was not fully aware of their role and their exact relationship with Welton Parent.

[12] The evidence shows to my satisfaction that the legal mandate of these lawyers included the setting up of the Plans and the giving of an opinion to the unnamed employers on the taxability of expenses associated with the Plans.

[13] There is no evidence that those lawyers actually promoted the use of the Plans[3] or that they were involved in the financing or setting up of the Plans in any capacity other than as legal advisers. In fact, the evidence indicates that employers wishing to set up such Plans were actually referred to the three counsel by accountants and financial advisers. For example, Mr. Sanders received referrals from various Canadian chartered banks, including the Royal Bank of Canadaand the Canadian Imperial Bank of Commerce.

[14] Those lawyers retained Welton Parent directly to perform actuarial valuations of the liabilities and funding requirements of their Plans and to make recommendations based on each unnamed employer's ability to pay. The extent to which the actuarial valuations were used to render the legal opinion and fulfill the legal mandate of each lawyer will be discussed later. It is sufficient to say at this stage that, in addition to being used by the three lawyers for their own purposes, these valuations were also remitted to the custodian or the trustee of the various Plans because, in each case, they had a contractual obligation to obtain such valuations once a given Plan was established.

[15] In the course of some of its audits, CCRA obtained copies of legal opinions rendered by Mr. Sanders and Mr. Johnston to some of the taxpayers it was investigating. In those instances, the Court can only assume that the taxpayers waived their legal advice privilege.

[16] As it appears clearly from the affidavit of Daniel Rivet, dated March 5, 2004 and submitted in support of the Minister's *ex parte* application to the Court for the order authorizing the imposition of a requirement on Welton Parent, one of the main purposes of the requested requirement was to obtain the names of the employers who had established such Plans and were still unknown to CCRA.

[17] In his affidavit, Mr. Rivet also mentions that, if necessary, CCRA would also issue a requirement to the employers or the "promoters" at a later date to obtain additional documentation such as letters of wishes and trust agreements.

[18] The involvement of the Ottawa lawyers is mentioned only once in this affidavit and it is in a paragraph which explains why the arrangements failed to meet the criteria set out in the interpretation bulletin.

Digitized by Google

[19] At subsection 9(h) of his affidavit, Mr. Rivet states:

9) Review of trust agreements to date reveal that these arrangements are failing to meet the above criteria for a number or reasons. These include cases where:

(...)

(h) the documents in the files that have been reviewed by the CCRA are similar and originate from two Ottawa based lawyers (the "promoters");

[20] Thereafter, in his affidavit and in his testimony before the Court at the hearing to obtain the authorization, Mr. Rivet referred to these lawyers only as promoters. He did not indicate that CCRA had obtained copies of the legal opinions provided by these lawyers which clearly indicate that their role was mainly to act as legal advisers to their clients, the unnamed employers. In the course of these audits, it also appears that CCRA had several discussions with Welton Parent and at least one of the Ottawa lawyers.

[21] In addition to the flaws identified in paragraph 9 of his affidavit, Mr. Rivet also indicates that Welton Parent did not calculate the contributions to the Plans in accordance with accepted actuarial standards (paragraph 12 of his affidavit).

[22] The order of March 31, 2003 was issued without special conditions or reference to solicitor-client privilege. When the requirement was delivered to Welton Parent, it immediately contacted the three lawyers who had appointed it. The lawyers in turn sought to obtain instructions from the unnamed employers as to whether or not they were authorized to waive solicitor-client privilege, with respect to their names and the other information in the files of Welton Parent. They were instructed to file the present motion to preserve privilege and have done so through the respondent, Welton Parent.[4]

[23] No attempt was made by CCRA to contact the Ottawalawyers to discuss the issue of privilege when the requirement was served. However, CCRA agreed to suspend the time granted to reply to the requirement until a decision is made with respect to this motion.

[24] Extensive evidence was filed by both parties on this motion. In particular, the respondent filed affidavits by Gregory Sanders, William Johnston, Hari S. Nesathurai and Joann Williams (Welton Parent) and the Minister filed an additional affidavit of Daniel Rivet. All affiants were cross-examined.

LEGISLATION

[25] The most relevant provisions of the *ITA* are the following:

Income Tax Act, R.S.C. 1985, c.1 (5th Supp.):	*Loi de l'impôt sur le revenu*, L.R.C. (1985), ch. 1 (5e suppl.) :
231.2(3) On ex parte application by the Minister, a judge may, subject to such conditions as the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection 231.2(1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") where the judge is satisfied by information on oath that (*a*) the person or group is ascertainable; and (*b*) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act. (*c*) (Repealed by S.C. 1996, c. 21, s. 58(1).)	**231.2** (3) Sur requête ex parte du ministre, un juge peut, aux conditions qu'il estime indiquées, autoriser le ministre à exiger de tod'un tiers la fourniture de renseignements ou production de documents prévue au paragraphe (1) concernant une personne non désignée nommément ou plus d'une personne non désignée nommément -- appelée "groupe" au présent article --, s'il est convaincu, sur dénonciation sous serment, de ce qui suit: *a*) cette personne ou ce groupe est identifiable; *b*) la fourniture ou la production est exigée pour vérifier si cette personne ou les personnes de ce groupe ont respecté quelque devoir ou obligation prévu par la

Digitized by Google

(*d*) (Repealed by S.C. 1996, c. 21, s. 58(1).)présente loi;
(5) Where an authorization is granted under*c*) (Abrogé par L.C. 1996, ch. 21, art.
subsection 231.2(3), a third party on whom58(1).)
a notice is served under subsection*d*) (Abrogé par L.C. 1996, ch. 21, art.
231.2(1) may, within 15 days after the58(1).)
service of the notice, apply to the judge who(5) Le tiers à qui un avis est signifié ou
granted the authorization or, where theenvoyé conformément au paragraphe (1)
judge is unable to act, to another judge ofpeut, dans les 15 jours suivant la date de
the same court for a review of thesignification ou d'envoi, demander au juge
authorization. qui a accordé l'autorisation prévue au
(6) On hearing an application underparagraphe (3) ou, en cas d'incapacité de
subsection 231.2(5), a judge may cancelce juge, à un autre juge du même tribunal
the authorization previously granted if thede réviser l'autorisation.
judge is not then satisfied that the(6) À l'audition de la requête prévue au
conditions in paragraphs 231.2(3)(a) andparagraphe (5), le juge peut annuler
231.2(3)(b) have been met and the judgel'autorisation accordée antérieurement s'il
may confirm or vary the authorization if then'est pas convaincu de l'existence des
judge is satisfied that those conditions haveconditions prévues aux alinéas (3)a) et b). Il
been met. peut la confirmer ou la modifier s'il est
convaincu de leur existence.

[26] The other relevant sections such as 231.7, 232 and 238 of the *ITA*, sections 7, 8 and 24 of the *Charter* and sections 487 and 488.1 of the *Criminal Code* are included in Annex 1.

ANALYSIS

A- Should the requirement be cancelled because it was not sought for the purpose of verifying compliance with any "duty or obligation" under paragraph 232.1(3)b) of the *ITA*?

[27] As mentioned, the respondent argues that the applicant has failed to provide the Court with proper evidence showing that the requirement was necessary to verify compliance with any specific "duty or obligation" under the *ITA*. In their view, the Minister only referred to an alleged breach of an untested interpretation bulletin which is not binding on the courts or CCRA.

[28] Welton Parent submits that subsection 231.2(3) sets a very high threshold for the issuance of an unnamed person requirement that must be contrasted with the threshold set out at subsection 231.2(1), which permits the issuance of a requirement "for any purpose related to the administration or enforcement of this act".

[29] On the other hand, the Minister says that the requirement is valid because the requested information may be relevant to the determination of the tax liability of the unnamed taxpayers and that, indeed, section 231.2 sets a low threshold even for unnamed persons.

[30] It is not disputed that, in this particular instance, the group of unnamed taxpayers is ascertainable (paragraph 231.2(3)a)). I am satisfied that the affidavit of Mr. Rivet (in particular paragraphs 3, 17, 21 and 25) and his testimony (particularly at page 464, line 10 through page 465 of volume 4 of Welton Parent's motion record) at the *ex parte* hearing established that the Minister was seeking the required information to verify compliance by the unnamed employers with their duty to pay taxes on all revenues except for deductions permitted under the *ITA*.

[31] The unnamed employers are clearly the persons who are being investigated by the applicant and I am satisfied on the evidence presented that there may be a problem with the deductions made by these unnamed employers, with respect to their contributions to the Plans.

[32] This situation is very similar to the one recently reviewed by the Federal Court of

Digitized by Google

Appeal in *Canada (M.N.R.) v. National Foundation for Christian Leadership*, [2005] F.C.J. No. 1115 (F.C.A.)(QL), where Justice Sharlow confirmed that the conditions in paragraph 231.2(3)b) had been properly met. I conclude that the order authorizing the issuance of the requirement should not be cancelled on that basis.

B- Are the information and documents targeted by the requirement protected from disclosure by solicitor-client privilege?

1) Information and documents other than the names of the employers:

[33] After reviewing the evidence, particularly the affidavits of Gregory Sanders, William Johnston and Hari S. Nesathurai, the transcripts of their cross-examinations and the samples of their opinions, I conclude that the valuation reports of Welton Parent and the advice it provided were important elements on which all counsel relied to give their opinions on the tax consequences of the Plans they were mandated to establish on behalf of their clients. There is no doubt that, for Mr. Sanders, an actuarial opinion was necessary to support the reasonableness of the clients' deductions under the *ITA* (motion record, volume 4, page 558). Similarly, Mr. Johnston's uncontradicted evidence was that such an opinion was an essential pre-condition for him to opine on compliance with Canadian income tax law (motion record, volume 3, page 217). For Mr. Nesathurai, it is equally clear that the actuary report was essential to determine whether the funding of the plan was reasonable. Only after receiving a confirmation of the reasonableness of the actuarial assumptions was he able to provide his legal opinion to his client. Even the applicant recognizes that pursuant to the interpretation bulletin, an actuarial report is essential to determine whether the contributions can be deducted.

[34] There is uncontradicted evidence that the lawyers' clients expected that the information given to their lawyers for the purpose of obtaining legal advice would remain privileged and confidential and would be disclosed to no one without their express consent.

[35] For example, the evidence of Gregory Sanders is that he discussed privilege virtually every time he first met with a potential client. He advised his clients that all information that they conveyed to him would be privileged, "including their names and contact information", since he was a tax lawyer and disclosing their name would violate their rights with respect to privilege (cross-examination of Mr. Sanders, motion record, volume 4, pages 484 to 486, questions 49, 50 and 52).

[36] It appears that Mr. Johnston even advised his clients not to tell others that he was their lawyer, because Ottawa is not a very big town and people know that he is a tax law practitioner with a specialized tax practice (motion record, volume 4, page 646).

[37] The lawyers also provided evidence that they had always expected that all the information that they provided to Welton Parent about their clients would be privileged and would be kept in the strictest confidence and not disclosed to anyone except themselves or their clients.

[38] On that basis, Welton Parent, on behalf of the unnamed employers, urges the Court to conclude that all the information in its files are protected by the legal advice privilege.

[39] I will deal with the status of the names of the various employers as a separate issue because, in respect of this question, the parties do not appear to disagree on the law. Rather, they disagree on how it should apply in the particular circumstances of this case. In contrast, their disagreement with respect to the other information and documentation referred to in the requirement directly concerns the extent of the concept of legal advice privilege in Canada.

[40] In effect, the respondent says that the law in Canadaactually recognises that its report and correspondence with the Ottawa lawyers are privileged. For Welton Parent, a correct interpretation of the decision of President Jackett in *Susan Hosiery Ltd. v. Canada*

Digitized by Google

(M.N.R.), [1969] 2 Ex. C.R. 27 indicates that communications between a client's accountant and a solicitor are privileged where the accountant was hired in the context of providing legal advice.

[41] This decision was in their view properly interpreted and applied by Justice Gibson in *Interprovincial Pipe Line Inc. v. M.N.R.*, [1996] 1 F.C. 367 at page 383, and by Justice Heneghan in *AFS and Co. v. Canada*, 2001 D.T.C. 5330.

[42] According to the respondent, *Susan Hosiery* has been interpreted too restrictively in several decisions including the decision of the Court of Appeal of Ontario in *General Accident Assurance Company et al. v. Chrusz et al.*, [1999] O.J. No. 3291.The respondent also says that *Chrusz* should be distinguished because, contrary to what happened in that case, there is no evidence here that the unnamed taxpayers are trying to use the legal advice privilege to artificially shield evidence that would otherwise not have been privileged.

[43] The respondent also refers to other decisions, such as *Long Tractor Inc. v. Canada (Deputy Attorney General)* (1997), 155 D.L.R. (4th) 747, *Methanex Corp. v. Canada(Department of National Revenue)*, [1997] 1 W.W.R. 573, *Cineplex Odeon Corp. v. M.N.R.* (1994), 114 D.L.R. (4th) 141, *Telus Communications Inc. v. Canada (Attorney General)*, [2004] F.C.J. No. 1918 (C.A.)(QL), which allegedly support its position.

[44] There is no doubt, and it is not contested, that solicitor-client privilege is a fundamental right and a substantive rule of law in Canada (*Canada v. Solosky*, [1980] 1 S.C.R. 821, *Descôteaux v. Mierzwinski*, [1982] 1 S.C.R. 860, *R. v. McClure*, [2001] 1 S.C.R. 445 and *Lavallee*, above). Courts have also often recognized the need to adopt a very liberal approach to the scope of such privilege (*Stevens v. Canada (Prime Minister)*, [1998] 4 F.C. 89 (C.A.) at paragraph 21).

[45] Because of the importance of the concept and recognizing the significance of the issue raised by the respondent in the context of multi-disciplinary practices and in areas of the law which have become extremely complex, such as tax law, the Court has very carefully examined all the authorities cited even though I will not deal in detail with each and every one of them here.

[46] Before reviewing these authorities, it is important to mention that the parties agree that Welton Parent was not serving as a channel of communication between the three lawyers involved
in this case and their clients. In fact, Welton Parent never communicated with anybody other than the solicitors themselves.[5]

[47] Also, as indicated, Welton Parent has taken the position that the Court does not need to change the law to conclude that their files are privileged. It simply has to properly construe the existing case law.

[48] The Minister takes the opposite view. He says that Canadian law on the subject has been properly summarized by Justice Doherty in *Chrusz* and that to conclude that the documentation and information in the possession of Welton Parent in this case is privileged would require an extension of the law with respect to legal advice privilege.

[49] In *Susan Hosiery*, the Exchequer Court of Canada used the decision in *Wheeler v. Le Marchant* (1881), 17 Ch. D. 675 as the starting point for its analysis of the law with respect to solicitor-client privilege.

[50] In *Wheeler*, a land surveyor had been retained by a solicitor for the purpose of obtaining information required to enable him to give the legal advice sought by his client.

[51] As in the present case, it was clear that the land surveyor had not been engaged to serve as a conduit between the solicitor and his client for the purpose of obtaining legal advice. He was not a representative or agent of the client. The English Court of Appeal decided that the communications between the solicitor and his expert were not communications to which legal advice privilege extended.

Digitized by Google

[52] After quoting from Justice Cotton's decision in *Wheeler*, President Jackett said that none of the decisions to which he had been referred since then seemed to have changed or added to the law so far as it was relevant to what he had to decide on the motion before him.

[53] I therefore understand that in *Susan Hosiery*, the Court applied to the particular facts before it the law as it then stood. The Court simply reformulated the principles set out in *Wheeler*, by saying at paragraph 8:

(a) all communications, verbal or written, of a confidential character, between a client and a legal adviser directly related to the seeking, formulating or giving of legal advice or legal assistance (including the legal adviser's working papers, directly related thereto) are privileged; and

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

[54] It then added at paragraph 12:

Applying these principles, as I understand them, to materials prepared by accountants, in a general way, it seems to me

(a) that no communication, statement or other material made or prepared by an accountant as such for a business man falls within the privilege unless it was prepared by the accountant as a result of a request by the business man's lawyer to be used in connection with litigation, existing or apprehended; and

(b) that where an accountant is used as a representative, or one of a group of representatives, for the purpose of placing a factual situation or a problem before a lawyer to obtain legal advice or legal assistance, the fact that he is an accountant, or that he uses his knowledge and skill as an accountant in carrying out such task, does not make the communications that he makes, or participates in making, as such a representative, any the less communications from the principal, who is the client, to the lawyer; and similarly, communications received by such a representative from a lawyer whose advice has been so sought are none the less communications from the lawyer to the client.

[55] Based on the evidence then before the Court and after recognizing that, in practice, smaller corporations do engage accountants to act for them in such matters, President Jackett concluded that Mr. Pall, Susan Hosiery's auditor, was indeed acting as representative of Susan Hosiery for the purpose of obtaining legal advice from Susan Hosiery's lawyer when it communicated with the lawyer. Thus, their communications were privileged.

[56] This interpretation of *Wheeler* has been adopted in England and in Australia (see *Pratt Holdings Pty Ltd. v. Commissioner of Taxation*, [2004] F.C.A.F.C. 122 (F.C.A.) at paragraphs 23 to 33 and 91 to 97, *Price Waterhouse (a firm) v. BCCI Holdings (Luxembourg) SA and other*, [1992] BCLC 583 (Ch. Div.), page 5, *Three Rivers District Counsel and others v. Governor and Company of the Bank of England (No. 5)*, [2004] UKHL 48, [2005] 4 All ER 948 (H. L.) at paragraph 99).

[57] This is also exactly how the Court of Appeal of Ontario in *Chrusz* understood *Wheeler* and *Susan Hosiery* (see pages 22 and 23 to 27).

[58] For example, at page 23, the Court says: "*Wheeler v. Le Marchant*, supra, illustrates the first principle that communications to or by a third party are not protected by client-solicitor privilege merely because they assist the solicitor in formulating legal advice for a client". In that respect, Justice Doherty notes that one must be careful when reviewing authorities on this subject given the inconsistent terminology used. He also points out that one must ascertain that comments made in a case about solicitor-client privilege were indeed intended to apply to communications with third parties where litigation was not ongoing or not contemplated.

Digitized by Google

[59] In *Chrusz*, the Court of Appeal had to determine whether the report of a claims adjuster who had originally been retained directly by the client, an insurance company, was privileged because, sometime after the appointment of this expert, the insurance company retained a lawyer and directed the claims adjuster to report to the lawyer. The Court of Appeal had to review and analyze the extent of the solicitor-client privilege not only in the context of legal advice but also in the context of litigation because in that case, ultimately, the insurance company commenced an action for fraud against its insured.

[60] The Court considered the rationale for the legal advice privilege (referred to as the solicitor-client privilege in the decision as opposed to the litigation privilege) and reviewed the authorities on the subject, particularly in respect of its application to communications by or to a third party. It concluded[6] that the privilege extended to all situations in which the third party's expertise was required to interpret, for the solicitor, information provided by the client or when the third party serves as a conduit of advice from the lawyer to the client or of instructions from the client to the lawyer.

[61] For Justice Doherty, the existence of a solicitor-client privilege should not depend on the concept of agency; rather, one should adopt a functional approach to determine if it should apply. In that respect, he said at page 26:

I agree with the Divisional Courtthat the applicability of client-solicitor privilege to communications involving a third party should not be determined by deciding whether Mr. Bourret is properly described as an agent under the general law of agency. I think that the applicability of client-solicitor privilege to third party communications in circumstances where the third party cannot be described as a channel of communication between the solicitor and client should depend on the true nature of the function that the third party was retained to perform for the client. If the third party's retainer extends to a function which is essential to the existence or operation of the client-solicitor relationship, then the privilege should cover any communications which are in furtherance of that function and which meet the criteria for client-solicitor privilege.

Client-solicitor privilege is designed to facilitate the seeking and giving of legal advice. If a client authorizes a third party to direct a solicitor to act on behalf of the client, or if the client authorizes the third party to seek legal advice from the solicitor on behalf of the client, the third party is performing a function which is central to the client-solicitor relationship. In such circumstances, the third party should be seen as standing in the shoes of the client for the purpose of communications referable to those parts of the third party's retainer.

[62] It is interesting to note that in drawing this distinction between essential and non-essential functions, Doherty J.A. returned to the seminal case of *Wheeler*.

[63] Applying this approach, the Court in *Chrusz* found that the claims adjuster did not have the authority to seek legal advice or to give instructions on legal matters on behalf of the insurance company; his authority did not reach inside the client-solicitor relationship. Rather, his function was to educate the solicitor as to circumstances surrounding the fire so that the client could receive the benefit of better informed advice from his lawyer and could then instruct the latter as to the legal steps to be taken on its behalf. Thus, the claims adjuster's correspondence and communications with the lawyer were not privileged.[7]

[64] In *College of Physiciansof British Columbia v. British Columbia (Information and Privacy Commissioner)*, [2002] B.C.J. No. 2779, the Court of Appeal of British Columbia found the analysis of Justice Doherty in *Chrusz* compelling and adopted it to determine whether the experts' opinions obtained by the College's lawyer were covered by a legal advice privilege.

[65] In that particular case, the experts were retained to help the lawyer interpret and assess whether the evidence supported an allegation that a certain doctor had hypnotized his patient. The Court, after adopting the functional approach, said:

Digitized by Google

The experts were not authorized by the College to direct the lawyer to act or to seek legal advice from her. The experts were retained to act on the instructions of the lawyer to provide information and opinions concerning the medical basis for the Applicant's complaint. While the experts' opinions were relevant, and even essential, to the legal problem confronting the College, the experts never stood in the place of the College for the purpose of obtaining legal advice. Their services were incidental to the seeking and obtaining of legal advice.

[66] It concluded that the opinions were not covered by legal advice privilege.

[67] In my review, I have obviously considered the decision of the New Brunswick Court of Appeal in *Lamey (Litigation Guardian of) v. Rice* (2000), 190 D.L.R. (4th) 486 (N.B.C.A.). In that case, the Court does not refer to or mention *Chrusz* and, after a brief analysis, it concludes that an adjuster's report prepared at the request of the lawyer, as well as the correspondence between the lawyer and the adjuster, were protected by solicitor-client privilege.

[68] Having carefully considered the reasoning of the Court in that case, I agree with the comments found in the Second Edition Supplement prepared by S. Lederman and A. Bryant, *The Law of Evidence in Canada*, LexisNexis Buttherworths, 2004, at paragraph 14.71.3, that the better view is that of Justice Doherty in *Chrusz*.

[69] Before concluding my comments on the authorities, I will briefly refer to the decisions of this Court and of the Federal Court of Appeal[8] cited by the respondent.

[70] In *Telus*, Justice Linden had to determine whether excised portions of a memorandum were subject to solicitor-client privilege. The Court reviewed certain cases dealing with legal advice communicated to a client through an agent and referred to *Susan Hosiery* as a case where "the communications between two accountants and a lawyer were deemed to be privileged because the accountants were obtaining legal advice on behalf of the client" (paragraph 15).

[71] The respondent put some emphasis on the fact that Justice Linden approved the decision of Master Peppiat in *Sunwell Engineering Co. et al. v. Mogilevski et al.* (1986),9 C.P.C. (3d) 479. I do not see how this case supports the respondent's position for it is clear that, in *Sunwell*, the communications between the patent agent and the client for which privilege was sought were nothing more than a mere passing on and restating of the solicitor's opinion obtained by the patent agent on behalf of his client. This was again a simple conduit case as was the case before the Court of Appeal in *Telus*, above.

[72] The respondent then says that Justice Gibson, in *Interprovincial Pipe-Line Inc.*, above, accepted that solicitor-client privilege extends "to advice provided by professionals retained by outside counsel in the course of preparation of legal advice to the counsel's clients" (at page 383).

[73] The learned judge did use such a description of the solicitor-client privilege in his decision but, in doing so, he was simply restating the principle as it was put before him by the parties. He clearly says that such a statement of the law was not in dispute. Therefore, he does not analyze the authorities in that respect. There are insufficient details in the decision to enable me to conclude without a doubt that, in *Interprovincial Pipe-Line Inc.*, the accountant Price Waterhouse was not a third party whose functions fell within the parameters set out in *Chrusz* and *Susan Hosiery*.

[74] My own review of the authorities leads me to conclude that the statement put before the Court by the parties in *Interprovincial Pipe-Line Inc.* was inaccurate if it was meant to apply to situations where litigation was not ongoing or contemplated.

[75] The respondent then referred to the decision of Justice Heneghan in *AFS and Co.*, above, particularly to paragraph 21 of her decision where she says:

The jurisprudence has established that there are two distinct branches of solicitor-client privilege: litigation privilege and legal advice privilege. The former protects all

Digitized by Google

communications between the solicitor, client or third parties made in the course of existing or contemplated litigation. The latter protects all communications between a solicitor and client and third parties, that directly relate to the seeking, formulating or giving of legal advice.

(My emphasis)

[76] Again, the decision contains few details as to the exact function performed by and role of the third party whose communications were the subject of the motion. Having carefully considered this decision, I am not prepared to accept that Justice Heneghan intended to add to or extend the law as it existed prior to her decision and as it was expressed in *Susan Hosiery* and *Chrusz*, to which she refers.

[77] In any event, Justice Heneghan revisited this issue in *Belgravia Investments Ltd. v. Canada*, [2002] F.C.J. No. 870. In that case, CCRA requested documents relating to certain investments by Belgravia and the taxpayer claimed that some of them were protected by solicitor-client privilege. This documentation consisted mostly of communications moving from Belgravia to its advisers, both legal and non legal, and the exchange of documents between the legal advisor and the other professional advisers, primarily the accountants.

[78] Justice Heneghan reviews the general principles applicable as well as various authorities, including *Susan Hosiery* and *Chrusz*, to determine if there were limits to the application of solicitor-client privilege to communications with non legal professionals or third parties. The learned judge concludes at paragraphs 49 and 50:

The limits on solicitor-client privilege, in relation to non-legal professionals, has been considered. The general rule is that communications, statements or other materials prepared by third parties for and on behalf of a solicitor are subject to the privilege only where those documents are prepared in contemplation of litigation; (...)

Accounting documents will be subject to the privilege if the accountant is used as a representative of a client to obtain legal advice; (...) Where a communication is made to an agent, such as an accountant who must consider it and provide an individual opinion, no privilege attaches. Where a document is created by a lawyer who has been consulted by the client's own lawyer in relation to the client's business, the general rule is that such documents will be privileged; (...).

(My emphasis)

[79] If Justice Heneghan's position in *AFS & co.* was ambiguous, she certainly clarified her views in *Belgravia*. I see nothing in her summary of the law that differs from my understanding of the authorities.[9]

[80] In view of the foregoing, the Court concludes that, in the present context, Welton Parent's file, including its reports, notes, drafts and communications with the unnamed taxpayers' lawyers, does not fall within the class of solicitor-client privilege simply because these lawyers used the respondent's views to provide legal advice to their client.

[81] Thus, this leaves only the question of whether, in the present case, the names of the employers are protected by solicitor-client privilege.

2) The names of the employers:

[82] The issue with respect to the disclosure of the names of the employers, as I understand it here, is that, in the very particular circumstances of this case, disclosure of this information would effectively reveal not only the fact that these employers sought legal advice from those specific lawyers but also the nature and the very substance of the legal advice given by the lawyers to these employers with respect to the Plans.

[83] Before reviewing the particular circumstances on which the respondent relies to support its position, I will briefly review the applicable principles.

[84] First, it is agreed that, as mentioned by Justice Arbour in *Lavallee*, at paragraph

Digitized by Google

28, "the names of the client may very well be protected by solicitor-client privilege, although this is not always the case".

[85] In saying this, Justice Arbour was echoing the concerns expressed by Justice Coté of the Alberta Court of Appeal in that same case ((2000), 184 D.L.R. (4th) 25) who had said at paragraph 56 that :

The very fact that a certain client consulted a certain type of lawyer may be very sensitive, and may indirectly reveal important secrets. It may well reveal the topic on which legal advice was sought: *Dorchak v. Krupka* (1997), 196 A.R. 81, 90 (C.A.).

[86] Justice Veit of the Alberta Queen's Bench in that case ((1998), 160 D.L.R. (4th) 508, at page 525) had also said:

(...) in some situations, it may be critically important for a client to be confident that no one will know that she has consulted a divorce lawyer, or a lawyer who specializes in sterilization claims, or in claims for individuals who contracted AIDS through the blood supply, or in defending drunk driving charges.

[87] The reasoning here is exactly the same as the one adopted to protect other types of information which would reveal the nature of the confidential legal advice provided (see *Maranda v. Richer*, [2003] 3 S.C.R. 193, at paragraph 22, with respect to administrative information). It is not new and it was applied in an income tax context (verification of a lawyer's tax returns) more than forty years ago in *Re Solicitor*, (1962), 36 D.L.R. (2d) 594 (BCSC), affirmed, (1964), 45 D.L.R. (2d) 134, leave to appealed dismissed, [1965] S.C.R. 84. There, the Court held that the Minister of National Revenue is not entitled to use his coercive powers to require a lawyer to disclose the names of his clients as these clients had the right to keep secret and privileged the fact that they had sought legal advices.

[88] In *Legal Services Society v. British Columbia (Information and Privacy Commissioner)* (2003), 226 D.L.R. (4th) 20 (B.C.C.A.), the British Columbia Court of Appeal had to consider whether a reporter should be permitted to obtain the names of the five lawyers with the highest billing for legal aid clients. The Court found that the names of the lawyers could not be disclosed because an assiduous reporter could use this information to deduce that particular clients were funded by legal aid (paragraphs 37-38). It held that because privilege must be retained as a right that is as close to absolute as possible, the line must be drawn on the side of the protection of the privilege (paragraph 40).

[89] This means that like any other information conveyed by a client to his lawyer on a confidential basis for the purpose of obtaining legal advice, the names and coordinates of a client will be protected by solicitor-client privilege if, on the particular circumstances of the case, disclosing them would reveal the topic and substance of the legal advice sought.

[90] In his memorandum and at the hearing, the Minister did not dispute the respondent's position as to the law on this issue.

[91] In fact, the applicant did not make any comments specific to the disclosure of the names of the employers in his memorandum. At the hearing, when asked to clarify his position, the applicant specifically referred the Court to paragraph 38 of his written representations, which simply says that, in any event, not everything in a solicitor-client relationship is privileged, and to paragraphs 44 to 47 of those submissions where the Minister takes the position that even if the information sought was privileged, the privilege was waived when the information was voluntarily sent to third parties such as, in this case, the trustees or custodians of the various Plans and Welton Parent.[10]

[92] It is interesting that the applicant did not argue at the hearing that the names sought were simply the names of the clients of Welton Parent rather than those of the Ottawa lawyers. This is probably because Mr. Rivet himself in his cross-examination acknowledged that although the request was sent to Welton Parent, it was indeed indirectly seeking the names of the clients of those lawyers (motion record, volume 5, pages 713-714,

Digitized by Google

questions 237-240).

[93] Given that Welton Parent only worked on the Plans set out by the three Ottawa lawyers and was at all times communicating only with them, the Court is satisfied that the requirement is indeed seeking the names of these lawyers' clients.

[94] What is of particular concern here, as it was for the British Columbia Court of Appeal in *Legal Services Society* (paragraph 22) and for Justice LeBel speaking for the majority in *Maranda* (paragraph 24), is that there is little doubt in my mind that if Welton Parent is required to disclose apparently neutral information (names of the employers) either as a separate list or as part of the documents exchanged with the lawyers, an assiduous and intelligent investigator at CCRA will be able to determine the nature of the legal advice given to each of these employers.

[95] Even though Mr. Rivet indicated in his testimony that the copies of the legal opinions in his possession did not mention any dollar amounts, the Court is satisfied that the copies of the legal opinions in the possession of CCRA disclose the nature and to a great extent, the substance of the legal advice given by those lawyers.[11]

[96] This is an exceptional case that goes well beyond the concerns expressed by Justice Coté and Justice Veit in *Lavallee*.

[97] With respect to Hari S. Nesathurai, even if CCRA did not have a sample of his opinion before the filing of this motion (the time at which the Court should focus its analysis), it appears to the Court that CCRA will obtain enough information from Welton Parent's file to again clearly know the nature of the services he rendered and of his legal advice.

[98] As noted in *Re Solicitor*, as far back as 1675, the common law has been that "the benefit of doubt should always go to sustain solicitor-client privilege" (page 599).

[99] One must, therefore, determine whether the unnamed employers waived the privilege protecting the nature and substance of the legal advice they sought from the three Ottawa lawyers when their names were voluntarily given by their lawyers to Welton Parent and to the trustees or custodians of the Plans.

[100] In their submissions and in their evidence, Welton Parent states that the solicitor-client privilege belongs to the client and may only be waived by the client through his or her informed consent (Justice Arbour at paragraph 39 in *Lavallee* and Justice Major at paragraph 37 of *R. v. McClure*, [2001] 1 S.C.R. 445).

[101] Since the nature of the legal advice privilege is so fundamental that the Supreme Court of Canada in *Lavallee*, at paragraph 36, held that it must be retained as a right as close to absolute as possible, the Court agrees that it should not lightly be abrogated.

[102] The Court recognizes that a client's intention to waive is not always determinative because, as mentioned in J. Sopinka, S. Lederman and A. Bryant, *The Law of Evidence in Canada*, Second Edition, Butterworths, Toronto and Vancouver, 1999, at paragraph 14.96, page 756, other considerations unique to the adversarial system, such as fairness to the opposite party and consistency of positions, may come into play. But the Court cannot find any such considerations here.

[103] Normally, the essentials of a waiver of a legal right (such as a time limitation or contractual rights) include a conscious intention to relinquish that right (see *Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*, [1994] 2 S.C.R. 490, at paragraphs 19-20).

[104] The Court should depart from the general principles applicable to the waiver of other types of legal rights only when absolutely necessary.

[105] In my view, it is because of the fundamental nature of the privilege that Courts are becoming more reluctant to find waivers of solicitor-client privilege, particularly legal advice privilege, than in the past. This can also explain why concepts such as common interest privilege and limited waivers have been developed. The most recent example is the decision

Digitized by Google

of the Ontario Divisional Court in *Philip Services Corp. (Receiver of) v. Ontario Securities Commission*, [2005] O.J. No. 4418).

[106] The Ottawa lawyers say that the disclosure to the trustees and custodians of the Plans and to Welton Parent was made for a limited purpose - that is, solely to establish and/or implement the Plans. In their affidavits, they say that their clients gave them no authority to waive their privilege beyond that limited purpose, and that neither they nor their clients gave that authority to Welton Parent.

[107] The respondent also relies on the "common interest privilege". This concept applies to information that is shared among parties to a commercial transaction and ensures that such sharing does not result in a waiver or loss of the privilege vis-à-vis parties outside of the group.

[108] It appears from the testimony of Hari S. Nesathurai that a trustee or a custodian of a purpose-based trust, such as those created for the Plans, must know from whom he received the money because anti-money laundering regulations require disclosure of that information. This makes eminent sense and the applicant produced no evidence that the Plans could be established without disclosing at all the names of the employers who funded them.

[109] At the hearing, the applicant also submitted that the Court should consider that this information was or could also be shared with everyone connected with the Plan, such as the employees, the enforcers of the Plans, etc. However, the applicant did not refer in its memorandum or at the hearing to any specific evidence that would indicate that the sharing of the names with these persons gave them sufficient information to know that these employers had retained the Ottawa lawyers to obtain their legal advice on the taxability of their contribution or to know the substance of such legal advice.

[110] There is little evidence as to how the trustee or the custodian treated this information[12] and no evidence on whether any other person to whom the name was or could be disclosed would be in
a position to know and ascertain the name of the lawyer representing that party, or the nature and substance of the legal advice he gave.

[111] Although it may well be that Welton Parent could issue a valuation report without having the names of the employers on file, it is clear that when this information was passed on by Mr. Sanders and Mr. Johnston, these lawyers were acting on the belief that such disclosure did not waive their clients' privilege with respect to the nature and substance of the legal advice that had been sought from them. They were wrong in that respect but at least this means that they did not act on the belief that their clients had expressly or implicitly authorized them to waive their legal privilege.

[112] The Court also finds that it was understood by Welton Parent that they had to protect the confidentiality and privilege of the information they received (discussions with the lawyers, notice of privilege on e-mails, etc.).

[113] In the present circumstances, the Court is not willing to infer that the clients implicitly authorized their lawyers to waive the privilege on the nature and substance of their legal advice when they authorized them to obtain an actuarial report from Welton Parent.

[114] The Court concludes that it is not satisfied that the privilege protecting the fact that they sought legal advice with respect to these Plans, and with respect to the nature and substance of such advice, has been waived by the unnamed taxpayers.

[115] In view of the foregoing, the Court concludes that the names of the employers in this very unique case are indeed protected by solicitor-client privilege.

[116] This means that, unless the subsections of the *ITA* that are challenged are found to be invalid, the order will have to be varied to exclude from the information sought the names of the employers, as well as any reference to such names or these employers' coordinates in

Digitized by Google

the documentation contained in the file of Welton Parent.[13]

C- Do subsections 231.2(3)(5) and (6) and section 232 of *ITA* unjustifiably infringe section 8 of the *Charter*?

[117] Although the notice of motion includes a reference to section 7 of the *Charter*, the respondent confirmed at the hearing that the Court should only review the validity of the impugned sections in light of section 8 of the *Charter*. The parties have limited their arguments to that section.

[118] Relying on the reasoning of the Supreme Court of Canada in *Lavallee*, Welton Parent submits that subsections 231.2(3), (5) and (6) of the *ITA* are unconstitutional because they do not allow a requirement to be cancelled by the Court on grounds of solicitor-client privilege.

[119] It also claims that section 232 is unconstitutional because it allows for the loss of privilege without the client's knowledge or consent and, as such, does not minimally impair their privilege, again, contrary to *Lavallee*.

[120] It is evident that, in this case, section 232 of the *ITA* does not directly apply. No requirement was sent to a lawyer, no document is about to be seized in the hand of a lawyer, and no lawyer is being prosecuted for failure to comply with a requirement.

[121] Despite this, Welton Parent argues that the Court should review the constitutionality of this section because it is indirectly involved. According to the respondent, the Minister was trying to circumvent the solicitor-client privilege by sending the requirement to Welton Parent instead of sending it to the Ottawa lawyers. Welton Parent also says that the Minister could assert that the scheme provided for in section 232 applies because, by serving the requirement on Welton Parent, the Minister was in fact serving it on their principals, the Ottawa lawyers (see paragraphs 190 and 191 of the respondent's written representations at page 1439 of their motion record).

[122] But, the Minister did not say that 231.2(3) was constitutional because it was supplemented by the procedure provided for at section 232. He argues that subsections 231.2(3), (5) and (6) stand on their own, and that they give sufficient flexibility to the authorizing judge and the reviewing judge to ensure their validity.

[123] The Court finds that section 232 is not engaged in this case and, therefore, that it would be inappropriate to review or comment on the constitutionality of this section.

[124] Obviously, this makes the task of the respondent more difficult because, in *Lavallee*, the Supreme Court of Canada quashed section 488.1 of the *Criminal Code* which dealt only with searches and seizures of documents in the possession of a lawyer and mirrored the procedure set out in section 232 of the ITA to a great extent. The respondent had thus focused its submissions on this section.

[125] Like section 487 of the *Criminal Code*, which deals with the issuance of search warrants in general, subsection 231.2(3) applies to the issuance of requirements with respect to unnamed taxpayers in general.

[126] The validity of section 487 has been confirmed by the Ontario Court of Appeal in *R. v. Piersanti & Co.*, [2003] O.J. No. 23 and has been discussed by the British Columbia Court of Appeal in its decision in *Festing v. Canada (A.G.)* (2003), 172 C.C.C. (3d) 321. It has not been reviewed by the Supreme Court of Canada except when leave to appeal from *Piersanti* was denied (*R. v. Piersanti & Co.*, [2003] S.C.C.A. No. 105). But I will say more about these decisions later.

[127] The majority of the Supreme Court of Canada in *Lavallee*, followed the approach set out in *R. v. Edwards*, [1996] 1 S.C.R. 128, where Justice Cory said:

There are two distinct questions which must be answered in any s. 8 challenge. The first is whether the accused had a reasonable expectation of privacy. The second is whether the search was an unreasonable intrusion on that right to privacy.

Digitized by Google

[128] This is the approach I will adopt.

[129] The Minister submits that in *R. v. McKinlay Transport Ltd.*, [1990] S.C.J. No. 25, the Supreme Court of Canada considered the constitutionality of the predecessor to subsection 231.2(3) and distinguished the investigation of criminal conduct from the enforcement of compliance with the *ITA*. At paragraph 35, the Court said:

In my opinion, s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the Income Tax Act can be effected. It involves no invasion of a taxpayer's home or business premises. It simply calls for the production of records which may be relevant to the filing of an income tax return. A taxpayer's privacy interest with regard to these documents vis-à-vis the Minister is relatively low. The Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them. At the same time, the taxpayer's privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies.

[130] It then concluded that the sending of a requirement did not offend section 8 of the *Charter* where the information was sought for the purpose of ensuring compliance with the *ITA*.

[131] More recently, in *Bisaillon v. Canada*, [1999] F.C.J. No. 1477 (F.C.A.)(QL), the Federal Court of Appeal dismissed the argument that a requirement to provide documents or information infringes sections 7 and 8 of the *Charter*. Justice Létourneau summarized the principles set out in *McKinlay* and found that they were still applicable. He said at paragraph 3:

In fact, McKinlay Transport Ltd., [...] a judgment by the Supreme Court of Canada, applies in the case at bar and disposes of the constitutional arguments made by the appellants. In that case the Supreme Court concluded that:

(a) the Act is essentially a regulatory measure;

(b) s. 231(3) (the predecessor of s. 231.2(1)) is not criminal or quasi-criminal law;

(c) application of that subsection constitutes a seizure since it infringes the individual's expectations of privacy;

(d) only unreasonable seizures contravene s. 8 of the Charter of Rights and Freedoms;

(e) seizure in an administrative and regulatory context must be distinguished from seizure in a criminal or quasi-criminal situation;

(f) in a taxation system based on the principle of self-reporting and self-assessment, the Minister of National Revenue has to have broad powers to audit taxpayers' returns and inspect records which may have been used to prepare those returns;

(g) the Minister of National Revenue must be able to exercise these powers whether or not he has reasonable grounds to believe that a particular taxpayer has breached the Act;

(h) s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the Act can be carried out; and

(i) the taxpayer's privacy interest with regard to documents which may be relevant in income tax returns is relatively low in relation to the Minister.

In our opinion, it is not a serious argument for the appellants to say that a requirement to

Digitized by Google

provide documents or information, like the one at bar, infringes the constitutional provisions of ss. 7 and 8 of the Charter when that requirement is made as part of a genuine administrative investigation for the purpose of recovering money owed and with a real objective of collecting information in that connection. Of course, it cannot be used as a stratagem for the covert purpose of obtaining information to be used in criminal proceedings.

[132] This does not mean, however, that even in the context of enforcing compliance of the *ITA*, a taxpayer has a low expectation of privacy with respect to documents or information protected by solicitor-client privilege. This question was never addressed in *Bisaillon* or in *McKinlay*.

[133] In *Lavallee*, the Supreme Court of Canada found that when solicitor-client privilege is at stake, the expectation of privacy is of the highest order. Even if the Court must adopt a contextual approach to such an issue, I see no reason why a taxpayer would have a lower expectation of privacy in respect of the legal advice sought by him simply because we are in the context of enforcing the ITA.

[134] Since the decision in *Re Solicitor*, no authorities have been cited that would indicate that solicitor-client privilege does not apply to the same extent in the income tax context as in any other context. Anyone looking at the language of section 231.7(1)(b), for example, would conclude that the legislator did not intend to lower the taxpayer's expectation in that respect.

[135] I find that the statement of Justice Arbour in *Lavallee* as to the expectation of privacy with respect to information protected by solicitor-client privilege applies here.

[136] In respect of the second part of the test, the only argument raised by the respondent to say that 231.2(3) constitutes an unreasonable intrusion on the right to privacy of the information protected by solicitor-client privilege is the fact that section 231.2(6) does not allow the Court to cancel the order authorizing the issuance of the requirement if the criteria set out in section 231.2(3) have been met.

[137] The respondent submits that it is important to also consider that any person who fails to comply with a requirement issued under section 231.2(3) is guilty of an offence and may be subject to imprisonment for a term not exceeding twelve months or to a fine not exceeding $25,000 or both (section 238(1)). In this case, the requirement warned Welton Parent specifically of the possibility of imprisonment and of a fine if it failed to comply within 30 days.

[138] The applicant says that pursuant to section 231.2(3), the authorizing judge has the discretion to impose any terms of execution or conditions he or she considers appropriate. This includes anything that would be relevant to the protection of solicitor-client privilege. He says that in fact, in this case, the Court did put its mind to the issue before issuing the authorization and could have set conditions.

[139] Furthermore, where solicitor-client privilege is raised or becomes an issue, a reviewing judge may vary the order and exclude information or documents on the basis of such privilege. According to the applicant, subsection 231.2(5) ensures that no documents are provided to the applicant before a reviewing judge has put his or her mind to the issue. He submits that the present motion shows that one can get the issue decided without disclosing the names of the clients seeking to rely on the privilege and without any infringement of such a right. Section 231.7 further ensures that no compliance order may be granted by a Court until it is satisfied, among other things, that the information and documentation sought by the Minister is not privileged.

[140] When the Supreme Court of Canada heard *Lavallee*, it was also seized with two other cases involving the validity of section 488.1 of the *Criminal Code*. One of them was *Festing v. Canada* (2001), 159 C.C.C. (3d) 97. In that case, the British Columbia Court of Appeal had struck down section 488.1 and this portion of its decision was affirmed by the

Digitized by Google

Supreme Court of Canada.

[141] But the Court of Appeal in *Festing* had also found that section 487 of the *Criminal Code* would be unconstitutional in so far as it applied to searches in law firms and had declared that the words "other than the law office" be read into the introductory words of that section. That portion of the decision was not before the Supreme Court of Canada and the Court of Appeal had suspended its effect until the Supreme Court of Canada ruled on the validity of section 488.1. In its remanded decision found at *Festing v. Canada (A.G.)* (2003), 172 C.C.C. (3d) 321, the Court of Appeal sets aside its previous order finding section 487 unconstitutional and it simply extends the definition of "law office" for the purpose of applying the *Lavallee* guidelines to any places where privileged documents may reasonably be expected to be located.

[142] At about the same time, the Ontario Court of Appeal (Justice Weiler, Justice Abella and Justice Charron) had to review a similar issue in *Piersanti & Co.*[14] In this case, Piersanti & Co. was appealing from the dismissal of its application for an order quashing a search warrant and declaring section 487 unconstitutional to the extent that it authorized the search of law offices and the seizure of documents therein. At paragraph 3 of its decision, the unanimous Court of Appeal agreed with the applications judge that the reasoning of the British Columbia Court of Appeal in its 2001 decision in *Festing* should not be followed in light of the recent decision of the Supreme Court of Canada in *Lavallee*. Instead, the Court of Appeal found that the constitutional imperatives for the protection of solicitor-client privilege can be adequately met through the application of common law principles relating to the issuance of search warrants.

[143] If the existence of the common law guidelines set out in *Lavallee* was found to constitute a sufficient safeguard against unreasonable searches in the context of criminal proceedings and the issuance of search warrants under section 487, it is difficult to envisage why they could not properly support the validity of a much less intrusive process in an administrative or regulatory context. A copy of the guidelines is attached as Annex 2 to these reasons.

[144] There is no reason why the *Lavallee* guidelines could not be applied to a search warrant issued under the *ITA* (section 232). Similarly, there is no reason why those guidelines, adapted to the circumstances, could not be applied in the context of a requirement authorised under subsection 231.2(3). As I said, and the parties did not dispute it, they would have to be adapted. For example, as this provision deals with unnamed taxpayers, it would simply not be possible for the Minister to contact or give notice to those taxpayers.

[145] If one applies the *Lavallee* guidelines, no authorization will be issued with regard to documents that are known to be protected by solicitor-client privilege.

[146] Further, no authorization will be granted without referring to the guidelines where it is reasonable to expect that privileged or potentially privileged information or documentation may be included in the material requested (*Festing* (2003)).

[147] As I will explain it later in these reasons, had I known all of the facts that were known to the applicant when it sought the *ex parte* authorization, I would not have authorized the issuance of the requirement unless it had included a specific reference to the fact that Welton Parent was not required to disclose any information or documentation protected by solicitor-client privilege, and that this issue had to be properly considered with its clients or its lawyers before any information or documentation was sent to CCRA.

[148] When one looks at subsection 231.2(3) in the context of the scheme provided for in sections 231.1 to 231.7 and 232, it is clear that Parliament intended the Court to take the steps necessary to protect solicitor-client privilege.

[149] The Court is also convinced that one cannot incur the penalties provided for in

Digitized by Google

section 238 of the *ITA* if one can establish that one could not fulfill the requirement because solicitor-client privilege prevented it. As section 232 does not apply, there was no need for Welton Parent to identify or name the person on whose behalf it was claiming solicitor-client privilege (*R. v. McNeney* (1984), 11 C.C.C. (3d) 557). Also, the Court agrees with the applicant that this case is proof enough that Welton Parent and their unnamed clients can assert their privilege within the existing scheme without having to disclose their identities.

[150] In view of the above, the Court is satisfied that subsections 231.2(3)(5) and (6) do not constitute an unjustified infringement of section 8 of the *Charter*.

[151] That does not mean that the requirement, as issued and sent to Welton Parent without any special warning or precaution with respect to solicitor-client privilege, does not constitute an unreasonable search.

[152] I will deal with this issue if it is necessary at the same time as I review the last argument raised with respect to the validity of the requirement and the *ex parte* order and when I exercise my discretion under subsection 231.2(6) of the ITA.

C- Breach of duty of full and frank disclosure

[153] It is not disputed that the applicant had the duty to make full and frank disclosure in the utmost good faith when it sought the authorization of the Court under paragraph 231.2(3).

[154] In *R. v. Araujo*, [2000] 2 S.C.R. 992, at paragraph 47, the Supreme Court of Canada said that "a corollary to the requirement of an affidavit being full and frank is that it should never attempt to trick its readers". The parties giving evidence in an *ex parte* application "should not allow themselves to be led into the temptation of misleading the authorizing judge, either by the language used or strategic omissions".

[155] Justice Gibson in *The Minister of National Revenue v. 159890 Canada Inc.*, 97 DTC 5495, at page 5497, also specified that the obligation of full and frank disclosure requires the Minister to disclose "what might reasonably be regarded as weaknesses in the case" for his *ex parte* order. His view was confirmed in another context by the Supreme Court of Canada in *Ruby v. Canada (Solicitor General)*, [2002] 4 S.C.R. 3 at paragraph 47 where Justice Arbour said that the disclosure must include the facts adverse to one's interest.

[156] What the respondent says is that the Minister's evidence was incomplete, inaccurate and misleading, and more particularly that:

i) it was incomplete because the Minister did not disclose that he knew that the information and documentation requested were potentially privileged because of their knowledge that the Ottawa lawyers were giving legal opinions to these employers and also because Mr. Johnston had already raised the issue of privilege during a meeting with CCRA concerning one of the twenty-five tax audits referred to earlier (memorandum of May 21, 2003 at page 1189 of the respondent motion record);

ii) it was incomplete because the Minister failed to disclose that his position on the validity of the Plans was untested and was solely based on an interpretation bulletin;

iii) it was inaccurate and misleading with respect to the manner in which Welton Parent's valuations were performed, and;

iv) it was misleading in how it presented the fact that Ottawalawyers were somewhat involved in the file as promoters.

[157] Although the affidavit filed in support of the *ex parte* application did not discuss the relative strength of the Minister's position with respect to the Plans, this issue was canvassed during the testimony of Mr. Rivet at the *ex parte* hearing. It was acknowledged that there had been no decision yet confirming the Minister's position and that a first appeal on this question was in progress. The Court is satisfied that there was full and frank disclosure in that respect.

[158] With respect of the allegation that the Minister failed to give accurate evidence

Digitized by Google

when Mr. Rivet said at paragraph 12 of his affidavit that the valuations were not made in accordance with accepted actuarial standards, the Court finds that there was no material misrepresentation that would justify quashing the order.

[159] Mr. Rivet acknowledged that although Ms. Laird, the expert in his department, challenges the reasonableness of some of the assumptions made by Welton Parent, she never said that its opinion was not made in accordance with accepted actuarial principles. Mr. Rivet agreed that the wording he used in his affidavit was "not quite what it should be".

[160] This overstatement did color the file but the Court is satisfied that it was not material because the Court clearly understood from Mr. Rivet's testimony that it was the reasonableness of the assumptions that was challenged. This is normally a matter of opinion. In any event, this was only one of the many issues raised by CCRA (paragraph 9 of Mr. Rivet's affidavit).

[161] The last deficiency raised by the respondent is more serious as it relates to the potentially privileged nature of the information sought by the Minister. After a careful review of the transcript of Mr. Rivet's cross-examination and the documentary evidence produced by the respondent, the Court is not convinced that CCRA or Mr. Rivet knew that Welton Parent or its principals considered all the documentation and information in their files privileged. There is insufficient evidence to support the respondent's assertion that the applicant intentionally deceived the Court as to the role played by the lawyers in this file. There is no doubt that the Court misunderstood the role of the lawyer because of the use of the term "promoters" throughout the affidavit and particularly during the testimony of Mr. Rivet. But I will come back to this issue later.

[162] It is clear that the Minister had to be alert and alive to the issue of solicitor-client privilege. He had the duty to ensure that all available information that could impact on the Court's exercise of its discretion, particularly in respect of the need to impose special conditions to protect solicitor-client privilege, was disclosed.

[163] Mr. Rivet testified that CCRA did not turn its mind to the fact that the Ottawa lawyers were acting at all times as legal advisers, and this despite the fact that he had personally reviewed one of Mr. Johnston's opinions with respect to the tax consequences of one of the Plans. He never turned his mind to the issue of solicitor-client privilege either because he presumed that "whether or not it (Welton Parent's valuation) went through the lawyer this was for the trustee and not for the legal opinion" (transcript of cross-examination at page 738 of the respondent motion record).

[164] On its face, this is contrary to what was argued in the applicant's memorandum for the *ex parte* hearing. At paragraph 13, the applicant says that "the group of unnamed persons is ascertainable as the respondent has provided opinions to each of the taxpayer employers known to have participated in these health and welfare trusts, (...)".

[165] Recognizing the complexity of the case, and the fact that in one of the sample opinions it is said that the valuation is obtained for the trustee, the Court will give the benefit of the doubt to the applicant.

[166] The Court finds that considering the information at paragraph 15 of Mr. Rivet's affidavit, it was not unreasonable to expect that the report of Welton Parent and its file would not be protected by any privilege. Welton Parent was clearly not a conduit between the Ottawa lawyers and their clients, the employers, and there was no indication that they were essential to the solicitor-client relationship.

[167] But this reasoning cannot be applied in respect of the request to disclose the names of the employers. Mr. Rivet knew that the "promoters" were acting as legal advisers to the employers. He knew the substance of their advice because CCRA had obtained samples of such legal opinions. He had even met with Mr. Johnston in the context of the audit of one of the Plans.

Digitized by Google

[168] As mentioned earlier, Mr. Rivet also acknowledged that although the Minister was asking for the names of the employers through Welton Parent, he was indirectly seeking the names of the clients of the two Ottawa lawyers.

[169] All this information was relevant and material. It should have been disclosed to the Court as clearly as possible. It should certainly not have been buried in the affidavit among technical details as the existence of the Ottawalawyers was in paragraph 9 of Mr. Rivet's affidavit.[15]

[170] The matter was evidently complex and the circumstances quite particular. But there was no urgency in this matter and the applicant had ample time to consider all the issues.

[171] The Court cannot adequately fulfill its role when it is not presented with all the evidence that could indicate that it was reasonable to expect that the names requested were protected by solicitor-client privilege.

[172] It was certainly open to the applicant to believe that any privilege which might have existed with respect to the names of the employers was waived when this information was given to the respondent and to the trustees. He simply had to say so to the Court. This did not relieve him of his obligation. As I said, the applicant has an onerous duty on an *ex parte* application. He must be conscious that all facts adverse to his position must be included in the evidence provided to the Court.

[173] The fact that the Court itself was alive to the issue of privilege and raised the point during the hearing, does not relieve the applicant of his duty either. Especially when it is evident that the Court misunderstood the role of the lawyers/promoters. It raised the matter because "(...) the promoter may have been given a legal opinion" At that time, it would have been simple to rectify the situation and explain to the Court that, in fact, the promoters were the ones giving the legal opinions to the employers. In his response, the applicant clearly focused on the nature of the actuarial opinion. The problem associated with the disclosure of the names of the employers was never discussed.

[174] I am satisfied that the Court was never in a position to assess the potentially privileged nature of this particular information and there is no doubt that, had it known all the facts that were within the knowledge of the applicant before its sought the *ex parte* authorization, the Court would not have granted the authorization with respect to the names of the employers unless the requirement clearly stipulated that it covered only documents or information that were not subject to a solicitor-client privilege and that Welton Parent had to discuss this issue with its clients and its lawyers, if necessary, before responding to the requirement.

[175] The respondent argued that any breach of the duty of full and frank disclosure would be sufficient to quash the order in its entirety. In the present circumstances, where there was no intention to deceive, the Court finds that the breach only affects the authorization with respect to the request to disclose the names of the employers.

[176] Pursuant to subsection 231(6), the Court has the authority to vary the order and I will do so.

[177] Because the names of the employers are covered by solicitor-client privilege or, alternatively, as a result of a breach of the duty of full and frank disclosure, the Court finds that the applicant should not be authorized to issue a requirement requesting the names of the employers and that reference to such names should also be deleted from any documentation and information to be provided to CCRA pursuant to the requirement. Now that the issue of solicitor-client privilege has been fully canvassed, there is no further need to refer to it in the requirement.

[178] The only issue left is whether the order should be quashed in its entirety because it also unjustifiably infringes the unnamed taxpayers' right to solicitor-client privilege contrary to section 8 of the *Charter*.

Digitized by Google

[179] I do not need to discuss this issue with respect to the names of the employers for this portion of the order has already been struck.

[180] With respect to other information listed in the requirement, the Court is not satisfied that the order of March 30, 2004 unjustifiably infringes section 8. As I said, the files and correspondence between Welton Parent and the Ottawalawyers are not covered by solicitor-client privilege and the applicant had no reason to believe that they would be.

[181] The motion is therefore granted in part. Both parties sought their costs but made no representations on that point at the end of the two days of hearing. The matter is somewhat unusual in that there were three different lawyers representing the Ottawa lawyers involved in the motion and, as I said, they were only partially successful.

[182] Should the parties not be able to agree on this matter, the respondent shall file its written representations on costs on or before February 14, 2006 and the applicant shall file his reply on or before February 24, 2006.

ORDER

THIS COURT ORDERS that:

1. The motion is granted in part;
2. The order dated March 30, 2004 is amended as follows:

paragraph a) shall read:

The Minister of National Revenue is authorized to impose on the respondent a Requirement in the form attached hereto except that paragraph 1(a) of the said Requirement shall be deleted and the names of the employers and their coordinates if any, shall be deleted from the documentation to be provided in accordance with paragraph 1(b) to 1(f) of the Requirement;

3. If necessary, an order with respect to costs will be issued after receiving the parties written representations.

"Johanne Gauthier"

JUDGE

In the case of MNR v. Bruce Kitsch, Leslie Tower, Robert Tower and BDO Dunwoody LLP, 2003 FCA 307, Ability of Minister to Elicit Information From *Tax Accountants* of Information of "Non-Document" Nature (Questions) And Documentary Evidence

Indexed as: Tower v. M.N.R. (F.C.A.)

Federal Court of Appeal, Létourneau, Sharlow and Malone JJ.A.--Vancouver, June 24; Ottawa, July 22, 2003.

Income Tax -- Practice -- On advice of accountant, taxpayers entering transactions to produce interest expense deductions -- M.N.R. issuing two requirements to accounting firm to provide tax files, tax planning documents, written responses to questions under Income Tax Act, s. 231.2(1) -- Applications Judge ordering compliance with requirements except parts requiring written responses or creation of new documents -- S. 231.2(1)(b) providing Minister with power to compel production of "any document" -- Minister entitled to compel production of documents, records under s. 231.2(1)(b), to ask questions to elicit knowledge, facts under s. 231.2(1)(a) which permits Minister to compel production of "information" -- Taxpayers' accountants having no right of redaction with respect to documents subject of requirements as no evidence of third party information therein -- As requested information may be relevant to tax liability requirements issued for purpose of administration, enforcement of Act.

Practice -- Privilege -- Whether material prepared by accountants for purpose of providing tax advice privileged communications -- "Class" privilege , "case-by-case"

Digitized by Google

privilege discussed -- Solicitor-client privilege rooted in proper administration of justice -- Advice given by tax accountants not elevated to level of solicitor- client privilege -- As disputed communications not meeting Wigmore's four principles set out in treatise on evidence, not covered by case-by-case privilege.
Construction of Statutes -- Income Tax Act, s. 231.2(1) -- S. 231.2(1)(a) giving Minister power to compel production of « information » ; s. 231.(1)(b) giving power to compel production of « any document » -- Presumption against redundancy and every word in statute presumed to make sense, play specific role in advancing legislative purpose -- Different interpretation must be given to both paragraphs, and different meanings given to « information » , « document » -- « Information » meaning knowledge or facts -- To exercise power, Minister must be able to ask questions to elicit knowledge, facts, figures.
REASONS FOR JUDGMENT

MALONE J.A.
Introduction

This appeal and cross-appeal arise from an order of a Judge of the Federal Court, Trial Division (the Applications Judge) dated September 3, 2002, which allowed, in part, an application for judicial review of two decisions of the Minister of National Revenue (the Minister) to issue two "Requirements to Provide Information" (Requirements). These Requirements were issued pursuant to subsection 231.2(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act). Reasons in support of this order are reported as *Tower v. Canada (Minister of National Revenue - M.N.R.) (T.D.)*, [2003] 2 F.C. 146, [2002] 4 C.T.C. 220, 2002 D.T.C. 7315.

[2] In his Requirements, dated July 11 and July 18, 2001, the Minister required BDO Dunwoody (Dunwoody), the accountants for Bruce Kitsch, Leslie Tower and Robert Tower (the Taxpayers) to deliver up all the tax files, tax planning documents and all of the files relating to the Taxpayers, and to provide written responses to certain questions. The Applications Judge ordered the Taxpayers to comply with the Minister's Requirements, except for those parts which required written responses to questions, or which compelled Dunwoody to create new documents; these latter demands being said to be outside the scope of subsection 231.2(1).

[3] Subsection 231.2(1) of the Act provides authority for the Minister to issue requirements. It reads:

Requirement to provide documents or information -	Production de documents ou fourniture de renseignements -
231.2. (1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act, including the collection of any amount payable under this Act by any person, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,	**231.2. (1)** Malgré les autres dispositions de la présente loi, le ministre peut, sous réserve du paragraphe (2) et, pour l'application et l'exécution de la présente loi, y compris la perception d'un montant payable par une personne en vertu de la présente loi, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne, dans le délai raisonnable que précise l'avis:
(*a*) any information or additional information, including a return of income or a supplementary return; or	*a*) qu'elle fournisse tout renseignement ou tout renseignement supplémentaire, y compris une déclaration de revenu ou une déclaration supplémentaire;
(*b*) any document.	*b*) qu'elle produise des documents.

Digitized by Google

[Emphasis added] [Je souligne]

Issues

[4] Various errors of law are alleged in the appeal and cross-appeal. In brief, these are the issues:

On Appeal

(a) does subsection 231.2(1) allow Dunwoody to refuse to answer the Minister's written questions or to create new documents?

(b) does subsection 231.2(1) permit Dunwoody to redact, that is, remove, confidential references and information in respect of persons other than the Taxpayers from the documents to be delivered in response to the Minister's Requirements?

On Cross-appeal

(c) were the Requirements issued for the purpose of the administration and enforcement of the Act within the meaning of section 231.2?

(d) was certain of the requested material that was prepared by Dunwoody for the purpose of providing tax advice to the Taxpayers privileged?

Facts

[5] The Taxpayers were businessmen who decided, in 1997, to emigrate from Canada and give up their Canadian residency. They informed their accountants, Dunwoody in Kelowna, British Columbia, of their intention and were referred to Jas Butalia, a chartered accountant with the Calgary office of Dunwoody, who specializes in income tax matters.

[6] As a result of their discussions with Mr. Butalia, the Taxpayers entered into transactions that apparently were intended to produce interest expense deductions that would offset the taxable income expected to arise when the Taxpayers ceased to be residents of Canada in 1998.

[7] The Taxpayers each negotiated separate loans with Canadian Imperial Bank of Commerce (CIBC) in amounts ranging from USD $50 million to $100 million. In their 1997 and 1998 income tax returns, the Taxpayers claimed deductions for the interest expenses associated with those loans.

[8] The Minister's initial assessment of the Taxpayers' 1997 taxation years allowed the Taxpayers their claimed interest deductions.

[9] By letters dated May 12, 2000, the Minister requested from the Taxpayers information regarding the 1997 and 1998 tax deductions. Dunwoody responded on behalf of the Taxpayers on September 20, 2000, but certain information requested by the Minister was not supplied.

[10] By letters dated May 11, 2001, the Minister set out his position as to why the Taxpayers should not be allowed the deductions taken for the CIBC loans in the 1997 taxation year. Subsequently, the Taxpayers were reassessed by the Minister and the interest deductions were disallowed for the 1997 and 1998 taxation years. On August 7, 2001, each of the Taxpayers filed notices of objection to challenge the correctness of the reassessments. Those objections are now outstanding. Meanwhile, on July 11 and July 18, 2001, the Requirements were served on Dunwoody.

[11] The Requirements required production of numerous documents, including all tax files, planning documents, working paper files, permanent files, records, minutes or notes of all conversations or meetings, detailed billings, detailed telephone records, promotional material, and correspondence relating to the Taxpayers. In addition, they required answers to a number of questions to be answered by Mr. Hughes, the Taxpayers' accountant at the Kelowna office of Dunwoody, and Mr. Butalia. The questions would appear to be designed to elicit facts that were likely to be within the knowledge of Mr. Hughes and Mr. Butalia. There has been no suggestion

Digitized by Google

that Mr. Hughes and Mr. Butalia did not possess the knowledge required to answer the questions. However, the Minister conceded that if they did not possess the information, an answer to that effect would have complied with the Requirements.

[12] The Taxpayers and Dunwoody commenced an application for judicial review challenging the validity of the Requirements, and also making a claim of privilege with respect to the required documents and information. The Applications Judge allowed the application in part. He found that the general tax liability of the Taxpayers was the subject of a genuine and serious inquiry by the Minister, and that the Requirements met the tests of relevance and reasonableness established by this Court in *AGT Limited v. Canada (Attorney General) (C.A.)*, [1997] 2 F.C. 878. However, he interpreted subsection 231.2(1) as giving the Minister the right to require the production of documents, but not the right to require the answers to questions, and on that basis he held that the Requirements were invalid with respect to the questions asked of Mr. Hughes and Mr. Butalia.

[13] The Applications Judge also indicated that if any of the documents or information to be produced under the Requirements referred to a client of Dunwoody unrelated to the appellants, Dunwoody had the right to redact the documents to expunge that person's name before the document or information was submitted to the Minister. Dunwoody did not redact any information from the requested material which it prepared but did not deliver to the Minister, pending the ultimate outcome of these proceedings.

Analysis

Issue a): *Does subsection 231.2(1) allow Dunwoody to refuse to answer the Minister's written questions or to create new documents?*

[14] The Applications Judge held that the powers of subsection 231.2(1) require the production of documents and information in existence, but that it is not framed so broadly that accountants can be required to respond to written interrogatories. He reasoned that if subsection 231.2(1) of the Act were intended to be so broad as to provide the Minister with the option to conduct a written examination for discovery, Parliament would have so provided. It is my respectful opinion that the learned Applications Judge erred in his interpretation of subsection 231.2(1). His error, in my view, lies in his failure to give a meaning to paragraph 231.2(1)(a).

[15] In statutory interpretation there is a presumption against redundancy. The governing principle has been described in Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes,* 4th ed. (Markham: Butterworths, 2002) at 158:

It is presumed that the legislature avoids superfluous or meaningless words, that it does not pointlessly repeat itself or speak in vain. Every word in a statute is presumed to make sense and to have a specific role to play in advancing the legislative purpose.

[16] The same principle is expressed as follows by Iacobucci J. in *Communities Economic Development Fund v. Canadian Pickles Corp.*, [1991] 3 S.C.R. 388 at paragraph 36:

It is a principle of statutory interpretation that every word of a statute must be given meaning: "A construction which would leave without effect any part of the language of a statute will normally be rejected" (see also *Maxwell on the Interpretation of Statutes* (12th ed. 1969), at p. 36).

[17] Applied in this case, that principle dictates that meaning must be given to both paragraphs (*a*) and (*b*) of the subsection 231.2(1), and unless there is good reason to the contrary, a different interpretation must be given to both paragraphs, and different meanings to the words "information" and "document".

[18] The word "information", used in paragraph 231.2(1)(*a*), is not defined in the Act.

Digitized by Google

Referring to the *The Concise Oxford English Dictionary*, 10th ed., "information" is defined as "facts or knowledge provided or learned as a result of research or study" or "what is conveyed or represented by a particular sequence of symbols, impulses, etc." The French version of paragraph 231.2(1)(*a*) uses the word "renseignement". In *Collins Robert Unabridged French-English Dictionary* (5th ed.), "renseignement" is defined as "information, piece of information".

[19] Turning to paragraph 231.2(1)(*b*), it provides the Minister with the power to compel production of "any document". Again, referring to *The Concise Oxford English Dictionary*, 10th ed., "document" is defined as "a piece of written, printed, or electronic matter that provides information or evidence or that serves as an official record." However, the word "document", as used in the Act, is not restricted to writings. It is defined in section 231 to include "money, a security and a record". "Record" in turn is defined in subsection 248(1) as including "an account, an agreement, a book, a chart or table, a diagram, a form, an image, an invoice, a letter, a map, a memorandum, a plan, a return, a statement, a telegram, a voucher, and any other thing containing information, whether in writing or in any other form".

[20] Paragraph 231.2(1)(*a*), when properly interpreted, empowers the Minister to compel a taxpayer to provide "information", meaning knowledge or facts. In order to exercise this power, the Minister must be able to ask questions to elicit the knowledge, facts or figures. The words "return of income or supplementary return" in paragraph (*a*) does not detract from this interpretation as the preceding word "including" means that the phrase is not exhaustive of the meaning of "information." These words enable the Minister not only to get the information regarding a taxpayer's income, but also to specify the form in which this information must be provided, i.e. a tax return containing prescribed information rather than in a letter. In my view, the Minister is therefore able to compel production of documents and records under paragraph 231.2(1)(*b*) and ask questions to elicit knowledge or facts under paragraph 231.2(1)(*a*).

Issue b): *Does subsection 231.2(1) of the Act permit Dunwoody to redact, that is, remove, confidential references and information in respect of persons other than the Taxpayers from the documents to be delivered in response to the Minister's Requirements?*

[21] In preparing to disclose the requested material to the Minister, Dunwoody was concerned that some material might contain the names of or information concerning other clients not legally associated with or related to the Taxpayers. Accordingly, during the course of argument, Dunwoody asked the Applications Judge for permission to redact such names or information from the material if it became necessary to protect confidential third party information. The Applications Judge agreed with this proposal.

[22] Once Dunwoody assembled the required documents, it was discovered that there was nothing to be redacted. It is argued for the Taxpayers that this issue should not be dealt with at all because it is moot, in the sense that there is no live controversy between the parties on the question of redaction of the documents. The Crown argues that this is an appropriate case in which to deal with the issue despite its mootness (see *Borowski v. Canada (Attorney General of Canada)*, [1989] 1 S.C.R. 342 at 353. In my view, it is appropriate to deal with the Applications Judge's conclusion on the redaction issue, despite its mootness, because of the likelihood of uncertainty and confusion that could result from the Applications Judge's comments, and also because the issue is amenable to a simple resolution.

[23] The record before the Applications Judge contains no evidence that there was any third party information in any of the documents that were the subject of the Requirements. Dunwoody's proposal to redact third party information was based solely on

Digitized by Google

speculation as to a potential future problem. Therefore, the Applications Judge erred in stating that Dunwoody has a right of redaction with respect to the documents that are the subject of the Requirements. Rather, what he should have concluded is that Dunwoody had failed to establish any factual basis for asserting a right of redaction (assuming, without deciding, that such a right may exist).

[24] That is sufficient to dispose of the redaction issue in this case. I recognize that this resolution of the matter leaves unanswered theoretical questions. For example, it is debatable whether there is a right of redaction at all with respect to documents that fall within the scope of a valid requirement under subsection 231.2(1). In this regard, there is jurisprudence from the Supreme Court of Canada that supports the proposition that a requirement is not invalid merely because it results in the disclosure of private transactions involving persons who are not under investigation and may not be liable to tax (see *Canadian Bank of Commerce v. Attorney General of Canada* (1962), 35 D.L.R. (2d) 49 at 54; *James Richardson & Sons v. Minister of National Revenue*, 9 D.L.R. (4th) 1 at 7; and *R. v. McKinlay Transport*, [1990] 1 S.C.R. 627 at paragraph 16.)

[25] If a right of redaction exists in theory, there is an issue as to who ought to determine whether the right should be exercised in a particular case, the person to whom the requirement is directed, or the Minister, or the Court. If a dispute should arise in future about the right to redact a document that is within the scope of a valid requirement but contains third party information that for some reason the Minister ought not to have, I have no doubt that the parties will find a way to have the issues debated in an appropriate forum. Meanwhile, I prefer to express no opinion on issues that do not arise in this case.

[26] For these reasons, the Minister's appeal is well founded and should be allowed, subject only to the resolution of the issues raised in the cross-appeal.

Issue c): *Were the Requirements issued for the purpose of the administration and enforcement of the Act within the meaning of section 231.2?*

[27] The evidence establishes that the Requirements are intended to test the Taxpayers' entitlement to the interest deduction. Broadly speaking, entitlement to the interest deduction depends upon whether the statutory conditions in paragraph 20(1)(c) of the Income Tax Act are met, and if not, whether the general anti-avoidance rule in subsection 245(2) applies.

[28] The position of the Taxpayers is that the Requirements would result in the disclosure of tax planning documents and information about their subjective intention in entering into the transactions that gave rise to the claim for the interest deduction. They argue that the Minister cannot possibly require tax planning documents and evidence of subjective intention for the purpose of the administration and enforcement of the Income Tax Act, because those matters are not relevant to the applicability of paragraph 20(1)(c) or subsection 245(2). I am unable to accept this argument. The scope of subsection 231.2(1) is not as limited as the Taxpayers suggest.

[29] A number of cases have dealt with the scope of subsection 231.2(1) (see *R. v. McKinlay Transport, supra*; *James Richardson & Sons v. Minister of National Revenue, supra*; *AGT Limited v. The Attorney General of Canada, supra*; and *R. v. Jarvis,* 2002 D.T.C. 7547 (S.C.C.) at paragraph 51). The relevant principles from these authorities establish that the determination of a taxpayer's tax liability is a purpose related to the administration and enforcement of the Act. A requirement is valid if the requested information may be relevant in the determination of the tax liability of the named taxpayer. This is a low threshold. Subsection 231.2(1) gives the Minister a

Digitized by Google

broader authority to obtain information than would be the case if, for example, the Minister were conducting pre-trial examinations for discovery in the context of an income tax appeal.

[30] In my view, the information which the Taxpayers object to producing may be relevant to determining their tax liability under the Act. As Desjardins J.A. stated at paragraph 23 for an unanimous panel of this Court in *AGT Limited v. The Attorney General of Canada, supra*:

Because of the nature of the conduct regulated by the *Income Tax Act*, there are, in many cases, no ways of determining whether prescribed conduct has been engaged in, short of studying the process by which a suspected corporation or business has made and implemented its decision.

[31] First of all, tax planning information can shed light on intention and therefore may be important in interpreting contracts or determining whether persons are acting at arm's length. Further, it may be relevant in determining the residency of the Taxpayers, which is an issue in the present case, since a relevant factor is whether they intended to sever their ties to Canada permanently or only temporarily. Finally, the subjective intention of the Taxpayers may be relevant in determining interest deductibility or the applicability of the general anti-avoidance provision. The purpose test may be an objective one, but a taxpayer's intention is certainly a relevant consideration (see *Ludco Enterprises Ltd. v. Canada*, [2001] 2 S.C.R. 1082 at paragraphs 54-55; and *Fraser Milner Casgrain v. Minister of National Revenue*, 2002 D.T.C. 7310, [2002] 4 C.T.C. 210 (F.C.T.D.)).

[32] The Taxpayers also assert that the Requirements, which are intended to elicit information about the 1997 and 1998 taxation years, were issued more than three years after the initial assessment of those years, and thus after the expiry of the normal limitation period for those years. They argue that because the Minister cannot reassess those years, they need not produce any documents covered by the Requirements. I cannot agree. First, there is no statutory time limit for requirements. Second, the record does not establish that the Minister cannot reassess the Taxpayers for 1997 and 1998. Assuming, without deciding, that the Requirements relate only to those years, there are numerous statutory provisions that permit the Minister to reassess within three years after the expiry of the normal limitation period. There are also statutory exceptions that remove all time limitations.

[33] Finally, the Taxpayers argue that the Requirements improperly subvert the *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a, relating to pre-trial discovery. The simple answer to this argument is no income tax appeal has been commenced in this case. In any event, the Minister's right to investigate the affairs of a taxpayer is not necessarily limited by the commencement of an appeal (see *Canada v. Imperial Oil Limited and Inco Limited*, 2003 FCA 289). There may be situations where the exercise of a statutory power of investigation is abusive, but this is not such a case.

[34] For the foregoing reasons, in my analysis, the Applications Judge correctly determined that the Requirements were issued for the purpose of the administration and enforcement of the Act.

Issue d): *Was certain of the requested material that was prepared by Dunwoody for the purpose of providing tax advice to the Taxpayers privileged?*

[35] This issue raised the question as to whether tax memoranda, notes of tax advice, or other documents which set out or show the tax advice given by a tax accountant to a client and the reasoning or analysis behind the tax advice are privileged communications. If so, such communications would not be subject to disclosure under Canadian law even though the subject matter may be relevant to an

Digitized by Google

income tax audit or Tax Court proceeding.

[36] The Supreme Court of Canada has recognized that there are two types of legal privilege - "class" privilege and "case-by-case" privilege (see *R. v. Gruenke,* [1991] 3 S.C.R. 263 at paragraph 26). The Taxpayers urge that their confidential communications with Mr. Butalia, when properly understood, can fit within either category of privilege. They assert that the evidence establishes that they dealt with Dunwoody, and Mr. Butalia in particular, on the understanding that the tax advice they received was confidential. **They argue that had they known that tax advice could only be shielded by solicitor-client privilege they would not have discussed the matters with Dunwoody.**

[37] In 1990, this Court confirmed that an accountant-client privilege does not exist in relation to advice given by an accountant in connection with the search and seizure provisions of the Act (see *Baron v. Canada*, [1991] 1 F.C. 688, (1990) 91 D.T.C. 5055, [1991] 1 C.T.C. 125). **The Taxpayers say it is now time to recognize a class privilege for communications between tax accountants who provide professional tax advice to their clients in the course of a professional relationship and such privilege should extend to all types of tax advice; income tax, excise tax, goods and services tax, sales tax and real property tax. It is urged that the categories of privilege are not static and can evolve over time, with the identification of a new class on a principled basis (see Lamer C.J. in *R. v. Gruenke, supra*, at paragraph 35).**

[38] I see nothing in the submissions of the Taxpayers that militates against the earlier ruling rendered by this Court in *Baron v. Canada, supra*. Solicitor-client privilege is rooted in the proper administration of justice, made necessary by the need for confidential advice in prosecuting one's rights and preparing defences against improper claims (see *R. v. McClure*, [2001] 1 S.C.R. 445 at 457-459). Lawyers are legally and ethically required to uphold and protect the public interest in the administration of justice (see *Fortin v. Chrétien*, [2001] 2 S.C.R. 500 at paragraph 49). In contrast, accountants are not so bound. Nor do they provide legal advice, as to do so would constitute a breach of provincial and territorial laws governing the legal professions. In my analysis, no overriding policy consideration exists so as to elevate the advice given by tax accountants to the level of solicitor-client privilege.

[39] As for case-by-case privilege, the Supreme Court of Canada has directed that the principles set out by Professor Wigmore in his American treatise on evidence provide a general framework to determine whether or not a communications is privileged. Within this framework, policy considerations and the requirements of fact-finding can be weighed and balanced on the basis of their relative importance in each case. Consequently, a principled approach to the question of case-by-case privilege should always be employed, taking into account each of the four factors, and the particular circumstances of each case (see *R. v. Gruenke, supra*, at paragraph 35).

[40] The four Wigmore principles are these:

(a) The communications must originate in a *confidence* that they will not be disclosed.

(b) This element of *confidentiality must be essential* to the full and satisfactory maintenance of the relation between the parties.

(c) The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*.

(d) The *injury* that would inure to the relation by the disclosure of the communications must be *greater than the benefit* thereby gained for the correct disposal of litigation.

(see John Henry Wigmore, *Evidence in Trials at Common Law*, vol. 8. (Boston: Little, Brown, 1961) at 527.)

Digitized by Google

[41] In discussing the first Wigmore principle, the Supreme Court of Canada has stated that "it is absolutely crucial that the communications originate with an expectation of confidentiality . . .. Without this expectation of confidentiality, the *raison d'être* of the privilege is missing" (see *R. v. Gruenke, supra*, at paragraph 39). **While a chartered accountant, as a matter of professional ethics, is required to keep his communications with clients confidential, the accountant knows, or should know, that this confidentiality is restricted by the power of the Minister to require disclosure. Therefore, Dunwoody and the Taxpayers have not discharged their onus of showing that the relationship in issue carried with it an expectation of confidentiality sufficient to meet this first Wigmore principle.**

[42] The Taxpayers have also not shown that confidentiality was essential to the full and satisfactory maintenance of their relationship with Mr. Butalia so as to satisfy Wigmore's second principle. **Confidentiality may be desired, as with all personal and professional relationships, but the relationships here did not depend on confidentiality for their existence. Indeed, according to his evidence, had Mr. Kitsch believed that there was no confidentiality involved, he would have still used the same firm of accountants for business and financial advice.**

[43] Further, the Taxpayers have not shown that the tax accountant-client relationship is one that in the opinion of the community ought to be sedulously fostered to the degree that would attract privilege. While confidentiality may be preferred, the tax accountant-client relationship is in no way as fundamental to society and the administration of justice as the solicitor-client relationship.

[44] The rare situations where case-by-case privilege has been extended to certain specifically identified communications have included clients and their doctors, sexual assault therapists and clergy. **These relationships are sedulously fostered to the extent that privilege may apply to them in certain limited circumstances. The reason is obvious. Canadian society puts a much higher value on the physical, mental and spiritual integrity of a person than on personal wealth.** It is recognized that unnecessary harm and suffering could result from deterring an individual from consulting a doctor, a sexual assault therapist, or a member of the clergy. **The worst that could happen if a person is discouraged from seeking income tax advice is that the person might fail to take advantage of a tax saving opportunity, unfortunate perhaps, but not a threat to one's physical, mental or spiritual well being.**

[45] In considering the fourth Wigmore principle, it must be determined whether the interests served by protecting the communications from disclosure outweigh the interest in getting at the truth and correctly disposing of the matter (see *M.(A.) v. Ryan,* [1997] 1 S.C.R. 157 at paragraphs 16 and 31). The balancing of the injury to the relationship against the benefit of the correct **disposal of the matter involves purely public policy considerations**. As Chief Justice McLachlin held, at this stage of analysis, an occasional injustice should not be accepted as the price of extending privilege from disclosure. **While it is true that the traditional categories of privilege necessarily run the risk of occasional injustice, "that does not mean that courts, in invoking new privileges, should lightly condone its extension." (*M.(A.) v. Ryan, supra*, at paragraph 32). In that case, the potential injury to be suffered due to the disclosure of the disputed information was described, at paragraph 30, as one that:**

perpetuates the disadvantage felt by victims of sexual assault, often women. The intimate nature of sexual assault heightens the privacy concerns of the victim and may increase ... the difficulty of obtaining redress for the wrong. The victim of a sexual assault is placed in a disadvantaged position as compared with the victim of a different wrong... She is doubly victimized, initially by the sexual assault and later by

Digitized by Google

the price she must pay to claim redress - redress which in some cases may be part of her program of therapy.
Nonetheless, the Court affirmed the disclosure of all documents except the personal notes of a person who would not be called as a witness at trial and whose opinion was of no consequence. The unsuccessful claim of privilege in that case illustrates the high threshold of injury necessary to overcome the benefit of correctly disposing of the matter.

[46] The Taxpayers have not shown that any public injury would occur should these tax accountant-client communications continue to be subject to review by the Minister. **Innumerable tax accountant-client relationships have functioned fully in the past notwithstanding the Minister's opportunity to review their communications. Whatever the public injury feared by the Taxpayers may be, it has not precluded the full and satisfactory maintenance of those past relationships despite the Minister's powers of review. If tax accountant-client communications are subject to the spectre of case-by-case privilege, the harm done to the verification and enforcement of the Act would be considerable, and would outweigh whatever injury, if any, that would inure to such relationships. Overall, in my analysis, the balancing of public interests favours disclosure.**

[47] The disputed communications in this appeal and cross-appeal do not meet any of Wigmore's four principles and are therefore not covered by case-by-case privilege. The Applications Judge correctly held that the documents requested in the Requirements are not subject to either class or case-by-case privilege.

[48] It was drawn to the courts attention that since July 22, 1998, the United States, pursuant to I.R.C. § 7525 (1986), has afforded a class privilege to federally authorized tax practitioners with respect to tax advice given to their clients. Except for criminal matters, the scope of that privilege, where the tax advice given involves either the Internal Revenue Service or United States Federal Court proceedings, is the same as for attorney-client privilege. While a matter of policy interest, it is of no consequence to the task at hand. In addition, a review of the content of that legislation undoubtedly reveals that enactment of the class privilege for accountants is better left with Parliament.

[49] The cross-appeal should be dismissed with costs. The appeal should be allowed with costs, the order of the Applications Judge, dated September 3, 2002, should be set aside, and the application for judicial review should be dismissed with costs.

"B. Malone"
J.A.
"I agree
Gilles Létourneau
J.A."
"I agree
K. Sharlow
J.A."

Opinion Provided to Lawyers From Sub-contractors (Accountants)

On the issue of accountants' (auditor's) material that was supplied to a solicitor to obtain a legal

Digitized by Google

opinion the Federal Court in Interprovincial Pipe Line Inc. and IPL Energy Inc. v. MNR[101] provided:

T-1229-95

Interprovincial Pipe Line Inc. and IPL Energy Inc. (*Applicants*)

v.

Minister of National Revenue (*Respondent*)

Indexed as: Interprovincial Pipe Line Inc.v. M.N.R. (T.D.)

Trial Division, Gibson J."Calgary, September 5; Ottawa, October 13, 1995.

Income tax " Practice " Privilege " Application under Income Tax Act, s. 232 to determine whether solicitor- client privilege validly claimed for auditors' notes, advice to applicants' counsel for purpose of providing legal advice " Applicants voluntarily disclosing information to auditors, subject to oral limitations, as required by Canada Business Corporations Act, s. 170 "Waiver depending on intention" Applicants intending to disclose privileged information only to assist in conduct of audit "Waiver for that limited purpose" Auditors lacking authority to waive privilege on behalf of applicants " Written statement of intent, formal arrangement re: auditors' notes advisable.

Corporations " Canada Business Corporations Act, s. 170 requiring corporation to furnish whatever documents auditor demands " Auditors not directly invoking s. 170, but applicants aware of its existence, auditors' rights thereunder and voluntarily disclosing solicitor-client privileged information subject to oral limitations " S. 170 to be invoked only in manner limiting privilege to extent absolutely necessary " To be interpreted restrictively.

This was an application under *Income Tax Act*, section 232 to determine whether solicitor-client privilege was validly claimed in respect of two groups of documents: (1) auditors' notes made in the course of an audit of the applicants, and (2) documents exchanged between the auditors' Edmonton and Toronto offices concerning advice provided by the auditors to independent counsel retained to give legal advice to applicants. There was no evidence that the applicants were aware of the existence of the group (2) documents. In conducting the audit, the auditors were entitled to rely on *Canada Business Corporations Act*, subsection 170(1) (which requires a corporation to furnish whatever documents the auditor demands). Subsection 170(1) was not directly invoked, but the applicants knew of its existence and of the auditor's rights thereunder, and voluntarily disclosed solicitor-client privileged information subject to strict oral limitations. The issues were: (1) whether solicitor-client privilege extended to the documents; and (2) if so, whether disclosure to auditors under section 170 constituted waiver of privilege, or waiver for a limited purpose only.

Held, solicitor-client privilege was validly claimed, subject to agreement to release privilege with respect to certain documents or portions of documents.

Subsection 170(1) gives an auditor the authority to demand access to documents which might interfere with solicitor-client confidentiality. It should be invoked only as necessary, and then in a manner that will limit the confidentiality or privilege only to the extent that is absolutely necessary. Subsection 170(1) must be interpreted restrictively. Since Parliament could easily have stated that any disclosure of a solicitor-client privileged document pursuant to subsection 170(1) amounted to a waiver of privilege for the purposes of tax investigations, but did not, it would be inappropriate to interpret subsection 170(1) more broadly than necessary to achieve the end clearly sought to be served.

Waiver depends on intention. The applicants intended to disclose the legal

---

[101] T-1229-95

Digitized by Google

opinions only for the limited purpose of assisting in the conduct of the audit and examination of financial statements. The legal opinions were made available in accordance with the duty to assist under subsection 170(1). It would be contrary to public policy if making the legal opinions available for the audit automatically removed the cloak of privilege otherwise available. The disclosure of legal advice received by the applicants to its auditors was a waiver of solicitor-client privilege for a limited purpose and did not extend to a waiver for other purposes, such as disclosure by the auditors in response to the Minister's requirements.

If the doctrine of limited waiver is to be relied on, it would be prudent to set forth in writing the client's intent regarding limited waiver in any disclosure to its auditors of solicitor-client privileged information and in the formal arrangement between the client and its auditors. Further, there should be some more formal arrangement regarding the disposition of auditors' notes of complex legal advice on complex transactions once those notes have served their purpose.

The auditors' advice to the applicants' legal counsel was covered by solicitor-client privilege and the applicants were unaware of the disclosure of that advice to another office of the auditors, and therefore did not consent to its disclosure and waive privilege. Finally, the auditors had no authority to waive privilege on behalf of the applicants.

statutes and regulations judicially considered

Canada Business Corporations Act, R.S.C., 1985, c. C-44 , s. 170(1).

Income Tax Act, R.S.C., 1985 (5th Supp.), c. 1, ss. 231.2(1), 232(1) "judge", "solicitor-client privilege", (3.1)(*b*), (4)(*a*)(i),(ii), (5)(*a*), (*b*), (i),(ii)(A) (as am. by S.C. 1994, c. 13, s. 7), (B) (as am. *idem*), (9).

cases judicially considered applied:

Descôteaux et al. v. Mierzwinski, 1982 CanLII 22 (SCC), [1982] 1 S.C.R. 860; (1982), 141 D.L.R. (3d) 590; 70 C.C.C. (2d) 385; 28 C.R. (3d) 289; 1 C.R.R. 318; 44 N.R. 462; *Playfair Developments Ltd v D/MNR*, reflex, [1985] 1 C.T.C. 302; (1985), 85 DTC 5155 (Ont. S.C.); *Ed Miller Sales & Rentals Ltd. v. Caterpillar Tractor Co.* 1988 ABCA 282 (CanLII), (1988), 61 Alta. L.R. (2d) 319; 22 C.P.R. (3d) 290 (C.A.); *British Coal Corp v Dennis Rye Ltd (No 2)*, [1988] 3 All ER 816 (C.A.).

considered:

Air Canada v. McDonnell Douglas Corp. 1994 CanLII 7295 (ON SC), (1994), 19 O.R. (3d) 537 (Gen. Div.).

APPLICATION under *Income Tax Act*, section 232 to determine whether solicitor-client privilege was validly claimed for auditors' notes and advice to the applicants' counsel for the purpose of providing legal advice to the applicants. Solicitor-client privilege was validly claimed, subject to agreement to release privilege in respect of certain documents or portions of documents.

counsel:

Mendy M. Chernos and *Douglas S. Ewens, Q.C.* for applicants.

Douglas B. Titosky for respondent. solicitors:

McCarthy Tétrault, Calgary, for applicants.

Deputy Attorney General of Canada for respondent.

The following are the reasons for order rendered in English by

Gibson J.: On May 8 and 15, 1995, requirements under subsection 231.2(1) of the *Income Tax Act*[1] were served on Dennis Blumenthal of Price Waterhouse, Edmonton, by the respondent, for document production relating to Price Waterhouse's audit and examination

Digitized by Google

of the 1993 consolidated financial statements of Interprovincial Pipe Line Inc. (the predecessor to IPL Energy Inc.) and for answers to **certain questions. The applicants instructed their internal legal counsel to advance claims of solicitor-client privilege on behalf of the applicants with respect to certain of the documents and information in the possession of Price Waterhouse, Edmonton which allegedly evidenced legal advice obtained by the applicants.** In the result, privilege was claimed in respect of 33 documents and with regard to information as to whether any officers, employees and representatives of the applicants had reviewed the relevant material in the hands of Price Waterhouse, Edmonton and, if so, who reviewed the material and when.

This application under section 232 [as am. by S.C. 1994, c. 13, s. 7] of the *Income Tax Act* resulted to determine the question of whether the claim to solicitor-client privilege is valid. The central provisions of section 232 of the *Income Tax Act* for the purpose of this application read as follows:

232. (1) In this section,

. . .

"judge" means a judge of a superior court having jurisdiction in the province where the matter arises or a judge of the Federal Court;

. . .

"solicitor-client privilege", means the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional confidence, except that for the purposes of this section an accounting record of a lawyer, including any supporting voucher or cheque, shall be deemed not to be such a communication.

. . .

(3.1) Where, pursuant to sections 231.1 and 231.2, an officer is about to inspect or examine a document in the possession of a lawyer and the lawyer claims that a named client of the lawyer has a solicitor-client privilege in respect of that document, the officer shall not inspect or examine the document and the lawyer shall

place the document, together with any other document in respect of which the lawyer at the same time makes the same claim on behalf of the same client, in a package and suitably seal and identify the package or, if the officer and the lawyer agree, allow the pages of the document to be initialed and numbered or otherwise suitably identified; and

retain it and ensure that it is preserved until it is produced to a judge as required under this section and an order is issued under this section in respect of the document.

Where a document has been seized and placed in custody under subsection (3) or is being retained under subsection (3.1), the client, or the lawyer on behalf of the client, may

within 14 days after the day the document was so placed in custody or commenced to be so retained apply, on three clear days notice of motion to the Deputy Attorney General of Canada, to a judge for an order

fixing a day, not later than 21 days after the date of the order, and place for the determination of the question whether the client has a solicitor-client privilege in respect of the document, and

requiring the production of the document to the judge at that time and place;

serve a copy of the order on the Deputy Attorney General of Canada and, where applicable, on the custodian within 6 days of the day on which it was made and, within the same time, pay to the custodian the estimated expenses of transporting the document to and from the place of hearing and of safeguarding it; and

if the client or lawyer has proceeded as authorized by paragraph (*b*), apply at the appointed

Digitized by Google

time and place for an order determining the question.
An application under paragraph (4)(*c*) shall be heard *in camera*, and on the application
the judge may, if the judge considers it necessary to determine the question, inspect the document and, if the judge does so, the judge shall ensure that it is repackaged and resealed; and
the judge shall decide the matter summarily and,
if the judge is of the opinion that the client has a solicitor-client privilege in respect of the document, shall order the release of the document to the lawyer, and
if the judge is of the opinion that the client does not have a solicitor-client privilege in respect of the document, shall order
that the custodian deliver the document to the officer or some other person designated by the Deputy Minister of National Revenue, in the case of a document that was seized and placed in custody under subsection (3), or
that the lawyer make the document available for inspection or examination by the officer or other person designated by the Deputy Minister of National Revenue, in the case of a document that was retained under subsection (3.1),
and the judge shall, at the same time, deliver concise reasons in which the judge shall identify the document without divulging the details thereof.
The documents in which solicitor-client privilege is claimed are generally of two types: first, notes apparently prepared by partners or employees of Price Waterhouse, Edmonton in the course of conduct of the audit and examination of the 1993 consolidated financial statements of Interprovincial Pipe Line Inc., and documents exchanged between Price Waterhouse, Edmonton and Price Waterhouse, Toronto concerning advice provided by Price Waterhouse, Toronto to independent counsel retained by the applicants to, in turn, provide legal advice to the applicants. In respect of documents in the first category, some of them on their face disclose that the applicants were aware of their existence prior to the service of the requirements on Price Waterhouse, Edmonton by the respondent. In respect of documents in the second category, the documents themselves provide no evidence, and there was no evidence before me, that the applicants were aware of their existence prior to the service of the requirements.
In the conduct of its audit and examination, Price Waterhouse, Edmonton was entitled to rely on subsection 170(1) of the *Canada Business Corporations Act*[2] which reads as follows:
170. (1) On the demand of an auditor of a corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such information and explanations, and access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries as are, in the opinion of the auditor, necessary to enable him to make the examination and report required under section 169 and that the directors, officers, employees or agents are reasonably able to furnish.
In the cross-examination of James Andrew Telford on his affidavit filed on behalf of the applicants in this matter, the following exchanges took place relative to Price Waterhouse, Edmonton's reliance on section 170 of the *Canada Business Corporations Act* and the applicants' response in relation to legal opinions that they had received from outside counsel:
Q. Did they (Price Waterhouse, Edmonton) give you a reason for requesting those legal opinions?
A. They said that they had "I mean, they had a statutory right under the *Canada Business Corporations Act* to ask for whatever they wanted, and they felt that in order to provide a clear audit opinion and not qualify as to generally accepted auditing standards that they needed to review those legal opinions.
Q. Did they indicate that to you in writing or verbally?

Digitized by Google

A. Verbally. Mr. Dennis Blumenthal, to me verbally.
Q. Did Mr. Blumenthal make specific reference to the *Canada Business Corporations Act* and his rights under that *Act*?
A. I don't believe that Mr. Blumenthal specifically referred to the *Canada Business Corporations Act*.
Q. Did Mr. Blumenthal specifically refer to a right to see the legal opinions?
A. Yes, he did.
Q. Did you agree with him?
. . .
A. My understanding, in my position as Manager, Tax and Risk Management, and as a Chartered Accountant, was that Mr. Blumenthal was entitled to see those documents.
Q. What did you do, given that understanding?
A. I requested the legal opinions be couriered to me from the law firms. I had a meeting with Mr. Blumenthal where I told him that basically I believe its paragraph 9 of my affidavit **where I say that I considered the documents to be subject to privilege, that I did not wish to release that privilege, and that I was only doing so because he had demanded them as an auditor, that he was not to make any copies or notes or extracts of the documents.**
Q. You specifically provided him not to make copies or notes of the "
A. I specifically provided him not to.
Q. Did you do this in writing or orally?
A. Orally.
Q. And do you recall what precisely you told Mr. Blumenthal during your meeting in mid-January, 1994?
A. What I precisely told him is what is contained in paragraph 9 in my Affidavit. That's to the best of my recollection.
Q. And having communicated that to Mr. Blumenthal, did he respond?
A. It's my recollection that Mr. Blumenthal agreed with my terms.
Q. And on that basis he was allowed to review the documents?
A. That's correct.[3]

POSITIONS OF THE PARTIES

The applicants assert that legal opinions provided to them by outside counsel are solicitor-client privileged and that that privilege extends to the notes produced by Price Waterhouse, Edmonton in the conduct of the audit and examination of the applicant's financial statements in the circumstances before me. The applicants argued that disclosure of the legal opinions to Price Waterhouse, Edmonton did not amount to a waiver of privilege or, if it did, it amounted to a waiver for a limited purpose only, that is, for the purpose of Price Waterhouse, Edmonton's audit and examination. In support of this position, the applicants argued that subsection 170(1) of the *Canada Business Corporations Act* should, in the absence of specific terminology to the contrary, be interpreted as interfering with solicitor-client privilege only to the extent absolutely necessary to achieve the ends of that provision and of provisions of the *Canada Business Corporations Act* related to it. They argued that any other interpretation of subsection 170(1) would be contrary to public policy since the result would be that compliance with the statutory duty would result in a waiver of a privilege that is seen to be in the public interest.
On behalf of the applicants, it was argued that the applicants did not intend to waive their privilege as evidenced by the exchange that apparently took place between James Andrew Telford on behalf of the applicants and Mr. Blumenthal on behalf of Price Waterhouse, Edmonton and **that intent is the governing factor in the determination of**

Digitized by Google

whether or not there has been a waiver of privilege under the law of Alberta which, it was agreed, is the appropriate law on the facts before me. Finally, with regard to the documents produced by Price Waterhouse, Edmonton, the applicants argued that to determine that the disclosure of legal opinions that took place by the applicants amounted to a waiver of privilege, other than for a limited purpose, would undermine the common interest of corporations, their auditors and the shareholders of corporations in full and open disclosure to auditors that is intended to ensure production of accurate audited financial statements.

In relation to the notes of advice provided to the applicants' outside counsel by Price Waterhouse, Toronto, the applicants argued that such notes were clearly subject to solicitor-client privilege as evidencing advice given **in the course of development of legal advice** and that there could not possibly be any waiver of that privilege by the applicants in circumstances where they were unaware of the provision of that information by Price Waterhouse, Toronto to Price Waterhouse, Edmonton.

Finally, on the information that the applicants refused to produce, the applicants argued that any examinations conducted by them of the documentation in the possession of Price Waterhouse, Edmonton **were conducted in contemplation of litigation and therefore the identity of those who conducted any such examinations and when they did so is privileged information.**

On behalf of the respondent, it was argued that documentation produced by independent auditors for their own purposes in the course of an audit and examination does not benefit from the solicitor- client privilege of the auditor's client in favour of the client. Further, the respondent argued that disclosure of documents subject to solicitor-client privilege, results in waiver whether or not the disclosure is under compulsion of law and that waiver for a limited purpose only is not recognized in Canadian law. With regard to the documentation evidencing advice provided by Price Waterhouse, Toronto, the respondent argued that there was no evidence before me that the applicants were unaware of this disclosure and that, if the applicants were aware, that awareness without objection amounted to a waiver of solicitor-client privilege.

ANALYSIS

In *Descôteaux et al. v. Mierzwinski*,[4] Lamer J., as he then was, speaking for the Supreme Court of Canada on the subject of solicitor-client privilege, stated at page 875:

It is quite apparent that the Court in that case [*Solosky v. The Queen*, 1979 CanLII 9 (SCC), [1980] 1
821] applied a standard that has nothing to do with the rule of evidence, the privilege, since there was never any question of testimony before a tribunal or court. The Court in fact, in my view, applied a substantive rule, without actually formulating it, and, consequently, recognized implicitly that the right to confidentiality, which had long ago given rise to a rule of evidence, had also since given rise to a substantive rule.

It would, I think, be useful for us to formulate this substantive rule, as the judges formerly did with the rule of evidence; it could, in my view, be stated as follows:

The confidentiality of communications between solicitor and client may be raised in any circumstances where such communications are likely to be disclosed without the client's consent.

Unless the law provides otherwise, when and to the extent that the legitimate exercise of a right would interfere with another person's right to have his communications with his lawyer kept confidential, the resulting conflict should be resolved in favour of protecting the confidentiality.

When the law gives someone the authority to do something which, in the circumstances of

Digitized by Google

the case, might interfere with that confidentiality, the decision to do so and the choice of means of exercising that authority should be determined with a view to not interfering with it except to the extent absolutely necessary in order to achieve the ends sought by the enabling legislation.

Acts providing otherwise in situations under paragraph 2 and enabling legislation referred to in paragraph 3 must be interpreted restrictively.

By reference to the facts here at issue, subsection 170(1) of the *Canada Business Corporations Act* clearly gives someone, an auditor, the authority to do something, demand access to records and documents, which, in the circumstances of the case, might interfere with solicitor-client confidentiality, as for example, when the respondent, as here, serves requirements for document production and information relating to the auditors' audit and examination of the financial statements of a client. In accordance with proposition 3, subsection 170(1) should be invoked only as necessary and then only in a manner that will limit the interference with the confidentiality or privilege to only the extent that is absolutely necessary. Further, by virtue of proposition 4, provisions such as subsection 170(1) must be interpreted restrictively.

On the facts before me, subsection 170(1) was not directly invoked on behalf of Price Waterhouse, Edmonton, but the applicants' knowledge of its existence and of the auditor's rights under that provision led to the disclosure of solicitor-client privileged information on a voluntary basis and only under strict limitations, albeit limitations that were only imposed orally.

In *Playfair Developments Ltd v D/MNR*,[5] Mr. Justice Galligan, at pages 307 and 308, reiterated the importance attached to preservation of solicitor-client privilege in the following terms:

If I tend to lean in favour of finding privilege, it is because, as has often been said, the confidentiality of a solicitor/client communication is very important. If in doubt, I think it is appropriate to uphold the privilege.

I find this statement to be consistent with the principle of interpreting subsection 170(1) of *Canada Business Corporations Act* restrictively.

In *Ed Miller Sales & Rentals Ltd. v. Caterpillar Tractor Co.*,[6] Chief Justice Laycraft held at pages 326 and 327:

It must first be noted that the director's inquiry is not a public proceeding. The director hears witnesses in private and even in the absence of other subjects of the inquiry and their solicitors. Secondly, to hand a privileged document to one party to litigation for the purpose of settlement or any other purpose, does not, in my opinion, show any intention that the privilege is thereby to terminate as to other parties or in related litigation.

The respondent also argued that the Caterpillar companies waived any privilege which existed by failing to object when the officer of [the other defendant] produced [the accountant's] report on his examination for discovery. The simple answer is that, even if one litigant has the status to interject on the examination for discovery of another, the objection is pointless if his co-defendant is resolved to produce the document. Waiver depends on intention. Failure to make a pointless objection does not, in my opinion, demonstrate that intention. [Underlining added by me for emphasis.]

This case is of particular importance in the context of this application for at least three reasons: first, it is a decision of the Alberta Court of Appeal and, under the definition "solicitor-client privilege" in subsection 232(1) of the *Income Tax Act*, it is the law of the province where the matter arises that is to be turned to, to determine the existence of solicitor-client privilege. It was not disputed before me that this matter arose in the province of Alberta. Second, Chief Justice Laycraft emphasizes in the underlined words that waiver

Digitized by Google

depends on intention and the evidence before me discloses that the applicants' intention was to do all in their power to protect their solicitor-client privilege while complying with the demands of their auditors under the potential sanction of a qualified auditor's certificate and, ultimately, subsection 170(1) of *Canada Business Corporations Act*. Finally, in the first paragraph quoted above, Chief Justice Laycraft can be seen to imply approval of the doctrine of a limited waiver of solicitor-client privilege. If the doctrine of limited waiver is adopted, then, even if the disclosure of legal advice received by the applicants to its auditors amounted to a waiver of solicitor-client privilege, and I am satisfied that it did, then, consistent with the intent of the applicants, it can be found that that waiver was for a limited purpose and did not extend to a waiver for other purposes such as disclosure by the auditors in response to the requirements of the respondent.

The doctrine of limited waiver is clearly enunciated in *British Coal Corp v Dennis Rye Ltd (No 2)*.[7] Neill L.J. stated at pages 821-822:

Has anything happened which has caused that privilege to be waived or otherwise lost?

In my judgment the answer to this question is plainly No. Let it be assumed that all the documents have come into the possession of the defendants with the implied consent of the plaintiff and that it could be established that it would have supplied the ... documents even without an order of the court. Nevertheless, it is clear that the plaintiff made the documents available for a limited purpose only, namely to assist in the conduct first of a criminal investigation and then of a criminal trial. This action by the plaintiff, looked at objectively as it must be, cannot be construed as a waiver of any rights available to it in the present civil action for the purpose of which the privilege exists.

. . .

In my judgment the action of the plaintiff in making documents available for the purpose of the criminal trial did not constitute a waiver of the privilege to which it was entitled in the present civil proceedings. Its action in regard to ... the ... documents was in accordance with its duty to assist in the conduct of the criminal proceedings, and could not properly be construed as an express or implied waiver of its rights in its own civil litigation. Indeed, it would in my view be contrary to public policy if the plaintiff's action in making the documents available in the criminal proceedings had the effect of automatically removing the cloak of privilege which would otherwise be available to them in the civil litigation for which the cloak was designed.

The foregoing passages can be adopted here by analogy. It was clearly the applicants' intent to disclose the legal opinions that it had received for a limited purpose only, namely to assist in the conduct of the audit and examination of its financial statements. It made the legal opinions available in accordance with its duty to assist that can be drawn from subsection 170(1) of the *Canada Business Corporations Act*. It would, in my view, be contrary to public policy if the applicants' action in making the legal opinions available for audit purposes "had the effect of automatically removing the cloak of privilege which would otherwise be available to them" on an audit by the respondent. This conclusion is, I am satisfied, consistent with the propositions quoted above that have been enunciated by the Supreme Court of Canada and consistent with a strict interpretation of the impact on solicitor-client privilege of subsection 170(1) of the *Canada Business Corporations Act*. If Parliament had intended there to be a secondary purpose in subsection 170(1) of the *Canada Business Corporations Act* beyond the primary purpose of accuracy in financial reporting, it was open to it to enunciate that purpose by clear direct or indirect amendment to the *Income Tax Act* stating that any disclosure of a solicitor-client privileged document pursuant to subsection 170(1) amounted to a waiver of privilege for the purposes of tax investigations. Since Parliament did not do so, it would be inappropriate and, indeed,

Digitized by Google

contrary to the principles enunciated in *Descôteaux*, to interpret subsection 170(1) more broadly than necessary to achieve the end clearly sought to be served.

Counsel drew my attention to the decision of Master Peppiatt of the Ontario Court (General Division) in *Air Canada v. McDonnell Douglas Corp.*[8] where the learned Master, at page 545, referred to the statement of Chief Justice Laycraft in *Ed Miller Sales*, *supra*, to the effect that "to hand a privileged document to one party to litigation for the purpose of settlement or any other purpose, does not, in my opinion, show any intention that the privilege is thereby to terminate as to other parties or in related litigation". The learned Master commented:

His Lordship cited no authority for this statement. While the judgment of an appellate court in another province is entitled to great respect, in this case it is contrary to authority in this province.

Counsel for the respondent cited authority from Ontario courts and from courts in the United States that the learned Master might have relied upon. With great respect, on the facts before me, and on the basis of the foregoing analysis, I prefer to adopt the doctrine of limited waiver that, as I stated earlier, I find implicit in the earlier-quoted statement of Chief Justice Laycraft. Once again, I find it particularly appropriate to adopt this position since it is acknowledged by the parties that this matter arose in the province of Alberta.

A final cautionary note before I leave this aspect of this matter. The evidence before me relating to the intent of the applicants to limit any waiver arising from the disclosure to their auditors was entirely based on recollection of oral discussion between James Andrew Telford on behalf of the applicants and Mr. Blumenthal on behalf of Price Waterhouse, Edmonton. If the doctrine of limited waiver is to be relied on in future in similar circumstances, it would appear to me to be the prudent course of action to set forth in writing the client's intent regarding limited waiver in any disclosure to its auditors of solicitor-client privileged information and in the formal arrangement between the client and its auditors. Further, it would appear to me to be the height of unreasonable expectation to expect auditors, in the course of a highly complex audit and examination, to refrain from making notes of complex legal advice on complex transactions provided, as was here apparently the case, in response to a demand of the auditors, a stipulation with which the auditors here obviously did not comply. Some more formal arrangement regarding the disposition of such notes as between the client and the auditors, once those notes have served their purpose for the auditor, would appear to be desirable.

I turn then to the documents purportedly disclosing advice provided by Price Waterhouse, Toronto to outside counsel for the applicants in the course of preparation by counsel of legal advice for the applicants. That disclosure apparently took place in exchanges between Price Waterhouse, Toronto and Price Waterhouse, Edmonton. As indicated earlier, counsel for the respondent indicated that there was no evidence before me that the applicants were unaware of these exchanges. Unlike counsel for the respondent, I have now had the advantage of reviewing the documents in question. They bear no indication whatsoever that the applicants were provided with copies of these documents. I am prepared on this basis to assume that the applicants were unaware of these documents. Since it was not disputed before me that solicitor-client privilege extends to advice provided by professionals retained by outside counsel in the course of preparation of legal advice to the counsel's client, I am satisfied that, first, the advice of Price Waterhouse, Toronto to outside legal counsel was covered by solicitor-client privilege, second, that the applicants were unaware of the disclosure of that advice by Price Waterhouse, Toronto to Price Waterhouse, Edmonton and therefore did not consent to its disclosure and thus waive privilege, and finally, that Price Waterhouse, Toronto had no authority to waive privilege on behalf of the applicants. My review of the documents in this category has been conducted in accordance with these

Digitized by Google

principles.
Finally, I turn to the information regarding examinations conducted by officers, employees or representatives of the applicants that the applicants' claim is privileged. Examination of claims to privilege with respect to such information does not easily fit within the scheme of section 232 of the *Income Tax Act*. Indeed, I conclude it does not fit at all. For that reason, no order is made with respect to the claim to privilege regarding that information. That being said, it should be abundantly apparent that one or more officers, employees or representatives of the applicants examined documents in the possession of Price Waterhouse, Edmonton relating to the audit and examination of the 1993 consolidated financial statement of Interprovincial Pipe Line Inc. How else would the claim for privilege asserted in respect of certain of those documents have arisen? Having so concluded, I am not certain that the identity of the officers, employees or representatives who reviewed the files and the date or dates when the review was conducted is particularly relevant if the respondent has received assurances, as he has, that no information or documentation was removed, transferred, culled, destroyed or altered, except as disclosed, with respect to the documents on which privilege is claimed.

CONCLUSION

Against the foregoing analysis, with the assistance of counsel for the applicants, and in the absence of counsel for the respondent, I reviewed the documents in respect of which privilege is claimed. As I indicated early on in these reasons, there are 33 such documents. They were provided to me in two packages, the first containing 30 documents and the second 3 documents. Each package was covered by an index and a copy of each index was provided to the respondent. At the opening of the hearing before me, counsel for the applicants released the applicants' claim to privilege in respect of documents 7, 8 and 26 in the first package and document 3 in the second package. Counsel also released the applicants' claim to privilege in respect of portions of documents 4, 5, 6, 13, 15 and 23 in the first package. During my examination of the documents in the presence of counsel for the applicants, counsel further released the applicants' claim to privilege in respect of a portion of document 25 in the first package. Also during my examination of the document in the presence of counsel for the applicants, I found myself to have a different view from counsel as to whether or not a document should be severed in order to provide as much information as possible to the respondent. If I do not do an injustice, the view of counsel was that the totality of the document should be protected unless a substantive portion of the document can be disclosed. With great respect, that would involve me in an attempt to exercise discretion as to what might or might not be of use to the defendant in his investigation and, inevitably, in the withholding of information, however innocuous, that is not subject to a valid claim of solicitor-client privilege. Accordingly, in my final examination of the documents, I have concluded in favour of releasing to the respondent all information, no matter how trivial I might consider it to be, that I do not regard, in itself, as being the subject of a valid claim to solicitor-client privilege. My conclusions in this regard are set out in my order.

TREATMENT OF COURT FILE

Paragraph 6 of the interim order in this matter provides as follows:
The existing court file in this proceeding, and any further materials filed in this proceeding, shall be sealed until further order of This Honourable Court.
Materials added to the file since the date of that order include the applicants' record, the written submissions of the respondent, the book of authorities of the respondent, the packages of documents handed to me sealed and that are the subject of the application,

Digitized by Google

the transcript of the hearing before me and a letter dated October 11, 1995 addressed to me from counsel for the applicants. I consulted with counsel on whether or not the file documentation other than the documents that are the subject of the application could be opened to the public on the principle that files of this Court are, in the absence of compelling reasons, open for public examination. Counsel agreed that all documentation on the file could be made open with the exception of the documents that are the subject-matter of the application and of certain references in the applicants' record and in the transcript to third parties with whom the applicants are involved in confidential business relationships. On that basis, I invited counsel for the applicants to review the applicants' record and the transcript and suggest to me appropriate deletions. Counsel's letter of October 11 is a response to this invitation. Subject to my review of the recommended deletions and my final decision with respect to them, my order will provide for the treatment of this file, other than the documents that are the subject of the application, as any other file in the registry of this Court.

COSTS

Counsel drew to my attention the fact that subsection 232(9) of the *Income Tax Act* provides as follows:

232. ...

(9) No costs may be awarded on the disposition of any application under this section.

Accordingly, no costs will be awarded to either party.

[1] R.S.C., 1985 (5th Supp.), c. 1, as amended.

[2] R.S.C., 1985, c. C-44, as amended.

[3] Transcript of cross-examination on affidavit of James Andrew Telford, Edmonton, Alberta, June 23, 1995, at pp. 8, 12 to 14, and 20. Applicant's record, Tab E. Paragraph 9 of Mr. Telford's affidavit referred to reads as follows:

9. All of the Privileged Documents evidence legal advice provided by Outside Counsel to IPL with respect to the Transaction or other business of IPL, and are therefore solicitor-client privileged. IPL has not waived, and wishes to preserve, that privilege. IPL provided the privileged information referenced in the Privileged Documents to Blumenthal in or about January of 1994 only because Price Waterhouse demanded it in its capacity as IPL's auditors, because IPL was statutorily compelled to comply with that demand, and because IPL needed to ensure full disclosure was made to Price Waterhouse to allow Price Waterhouse to conduct a complete audit. In doing so, IPL never intended to waive, and indeed expressed its intention to preserve, its proper claim to solicitor-client privilege in respect of that information. I specifically told Blumenthal that IPL considered the legal advice in question to be solicitor-client privileged information of IPL, that IPL would not release and wished to retain that privilege, and that accordingly Price Waterhouse should not take copies or make notes of that legal advice.

[4] 1982 CanLII 22 (SCC), [1982] 1 S.C.R. 860.

[5] reflex, [1985] 1 C.T.C. 302 (Ont. S.C.).

[6] 1988 ABCA 282 (CanLII), (1988), 61 Alta. L.R. (2d) 319 (C.A.)

[7] [1988] 3 All ER 816 (C.A.).

[8] 1994 CanLII 7295 (ON SC), (1994), 19 O.R. (3d) 537 (Gen. Div.).

Common Interest Privilege

Digitized by Google

Whether a particular record retains common interest privilege – where a legal opinion is provided to more than one party and one party relinquishes its interest is an interesting point by which CRA can obtain access to information in determining tax aspects. It was examined in Pitney Bowes Of Canada Ltd., Pitney Bowes Credit Corporation, Royal Bank Of Canada, Maple Assets Pipin Limited v. Her Majesty The Queen whereby it was held:

REASONS FOR JUDGMENT AND JUDGMENT

[1] This is a motion pursuant to s. 232(4) of the *Income Tax Act*, R.S.C. 1985, c. 1, as amended (hereinafter "the *Act*") to determine whether the applicants have a solicitor-client privilege in respect of certain documents that would protect them from disclosure to the Canada Customs and Revenue Agency (hereinafter "the CCRA"), which is otherwise required under s. 231.2 of the *Act*.

I. Factual Background

[2] The documents in question relate to a multilateral commercial transaction that took place in 1997 ("the leasing transaction"). As part of that transaction, Pitney Bowes of Canada Ltd. ("Pitney Bowes") purchased railway cars from NS Group N.V. ("N.S. Group"), and then leased them to Maple Assets Pipin Limited ("MAPL"), who then sub-leased these cars to NS Group. Royal Bank of Canada ("Royal Bank") loaned Pitney Bowes a portion of the purchase price of the railway cars.

[3] Various parties were represented by different legal counsel in the leasing transaction. In particular, McMillan Binch represented all of the applicants in one way or another. To avoid conflicts, different lawyers were involved in different aspects of the transaction, and Clifford Chance of the UK provided independent advice on certain matters to Royal Bank and MAPL.

[4] The parties to the leasing transaction agreed that, where multiple parties needed legal advice in areas where their interests were not adverse, they would all obtain advice from one legal counsel, regardless of the general legal representation in the transaction. In particular, Clifford Chance of the UK provided two opinions on United Kingdom law, both dated December 12, 1997: one addressed solely to Pitney Bowes, and the other addressed jointly to N.S. Group and Royal Bank. It is these two opinions that are the subject of this application.

[5] On April 18, 2002, the CCRA served McMillan Binch with a requirement pursuant to s. 231.2 of the *Act* to provide documents related to the leasing transaction. McMillan Binch refused to provide certain documents to the CCRA, claiming that they were exempt from disclosure on the basis of solicitor-client privilege. Those documents were sealed in two boxes and have been retained by McMillan Binch in accordance with s. 232(3.1) of the *Act*. McMillan Binch then brought an application to determine the question of solicitor-client privilege which has resulted in this motion.

[6] The parties have reached a settlement with regard to many documents. The only documents that remain in dispute are the two legal opinions by Clifford Chance described above. The sole issue is whether these two documents are protected by solicitor-client privilege and are thereby excluded from disclosure to the CCRA.

[7] The relevant sections of the *Act* are set out below as an Annex.

II. Issue

[8] Are the two legal opinions dated December 12, 1997, authored by the United Kingdom law firm of Clifford Chance and in the possession of the applicants, protected by solicitor-client privilege?

Digitized by Google

III. Analysis

[9] I have reviewed the numerous cases cited to me by the parties on the subject of solicitor- client privilege. Those that were decided in circumstances similar to the matter before me appear to support the position of the applicants. Counsel for the respondent, in all candour, urged me to conclude that those cases were wrongly decided.

[10] On one level, this matter is simple. Indeed, the applicants see it that way. The respondent is seeking disclosure of legal opinions in the custody of the applicants' solicitors. Those opinions, say the applicants, are privileged under the ordinary rules protecting solicitor-client communications.

[11] The respondent sees things differently, arguing that attaching privilege to the documents in issue would amount to an unjustified extension of the concept of privilege, even beyond what is contemplated by the so-called "common interest" privilege.

A. *Common Interest Privilege in Litigation*

[12] In *Buttes Gas and Oil Co.* v. *Hammer, et al. (No. 3)*, [1980] 3 All E.R. 475, Lord Denning described common interest privilege as "a privilege in aid of anticipated litigation in which several persons have a common interest" (at 483). In that case, privilege was found to attach to documents prepared after the point in time when litigation between the parties was anticipated. The privilege extended to documents prepared by the litigants and shared with other persons who, while not parties to the litigation, had interests in common with the respective litigants. Lord Denning provided a simple example to illustrate the kind of situation where this kind of privilege should be recognized:

> **Owners of adjoining houses complain of a nuisance which affects them both equally. Both take legal advice. Both exchange relevant documents. But only one is a plaintiff. . . In all such cases I think the courts should, for the purposes of discovery, treat all the persons interested as if they were partners in a single firm or departments in a single company. Each can avail himself of the privilege in aid of litigation (at 484).**

[13] One can readily see the logic of such a rule. However, its relevance to these proceedings is not immediately apparent. Clearly, the common interest privilege Lord Denning had in mind was a specific kind of privilege that applied in circumstances when litigation was contemplated. In those circumstances, it is clear which parties have interests in common and which are adversaries. That is not the case here. In the case at bar, the parties were trying to achieve a fairly large commercial transaction. There is no suggestion that litigation was on their minds. The parties had overlapping, but not identical, interests. They were neither adversaries nor brothers-in-arms. It would be difficult to view them "as if they were partners in a single firm or departments in a single company", to use Lord Denning's words.

[14] Strictly speaking, then, the rule in *Buttes* is not applicable here. However, Lord Denning's reasoning may be. The point of recognizing common interests is not as a means of determining whether privilege exists. The real issue is whether privilege has been lost. In Lord Denning's example, a legal opinion secured by the plaintiff homeowner is clearly privileged. The question is whether that privilege would be lost if the opinion was shared with the plaintiff's neighbour. His answer was that the privilege would remain intact if the opinion was shared with persons who had common interests. It would be otherwise if the opinion was shared with the nuisance-causing defendant.

[15] In the matter before me, it seems obvious that the legal opinions the disclosure of which is sought by the respondent are *prima facie* privileged. The question is whether privilege was lost when those opinions were shared with other parties to the transaction. To

Digitized by Google

answer that question, one must decide whether the logic of *Buttes* has any application to commercial transactions.

B. *Common Interest Privilege in Commercial Transactions*

[16] Other courts have addressed this issue and have concluded that *Buttes* applies when parties to a commercial transaction share legal opinions with one another. Of the cases cited to me, *Fraser Milner Casgrain LLP* v. *Canada (Minister of National Revenue)*, [2002] B.C.J No. 2146, is closest to the circumstances before me. There, the respondent sought production of a number of documents relating to the creation of certain business partnerships. The documents in issue included legal advice that was prepared for one group of companies and then shared with other corporate parties to the proposed transaction. In the course of his reasons, Lowry J. summarized in the following terms the other recent cases in the area, all of which were cited to me (*Archean Energy Ltd.* v. *Canada (Minister of National Revenue)* (1997), 98 D.T.C. 6456 (Alta. Q.B.), [1997] A.J. No. 347 (QL); *Anderson Exploration Ltd.* v. *Pan Alberta Gas Ltd.*, [1988] 10 W.W.R. 633 (Alta. Q.B.) and *St. Joseph Corp.* v. *Canada (Public Works and Government Services)*, 2002 FCT 274, [2002] F.C.J. No. 361 (QL) (T.D.):

In *Archean Energy*, legal opinions concerning the tax consequences of a number of share purchases were developed for one company which subsequently provided them to a second company, the purchaser in the transactions. The opinions were held, on application by the purchaser under the *Income Tax Act*, to be privileged because they had been provided to further the common interest of having the transaction concluded and not with the intent of waiving the privilege attached. In *Anderson Exploration*, two corporations exchanged confidential documents of a proprietary nature in negotiating a merger. A legal opinion obtained by one was also given to the other. Later, in unrelated litigation involving a subsidiary of one of the corporations, the plaintiff sought access to the documents arising from the merger negotiations. The court held that the disclosure of the documents to third parties did not waive the privilege that attached to all of the documentation because of the common interest associated with their disclosure. And in St. Joseph, legal opinions exchanged in the course of a commercial transaction were held to be privileged given that the parties had a joint interest in ensuring its completion (at para.8).

[17] In the result, Lowry J. held that besides the common interest litigation privilege recognized in *Buttes*, the courts should also recognize another kind of common interest privilege: one based on "the parties' common interest in the successful completion of a transaction" at (para. 12). He found that "economic and social values inherent in fostering commercial transactions" favoured the recognition of such a privilege. It is that kind of privilege that he applied to the circumstances before him.

[18] As mentioned above, in these kinds of cases the real issue is whether the privilege that would originally apply to the documents in dispute has somehow been lost - through waiver, disclosure or otherwise. This is a question of fact that will turn on a number of factors, including the expectations of the parties and the nature of the disclosure. I read the foregoing cases as authority for the proposition that in certain commercial transactions the parties share legal opinions in an effort to put them on an equal footing during negotiations and, in that sense, the opinions are for the benefit of multiple parties, even though they may have been prepared for a single client. The parties would expect that the opinions would remain confidential as against outsiders. In such circumstances, the courts will uphold the privilege.

[19] However, the cases do not say, as I read them, that the mere existence of a commercial transaction is sufficient on its own to insulate all shared solicitor-client

Digitized by Google

communications from attempts to gain access to them. There may well be cases where the parties to a commercial transaction disclose privileged documents in circumstances that suggest that there has indeed been a loss or waiver of privilege. As mentioned, in the commercial setting it is less clear than in Lord Denning's example which parties have common interests. Therefore, it is more difficult to make a hard and fast rule. I agree with the observation of Slatter J. in *Pinder v. Sproule*, [2003] A.J. No. 32 (QL)(Q.B.) that "[p]otential parties to a merger or other business transaction are in many ways adverse in interest, and it strains the common interest exception to try and fit disclosures between such parties within that exception" (at para. 62).

[20] Still, in many commercial transactions, the parties will want to negotiate on the footing of a shared understanding of each other's legal position. They will seek legal advice from reputable solicitors whose opinions will be respected by the other parties. Indeed, the solicitors may represent more than one party to the deal. The sharing of legal opinions will ensure that each party has an appreciation of the legal position of the others and negotiations can proceed in an informed and open way. The advice may be provided for one or more party on the understanding that others should be provided copies. The expectation, whether express or implied, will be that the opinions are in aid of the completion of the transaction and, in that sense, are for the benefit of all parties to it. Such circumstances, in my view, create a presumption that the privilege attaching to the solicitor-client communications remains intact notwithstanding that they have been disclosed to other parties.

C. *Application to the Facts of this Case*

[21] Here, the legal opinions in issue were prepared by Clifford Chance for specific parties: Pitney Bowes of Canada Ltd. on the one hand, and N.S. Group N.V. and Royal Bank of Canada on the other. Those opinions were privileged communications between solicitors and clients. The question is whether the disclosure of those opinions to the other parties dissolved that privilege.

[22] The applicants acknowledge that some of the parties were adverse in interest in many aspects of the transaction. However, the expectation was that these opinions, as well as others, should be sought and distributed among them so that the parties would have a common understanding of certain legal aspects of the transaction. The opinions were prepared with distribution in mind. This approach was economical, in that each party did not have to seek the same legal advice. It also facilitated completion of the transaction because parties were informed of the respective legal positions of the others. While the opinions are addressed to particular clients, they were prepared with the intention of sharing them with other parties with like interests for their collective benefit.

[23] In these circumstances, the presumption is that the privilege should be maintained unless there is some evidence to suggest that it was somehow waived, disclosed to outsiders or otherwise terminated. There is no evidence of this in the case before me. Accordingly, these documents are privileged and should remain in the custody of McMillan Binch.

JUDGMENT

IT IS HEREBY ADJUDGED THAT:

(x) an opinion written by Clifford Chance dated December 12, 1997 addressed solely to Pitney Bowes of Canada Limited, and

(b) an opinion written by Clifford Chance dated December 12, 1997 addressed jointly to NS Group N.V. and to Royal Bank of Canada, London Branch;

Digitized by Google

are not required to be produced to the Canada Customs and Revenue Agency under the requirement to provide documents dated April 18, 2002 and shall remain in the custody of McMillan Binch.

The remaining documents are to be dealt with in the manner set out in the Consent to Order dated February 10, 2003 and filed with the Court at the hearing of this motion on February 11, 2003 in Toronto.

"James W. O'Reilly"
J.F.C.C.

The Minister Of National Revenue v. Grant Thornton et al., 2012 FC 1313, A Recent SCP: Documents realized *Through Auditor* Which Prompted Extension of Privilege to Cover as well as Concerns Over Common Interest

REASONS FOR JUDGMENT AND JUDGMENT

[1] **The central dispute in this case concerns whether three short documents are protected by solicitor client privilege [SCP].**

[2] **The Intervener has also challenged the constitutionality of the statutory provisions pursuant to which the Applicant seeks to compel the production of those documents, on the basis that that they potentially permit the Minister to access documents that are protected by SCP, without the privilege- holder's knowledge or consent. The Intervener submits that such potential access to documents protected by SCP constitutes an unreasonable search and seizure, and thereby contravenes s. 8 of the *Canadian Charter of Rights and Freedoms*.**

[3] **The documents in question were either knowingly or inadvertently disclosed by the Intervener to its auditor, the Respondent, which did not participate in these proceedings.**

[4] For the reasons that follow, I find that:
each of the three documents is protected by SCP; and
on the particular facts in this case, it is not necessary or appropriate to decide the constitutional question that has been raised.

Background

[5] The Canada Revenue Agency [CRA] is engaged in a review of the 2005 reorganization [Reorganization] of the Foremost Industries Income Fund [FIIF].

[6] Foremost Industries Inc., at all relevant times, acted as the administrator of FIIF.

[7] Following the Reorganization, FIIF ceased to exist, and Foremost Income Fund [Fund] was created. Foremost Industries Inc., at all relevant times in 2005 and 2006, was also the administrator of Fund. **In 2006, the Intervener, Foremost Industries Ltd., became the new administrator of Fund, as successor to Foremost Industries Inc. Except where otherwise indicated below, the various entities referred to above will be collectively referred to as Foremost.**

[8] Among other things, it appears that CRA is reviewing losses that were claimed by one of Fund's unit holders, which resulted from a complicated series of transactions that followed the Reorganization, and which apparently were unavailable to other unit holders.

[9] In a letter dated January 30, 2010, Mr. Craig Bell advised that he was the Secretary and General Counsel of FIIF, and director of the administrator of FIIF, before and at the time of the Reorganization. **He further advised that he was the initial trustee of FIIF, and**

Digitized by Google

that he no longer serves Fund in any of the aforementioned capacities. In addition to being a member of the Law Society of Alberta, Mr. Bell has been a chartered accountant since 1988.

[10] The Respondent was retained as the auditor for FIIF and also performed some ancillary tax filing work for FIIF.

[11] **Pursuant to subsections 231.1(1)(a) and (b) of the *Income Tax Act*, RSC 1985, C. 1 (5th Supp.) [ITA], CRA sent a letter dated December 2, 2010 to the Respondent notifying it that it was required to produce certain information and documents in relation to the Reorganization within 30 days of the**
date of the letter [the "Requirement Letter"]. That letter did not indicate the procedure to be followed if any of the documents or other information falling within its scope [Documents and Information] were entitled to the protection of SCP. Indeed, that letter did not mention SCP whatsoever and was not copied to the Intervener.

[12] By letter dated December 22, 2010, CRA received a reply from the Respondent which provided some of the Documents and Information in response to the Requirement Letter. **The Respondent also stated that it had been advised by FIIF that FIIF was asserting SCP over three documents [Retained Documents], which it identified as follows:**

Memo to Trustees, October 31, 2005, Re: Transaction Backgrounder, 4 pages, by Craig Bell, CA LLP;

Memo to File, March 22, 2006, Re: T3 and Other Tax Considerations, 3 pages by Craig Bell, CA LLP;

Memo, untitled, undated, 3 pages, by Craig Bell, CA LLP.

[13] On March 28, 2011, Wendy Bridges, counsel to the Applicant, sent the Respondent a letter proposing the following two options to resolve the issue of whether or not the Retained Documents were protected by SCP:

proceedings pursuant to subsection to 237.7(1)(b) of the ITA, or
referral of the matter to a Department of Justice lawyer located outside Edmonton, for a non-binding opinion as to whether the Retained Documents are protected by SCP.

[14] **The Respondent subsequently advised a representative of the Applicant by telephone that it elected to proceed with the first of those two options. In addition, Ronald J. Robinson, litigation counsel to Fund, became aware of Ms. Bridges'proposal and objected to it on the basis that it did not provide any role for the privilege holder in the process and was contrary to CRA's stated policy of obtaining information directly from taxpayers rather than from third parties.**

[15] **In May 2011, CRA filed a Notice of Application for a compliance order under subsection 231.7(1) solely against the Respondent, although it did serve a"courtesy copy" of that document on the Intervener. A few weeks later, the Intervener sought leave to intervene in these proceedings, which was granted on consent on June 15, 2011. One month later, the Intervener filed a Notice of Constitutional Question in respect of sections 231.2(1) and 231.7 of the ITA.**

[16] At an initial hearing before me on August 16, 2011, a dispute as to whether the Intervener was entitled to raise its constitutional question without Leave of the Court was settled on consent. That consent was reflected in an Order dated September 7, 2011, which also revised the timetable for the hearing of this matter and the steps to be taken by the parties prior to that hearing.

Relevant Legislation

[17] The legislation relevant to this application is set forth in the ITA and is attached to these reasons as Appendix "A".

[18] In brief, subsection 231.2(1) permits the Minister, for any purpose related to the

Digitized by Google

administration or enforcement of the ITA, to require any person to provide any information or any document within such reasonable period of time as stipulated in a written notice served in accordance with that provision. Pursuant to subsection 238(1), it is an offence to fail to comply with a requirement issued under section 231.2. That offence is punishable on summary conviction by (a) a fine of between $1,000 and $25,000, or (b) a fine in that range and imprisonment for a term not exceeding 12 months.

[19] Pursuant to subsection 231.7(1), on summary application by the Minister, a judge may, among other things, order a person to provide any information or documents sought by the Minister under section 231.2, if the judge is satisfied that:

the person was required under section 231.1 or 231.2 to provide the information or document and did not do so; and

the information or document is not protected from disclosure by SCP, as that term is defined in subsection 232(1).

Analysis

Are the Documents protected by SCP?

Relevant legal principles

[20] SCP has evolved from a rule of evidence into a substantive principle and a principle of fundamental justice (*Lavallee, Rackel & Heintz v Canada (Attorney General)* [2002] 3 SCR 209, at paras18 and 49 [*Lavallee*]). This principle protects not only the privacy interests of a person who seeks legal advice, but also supports the integrity and fairness of our judicial system (*Lavallee*, above, at paras 36 and 49).

[21] **At its core, and subject to very limited exceptions that either do not apply in this case or are discussed in Part III. A. (iii) below, this principle protects from disclosure (i) communications between a solicitor and his or her client, (ii) which entail the seeking or giving of legal advice, and (iii) which are intended to remain confidential (*Canada v Solosky* [1980] 1 SCR 821, at 837 [*Solosky*]).**

[22] This protection is not confined to communications in which legal advice is provided. **Rather, it extends to all communications "engaged in for the purpose of enabling the client to communicate and obtain the necessary information or advice in relation to his or her conduct, decisions or representation in the courts" (*Miranda v Richer*, [2003] SCR 193, at para 30 [*Miranda*]). In brief, SCP protects all communications made within the framework of the solicitor-client relationship (*Descôteaux v Mierzwinski* [1982] 1 SCR 860, at para 71; *Canada (Privacy Commissioner) v Blood Tribe Department of Health* [2008] 2 SCR 574, at para 10 [*Blood Tribe*] ; *Samson Indian Band v Canada*, [1995] FCJ No 734, at para 8). However, communications made outside of that framework are not protected by SCP (*Solosky*, above, at 835). For example, SCP does not extend to purely business or policy advice that may be provided by a solicitor (*R v Campbell* [1999] 1 SCR 565, at para 50), or to documents that are not otherwise privileged and somehow come into the possession of a solicitor (*Belgravia Investments Ltd v Canada*, [2002 F.C.R. No. 870, at para 46 [*Belgravia*]).**

[23] As acknowledged by the Applicant at the hearing of this Application on March 12, 2012, the **foregoing applies with equal force to a solicitor's work product. That is to say, a solicitor's work product produced for the purpose of giving legal advice and intended to remain confidential is protected by SCP. (*Keefer Laundry Ltd v Pellerin Milnor Corp* [2006] BCJ No 1761, at paras 103- 104 [*Keefer*];*Susan Hoisery v Minister of National Revenue*, 69 DTC 5278, at 5282 [*Susan Hoisery*]). This** is based on the theory that no one should be permitted to "look into the mind" of the lawyer as he or she

Digitized by Google

is preparing a case (*Keefer*, above, at para 104). It is also entirely in keeping with the "broad and all-encompassing" approach to SCP (*Pritchard v. Ontario (Human Rights Commission)*, 2004 SCC 31, at para 16 [*Pritchard*]). However, while such work product itself is protected by SCP, facts that have **an independent existence and do not arise "out of the solicitor-client relationship and of what transpires within it" are not so protected if they are otherwise discoverable (*Miranda*, above, at paras 30-32; *Belgravia*, above, at paras 44-45, quoting with approval *Susan Hoisery*, above).**

[24] **When an investigating authority comes into possession or otherwise becomes aware of a document or other information that may be protected by SCP, every effort should be made to contact the privilege holder, who should then be given a reasonable opportunity to (i) determine whether a claim of privilege should be asserted, (ii) make such assertion, if he or she decides to do so, and (iii) have the issue judicially decided, if the claim is contested. An investigating authority can only inspect the documents if and when it has been judicially determined that the documents are not protected by privilege (*Lavallee*, above, at para 49).**

[25] Privilege does not come into being by an assertion of a privilege claim. It exists independently. In addition, the privilege belongs to the client and can only be asserted or waived by the client or through his or her informed consent (*Lavallee*, above, at para 39).

[26] **The burden of proof rests on the person asserting SCP to establish that the information in question meets the necessary requirements (*Belgravia*, above, at para 47). However, once established, the onus is on the party seeking to overcome the privilege to establish that the information should be disclosed (*Smith v Jones*, [1999] 1 SCR 455, at para 46; *Camp Development Corp v South Coast Greater Vancouver Transportation Authority*, [2011] BCJ No9 104, at para 10 ; *Archean Energy*, above, at para 30; *Western Canada Place Ltd v Con-Force Products Ltd* [1997] AJ No 354, at para 18).**

The Documents and SCP

[27] From the outset of these proceedings, the Applicant has specifically maintained that the Minister is not seeking production of documents that are protected by SCP. **However, the Applicant has emphasized that any of the Retained Documents that involve communications by Craig Bell in his capacity as trustee or accountant are not protected by SCP. Therefore, the Applicant took the position that if the Court was if the view that any of the Retained Documents may be entitled to the protection of SCP, the Respondent should produce those documents to the Court to enable the Court to determine the validity of the Intervener's assertion of SCP.**

[28] Foremost took the position that it was not necessary for the Court to review the Retained Documents to determine whether they are protected by SCP, which it is asserting as administrator of Fund and on behalf of Fund and other Foremost entities. In support of this position, it asserted that the uncontroverted evidence is that the Retained Documents are related to legal advice and not accounting advice or services.

[29] The"uncontroverted evidence" in question consisted of:

the"privilege" markings on the Retained Documents;

its assertion that the Retained Documents were created outside the limited time period in which Mr. Bell was a trustee of fund;

its assertion that Mr. Bell did not create the Retained Documents in his capacity as an accountant, and has never acted for Foremost in an accounting capacity;

its assertion that there is no evidence to suggest that Mr. Bell provided any accounting services whatsoever to Foremost, which has its own chief financial officer and a complement of accounting staff; and

Digitized by Google

its assertion that the Retained Documents relate to the provision of legal advice on the Reorganization, and not to the provision of advice on accounting matters.

[30] With respect to the markings on the Retained Documents, the word "PRIVILEGED" was typed at the top of the initial page of the first of the three documents. As to the second of those documents, the words "PRIVILEGED AND CONFIDENTIAL" were stamped at the bottom of each page. In addition, the following was stamped on each page: "The writer has been retained by Counsel to act on its behalf for the purposes of supporting legal advice in this matter." As to the third of the documents, the following words were typed at the top of the first page: "PRIVILEGED & CONFIDENTIAL – PREPARED UNDER EXPECTATION OF SOLICITOR & CLIENT PRIVILEGE".

[31] There may well be circumstances in which it is not necessary for the Court to review documents in respect of which a claim of privilege has been made, in order to determine whether they are protected by privilege. However, the evidentiary record in this case, as it existed at the time of the hearing on March 12, 2012, was not such as to enable me make that determination in respect of the Retained Documents. Accordingly, in a Direction issued on May 18, 2012, I stated that it was necessary for the Court to examine the documents to assess whether they are entitled to such protection (*Solosky*, above, at 837;*Risi Stone Ltd v Groupe Permacon Inc,* [1990] 3 FC 10, at para 4). I therefore directed the Respondent to file the Retained Documents under seal with the Court within 10 days, to permit a determination on the privilege issue to be made.

[32] **In determining whether a document authored by a solicitor contains a communication that is protected by SCP, and in the absence of other evidence, it would ordinarily be appropriate to give substantial weight to the fact that the document is identified as being privileged. However, in this case, there was such other evidence, which included the following**:

In addition to being a solicitor, Mr. Bell has been a chartered accountant since 1988;

One of the Retained Documents was undated, and may, notwithstanding Mr. Bell's representations to the contrary, have been prepared during the time that Mr. Bell was a trustee of FIIF;

Mr. Bell, who did not provide any evidence with respect to the Retained Documents, has advised numerous parties, including Mr. Pat Breen, "as to their respective governance roles, duties, responsibilities and liabilities" (Breen Affidavit, sworn on July 27, 2011, at para 11 [Breen Affidavit #2]). Mr. Breen has been the President and a Director of the Intervener since before the reorganization of FIIF into Fund.

Most importantly, Foremost had prior opportunities to identify and assert a claim of privilege in respect of the Retained Documents, yet failed to do so. This is reflected in Exhibit "D" to the Affidavit sworn by Mr. Breen on June 8, 2011 [Breen Affidavit #1], which includes a copy of a Service-Related Complaint that evidences a long and acrimonious series of exchanges, dating back to 2006, between Foremost and CRA regarding the reorganization. This was also confirmed during Foremost's cross- examination of Ms. Helen Little, a Team Leader in the Aggressive Tax Planning Section of the CRA (Cross-Examination on Affidavit of Helen Mary Little, December 8, 2011, at pages 15, 28, 38 and 42). Moreover, in oral submissions to the Court on March 12, 2012, counsel to the Applicant stated that Messrs. Breen and Bell were specifically requested to provide the information that was subsequently sought from the Respondent. In Response, counsel to Foremost simply observed that Mr. Bell received a "request letter"from CRA, rather than a "requirement letter," and that Mr. Bell was under no obligation to "self-identify privileged documents which are exempt from disclosure" under the ITA (Transcript, at 10 – 17).

[33] I have some difficulty with the suggestion that documents or other information that is within the scope of a request or requirement issued by CRA pursuant to the ITA may

Digitized by Google

simply be withheld, without ever being identified on a privilege log, or otherwise, based on a view that the information is protected by SCP. Such a manner of proceeding would prevent the CRA or another regulatory authority in similar circumstances from ever being able to contest the assertion that the information in question is protected by SCP. Given that the party asserting SCP may well be wrong in that regard, it is essential that any information which falls within the scope of a request made pursuant to validly enacted legislation, and in respect of which a claim of SCP is asserted, be identified on a privilege log or in some other manner, so that the regulatory authority is aware of its existence and has an opportunity to challenge the assertion.

[34] Turning to three Retained Documents, the document dated October 31, 2005 is addressed to "Trustees" and is identified as a "Transaction Backgrounder". In Breen Affidavit #2, at para 14, Mr. Breen stated that this "document was created for the trustees of the Fund (as client representatives and proposed trustees as of that date) on the legal aspects and considerations surrounding the Reorganization." This document is largely devoted to describing the structure, objectives and broad steps of the Reorganization. Towards the end, under the heading" Considerations," there is a reference to "counsel" having been sought in respect of certain issues that appear to be legal in nature, although there is no discussion of the specifics of any legal advice that may have been received. Taken alone, this suggests that the document may not have been prepared by Mr. Bell in his capacity as legal counsel. However, there is a subsequent general statement of belief that appears to convey a legal conclusion. This is followed by a second statement of belief regarding another legal issue. With the foregoing in mind, and given that a "broad and all-encompassing" approach should be taken to SCP (*Pritchard*, above, at para 16), I am inclined to err on the side of caution and conclude that this document is a protected communication that was (i) generated within the framework of a solicitor-client relationship, (ii) related to the giving of legal advice, and (iii) intended to be kept confidential, as evidenced by the word "PRIVILEGED" at the top of the first page. I note also that this document pre-dates the short period of time during which Mr. Bell was a trustee of Fund.

[35] The second of the Retained Documents, dated March 22, 2006, is a memorandum to"file," entitled "T3 and Other Tax Considerations." In Breen Affidavit #2, at para 15, Mr. Breen stated that he was advised by Mr. Bell "that the document was created by him to memorialize his legal analysis of certain aspects of the Reorganization and was the basis of legal advice provided to the Fund and its predecessor and related and affiliated entities." As with the document described immediately above, this document is largely descriptive. Generally speaking, it describes certain transactions that appear to relate to the reorganization and then describes and their tax consequences for certain Foremost entities and other taxpayers. In several places, it is difficult to ascertain whether the statements made are based on accounting or legal considerations. However, once again, I decided to err on the side of caution and conclude that the document is protected by SCP, on the basis that it is work product which could well have been prepared by Mr. Bell in his capacity as a solicitor, and for the purpose of either providing legal advice to Foremost or assisting another solicitor to provide such advice. In reaching this conclusion, I also gave some weight to (i) Mr. Breen's evidence that, to the best of his knowledge, Mr. Bell "has never acted for the Fund or any of the Foremost entities in an accounting capacity", and (ii) the lengths to which Mr. Bell went to convey his view that the document is protected by SCP. As previously noted, that document is stamped "PRIVILEGED" in very large font at the top of each page, "PRIVILEGED AND CONFIDENTIAL" at the bottom of each page, and is stamped with the following statement on each page: "The writer has been retained by Counsel to act on its behalf for the purposes of supporting legal advice in this matter." With respect to this last statement, given that SCP also extends to documents created by a

Digitized by Google

lawyer who has been consulted by another lawyer in the course of the latter's provision of legal advice to his or her client (*Belgravia*, above at para 50), the fact that Mr. Bell may not have been retained directly by Foremost, but rather by other counsel to Foremost, had no bearing on my determination. I should add that the lengths to which Mr. Bell went to convey his view that this document is protected by SCP satisfy me that the document was intended to remain confidential. In addition, I note that the document post-dates the short period during which Mr. Bell was a trustee of Fund.

[36] I also hasten to add that it is not necessary on the specific facts of this case to consider the potential relevance of the definition of SCP set forth in subsection 232(1) of the ITA, which, on its face, is confined to"communications … passing between the person and the person's lawyer in professional confidence." This is because the Applicant has acknowledged that SCP extends to work product created in connection with the giving of legal advice, and it has also confirmed that it is not seeking access to any documents that are protected by SCP. In addition, Foremost has not questioned the scope of the definition of SCP in subsection 232(1), which is referred to in paragraph 231.7(1)(b). That said, I would observe in passing that "legislative language that may (if broadly construed) allow incursions on solicitor-client privilege must be interpreted restrictively" (*Blood Tribe*, above, at para 11).

[37] The third of the Retained Documents (the "Undated Memo") is undated and unaddressed. In Breen Affidavit #2, Mr. Breen stated that he was advised by Mr. Bell that he created the memo "in conjunction with the parties *[sic]*outside legal advisers at both Bennett Jones LLP and Blakes LLP in early 2006." Mr. Breen also stated that Mr. Bell advised him that "the document delineates legal analysis on the structure of the Reorganization" and "formed the basis of legal advice provided to the Fund and its predecessor and related and affiliated companies."

[38] As with the second of the Retained Documents, the Undated Memo contains no solicitor-client communication. Contrary to Mr. Breen's statement, it also does not appear to contain any legal analysis on the structure of the reorganization. This undermines Mr. Breen's assertion, which is hearsay, regarding the legal purpose of the memo, which is not otherwise immediately ascertainable. On its face, the document simply begins by stating certain historical facts and then briefly describes certain transactions that will occur prior to the Closing Date, as well as the various steps involved in the previously mentioned reorganization. The document ends by stating certain "Final Balances" and referring to an unspecified "taxable capital gain/income." Given the foregoing, I initially concluded that this document is not protected by SCP.

[39] After conveying the above conclusions regarding the Retained Documents to counsel during a telephone conference on June 12, 2012, and inviting counsel to advise as to how they wished to proceed, counsel to the Intervener offered to provide further background information with respect to the creation and intent of the Undated Memo. I accepted that offer and issued a Direction, dated June 26, 2012, that set forth the dates by which such further information, and any response and reply that the Applicant and the Intervener, respectively, might wish to make, would have to be submitted.

[40] On July 5, 2012, the Intervener filed an Affidavit by Mr. Wallace Shaw, a member of the Law Society of Alberta and counsel with Blake Cassels & Graydon LLP. Based on the additional evidence set forth in that Affidavit, I am now satisfied that, as with the first two Retained Documents, the Undated Memo is also protected by SCP.

[41] In his affidavit, Mr. Shaw stated that he created the Undated Memo with Mr. Bell"while working with him to analyze the legal tax implications of various steps in the Reorganization." Among other things, he also stated that the document:

"was definitely not an accounting exercise";

Digitized by Google

"was created to track the legal tax implications of steps in the Reorganization, which analysis I later communicated to my clients involved in the Reorganization"; and
"was directly related to the provision of legal tax advice to my clients as well as Mr. Bell's".

[42] In contrast to Mr. Breen's hearsay evidence, Mr. Shaw's evidence is that of one of the authors of the Undated Memo, who is also an officer of the Court. In addition, Mr. Shaw's description of the contents of that document is more accurate and his description of their link to legal advice rings truer and is more persuasive than Mr. Breen's. It also corroborates Mr. Breen's evidence regarding the co-authorship of the document. In my view, Mr. Shaw's evidence warrants sufficient weight to tip the balance in favour of a conclusion that the Undated Memo is legal work product that is protected by SCP. In contrast to the term sheet that was discussed in *Belgravia*, above at para 78, and that was distributed to third parties for the purposes of "relaying the proposed terms of the transaction," I am satisfied that the Undated Memo was directly related to the provision of legal tax advice to Foremost and to Mr. Shaw's clients. I am also satisfied that this document was created for the purpose of providing such legal advice. Therefore, the fact that it does not appear to contain any legal thinking or analysis, and may even simply list facts that are otherwise discoverable, is not sufficient to deprive it of the protection afforded by SCP (*Universal Sales Ltd v Edinburgh*, 2009 FC 151, at para 22 [*Universal Sales*]).

[43] In addition, given that the authors of the Undated Memo inserted the words "PRIVILEGED AND CONFIDENTIAL– PREPARED UNDER THE EXPECTATION OF SOLICITOR & CLIENT PRIVILEGE" at the top of the document, I am satisfied that they intended that the document be kept confidential.

[44] I have some sympathy with the Applicant's position that Mr. Bell, as the author of the first two Retained Documents and as one of the authors of the Undated Memo was best placed to provide evidence regarding those documents. However, given that he is also Foremost's counsel, I am not prepared to draw an adverse inference from the fact that he did not provide such evidence. (*Butterfield v. Canada (Attorney General)*, 2005 FC 396, at para 12). I agree with Foremost that there is now sufficient reliable evidence before the Court to enable me to determine that the Retained Documents are protected by SCP.

iii. Was there a Limited Waiver of SCP or an inadvertent disclosure of the Retained Documents?

[45] The Applicant submits that even if the Retained Documents were at one time protected by SCP, that privilege was waived when those documents were disclosed to the Respondent, Foremost's auditor.

[46] The Respondent was retained subsequent to the Reorganization of Fund, to audit Fund's financial statements.

[47] **Documents that are protected by SCP and that are knowingly disclosed in confidence by the privilege holder to an auditor for the limited purpose of enabling the auditor to perform an audit and issue a fairness opinion retain such protection vis à vis other third parties, under the doctrine of limited waiver (*Interprovincial Pipe Line Inc and IPL Energy Inc v The Minister of National Revenue* ((1995), 95 DTC 5642, at 5646-7; *Anderson Exploration Ltd v Pan-Alberta Gas Ltd*, [1998] A.J. No 575, at paras 28-30 [*Anderson Exploration*]; *Philip Services Corp v Ontario Securities Commission*, [2005] OJ No 4418, at paras 47 and 57-58 [*Philip Services*]). It bears emphasizing that under this doctrine, the intention of the privilege holder is key.**

[48] It also bears emphasizing that cases involving disclosure of privileged information to financial institutions are not particularly relevant to a consideration of the issue of limited waiver in the context of **such disclosure to an auditor**. **In the latter context, there is a**

Digitized by Google

strong public interest in companies and other types of business organizations being properly audited, for the benefit of actual and potential shareholders or other members of the investing public, even where the disclosure of privileged information is not strictly mandated by statute (see, for example, *Philip Services*, above, at para 57). In furtherance of that public interest, the disclosure of privileged information that may reasonably be required by an auditor for the purposes of providing a fairness opinion will not be considered to constitute an unlimited waiver of SCP, when such disclosure is made in confidence and solely for that purpose.

[49] Unfortunately, neither the Applicant nor Foremost has adduced any evidence to establish how the documents came into the possession of the Respondent. However, Mr. Breen stated that (i) he is unaware of how the Respondent came into possession of the Retained Documents, (ii) none of the Foremost entities, to his knowledge, voluntarily or knowingly provided those documents to the Respondent, and (iii) there was no intention to waive any SCP in those documents (Breen Affidavit #1, at para 18). During cross-examination on his affidavits, Mr. Breen added that (i) he had never seen the Retained Documents, (ii) he did not contact anyone in the Respondent's organization to inquire as to how the Retained Documents came into possession of those documents, and (iii) he was informed by CFO of Foremost, who was responsible for overseeing Foremost's dealings with its auditor (the Respondent), that he did not know how the Respondent came into the possession of those documents (Cross-Examination on Affidavits of Patrick Warren Breen, October 6, 2011, at pp. 20-21).

[50] In these circumstances, I am not satisfied that Foremost knowingly disclosed the Retained Documents to the Respondent for the limited purpose of enabling it to perform its audit, and with the intention of maintaining SCP over those documents for all other purposes. Indeed, Mr. Breen's evidence suggests that it is unlikely that Foremost did so. **It follows that the limited waiver exception cannot be relied upon by Foremost to maintain the SCP in the Retained Documents. However, Foremost may still be able to maintain that SCP pursuant to the doctrine of inadvertent disclosure, discussed below.**

[51] The Applicant further submits that any SCP which may have attached to the Undated Memo was waived when the contents of that document were presumably shared with the clients of Mr. Shaw, who stated in his affidavit that (i) he communicated his analysis to his "clients involved in the Reorganization" and (ii) the purpose of the Undated Memo was "directly related to the provision of legal tax advice to my clients." **The Applicant also impugned Mr. Shaw's affidavit on the basis that he failed to identify his client, to explain the nature of his involvement in creating the memo, and to explain the nature of the relationship between his clients and Foremost.**

[52] In his affidavit, Mr. Shaw did in fact identify one of the "several entities" by whom he was retained, namely, TOM 2003-4 Income Fund. While his description of his involvement in the creation of the Undated Memo was somewhat vague, I am satisfied that he was a co-author of the document. As noted above, this was corroborated by Mr. Breen. In addition, this is implicit in his statement that the document "was created in conjunction with Craig Bell while working with him to analyze the legal tax implications of various steps in the Reorganization."I am also satisfied that he co-authored the document in his capacity as a solicitor to one or more entities involved in the Reorganization, and for the purpose of providing legal tax advice to those clients. This is clear from his statement quoted immediately above and his additional statements that "the document was created to track the legal tax implications of steps in the Reorganization" and that he communicated his analysis to his clients "involved in the Reorganization."

[53] In these circumstances, I am satisfied that the Undated Memo did not lose its privileged

Digitized by Google

nature merely because it was co-authored by Mr. Shaw, a solicitor who did not represent Foremost, or because its contents were disclosed to his clients in the context of the provision of legal advice to them by him.

[54] **It can be inferred from the fact that Messrs. Bell and Shaw co-authored the Undated Memo and then relied on that memo to provide legal tax advice to their respective clients that those clients shared a common interest in completing the Reorganization in a manner that had certain tax consequences. It can also be inferred that Messrs. Bell and Shaw intended that their joint work product as set forth in Undated Memo would be used by each of them in providing advice to their respective clients, and that such work product was produced for the common benefit of their clients.** [55] There is no evidence that Mr. Bell, Mr. Shaw or their respective clients intended or anticipated that the Undated Memo would be disclosed to anyone who did not have a common interest in the completion of the Reorganization (*St. Joseph Corp v Canada (Public Works and Government Services)*, 2002 FCT 274, at para 79). Indeed, the insertion of the words "PRIVILEGED AND CONFIDENTIAL – PREPARED UNDER THE EXPECTATION OF SOLICITOR & CLIENT PRIVILEGE" at the top of the document make it readily apparent that Messrs. Bell and Shaw intended that the document remain confidential.

[56] There is also no evidence that the Undated Memo was disclosed to anyone who did not have a common interest in the completion of the reorganization.

[57] **Given all of the foregoing, I am satisfied that the common interest exception to the rule that SCP is lost when the protected information is disclosed to a third party applies (*Pitney Bowes of Canada Ltd v Canada*, 2003 FCT 214, at paras 16-23; *Anderson Exploration*, above, at paras 21-27; *Almecon Industries Ltd v Anchortek Ltd,* [1999] 1 FC 507, at para 9; *Maximum Ventures Inc v De Graaf*, [2007] BCJ No 2355, at paras 14-16; *Archean Energy Limited and Titleist Energy Inc v The Minister of National Revenue*(1997), 98 DTC 6456, at para 30 [*Archean Energy*]).** Accordingly, the SCP attached to the Undated Memo was not waived due to the fact that Mr. Shaw participated in its creation or communicated all or part of the work product set forth in that document to his clients in the course of providing legal tax advice to them.

[58] **This brings me to the doctrine of inadvertent disclosure.**

[59] **It appears to be settled now that the mere physical loss of custody of documents protected by SCP does not automatically result in the loss of the protection afforded by SCP (*Royal Bank of Canada v Lee*, [1992] AJ No 433, at p. 5).**

[60] Indeed, one line of jurisprudence holds that **SCP can only be waived through informed consent.** (See, for example, *Metcalfe v Metcalfe*, [2001] MJ No 115, at para 14 (CA); and *Lavallee,* above, at para 36). To the extent that this jurisprudence stands for the proposition that inadvertent disclosure can never result in the loss of SCP, even, for example, where the privilege holder was negligent, careless, or failed to act promptly to assert SCP upon discovering the inadvertent disclosure, I do not endorse it.

[61] I prefer a second line of jurisprudence that holds that it is preferable to look at all of the circumstances of the case in determining whether to maintain SCP over documents that have been inadvertently disclosed (*Chapelstone Developments Inc v Canada*, [2004] NBJ No 450, at paras 46- 55 (CA) [*Chapelstone*];*Stevens v Canada*, [1998] FCJ No 794, at para 50 (FCA); *Armstrong v Canada (Attorney General)*, 2005 FC 1013, at para 23; *Brass v Canada*, 2011 FC 1102, at para 83 [*Brass*]; *Dublin v Montessori Jewish Day School of Toronto*, [2007] OJ No 1062, at paras 67-70; *S&K Processors v Campbell Avenue Herring Producers Ltd* [1983] BCJ No 1499, at para 6 (BCSC); *Maximum Ventures Inc v de Graaf*, [2007] BCJ No 1784, at para 40;*Toronto Port Authority v Toronto (City)*, [2008] OJ 5274, at paras 30-32;).

Digitized by Google

[62] This second line of jurisprudence has identified numerous factors to be considered by a Court in determining whether to exercise its discretion to maintain SCP over documents that have been inadvertently disclosed.

[63] One such factor is whether the privilege holder took swift steps to assert SCP upon learning of the inadvertent disclosure of privileged documents (*Chapelstone*, above, at para 55; *Universal Sales*, above, at para 31; *Pacific Northwest Herb Corp v Thompson*, [1999] BCJ No 2772, at paras 21-23). In the case at bar, there is no evidence that Foremost was aware that the Retained Documents had been inadvertently disclosed to the Respondent, or that it remained silent or did not take immediate action to assert SCP once it became aware of that disclosure. Indeed, the opposite appears to be true. Foremost seems to have learned that the Applicant was contesting the Respondent's assertion of SCP over the Retained Documents when Mr. Bell was copied on the Applicant's letter to the Respondent dated March 28, 2011. Two weeks later, on April 14, 2011, Foremost's outside litigation counsel (Mr. Robinson) wrote to the CRA to insist that the CRA's efforts to achieve a resolution regarding the privilege claim that had been asserted by the Respondent be henceforth directed to him, rather than the Respondent. Foremost then promptly sought intervener status in these proceedings for the explicit purpose of defending its SCP in the Retained Documents. In my view, these actions by Foremost weigh in favour of exercising the Court's discretion to maintain SCP over the Retained Documents.

[64] A number of additional factors to be considered by a Court in determining whether to exercise discretion to maintain privilege over inadvertently disclosed documents were identified by Wein J. in *Airst v Airst*, [1998] OJ No 2615, at paras18-19 [*Airst*]. These are:

i. the way in which the documents came to be released; ii. the timing of the discovery of the disclosure;
the timing of the application to recover the documents;
the number and nature of the third parties who have become aware of the documents;
v. whether the maintenance of the privilege will create an actual or perceived unfairness
to the opposing party; and
vi. the impact on the fairness, both actual and perceived, of the processes of the Court.

[65] With respect to the manner of release of the documents, Wein J. suggested that admission of the disclosed documents into evidence may be appropriate where the disclosure occurred through the carelessness of the party claiming privilege, as opposed to through any wrongdoing of the opposing party. In the present case, there is no evidence to suggest such carelessness or wrongdoing.

[66] Wein J. also suggested that it may be appropriate to admit inadvertently disclosed documents where a failure to do so could leave a party with a sense that the Court was denying itself the opportunity to assess conflicting information on a material point, and consequently could negatively reflect on the public perception of the administration of justice. That consideration is not a factor in the case at bar, as I would not be depriving myself of an opportunity to assess conflicting information on a material point, if I were to maintain the SCP in the Retained Documents.

[67] In addition, Wein J. observed that in other cases, the information might have become so widely distributed that it would be futile as a practical matter to attempt to prevent its admission into Court. Once again, that is not a relevant consideration in the case at bar, as there is no evidence that the Retained Documents have been disclosed to anyone other than the Respondent and the clients of Messrs. Bell and Shaw. On the contrary, the record suggests that the inadvertent disclosure was limited to the Respondent, who appears to have obtained the documents in the context of an auditor-client relationship.

[68] Ultimately, Wein J. exercised his discretion to maintain SCP over the documents in

Digitized by Google

question in *Airst*, above, after finding that the disclosure was limited in scope and restricted to one individual who had been retained in a capacity that might be broadly construed as confidential. In reaching this conclusion, Wein J. added that the Court's ability to assess facts underlying the issues in the case would not be impaired by the lack of disclosure. In the case at bar, each of these factors weighs in favour of the exercise of my discretion to maintain SCP over the Retained Documents.

[69] In *Brass*, above, at paras 86-91, Prothonotary Lafrenière of this Court exercised his discretion to maintain SCP in respect of inadvertently disclosed documents, primarily on the basis that (i) **the party asserting SCP reacted quickly upon discovering its inadvertent production of privileged documents to the other party in the litigation**, (ii) **the party asserting privilege would have suffered significant prejudice if the SCP were not maintained, whereas the other party would suffer little prejudice if that occurred, and** (iii) **there was no evidence that the privilege holder had intended to waive its privilege.** In the course of reaching that conclusion, Prothonotary Lafrenière observed that prejudice is more easily made out where the privilege at issue is SCP. I agree, and find that the considerations upon which he relied in reaching his conclusion also weigh in favour of exercising my discretion to maintain SCP in respect of the Retained Documents.

[70] In addition to the foregoing, the Applicant has not been able to establish that it would suffer any prejudice if SCP were maintained over the Retained Documents in the circumstances of this case.

[71] As to the fairness and truth seeking functions of the Court, given that the principle issue in these proceedings is whether the Retained Documents are protected by SCP, I am not satisfied that this consider merits significant weight in the Applicant's favour in this particular case.

[72] In its oral submissions, the Applicant essentially suggested that I should give negative weight to the fact that (i) Mr. Breen did not contact the Respondent to ascertain how it obtained the Retained Documents, and

(ii) Foremost did not adduce evidence with respect to the various factors that are relevant to the Court's determination of whether to exercise its discretion to maintain SCP in respect of the Retained Documents. I am sympathetic to this position, and have therefore given some negative weight to these considerations.

[73] However, given the other factors that I have discussed above, and, most importantly, given the fact that the Retained Documents appear to have been inadvertently disclosed to Foremost's auditor, a party with whom Foremost implicitly had a relationship of confidence, I am inclined to exercise my discretion in favour of maintaining SCP in respect of the Retained Documents. In my view, in the absence of any evidence whatsoever to suggest otherwise, it can be inferred that the Respondent came into possession of the Retained Documents in confidence, in the course of conducting its audit of Foremost.

Conclusion regarding the Retained Documents

[74] For the reasons set forth above, I find that the Retained Documents:

are protected by SCP;

were not knowingly disclosed to the Respondent pursuant to an express or implied limited waiver of privilege; and

were inadvertently disclosed to the Respondent in circumstances which, considered together with the actions taken by Foremost to swiftly assert SCP in relation to the Retained Documents upon discovering such disclosure, warrant the exercise of the Court's discretion to maintain SCP in respect of those documents.

The Constitutional issue

Digitized by Google

[75] **Foremost has requested this Court to declare sections 231.2 and 237.1 of the ITA unconstitutional, on the basis that they potentially permit the Minister to access documents that are protected by SCP, without the privilege-holder's knowledge or consent. Foremost asserts that this constitutes an unreasonable search and seizure, contrary to s. 8 of the *Canadian Charter of Rights and Freedoms*.**

[76] I agree with the Applicant that this is not an appropriate case for the Court to make a determination on the question of the constitutionality of sections 231.2 and 237.1 of the ITA. In short, the allegedly unconstitutional fact scenario identified by Foremost did not arise in this case and remains somewhat hypothetical.

[77] In this case, Foremost was served a copy (albeit on a "courtesy" basis) of the Applicant's Notice of Application for a compliance order against the Respondent under subsection 231.7(1). Indeed, it was also copied on a letter dated March 28, 2011 from the Applicant to the Respondent, which proposed two alternatives for addressing the privilege issue that the Respondent raised in respect of the Retained Documents. These communications quickly led Foremost to seek intervener status in this proceeding, which ultimately was granted on consent. Foremost then availed itself of its opportunity to vigorously defend its interest in maintaining SCP in the Retained Documents. After considering the written and oral submissions made by the Applicant and Foremost, I ultimately determined that each of the Retained Documents were and remain protected by SCP. As a result, the Applicant will not, in fact, obtain access to any privileged information, and there is certainly no issue of such access being obtained without the privilege holder's knowledge or consent.

[78] In these circumstances, it is unnecessary, and would not be appropriate, for the Court to address the constitutional question raised by Foremost. That issue can be revisited if and when a more appropriate factual matrix presents itself (*Phillips v Nova Scotia(Commission of Inquiry into the Westray Mine Tragedy)*, [1995] 2 SCR 97, at para 6; *Apotex Inc v Astrazeneca Canada Inc*, 2012 FC 559, at paras 69 and 70; *Duitama Gomez v Canada (Minister of Public Safety & Emergency Preparedness),* 2010 FC 593, at paras 71-74; *Suescan v Canada (Minister of Citizenship and Immigration),* 2007 FC 438, at paras 26-28; *Bedada v Canada (Solicitor General),* 2007 FC 121, at paras 16-20; *Native Council of Nova Scotia v Canada (AttorneyGeneral),* 2007 FC 45, at paras 40 and 57-58; *Canada (Minister of National Revenue) v Welton Parent Inc,* 2006 FC 67, at paras 123, 149-150, and 178-179; *Canada (Information Commissioner) v Canadian Transportation Accident Investigation& Safety Board*, 2005 FC 384, at paras 67-75; *Mahjoub v Canada (Minister of Citizenship and Immigration)*,2006 FC 1503, at para 111).

[79] *Chambre des notaires du Québec c Canada (Procureur général)*, 2010 QCCS 4215, [2010] JQ 8868, is distinguishable, as it involved requirements letters issued by the CRA to a number of lawyers. It also involved certain issues that do not arise on the facts of this case, particularly with respect to subsection 232 (1) of the ITA and the Quebec *Charter of Human Rights and Freedoms,* RSQ, c C-12.

Costs

[80] Foremost submitted that it should be granted full indemnification costs for its intervention, on the ground that it should have been named as the Respondent in Notice of Application filed by the Applicant in these proceedings, in which the Applicant sought production of the Retained Documents. It further submitted that the Applicant's tactics in seeking access to privileged documents from a third party, rather than the privilege holder, should be soundly discouraged.

[81] In my view, the situation is much more nuanced than suggested by Foremost.

[82] As previously discussed in these reasons, Foremost and its trustees had numerous opportunities to identify and claim SCP in respect of the Retained Documents. At no time did they do so. The documents only came to light on December 22, 2010, when they were

Digitized by Google

identified by the Respondent, in its response to the Applicant's requirements letter. In these circumstances, I am sympathetic to the Applicant's position that the appropriate respondent in this proceeding was Grant Thornton, the entity which was known to have possession of the Retained Documents, as opposed to Foremost, an entity that had never disclosed the existence of those documents and that might well not have possession of the originals or copies of those documents. That said, the Applicant may have been able to avoid the costs associated with these proceedings had it availed itself of Foremost's request to discuss the issue of whether the Retained Documents were protected by SCP, directly with Foremost.

[83] In its own attempt to find an expeditious resolution to the issue of whether the Retained Documents were in fact protected by SCP, the Applicant proposed to the Respondent, in a letter dated March 28, 2011 that was copied to Foremost, that this narrow issue be referred to the Court for a determination. Neither the Respondent nor Foremost availed itself of that opportunity. In fact, even during the hearing of this matter in March 2012, Foremost resisted the suggestion that the Court review the Retained Documents to determine whether they are protected by SCP. Foremost also continued to press the constitutional issue it had raised, even after the Applicant made clear that it did not want access to any documents that the Court might determine are protected by SCP, and even after I reminded Foremost's counsel of this during the hearing. [84] Moreover, Foremost curiously made no effort whatsoever to contact the Respondent to find out how the Retained Documents came into the Respondent's position. The Applicant also made no such effort. This left the Court in a much more difficult position when addressing the submissions made by Foremost with respect to the issues of limited waiver and inadvertent disclosure. In addition, by leading its evidence with respect to the Retained Documents through Mr. Breen, whose only information about those documents came from Mr. Bell, Foremost made it very difficult for the Applicant to conduct a meaningful cross-examination with respect to those documents.

[85] In these circumstances, and given the findings that I have made on the issue of limited waiver and on the constitutional issue, I have determined that there should be no cost award made in this proceeding.

Conclusion

[86] The Retained Documents are protected by SCP. Accordingly, this Application is dismissed.

[87] As to the constitutional issue raised by Foremost, this is not an appropriate case for the Court to make a determination, because the allegedly unconstitutional fact scenario identified by Foremost did not arise on the particular facts of this case and remains somewhat hypothetical.

JUDGMENT

THIS COURT'S JUDGMENT is that

Digitized by Google

this Application is dismissed;
this is not an appropriate case in which to make a determination on the constitutional issue raised by Foremost; and
there shall be no award of costs.

"Paul S. Crampton"
Chief Justice

Material Released Pursuant to Another Statutory Requirement
When material is provided under an assumption of confidentiality to another government body solicitor- client may be de facto waiver as may be held by a court subsequently. This was found in the following where the issues were thoroughly canvassed.

A-514-96
AGT Limited (*Applicant*)
v.
The Attorney General of Canada (*Respondent*)

REASONS FOR JUDGMENT

DESJARDINS J.A.

This appeal deals with the validity and enforceability of three notices of requirements issued by the Minister of National Revenue (the "Minister") to the appellant AGT Limited (AGT) pursuant to subsection 231.2(1) of the *Income Tax Act*.[1]

These notices of requirements read in their substantive parts:[2]

> For the purposes related to the administration or enforcement of the Income Tax Act, pursuant to the provisions of subsection 231.2(1) thereof, I hereby require from you within 30 days from the date of delivery of this notice, file copies of correspondence, agreements, reports, memoranda, schedules, working papers, minutes of meetings, notes to files, telexes, facsimile transmissions and other documents in your possession or under your control, and in the manner originally kept relating directly or indirectly to the following:
>
> (i) documents and information filed with the Canadian Radio and Telecommunication Commission and not previously provided for the years 1990 to July 1995
>
> The aforementioned enumeration of classes of documents or information is not to be presumed to be exhaustive of the material which the officer or officers of this Department will wish to review and subsequent reference may be made to classes or specific documents or information which must be provided pursuant to this agreement.
>
> ...
>
> If this requirement is not complied with you may be liable to prosecution without further notice under subsection 238(1).

The documents and information sought by the Minister under the notices of requirements are materials the appellant filed with the Canadian Radio-television and Telecommunications Commission (the "CRTC") for the years 1990 to July 1995, which now enjoy the status of confidential material by virtue of a decision of the CRTC made pursuant to sections 350 and

Digitized by Google

358 of the *Railway Act*,[3] and sections 18 and 19 of the *CRTC Telecommunications Rules of Procedure*.[4]

The facts

The appellant is a telephone company whose activities have been regulated by the CRTC since October 4, 1990. Prior to October 4, 1990, telephone service in the province of Alberta was provided by the Alberta Government Telephones Commission. Being a Crown corporation exempt from federal and provincial income tax, it never claimed capital cost allowance. For accounting purposes, however, it did calculate an annual depreciation expense which it included in the calculation of its revenue requirement. Pursuant to the *Alberta Government Telephones Reorganization Act*,[5] the Commission was restructured as of October 4, 1990, for purposes of privatization. Telus Corporation was formed to act as a holding corporation to facilitate the privatization of the provincial Crown agent. Most telephone operations and assets were transferred to the appellant, a subsidiary of Telus which became a regulated business under the jurisdiction of the CRTC. AGT became, at the same time, a taxable entity.

In preparation for the organization and privatization of the Alberta Government Telephones Commission, the Minister was asked for an advanced tax ruling as to whether depreciable assets for tax purposes should be valued at original cost, approximately $ 4 billion, or a net book value, i.e. original cost less depreciation of about $ 2.2 billion. The tax ruling allowed the original cost as undepreciated capital cost.

In October 1991, the appellant filed an application to the CRTC for a Revenue Requirement proceeding, initially for 1992. The revenue requirement is intended to cover AGT's expenses, costs of capital and other items; but of relevance here, is the fact that the allowed revenue is also intended to cover AGT's income tax liability.

During the course of its application to the CRTC, AGT took a more conservative approach on its income tax liability than in its income tax returns to the Minister. Before the CRTC, the corporate taxpayer furnished the CRTC with certain documents on which it claimed and obtained confidentiality pursuant to sections 18 and 19 of the *CRTC Telecommunications Rules of Procedure*.

The Minister of National Revenue, who had been conducting a general audit of AGT involving the review and verification of the financial statements and tax returns filed by the appellant in 1990 and 1991,[6] became aware of the confidential material the appellant had filed with the CRTC. As a result of an internal memo, three representatives of the Minister visited the CRTC on 22 June 1995, so as to have access to the material. The CRTC, however, refused to release the confidential documents.

In July 1995, after attempting unsuccessfully to obtain the confidential documents in issue directly from the CRTC, the Minister issued the notices of requirements under subsection 231.2(1) of the Act requiring AGT to produce the documents in question.

The taxpayer applied for judicial review to the Trial Division of this Court challenging the validity and enforceability of the notices of requirements. The application was dismissed in a decision which is now reported.[7]

The parties' contentions

The appellant has pressed upon us two key arguments. Firstly, that the notices of requirements were not authorized under subsection 231.2(1). Secondly, that the documents sought to be seized were privileged under the "Wigmore Rules" as outlined in cases such as *R. v. Gruenke*.[8] We chose not to hear the respondent on this second issue, since we are satisfied that the motions judge did not err in his disposition of that argument.

With regard to the first issue, the appellant contends that the notices of requirements are invalid because they do not meet the conditions set out by the Supreme Court of Canada in *R. v. McKinlay Transport Ltd.*,[9] namely that the documents "be relevant to the filing of the

Digitized by Google

income tax return", and that the seizure be "reasonable" within the meaning of section 8 of the *Charter of Rights and Freedoms*.[10]

With regard to the threshold test for relevance, the appellant submits that although *McKinlay* stands for the proposition that seizures under subsection 231.2(1) of the *Income Tax Act* have a lower threshold test than the "reasonable grounds" test for seizure in a criminal law context, it is still incumbent upon the Minister to demonstrate to the court, by affidavit or otherwise, that the notices of requirements are designed to seek production of only those documents that may be relevant to his compliance verification function. To issue a notice of requirement which deliberately disregards the potential relevance of a document is clearly outside the scope of the section.

In the case at bar, there are issues as between the Minister and AGT with regard to the classification of certain assets for tax purposes.[11] The appellant submits that the Minister has admitted that the notices of requirements seek the production of information which is irrelevant to these issues. During cross-examination, Ms. Sharon Marlene White, a representative of the respondent, conceded that AGT could not be forced to give its opinion on the risk assessment of those assets.[12] She made clear, however, that the Minister is interested in the facts underlying the risk assessment. The following exchange then occurred:[13]

> Q You just issued the requirement knowing that a consequence may be that you would end up with information that you are not entitled to?
>
> A I issued a requirement asking for all documents filed with the CRTC, whatever they may be.
>
> [Emphasis added]

Such an admission, claims the appellant, indicates that the Minister is operating an impermissible fishing expedition. The Minister, it says, is entitled to business records a taxpayer is obligated to keep, but not to opinion documents and business strategies.

The appellant further argues that the seizure is unreasonable because the appellant's privacy interest in the documents sought to be seized outweighs the state's interest in those documents. The appellant submits that it has a compelling privacy interest in the documents because, at the time the notices of requirements were issued, the sought for documents enjoyed confidentiality by virtue of the CRTC's decision which had determined that it is in the public interest that the documents remain confidential. The fact that the appellant is not required by the Act to maintain the type of documents in issue is further evidence that the state's interest in obtaining the documents does not outweigh the appellant's privacy interest. The motions judge should have considered that the documents at issue came into existence by compulsion of law for a very specific purpose since the information was prepared and provided to the CRTC so as to allow the CRTC to discharge its statutory duty. The diversion which the Minister is seeking is, therefore, unreasonable.

The appellant finally argues that the Minister's extra-legal conduct in seeking access to the information is clearly at odds with the rule of law and the values embodied by section 8 of the Charter. The attempt to obtain the documents through the CRTC is an intricate part of the seizure in issue and goes to the determination of whether the seizure was reasonable.

The respondent maintains that the notices of requirements meet the legal requirements of *McKinlay*. The Minister is entitled to obtain documents which might contain not only facts, but which might reveal the roadmap followed by the taxpayer in his assessment. The Minister is entitled to have access to documents which might flag situations likely to assist him in the enforcement of the Act.

Analysis

The seminal case is *McKinlay* where the Supreme Court of Canada found that subsection

Digitized by Google

231(3) of the *Income Tax Act*, now 231.2(1), constitutes a valid seizure within the meaning of section 8 of the Charter. The Court upheld the Minister's warrantless demand for a taxpayer's private documents and information, in the context of the administration or enforcement of the Act, on the basis that there was a lower standard of reasonableness for the production of those documents.

Wilson J., speaking for herself and Lamer C.J.,[14] noted that the federal *Income Tax Act* was a regulatory statute, and that the meaning to be given to the word "unreasonable", as found in section 8 of the Charter, would be less strict in an administrative and regulatory context:[15]

> It is consistent with this approach, I believe, to draw a distinction between seizures in the criminal or quasi-criminal context to which the full rigours of the *Hunter* criteria will apply, and seizures in the administrative or regulatory context to which a lesser standard may apply depending upon the legislative scheme under review. I do not believe that when the Chief Justice said in *Simmons* at p. 527 that departures from the *Hunter* criteria would be rare he was applying his mind to searches or seizures in the context of regulatory legislation. I think he was addressing as in the cases of *Hunter* and *Simmons* themselves searches or seizures in a criminal or quasi-criminal context. It is with these considerations in mind that I examine the reasonableness of s. 231(3) of the *Income Tax Act*.

She then continued:[16]

> At the beginning of my analysis I noted that the *Income Tax Act* was based on the principle of self-reporting and self-assessment. The Act could have provided that each taxpayer submit all his or her records to the Minister and his officials so that they might make the calculations necessary for determining each person's taxable income. The legislation does not so provide, no doubt because it would be extremely expensive and cumbersome to operate such a system. However, a self-reporting system has its drawbacks. Chief among these is that it depends for its success upon the taxpayers' honesty and integrity in preparing their returns. While most taxpayers undoubtedly respect and comply with the system, the facts of life are that certain persons will attempt to take advantage of the system and avoid their full tax liability.
>
> Accordingly, the Minister of National Revenue must be given broad powers in supervising this regulatory scheme to audit taxpayers' returns and inspect all records which may be relevant to the preparation of these returns. The Minister must be capable of exercising these powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act. Often it will be impossible to determine from the face of the return whether any impropriety has occurred in its preparation. A spot check or a system of random monitoring may be the only way in which the integrity of the tax system can be maintained. If this is the case, and I believe that it is, then it is evident that the *Hunter* criteria are ill-suited to determine whether a seizure under s. 231(3) of the *Income Tax Act* is reasonable. The regulatory nature of the legislation and the scheme enacted require otherwise. The need for random monitoring is incompatible with the requirement in *Hunter* that the person seeking authorization for a search or seizure have reasonable and probable grounds, established under oath, to believe that an offence has been committed. If this *Hunter* criterion is inapplicable, then so

Digitized by Google

too must the remaining *Hunter* criteria since they all depend for their vitality upon the need to establish reasonable and probable grounds. For example, there is no need for an impartial arbiter capable of acting judicially since his central role under *Hunter* is to ensure that the person seeking the authorization has reasonable and probable grounds to believe that a particular offence has been committed, that there are reasonable and probable grounds to believe that the authorization will turn up something relating to that particular offence, and that the authorization only goes so far as to allow the seizure of documents relevant to that particular offence.

This is not to say that any and all forms of search and seizure under the *Income Tax Act* are valid. The state interest in monitoring compliance with the legislation must be weighed against an individual's privacy interest. The greater the intrusion into the privacy interests of an individual, the more likely it will be that safeguards akin to those in *Hunter* will be required. Thus, when the tax officials seek entry onto the private property of an individual to conduct a search or seizure, the intrusion is much greater than a mere demand for production of documents. The reason for this is that, while a taxpayer may have little expectation of privacy in relation to his business records relevant to the determination of his tax liability, he has a significant privacy interest in the inviolability of his home.

In my opinion, s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the *Income Tax Act* can be effected. It involves no invasion of a taxpayer's home or business premises. It simply calls for the production of records which may be relevant to the filing of an income tax return. A taxpayer's privacy interest with regard to these documents *vis-à-vis* the Minister is relatively low. The Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them. At the same time, the taxpayer's privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies.

The appellant claims in essence that although subsection 231.2(1) of the Act has been declared constitutionally valid, each notice of requirement issued under that provision must meet the test of relevancy and reasonableness.

The short answer to this contention is that once a statutory provision is declared valid, as was done with respect to subsection 231.2(1) of the Act in *McKinlay*, the constitutional analysis ends. Only a statutory analysis is then required. It is under this analysis that I now consider the appellant's arguments about relevancy and reasonableness.

Under the *Income Tax Act*, the Minister is concerned with verifying the tax liability of the taxpayer which is first revealed in the taxpayer's return. It will often be "impossible to determine from the face of the return whether any impropriety has occurred in its preparation".[17] Because of the nature of the conduct regulated by the *Income Tax Act,* there are, in many cases, no ways of determining whether proscribed conduct has been engaged in, short of studying the process by which a suspected corporation or business has made and implemented its decision.[18] Investigatory mechanisms which force corporations and other businesses to divulge what they and only they can know about their internal affairs are part of the state's interest in the enforcement of the Act.[19]

While an individual or a corporation's interest in having business strategies kept in confidence is recognized,[20] the balancing no doubt favours the state. Wilson J. in *McKinlay*

Digitized by Google

recognizes that the "Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them".[21] There is an ultimate safeguard. Not all of those documents are necessarily admissible against the taxpayer in a court of law or in another proceeding. Only those in accord with the rules of evidence shall be admissible.

The fact that the documents in issue were prepared for another forum, namely for providing the CRTC with information required under a rate setting process, does not prevent the Minister from having access to them since they are relevant to the potential tax liability of the taxpayer. Moreover, the fact that they were sealed by order of the CRTC from public access does not prevent the Minister from having access to them when he is engaged in enforcing the Act. These propositions follow from *McKinlay*.

The notices of requirements constitute the least intrusive means by which effective monitoring of compliance with the Act can be effected.[22] The fact that the Minister used extra-legal means to try to obtain the documents is an irrelevant consideration with respect to the validity of the notices of requirements. The fact of the matter is that those documents were not obtained from the CRTC.

Subsection 231.2(1) is drafted in broad language, but its scope has been reduced through the rules of interpretation[23] to situations where the information sought by the Minister is relevant to the tax liability of some specific person or persons, and when the tax liability of such person or persons is the subject of a genuine and serious inquiry. Given these criteria, I find that no error was committed by the motions judge.

I would dismiss this appeal with costs.

The appellant asked, in the event the appeal is dismissed, that the judgment of this Court be stayed for a period of ninety days so as to allow the appellant to submit an application to the Supreme Court of Canada for leave to appeal to that Court. The respondent agreed. On consent, I would stay this judgment for a period of ninety days. If an application for leave to appeal to the Supreme Court of Canada is filed before the expiry of that period, the stay would stand until the application is disposed of by that Court.

"Alice Desjardins"

J.A.

"I agree

A.J. Stone J.A."

"I agree

A.M. Linden J.A."

Privilege Doesn't Apply to Supporting Financial Transactions of Lawyer

In MNR v. S. Bruce Cornfield et al.[102] the court reviwed the jurisprudence on whether a lawyers account ledgers and resulting cheques and vouchers were subject to solicitor-client and provided:

REASONS FOR ORDER

SNIDER J.

[1] The Minister of National Revenue (the Minister) is asking this Court to issue an Order (Compliance Order), under section 289.1 of the *Excise Tax Act*, R.S.C, 1985, c. E-15, that would require the Respondent, Mr. S. Bruce Cornfield, to provide certain documents and information to the Minister.

I. Background

[102] 2007 FC 436

Digitized by Google

[2] Mr. Cornfield is a lawyer and a member of the Law Society of British Columbia. His client, Child Construction Ltd. (CCL), is indebted to Her Majesty the Queen in Right of Canada for GST in the amount of $53,382.29 as of September 15, 2006.

[3] In July 2003, Mr. Cornfield handled the conveyance involving a transfer of property by CCL to a third party.

[4] By letter served on January 6, 2006, the Minister issued a requirement for information (RFI) pursuant to subsection 289(1) of the *Excise Tax Act*, requiring Mr. Cornfield to provide the following information and documents to the Minister (the Information and Documents) within 30 days of the date of service of the RFI:

(a) A statement of adjustments with respect to the sale of the property described as Parcel Identifier 023014806, Strata Lot 105, Section 9, Victoria District, Strata Plan VIS3305, by CCL to Sarah Harper and Richard Allan Stensrud, on July 30, 2003.

(b) A copy of the direction to pay with respect to the property transaction identified in paragraph (a) above.

(c) Copies, front and back, of the cancelled cheques in regards to the distribution of monies with respect to the property transaction identified in paragraph (a) above.

[5] Mr. Cornfield has refused to provide the Minister with the Information and Documents sought by the RFI within 30 days. In a letter to the Vancouver Island Tax Services Office of the Canada Revenue Agency (CRA), dated January 23, 2006, Mr. Cornfield explained his reasons for not providing the Information and Documents:

> **I have been unable to locate my client . . . Absent instructions to the contrary from the client, I must take the position that the requested information may be subject to a solicitor-client privilege. . . . I draw your attention to the *Professional Conduct Handbook* for B.C. Lawyers that states:**
>
> > **a lawyer who is required under the *Criminal Code*, the *Income Tax Act*, or any other federal or provincial legislation, to produce or surrender a document or provide information which is or may be privileged shall, unless the client waives the privilege, claim a solicitor-client privilege in respect to the document.**
>
> **Given the above, what you are asking me to do is something that is contrary to my governing society's code of conduct, and compliance may even result in disciplinary action against me.**

[6] Upon application, the Law Society of British Columbia (the Law Society) was granted intervener status in this Application by Order of Justice Gauthier dated December 20, 2006. In her Order, Justice Gauthier described the right of the intervener to:

> make representations in writing and orally in respect of all issues concerning solicitor-client privilege raised in this application including the procedures which a Court should follow in considering an order for production of documents in the possession of a lawyer and the protection of solicitor-client privilege in the face of a demand for production of documents by the applicant.

[7] Written and oral submissions were made by the Minister and the Law Society.

Digitized by Google

II. Issues

[8] The overarching issue in this application is whether the Compliance Order should issue to require Mr. Cornfield to produce the Information and Documents. To respond, two questions must be addressed:

1. **Are the Information and Documents, in this case, subject to solicitor-client privilege?**
2. **Does s. 289.1 of the *Excise Tax Act* provide adequate protection to the rights of the lawyer's client (or former client) to claim solicitor-client privilege? And, if not, should the Federal Court consider adding certain procedural safeguards such as a requirement to serve notice on the client?**

[9] As I understand the submissions of the Intervenor, they are not seeking to require the suggested procedures be applied to this particular case. Thus, if I determine that the Information and Documents are not subject to solicitor-client privilege and that the other requirements of s. 289.1 have been met, the Compliance Order will issue.

III. Analysis

A. *What is the relevant statutory framework?*

[10] In brief, the relevant provisions of the *Excise Tax Act* operate in the following manner. The full text of these provisions is set out in Appendix A to these reasons. Almost identical provisions are contained in the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.).

[11] The Minister is authorized, pursuant to s. 289(1) of the *Excise Tax Act*, to require a person to provide any requested information or documents, upon notice. It is important to note that the Minister's authority is not restricted to the taxpayer. Third parties may be served with requests for information. The only stipulation is that the purpose be "related to the administration or enforcement of this Part, including the collection of any amount payable or remittable under this Part".

[12] Where a request for information is made and the person has failed to comply, s. 289.1 provides the Minister with a means to enforce compliance with s. 289. Specifically, s. 289.1(1) allows the Minister to seek, by way of "summary application", a court order requiring the person to provide the information or document sought under s. 289. To issue the order – commonly referred to as a Compliance Order – the judge must be satisfied that: (a) the person was required under s. 288 or s. 289 to provide the information; and (b) "in the case of information or a document, the information or document is not protected from disclosure by solicitor-client privilege (within the meaning of subsection 293(1))".

[13] **The definition of solicitor-client privilege, in s. 293(1) of the *Excise Tax Act*, is as follows:**

"solicitor-client privilege" means the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional	**«privilège des communications entre client et avocat » Droit qu'une personne peut posséder, devant une cour supérieure de la province où l'affaire prend naissance, de refuser de divulguer une communication entre elle et son avocat en confidence professionnelle. Toutefois,**

Digitized by Google

confidence, except that, for the purposes of this section, an accounting record of a lawyer, including any supporting invoice, voucher or cheque, shall be deemed not to be such a communication.	**pour l'application du présent article, le relevé comptable d'un avocat, y compris une facture ou une pièce justificative ou tout chèque, ne doit pas être considéré comme une communication de cette nature.**

[14] Under s. 289.1(2), the person must be given notice of the application at least five clear days before it is heard. Subsection 289.1(3) gives the judge hearing the application the discretion to impose such conditions on the order as the judge considers appropriate.

B. *What has been the practice of the Federal Court in these matters?*

[15] The *Excise Tax Act* and the *Income Tax Act* contain an explicit procedure for bringing compliance order applications. As noted above, s. 289.1 (1) of the *Excise Tax Act* provides that the compliance order is to be obtained "on summary application by the Minister". The same requirement for a "summary application" is set out in s. 231.7 of the *Income Tax Act*. In that context, Prothonotary Lafrenière of this Court provided a format for bringing such applications in *Minister of National Revenue v. Norris*, 2002 CarswellNat 1250, [2002] 3 C.T.C. 346. In *Norris*, the Prothonotary authorized the Minister of National Revenue to institute proceedings under s. 231.7 of the *Income Tax Act* by way of motion under Rule 358 *et seq.* of the *Federal Courts Rules,* SOR/98-106 (the Rules), rather than by way of application under Rule 300 *et seq.* of the Rules. As stated by Prothonotary Lafrenière in *Norris*, above, at paras. 5-7:

> **Although a proceeding under subsection 231.7 of the *Income Tax Act* must be brought by way of notice of application, the procedure set out in the *Federal Court Rules, 1998* which governs applications appears ill-suited for summary disposition of such matters. Consequently, in this particular case and subject to any further directions or order of the Court, the following procedure should be followed in the proposed proceeding under subsection 231.7.**
>
> The Applicant shall file a Notice of Application in Form 301, to be treated by the Registry as both an originating document and notice of motion, which shall:
>
> (a) set out the day, time and place at which the application will be heard, either at a General Sittings of the Court or such special sitting date as may have been appointed by the Judicial Administrator upon informal request by the Applicant:
>
> (b) be amended by deleting any references to Rule 300 et seq.;
>
> (c) contain a notice in capital and bold characters which reads as follows: "The Respondent who wishes to oppose the application shall serve a Respondent's Record and file three copies of it not later than 2:00 p.m. on the last business day before the hearing of the application."; and
>
> (d) be accompanied by the appropriate filing fee.
>
> Once the Notice of Application has been filed, the Applicant shall personally serve the Respondent with an Application Record

Digitized by Google

> containing a table of contents, the notice of application, each supporting affidavit and documentary exhibit and the Applicant's memorandum of fact and law. The Applicant shall file three copies of the Application Record, and proof of service thereof in accordance with ss. 237.1 of the *Income Tax Act*, forthwith and in any event no later than two clear days before the return date of the hearing of the application.

[16] Although one may argue that the Order was limited to the particular case before the Prothonotary, the procedure that he outlined has been followed, for compliance orders under both the *Income Tax Act* and the *Excise Tax Act*, since 2002.

[17] Consistent with the direction provided by Prothonotary Lafrenière and with the notice provisions set out in s. 289.1(2) of the *Excise Tax Act*, the Minister's practice is to serve notice on "the person against whom the order is sought". Thus, the Minister, following s. 289.1(2) of the *Excise Tax Act* and the direction of Prothonotary Lafrenière, has not followed Rule 303 of the Rules and named, as a Respondent, the affected taxpayer as a "person directly affected by the order sought in the application".

C. *Are the Information and Documents sought in this case subject to solicitor-client privilege?*

[18] I turn now to the first issue before me. Specifically, should a Compliance Order be issued? Resolution of this issue requires that I first determine whether the Information and Documents, in this case, are subject to solicitor-client privilege.

[19] In recent decisions, the Courts have consistently affirmed that, in the context of a real estate transaction, cheques from a solicitor's account and a statement of adjustments are not subject to solicitor-client privilege (*In the Matter of the Legal Profession Act and Martin K. Wirick*, 2005 BCSC 1821, 51 B.C.L.R. (4th) 193, [2005] B.C.J. No. 2878 (B.C. Sup. Ct.) (QL); *Minister of National Revenue v. Vlug*, 2006 FC 86, 2006 D.T.C. 6285, [2006] F.C.J. No. 142 (F.C.) (QL); *Canada (Minister of National Revenue) v. Reddy*, 2006 FC 277, 146 A.C.W.S. (3d) 568, [2006] F.C.J. No. 348 (F.C.) (QL); *Canada (Minister of National Revenue) v. Singh Lyn Ragonetti Bindal LLP*, 2005 FC 1538, [2006] 1 C.T.C. 113, [2005] F.C.J. No. 1907 (F.C.) (QL)). More specifically, the Federal Court in *Singh Lyn Ragonetti Bindal LLP*, *Vlug* and *Reddy* held that such documents and information requested under the *Excise Tax Act* or the parallel provisions of the *Income Tax Act* are not subject to solicitor-client privilege.

[20] Given this clear authority, there is no question that the Information and Documents requested in the RFI are not the subject of solicitor-client privilege.

D. *Should the procedures currently used by the Court be amended?*

[21] The Law Society has intervened in this application with a concern that they describe as the "greater good". They assert that, once a lawyer is served with an RFI, the lawyer is in an immediate conflict between their duty to their client vis-à-vis privilege and the duty to comply with the statute. At a minimum, the Law Society requests that this Court direct the Minister to take the following steps in all such compliance order applications:

1. **Name the taxpayer as a Respondent to the application pursuant to Rule 303 of the Rules, thereby giving the taxpayer immediate rights to assert any claims of privilege; and**
2. **Require the sealing of the documents and their submission to the Court.**

[22] While acknowledging (I think) that the Information and Documents in this case are not subject to solicitor-client privilege, the Law Society argues that there may be circumstances where this type of document or information held by a lawyer may be privileged. The Law Society submits that the lawyer's client is the only party who can

Digitized by Google

waive that privilege. They refer the Court to certain provisions of Chapter 5 of the *Professional Conduct Handbook* of the Law Society dealing with "Confidential Information". In particular, paragraphs 13 and 14 are entitled "Disclosure required by law" and provide as follows:

> **13. A lawyer who is required by law or by order of a court to disclose a client's affairs shall not divulge more information than is necessary.**
>
> **14. A lawyer who is required under the Criminal Code, the Income Tax Act or any other federal or provincial legislation, to produce or surrender a document or provide information which is or may be privileged shall, unless the client waives the privilege, claim a solicitor-client privilege in respect of the document.**

[23] In general, I would not presume to interpret the rules of the Law Society. However, in this case, two of these rules have been raised as a reason for changing the practice of the Federal Court. Accordingly, I feel that I should respond to the arguments before me. And, in my view, there are a number of problems with those arguments.

[24] In the face of consistent and clear direction from this and other courts that documents in the nature of those described in the RFI are not subject to solicitor-client privilege, it is difficult to see how paragraph 14 of Chapter 5 of the *Professional Conduct Handbook* of the Law Society can have any applicability. Paragraph 14 applies only where the document or information "is or may be privileged". If the Information and Documents do not satisfy that test, paragraph 14 is not engaged.

[25] Since the Information and Documents under discussion in this application – and, more generally, as provided for in the *Excise Tax Act* and the *Income Tax Act* – are not privileged, there is nothing for the client to waive. The provisions of the *Excise Tax Act* and the *Income Tax Act* are very clear. Upon a request, the lawyer must provide the requested information, unless it is subject to solicitor-client privilege. Whether one uses the definition in the statutes or a common law definition of solicitor-client privilege, the law has established that accounting records, including any supporting invoice, voucher or cheque, are not protected by solicitor-client privilege.

[26] Further, the position of the Law Society fails to take into account the difference between confidential and privileged documents. As acknowledged by counsel for the Law Society, privileged documents form a subset of documents that are "confidential". All documents in the possession of a lawyer may be described as confidential but only those that satisfy the test for a claim of solicitor-client privilege may be withheld pursuant to the provisions of the *Excise Tax Act* and the *Income Tax Act*. If paragraph 14 of Chapter 5 of the *Professional Conduct Handbook* is to apply to documents which, in the opinion of the courts, are not subject to privilege, then lawyers would be obliged to obtain the waiver from the client of all documents held by the lawyer for a client. This ignores the intent of paragraphs 13 and 14 which, on my reading, permit the disclosure of non-privileged information where a lawyer is required by law to produce or surrender a document or provide information.

[27] The Law Society argues that only the client – and not the lawyer – has the right to decide whether a document may be privileged and whether to claim that privilege. While this is no doubt correct, it appears to me that, where the law is clear that certain information is not privileged, such a right simply does not arise.

[28] The Law Society raises the problem that sometimes these types of documents may contain notations or other information that may be privileged. This is not the case with the Information and Documents that are the subject of this

Digitized by Google

application; the Law Society does not assert that the documents at issue in this application are annotated. Further, this situation has never arisen to the knowledge of the parties to this application. However, I acknowledge that this situation could arise in a future case. The simple response to this concern is that a financial or accounting record that contains privileged information in the form of a notation is not a document that satisfies the definition of non-privileged information or documents. A Compliance Order may only be issued if the information or document is not protected from disclosure by solicitor-client privilege, either pursuant to s. 289.1 of the *Excise Tax Act* or under principles of common law. If such circumstances were to arise, the statute and the Federal Court procedures for obtaining a Compliance Order would, in my view, suffice to provide the important protection for privileged documents and information.

[29] I also note that the judge hearing the application for a Compliance Order may impose any conditions in respect of the order that the judge considers appropriate (*Excise Tax Act*, s. 289.1(3)). Further service requirements could be imposed. Since the submissions of the Law Society are based on hypothetical situations, it is impossible to address every possible scenario.

[30] Lastly, I turn to the Law Society's submission that the Minister should be required to follow Rule 303(1) and name the taxpayer as a Respondent. In their view, the taxpayer is a "person directly affected by the order sought in the application". The problem with this argument is, first, that the Court, in *Norris*, above, expressly determined that this Rule would not apply. Second, and more importantly, the summary application procedure set out in the *Excise Tax Act* requires service only on the party from whom the information is sought.

[31] In sum, I am not persuaded that the evidentiary record in this case establishes a need for further procedural steps for the protection of solicitor-client privilege. More generally, there is no evidence that the current procedure has resulted in a breach of the fundamental legal rights of solicitor-client privilege. There is no need, at this time, to add a requirement to serve the taxpayer or to provide a sealed copy of the documents to the Court, unless such procedures are warranted on the facts of a particular application.

IV. Conclusion

[32] In conclusion, I am satisfied that:

(a) the Respondent was served with the RFI as required under s. 289(1) of the *Excise Tax Act*;

(b) the Respondent did not provide the Information and Documents sought by the Minister; and

(c) the Information and Documents are not protected from disclosure by solicitor-client privilege.

[33] Accordingly, the Compliance Order will issue. Further, the Court will provide no direction on the procedure for making application for Compliance Orders and affirms the procedure set out in the *Excise Tax Act* and in *Norris*, above.

[34] Since the Minister did not seek costs, no costs will be awarded.

"Judith A. Snider"

Judge

See also R. v. Stewart McKelvey & Dee - 2007 NBQB 081 for: D E C I S I O N

RUSSELL, J.

[1] In this application the Crown seeks an Order, *inter alia:*

… requiring Sheriff Keith Ball to bring the seized documents marked with the affidavit of Britt Dysart which was provided to him by Veronica Hatt on September 1, 2006 before this

Digitized by Google

Honourable Court at a specified date and time for the purpose of permitting this Honourable Court to examine the contents of the box, hear representations of the applicant and respondents, and make a determination of whether a solicitor/client privilege exists;
a review of the documents by this Honourable Court to ensure that the only person holding a potential solicitor/client privilege in the documents is Mark Dee;
(e) a determination by this Honourable Court as to the existence of any solicitor/client privilege in the seized documents and consequent Orders:
for the return of solicitor/client privileged documents to the law firm of Stewart McKelvey Stirling Scales; and
allowing the applicant herein to make use in accordance with the law of the documents to which no solicitor/client privilege attaches.
[2] The background of the matter is that on August 21, 2006 an officer of the CCRA swore an Information to Obtain Production Order and consequently obtained such an order for the premises of the law firm of Stewart McKelvey Stirling and Scales. The Production Order was served on a lawyer of that firm at their Fredericton address. The Production Order, obtained pursuant to the provisions of Section 487.012 of the *Criminal Code*, "authorized the production of records pertaining to the estate of Joan Dee including correspondence, memorandum, and other documentation including letters of directions, statement of adjustments and statement of trust funds, and banking records and copies thereof, including cancelled cheques drawn on Royal Bank of Canada Account Number 00884-003-1252154, Petrie Richmond Goss "Trust". On September 1, 2006 the lawyer provided the CCRA officer with a box of documents. She immediately turned them over to Sheriff Keith Ball pending this application to determine whether solicitor-client privilege applied to any of the documents.
[3] At the hearing of the matter Counsel for Mark Dee appeared and argued the documents were subject to solicitor-client privilege. In the Information to Obtain Production Orders the CCRA officer alleged that she has reasonable grounds to believe Mark Dee has committed the following offence: Mark Dee, in his role as executor of the Estate of Joan Dee, has committed an offence as defined by paragraph 239(1)(d) of the *Income Tax Act* by willfully evading the payment of taxes imposed by the *Income Tax Act* upon the Estate of Joan Dee for the 1998 taxation year.
[4] It should be noted he has not been charged with that or any other offence on the material before me. It is also apparent that the named law firm acted with respect to the estate of Joan Dee.
[5] Following argument I retained the documents received from Sheriff Keith Ball and reviewed them individually.

THE LAW
[6] In *Descouteaux v Mierzwinksi* [1982] 1 S.C.R. 860, the Supreme Court of Canada in quoting from Wigmore said: 2007 NBQB 81 (CanLII)

"Where legal advice of any kind is sought from a professional legal adviser in his capacity as such, the communication relating to that purpose, made in confidence by the client, are at his instance permanently protected from disclosure by himself or by the legal adviser, except the protection be waived."
[7] In *Stevens v Canada (Prime Minister)* [1998] 4 F.C. 89 C.A., Mr. Justice Linden for the Court wrote at paragraph 15:
It will be seen that Canadian law has sought to strike an appropriate balance between openness and secrecy by creating two exceptions to the privilege. One exception, which will be discussed later, is for communications which are themselves criminal or which

Digitized by Google

counsel a criminal act (e.g. where a lawyer advises a client to conceal evidence). The second exception, which will be analysed in depth later, relates to that information which is not a communication but is rather evidence of an act done by counsel or is a mere statement of fact. This prevents a stifling of the discovery process which would take place if a client could, by merely communicating a fact to his or her lawyer, prevent the discovery of that fact. Similarly, a person is not immune from discovery with regard to certain transactions merely because they were performed by counsel. Both exceptions acknowledge that tension involved in this area of the law, and both accept that justice is better served by lifting the privilege in those cases.

[8] And at paragraph 25:

Perhaps the most important distinction that needs to be highlighted is that it is only communications that are protected by the privilege. Acts of counsel or mere statements of fact are not protected. In Susan Hosiery Ltd. v Minister of National Revenue, Jackett P., after reviewing the rules relating to solicitor-client privilege stated:

"What is important to note about both of these rules is that they do not afford a privilege against the discovery of facts that are or may be relevant to the determination of the facts in issue. What is privileged is the communications or working papers that came into existence by reason of the desire to obtain a legal opinion or legal assistance in the one case and the materials created for the lawyer's brief in the other case. The facts are documents that happen to be reflected in such communications or materials are not privileged from discovery if, otherwise, the party would be bound to give discovery of them."

The general rationale for not protecting matters of fact or acts done is the detrimental effect it would have on litigation. For example, a person cannot avail himself or herself of the privilege by simply communicating a fact to a lawyer or allowing the lawyer to perform an act in his or her place.

[9] And at paragraphs 41 through 44:

¶41 In Law Society of P.E.I. v. P.E.I. (Attorney General), the R.C.M.P. attempted to seize documents in the possession of a lawyer relating to trust ledgers, general ledgers, and bank reconciliation ledgers which pertained to the dealings of a number of the lawyer's clients. MacDonald C.J.T.D. determined:

It is the communications between the client and his lawyer that are privileged. The trust ledgers, general ledgers and bank reconciliation ledgers are not communications between the solicitor and the client. These documents form part of the solicitor's records and are reports of acts, not communications. Privilege does not attach to these documents.

¶42 Thus, the jurisprudence in this area is not really in conflict. It merely reflects the existence of a broad exception to the scope of the privilege, namely, that it is only communications which are protected. The acts of counsel or mere statements of fact are not protected. This is an important balancing mechanism which, along with the prohibition against protecting communications which are themselves criminal, takes into account the public interest inherent in the proper administration of justice.

¶43 Where a lawyer is involved in the dealings of his or her client, like the disposition of funds held in trust for the client, as in Greymac, or the execution of an agreement for the purchase and sale of property, the existence or contents of these acts are not protected. The lawyer, in those situations, is not in the process of giving advice to the client, but is more like a witness to an objective state of affairs.

¶44 This explains the apparent conflict between the reasons of Southey J. in Greymac and Mutual Life Assurance Company of Canada. In the former case the trust account was determined not to be protected by the privilege, while the solicitor's accounts in the latter case were held to be privileged. The statement of account is privileged because it is integral to the seeking, formulating and giving of legal advice. The trust account ledger is not

Digitized by Google

protected because it relates to acts done by counsel. [10] I am satisfied this reflects the state of the law in claims of solicitor-client privilege and have reviewed the documents having regard to these principles.

DISPOSITION

[11] I was provided an accordian file which was wrapped and sealed. It contained 7 buff file folders each of which contained documents, letters, memos and other written material. The file folders have been replaced in the accordian file and resealed.

That packet will, pursuant to Section 488.1(4)(d)(ii) of the *Criminal Code*, be delivered to Sheriff Keith Ball who will deliver it to Veronica Hatt, the officer of the CCRA who seized the documents. This packet contains only material that I have concluded does not attract solicitor-client privilege.

[12] The material that I conclude was privileged has been removed from the file folders and placed in a large envelope which I have sealed. Pursuant to Section 488.1(4)(d)(i) that envelope will be returned to the Respondent by Sheriff Ball.

David H. Russell, J.C.Q.B.

See also

20110224

Docket: T-88-09 Citation: 2011 FC 224

Ottawa, Ontario, February 24, 2011

PRESENT: The Honourable Mr. Justice Mandamin BETWEEN:

TAXPRO PROFESSIONAL CORPORATION AND HARI NESATHURAI

Applicant and

THE MINISTER OF NATIONAL REVENUE

Respondent

REASONS FOR JUDGMENT AND JUDGMENT

[1] The Applicant, a lawyer and his professional corporation, seeks, among other remedies, an Order setting aside the Respondent's requirement to provide information and documents relating to the Applicant's client, a Canadian corporate taxpayer, 1082955 Ontario Limited.

[2] An officer of the Canada Revenue Agency issued the requirement pursuant to paragraphs 231.2(1)(a) and

of the Income Tax Act, R.S.C. 1985 (5th Supp.), c.1 as amended (ITA) by a letter dated December 22, 2008. The Applicant is required by the legislation to comply.

[3] The Applicant claims the information and documents sought by the Respondent are covered by solicitor- client privilege and brings this application.

[4] The Respondent asks the Court to either dismiss the application or require the Applicant to prepare a list of documents over which solicitor-client privilege is claimed to be reviewed and decided upon by the Court.

[5] I have decided that the documents are reviewable by the Court in order to determine whether solicitor-client privilege applies.

Background

[6] Mr. Nesathurai is a lawyer licensed to practice law in Ontario. The bulk of his practice is tax law. 1082955 Ontario Limited (108 Ltd.) is his client.

[7] Mr. Roy Crooker is an officer of the Canada Revenue Agency (CRA). He began an audit of 108 Ltd.'s 2005 taxation year and later expanded his audit to include the 2003 and 2004 taxation years.

Digitized by Google

[8] The impetus for the CRA requirement for information and documents relate to payments made by 108 Ltd. to Specialty Insurance Limited (SIL), an entity organized in St. Lucia, West Indies, in the years 2003, 2004 and 2005. The payments were made for the purpose of acquiring three separate Group Sickness and Accident Insurance Polices from SIL. The CRA alleges the same amounts, less an accommodation fee, were loaned back to 108 Ltd. by Continental Trust Corporation (CTC), a Bermudian corporate entity related to SIL.

[9] The December 22, 2008 s. 231.2(1) requirement under the ITA was sent to the Applicant for information and documents with a listing of items sought. **A similar request was delivered to the Applicant's client, 108 Ltd., which responded on February 11, 2009 by providing the CRA with the documents and information not covered by the solicitor-client privilege claimed. 108 Ltd. did not waive solicitor-client privilege with respect to the documents the Applicant claimed to be covered by privilege.**

[10] The remaining items at issue from the December 22, 2008 requirement are items A, G and H. from the original list. They read:

Any and all planning documents or information with respect to 1082955 Ontario Limited (1082955) and the purchase of the insurance premiums from Specialty Insurance Limited (SIL) and the loans from Continental Trust Corporation Limited (CTC).

Any and all memorandum, correspondence, letters, emails, notes, records of discussions or any other kind of document, whether in paper format, electronic format or any other type of format between any of 1082955, Hari S. Nesathurai, SIL or CTC or any other third party with respect to SIL, GSAIP or CTC;

Any and all documents or information of any type whatsoever attached to any correspondence between Hari Nesathurai and 1082955; …

[11] The Applicant has placed before the Court a sealed envelope labelled: "Confidential Documents – Solicitor- Client Privileged Materials: Not to Be Opened Until Hearing of this Application".

Legislation

[12] The Income Tax Act, (1985, c. 1 (5th Supp.)) provides:

231.2 (1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act (including the collection of any amount payable under this Act by any person), of a comprehensive tax information exchange agreement between Canada and another country or jurisdiction that is in force and has effect or, for greater certainty, of a tax treaty with another country, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as stipulated in the notice,

any information or additional information, including a return of income or a supplementary return; or

any document.

…

232. (1) In this section,

"judge" means a judge of a superior court having jurisdiction in the province where the matter arises or a judge of the Federal Court;

"lawyer" means, in the province of Quebec, an advocate or notary and, in any other province, a barrister or solicitor;

"officer" means a person acting under the authority conferred by or under sections 231.1 to 231.5;

"solicitor-client privilege" means the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional confidence, except that

Digitized by Google

for the purposes of this section an accounting record of a lawyer, including any supporting voucher or cheque, shall be deemed not to be such a communication.

…

An application under paragraph 232(4)(c) shall be heard in camera, and on the application

the judge may, if the judge considers it necessary to determine the question, inspect the document and, if the judge does so, the judge shall ensure that it is repackaged and resealed; and

the judge shall decide the matter summarily and,

if the judge is of the opinion that the client has a solicitor-client privilege in respect of the document, shall order the release of the document to the lawyer, and

if the judge is of the opinion that the client does not have a solicitor-client privilege in respect of the document, shall order

that the custodian deliver the document to the officer or some other person designated by the Commissioner of Revenue, in the case of a document that was seized and placed in custody under subsection 232(3), or

that the lawyer make the document available for inspection or examination by the officer or other person designated by the Commissioner of Revenue, in the case of a document that was retained under subsection 232(3.1),

and the judge shall, at the same time, deliver concise reasons in which the judge shall identify the document without divulging the details thereof.

(emphasis added)

Issue

[13] The Applicant identifies a single issue: Does solicitor-client privilege protect the documents from production?

[14] The Respondent frames the issue as whether the Minister properly issued a requirement for information documents to the Applicant.

Analysis

[15] Pursuant to paragraphs 231.2(1)(a) and (b), the Minister may require that any person provide any information or any document for any purpose related to the administration or enforcement of the ITA. This requirement is broad, limited only to any purpose related to the administration or enforcement of this Act.

[16] The Applicant contends the Respondent's requirement is overly broad, as demonstrated by the words "Any and all …" and amounts to a fishing expedition. But, even if it was not, the Applicant contends the information and documents are protected from production because of solicitor-client privilege.

[17] The Applicant submits the applicable principle is that articulated in Descoteaux v Mierzwinski, [1982] 1 SCR 860 (Descoteaux) by the Supreme Court of Canada:

In summary, a lawyer's client is entitled to have all communications made with a view to obtaining legal advice kept confidential. Whether communications are made to the lawyer himself or to employees, and whether they deal with matters of an administrative nature such as financial means or with the actual nature of the legal problem, all information which a person must provide in order to obtain legal advice and which is given in confidence for that purpose enjoys the privileges attached to confidentiality. This confidentiality attaches to all communications made within the framework of the solicitor-client relationship, which arises as soon as the potential client takes the first steps, and consequently even before the formal retainer is established.

[18] The Applicant cites from Vern Krishna, The Fundamentals of Income Tax Law, 7th ed.

Digitized by Google

(Carswell: 2009) for the proposition that the tax plans are included as documents over which privilege should be recognized. That text reads:

For tax purposes, "privilege" means the right that a person has to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between client and lawyer in a professional confidence.

In general terms, the following types of documents are covered by solicitor-client privilege:

Correspondence between solicitor and client

Opinion letters

Tax plans, reorganizations, agreements of purchase and sale and other agreements.

[19] The Applicant submits that he has tendered affidavit evidence in support of the claim for solicitor-client privilege and the Respondent must consequently advance its own evidence refuting the claim of privilege. Since the latter has not, the Applicant submits the solicitor-client privilege claim should be sustained: Watt v Baycrest Hospital, [1991] OJ No. 1107 at p. 2 (Gen. Div.) (Watt).

[20] The Applicant also points out solicitor-client privilege is a constitutional right recognized by sections 7 and 8 of the Canadian Charter of Rights and Freedoms, Part I of the Constitution Act, 1982, being schedule B to the Canada Act, 1982 (U.K.), 1982, c. 11. The Applicant submits that the privilege is absolute and will only yield in defined circumstances. It does not involve a balancing of interests on a case by case basis: Lavallee, Rackel & Heintz v Canada (Attorney General) 2002 SCC 61, [2002] 3 SCR 209 at para 36 (Lavallee, Rackel & Heinz).

[21] The Applicant submits the Respondent is not entitled to any documents beyond those already provided by 108 Ltd. and, more specifically, the Respondent is not entitled to any documents in the Applicant's possession that are protected by solicitor-client privilege.

[22] The Respondent states that s. 231.2 requires the production of information and documents for any purpose related to the administration and enforcement of the ITA. The Respondent argues this is necessary in a self-reporting tax system since the Minister must be given broad powers to audit a taxpayer's returns, including inspection of all records which may be relevant to the preparation of those returns. Unless the material is subject to solicitor-client privilege, the Minister is entitled to review anything which may be relevant in verifying the tax liability of a taxpayer under audit: R v McKinlay Transport Ltd, [1990] 1 SCR 627 at para 33 (McKinlay Transport). I agree with this submission.

[23] The Respondent asserts it is not seeking documents protected by solicitor-client privilege. Rather, the Respondent "... seeks production of ... those documents in the Applicant's file that are not subject to solicitor-client privilege because they pertain to acts of counsel or statements of fact that are located in Mr. Nesathurai's file or are document[s] exchanged between the Applicant and a third party".

[24] The Respondent argues acts of counsel or mere statements of fact, as well as communications with third parties are not subject to solicitor-client privilege. While statements of account are generally held to be privileged, trust ledgers and other financial reports of that type are not privileged: Stevens v Canada (Prime Minister) [1998] 4 FC 89 (FCA) at paras 27, 42-43 (Stevens).

[25] **The Respondent adds the party asserting solicitor-client privilege must provide evidence the documents are privileged. It submits that, other than making an assertion that all the documents in his file is covered by solicitor-client privilege, the Applicant has not provided any evidence to support that statement.** Further, the Respondent has not been able to make any assessment of the validity of that assertion as

Digitized by Google

the Applicant has declined to provide a list of the documents over which privilege is asserted.

[26] The starting point for any analysis is section 231 of the ITA, in particular:

"solicitor-client privilege" means the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional confidence, except that for the purposes of this section an accounting record of a lawyer, including any supporting voucher or cheque, shall be deemed not to be such a communication.

[27] The classic definition of solicitor-client privilege can be found in Wigmore on Evidence (McNaughton rev. 1961) at para 2292:

Where legal advice of any kind is sought from a professional legal advisor in his capacity as such, the communications relating to that purpose, made in confidence by the client, are at his instance permanently protected from disclosure by himself or by the legal advisor except the protection be waived.

[28] Solicitor-client privilege is one of the few nearly absolute class privileges recognized at common law:

v McClure, [2001] 1 SCR 445 at paras 27-28.

[29] The Supreme Court has recognized solicitor-client privilege as a right protected by sections 7 and 8 of the Canadian Charter of Rights and Freedoms (the Charter). In Lavallee, Rackel & Heintz, the Supreme Court declared a section of the Criminal Code permitting searches of law offices violated the section 8 of the Charter. The Court wrote at para. 49:

Solicitor-client privilege is a rule of evidence, an important civil and legal right and a principle of fundamental justice in Canadian law. While the public has an interest in effective criminal investigation, it has no less an interest in maintaining the integrity of the solicitor-client relationship. Confidential communications to a lawyer represent an important exercise of the right to privacy, and they are central to the administration of justice in an adversarial system. Unjustified, or even accidental infringements of the privilege erode the public's confidence in the fairness of the criminal justice system. This is why all efforts must be made to protect such confidences.

[30] At the same time, a distinction must be recognized between the lawyer's ethical duty to keep matters concerning a client confidential and the concept of solicitor-client privilege. The distinction between confidentiality and privilege was recognized in Solosky v Canada, [1980] 1 SCR 821, (1979) 50 CCC (2d) 495 (Solosky), at p. 502:

... it is not every item of correspondence passing between solicitor and client to which privilege attaches, for only those in which the client seeks the advice of counsel in his professional capacity, or in which counsel gives advice, are protected.

[31] In R v B, [1995] 3 BCLR (3d) 363, 5 WWR 374 (BCSC) Justice Thackray canvassed the law concerning this distinction. His comments at paras 26 and 27 are apt:

I find helpful the following passage from Sopinka, Lederman and Bryant, The Law of Evidence in Canada (Toronto: Butterworths, 1992) [pp. 626-27]:

Although confidentiality is the cornerstone for the protection of communications within particular relationships, confidentiality alone is not sufficient to attract privilege. Confidentiality may well attract other legal and ethical rights and obligations but it does not have its foundation in the evidentiary doctrine of privilege. Evidence law does not concern itself with the ethical requirement upon a professional such as a lawyer to hold in strict confidence all information acquired in the course of his or her professional relationship concerning the business and affairs of a client. The lawyer has a professional duty not to divulge such information without the client's approval or unless required by law to do so. This ethical rule is

Digitized by Google

wider than the evidentiary solicitor-client privilege and applies without regard to the nature of the source of the information or the fact that others may share the knowledge. Where there is a stronger public interest in disclosure, it will override the professional duties of confidence. [Footnotes omitted.]

In spite of the difficulty in defining the concepts of confidentiality as distinct from privilege, I am satisfied that there is a distinction. It is not enough, in my opinion, to establish only confidentiality in order to effect non-disclosure. It is only those documents that are privileged that are subject to non-disclosure.

[32] There are also limits to solicitor-client privilege. It does not apply if the privilege has been waived. Further, there are exceptions: privilege does not apply to communications in which legal advice is neither sought or offered, nor where the communication is not intended to be confidential and not where a client seeks the assistance or advice of a lawyer in order to facilitate the commission of a crime or a fraud: Solosky, above.

[33] In Descoteaux, the Supreme Court of Canada identified limitations to solicitor-client privilege at para 71:

… This confidentiality attaches to all communications made within the framework of the solicitor-client relationship, which arises as soon as the potential client takes the first steps, and consequently even before the formal retainer is established.

(emphasis added)

[34] Finally, paragraph 231.2(1) of the ITA provides a statutory clarification of the limitation with respect to a lawyer's records: "… except that for the purposes of this section an accounting record of a lawyer, including any supporting voucher or cheque, shall be deemed not to be such a communication."

[35] An issue may also arise with documents exchanged between a lawyer and third parties. In Copthorne Holdings Ltd v Canada, 2005 TCC 491 (Copthorne Holdings), a Tax Court case, Mr. Chief Justice Rip considered whether privilege attached to four types of communications between a lawyer and others. Of relevance are communications between a law firm and third parties. **The Court found if the third party was an agent of the law office, then the same privilege that applies to employees of the firm applies to agents. The Court relied in part on para. 14.71 of J. Sopinka, S.N. Lederman, and A.W. Bryant, The Law of Evidence in Canada (1999):**

A lawyer, in the ordinary course of his or her practice, utilizes employees such as articling students, law clerks and secretaries. Communication to such agents for the purpose of facilitating the obtaining of legal advice is equally protected. The same can be said about the client's agents, so long as they are employed as his or her agents for the purpose of obtaining legal advice. That is so, notwithstanding that the agent may add something to the communication as a product of his or her own skill. [...] In Goodman & Carr v. Minister of National Revenue, an accountant's opinion was sent to the client's lawyer at the client's request. It was held not to be privileged because the agent was not an agent for the client seeking legal advice, but was really offering his own opinion. Because these communications through agents are not normally made in a litigious atmosphere, this situation must be distinguished from the case where a third party is retained to obtain facts or to make a report to assist the client or his or her solicitor in litigation.

(emphasis added)

[36] Another distinction arises in Maranda v Richer, 2003 SCC 67 (Maranda) where the Supreme Court drew the distinction between facts and communications in paragraph 30:

…The protection conferred by the privilege covers primarily acts of communication engaged in for the purpose of enabling the client to communicate and obtain the necessary

Digitized by Google

information or advice in relation to his or her conduct, decisions or representation in the courts. The distinction is made in an effort to avoid facts that have an independent existence being inadmissible in evidence (Stevens, supra, at para. 25). It recognizes that not everything that happens in the solicitor-client relationship falls within the ambit of privileged communication, as has been held in cases where it was found that counsel was acting not in that capacity but simply as a conduit for transfers of funds (Re Ontario Securities Commission and Greymac Credit Corp. (1983), 41 O.R. (2d) 328 (Div. Ct.); Joubert, supra). (emphasis added)

[37] **In Westra Law Office (RE), 2009 ABQB 391 (Westra) the court held that a signed agreement, such as a loan or a mortgage, is not privileged because they are "actions rather than communications directly related to the seeking, formulating or giving of legal advice."** That case involved three parties to a mortgage, purchaser (Gours), seller (Sharma) and mortgage company (ResMor). The Court wrote at para 43:

"Mr. Sharma has not demonstrated solicitor-client privilege over the documents held by Westra Law office pertaining to this real estate transaction as against the Gours or ResMor. The parties to the real estate transaction all used the services of Mr. Westra to effectuate the deal and each is entitled to be privy to the information he had respecting the arrangements pertaining to the others. The communications are not confidential as between the parties, so as to meet that condition of solicitor- client privilege, although they are confidential vis a vis the outside world. However, the Gours and ResMor have waived any privilege that did exist as against the outside world. Documents that are communications between Mr. Westra and any of the three parties must be disclosed on that basis." (emphasis added)

[38] The questions when presented with the documents at issue will be whether or not they constitute a communication or some statement of fact. In Belgravia Investments Ltd v R, 2002 FCT 649, Justice Heneghan stated at paras 44-46:

In Susan Hosiery Ltd., supra, the Exchequer Court distinguished between documents and the facts contained in those documents, for the purpose of recognizing privilege. President Jackett expressed himself on this point as follows at pages 5282-5283:

…the letter or statement itself is privileged but the facts contained therein or the documents from which those facts were drawn are not privileged from discovery if, apart from the facts having been reflected in the privilege documents, <u>they would have been subject to discovery.</u> <u>For example, the financial facts of a business would not fall within the privilege merely because</u> <u>they had been set out in a particular way as requested by a solicitor for purposes of litigation,</u> <u>but the statement so prepared would be privileged.</u>

<u>This statement of principle means that although certain documents may be protected against</u> <u>disclosure, facts contained in those documents, which otherwise may be discoverable, are not</u> <u>protected.</u>

Furthermore, no automatic privilege attaches to documents which are not otherwise privileged simply because they come into the hands of a party's lawyer. **In General Accident Assurance Ltd. v. Chrusz (1998), 37 O.R. (3d) 790 (Ont. Div. Ct.) at page 796 (reversed on other grounds (2000), 45 O.R. (3d) 321 (Ont. C.A.)), the Court said "An original document that is clothed with no privilege does not acquire privilege simply because it gets into the hands of a solicitor."**

[38] The first question I have to address is how to proceed. The Applicant has provided an affi davit upon which he was cross-examined. Since he has declined to present a list with information concerning the documents for which he asserts privilege, his evidence does not establish any or all the documents are covered by solicitor-client privilege. Not

Digitized by Google

surprisingly, the Respondent has also provided insufficient evidence that any or all the documents in the Applicant's possession are not covered by privilege. In my view, neither Applicant nor Respondent has put sufficient evidence before me to resolve this issue on their submissions alone. In result, it is necessary that I examine the documents themselves to ascertain whether they are covered by solicitor-client privilege in accordance with the principles discussed above.

Documents under Solicitor-Client Privilege

[39] The Applicant has provided within his sealed envelope a numbered listing of documents and descriptions which, considering paragraph 232(5), I will follow without the accompanying description.

[40] I consider the following documents to be covered by solicitor-client privilege, and they may not be disclosed without the client's waiver or consent. My reason for finding privilege follows the listing of the exhibit numbers.

Exhibit Author Recipient Date

1

Hari S. Nesathurai ("HSN") Darko Vranich/Vrancor (the Client)

June 22, 2004

[41] The cover letter, legal opinion and appended documents prepared for 108 Ltd. are privileged legal advice. 108 Ltd. has not waived privilege for these documents.

2

HSN

Colin Hames of Continental Trust Corporation Limited June 20, 2003

[42] The cover letter to Colon Hanes of CTC conveys the legal opinion and appended documents for 108 Ltd. prepared in 2003. The Applicant testified in cross examination he acted for 108 Ltd., SIL and CTC. This legal opinion would not be privileged as between 108 Ltd., SIL and CTC but is privileged in regard to outside persons unless waived by one of the three clients. As there is no evidence of waiver by 108 Ltd, SIL or CTC, this document remains privileged.

7-30

HSN and Tyler McDiarmid Tyler McDiarmid and HSN

June 18, 2007 to November 24, 2008

[43] The initial email correspondence beginning with the Exhibit 7 involves a request for information which arguably relates to financial information rather than legal questions. In Exhibit 10, there is a request by 108 Ltd. for another copy of HSN's invoice which is eventually provided. In my view, if it weren't for the disclosure by 108 Ltd. in its own response to the requirement served on it by Respondent, the correspondence would have been privileged, given the client's request and the Applicant's provision of the invoice. Accordingly, because of the waiver, I do not think privilege arises on this ground.

[44] However, this correspondence, Exhibits 7 – 30, evolves into exchanges about the Respondent's requirement leading to the Applicant's provision of legal advice concerning solicitor-client privilege. In Descoteaux, the Supreme Court noted confidentiality attaches to all communications within the framework of solicitor-client relationships as soon as the client takes the first steps. In result, I find all the communications contained in the entire sequence, Exhibits 7 – 30, to be privileged.

31

HSN

Client, 1082955 Ontario Limited October 4, 2005

[45] The invoice by the Applicant for legal services is privileged as it identifies the subject matter for which legal services were provided to 108 Ltd. The privilege has not been waived

Digitized by Google

by 108 Ltd., unlike the June 2004 Invoice referred to in the above in document email correspondence. I conclude this document is privileged.

Documents not under Solicitor-Client Privilege

[46] I turn now to those documents I do not consider to be privileged. 3

HSN

Darko Vranich/Vrancor June 2005

[47] The above description states the document "missing the actual reporting letter as per Exhibits 1 and 2 above." The document only includes a Deed of Settlement made June 1, 2005 between SIL and CTC with attachments. While the Deed of Settlement is between parties who are subject to the Respondent's audit, the subject matter concerns 108 Ltd. and falls within the broad scope of subsections 231.2(1) as discussed in paragraph 22 above.

[48] **The document and attachments in Exhibit 3 are essentially similar to the above mentioned appended documents in Exhibits1 and 2. It involves an agreement between the two offshore parties who the Applicant says are his clients also. The subject matter touches on the broad scope of matters relevant to 108 Ltd.'s taxable status. However, there are three significant differences. First, not only is there no covering letter, there is also there is no legal opinion. Second, there is no evidence, either in the Applicant's affidavit or in his cross examination, that these documents were part of a legal opinion provided to 108 Ltd., SIL or CTC. There is only the unsworn assertion in the listing of documents which does not have any weight as evidence.** Finally, the appended documents in Exhibits 1 and 2 included unsigned documents. Here the Deed of Settlement and attachments are signed and complete in that respect.

[49] I conclude that the document in Exhibit 3 comes with a statement of fact as discussed in Maranda and Westra rather than a communication given in the course of formulating or providing professional advice. I conclude this document is not covered by solicitor-client privilege.

4-6

HSN and Tyler McDiarmid HSN and Tyler McDiarmid June 18, 2007

[50] These emails involve discussion of financial matters without any indicia or suggestion that legal advice is being sought or given. They also were sent on one day, June 18, 2007 approximately six months before the remaining emails in Exhibits 7 to 30. They clearly constitute a separate batch of emails. I conclude these emails fall outside the framework of the solicitor-client relationship as described in Descoteaux.

Conclusion

[51] I conclude the documents identified as being subject to solicitor-client privilege, the documents in Exhibits 1, 2, 7 to 30 and 31 are exempt from disclosure pursuant to paragraph 232(5)(b)(i) of the ITA.

[52] The documents not identified as being covered by solicitor-client privilege, the documents in Exhibits 3 and 4 to 6, are not exempt from disclosure under the paragraph 231.2(1)(a) and (b) of the ITA.

[53] For the protection of the Applicant and his client 108 Ltd., all documents shall remain under seal until the expiry of the applicable appeal period. Upon expiry of the appeal period and upon no appeal being filed, the Applicant will provide the documents in Exhibits 3 and 4 to 6 to the Respondent.

[54] There will be no order for costs. JUDGMENT

THIS COURT ORDERS AND ADJUDGES that:

The documents identified as being subject to solicitor-client privilege, in Exhibits 1, 2, 7 to 30, and 31 are exempt from disclosure pursuant to paragraph 232(5)(b)(i) of the ITA.

The documents not identified as being covered by solicitor-client privilege, in Exhibits 3, and

Digitized by Google

4 to 6, are not exempt from disclosure under the paragraph 232.1(2)(a) and (b) of the ITA. For the protection of the Applicant and his client 108 Ltd., all documents shall remain under seal un til the expiry of the applicable appeal period. Upon expiry of the appeal period and upon no appeal being filed, the Applicant will provide the documents in Exhibits 3 and 4 to 6 to the Respondent.
There will be no order for costs.
"Leonard S. Mandamin"
Judge

MNR v. Joseph R. Jakabfy, 2013 FC 706, An Example of SCP Not Applying to a Lawyer's Financial Records

Date: 20130625
Docket: T-1040-13
Citation: 2013 FC 706
Toronto, Ontario, June 25, 2013
PRESENT: The Honourable Mr. Justice Zinn
BETWEEN:

THE MINISTER OF NATIONAL REVENUE

Applicant

and

JOSEPH R. JAKABFY

Respondent

REASONS FOR ORDER AND ORDER

[1] The Minister of National Revenue is asking the Court to issue an Order under section 231.7 of the *Income Tax Act*, RSC 1985, c 1 (5th Supp) requiring Joseph R. Jakabfy, a barrister and solicitor, to provide certain documents and information to the Minister.

[2] The documents and information sought from the Respondent relate to the sale of a property by Donald Lavallee and his wife Nicole Lavallee. Donald Lavallee has unpaid personal income taxes and unpaid GST. The Minister wished to determine how Donald Lavallee distributed the proceeds from the sale of the property in order to determine whether he transferred any or all of the proceeds to a non-arm's length person such that an assessment might be raised against the transferee pursuant to section 160 of the *Income Tax Act*, or section 325 of the *Excise Tax Act*, RSC 1985, c E-15.

[3] To that end, in November 2010, pursuant to section 231.2(1) of the *Income Tax Act*, a requirement for information and documents was delivered to the Respondent, who had acted for Donald Lavallee in respect of the sale of the property. The requirement required Mr. Jababfy to provide the Minister with the following:

a. A copy of trust account ledger showing names and amounts for all transactions where disbursements were made to

Digitized by Google

or on behalf of Nicole Lavallee, 920199 Ontario Ltd.[a corporation owned and controlled by Donald Lavallee and his family] or Donald Lavallee.

b. A copy of trust account ledger or cheque journal showing names and amounts for all transactions where money was received and was paid on behalf of Nicole Lavallee, 920199 Ontario Ltd. Or Donald Lavallee.

c. Copies of all cancelled cheques (front & back) for all transactions in which amounts were paid to or on behalf of Nicole Lavallee, 920199 Ontario Ltd. or Donald Lavallee.

d. A copy of the statement of adjustments or disbursement statement for all transactions.

e. Copies of all invoices/receipts for payment made on behalf of Nicole Lavallee, 920199 Ontario Ltd. or Donald Lavallee.

[4] Upon receipt of this requirement for information and documents, Mr. Jababfy wrote to his clients seeking their instructions:

> I would request your Authorization to release documentation to Canada Revenue Agency (if we still have it), so that the Revenue Canada will not be put to the expense of obtaining an Order of the Court for compliance.
>
> On the other hand, of you want to oppose their Application you should indicate this to me.

[5] In an affidavit sworn in this matter, Mr. Jakabfy attests:

> Shortly after sending this letter I was instructed by Mr. Lavallee, in very strong terms, not to produce the Documents to CRA and instead to claim privilege over them.
>
> I advised CRA of the position that my Former Clients were taking in a letter dated November 16, 2010.... Since that time, I have received no contrary instructions from the Lavallees. ...I have advised CRA that I am not in a position to produce the documents in response to the Requirement without an Order from the Court.

[6] Mr. Jakabfy, in his affidavit, and through the representations of counsel he has retained, advises the Court that he takes no position on this application "other than that the Court should decide whether the Documents are privileged and that no costs should be awarded against me." He has provided a schedule to the Court listing the documents in his possession which conform to the request for information. Further, his counsel has filed with the Court, in a sealed envelope, those documents and has instructions from Mr. Jakabfy that if the Court determines that no privilege attaches to the documents, they are to be delivered by counsel to the Minister immediately.

[7] The Court observes that Mr. Jakabfy has acted appropriately in this matter in his dealings with his former clients, with the Minister, and with the Court. No costs will be ordered against him.

[8] This Court has held that three conditions must be satisfied under subsection 231.7(1) of the *Income Tax Act* before the Court can order a person to provide the information and documents sought by the Minister under section 231.2 of that Act; See *Canada (Minister of National Revenue – MNR) v Currie*, 2008 FC 237, para 25:

> a) the Respondent was required under subsection 231.2(1) of the *Income Tax Act* to provide the Information and Documents

Digitized by Google

sought by the Minister;

b) the Respondent has failed to provide the Information and Documents sought by the Minister; and

c) the Information and Documents sought by the Minister are not protected from disclosure by solicitor-client privilege.

[9] The Court is satisfied, based on the record before it that the first two conditions are satisfied. The only question is whether the information sought is protected by solicitor-client privilege.

[10] Not all communication between a solicitor and his client is protected by the privilege. Section 232 of the *Income Tax Act* defines solicitor-client privilege for the purposes of that Act, as follows:

> **"solicitor-client privilege" means the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional confidence, except that for the purposes of this section an accounting record of a lawyer, including any supporting voucher or cheque, shall be deemed not to be such a communication.**

[11] This definition is in keeping with the law of solicitor-client privilege which has held that the protection applies to communications involving the seeking and providing of legal advice and does not apply to documents that are "evidence of an act or transaction rather than a communication:" *Canada (Minister of National Revenue – MNR) v Singh Lyn Ragonetti Bindal LLP*, 2005 FC 1538, para 18.

[12] This Court has ordered the production of information and documents relating to financial transactions directed through a solicitor's trust account, such as cheques, statements of adjustment, and account ledgers, on numerous occasions: See for example: *Canada (Minister of National Revenue – MNR) v Reddy*, 2006 FC 277; *Canada (Minister of National Revenue – MNR) v Singh Lyn Ragonetti Bindal LLP*, 2005 FC 1538; *Canada (Minister of National Revenue – MNR) v Cornfield*, 2007 FC 436; *Canada (Minister of National Revenue – MNR) v Currie*, 2008 FC 237.

[13] Counsel for the Minister, as an officer of the Court, brought to our attention the decision of the Québec Superior Court in *Chambre des notaires du Québec c Canada (Procureur général)*, 2010 QCCS 4215, [2010] JQ 8868 which held that sections 231.2 and 231.7 and the definition of "solicitor-client privilege" in subsection 232(1) of the *Income Tax Act* were contrary to sections 7 and 8 of the *Canadian Charter of Rights and Freedoms* and are of no force and effect as against Quebec notaries and lawyers with respect to documents and information protected by "professional secrecy." That decision is under appeal.

[14] The Court declines to follow that decision for three reasons. First, a decision of the Québec Superior Court is not binding on this Court. Second, the decision appears to rely heavily on the professional obligations of notaries and lawyers set out in their respective Codes of Professional Conduct, which is not applicable to the Respondent. **Third, and most importantly, there is no "professional secrecy" or privilege attaching to the requested documents and information in Ontario jurisprudence.**

[15] For these reasons, the Court finds that the documents and information the Minister required the Respondent to produce are not subject to solicitor-client privilege.

Digitized by Google

ORDER

UPON the application of the Minister of National Revenue (the "Minister"), coming for hearing on June 24, 2013, at the Federal Court, 180 Queen Street West, Suite 200, Toronto, Ontario M5V 3L6;

AND UPON reviewing the materials filed by the parties and upon hearing the submissions of the parties;

AND UPON BEING SATISFIED THAT:

1. By requirement dated November 1, 2010 (and also bearing the date October 22, 2010), the Minister required Mr. Jakabfy, barrister and solicitor, pursuant to subsection 231.2(1) of the *Income Tax Act*, to provide information and documents relating to Mr. Donald Lavallee and Ms. Nicole Lavallee's sale of real property in August 2003 to third party purchasers. The respondent acted as counsel for the Lavallees on the sale of the property.
2. Mr. Lavallee is indebted under the *Income Tax Act* with respect to his 2001 to 2003 taxation years; as at September 1, 2011, Mr. Lavallee owed the amount of approximately $62,734.00. Mr. Lavallee also owes a GST debt under the *Excise Tax Act* with relating to the January 1, 2001 to December 31, 2003 reporting periods; as at April 10, 2013, Mr. Lavallee owed in the amount of approximately $59,838.00.
3. The Minister requires the information and documents sought from the Respondent for purposes related to the administration and enforcement of the *Income Tax Act*. More specifically, the purpose is to determine how Mr. Lavallee distributed his share of the proceeds from the sale of the real property, in particular, to determine whether Mr. Lavallee has any assets that the Canada Revenue Agency may take action against to collect upon to satisfy Mr. Lavallee's outstanding income tax debt (and GST debt) and to determine if Mr. Lavallee transferred any or all of his share of the proceeds received from the sale of the property to an non-arm's person such that an assessment may be raised against the transferee(s) pursuant to section 160 of the *Income Tax Act* (and/or section 325 of the *Excise Tax Act)* and whether the transferee(s) have any assets or other sources of income that the Canada Revenue Agency can collect against.
4. To date, Mr. Jakabfy has not provided the information and documents required by the Minister;
5. The Minister does not seek information or documents that are protected by solicitor-client privilege within the meaning of subsection 232(1) of the *Income Tax Act* (or subsection 293(2) of the *Excise Tax Act*).

THIS COURT ORDERS that Mr. Jakabfy shall, within three weeks after being served with a copy of this Order, provide the information and documents required in the requirement dated November 01, 2010 (and also dated October 22, 2010) which is attached as Appendix "A" to this Order, to Ms. Carole Cameron of the Canada Revenue Agency, Sudbury Tax Services Office, 1050 Notre Dame Avenue, Sudbury, Ontario, P3A 5C1, or another officer who may be identified by the Applicant for that purpose.

AND THIS COURT FURTHER ORDERS that the Minister is authorized to effect service of this Order on Mr. Jakabfy by personal service under Rule 128 of the *Federal Courts Rules*.

AND THIS COURT FURTHER ORDERS that no costs are ordered on this application.

"Russel W. Zinn"
Judge

Digitized by Google

MNR v. Singh Lyn Ragonetti Bindal, 2005 FC 1538, A Clear Instance of Lawyer's Financial Records Not Being Subject to SCP

REASONS FOR ORDER AND ORDER

[1] This is an application for a compliance order under section 231.7 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) as amended (the "*Act*"), regarding a requirement for documents and information issued by the Minister of National Revenue (the "Minister") to the respondents on February 18, 2004 pursuant to section 231.2 of the Act (the "Requirement"). The respondents are a firm of barristers and solicitors practising in Calgary, Alberta. The issue in these proceedings is whether the records sought by the applicant are protected by solicitor-client privilege.

[2] The Minister's department, Canada Customs Revenue Agency ("CCRA") commenced an audit of 173 individual Registered Retirement Savings Plan ("RRSP") annuitants respecting transactions in 2001 and 2002. Funds totalling $8, 425, 330 were allegedly paid to the respondents, in trust, by trust companies administering the annuitants self-directed RRSP's. The funds are alleged to have been used to subscribe for common shares of a corporation called Asset Trax Inc., ("ATI"). Some of the shares were issued to the RRSP trusts indirectly through a Costa Rica based corporation called Transportes Castlewood S.A. ("Transportes").

[3] CCRA suspects that the RRSP annuitants were participating in a scheme designed to extract funds from their RRSPs without payment of income tax. It is alleged that ATI received $1.00 per share from the $10.00 per share paid into the respondents' trust account. **CCRA wishes to audit the respondents' accounting records to determine who received the $9.00 per share balance allegedly disbursed from the respondent's trust account. Accordingly, CCRA requested documents and information related to ATI share purchases from the respondents, which requests were refused on the ground that the information was subject to solicitor-client privilege.**

[4] On February 18, 2004, CCRA served a notice (the "requirement") in accordance with subsection 231.2(1) requiring the respondents' trust account records pertaining to transfers from nine trust companies for ATI share purchases.

[5] Subsequent to service of the requirement, an order was issued under the *Legal Profession Act* of Alberta by the Court of Queen's Bench appointing a Custodian for the practice of Mr. Manesh Bindal, a member of the respondent law firm during the material times. Counsel acting on behalf of the Custodian represented the respondents in these proceedings, effectively as a surrogate for the Law Society.

[6] The Custodian stands in the same place as Mr. Bindal with respect to any solicitor-client relationship he may have had at the relevant times and maintains the position that the information sought by the applicant is privileged. The respondents contend that Transportes and all 173 of the annuitants should be given notice of the application for a compliance order to allow them to assert their claim to privilege.

[7] An affidavit from Mr. Bindal was tendered in evidence on this application by the respondents and he was cross-examined on that affidavit.

[8] In his affidavit, Mr. Bindal states that in January 2001 he entered into a retainer arrangement with Transportes under which certain sums of money were deposited into and paid out of his trust account. In the course of his retainer, cheques were sent to him by trust companies, by Transportes or directly by investors for the purchase of shares in various companies. The cheques were usually designated "In Trust" for a particular investor.

[9] On cross-examination, Mr. Bindal stated that his arrangement with Transportes was very limited. No client was specified for the purchase and sale of shares. He would simply act on behalf of Transportes to deal with the funds that came into his trust account and which would

Digitized by Google

be released at the direction of Transportes. There were no specific trust conditions attached to these funds and he was not retained specifically in connection with the ATI share sale that is the subject matter of the requirement.

[10] The respondents submit that Bindal had a solicitor-client relationship with Transportes. While Transportes was undoubtedly a client of the law firm, there is nothing on the record before me to suggest that this relationship in any way entailed communications for the purpose of obtaining or providing legal advice. This was a straight commercial relationship using the law firm's trust accounts to receive and transfer funds.

[11] Further, the respondents submit that Mr. Bindal owed a duty of care to the investors to safeguard their investments giving rise to a reasonable inference that they were also "clients" entitled to assert privilege over their communications with the law firm. In support of the second proposition, respondents rely upon an excerpt from a text on Lawyers' Professional Liability, by Grant and Rothstein (Butterworths, 1998) which, at pages 89-90, addresses solicitors' liability to third parties. The learned authors cite *Yang v. Overseas Investments (1986) Ltd.*, [1995] 4 W.W.R. 231 and Texas *Industries Ltd.v. Siewert (1996)*, 194 A.R. 303 (Q.B.) as providing examples of circumstances in which a duty of care to third parties by lawyers may arise. [12] It may well be that the respondents owed a duty of care to the RRSP annuitants to safeguard their investments but that does not, in my view, establish a solicitor-client relationship between the respondents and the investors or dispose of this matter. Indeed, the cases cited by Grant and Rothstein are notable for concluding that a duty of care may arise notwithstanding the absence of any direct client relationship with the solicitor and do not directly address the question at issue.

[13] Counsel for the respondent candidly admits that he could find no authority which expressly states that a solicitor-client relationship may arise with respect to third parties but points to the broad principles set out by the Supreme Court of Canada in *Lavallee, Rackel & Heintz v. Canada (Attorney General); White, Ottenheimer & Baker v. Canada (Attorney General); R.v. Fink,* [2002] 3 S.C.R. 209 for determining questions of privilege in relation to the search for and seizure of records from lawyers' offices.

[14] The *Lavallee* principles, among other things, require that every effort should be made to contact potential clients and to give them a reasonable opportunity to assert a claim of privilege and, if contested, to have the issue judicially determined. Where notification of potential privilege holders is not possible, the lawyer who had custody of the documents seized or another lawyer appointed either by the Law Society or by the Court, should examine the documents to determine whether a claim of privilege should be asserted.

[15] **I note that the trust account records in question here are currently in the possession of counsel for the respondents. In July 2005, respondents' counsel wrote to Transportes and to several of the trust companies that acted on behalf of the RRSP annuitants to inform them of the application before the court. There appears to have been no application to intervene in these proceedings. That, of course, would not be determinative of whether privilege attaches to the records but indicates, nonetheless, that some effort was expended to notify the "potential" clients, albeit by the respondents and not by the state.**

[16] The applicant's position is that while the accounting records may be confidential records of the respondents' law practice, they are not privileged at common law or under subsection 232(1) of the Act. Subsection 232(1) excludes accounting records from the scope of oral or documentary communications protected by solicitor-client privilege. The respondent suggests, without formally **challenging the provision, that subsection 232(1) is constitutionally suspect in light of *Lavallee*, above, and the subsequent decision by the Supreme Court in *Maranda v. Richer*, 2003 SCC 67.**

[17] Among other decisions, the applicant relies upon *Re Ontario Securities Commission*

Digitized by Google

and Greymac Credit Corp., Re OntarioSecurities Commission and Prousky (1983), 146 D.L.R. (3d) 73 (Ont. Div. Ct.); *Stevens v. Canada (Prime Minister)*, [1998] 4 F.C. 89 (F.C.A.) and *R. v. Serfaty*, [2004] O.J. No. 1952 (Sup. Ct.) (QL).

[18] *Greymac*, above, has long stood for the proposition that solicitor-client privilege does not extend to records of financial transactions directed through solicitor's trust accounts as such records are evidence of an act or transaction rather than communications. Hence, oral evidence regarding such matters and the solicitor's books of account and other records pertaining thereto, with advice and communications relating to advice expunged, are not privileged and the solicitor may be compelled to answer questions and produce the material.

[19] **Contrary to the respondents' submission, in my view *Greymac* remains good law notwithstanding *Lavallee* and *Maranda*. In *Maranda*, Justice LeBel, for the majority (Justice Deschamps concurring in the result) held that the substantive rule of privilege cannot rely on the distinction between facts and communication and thus, in that case, defence counsel's fee records were protected. However, he expressly noted, at paragraph 30, that not everything that happens in the solicitor-client relationship falls within the scope of privilege "as has been held in cases where it was found that counsel was not acting in that capacity but simply as a conduit for transfers of funds" citing *Greymac* as authority.**

[20] In *Kilbreath v. Saskatchewan (Attorney General)*, [2004] S.J. No. 770, 2004 SKQB 489, Wilkinson J., reviewing the cases prior to and after *Lavallee* and *Maranda* respecting the scope of the privilege for records in the possession of lawyers summarized the cases in which the privilege was found not to attach, as follows at paragraph 16:

Thus, as examples that are by no means exhaustive, the solicitor-client privilege does not attach to documents unrelated to the giving of proper advice, but stored with the solicitor to avoid seizure. (R. v. Colvin, Ex parte Merrick, [1970] 3 O.R. 612 (Ont. H.C.J.)). The privilege does not apply to documents merely held by the lawyer, including accounting records and trust reconciliations, conveyancing documents and documents relating to the sale of property where no advice was sought or given in respect of them: Kranz, supra. It does not apply to actual currency, which does not communicate any information other than the value of the individual bill: R. v. Law Office of Simon Rosenfield, [2003] O.J. No. 5821 (S.C.J.). It does not apply to deposits of funds into a lawyer's trust account unrelated to the giving or receiving of advice, but merely to protect the funds from seizure: R. v. Serfaty, [2004] O.J. No. 1952 (S.C.J.). It does not apply where the connection between the parties is more in the nature of a business or commercial relationship, or where the disclosure sought is of actions taken, rather than communications passing between solicitor and client, or where the communications are in furtherance of criminal or fraudulent activity. It does not apply to documents if the client possessing the privilege exercises the right to waive the privilege either expressly, or implicitly in a manner acceptable to the court: Rosenfeld, supra, and R. v. Serfaty, supra.

[21] **In this case, there is no evidence in the record before me that the respondents were retained to provide legal advice to Transportes, or to any of the 173 individual annuitants on behalf of whom the trust companies forwarded funds to the respondents for the purchase of shares. At best, the respondents were merely "conduits for the transfer of funds" as described by LeBel J., in *Maranda* and there is no basis in the evidence to conclude that the records will disclose any privileged communication.**

[22] At the conclusion of the hearing and after I had indicated the outcome of the application, counsel for the respondents' questioned whether the scope of my order should extend to the last item in the list of requirements sought in the February, 18, 2004 notice, that is: "[c]ontracts between Singh Walters Bindal and their client/s that determined the handling

Digitized by Google

of any money/funds on behalf of any person, as defined by subsection 248(1) of the Income Tax Act..." Counsel submitted that this last requirement may be outside the scope of the non-privileged trust account records pertaining to funds transfers.

[23] Mr. Bindal's evidence was that he had a retainer solely with Transportes. As I have concluded that was simply a commercial arrangement for funds transfers, I see no reason why any contracts setting out the terms of that arrangement should not be disclosed, so long as they contain no privileged communications or facts. Counsel for the respondents should review any contracts in the records before they are released to the applicant and may seek direction from the Court if there are any communications or statements believed to be privileged.

[24] The applicant seeks costs in the amount of $1000.00. As the application arose over a question of privilege, I will exercise my discretion not to award costs to the successful party.

ORDER

THIS COURT ORDERS that the Respondents shall comply with the Requirement to Provide Documents and Information attached as Exhibit "D" to the September 9, 2004 affidavit of Margaret Nieboer, within 15 days of the date of this order. No costs are awarded.

"Richard Mosley"

JUDGE

Calgary, Alberta November 15, 2005

Procedure to Handle Solicitor-client Assertions

In MNR v. S. Bruce Cornfield et al.[103] the Federal Ct. opined that the procedure to attend to s. 231.7 (RFI) requests that caused solicitor-client to arise was:

REASONS FOR ORDER

SNIDER J.

[1] The Minister of National Revenue (the Minister) is asking this Court to issue an Order (Compliance Order), under section 289.1 of the *Excise Tax Act*, R.S.C, 1985, c. E-15, that would require the Respondent, Mr. S. Bruce Cornfield, to provide certain documents and information to the Minister.

I. Background

[2] Mr. Cornfield is a lawyer and a member of the Law Society of British Columbia. His client, Child Construction Ltd. (CCL), is indebted to Her Majesty the Queen in Right of Canada for GST in the amount of $53,382.29 as of September 15, 2006.

[3] In July 2003, Mr. Cornfield handled the conveyance involving a transfer of property by CCL to a third party.

[4] By letter served on January 6, 2006, the Minister issued a requirement for information (RFI) pursuant to subsection 289(1) of the *Excise Tax Act*, requiring Mr. Cornfield to provide the following information and documents to the Minister (the Information and Documents) within 30 days of the date of service of the RFI:

(a) A statement of adjustments with respect to the sale of the property described as Parcel Identifier 023014806, Strata Lot 105, Section 9, Victoria District, Strata Plan VIS3305, by CCL to Sarah Harper and Richard Allan Stensrud, on July 30, 2003.

(b) A copy of the direction to pay with respect to the property transaction identified in paragraph (a) above.

(c) Copies, front and back, of the cancelled cheques in regards to the

[103] 2007 FC 436

Digitized by Google

distribution of monies with respect to the property transaction identified in paragraph (a) above.

[5] Mr. Cornfield has refused to provide the Minister with the Information and Documents sought by the RFI within 30 days. In a letter to the Vancouver Island Tax Services Office of the Canada Revenue Agency (CRA), dated January 23, 2006, Mr. Cornfield explained his reasons for not providing the Information and Documents:

> **I have been unable to locate my client . . . Absent instructions to the contrary from the client, I must take the position that the requested information may be subject to a solicitor-client privilege. . . . I draw your attention to the *Professional Conduct Handbook* for B.C. Lawyers that states:**
>
> > **a lawyer who is required under the *Criminal Code*, the *Income Tax Act*, or any other federal or provincial legislation, to produce or surrender a document or provide information which is or may be privileged shall, unless the client waives the privilege, claim a solicitor-client privilege in respect to the document.**
>
> **Given the above, what you are asking me to do is something that is contrary to my governing society's code of conduct, and compliance may even result in disciplinary action against me.**

[6] Upon application, the Law Society of British Columbia (the Law Society) was granted intervener status in this Application by Order of Justice Gauthier dated December 20, 2006. In her Order, Justice Gauthier described the right of the intervener to:

> make representations in writing and orally in respect of all issues concerning solicitor-client privilege raised in this application including the procedures which a Court should follow in considering an order for production of documents in the possession of a lawyer and the protection of solicitor-client privilege in the face of a demand for production of documents by the applicant.

[7] Written and oral submissions were made by the Minister and the Law Society.

Digitized by Google

II. Issues

[8] The overarching issue in this application is whether the Compliance Order should issue to require Mr. Cornfield to produce the Information and Documents. To respond, two questions must be addressed:

2. **Are the Information and Documents, in this case, subject to solicitor-client privilege?**
3. **Does s. 289.1 of the *Excise Tax Act* provide adequate protection to the rights of the lawyer's client (or former client) to claim solicitor-client privilege? And, if not, should the Federal Court consider adding certain procedural safeguards such as a requirement to serve notice on the client?**

[9] As I understand the submissions of the Intervenor, they are not seeking to require the suggested procedures be applied to this particular case. Thus, if I determine that the Information and Documents are not subject to solicitor-client privilege and that the other requirements of s. 289.1 have been met, the Compliance Order will issue.

III. Analysis

A. *What is the relevant statutory framework?*

[10] In brief, the relevant provisions of the *Excise Tax Act* operate in the following manner. The full text of these provisions is set out in Appendix A to these reasons. Almost identical provisions are contained in the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.).

[11] The Minister is authorized, pursuant to s. 289(1) of the *Excise Tax Act*, to require a person to provide any requested information or documents, upon notice. It is important to note that the Minister's authority is not restricted to the taxpayer. Third parties may be served with requests for information. The only stipulation is that the purpose be "related to the administration or enforcement of this Part, including the collection of any amount payable or remittable under this Part".

[12] Where a request for information is made and the person has failed to comply, s. 289.1 provides the Minister with a means to enforce compliance with s. 289. Specifically, s. 289.1(1) allows the Minister to seek, by way of "summary application", a court order requiring the person to provide the information or document sought under s. 289. To issue the order – commonly referred to as a Compliance Order – the judge must be satisfied that: (a) the person was required under s. 288 or s. 289 to provide the information; and (b) "in the case of information or a document, the information or document is not protected from disclosure by solicitor-client privilege (within the meaning of subsection 293(1))".

[13] **The definition of solicitor-client privilege, in s. 293(1) of the *Excise Tax Act*, is as follows:**

"solicitor-client privilege" means the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional	**«privilège des communications entre client et avocat » Droit qu'une personne peut posséder, devant une cour supérieure de la province où l'affaire prend naissance, de refuser de divulguer une communication entre elle et son avocat en confidence professionnelle. Toutefois,**

Digitized by Google

confidence, except that, for the purposes of this section, an accounting record of a lawyer, including any supporting invoice, voucher or cheque, shall be deemed not to be such a communication.	**pour l'application du présent article, le relevé comptable d'un avocat, y compris une facture ou une pièce justificative ou tout chèque, ne doit pas être considéré comme une communication de cette nature.**

[14] Under s. 289.1(2), the person must be given notice of the application at least five clear days before it is heard. Subsection 289.1(3) gives the judge hearing the application the discretion to impose such conditions on the order as the judge considers appropriate.

B. *What has been the practice of the Federal Court in these matters?*

[15] The *Excise Tax Act* and the *Income Tax Act* contain an explicit procedure for bringing compliance order applications. As noted above, s. 289.1 (1) of the *Excise Tax Act* provides that the compliance order is to be obtained "on summary application by the Minister". The same requirement for a "summary application" is set out in s. 231.7 of the *Income Tax Act*. In that context, Prothonotary Lafrenière of this Court provided a format for bringing such applications in *Minister of National Revenue v. Norris*, 2002 CarswellNat 1250, [2002] 3 C.T.C. 346. In *Norris*, the Prothonotary authorized the Minister of National Revenue to institute proceedings under s. 231.7 of the *Income Tax Act* by way of motion under Rule 358 *et seq.* of the *Federal Courts Rules,* SOR/98-106 (the Rules), rather than by way of application under Rule 300 *et seq.* of the Rules. As stated by Prothonotary Lafrenière in *Norris*, above, at paras. 5-7:

> **Although a proceeding under subsection 231.7 of the *Income Tax Act* must be brought by way of notice of application, the procedure set out in the *Federal Court Rules, 1998* which governs applications appears ill-suited for summary disposition of such matters. Consequently, in this particular case and subject to any further directions or order of the Court, the following procedure should be followed in the proposed proceeding under subsection 231.7.**
>
> The Applicant shall file a Notice of Application in Form 301, to be treated by the Registry as both an originating document and notice of motion, which shall:
>
> (a) set out the day, time and place at which the application will be heard, either at a General Sittings of the Court or such special sitting date as may have been appointed by the Judicial Administrator upon informal request by the Applicant:
>
> (b) be amended by deleting any references to Rule 300 et seq.;
>
> (c) contain a notice in capital and bold characters which reads as follows: "The Respondent who wishes to oppose the application shall serve a Respondent's Record and file three copies of it not later than 2:00 p.m. on the last business day before the hearing of the application."; and
>
> (d) be accompanied by the appropriate filing fee.
>
> Once the Notice of Application has been filed, the Applicant shall personally serve the Respondent with an Application Record

Digitized by Google

> containing a table of contents, the notice of application, each supporting affidavit and documentary exhibit and the Applicant's memorandum of fact and law. The Applicant shall file three copies of the Application Record, and proof of service thereof in accordance with ss. 237.1 of the *Income Tax Act*, forthwith and in any event no later than two clear days before the return date of the hearing of the application.

[16] Although one may argue that the Order was limited to the particular case before the Prothonotary, the procedure that he outlined has been followed, for compliance orders under both the *Income Tax Act* and the *Excise Tax Act*, since 2002.

[17] Consistent with the direction provided by Prothonotary Lafrenière and with the notice provisions set out in s. 289.1(2) of the *Excise Tax Act*, the Minister's practice is to serve notice on "the person against whom the order is sought". Thus, the Minister, following s. 289.1(2) of the *Excise Tax Act* and the direction of Prothonotary Lafrenière, has not followed Rule 303 of the Rules and named, as a Respondent, the affected taxpayer as a "person directly affected by the order sought in the application".

C. *Are the Information and Documents sought in this case subject to solicitor-client privilege?*

[18] I turn now to the first issue before me. Specifically, should a Compliance Order be issued? Resolution of this issue requires that I first determine whether the Information and Documents, in this case, are subject to solicitor-client privilege.

[19] In recent decisions, the Courts have consistently affirmed that, in the context of a real estate transaction, cheques from a solicitor's account and a statement of adjustments are not subject to solicitor-client privilege (*In the Matter of the Legal Profession Act and Martin K. Wirick*, 2005 BCSC 1821, 51 B.C.L.R. (4th) 193, [2005] B.C.J. No. 2878 (B.C. Sup. Ct.) (QL); *Minister of National Revenue v. Vlug*, 2006 FC 86, 2006 D.T.C. 6285, [2006] F.C.J. No. 142 (F.C.) (QL); *Canada (Minister of National Revenue) v. Reddy*, 2006 FC 277, 146 A.C.W.S. (3d) 568, [2006] F.C.J. No. 348 (F.C.) (QL); *Canada (Minister of National Revenue) v. Singh Lyn Ragonetti Bindal LLP*, 2005 FC 1538, [2006] 1 C.T.C. 113, [2005] F.C.J. No. 1907 (F.C.) (QL)). More specifically, the Federal Court in *Singh Lyn Ragonetti Bindal LLP*, *Vlug* and *Reddy* held that such documents and information requested under the *Excise Tax Act* or the parallel provisions of the *Income Tax Act* are not subject to solicitor-client privilege.

[20] Given this clear authority, there is no question that the Information and Documents requested in the RFI are not the subject of solicitor-client privilege.

D. *Should the procedures currently used by the Court be amended?*

[21] The Law Society has intervened in this application with a concern that they describe as the "greater good". They assert that, once a lawyer is served with an RFI, the lawyer is in an immediate conflict between their duty to their client vis-à-vis privilege and the duty to comply with the statute. At a minimum, the Law Society requests that this Court direct the Minister to take the following steps in all such compliance order applications:

2. **Name the taxpayer as a Respondent to the application pursuant to Rule 303 of the Rules, thereby giving the taxpayer immediate rights to assert any claims of privilege; and**
3. **Require the sealing of the documents and their submission to the Court.**

[22] While acknowledging (I think) that the Information and Documents in this case are not subject to solicitor-client privilege, the Law Society argues that there may be circumstances where this type of document or information held by a lawyer may be privileged. The Law Society submits that the lawyer's client is the only party who can

Digitized by Google

waive that privilege. They refer the Court to certain provisions of Chapter 5 of the *Professional Conduct Handbook* of the Law Society dealing with "Confidential Information". In particular, paragraphs 13 and 14 are entitled "Disclosure required by law" and provide as follows:

> **13. A lawyer who is required by law or by order of a court to disclose a client's affairs shall not divulge more information than is necessary.**
>
> **14. A lawyer who is required under the Criminal Code, the Income Tax Act or any other federal or provincial legislation, to produce or surrender a document or provide information which is or may be privileged shall, unless the client waives the privilege, claim a solicitor-client privilege in respect of the document.**

[23] In general, I would not presume to interpret the rules of the Law Society. However, in this case, two of these rules have been raised as a reason for changing the practice of the Federal Court. Accordingly, I feel that I should respond to the arguments before me. And, in my view, there are a number of problems with those arguments.

[24] In the face of consistent and clear direction from this and other courts that documents in the nature of those described in the RFI are not subject to solicitor-client privilege, it is difficult to see how paragraph 14 of Chapter 5 of the *Professional Conduct Handbook* of the Law Society can have any applicability. Paragraph 14 applies only where the document or information "is or may be privileged". If the Information and Documents do not satisfy that test, paragraph 14 is not engaged.

[25] Since the Information and Documents under discussion in this application – and, more generally, as provided for in the *Excise Tax Act* and the *Income Tax Act* – are not privileged, there is nothing for the client to waive. The provisions of the *Excise Tax Act* and the *Income Tax Act* are very clear. Upon a request, the lawyer must provide the requested information, unless it is subject to solicitor-client privilege. Whether one uses the definition in the statutes or a common law definition of solicitor-client privilege, the law has established that accounting records, including any supporting invoice, voucher or cheque, are not protected by solicitor-client privilege.

[26] Further, the position of the Law Society fails to take into account the difference between confidential and privileged documents. As acknowledged by counsel for the Law Society, privileged documents form a subset of documents that are "confidential". All documents in the possession of a lawyer may be described as confidential but only those that satisfy the test for a claim of solicitor-client privilege may be withheld pursuant to the provisions of the *Excise Tax Act* and the *Income Tax Act*. If paragraph 14 of Chapter 5 of the *Professional Conduct Handbook* is to apply to documents which, in the opinion of the courts, are not subject to privilege, then lawyers would be obliged to obtain the waiver from the client of all documents held by the lawyer for a client. This ignores the intent of paragraphs 13 and 14 which, on my reading, permit the disclosure of non-privileged information where a lawyer is required by law to produce or surrender a document or provide information.

[27] The Law Society argues that only the client – and not the lawyer – has the right to decide whether a document may be privileged and whether to claim that privilege. While this is no doubt correct, it appears to me that, where the law is clear that certain information is not privileged, such a right simply does not arise.

[28] The Law Society raises the problem that sometimes these types of documents may contain notations or other information that may be privileged. This is not the case with the Information and Documents that are the subject of this

Digitized by Google

application; the Law Society does not assert that the documents at issue in this application are annotated. Further, this situation has never arisen to the knowledge of the parties to this application. However, I acknowledge that this situation could arise in a future case. The simple response to this concern is that a financial or accounting record that contains privileged information in the form of a notation is not a document that satisfies the definition of non-privileged information or documents. A Compliance Order may only be issued if the information or document is not protected from disclosure by solicitor-client privilege, either pursuant to s. 289.1 of the *Excise Tax Act* or under principles of common law. If such circumstances were to arise, the statute and the Federal Court procedures for obtaining a Compliance Order would, in my view, suffice to provide the important protection for privileged documents and information.

[29] I also note that the judge hearing the application for a Compliance Order may impose any conditions in respect of the order that the judge considers appropriate (*Excise Tax Act*, s. 289.1(3)). Further service requirements could be imposed. Since the submissions of the Law Society are based on hypothetical situations, it is impossible to address every possible scenario.

[30] Lastly, I turn to the Law Society's submission that the Minister should be required to follow Rule 303(1) and name the taxpayer as a Respondent. In their view, the taxpayer is a "person directly affected by the order sought in the application". The problem with this argument is, first, that the Court, in *Norris*, above, expressly determined that this Rule would not apply. Second, and more importantly, the summary application procedure set out in the *Excise Tax Act* requires service only on the party from whom the information is sought.

[31] In sum, I am not persuaded that the evidentiary record in this case establishes a need for further procedural steps for the protection of solicitor-client privilege. More generally, there is no evidence that the current procedure has resulted in a breach of the fundamental legal rights of solicitor-client privilege. There is no need, at this time, to add a requirement to serve the taxpayer or to provide a sealed copy of the documents to the Court, unless such procedures are warranted on the facts of a particular application.

IV. Conclusion

[32] In conclusion, I am satisfied that:

(a) the Respondent was served with the RFI as required under s. 289(1) of the *Excise Tax Act*;

(b) the Respondent did not provide the Information and Documents sought by the Minister; and

(c) the Information and Documents are not protected from disclosure by solicitor-client privilege.

[33] Accordingly, the Compliance Order will issue. Further, the Court will provide no direction on the procedure for making application for Compliance Orders and affirms the procedure set out in the *Excise Tax Act* and in *Norris*, above.

[34] Since the Minister did not seek costs, no costs will be awarded.

"Judith A. Snider"
Judge[104]

---

[104] In Lavallee, Rackel & Heintz v. Canada (Attorney General); White, Ottenheimer & Baker v. Canada (Attorney General); R. v. Fink, 2002 SCC 61, [2002] 3 S.C.R. 209, the SCC provided opinion in handling searches of law firms and attending to protecting solicitor-client privilege with:

The following guidelines reflect present-day constitutional imperatives for the protection of solicitor-client privilege and apply to law office searches until new legislation is in place.

A search warrant should not issue for documents known to be protected by solicitor-client privilege.

Digitized by Google

Duncan Thompson v. The Minister Of National Revenue, 2013 FCA 197, SCP of a Lawyer Subject to Enforcement Action

Heard at Calgary, Alberta, on June 12, 2013.
Judgment delivered at Ottawa, Ontario, on August 29, 2013.
REASONS FOR JUDGMENT BY: TRUDEL J.A.
CONCURRED IN BY: PELLETIER J.A.
MAINVILLE J.A.

As well, they should not issue if other reasonable alternatives to the law office search exist.
The issuing justice must be rigorously demanding with respect to solicitor-client privilege.
Unless otherwise authorized by the warrant, all documents in a lawyer's possession must be sealed before being examined or seized.
Every effort must be made to contact the lawyer and the client when the search warrant is executed and, where the lawyer or the client cannot be contacted, a representative of the Bar should oversee the sealing and seizure of documents.
The investigating officer executing the warrant should report the efforts made to contact all potential privilege holders to the justice of the peace. These privilege holders should then be given a reasonable opportunity to assert a claim of privilege and, if that claim is contested, to have the issue judicially decided.
If notification of potential privilege holders is not possible, the lawyer who had custody of the documents seized, or another lawyer appointed either by the Law Society or by the court, should examine the documents to determine whether a claim of privilege should be asserted, and should be given a reasonable opportunity to do so.
The Attorney General may make submissions on the issue of privilege but should not be permitted to inspect the documents beforehand, and the prosecuting authority can only inspect the documents if and when it is determined by a judge that the documents are not privileged.
Where sealed documents are found not to be privileged, they may be used in the normal course of the investigation.
Where documents are found to be privileged, they are to be returned immediately to the holder of the privilege, or to a person designated by the court.

Digitized by Google

Date: 20130829
Docket: A-515-12
Citation: 2013 FCA 197
CORAM: PELLETIER J.A.
TRUDEL J.A.
MAINVILLE J.A.
BETWEEN:
DUNCAN THOMPSON
Appellant
and
THE MINISTER OF NATIONAL REVENUE
Respondent
REASONS FOR JUDGMENT
TRUDEL J.A.

Introduction

[1] This appeal calls upon this Court to consider the solicitor-client privilege (or privilege) asserted by a lawyer who is the subject of enforcement proceedings pursuant to the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act).

[2] Mr. Thompson (or the appellant) has raised the shield of solicitor-client privilege to protect basic information regarding his accounts receivable, arguing that his clients' names and amounts owing are protected and out of the Minister of National Revenue's reach (Minister or respondent).

Background and Context

[3] More specifically, this appeal is from an Order of the Federal Court (T-1180-12) wherein Russell J. (the Judge) allowed the application of the Minister for a compliance order under subsection 231.7(1) of the Act.

[4] The Judge found that the appellant did not comply with the Requirement for Information (Requirement) provided to him by the respondent pursuant to subsection 231.2(1) of the Act, which states:

231.2 (1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act (including the collection of any amount payable under this Act by any person), of a comprehensive tax information exchange agreement between Canada and another country or jurisdiction that is in force and has effect or, for greater certainty, of a tax treaty with another country, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as stipulated in the notice,	231.2 (1) Malgré les autres dispositions de la présente loi, le ministre peut, sous réserve du paragraphe (2) et pour l'application ou l'exécution de la présente loi (y compris la perception d'un montant payable par une personne en vertu de la présente loi), d'un accord général d'échange de renseignements fiscaux entre le Canada et un autre pays ou territoire qui est en vigueur et s'applique ou d'un traité fiscal conclu avec un autre pays, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne, dans le délai raisonnable que précise l'avis :

Digitized by Google

(*a*) any information or additional information, including a return of income or a supplementary return; or	*a*) qu'elle fournisse tout renseignement ou tout renseignement supplémentaire, y compris une déclaration de revenu ou une déclaration supplémentaire;
(*b*) any document.	*b*) qu'elle produise des documents.

[5] As a result, the Judge ordered that "the respondent shall comply with the Requirement issued by the Minister and shall forthwith, and in any event not later than 30 days after being served with this Order, provide the information and documents [sought]" (Speaking Order, appeal book, volume 1, page 30 at paragraph 1). Hence the within appeal by Mr. Thompson, which I propose to allow in part, but for completely different reasons than those advanced by the appellant.

[6] Although I generally agree with the legal statements made by the Judge in his Speaking Order, I am of the view that the appellant's objections called for an intervention by the Federal Court to ensure that the question of privilege over individual client names was addressed before the release of the clients' accounts receivable information was ordered.

[7] The information and documents sought by the Canada Revenue Agency (CRA) consist of:

> 1. A completed statement of your income and expenses, and assets and liabilities as of January 30, 2012 (form enclosed). The income and expense, and asset and liability statement includes any sole or joint income, expense, asset, or liability.
> 2. A current accounts receivable listing as of January 30, 2012.
> 3. Copies of all your bank statements, credit card statements, utility bill statements, gas and electric bill statements, loans statements and mortgage statements for sole and joint accounts for the period January 1, 2011 to December 31, 2011.
>
> (affidavit of Maria Van Dyk, collection officer with the Canada Revenue Agency, Exhibit A, Requirement date February 6, 2012, appeal book, volume 1, page 41).

[8] Mr. Thompson responded to the Requirement giving his explanation under six headings: Income; Expenses (personal and business); Assets as of January 30, 2012; Liabilities (excluding Canada Revenue Agency); Accounts Receivable Listing; and Statements (*ibidem*, Exhibit C, page 47).

[9] Following a review of the appellant's information, the CRA found that he had provided sufficient information only with regard to his income and business expenses. The CRA noted that no details were provided regarding his accounts receivable other than a total balance owing.

[10] Despite his failure to follow through with the Requirement under most headings, Mr. Thompson, both in this Court and below, has made solicitor-client privilege the focus of his objection to the Requirement. Amongst other arguments, he has raised section 8 of the *Canadian Charter of Rights and Freedoms*, Part 1 of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c. 11 (Charter) alleging that the Requirement is akin to an unreasonable search or seizure. He has also filed a Notice of Constitutional Question pursuant to section 57 of the *Federal Courts Act*, R.S.C. , 1985, c. F-7:

> Can Section 231.2(1) of the *Income Tax Act* be interpreted, applied or enforced so as to require a Barrister and Solicitor who, himself, is the subject of the

Digitized by Google

proceedings or inquiry by the Applicant (and not his clients), to divulge information about unnamed clients, which information is protected by the principles of solicitor-client privilege, found in the *Legal Professions Act*, R.S.A. 2000 c. L-8, the *Rules of the Law Society of Alberta* and the *Law Society of Alberta Code of Conduct*, and in the common law applicable to the Province of Alberta thereby causing that Barrister and Solicitor to violate his *Code of Conduct*, breach those Rules and contravene the Act, rendering him liable for serious penal and civil consequences? (appeal book, volume 2, page 521).

Standard of Review

[11] Even before discussing the Judge's Speaking Order and the parties' position, it is useful to state the applicable standard of review.

[12] The standard of correctness applies to questions of law, while the standard of palpable and overriding error applies to questions of fact and mixed fact and law: *Canada (National Revenue) v. RBC Life Insurance Company*, 2013 FCA 50 at paragraph 11. The interpretation of the Act and the legal approach to solicitor-client privilege are questions of law. They attract no deference. Most issues in this appeal are questions of law.

[13] With this said, I can immediately dispose of one of the ten grounds of appeal raised by the appellant in his memorandum of fact and law at paragraph 66 and following (ground of appeal E) :

> The Learned Justice erred in law by concluding under Section 231.7(1)*(a)* of the *Income Tax Act* that the Appellant had failed to provide all the information and documents sought by the Minister in the specific Requirement issued February 6, 2012, and improperly allowed the Minister to amend, change, amplify or expand the Requirement by ordering the Appellant to "provide additional information and documents sought by the Minister as set forth in the Affidavit of Maria Van Dyk" filed with this Application.

[14] I find that the Judge did not expand the Requirement. In his Speaking Order, the Judge states:

> My review of the evidence suggests to me that the [appellant] has not fully complied with the Minister's request and I do not think his arguments that it is not clear what the Minister wants, or that the Minister already has the information and documentation, stand up to scrutiny or are supported by the evidence. (Judge's Speaking Order, appeal book, volume 1, page 21 at paragraph 2).

[15] This is a finding of fact. The appellant has not convinced me that the Judge committed a reviewable error in concluding as he did.

[16] Neither did he convince me that it was not open to the Judge to order the appellant to provide "additional information and documents … as set out in the affidavit of Maria Van Dyk" where such information was not listed in the Requirement (*ibidem*, page 29 at paragraph 2).

[17] As I read this affidavit, it appears to me that the Minister is simply seeking <u>full disclosure</u> of the information and documents sought in the Requirement. The "additional" information and documents are, in reality, the documents related to the three categories of information and documents described in the Requirement (see paragraph [7] of these reasons), which the appellant has failed to provide in his response to the Requirement.

[18] The failure of the appellant to make full disclosure as requested by the Minister is what brought the parties to court. As soon as the Judge was satisfied under subsection 231.7(1) that (a) Mr. Thompson was required under section 231.2 to provide information or documents and did not do so; and (b) the information or document was not protected from

Digitized by Google

disclosure by solicitor-client privilege within the meaning of subsection 232(1), he was entitled make the order that he did.

[19] The remaining nine grounds of appeal raised by the appellant all concern, in one way or another, the question of solicitor-client privilege. For the sake of convenience, I have regrouped them under the following three issues:

(1) Which party bore the evidentiary burden to establish that the information at issue was subject to privilege?

(2) Did the Court err in finding that the information requested by the respondent – information relating to the appellant's business accounts receivable, including the names and amounts owed by the appellant's client – consists of accounting records and is not subject to solicitor-client privilege?

(3) Did the Court err in finding that the decision does not infringe any privacy rights under section 8 of the Charter?

[20] I will return to these issues after reviewing the relevant portion of the Speaking Order under appeal, the general scope of the solicitor-client privilege and subsection 232(1) of the Act, which states:

"solicitor-client privilege" means the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional confidence, except that for the purposes of this section an accounting record of a lawyer, including any supporting voucher or cheque, shall be deemed not to be such a communication.	« privilège des communications entre client et avocat » Droit qu'une personne peut posséder, devant une cour supérieure de la province où la question a pris naissance, de refuser de divulguer une communication orale ou documentaire pour le motif que celle-ci est une communication entre elle et son avocat en confidence professionnelle sauf que, pour l'application du présent article, un relevé comptable d'un avocat, y compris toute pièces justificative out tout chèque, ne peut être considéré comme une communication de cette nature.

[21] Finally, I shall dispose of the constitutional question.

The Judge's Speaking Order

[22] The Judge expressed his conclusion in these words:

> … I have considerable sympathy for the situation [Mr. Thompson] now finds himself in whereby his clients could face garnishee proceedings if their names are disclosed, which might come as a surprise to them and will certainly not assist the [appellant] who practices law in a small town … [H]owever I do not think the law supports [his] position. The information and documents that the Minister is seeking are simply financial records of the [appellant] and, in my view, are not privileged… (*ibidem*, appeal book, volume 1, pages 21-22 at paragraphs 3 and 4).

[23] Referring to *Lavallee, Rackel & Heintz v. Canada (Attorney General); White, Ottenheimer & Baker v. Canada (Attorney General); R. v. Fink*, 2002 SCC 61, [2002] 3 S.C.R. 209 [*Lavallee*], the Judge noted that clients' names are not always privileged. He found, as a matter of fact, that Mr. Thompson had provided no evidence to show that any

Digitized by Google

particular client name should be protected and that Mr. Thompson had failed to establish that the financial records sought by the Minister constituted or contained information or documents properly protected by solicitor-client privilege.

[24] The Judge also considered the appellant's argument on section 8 of the Charter and dismissed it. Noting that Mr. Thompson conceded that section 8 protects against unjustified state intrusions on a person's reasonable expectation of privacy, the Judge observed that taxpayers have a very low expectation of privacy in their business records relevant to the determination of their tax liability, and that an expectation of privacy should not be confused with a duty of confidentiality.

[25] Furthermore, the Judge pointed out that duties of confidentiality pursuant to the regulatory directives of bodies such as the Law Society of Alberta cannot be relied on to invalidate a provision of the Act: *Canadian Western Bank v. Alberta*, 2007 SCC 22, [2007] 2 S.C.R. 3; *Law Society of British Columbia v. Mangat*, 2001 SCC 67, [2001] 3 S.C.R. 113. In any case, the Law Society of Alberta's *Code of Conduct* contains an explicit exception to the duty of confidentiality where "required by law or a court to do so": Rule 2.03(1)(*b*) Confidential Information (Judge's Speaking Order, appeal book, volume 1, page 27 at paragraph 22).

[26] Finally, relying on *R. v. McKinlay Transport Ltd.*, [1990] 1 S.C.R. 627, the Judge stated that subsection 231.2(1) of the Act provides the least intrusive means to effectively monitor compliance with the Act. For the aforementioned reasons, and in light of the circumstances, the Judge concluded that both the provision of the Act and the Requirement met the requirements of section 8 of the Charter (*ibidem* at paragraphs 25-28).

The Position of the Parties

[27] Mr. Thompson's position is straightforward. He asserts that the names, addresses, phone numbers of clients and the amount that they owe their lawyers for legal services rendered are always privileged. They cannot form part of a lawyer's accounting records within the meaning of subsection 232(1) of the Act.

[28] Bills or statements of accounts are at the very core of the relationship between solicitors and clients. They are privileged. The Minister would be interfering in that unique relationship if she was allowed to enforce her Requirement. Amongst other consequences, the appellant would no longer be in a position to diminish the amount owed by a given client or write it off completely after service of garnishment proceedings by the Minister to this client.

[29] As a result, the appellant argues that the Judge took an incorrect and restrictive approach to the meaning of solicitor-client privilege and failed to give full effect to the common law principles of solicitor-client privilege set out in *Canada (Privacy Commissioner) v. Blood Tribe Department of Health*, 2008 SCC 44, [2008] 2 S.C.R. 574.

[30] Furthermore, the appellant argues that the Judge erred in applying the definition of "solicitor-client privilege" found at subsection 232(1) of the Act, reproduced above at paragraph [20], to the facts of this case. In his view, this definition applies only to matters arising under section 232 of the Act (entitled solicitor-client privilege) and not to a consideration of whether a compliance order should issue under section 231.7 of the Act.

[31] In any event, the appellant also states that the Judge erroneously prioritized the Act over the *Legal Profession Act*, R.S.A. 2000 c. L-8, the Rules and the *Code of Conduct* of the Law Society of Alberta, which he submits take precedence over the Act as matters of property and civil rights in the province.

[32] Finally, as mentioned above, the appellant invokes section 8 of the Charter. Relying upon the case of *Baron v. Canada*, [1993] 1 S.C.R. 416, a case in which the Supreme Court of Canada found section 231.3 of the Act of no force and effect and in violation of section 8, the appellant opines that the same reasoning applies to subsection 231.2(1) of the Act. He submits that sections 231 through 232 of the Act interfere with the administration of justice in a

Digitized by Google

manner comparable with subsection 231(3). He states:

> … the Minister's attempted interference with the clients' guaranteed right and freedom regarding "solicitor-client privilege" can not [*sic*] be "demonstrably justified in a free and democratic society" as is required by Section 1 of the [Charter] and as provided in Section 8 thereof (appellant's memorandum of fact and law, page 26, Ground of Appeal "J").

[33] The respondent fully supports the Order of the Federal Court. She asserts that the Judge made no reviewable error, whether in law or in fact.

Solicitor-Client Privilege

[34] Solicitor-client privilege is one of the most revered doctrines under the common law, described by the Supreme Court of Canada as "one of the most ancient and powerful privileges known to our jurisprudence". It is generally seen as a "fundamental and substantive rule of law": *R. v. National Post*, 2010 SCC 16, [2010] 1 S.C.R. 477 at paragraph 39, quoting *R. v. McClure*, 2001 SCC 14, [2001] 1 S.C.R. 445 [*McClure*] discussed by Professor Adam Dodek in "Solicitor-Client Privilege in Canada, Challenges for the 21st Century" (Discussion Paper for the Canadian Bar Association, February 2011).

[35] In *McClure* at paragraph 35, Major J. wrote:

> … solicitor-client privilege must be as close to absolute as possible to ensure public confidence and retain relevance. As such, it will only yield in certain clearly defined circumstances, and does not involve a balancing of interests on a case-by-case basis.

[36] Court reiterated this position in *Lavallee*, adding:

> Accordingly, this Court is compelled in my view to adopt stringent norms to ensure its protection (at paragraph 36).

[37] More recently, the Supreme Court stated as follows in *R. v. Cunningham*, 2010 SCC 10, [2010] 1 S.C.R. 331 at paragraph 26, [*Cunningham*]:

> It need hardly be said that solicitor-client privilege is a fundamental tenet of our legal system. The solicitor-client relationship is integral to the administration of justice; privilege encourages the free and full disclosure by the client required to ensure effective legal representation.

[38] While the Supreme Court of Canada has adopted a firm stance on the importance of privilege, it has also consistently recognized that the claim of privilege is not absolute. As stated above, solicitor-client privilege will yield in clearly defined circumstances. Of relevance to the within appeal are the following limitations to the protection against disclosure afforded by privilege.

[39] Firstly, the privilege belongs to the client, not the lawyer: *Smith v. Jones*, [1999] 1 S.C.R. 455 at paragraph 46. It can only be asserted or waived by the client or through his or her informed consent (*Lavallee* at paragraph 39). It "serves to both protect the essential interests of clients and ensure the smooth operation of Canada's legal system…": *Foster Wheeler Power Co. v. Société intermunicipale de gestion et d'élimination des déchets (SIGED) inc.*, 2004 SCC 18, [2004] 1 S.C.R. 456 at paragraph 34 [*Foster Wheeler*] [Emphasis added.]

[40] Secondly, solicitor-client privilege applies only to a communication between a lawyer and client, which is of a confidential character, and which is directly related to the seeking, formulating or giving of legal advice. Put differently, privilege will not attach to communications in which legal advice is neither sought nor offered or where the communication is not intended to be confidential. The purpose of privilege is to ensure that clients will not fear that information given in confidence to their lawyers may later be disclosed and used against them: *Canada (Combines Investigation Act)* (*Re*), [1975] F.C. 184, 55 D.L.R. (3d) 713 at paragraph 12 approved and adopted in *Solosky* v. *The Queen* [1980] 1 S.C.R. 821, page 834).

Digitized by Google

[41] Thirdly, courts have determined that solicitor-client privilege protects client names, but only in certain circumstances. In *R. v. Budd*, 2002, [2002] O.T.C. 893, the Ontario Superior Court canvassed Canadian case law and authorities on the question of privilege over client names, and concluded that privilege protects client names where the identity of the client "constitutes the foundation of the retainer" or "the essence of the consultation" (at paragraphs 14-15). The Court determined that the general rule is that client names are not *per se* privileged in Canadian law.

[42] In the same year that *Budd* was decided, the Supreme Court concluded to the same effect in *Lavallee*. It stated: "The name of the client may very well be protected by solicitor-client privilege, although this is not always the case": See also *Thorson v. John Jones* (1973), 38 D.L.R. (3d) 312 (B.C.S.C.) and R. D. Manes and M. P. Silver, *Solicitor-Client Privilege in Canadian Law* (Markham, Ont: Butterworths, 1993) at page 141, quoted in *Lavallee*.

[43] Lastly, privilege is distinct from, and narrower than, the duty of confidentiality. The appellant relies on the duty of confidentiality he owes his clients pursuant to the Law Society of Alberta's *Rules* and its *Code of Conduct*. However, courts and law societies recognize the distinction between the duty of confidentiality and solicitor-client privilege. The Law Society of Alberta's *Code of Conduct* includes this commentary under Rule 2.03 concerning confidentiality:

> This rule must be distinguished from the evidentiary rule of lawyer and client privilege, which is also a constitutionally protected right, concerning oral or documentary communications passing between the client and the lawyer. The ethical rule is wider and applies without regard to the nature or source of the information or the fact that others may share the knowledge.

[44] The Supreme Court has similarly distinguished between the two concepts. In *Cunningham,* the Court stated that its reasons, which "address the application, or non-application, of solicitor-client privilege" should not be taken as affecting "counsel's ethical duty of confidentiality" (at paragraph 31). Similarly, in *Foster Wheeler*, the Court distinguished between "the scope of the lawyer's obligation of confidentiality" (i.e., the duty of confidentiality) on the one hand, and "the application of the immunity from disclosure designed to protect that confidentiality" (*i.e.*, solicitor- client privilege) on the other (at paragraph 29).

Subsection 232(1) of the Act

[45] As mentioned above, subsection 232(1) defines solicitor-client privilege for the purposes of the Act. For ease of reference, I reproduce it again:

"solicitor-client privilege" means the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional confidence, except that for the purposes of this section an accounting record of a lawyer, including any supporting voucher or cheque, shall be deemed not to be	« privilège des communications entre client et avocat » Droit qu'une personne peut posséder, devant une cour supérieure de la province où la question a pris naissance, de refuser de divulguer une communication orale ou documentaire pour le motif que celle-ci est une communication entre elle et son avocat en confidence professionnelle sauf que, pour l'application du présent article, un relevé comptable d'un avocat, y compris toute pièces

Digitized by Google

such a communication.

justificative out tout chèque, ne peut être considéré comme une communication de cette nature.

[46] This definition is in line with the teachings of the Supreme Court of Canada on the law of solicitor-client privilege. It protects from disclosure those communications passing between solicitor and client in professional confidence, *i.e.* communications that involve seeking and providing legal advice. I fail to see how it applies to accounting records and supporting vouchers and cheques, which constitute, as a general rule, evidence of an act or transaction rather than a privileged communication: See also *Canada (Minister of National Revenue – M.N.R.) v. Jakabfy*, 2013 FC 706 at paragraph 11 [*Jakabfy*]; *Canada (Minister of National Revenue – M.N.R.) v. Singh Lyn Ragonetti Bindal LLP*, 2005 FC 1538 at paragraph 18; *Canada (Minister of National Revenue – M.N.R.) v. Reddy*, 2006 FC 277; *Canada (Minister of National Revenue – M.N.R.) v. Cornfield*, 2007 FC 436; *Canada (Minister of National Revenue – M.N.R.) v. Currie*, 2008 FC 237. Of course, if for some unusual circumstances a lawyer's accounting records contain privileged communications, these communications would remain subject to judicial scrutiny under the Act since legislative language governing the production of documents must be read so that it does not include communications subject to solicitor-client privilege: *Canada (Privacy Commissioner) v. Blood Tribe Department of Health*, above at paragraph 11.

[47] I also fail to understand the appellant's argument as to the non-applicability of the definition of solicitor-client privilege found in the Act to his case. The Minister has instituted her proceedings under subsection 231.7(1) because the appellant had failed to comply with a Requirement served pursuant to subsection 231.2(1) of the Act. Paragraph 231.7(1)(*b*) refers specifically to that definition when stating the Judge's task when presented with a summary application for a compliance order.

[48] I now turn to the three specific issues identified earlier at paragraph [19] of these reasons.

The Burden of Proof

[49] Mr. Thompson raised the shield of solicitor-client privilege. It is the party asserting privilege that bears the evidentiary burden to establish the claim on a balance of probabilities.

[50] Mr. Thompson did not. To the contrary, the Judge found that "on the record before [him], there is nothing to suggest that any client's name requires the protection of privilege" (Judge's Speaking Order, appeal book, volume 1, page 22 at paragraph 5). This factual finding is fully supported by the evidence, especially Mr. Thompson's affidavit, which contains only generalities about his legal practice (appellant's affidavit, appeal book, volume 2, page 335 and ff.).

[51] One of the difficulties with the appellant's position that names of clients are always privileged is that it runs contrary to the foundation of the taxation system in Canada, which is a self-assessing and self-reporting system. On his theory, the CRA could never seek and obtain information from a solicitor or barrister about the revenue generated by his practice or otherwise that would enable the CRA to ensure compliance or determine non-compliance by a lawyer. Indeed, the appellant goes as far as arguing that privilege covers the financial institutions who hold registered mortgages on his own personal interests because he provides legal services to these financial institutions where he also has bank accounts.

[52] In my view, the appellant could not succeed on his argument by simply raising the shield of privilege on behalf of his clients whose names the Minister was seeking and by hiding behind it. The appellant is a taxpayer whose compliance with the Act the Minister is fully

Digitized by Google

entitled to verify. Had Mr. Thompson raised solicitor-client privilege until he had further opportunity to consult with his clients and assess their rights, and then provided specifics in his affidavit explaining why some of the names might attract privilege, he would have been in a better position to persuade the Judge that his position might be justified.

[53] It is also noteworthy that the Court observed that there was no indication, on record, that the appellant had even informed his clients that he was asserting privilege on their behalf. Rather, it appears that he is attempting to protect his clients from knowledge of the whole matter. Once again, the Judge found that the appellant "has provided no evidence to show that any particular client name should be protected in this case" (Judge's Speaking Order, appeal book, volume 1, page 25 at paragraph 14). I have not been persuaded that the Judge committed reviewable errors when he made these findings.

The Information Requested is not Subject to Solicitor-Client Privilege

[54] Interestingly, case law provides a very recent example of a barrister and solicitor whose clients were facing a compliance order under section 231.7 of the Act. In *Jakabfy*, Mr. Jakabfy was found to have acted appropriately in his dealings with his former clients (the Lavallees) and with the Minister. Upon receipt of the Requirement addressed to him, seeking information as to how Mr. Lavallee had distributed the proceeds from the sale of a property, Mr. Jakabfy wrote to his clients and sought their specific instructions. He then, by sworn affidavit, informed the CRA of his clients' refusal to disclose the relevant information. In the end, the Federal Court Judge ordered Mr. Jakabfy to provide the information in the form of, *inter alia*, trust account ledger, cheque journal, statement of adjustments or disbursements, copies of invoices or receipts for payments. All these documents were found not to be privileged.

[55] In Mr. Thompson's case, the Minister seeks similar documents, more particularly a "current accounts receivable listing". In his memorandum of fact and law, the appellant argues that names of clients are as privileged as statements of account. He asserts that, contrary to what the Judge found, client names do not form part of an accounting record of a lawyer (at paragraphs 35-37). I disagree with the appellant.

[56] Section 230 of the Act generally defines the terms "Records and Books of Account". They are documents containing "such information as will enable the taxes payable under this Act or the taxes or other amounts that should have been deducted, withheld or collected to be determined". The particular situation of lawyers is addressed in subsection 230(2.1) in these terms:

(2.1) For greater certainty, the records and books of account required by subsection 230(1) to be kept by a person carrying on business as a lawyer (within the meaning assigned by subsection 232(1)) whether by means of a partnership or otherwise, include all accounting records of the lawyer, including supporting vouchers and cheques.	(2.1) Il est entendu que les registres et les livres de comptes qui doivent, en vertu du paragraphe (1), être tenus par une personne exploitant une entreprise consistant dans l'exercice de la profession d'avocat (au sens du paragraphe 232(1)) en société de personnes ou autrement comprennent tous les registres comptables de l'avocat, y compris les pièces justificatives et les chèques.

[57] Statements of account are not the same as a lawyer's accounting records. The

Digitized by Google

latter consist essentially of statements of fact such as the name of the client, the amount billed for the professional services, the payments received and the amounts still owed. Statements of account, by contrast, may reveal a history of the file. They may contain information including the nature of the consultation, a summary of communications between solicitor and client, and so on, which may be covered by solicitor-client privilege.

[58] In this case, the Minister is not seeking the information contained in statements of account. She seeks purely factual information consisting of the names of the clients and the amounts of money owed by these clients individually.

[59] At the hearing of this appeal, Mr. Thompson admitted that he could institute legal proceedings to recover his fees from an uncooperative client. In light of the public nature of court proceedings, he would be obliged to reveal an uncooperative client's identity and amounts owing in order to recover these fees. On that answer alone, it is difficult to accept his position that this information is subject to solicitor-client privilege. I note that the Law Society of Alberta's *Code of Conduct* provides for circumstances where this type of information may be disclosed. Rule 2.03(5) states:

> 2.03(5) A lawyer may disclose confidential information in order to establish or collect the lawyer's fees, but must not disclose more information than is required.

[60] Consistent with this example, what Mr. Thompson is asked to provide is no more than the information he would need to include in a Statement of Claim to disclose a cause of action.

[61] In light of the foregoing, I conclude that the Judge did not err in finding that the information requested in the Requirement was not subject to solicitor-client privilege.

Privacy Rights not Infringed under Section 8 of the Charter

[62] The appellant asserts that the Minister's attempted interference with clients' guaranteed rights in relation to solicitor-client privilege violates section 8 and is not saved by section 1 of the Charter. As the appellant has failed to establish that the Court erred in finding that a class privilege does not attach to the accounting records and client names requested by the Minister, there is no interference with any rights in relation to privilege, and this argument cannot succeed.

[63] The appellant also refers to the case of *Baron v. Canada*, [1993] 1 S.C.R. 416 in which the Supreme Court of Canada struck down section 231.3 of the Act, because the provision interfered with judicial discretion as to whether or not a search warrant should be issued to enter, search any building, receptacle or place and seize any document or thing that may afford evidence as to the commission of an offence under this Act. However, in the circumstances at bar, the appellant points to no evidence that the Court's decision-making ability is fettered by the wording of the provisions at issue.

[64] Further, the appellant's analogy with the physical seizure of documents in the course of executing a warrant does not apply on the facts. There is no entry of tax officials onto the appellant's premises. The Requirement consists solely of a demand for production of documents. Finally, I note a recent decision from the Superior Court of Quebec wherein a Judge of that Court declared unconstitutional and inoperable sections 231.2, 231.7 and subsection 232(1)(5) of the Act as far as Quebec lawyers and notaries were concerned: *Chambre des notaires du Québec c. Canada (Procureur general)*, 2010 J.Q. no. 8868; [2010] QCCS 4215.

[65] I am unmoved by this decision. Firstly, a Quebec Superior Court decision is not binding on this Court. That decision is under appeal and no decision on the appeal has been rendered to date (appeal filed on October 7, 2010, 500-09-021073-101). Secondly, the facts of that case are distinguishable as they involve information requirements issued by the CRA to a

Digitized by Google

number of Quebec notaries in order to obtain information and documents concerning their clients. The Quebec *Charter of Human Rights and Freedoms*, R.S.Q. c. C-12 and Quebec's *Code of Ethics of Notaries,* R.R.Q., c. N-3, r. 2 and *Code of Ethics of Advocates*, R.R.Q., c. B-1, r. 3 are also relied upon. They are not applicable to the appellant.

[66] As a result, I conclude that the appellant points to no palpable error in the Judge's reasons on the Charter questions that would justify our intervention.

The Notice of Constitutional Question

[67] The need for a notice of constitutional question is linked to the remedy sought by a party: *Canada (Minister of Canadian Heritage) v. Mikisew Cree First Nation*, 2004 FCA 66, [2004] 3 F.C.R. 436. Section 57 of the *Federal Courts Act* states that the constitutional validity, applicability, or operability of an Act of Parliament shall not be judged unless notice has been served. Neither in his Notice of Appeal nor in the Order Sought section of his memorandum of fact and law does the appellant seek a finding that the provisions of the Act under which the Minister acted in this case are invalid, inapplicable or inoperable as required by section 57. As a result, it is not necessary to address the question raised in the notice of constitutional question.

Conclusion

[68] As announced at the outset of these reasons, I propose to partially allow the appeal although, as did the Judge, I dismiss all of Mr. Thompson's arguments. In my respectful view, however, the Judge's order was premature with respect to the accounts receivable listing. Once he had decided that Mr. Thompson's position on that issue could not stand, the Judge had to take the appropriate steps to verify whether solicitor-client privilege protected any of Mr. Thompson's clients individually. The appellant had built his case on an erroneous understanding of the law of solicitor-client privilege. As a result, he had made the blanket statement that clients' names are always privileged. On a proper understanding of privilege and the construction of the statutory provisions and rules at play, it is possible that some of the appellant's clients' names are protected by solicitor-client privilege. If that is the case, these clients ought to have the opportunity to assert this privilege, and Mr. Thompson should be given the chance to lay the proper evidentiary foundation on their behalf.

[69] There is no specific obligation on a lawyer to advise a client when asserting a right on his or her behalf, when this right is in jeopardy. That being said, provincial law societies impose general obligations on lawyers, or make recommendations to lawyers, which suggest that the appellant should be asserting and pursuing the claims of solicitor-client privilege after having informed his clients and having obtained their instructions in this regard.

[70] With respect, I find that the Judge, as guardian of the law, should have fashioned a remedy addressing the critical issue of privilege before making his Order. The Act provides for the compliance order to be made by a Judge ensuring enough flexibility and discretion for him or her to remain the protector of the rights attached to solicitor-client privilege.

[71] As he did not fashion such a remedy, I propose to return the file to the Federal Court for a new hearing, on the question of the accounts receivable listing. Mr. Thompson may then have the opportunity to get his clients' instructions and, on the basis of these reasons, may file new sworn affidavits explaining why individual clients' names are privileged, if in fact this continues to be the case. I will not impose a time limit to do so and leave it up to the Federal Court to set the timelines for the parties to exchange further affidavits or materials. However, I should add that the clients on whose behalf the appellant is claiming privilege should produce their own affidavits explaining the history of their accounts. Copies of such affidavits should be served on the respondent, with clients' names redacted.

[72] As for the rest of the missing information and documents, as listed in Ms. Maria Van Dyk's affidavit (appeal book, volume 1, page 35 and ff.), the Judge's Speaking Order

Digitized by Google

stands. The missing information and documents shall be produced as ordered and in an unredacted version within thirty (30) days of the judgment to issue. For the sake of clarity, the relevant paragraphs of Ms. Van Dyk's affidavit describing the missing information and documents are reproduced in an Annex to these reasons.

Costs

[73] Considering the result of this appeal, I would order that each party bear its own costs.

"Johanne Trudel"
J.A.
"I agree
J.D. Denis Pelletier J.A."
"I agree
Robert M. Mainville J.A."

Digitized by Google

ANNEX

(Ms. Maria Van Dyk's sworn affidavit
of June 21, 2012)

8. […]

(a) N/A

(b) N/A

(c) Personal Expenses: the [appellant] provided insufficient information. The [appellant] provided a listing of various discretionary expenses that include food/groceries, life insurance, household repair, vacation, charitable donations, clothing, memberships, recreation/entertainment, gifts to family, miscellaneous spending and medical & prescription. He indicated that his expenditures for the utilities, satellite and internet were detailed on the statements he provided to the CRA. However, the information provided is in the form of numerous redacted utility and banking documents, making it impossible to ascertain the various expenses. No information was provided for the following:

(i) mortgage payments;
(ii) property tax payments;
(iii) phone payment (home phone & personal cell);
(iv) cable payment;
(v) internet payment;
(vi) utility payment (water / sewage);
(vii) gas & electric payment;
(viii) home and auto insurance payments;
(ix) vehicle payments;
(x) gas and oil payments (for vehicle);
(xi) vehicle maintenance payments;
(xii) credit card payments;
(xiii) bank loan payments;
(xiv) other loan payments; and
(xv) any other expenses he may have but has not reported with his response to the Requirement;

(d) Assets: the [appellant] provided insufficient information in regards to his assets, as follows:

(i) the [appellant] stated he has a joint interest in 80 acres but failed to provide the location of the 80 acres. Furthermore, no information was provided as to whether his personal residence is located on the 80 acres or where otherwise the personal residence might be located;
(ii) the [appellant] stated that he owns six motor vehicles, but has failed to list the motor vehicles, with their respective VIN and value for each vehicle;
(iii) the [appellant] stated that he has three recreational vehicles but failed to list them or provide any identifying features; and
(iv) the [appellant] stated that he has $1,100 on deposit at the bank, but failed to disclose which bank the deposit is with. The bank statements provided were redacted. The information the [appellant] redacted from the bank statements include: bank information, transit number, bank number, bank account number and transaction details;

(e) Liabilities: the [appellant] failed to provide sufficient information regarding his liabilities as follows:

(i) the [appellant] stated he had credit card debt of $33,000 but did not provide details as to which credit card companies with which he carries

Digitized by Google

debt. The
[appellant] redacted the relevant information in the credit card statements including the credit card issuer, account number and transaction details;

(ii) the [appellant] claimed to have $80,000 in payables but has not broken this balance down or associated this balance with business or personal payables; and

(iii) the [appellant] provided total balances in regard to mortgages and a statement concerning a "judgment debt" but failed to provide any supporting details or any supporting documents that show what payments he is making on the judgment debt or mortgage.

CRA Internal Operations Manual - Requests for Information

(see below)

Digitized by Google

REQUIREMENTS FOR INFORMATION 1

Overview 1

Legislation 1

Background Information 1
Financial Institutions that Accept Service of RFI Letters 1
Lapse of RFI's 1

Policy 2
Initial Informal Request for Information 2
Cases Where an Informal Request is Not Issued 3
Restricted Use of an RFI 3
When to Issue a Written RFI 3
Cases Where it is Necessary to Issue a Second RFI 4
ELCS RFI Letters 4
Time Allowed to Comply 4
Dates Required Within RFIs 4
The "Re-Line" 5
RFI to Financial Institution 6
Joint Accounts 7
Other RFI Situations 7
RFI and Unnamed Persons 7
Approval Authority 9
Situations Where Client Privilege is Claimed 9
Solicitor-Client Privilege 9
Information in Respect of the Affairs of a Lawyer's Client 10
Information in Respect of a Lawyer who is the Subject of Collection Action 11
Service of an RFI Letter 11
Service of the RFI at Designated Branch 11
Personal Service of an RFI Letter 12
Circumstances When Personal Service Should be Effected on Banks 12
Obtaining Information from the Bank of Canada 12
Requests for Payment by Third Party for Costs Incurred 12
Extension of Time 13
RFI Non-Compliance Action Against Financial Institutions (Joint and Unknown Account Holders) 14

Procedures 14
RFI Letters Issued to a Third Party Residing Out of the TSO Area 15
RFI Issued by Mail to a Third Party Residing Out of the TSO Area 15
Personal Delivery or Servicing of an RFI to a Third Party Out of the TSO Area 16
Assistance Required by the Investigations Division in Another TSO 16
Solicitor-Client Privilege: Information in Respect of the Affairs of a Lawyer's Client 17
Solicitor-Client Privilege: Information in Respect of a Lawyer Who is the Subject of Collection Action 18
Completing an RFI Letter 18
Identifying the Client 19
Identifying an Individual 19
Identifying a Proprietor 19
Identifying a Partnership 19
Identifying a Corporation 20
Completion of the "Re-Line" 21
Date of Director's Signature 21

Digitized by Google

Time Allowed for Compliance 21
Time Period for RFI 22
Suggested Verses for RFIs 22
Phrases for Information/Documents Required from an Individual 23
Phrases for Information/Documents Required from Financial Institutions 23
Phrases for Information/Documents Required from Insurance Companies 24
Phrases for a Review of Books and Records 25
Phrases for Information/Documents Required from a Credit Card Company 25
Phrases for a Review of Books and Records of Paydac Accounts 25
RFI Approval Levels 26
Number of Copies Required 26
Completing an RFI When Serving a Designated Branch 27
Personal Service of an RFI 27
Identifying Yourself 28
Service of the RFI 28
Documenting Service 28
The Need for a Witness 29
Completing an Affidavit for Personal Service, Form TX605 29
Swearing of the Affidavit for Personal Service, Form TX605 30
Non Compliance With an RFI Letter 30
Prosecution Action 30
Compliance Order 31
Non-Compliance by a Provincial Ministry 31
RFI Non-Compliance Action Against Financial Institutions (Joint and Unknown Account Holders) 31
Completing Approval for Prosecution 32

Resource Material 33

Digitized by Google

Requirements for Information

Collections Manual Updates

Overview

This chapter provides particulars regarding the issuance of Requirements to Provide Information and Documents (RFI), to financial institutions such as Banks, Caisses Populaires, Credit Unions, Trust Companies, as well as to various third party sources.

Legislation

This section identifies legislation related to Requirements for Information (RFI):

- *Income Tax Act*, section: 231.2, 231.5, 231.6, 231.7, 233.1
- *Excise Tax Act*, subsection: 289(1), 289(2), 289(3), 289(4), 289(5), 289(6), 289.1(1), 293
- *Excise Act (2001)*, section: 208(1)
- *Customs Act*, subsection: 43(1)
- *Air Travellers Security Charge Act* subsection: 38(1)
- *Canada Pension Plan* subsection: 25(5), 25(7)
- *Employment Insurance Act* subsection: 88(5), 88(7)

Background Information

This section identifies background information related to Requirements for Information (RFI):

- **Financial Institutions that Accept Service of RFI Letters**
- Lapse of RFI's

Financial Institutions that Accept Service of RFI Letters

The following institutions accept service at their branches of RFI Letters:

- all chartered banks
- caisses populaires
- credit unions
- trust companies

Lapse of RFI's

Technically, an RFI never lapses. However, compliance with an RFI is considered complete when all the details, available by the third party or at or through a branch bank at the time of service, have been provided for the names given.

Digitized by Google

Policy

This section identifies policies related to Requirements for Information:

- Initial Informal Request for Information
- Cases Where an Informal Request is Not Issued
- Restricted Use of an RFI
- When to Issue a Written RFI
- Cases Where it is Necessary to Issue a Second RFI
- ELCS RFI Letters
- Time Allowed to Comply
- Dates Required Within RFIs
- The "Re-Line"
- RFI and Unnamed Persons
- Approval Authority
- Situations Where Client Privilege is Claimed
- Solicitor-Client Privilege
- Service of an RFI Letter
- Service of the RFI at Designated Branch
- Personal Service of an RFI Letter
- Circumstances When Personal Service Should be Effected on Banks
- Obtaining Information from the Bank of Canada
- Requests for Payment by Third Party for Costs Incurred
- Extension of Time
- RFI Non-Compliance Action Against Financial Institutions (Joint and Unknown Account Holders)

Initial Informal Request for Information

It is recommended that when requesting information for the first time from a third party source or from the tax debtor, a written information request letter be sent. Issue ELCS letter 19641 prior to proceeding with an RFI letter. However, do not issue a request letter if information or documents are required from a financial institution. Proceed directly to the issuance of an RFI.

Digitized by Google

Cases Where an Informal Request Is Not Issued

An informal written request for information is made prior to proceeding with a formal RFI letter except in cases where:

- it is believed that a formal request would serve no purpose
- the information is required on an urgent basis, or
- the letters are issued to financial institutions and trust, savings, loan and mortgage companies, investment companies

Restricted Use of an RFI

The issuance of an RFI to a financial institution, such as a bank, regarding one or more of its customers, is a serious step. It is serious from the bank's viewpoint because of time, expense and that valuable customers are involved and because the RFI is enforceable under the law. It is serious from the tax debtor's viewpoint because it may adversely affect his credit rating or otherwise strain his relationship with the financial institution.

Therefore, the use of an RFI should be limited. Refer to the section **When to Issue a Written RFI** for further detail.

When to Issue a Written RFI

The issuance of RFIs to institutions are to be closely controlled and their use limited to these situations:

- the information required is essential to the investigation
- the amount of the debt is substantial
- there is evidence that the tax debtor is uncooperative or is using evasive tactics to avoid payment of tax
- it is necessary to prove non-compliance with a Requirement to Pay or non-arms length transfer
- the information is required on an urgent basis
- the information cannot be obtained from other sources and is so clearly essential to the investigation that prosecution would be warranted in the event of non-compliance
- investigations cases where fraud is established or seriously suspected
- an urgent payroll examination is required and the Trust Examiner has been unsuccessful in gaining access to the books and records
- the Agency is a substantial creditor within an insolvency proceeding and information is required to confirm the legitimacy of an insolvency/proposal
- information is required to confirm the validity of any type of Memorandum Assessment being considered

Digitized by Google

Cases Where it is Necessary to Issue a Second RFI

Issue a second RFI when either:

- a second investigation into the affairs of a tax debtor is opened some time after the conclusion of the first investigation, or
- when a tax debtor, named in the RFI, makes use of an alias not set out in that RFI

Some scenarios may necessitate the involvement of the Department of Justice or our Investigation Section. Therefore, all scenarios must be reviewed on a case-by-case basis with the available facts used to determine the best course of action. Keep in mind that your main consideration should be that of perfecting proper service in order to avoid potential problems if the prosecution process becomes a necessity later on.

For further details refer to the sections **Personal Service of an RFI Letter** and **Extension of Time**.

ELCS RFI Letters

The following are the ELCS system RFI letters:

- ELCS letters 19647: Formal Requirement for Information
- ELCS letters 19646: Requirement for Production of Books and Records
- ELCS letters 19648: Requirement to Produce Information and Documents for Financial Institutions
- ELCS letters 80789: Requirement to Provide Documents or Information for an RRSP

For further information regarding ELCS letter 80789 refer to Communication ARD-2003-004, entitled **Funds held in RRSPs**.

Time Allowed to Comply

RFI letters have successfully been attacked in court because the time allowed for compliance was unreasonable. The tax debtor or a third party cannot be expected to drop everything in order to comply immediately with an RFI letter. Terms such as "forthwith" or "without delay" are unacceptable. The length of time to comply will be dictated by such factors as the number of documents, availability of information or documents, and number of tax years involved. If there is a possibility of error, it should be that too much time rather than too little time was allowed. Normally, an RFI letter will allow thirty days for compliance.

RFI letters to financial institutions will normally allow a time limit of thirty days to comply. The thirty days is pre-printed on the Requirement to Provide Information and Documents form (T375 or T375A), however the ELCS forms allow any number of days to be entered. It is recommended that discretion be used when allocating the number of days required to respond.

For further details, refer to **Time Allowed for Compliance**.

Dates Required Within RFIs

RFI letters must bear the date on which the authorized person signs the letter. In order to allow the full number of days for compliance, TSOs should estimate the number of days as follows:

Digitized by Google

- the day which marks the start of the time limit is not counted, but the due date is counted
- non-juridical days are counted but when the last day is a non-juridical day, the time limit is extended to the next following juridical day

The RFI letter must also include the date of service as the opening paragraph of the RFI document states *"from the date of delivery."* Therefore, the RFI must have two dates indicated on the document.

- date of Director's signature or stamp
- date of service on the party

These dates must be indicated on the document to show the Courts that non-compliance has occurred when it comes to prosecuting for failure to comply with an RFI. As a result, it is suggested that the Collection Officer estimate the date of when the authorized person will sign or stamp the RFI. It is then recommended that the officer date stamp the RFI when perfecting service or estimate the number of days required to effect personal service or registration delivery and add this time to the number of days allowed to respond.

For more details refer to **Completing an RFI Letter**.

The "Re-Line"

The Agency currently faces numerous challenges from various third parties regarding the issuance of Requirements for Information (RFIs).

To address these issues, changes have been made to the wording of all RFIs to minimize further legal challenges.

The RFI letters available on ELCS (19646, 19647, and 19648) have two "Re-line" options available for completion. These "Re-line" options must also be included within all non-ELCS based RFIs currently in use.

They are as follows:

1. Re: "X"
   - for taxpayer(s) who are the subject of an RFI where the RFI precedes the assessment itself
2. Re: The Tax Liability of "X"
   - for taxpayers who are the subject of an RFI with an assessed liability

     Note: There are no issues of confidentiality when selecting "Re-line" option number two as the Agency is entitled to divulge the fact that the subject of the RFI holds a tax liability.

Only the tax debtor who is the subject of the collection investigation and is liable or about to be liable to pay tax, should be added to the selected "Re-line."

Digitized by Google

Please refer to **Appendix "A"** Examples 1 & 2, within Communication ARD-2004-044, entitled Requirement for Information (RFI), Differentiating Taxpayer(s) who are the Subject of Collection Action from Co-Account Holders and Others.

All other parties who are not the subject of the collection action, should be identified in the body of the RFI.

Therefore an "introductory phrase" in the body of all RFIs must be present and read as follows:

"The information sought under this Requirement for Information is

- "held by" or "in respect of" (insert the person's name who we seek information on)
- "in respect of the account held by (insert name of account holder)"

Refer to **Appendix "A"** Example 5, within Communication ARD-2004-044, entitled Requirement for Information (RFI), Differentiating Taxpayer(s) who are the Subject of Collection Action from Co-Account Holders and Others.

Related Topics:

- **RFI to Financial Institution**
- **Joint Accounts**
- **Other RFI Situations**

RFI to Financial Institution

Recently, numerous financial institutions have not properly complied with our RFIs due to a wording issue. Changes have been made to ELCS letter 19648 to resolve this issue.

ELCS letter 19648 previously required information from financial institutions "in respect of the account held by..." This RFI letter has been amended to allow a collector the option to select one of the following:

1. "in respect of..."
   - This option should be used where the collector is requesting all information related to the dealings of the named taxpayer(s).
2. "in respect of the accounts held by..."
   - This option should be used where we are trying to verify the existence of bank accounts held by the named taxpayer(s).

For further details refer to Communication ARD-2005-039 entitled, **Change Made to ELCS versa 19648-Requirement for Information to Financial Institution**.

Where a taxpayer who is the subject of a collection action has been identified by the selected "Re-line", and the information is being requested from a bank or credit union, and the information sought relates to, for example, a company with which the taxpayer is associated or the taxpayer's spouse, neither of which have a tax liability; the company or the taxpayer's spouse should be identified in the body of the RFI but not the "Re-line."

Digitized by Google

For further details, please review **Appendix "A"** Example 5, within Communication ARD-2004-044, entitled Requirement for Information (RFI), Differentiating Taxpayer(s) Who are the Subject of Collection Action from Co-Account Holders and Others.

Joint Accounts

In a "joint account" situation, other co-account holders, who are not the subject of collection action or information gathering should not be added to the "Re-line." Rather, they should be included instead in the body of the RFI as part of the bank account description. The "introductory phrase" cited above in the section, **The "Re-Line"**, should be used for this purpose.

In a "joint account" situation, the completed introductory phrase should read:

"The information sought under this *Requirement for Information and Documents* is in respect of the account held by "X", "Y", and "Z"."

Please note that "X" would appear in the selected "Re-line" in addition to the introductory phrase or "account description" in the body of the RFI.

This change responds to the need to differentiate between taxpayers who are the subject of collection or information gathering action and co-account holders who may not be.

Clearly distinguishing between persons who are the subject of collection or information gathering action and co-account holders should help minimize the rejection of RFIs or subsequent compliance orders on the grounds that the RFIs are seeking information on an "unknown person."

For further details, please review **Appendix "A"** Example 3, within Communication ARD-2004-044, entitled Requirement for Information (RFI), Differentiating Taxpayer(s) Who are the Subject of Collection Action from Co-Account Holders and Others.

Other RFI Situations

Where the taxpayer who is the subject of collection action has been identified by the selected "Re-line" but the information is being requested from a third party who does not have a tax liability, for example the taxpayer's employer or business associate; the third party should be identified in the body of the RFI but not in the "Re-line."

For further details, please review **Appendix "A"** Example 4, within Communication ARD-2004-044, entitled **Requirement for Information (RFI), Differentiating Taxpayer(s) Who are the Subject of Collection Action from Co-Account Holders and Others**.

Where exceptional circumstances exist not covered by Communication ARD-2004-044, please contact the Department of Justice prior to issuing an RFI for further guidance.

RFI and Unnamed Persons

In the context of collection action in respect of an identified taxpayer, on numerous occasions Collectors will need to obtain information such as client lists, the names of persons or businesses to whom the taxpayer has paid or received money or the names of parties with whom the taxpayer may have entered into a contract for the lease or purchase of goods and services. In short, persons or businesses that are "unknown" to the collector.

In respect of "unknown persons", recent case law has impacted the effectiveness of an RFI where that document may divulge the identity of an unnamed person.

Digitized by Google

In the case *Minister of National Revenue v. Banque Toronto Dominion* (2004 FCA 359), the Federal Court of Appeal (FCA) stated than an RFI issued under subsection 231.2(1) of the *ITA* could not compel a third party to provide information which would divulge the identity of an unnamed person. The FCA further directed the CRA to seek a "judicial authorization" under the provisions of subsection 231.2(2) and (3) of the *ITA* when faced with type of situation. The Court also recognized however, that in practical terms this would be not possible to do, since the same subsections stipulate that the unnamed persons in question must be themselves under investigation (which would not be the case).

In a more recent FCA decision, *Canada Revenue Agency v. Artistic Ideas Inc* (2005 FCA 68), the Court stated that where unnamed persons are not under investigation, that subsection 231.2(2) and (3) do not apply.

Where in the context of collection action in respect of an identified taxpayer, a Collector contemplates issuing RFIs that are intended to obtain or could have the effect of forcing disclosure of unnamed third parties not identified in the RFI, the following course of action should be followed:

1. Collectors should first (where applicable and practical), conduct an audit or inspection of the taxpayer's books and records either at the taxpayer's or employer's premises or at the premises of a third party (i.e. accountant).

   The inspection or audit of books and records is not subject to any restrictions as to the information relating to unnamed parties that may have dealings with the taxpayer. These inspections are authorized by subsection 231.1(1) of the *ITA* and 289(1) of the *ETA*.

2. Where the taxpayer or employer does not keep books and records or where the above is not feasible or practical, Collectors should seek the information required from the taxpayer or employer by issuing an RFI to them directly.

   In this context Collectors may also request from third parties such as financial institutions, information in respect of the taxpayer or employer. The issuance of RFIs would be authorized by section 231.2(1) of the *ITA* and subsection 289(1) of the *ETA*.

3. Where an identified taxpayer, employer, or financial institution to whom an RFI has been issued, invokes the TD Bank decision or subsections 231.2(2) and (3) of the *ITA* or subsections 289(2) and (3) of the *ETA* and refuses to provide information that may disclose the identity of unnamed persons, Collectors must consult with the Department of Justice (DOJ) as to the proper course of action to take in the particular circumstance.

   Notwithstanding the TD Bank decision, DOJ takes the position that in view of the FCA decision in Canada Revenue Agency v. Artistic Ideas Inc, the taxpayer, the employer or a financial institution may be the subject of an application under section 231.7 of the *ITA* or 289.1 of the *ETA*, to compel production of the information.

   The rational behind this view is that where unnamed persons are not themselves the subject of investigation, collection or other administrative action, subsections 231.2(2) and (3) *ITA* and 289(2) and (3) *ETA*, do not apply since the names of unnamed persons are necessary solely for the Minister to investigate, take collection or other administrative action against the identified taxpayer referred to in the RFI.

4. According to the current case law, judicial authorization to issue an RFI is required where the Agency is seeking the identity of unnamed persons in order to take collection action against them or to verify compliance by the unnamed person. In these circumstances, the matter must be referred to the Department of Justice for action.

Digitized by Google

In all cases not covered in the previous steps, ensure that you seek the advice/assistance of the Department of Justice.

For further details, refer to Communication ARD-2005-016, entitled **Requirement for Information-Unnamed Person** or seek assistance from your **Field Support** representative.

Approval Authority

The approval authorities for RFI letters are:

A. To a Financial Institution or third party source:

   Authority to use the Director's facsimile signature stamp is given to lower level positions, but not lower than Manager, Revenue Collections.

B. In circumstances where an ex-parte application to require a third party to provide information or documents (unnamed persons):

   Where an RFI is to be issued in the above circumstance, the authority is delegated to the Director's signature.

Where it is anticipated that non-compliance may occur and enforcement action may be necessary it is suggested that the RFI letter only be issued under the personal original signature of the TSO Director.

A Director of a TSO seeking information can issue and sign the standard bank RFI letters on any branches of banks and financial institutions located within Canada. The territorial scope of the Director's authority to sign a requirement letter is not restricted by legislation.

Ensure the signature block, of the Requirement for Information, reflects the correct title for the work description of the delegated authority approving the Requirement for Information.

For further details, refer to **RFI Approval Levels** and TSDMB-2008-017 **Correct Signatures for Requirement for Information (RFI) and Requirement to Pay (RTP)**

Situations Where Client Privilege is Claimed

When a collection officer is attempting to obtain information from a professional, for example: a doctor or lawyer, it is imperative that the information is not demanded after client privilege is claimed. If client privilege is claimed, the collections officer should leave the premises and contact the Department of Justice advising of the situation along with the type of information requested to determine available courses of action.

Solicitor-Client Privilege

While not all communications between a lawyer and a client are covered by privilege, there is a judicial trend towards widening the scope of solicitor-client privilege. Recent decisions made by the Supreme Court of Canada in ***Lavalle, Rakel & Heintz v Canada*** *(Attorney General)*, 2002 SCC 61 and **Leo Rene Maranda v. Corporal Normand Leblanc et al**, 2003 SCC67, have resulted in significant implications for CRA operations, in respect of the issuance of RFIs.

These decisions have given rise to the following legal interpretations:

- Solicitor-client privilege has evolved from a mere "rule of evidence" into a "constitutionally protected right" that must be protected by both the state and the Courts.

Digitized by Google

- Procedure set out in section 488.1 of the *Criminal Code* for protecting solicitor-client privilege is unconstitutional and accordingly has been struck down, because it does not sufficiently protect solicitor-client privilege.

- Procedures set out in section 232 of the *Income Tax Act* and section 293 of the *Excise Tax Act* for protecting solicitor-client privilege are likely also unconstitutional given that Section 488.1 of the Criminal Code was modelled after section 232 of the *Income Tax Act*. Also, as the Supreme Court of Canada points out at paragraph 21 of its reasons for judgment in ***Lavallee***, "s. 232 of the *Income Tax Act* was enacted in 1956, long before the constitutional entrenchment of the protection against unreasonable search and seizure and other fundamental rights and freedoms."

Therefore, the procedure outlined within in sections 232 of the *Income Tax Act* and 293 of the *Excise Tax Act* should also be considered unconstitutional and cease to be used.

Until new legislation is in place, stringent norms must be respected to protect solicitor-client privilege when in search of documents or information:

- An RFI should not be issued for documents or information known to be protected by solicitor-client privilege.

- Officials must minimize interference with law offices. Accordingly an RFI should not be issued to law offices if other reasonable alternatives exist in terms of possible source of information.

- Potential privilege holders must, to the extent possible, be contacted so as to afford them a reasonable opportunity to assert a claim of privilege.

For further details, refer to Communication ARD-2004-033, **Issuing Requirements for Information to Lawyers-Solicitor-Client Privilege**.

Related Topics:

- **Information in Respect of the Affairs of a Lawyer's Client**

- **Information in Respect of a Lawyer Who is the Subject of Collection Action**

Information in Respect of the Affairs of a Lawyer's Client

Where CRA seeks information from a lawyer in respect of the affairs of the lawyer's client, great care must be taken to protect solicitor-client privilege.

First of all, the CRA can no longer demand information from a lawyer it knows is solicitor-client privilege. In practical terms, this essentially means that, in keeping with the applicable law, only accounting records of a lawyer, including any supporting vouchers or cheques, can now be demanded from a lawyer when trying to collect tax amounts owing by one of his/her clients.

This type of information would include, for example, information relating to the lawyer's trust account including debits and credits, monthly statements of account and cheques drawn upon or deposited to that account.

It is to be expected that lawyers will attempt to invoke solicitor-client privilege to protect such information. For the time being, the CRA considers that other types of information in the lawyer's

Digitized by Google

possession are presumed to be covered by solicitor-client privilege and should not be made the subject of an RFI, unless there are grounds to reverse the presumption.

Secondly, when in search of trust account information, the law office must be seen as a source of information of last resort. As mentioned above, there exists a duty to protect solicitor-client privilege and, by implication, to limit the number and scope of demands for information to lawyers.

For further details, refer to the Procedures section entitled **Solicitor-Client Privilege: Information in Respect of the Affairs of a Lawyer's Client** and to Communication ARD-2004-033, **Issuing Requirements for Information to Lawyers-Solicitor-Client Privilege**.

Information in Respect of a Lawyer who is the Subject of Collection Action

Where CRA seeks to obtain information from a lawyer who is himself or herself the subject of collection action, the rules are slightly different. The CRA takes the position that, since the information sought in such circumstances amounts to nothing more than the books and records of the lawyer in his/her capacity as taxpayer, the presumption in ***Maranda*** does not apply.

Until further notice, the CRA may in such cases choose from a list of options to acquire trust account information. For further details, refer to the Procedures section entitled, **Solicitor-Client Privilege: Information in Respect of a Lawyer Who is the Subject of Collection Action** and to Communication ARD-2004-033, **Issuing Requirements for Information to Lawyers-Solicitor-Client Privilege**.

Service of an RFI Letter

An RFI letter can be served using the following methods:

- registered mail
- personal service, refer to the policy **Personal Service of an RFI Letter** for further detail

Subsections 231.2 (1) of the ***Income Tax Act*** (*ITA*) and 289(1) of the ***Excise Tax Act*** state that the Minister can effect service by notice served personally or by registered mail. Also subsections 244(5) and 244(6) of the *ITA* and subsections 335(1) and 335(2) of the *ETA* provide means for proof of service by mail or by personal service.

Service of the RFI at Designated Branch

The Bank Act now allows the serving of an RFI to designated branches for the Chartered Banks. These service points are to be used when the Bank may be known, but the particular branch is unknown.

Under no circumstances may the use of this new facility be used as a method to arbitrarily search for bank account(s). You must have reasonable expectation that the taxpayer does in fact deal with a particular financial institution.

For a list of all designated branches, refer to **Appendix "A"** of Communication TSDMB-2006-020, Changes to the Bank Act allowing a Designated Branch for the point of Service for Requirements to pay and Requirements for Information.

Refer to the Procedures section entitled, **Completing an RFI When Serving a Designated Branch**.

Digitized by Google

Personal Service of an RFI Letter

Personal service is preferred because it facilitates the proof of service when prosecution for failure to comply is warranted. There may be restrictions within each province as to how we may effect service of any document, such as effecting service on a Sunday or holiday or restrictions to the time of day service can be made. Collectors must determine and be aware of any restrictions that may apply within the jurisdiction to which the RFI will be served.

RFI letters are served personally:

- to the person to whom it is directed in the case of an individual
- to a director officer, official or adult person in the employ of the addressee in the case of a corporation

It is important to remember that personal service of a bank RFI does not entitle our officers to request immediate production of large amounts of documents and/or information. The bank remains entitled to a reasonable compliance period specified in the requirement.

Circumstances When Personal Service Should be Effected on Banks

Effect personal service on bank branches in the following circumstances:

- servicing of an RFI letter simultaneously with or soon after the seizure of a tax debtor's records, thus preventing the tax debtor from obtaining the release of any original documents which might have been retained by the bank, for example, financial statements, undelivered cancelled cheques, etc.
- situations when a tax debtor is suspected of having conducted bank transactions using nominees, fictitious persons, and/or outside accommodating agents, the personal contact is intended to ascertain the relation between the tax debtor and any bank transaction carried in the name of the above mentioned type of individual
- situations where a tax debtor is suspected of having obtained either leniency and/or outright accommodation from one or more bank employees

It is important to remember that personal service of a bank RFI does not entitle a Canada Revenue Agency (CRA) officer to request immediate production of large amounts of documents and/or information. The bank remains entitled to a reasonable compliance period specified in the RFI letter.

Obtaining Information from the Bank of Canada

RFI letters for the Bank of Canada must go through the Investigations Division in the TSO. Investigations will forward the RFI to the Investigations Directorate at Headquarters who will then send the request to the Bank of Canada. The Investigations Directorate has assured that these requests will be handled on a priority basis.

For further details, refer to **Memorandum 01-02** and **Memorandum 01-10** both of which are entitled, Statutory Set-Offs and Requirements for Information to the Bank of Canada.

Requests for Payment by Third Party for Costs Incurred

CRA does not pay financial institutions or other tax debtors for the internal costs incurred by them in relation to the servicing of statutory requirements under section 231.2 of the *Income Tax Act* or

Digitized by Google

subsection 289(1) of the *Excise Tax Act*. Should a financial institution send you an invoice for search costs simply inform them that our Policy is not to pay fees related to a search for information relating to the issuance of an RFI.

Extension of Time

There is no provision in either the *Income Tax Act* or the *Excise Tax Act* to grant extensions. The granting of an extension will invalidate the RFI and make prosecution impossible. This factor should always be considered when stipulating a time frame in the RFI.

It is therefore essential that when service is executed, the Collector ensure that the person being served fully understands that the RFI must be complied with in the time stipulated.

Although an extension cannot be granted, the Department will be reasonable if the RFI is complied with before the summons to appear in Court is issued. As a rule, if the person complies before the summons is issued, we will not proceed with further action.

The following are situations that may arise and the procedures that should be followed in each case by Collectors:

A. A Collector is informed by the person served that the books, records, or information are available, but the time period has not yet expired:

   - In this situation, it is up to the Collector to immediately make arrangements to review the books and records, or information required at the place where they are located. If you do not do this immediately, or do so after the time period has expired, access is denied, you may not be able to prosecute for non-compliance.

B. We are informed after the time period has expired that the information or records are available at a given location. Steps have been taken to commence prosecution action, but a summons has not yet been served:

   - Again, it is up to the Collector to attend and obtain the information or records immediately, however, no promise will be given not to prosecute. This decision will be made after the required information or records are in hand.

C. We are informed, after the summons is served, that the information or records are available at a given location.

   - Again, arrangements must be made immediately to attend the location of the records or information. However for compliance purposes, prosecution will very likely continue.

D. The party served with the RFI shows that there are exceptional circumstances that prohibit them from honouring the RFI within the time frame specified. However, the party has been attempting to comply with the terms.

   - We can issue a new RFI extending the time frame allowed. Therefore, we are in effect invalidating the first RFI issued and now binding the party to the new date listed on the second RFI. If prosecution procedures were to be initiated it would be under the second RFI. However, this method must be used on an extremely rare basis. The party must provide clear, irrefutable evidence that compliance with the first RFI is impossible.

Digitized by Google

RFI Non-Compliance Action Against Financial Institutions (Joint and Unknown Account Holders)

Circumstances may arise wherein a financial institution will fail to comply with the issuance of an RFI served because the bank account holder is either unknown to the CRA or where only one of the bank holders is named within the RFI in the case of a joint account. It is the Agency's position, that the CRA is entitled to all information regarding an account, even though it does not know the name of the joint account holder or of the account holder.

It is the Agency's policy to pursue non-compliance action against a financial institution, which fails to comply with a valid RFI once all reasonable attempts to resolve legitimate concerns, if any, have been exhausted.

The following situations must be referred to the Department of Justice for consideration of non-compliance action after having consulted with your **Field Support Program Officer**:

- where the information is refused because only one bank account holder is identified (joint bank account)
- where the information is refused because the bank account holder is unknown

For additional details, refer to Communication ARD-2004-037, entitled **Requirements for Information-Financial Institutions Non-Compliance Action (Joint and Unknown Account Holders)** and Communication ARD-2005-016, entitled **Requirements for Information-Unnamed Person**.

Procedures

This section identifies procedures related to Requirements for Information letter:

- **RFI Letters Issued to a Third Party Residing Out of the TSO Area**
- **RFI Issued by Mail to a Third Party Residing Out of the TSO Area**
- **Personal Delivery or Servicing of an RFI to a Third Party out of the TSO Area**
- **Assistance Required by the Investigations Division in Another TSO**
- **Solicitor-Client Privilege: Information in Respect of the Affairs of a Lawyer's Client**
- **Solicitor-Client Privilege: Information in Respect of a Lawyer Who Is the Subject of Collection Action**
- **Completing an RFI Letter**
- **Completing an RFI When Serving a Designated Branch**
- **Personal Service of an RFI**
- **Completing an Affidavit for Personal Service, Form TX605**
- **Swearing of the Affidavit for Personal Service, Form TX605**
- **Non-Compliance with an RFI Letter**

Digitized by Google

- **RFI Non-Compliance Action Against Financial Institutions (Joint and Unknown Account Holders)**
- **Completing Approval for Prosecution**

RFI Letters Issued to a Third Party Residing Out of the TSO Area

Delivery and servicing of an RFI letter is the primary responsibility of the TSO who issued and signed the RFI letter, unless alternate arrangements are made beforehand between offices.

In any case, where enforcement action (prosecution) is likely, the RFI letter should be signed and issued by the Director of the Tax Services Office within whose territory the RFI letter is served. This procedure recognizes the responsibility of the resident Director for enforcement of the RFI letter, the different court systems across the country, the different jurisprudence in each province and the different procedures followed by the Regional Offices of the Department of Justice.

RFI Issued by Mail to a Third Party Residing Out of the TSO Area

When it is necessary to issue an RFI letter by either certified or registered mail to a party residing out of the TSO area where enforcement action (prosecution) is likely, proceed in the following manner:

1. Complete the RFI letter as outlined in the procedures **Completing an RFI Letter**. The delivery and service of an RFI letter is the primary responsibility of the TSO who issued and signed the RFI letter, unless alternate arrangements are made beforehand between offices.
2. Make a copy of the RFI letter, following the procedures outlined within **Number of Copies Required**.
3. Prepare a memorandum summarizing the particulars of the account, including the following:
   - account number
   - name of tax debtor
   - name and address of branch
   - intended date of service
   - name and telephone number of the collections officer
4. Attach the copy of the RFI letter to the memorandum.
5. Fax this information to the Assistant Director of Revenue Collections of the TSO in whose area the addressee resides so they are aware of the action being taken in their area.
6. Forward an extra copy of the RFI letter to the Director of the TSO in whose area the addressee resides.

If enforcement action (prosecution) is likely, the RFI letter should be signed and issued by the Director of the TSO within whose territory the RFI letter is served. This procedure recognizes the responsibility of the resident Director for enforcement of the RFI letter, the different court systems across the country, the different jurisprudence in each province and the different procedures

Digitized by Google

followed by the Regional Offices of the Department of Justice. This is particularly important where jurisdictions cross provincial boundaries.

Personal Delivery or Servicing of an RFI to a Third Party Out of the TSO Area

Where the assistance of the TSO in whose area the addressee resides is required for personal delivery and/or servicing of the RFI letter, proceed in the following manner:

1. Prepare a Memorandum for signature in the name of the originating office's Assistant Director, Revenue Collections requesting the assistance of the other TSO.

2. The Memorandum to the Assistant Director should include the following:

   - sufficient background and particulars of the case
   - instructions necessary for the TSO to service the RFI letter
   - name of the tax debtor
   - account number
   - name of collections officer in charge of the case
   - telephone number of the collections officer in charge of the case

   The local Assistant Director should then forward the Memorandum to their counterpart at the TSO where the assistance is required.

3. If only servicing assistance is requested of the TSO, attach a copy of the signed RFI letter addressed to the financial institution or third party.

4. When the Director of the TSO where the tax debtor is resident is asked to sign the RFI attach the required copies of the completed and unsigned RFI letter.

Assistance Required by the Investigations Division in Another TSO

Where the assistance of the Investigations Division in the affected TSO is desirable in delivering and/or servicing of an RFI letter on a financial institution or third party, proceed with the following:

1. Prepare a Memorandum for signature in the name of the originating office's Assistant Director, Revenue Collections requesting the assistance of the Investigations Division. The Memorandum should include the following:

   - sufficient background and particulars of the case
   - instructions necessary for the TSO to service the RFI letter
   - name of the tax debtor
   - account number
   - name of collections officer in charge of the case
   - telephone number of the collections officer in charge of the case

Digitized by Google

2. The Memorandum should then be forwarded to the Assistant Director, Investigations Division, of the originating TSO who will then forward the request to their counterpart in the applicable TSO.

Solicitor-Client Privilege: Information in Respect of the Affairs of a Lawyer's Client

As mentioned in the Policy section entitled **Information in Respect of the Affairs of a Lawyer's Client**, there exists a duty to protect solicitor-client privilege and, by implication, to limit the number and scope of RFIs to lawyers.

The following are the recommended steps to follow (in order of consideration) regarding the issuance of RFIs in these circumstances:

1. Provided this will not jeopardize or unduly delay collection, the first step is to request (formally by way of RFI or informally, depending on the circumstances) from people other than the lawyer the accounting information of interest to the collections investigation. Namely: the taxpayer who is the subject of the collections investigation, the seller or the buyer in transactions of interest, etc. On the basis that jeopardy and undue delay in collection are not present in the vast majority of cases, the first step to take in trying to obtain information concerning transactions that have gone through a lawyer is, as a general rule, to contact people other than the lawyer

2. If the name of the bank responsible for the trust account information of interest to the CRA is not known:

   - demand from the lawyer by way of an RFI the name of the bank as well as the trust account number; and

   - send an RFI to that bank demanding that it provide accounting information relating to transactions of interest to the collections investigation – copying the potential privilege holder (to the extent possible) at the two stages of communication

     Note: Until such time as the Courts provide clear guidance on the issue of whether accounting information relating to a lawyer's trust account are covered by solicitor-client privilege in a tax collection context, there is good reason to err on the side of caution and give the potential privilege holder every opportunity to be heard.

3. If the name of the bank responsible for the trust account information of interest and the trust account number are known:

   - demand the information directly from the Bank, by way of an RFI, and inform the lawyer and his client of having done so by sending them each a copy of the RFI

4. If all of the above steps fail to obtain accounting information relating to transactions that have gone through a lawyer, the next step is to send an RFI to the lawyer demanding all of the accounting information in his or her possession that concerns the transaction(s) at issue, and copy the potential privilege holder on the communication.

For more details refer to Communication ARD-2004-033, **Issuing Requirements for Information to Lawyers-Solicitor-Client Privilege**.

Digitized by Google

Solicitor-Client Privilege: Information in Respect of a Lawyer Who is the Subject of Collection Action

The following are the recommended steps to take when the CRA seeks to obtain information from a lawyer who is himself or herself the subject of collection action:

1. Issue an RFI to the lawyer in order to obtain information as to the amount of fees paid or owed to the lawyer by his/her clients, his or her list of clients, and other like information essential for collection purposes; OR

2. Issue an RFI to clients of the lawyer in order to seek information or documents as to the amount of fees paid or owed by the clients to the lawyer; OR

3. Issue an RFI to the bank with which the lawyer deals and seek from the bank information such as monthly statements of account as well as cheques drawn upon or deposited to such accounts.

For more details refer to Communication ARD-2004-033, **Issuing Requirements for Information to Lawyers-Solicitor-Client Privilege**.

Completing an RFI Letter

When completing an RFI, form **T375** or **T375A** or ELCS letters 19646, 19647, 19648 or 80789, there must be no spelling errors or typing erasures.

The following is a breakdown of an RFI letter by area. Each area has its own part to play in the overall process. A mistake or error in any one of the areas may invalidate your efforts to secure information or to prosecute for failure to comply.

Related Topics:

- **Identifying the Client**
- **Identifying an Individual**
- **Identifying a Proprietor**
- **Identifying a Partnership**
- **Identifying a Corporation**
- **Completion of the "Re-Line"**
- **Date of Director's Signature**
- **Time Allowed for Compliance**
- **Time Period for RFI**
- **Suggested Verses for RFIs**
- **RFI Approval Levels**
- **Number of Copies Required**

Digitized by Google

Identifying the Client

In preparing an RFI you first must properly identify the party you will be serving. Once you have identified the party you need to confirm the legal name when possible. As in all legal documents, naming the wrong party can invalidate the action.

Identifying an Individual

The proper legal given name of the individual identified must be used when addressing an RFI. If you know that the party uses an alias, use the alias also in addressing the RFI letter.

For example, the party is a doctor using her maiden name professionally, Dr. Mary Elizabeth Smith. She is married to David Jones and represents herself as Mary Jones in her non-professional life.

In this example, the RFI should read:

- Mary Elizabeth Jones (sometime known as Mary Elizabeth Smith)

The address listed should be the known address of the individual named on the RFI.

Identifying a Proprietor

Use the proper given legal name when preparing an RFI for the proprietor of a business. You must include the name or trade style of the business operated if your investigation reveals that it is their only source of income.

For example, if you know that the client's name is John Thomas Jones and that he operates a proprietorship entity operating as Jones Cafe, address the RFI in this format. Do not use John T. Jones. Avoid the use of initials wherever possible.

In this example, the RFI should read:

- John Thomas Jones (sometime carrying on business as Jones Cafe)

The address listed in an RFI to a proprietorship should be the home address of the proprietor, if the address is different from the business address of the proprietorship entity.

Identifying a Partnership

When prosecution action is taken against a partnership for failure to provide information, action will be taken against only one of the partners. Therefore a decision should be made prior to the issuance of the RFI as to which partner we would consider any prosecution action against in the event of non-compliance. The partner should be the one who has the ability to comply with the terms of the RFI. Section 244(20) of the *ITA* allows the Agency to enjoin all members of a partnership when at least one partner has been served.

Use the full proper legal given name of the partner identified and the partnership name/trade style.

For example, a partnership operates as D & A Accounting Service. There are two partners, Douglas McGregor and Andy Smith. We have identified Douglas McGregor as the partner to which we intend to serve the RFI.

In this example the RFI should read:

Digitized by Google

Douglas McGregor
D & A Accounting Service

The RFI should be addressed to the address of the partnership. In the case of an inactive partnership, it is acceptable to address it to the identified partner's home address.

Identifying a Corporation

In all cases the RFI must identify the Corporation's legal name and Head Office address as registered within the applicable provincial or federal registry system, regardless of where the corporation actually operates. If you are aware that the legal name and the name under which the client is operating are different, there is nothing wrong with using both names on the RFI. This should be confirmed by a corporate registry search prior to the issuance of the RFI.

When issuing an RFI to a corporation that is being investigated, a director or officer of the corporate entity must be named in the RFI and both the director (or officer) and the corporate entity served.

During this process, two RFIs are prepared for service concurrently. The first RFI will indicate the proper name and address of the corporation. The second RFI will be issued indicating the name and address of a corporate director or officer and citing the name of the corporation within the "Re" line.

For example, RFIs to a corporation should be prepared as follows:

- For service on the corporate entity (RFI #1):

  ABC Company Ltd.
  111 Any Street
  Anytown, Province, Postal Code

- For service on the director/officer (RFI #2):

  John Doe
  123 Main St.
  Anytown, Province, Postal

  Re: ABC Company Ltd.

The RFI in the name of the corporate director can be served wherever they can be located. This process also ensures that the CRA can prosecute the enjoined Director or Officer in a case of non-compliance.

Care must be exercised by the collections officer to ensure the named individual is an actual officer or director of the company. To establish who is the responsible officer or director, reference may be made to:

- prior T2 returns for corporate director/officer information
- the applicable provincial/federal corporate registry system
- the corporation's Minute Book (if available)

Digitized by Google

- any corporate document signed by the individual that would indicate control of the corporation

Occasions may arise when the sources listed above are not available or are of such an age that doubt exists as to current application. In these instances, it will be necessary to interview in person the last known officers to establish who is responsible for the operation and/or control of the company.

Completion of the "Re-Line"

The proper completion of the "Re-Line" is vital so as to minimize future legal challenges regarding the issuance of RFIs as they relate to the issue of "unnamed persons."

For details regarding the proper use and completion of the "Re-Line", refer to the Policy section entitled **The "Re-Line."**

Date of Director's Signature

RFIs must bear the date on which the Authorized Person signs the letter. Enter the date on which the Authorized Person has signed the letter. It is recommended that a date stamp be used when dating the document.

Ensure the signature block, of the Requirement for Information, reflects the correct title for the work description of the delegated authority approving the Requirement for Information.

For further details refer to the section entitled **Approval Authority**, and TSDMB-2008-017 **Correct Signatures for Requirement for Information (RFI) and Requirement to Pay (RTP)**.

Time Allowed for Compliance

The normal time frame allocated for compliance with an RFI is 30 days. The courts have determined this period as a reasonable length of time for the party to respond to the RFI.

However, RFIs have been challenged in court because the time limit set for the production of information was found to have been unreasonable.

What is reasonable is a question of fact in each case. A party cannot be expected to drop everything in order to comply with the RFI. In addition, the effort required to produce the information should be taken into account.

The following factors must be taken into consideration:

- the amount of work involved to compile the information in relationship to the staff available
- the time of year, given that some businesses have peak periods in their year and as such may not have the time to gather the information at that time
- if the use of a professional is required, then consideration must be given to their schedule as well

You must also consider the following:

- every effort must be made to ensure that the due date does not fall on a Saturday, Sunday or holiday (**non-juridical days**). However, in the event that the due date does fall on a Saturday, Sunday or holiday after service/delivery of the RFI has occurred, then the

Digitized by Google

federal *Interpretation Act* (Section 26) deems the date for compliance to be the next business day.

- add time to the due date to permit the service or delivery of the RFI if you are predating your RFI before delivery
- when requiring multiple years, the general rule is to allow at least 30 days for each tax year requested
- possible delays in the servicing of the RFI

Therefore, you must ensure that all factors are considered when making your determination of reasonable time. The decision must be based on the facts at hand, the circumstances involved, on a case-by-case basis.

Time Period for RFI

When completing an RFI, you must determine the exact periods required for the review of information. Each tax year involved should be on a separate RFI letter. Also, any information requested for a time period that spans more than one fiscal period requires an RFI for each period.

For example:

> Information is requested from a party in the form of cancelled cheques and sales invoices for the period August 1, 2003 to August 1, 2004.

In this example, we must issue two separate RFIs for the information desired:

- one for the period August 1, 2003 to December 31, 2003; and
- one for the period January 1, 2004 to August 1, 2004

Each RFI non-compliance may constitute a separate offence where prosecution is contemplated. However, where the practice is to seek remedy to a failure to comply by obtaining a Compliance Order pursuant to section 231.7 *ITA* or section 289.1 *ETA*, multiple RFIs are not necessary to the action.

> Note: When identifying the period for review, no short forms or abbreviated dates can be used. You must write the dates in full: Month, Day, Year to Month, Day, Year.

Suggested Verses for RFIs

You may encounter situations where the use of an RFI requires that the document be customized to secure specific information unique to the third party being served. In those instances, it is suggested that the RFI be customized to narrow the scope of your search, which will allow the third party to better expedite the return of the information required.

The following are some suggested phrases for use against various third parties.

Related Topics:

- **Phrases for Information/Documents Required from an Individual**
- **Phrases for Information/Documents Required from Financial Institutions**

Digitized by Google

- **Phrases for Information/Documents Required from Insurance Companies**
- **Phrases for a Review of Books and Records**
- **Phrases for Information/Documents Required from a Credit Card Company**
- **Phrases for Review of Books and Paydac Accounts**

Phrases for Information/Documents Required from an Individual

A Net Worth Statement as of (INSERT DATE), complete with supporting schedules, showing full details of all your assets, liabilities, household expenses and including information as follows:

The names, branches and account numbers of all financial institutions in which you maintain either accounts or safety deposit boxes or both, including information of amounts on deposit as at (INSERT DATE). For the period (INSERT START OF PERIOD) to (INSERT END OF PERIOD) provide copies of monthly banking statements for all accounts.

Details of all bonds, common shares and preferred shares maintained by you, whether or not registered in your name, including the individual cost per share, and the current location of each security.

Details of all real property owned by you, whether or not registered in your name, including the legal description, and amounts of encumbrances. Provide the names and addresses of encumbrances, and the location of the applicable Registry office.

Details of all insurance carried by you, with names of insurance companies, face value of policies, policy numbers, cash surrender values and accrued dividends where applicable, and the location of policies.

Details of all mortgages and loans receivable in which you have a beneficial interest, giving details of amounts due to you as of (INSERT DATE), dates of registration, Registry Office where registered, and legal description of property encumbered. Where applicable provide terms of repayment, maturity date, and names and addresses of all mortgages or other debtors.

Details of all loans and mortgages payable by you as at (INSERT DATE), including the current market value of all security given, together with legal description of all property pledged.

Details of all automobiles owned by you, as at (INSERT DATE), including year, model and make of vehicle, license plate number, vehicle identification number, names and addresses of lien holders or encumbrances and cost of each vehicle.

Full details of any other assets owned by you, whether or not registered in your name, but not included in the foregoing.

Phrases for Information/Documents Required from Financial Institutions

Statements of account setting out all entries in all accounts including, but not limited to, chequing, savings, current accounts, term deposits, Guaranteed Investment Certificates and Canada Savings Bonds, at your Branch, that are known to be or to have been operated or controlled by, for, or on behalf of the person(s) named above or any of them and all joint accounts in the names of any of those persons and another or others.

Digitized by Google

A statement setting out particulars of all transactions, including but not limited to loans, loan applications lines of credit, mortgages, mortgage applications, signature cards for all accounts held, credit card accounts, safety deposit box rentals, safekeeping and security dealings at your Branch with, to, for or on behalf of the person(s) named above or any of them either alone or with another or others, or any person or persons known to be or to have been acting on behalf of those persons or any of them.

All documents, including but not limited to authorizations, power of attorney, mail and telegraphic transfers, accounts, vouchers, letters, contracts, letters of credit and statements that are known to be or to have been related to the entries or transactions set out in the statements required above.

Copies of Signature cards for all accounts held.

Phrases for Information/Documents Required from Insurance Companies

For general information the following can be used:

Statement setting out all policy numbers, investments and mortgages held with your company that are known to be or to have been operated or controlled by, for, or on behalf of the persons named above or any of them and all joint accounts, policies in the name of any of those person(s) and another or others. Any investments held with your institution shall include reference numbers and current market value for any RRSP's, Term Deposits and Mutual Funds.

A statement setting out all particulars of all transactions, including the face value of any policies, cash surrender values, accrued dividends, loans and collateral thereto held by (INSERT NAME OF INSURANCE COMPANY) with, to, for or on behalf of the person(s) named above or any of them either alone or with another or others, or person or persons known to be or to have been acting on behalf of those persons or any of them.

A statement setting out particulars of all provisions of the above noted policy or policies. This statement shall include the renewal, conversion, beneficiary, settlement and general provisions of the said policy or policies. In addition, please provide all policy riders that modify or restrict the conditions of any and all policies held by (INSERT NAME OF DEBTOR).

A statement setting out the effective insurance date(s), term period(s), reinstatement dates of any lapsed policy or policies and the amount and method of the premium payments. Please provide all details of the premium payments including front and back true copies of the last three (3) months worth of cheques received by (INSERT NAME OF INSURANCE COMPANY) for policy payment. If any or all policies held by your institution are paid on an annual basis, please provide front and back true copies and/or the method of payment for a one (1) year policy period. These true copies shall include any cancelled cheques, drafts, mail and telegraphic transfers, deposit slips and debit and credit advances that are known to be or to have been related to the method of payment of any instruments held by your institution.

All documents, including authorizations, power of attorney, mail and telegraphic transfers, accounts, vouchers, letters, contracts, letters of credit and statements that are known to be or have been related the entries or transactions set out in the statements required under above.

For specific information the following can be used:

Copy of all policies maintained by your firm on behalf of (INSERT NAME).

Description of all insured items with details as to coverage amount, value and replacement value of all items insured. Such items include chattels/personal property, livestock, real property and/or dwellings.

Digitized by Google

Details of all insurance brokers, including name, address and policy number(s) associated with (INSERT NAME).

Details of all claims made, including front and back copies of all cheques issued to (INSERT NAME).

If applicable, copies of post dated cheques on file. If payments are made via direct withdrawal, provide the financial institution name, transit number, account number in which insurance fees are deducted from.

Any other documents held other than those listed above relating to (INSERT NAME).

Phrases for a Review of Books and Records

All books and records relating to the above, for the fiscal period (INSERT START OF PERIOD) to (INSERT END OF PERIOD) including, however, not limited to:

The Corporate Minute Book including, but not limited to the Shareholders Register, Directors Register, Share Certificate Register, Minutes of Shareholder Meetings, Minutes of Directors Meetings.

All records recording day to day business transactions including, but not limited to cash receipts, cash disbursements, billing statements, cancelled cheques, bank statements, cheques registers, payroll records, journal entries, shareholder loan accounts and deposit books.

A complete list of money, shares, securities, interest, dividends or any asset held directly, indirectly or beneficially by (INSERT NAME OF CORPORATION) for (INSERT NAME OF DIRECTOR (S) if applicable).

A complete list of all personal guarantees, trust agreements and/or power of attorneys signed by (INSERT DIRECTOR (S) NAME (S) in his capacity as director/shareholder of (INSERT NAME OF CORPORATION).

A complete list of all corporate assets that (INSERT NAME OF DIRECTOR (S)) has or had a beneficial, direct or indirect interest in for the above noted period.

A complete list of any type of financial remuneration received by (INSERT NAME OF DIRECTOR (S)) from (INSERT NAME OF CORPORATION) for the above noted period.

Phrases for Information/Documents Required from a Credit Card Company

Credit card application forms, copies of monthly statements, copies of cheques received in payment, and the names of authorized signatures for the period (INSERT START OF PERIOD) to (INSERT END OF PERIOD).

Phrases for a Review of Books and Records of Paydac Accounts

For purposes related to the administration or enforcement of the *Income Tax Act*, pursuant to the provision of subsection 231.2(1) of the said Act, I hereby require from you, within (INSERT NUMBER OF DAYS IN FULL) (INSERT NUMBER OF DAYS NUMERICALLY) days from the date of service hereof, information and documents as follows for the period (INSERT START OF PERIOD) to (INSERT END OF PERIOD);

1. Payroll journals (salary, wages, commission etc.).

Digitized by Google

2. Cheque register or cash disbursement journal.
3. Sales journal.
4. Cash receipts journal.
5. Accounts receivable ledger.
6. General ledger.
7. Accounts payable ledger.
8. Cancelled bank cheques and statements.
9. Payroll remittance receipts.
10. Minute book including Shareholder's register.
11. Your copy of Employment Insurance Commission Record of Employment forms that were completed during the above-noted period.

RFI Approval Levels

The approval levels for the issuance of RFIs within Revenue Collections are outlined in the

Authorities Matrix which stipulates that the persons authorized to approve the issuance of RFIs at the TSO level are as follows:

- Director, Tax Services Office
- Assistant Director, Revenue Collections Division
- Assistant Director, Revenue Collections and Client Services
- Manager, Revenue Collections Division
- Manager, Revenue Collection and Client Services

It is recommended that all RFIs be issued in the name of the Director, Tax Services Office, regardless of who has the delegated authority to sign the document.

RFIs are to bear the date on which the Director or his/her delegates, sign the RFI, regardless of when they are served. This can be done by printing the letter with an estimated date of signature or by date-stamping the document upon receiving the appropriate signature.

Ensure the signature block, of the Requirement for Information, reflects the correct title for the work description of the delegated authority approving the Requirement for Information.

For further details, refer to Communication TSDMB-2008-017 **Correct Signatures for Requirement for Information (RFI) and Requirement to Pay (RTP)**Co

Number of Copies Required

Upon receipt of the signed original, the Collector must make three (3) copies of the signed original. At this point the Collector must visually compare the copies to the original and then proceed to initial and date the lower right hand corner of the copies AND the original. This procedure is necessary for court purposes when it comes to possible non-compliance prosecution as the Collector is attesting to the fact that the duplicates are in fact copies of the original RFI.

Digitized by Google

It is the practice of some TSOs to submit four original versions of the same RFI for signature. In these circumstances the process noted above would not be required.

When serving the RFI, the Collector will then serve an original copy of the requirement on the third party and have the third party sign a copy to acknowledge receipt (or all copies) of the document for our records. The other two clean copies are kept on file for use in the case of prosecution for non-compliance. Please refer to the section **Personal Service of an RFI**, for further details.

Completing an RFI When Serving a Designated Branch

When serving an RFI to a designated branch, you are to prepare the accompanying ELCS letter 19648. On the "third party address" screen you must insert Designated Branch on the "Attention line." This distinction will let the Bank know that they are to search all data bases for information and assets. It is critically important to ensure that you have indicated the proper legal entity of the Bank to reduce the exposure of non-compliance.

To ensure the best search results from the Designated Branch, please be as specific as is possible when identifying the taxpayer or third party. Please refer to the section **The Re-Line** for further details.

Personal Service of an RFI

When choosing personal service it is of extreme importance that you:

- Properly identify the person to whom the RFI is addressed. Service on the wrong person will adversely effect any attempt to prosecute for failure to comply.
- Make a note of who was present when the document was served (witnesses).
- In the case of a corporation ensure your information is current and that you are dealing with the proper authorized person. In addition you must ensure that you have two (2) copies of the requirement, one for the corporation and one for the officer and/or director you wish to enjoin in the action.

Please refer to the section **Completing an RFI Letter** for further details.

Care must be exercised when addressing an RFI to an incorporating lawyer. Ensure that his involvement goes beyond the incorporation of the firm. In cases where there is denial of any knowledge of the person you are seeking, it is extremely important to probe for information. Do not accept what you are being told without a more satisfactory explanation.

Related Topics:

- **Identifying Yourself**
- **Service of the RFI**
- **Documenting Service**
- **The Need for a Witness**

Digitized by Google

Identifying Yourself

It is important to identify yourself so as to clearly establish the Agency's legal authority to serve the RFI. The best way to identify yourself is with the use of the RC121A identification card issued to you by the Agency. It is also good practice to leave your business card.

Service of the RFI

Serve the RFI letter by giving the original to the person named on the RFI or in the case of a financial institution, an authorized person. At this time you should:

- explain the content and deadline date
- ask for a signature to acknowledge receipt on one of the duplicate copies (or all copies)
- take note of the time and date of service in case you have to swear an affidavit
- where possible, obtain the name and phone number of the person responsible for providing the information in case you need to follow-up on the status of the RFI

In the event the party refuses to accept and sign the duplicate copy you should leave the original there. The party served does not have to touch the RFI. By leaving the document with them you have perfected service. Return to the office and swear out the affidavit of service immediately.

Please refer to the section **Completing An Affidavit for Personal Service, Form TX605**, for more details.

If the party is not readily available or you have been told that the party is not there, do not leave the RFI with an employee, secretary or other third party, as this method of service will nullify any potential prosecution should non-compliance occur. This method of service is problematic as the Agency will not be able to show the Courts that service of the RFI was properly perfected.

As a result, simply inform the third party you are dealing with that you will return again to attempt to serve the documents. At this juncture you may attempt to serve the documents at another site if you have located the party somewhere else.

Remember while the RFI letter must be addressed to the corporate head office or an individual's residential address, you may serve the RFI anywhere the named party can be physically located with the exception of financial institutions. The Agency must make what the Courts deem a "reasonable effort" to serve the named party on the RFI letter before they will consider the issue of non-compliance with the RFI in the prosecution process.

The remaining 3 copies of the RFI are retained following service for the following:

- the first copy is attached to the Affidavit of Service Form TX605 (if required)
- a second copy is utilized as evidence for any potential prosecution action (if applicable)
- the third copy is retained within the tax debtor's file

Documenting Service

It is important that notes be taken whenever an RFI is served, as certain information may be needed in court to establish service. The following information must be recorded when serving an RFI:

Digitized by Google

- the date of service
- the time of service
- the address of service if different from the address indicated on the RFI
- the full name of the party served including a brief description (male or female, height, colour of hair, etc.)
- how the identity of the party was confirmed (verbal confirmation, by a review of legal identification, etc.)
- what explanation was given to the client about their responsibilities with respect to the information and documents required and the time limits imposed
- a warning of potential prosecution should the non-compliance occur

The Need for a Witness

The following are examples of when you might consider taking a witness when effecting service on an RFI:

- the history of the client indicates he/she is belligerent
- there is a previous history of non-compliance
- service will take place in a remote area or location where the safety of the collector may be an issue if the client has an history of non-compliance

The safety of the Collector is a key issue. Your safety is your prime consideration. When in doubt, take a witness with you.

Completing an Affidavit for Personal Service, Form TX605

When applicable, upon returning to the office the Collection Officer will swear out a complete Affidavit of Personal Service Form TX605. Form TX605 can be accessed through the Infozone web site within the **Forms and Publications** section.

Complete the form as follows:

1. Enter the full name and address of the tax debtor exactly as shown on the true copy of the RFI, after the phrase "In the Matter of the *Income Tax Act* or *Excise Tax Act*."
2. Enter the full name and home address of the officer of CRA who personally served the RFI on the named party.
3. Record the date the RFI was personally served.
4. Enter the name and address of the tax debtor exactly as shown on the true copy of the RFI.

   Note: Where an RFI is served on an officer of a corporation, include the statement, "Personally served ABC Corporation Limited by leaving the Requirement to Provide Information and Documents with Mr. John Doe who is an officer/director of the company."

Digitized by Google

5. Enter the word "Notice" after the words "with a."

6. Enter the applicable section of the *Income Tax Act* or *Excise Tax Act* referred to in the notice after the words "pursuant to."

7. Enter the word "Notice" after the words "handing the said."

After the Affidavit for Personal Service, TX605 is prepared, it is to be sworn before an officer designated to administer oaths, refer to **Swearing of the Affidavit for Personal Service, Form TX605**.
Where any difficulties are encountered in the completion of RFI letter affidavits, it is recommended that the assistance of the Investigation Division be sought in order to ensure that the documentation is properly prepared.

Swearing of the Affidavit for Personal Service, Form TX605
After the Affidavit for Personal Service, form TX605 is prepared, it is to be sworn before an officer designated to administer oaths. You must ensure that the following guidelines are met:

- The date must be the same as the date the affidavit is sworn.
- The officer designated under the *Income Tax Act* or *Excise Tax Act* to administer oaths ensures that the true copy of the RFI letter is stapled to the affidavit for personal service, form TX605.
- Under no circumstances should an Affidavit of Personal Service, form TX605, be prepared if the RFI letter was not served personally on the individual but was left instead with someone else (for example tax debtor's spouse), substitution service cannot support a prosecution.

Non Compliance With an RFI Letter
This section contains information on measures dealing with non-compliance to an RFI.

Related Topics:

- **Prosecution Action**
- **Compliance Order**

Prosecution Action
When the RFI is not complied with by the due date plus 10 days:

1. Complete an Approval for Prosecution, form TX615 in duplicate.
2. Attach copies of relevant documents including:
   - RFI letter
   - the Affidavit for Personal Service, Form TX605
   - details of the case

Digitized by Google

3. Obtain the Assistant Director, Revenue Collections approval in the area indicated as recommended by supervisor.

4. Obtain the approval of the Director of the TSO once the Assistant Director Revenue Collections has approved the recommendation. The Director may delegate the signing authority to the Assistant Director of Revenue Collections.

5. Once the Director has approved the prosecution forward all documents to the appropriate section responsible for prosecutions as per local TSO parameters.

Compliance Order

Collections has a second option when dealing with non-compliance to an RFI. Legislation passed on June 14, 2001, contained in Sections 231.7 of the *ITA* and 289.1 of the *ETA* allows the Minister to seek an order to provide the access, assistance, information, or document sought by way of summary application, known as a Compliance Order. The judge hearing the application will have the discretion to allow the order or to attach such conditions to the order, as he/she considers appropriate. A person who refuses to comply with the judge's order may be found in contempt of court.

The Ministerial powers relating to Sections 231.7 of the *ITA* and 289.1 of the *ITA* to seek a Compliance Order have been delegated to the Director.

For further details, refer to Memorandum 01-08, entitled **Bills C-13 and C-22**, or contact your **HQ Field Support** officer for assistance. It is also recommended that Collection Officers refer to Communication ARD-2004-015, entitled **Guidelines for the Use of *ITA* 231.7 and *ETA* 289.1**, or access the **guidelines** directly.

Related Topic:

- **Non-Compliance by a Provincial Ministry**

Non-Compliance by a Provincial Ministry

When forwarding Requirements for Information to Provincial Ministries or Agencies, please note that if any non-compliance issues arise you should immediately contact your respective **HQ Field Support Officer** for his/her review and approval of any proposed non-compliance proceedings. It is recommended that you consult HQ prior to obtaining a legal opinion from the Department of Justice.

RFI Non-Compliance Action Against Financial Institutions (Joint and Unknown Account Holders)

As noted within the Policy section entitled, **RFI Non-Compliance Action Against Financial Institutions (Joint and Unknown Account Holders)**, scenarios that fall within this category should be referred to the Department of Justice for review and possible action.

The following information should be forwarded to the Department of Justice for such a referral:

- details regarding the primary account involved within the investigations including the reasons the RFI action was taken

- a copy of the RFI served to the offending financial institution

Digitized by Google

- a copy of any written response from the financial institution outlining the reasons why the RFI was not complied with or any facts regarding proof of non-compliance
- full contact information for all involved parties

The Department of Justice will consult with the Agency's banking liaison and advise them of the course of action to be taken. The Department of Justice will then proceed with an Application on the Agency's behalf under section 231.7 *ITA* or section 289.1 *ETA* to compel compliance.

Once the case has been referred to the Department of Justice, optional ELCS letter 80794 may be sent to the financial institution notifying them that the matter has been referred to the Department of Justice and that the filing of an Application under section 231.7 *ITA* or section 289.1 *ETA* has been made or that other legal measures may be taken.

For further details, refer to Communication ARD-2004-037, entitled, **Requirements for Information-Financial Institutions Non-Compliance Action (Joint Account Holders)** and Communication ARD-2005-016, entitled **Requirements for Information-Unnamed Person**.

Completing Approval for Prosecution

If the RFI letter is not complied with by the due date plus 10 days, an Approval for Prosecution, form TX615 (formerly TX13) which summarizes the case for the Tax Services Office Director or Assistant Director, Revenue Collections depending on local policy, will be completed in duplicate. Form TX615 can be accessed through InfoZone under the **Forms and Publications** section.

Complete form TX615:

The minimum fine requested is usually $1,000 as prescribed by subsection 238(1); of the *ITA* or ss 326(1) of the *ETA* however, depending upon the circumstances, the amount can be to a maximum of $25,000.

Where Approval for Prosecution, form TX615, refers to convictions or acquittals for other offences, only list those prosecutions normally handled by CRA. If the tax debtor has not been prosecuted during the preceding four years, no prosecution history will be shown.

Obtain your local delegated signatures for the authority lines "File reviewed by" and "Recommended by", located on the bottom of the Approval for Prosecution TX615.

Forward the following items to the delegated approval level for signature:

- duplicate copies of the Approval for Prosecution, forms TX615 and Affidavit of Personal Service, form TX605 (formerly TX25)
- the true copy of the Requirement for Information Letter, as Exhibit A

After the file has been approved, forward the following items to the person assigned within Revenue Collections or within the TSO for prosecutions:

- the prosecution file
- the Approval for Prosecution, form TX615
- the Affidavit of Personal Service, form TX605
- a true copy and two other copies of the RFI letter

Digitized by Google

The officer responsible for the prosecution will prepare an Affidavit form TX610 (formerly TX17) as evidence that the information was not supplied by the due date as well as the information and Summons. Once a court date is set, both the Officer named on the Affidavit, form TX610 and the Collection Officer who swore the Affidavit of Personal Service, form TX605 may be required to attend.

For more extensive information refer to **NF/NR Prosecutions Chapter**, located in the Trust Accounts NF/NR – Operations Manual.

> Note: Procedures for prosecution are contingent on local TSO parameters. Some Revenue Collections Divisions will continue to utilize the Investigations Division for all prosecution actions, while others have their own Divisional prosecution officers or specialists assigned the task of prosecutions. Local TSO or Revenue Collections Divisional policy will ultimately determine how prosecutions are actioned within each TSO.

Resource Material

Memorandum 01-02, **Statutory Set-Offs and Requirements for Information to the Bank of Canada**, issued February 12, 2001.

Memorandum 01-08, **Bills C-13 and C-22**, issued June 26, 2001.

Memorandum 01-10, **Statutory Set-Offs and Requirements for Information to the Bank of Canada**, issued July 6, 2001.

Memoranda 01-21, **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act***, issued December 18, 2001.

Communication ARD-2003-004, **Funds held in RRSPs**, issued October 21, 2003.

Communication ARD-2004-015, **Guidelines for the Use of *ITA* 231.7 and *ETA* 289.1**, issued April 13, 2004.

Communication ARD-2004-033, **Issuing Requirements for Information to Lawyers-Solicitor-Client Privilege**, issued June 11, 2004.

Communication ARD-2004-037, **Requirements for Information-Financial Institutions Non Compliance Action (Joint and Unknown Account Holders)** issued June 23, 2004.

Communication ARD-2004-044, **Requirement for Information (RFI) Differentiating taxpayer(s) who are the subject of collection action from co-account holders and others**, revised April 7, 2005.

Communication ARD-2005-016, **Requirement for Information-Unnamed Person**, issued April 1, 2005.

Communication ARD-2005-039, **Change Made to ELCS Verse 19648-Requirement for Information to Financial Institution**, issued November 10, 2005.

Communication TSDMB-2006-020, **Changes to the Bank Act allowing a Designated Branch for the point of Service for Requirements to pay and Requirements for Information**, issued February 27, 2006.

Digitized by Google

Glossary

Form T375 (ELCS letter 19648)

Used to obtain information and/or documents from financial institutions and is issued by registered mail.

Form T375A

Utilized to obtain information and/or documents from financial institutions. The only difference from Requirement to Provide Info and Documents is that this format is used to effect personal service of the letter.

Non-juridical day

Black's Law Dictionary defines "Non-juridical day" as a "Day on which process cannot ordinarily issue or be executed or returned, and on which courts do not usually sit."

Digitized by Google

Digitized by Google

Digitized by Google

[105]

OFFENCES AND PUNISHMENT

Offences and punishment - S. 238(1)

238. (1) Every person who has failed to file or make a return as and when required by or under this Act or a regulation or who has failed to comply with subsection 116(3), 127(3.1) or 127(3.2), 147.1(7) or 153(1), any of sections 230 to 232 or a regulation made under subsection 147.1(18) or with an order made under subsection 238(2) is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

(*a*) a fine of not less than $1,000 and not more than $25,000; or

(*b*) both the fine described in paragraph 238(1)(*a*) and imprisonment for a term not exceeding 12 months.

Compliance orders

(2) Where a person has been convicted by a court of an offence under subsection 238(1) for a failure to comply with a provision of this Act or a regulation, the court may make such order as it deems proper in order to enforce compliance with the provision.

Saving

---

[105] "Sun Tears", 2011, Patricia Vertes, Howick, Quebec

Digitized by Google

(3) Where a person has been convicted under this section of failing to comply with a provision of this Act or a regulation, the person is not liable to pay a penalty imposed under section 162 or 227 for the same failure unless the person was assessed for that penalty or that penalty was demanded from the person before the information or complaint giving rise to the conviction was laid or made.

Filing is a Strict Obligation, Absent of Frame of Mind

In Sandra June Gibbs v. Regina[106] the filing requirements of the Act were commented on. It's important to note that the only method to defend a strict liability (obligation) as this is with the defence of due in that the steps the taxpayer took to comply with the Act were those a reasonable person would have taken. In this case the court held:

> *Did the trial judge err in characterizing the offence as one of strict liability when it should be considered a full mens rea offence?*
>
> [65] The offences in question are created by s. 238(2) of the ***Act***. It is common ground that offences created by s. 238 are strict liability offences for which the defence of due diligence is available: ***R v. Rohan's Rockpile Ltd.*** (1981), 26 B.C.L.R. 125, 57 C.C.C. (2d) 388 (B.C.C.A.); ***R v. Adair***, [2000] 3 C.T.C. 116, 2000 BCSC 861 at para. 5. Further, in ***R v. Bordignon***, [1981] B.C.J. No. 342 (B.C. Co. Ct.), the court considered a corporate offence, not dissimilar to counts 3 and 4 in this case, and concluded that following the Court of Appeal's decision in ***Rohan's Rockpile***, these were also strict liability offences. For this reason, there is no requirement to establish the mental element or *mens rea* for the offences the appellant was charged with. **[66] The only defence available to an individual charged with a strict liability offence is due diligence. The appellant must "establish, on the balance of probabilities, that [s]he took all reasonable steps, which would have been expected of a reasonable man, to comply with the Notice" (*Adair* at para. 5). As acknowledged by this court in *Adair*, a finding of due diligence is considered a finding of fact and an appellant court must not interfere with a trial judge's conclusions on matters of fact unless there is a palpable or overriding error.**
>
> [67] With regard to counts 3 and 4, the offences relating to the filing of the corporate income tax returns, the Crown has the additional burden of proving that a defendant is a director of the corporation, and that the defendant is a party as defined in s. 242 of the ***Act***. Section 242 of the ***Act*** reads: Where a corporation commits an offence under this Act, any officer, director or agent of the corporation who directed, authorized, assented to, acquiesced in or participated in the commission of the offence is a party to and guilty of the offence and is liable on conviction to the punishment provided for the offence whether or not the corporation has been prosecuted or convicted.
>
> [68] The trial judge found that since the appellant had been personally served with the Requirements to file the corporate returns, was a director of the corporation and was in charge of the tax aspects of the corporation, that she was a party to the corporate offence. She received the Requirements and did nothing to bring herself in compliance with them.
>
> *Did the trial judge err in finding that the appellant's actions did not amount to due diligence?*
>
> [69] The appellant submitted to this court, as she did to the learned trial judge, that she exercised due diligence in:
>
> Refusing to respond to the Requirements because of the failure on the part of the CRRA field officer to fill out the questionnaire.
>
> Trying and failing to find a certified compilation of the ***Act***.

---

[106] 2006 BCSC 481

Digitized by Google

[70] The appellant's claim that her obligation to comply with statutory requirements disappeared when Amissah failed to fill out a questionnaire cannot constitute due diligence. This same argument was rejected by the Summary Appeal Court in ***Canada (Attorney General) v. Voth*** (2001), 211 Sask. R. 270, 2001 SKQB 469. The court ruled at para. 27:

Nor was Revenue Canada faced with a simple or straight-forward request to clarify its purpose. Instead, it was asked to complete and return a detailed and offensive questionnaire. It was quite justified in refusing to do so.

[71] The decision was upheld by the Saskatchewan Court of Appeal in ***Canada (Attorney General) v. Voth*** 2002 SKCA 47.

[72] In this case, the "Notice of Demand for Information" given to Amissah was incomprehensible. Amissah was not under any obligation to respond to such a document, nor was he likely even able to respond.

[73] The appellant's belief that the ***Act*** does not exist in a form binding on her is a mistake of law, and cannot constitute due diligence.

[74] In ***R. v. Klundert*** (2004), 242 D.L.R. (4th) 644, 187 C.C.C. (3d) 417, leave to appeal to S.C.C. refused (2005), 339 N.R. 198, the Ontario Court of Appeal allowed the Crown's appeal from an acquittal of a person charged with tax evasion. Dr. Klundert had been acquitted based on his belief that the ***Act*** was invalid. Doherty J.A., for the panel, wrote at paras 59 and 60:

A person's mistaken belief that a statute is invalid or is otherwise not applicable to that person's conduct is a mistake of law. It is, however, a mistake of law that is irrelevant to the existence of the fault requirement in s. 229(1)(d). Nor can that kind of mistake of law provide a freestanding excuse for the commission of a crime: *Criminal Code*, s. 19; *R. v. Jones* (1991), 66 C.C.C. (3d) 512 (S.C.C.) at 516- 517; *R. v. Watson* (1999), 137 C.C.C. (3d) 422 (Nfld. C.A.), at 431-33.

There are solid policy reason for drawing a distinction between an accused who mistakenly believes that he or she is complying with the *Act* and an accused who knowingly violates the *Act*, but mistakenly believes that the *Act* is invalid. The former is trying to comply with the law. Particularly where the law is complex, a mistake concerning the applicable law can logically negate the blameworthiness of the person's conduct. The latter is not trying to obey the law, but is instead deciding which laws should be obeyed. An acquittal based on a mistaken belief as to the validity of a law would undermine the rule of law.

[75] The British Columbia Court of Appeal adopted the reasoning in ***Klundert*** in ***R. v. Kennedy***, [2005] I.C.T.C. 321, 2004 BCCA 638.

[76] The trial judge's finding that the appellant had not exercised due diligence is one of fact. Again, the trial judge not only did not err in his finding, he was correct.

Further, in R. v. Burko[107] the Ontario Superior Court of Justice held:

[29] The parties are on common ground that this is a regulatory offence, and is thus one of strict liability. Accordingly, once the *actus reus* of the offence has been established, the only defence is that the accused exercised due diligence. The onus is on the accused to show due diligence.

[30] In my view, once the *actus reus* of the offence has been proven, and the onus shifts to the accused to establish due diligence, I cannot see that a *W.(D.)* analysis is required. Such an analysis is required in order to determine whether the Crown has proven an offence beyond a reasonable doubt. In doing so, a trial judge must consider whether defence evidence raises a reasonable doubt, even if it is not believed. However, in the case of a

[107] 2011 ONSC 479

Digitized by Google

regulatory offence, once the *actus reus* has been established, and the onus is on the accused to establish due diligence, it is no longer relevant to consider whether the evidence of the accused, even if not believed, raises a reasonable doubt.

[31] I did not understand Mr. Halfyard to dispute what I have just articulated. However, he submitted that in determining whether the *actus reus* of an offence has been committed, even in the case of a regulatory offence, the onus is on the Crown to prove the *actus reus* beyond a reasonable doubt. At that stage, a *W.(D.)* analysis is still appropriate. Thus, in considering whether the *actus reus* had been proven beyond a reasonable doubt, the trial judge was required to consider whether the evidence of Mr. Burko and his wife, even if not accepted, raised a reasonable doubt.

[32] I agree with Mr. Halfyard. In my view, the trial judge conflated the issue of whether the *actus reus* had been established with the defence of due diligence. However, in the particular circumstances of this case, the appeal should nevertheless be dismissed.

[33] In this case, as far as the *actus reus* was concerned, the only issue was whether the documents had been filed in time. If they had been filed in time, no offences were committed. If they were not filed in time, the *actus reus* was made out.

[34] As far as the defence of due diligence was concerned, the only evidence was that of Mr. Burko and his wife. If that evidence was accepted, the defence of due diligence was made out. If the evidence was not accepted, the defence of due diligence was not made out.

[35] The evidence of the accused in relation to both the *actus reus* of the offences and the defence of due diligence was the same – the evidence of Mr. Burko and his wife. In her Reasons for Judgment, the trial judge made it clear that she did not believe the evidence of either Mr. Burko or his wife. In these narrow circumstances, once the trial judge did not accept any of the defence evidence, there was no room to find that there was any reasonable doubt as to the *actus reus* of the offences. The only other evidence before the trial judge supported a finding that the *actus reus* of the offences had been established. In the particular, narrow, circumstances of this case, a *W.(D.)* analysis would have made no difference to the result. This was a very simple case, and the evidence was straightforward. The trial judge made clear findings. No reviewable error has been shown.

[36] With respect to the defence of due diligence, since the trial judge did not believe the evidence of Mr. Burko and his wife, the defence was simply not made out.

[37] Thus, I do not accept Mr. Burko's argument based on *R. v. W.(D.)*.

Various Excuses Not Enough to Not Comply

The Proverbial Mouldy/Damaged Papers

In the recent case of R. v. Hanlon[108] the BC Appeal Court canvassed the issue of when source documents necessary to prepare the tax returns of the offending taxpayer had been damaged through neglect thereof. It held:

[13] There is no dispute that the appropriate income tax return was not filed by the specified date. The only issue at trial and on appeal was the question of whether Ms. Hanlon could succeed on her due diligence defence to a strict liability offence: *R. v. Sault Ste. Marie*, [1978] 2 S.C.R. 1299.

[14] The provincial court judge reviewed the evidence and concluded:

[18] While I am enormously sympathetic to her physical condition and what she was living through with respect to her sons' medical conditions, and all of the problems at the school, and all of the problems with respect to mountains of disorganization and paper

[108] 2009 BCCA 598

Digitized by Google

everywhere, I do not read from the medical records that that is necessarily a complication in her life. It does not necessarily flow from the medical. It is tied in with, but I am sure that there are many people that suffer from that syndrome that have found ways and have been forced to find ways of helping themselves get organized.

[19] That does not appear to have been the case with Ms. Hanlon and I find that the efforts that were made or not made and the amount of time that it took are not reasonable. So that the defence with respect to due diligence, either looking at it strictly from her personal circumstances or that of the reasonable person, are not sufficient and were not sufficient at the time. So that results in a conviction.

[15] The appellant appealed her conviction and applied for an order admitting fresh evidence on appeal in the form of *viva voce* testimony from one of her doctors.

[16] The summary conviction appeal judge admitted the fresh evidence. He noted, as did the provincial court judge, that there had been some flooding in her home and that as a consequence, a number of documents that might have assisted her in filing her income tax return, were damaged and mouldy.

[17] The summary conviction appeal judge dismissed the appeal, having concluded that the provincial court judge made no error in law and that the judge had considered the medical evidence and properly considered whether, on a balance of probabilities, the due diligence defence had been established.

[18] He held that the fresh evidence, which he had admitted, did not impact any of the findings of the trial judge.

[19] At the application for leave to appeal before me, counsel for the appellant emphasized the consequences of the flood. In his written argument he asserted: However the learned Supreme Court Judge concerned himself only with subjective considerations in Paragraphs 15, 16, 17. No consideration is ever given to the objective consequences of the flood, which was the reason for the extension request of Exhibit

That request was not alleging mental illness but physical incapacity. That incapacity expressed in Exhibit 7 and the evidence at trial from the Appellant was disregarded by Silverman J., just as it had been by Gedye, PCJ.

[20] He argued that the combination of her medical condition and the circumstances of the water damage were ignored by both judges. He says that “this case, of all cases, should meet the test of due diligence”.

[21] In *R. v McKinney*, 2004 BCPC 9, [2004] B.C.J. No. 161 (aff’d 2008 BCCA 211), the trial judge summarized the principles applicable to the defence of due diligence at para. 60:

[60] The Court of Appeal in the *Whissell-McLeod* decision agreed with the reasoning of Judge Oliver of this Court in *R. v. Gill*, [1989] B.C.J. No. 2225, October 19, 1989. A “taxpayer who allows his records to get into such a state that his income tax obligations can only be fulfilled through costly efforts does so at his peril” (at paragraph 9). The *Act* obligates taxpayers to both provide timely information when required, as well as to file income tax returns.

[22] In order for leave to be granted, the appellant must:

identify an error on the part of the summary conviction appeal court, which raises an issue of law alone,

establish that the appeal is of general importance, and

establish that the appeal has a reasonable possibility of success: *R. v. Moore*, 2000 BCCA 588, [2000] B.C.J. No. 2164.

[23] In *R. v. Meikle*, 2006 BCCA 558, 71 W.C.B. (2d) 784, it was held that the overriding concern in considering the last two parts of the test in *Moore* is the interests of justice.

Digitized by Google

[24] The error which the appellant identifies is the failure of the trial judge and the summary conviction appeal judge to recognize the consequences of the water damage on her efforts to file her 2002 income tax return. Her counsel says this evidence should have satisfied the defence of due diligence.

[25] Having reviewed the transcript of her evidence on this point, I would not accede to this argument. The appellant has failed to identify an error on the part of the summary conviction appeal court judge that raises an issue of law alone. The appellant has, at best, identified an issue of mixed fact and law, and therefore fails to establish this ground for leave to appeal. Moreover, the appellant has also failed to establish that this appeal is of general importance and has failed to establish that the appeal has a reasonable possibility of success, particularly considering the explanation of the due diligence defence in *R. v. McKinney*.

"I Had No Taxes Payable, Thus No Need to File, and I ignored the Demand to File"

In R. v. Carter[109] the BC Provincial Court had to determine whether, amongst other reasons, a taxpayer charged under s. 238(1) had various defences available to him, including recent bad health. It opined:

Issues

[16] In his written argument, Mr. Drove, counsel for Mr. Carter, raised a number of issues, which were reframed by Federal Crown Counsel, Mr. Kaun, in his argument and are now restated by me as follows:

Was the tax liability of Carter subject to a genuine and serious inquiry by the Minister of National Revenue?

Did Carter exercise due diligence in filing his tax returns in response to the notices of requirement to file?

Is the imposition of a minimum penalty of $1,000 per count cruel and unusual punishment, thereby violating s. 12 of the Charter?

Is the decision of the Minister to proceed with charges of failure to comply with the notices pursuant to s. 231.2(1) and (1)(a) of the Act rather than with charges of failure to file within a reasonable time contrary to s. 150(1) and 162 cruel and unusual punishment contrary to s. 12 of the Charter?'

Discussion

[17] Dealing first with number three above, the minimum penalty and s. 12 of the Charter of Rights, this clearly is an issue, which must await a verdict of guilt or innocence, as it only applies to any penalty that may be imposed after a conviction, if any. Therefore, I will not deal with it at this time.

[18] Before going on to discuss the evidence, I must take note of the fact that the accused gave evidence and called an additional witness. Therefore, I must instruct myself in the principles of W.(D.) as to the defence evidence as follows:

If I believe the accused and his evidence raises a defence, I must acquit.

If I do not believe his evidence, but the defence evidence as a whole raises a defence I must acquit.

It is only after I have rejected the evidence of the accused and the defence witness that I may examine the case for the Crown to see if they have proved their case beyond a reasonable doubt.

[19] Number one: Was the tax liability of Mr. Carter the subject of a genuine and serious inquiry by the Minister of National Revenue?

---

[109] 2011 BCPC 253

Digitized by Google

[20] This argument arises as a result of the decision of the Supreme Court of Canada in James Richardson the Minister of National Revenue, 1984 CanLII 1 (SCC), [1984] 1 S.C.R. 614.

[21] In that case the Supreme Court of Canada examined the scope of what is now s. 231.2(1) and concluded the Minister cannot go on a "fishing expedition," but rather the section is only available to be used if the Minister is seeking information relevant to the tax liability of a specific person, and that person is the subject of a genuine and serious inquiry. (My summary).

[22] In the Richardson case, the Minister was trying to check out compliance by traders in the commodities futures market, but the Minister did not know the identity of the customers of the appellant commodities broker. Justice Wilson writing for the court found that this type of broad general inquiry without being related to a specific person's tax liability was not a serious and genuine inquiry. The requirement to file cannot be used as "a subterfuge for some other purpose." (See Canadian Bank of Commerce v. the Attorney General of Canada, 1962 CanLII 1 (SCC), [1962] S.C.R. 729 and R. v. Dakus, 1988 AJ, No. 608).

[23] Further the B.C. Court of Appeal in R. v. Van Egmond, 2002 BCCA 226 (CanLII), 2002 BCCA 226, commented on this issue as follows in the words of Mr. Justice Braidwood: Mr. Van Egmond, as a result of his not having filed his own tax returns for a considerable number of years, was under legitimate investigation. (See also R. v. Sharma, [1995] B.C.J. No. 2113).

[25] On the evidence that I have before me, especially the running notes and history contained in Exhibit 1, there is ample evidence to support the conclusion that Revenue Canada was conducting a serious and genuine inquiry into the tax liability, if any, of Mr. Carter. To determine this, the Minister needed Mr. Carter to complete and sign a tax return for each of the years set out in the Indictment.

[26] The notice of requirement to file commenced the process of determining what, if any, income tax was owing by Mr. Carter. Mr. Carter failed to comply with the notice of requirement to file for over a year, well beyond the 90-day time limit set out in the notice. (See Exhibit 1).

[27] The defence argument that because there were no taxes owing by Mr. Carter at the time the demand was served on him and therefore there was no genuine and serious inquiry, is circular at best.

[28] In the case of R. v. Packard, 2006 BCSC 719 (CanLII), 2006 BCSC 719, the court held that tax liability is not a pre-requisite to issuing a valid notice of requirement.

[29] The only way the correct tax liability of Mr. Carter could be determined was by assessing completed and signed returns. Mr. Carter failed to do that as required. I find there was a genuine and serious inquiry in this case for each of the taxation years.

[30] Number two: Did Carter exercise due diligence in filing his tax returns in response to the notice of requirement?

[31] These offences under s. 238 of the Income Tax Act are offences of strict liability where the defence of due diligence is available to the accused on a balance of probabilities. In strict liability offences the Crown must only lead evidence the accused has not done what he was required to do by performing some duty or fulfilling some obligation.

[32] Once that is established the offence is proven unless the accused can show on a balance of probabilities that he has taken reasonable steps to comply with the Income Tax Act requirements and the notice of requirement to file. (See R. v. Rolin, 2 C.R.R. 166, and the case of Sault Ste. Marie, (1978) 40 C.C.C. (2d) 353, (S.C.C.)).

[33] If the accused can show he took all reasonable steps then he may argue that he exercised due diligence. In support of the due diligence defence, the defence points out in

Digitized by Google

part:
On receipt of the notice Carter faxed them to Knudson.
Carter's stroke in April 2006 affected his memory and hampered his ability to comply with the 90- day requirement in the notice of requirement to file.
Revenue Canada refused to grant an extension of the 90-day time limit.
[34] Counsel for Mr. Carter submits that his client did comply with the requirements and that the 90-day time limit was unreasonable in these circumstances; therefore, submits the defence, the unsigned nil returns were filed in June 2008 and this constituted due diligence on the facts in the case at bar.
[35] The first thing I would note is that these charges were not laid until April 14th, 2008 some 10 months after the notice of requirement was personally served on Mr. Carter. Had the Crown proceeded with these charges on the 91st day after the day of service I might give some weight to this argument; however, I find that over 10 months even in these circumstances is more than reasonable time to comply with the notice. [36] As tragic as the aftermath of Mr. Carter's stroke was, the courts have rejected the submission that some attempts to comply, together with compassion, equate to due diligence. (See Mr. Justice Hood in R. v. Adair, 2000 BCSC 861 (CanLII), 2000 BCSC 861, at Paragraph 18.)
[37] Further the Indictment covers the years 2001 to 2006 and Ms. Knudson, the bookkeeper, was retained in March 2006 before the stroke occurred. There was no evidence of any health issues for Mr. Carter in the years 2001 to 2005 when he failed to file his income tax returns for those years.
[38] In R. v. Kemnay, 27th of November 2001, unreported, Port Coquitlam Registry 6200701T in the B.C. Provincial Court, the court there commented that [as read in]:
Citizens of Canada have both rights and duties. One of those duties being the filing of income tax returns. The failure to file is both blameworthy and culpable.(See Paragraph 13 of that decision).
[40] As further evidence of a lack of due diligence, the Crown points out that even when the returns were filed in 2008 they were not signed, nor were they completed as they just had the words "Nil" written on them. [41] The notice of requirement served on Mr. Carter sets out plainly what is required; that is, completed and signed tax returns for each of the years set out. The filing of nil or not applicable returns has been held not to constitute compliance with a notice of requirement. (See Jacques v. HMTQ, 2000 BCSC 430 (CanLII), 2000 BCSC 430).
[42] The defence argument that the Canada Revenue Agency does not absolutely require all income tax returns to be signed by the taxpayer is answered by the fact that the notice of requirement does have this obligation clearly and plainly set out.
[43] In the case of R. v. Euerby, 1992 B.C.J. No. 396, the court had this to say in the words of Mr. Justice Murphy:
I only wish to note that the charge is not one of failing to file a return but failing to comply with a notice to file a return. In the notice, sufficient time is given to comply and as well the consequences of failing to comply are set out. A person receiving such a notice is well aware of the consequences of failing to comply, and therefore has the opportunity to avoid the consequences.
[44] Even if I reject none of the defence evidence, here I find the accused has failed to establish on a balance of probabilities due diligence.
[45] Number four. Is the decision of the Minister to proceed with charges of failing to comply with the notices of requirement pursuant to s. 231.2(1) and 238 of the Act rather than with charges of failure to file within a reasonable time contrary to s. 150(1) and 162, cruel and unusual punishment contrary to s. 12 of the Charter?
[46] The defence submissions on this argument are unclear as to what remedy, if any,

Digitized by Google

they are seeking assuming they establish a breach of s. 12 on a balance of probabilities. Further this defence argument seems to be predicated on the assumption that the Minister of National Revenue, rather than the Director of Public Prosecutions, makes the prosecutorial decisions in cases like this.

[47] I think I can take judicial notice of the fact that while the Canada Revenue Agency may investigate offences like this, they do not prosecute them. It is also trite law that prosecutorial decisions made by the Crown are, absent egregious conduct, susceptible to limited judicial review. However, while the Supreme Court of Canada in Krieger v. the Law Society of Alberta, 2002 SCC 65 (CanLII), [2002] 3 S.C.R. 372, makes it clear some decisions of the Crown are not a true exercise of prosecutorial discretion and therefore open to judicial review, these instances will by their very nature be rare.

[48] For example, tactical decisions about the conduct of a trial versus prosecutorial discretion about whether or not to lay a charge will be treated differently. (See R. v. DeZenet al, 2010 ONSC 974 (CanLII), 2010 ONSC 974, Ontario Supreme Court.)

[49] In the case at bar, I find that this decision of the Director of Public Prosecutions is one of those decisions that is not open to judicial review. There is no evidence of any improper motive or conduct on the part of the Crown. Accordingly, there is no evidence to the standard on a balance of probabilities to hold that Mr. Carter's s. 12 Charter rights have been breached. I dismiss that argument.

[50] Accordingly and for the reasons given, I find the accused guilty as charged on all six counts.

[51] All right, I will deal now with the matter of the decision in Logan and then we can go back and discuss the next steps in Carter.

(REASONS CONCLUDED)

CORRIGENDUM – Released October 20, 2011

In the Oral Reasons for Judgment dated June 16, 2011, the following change has been made:

[1] In paragraph 16, reference to s. 231.2(2)(a) of the Income Tax Act should have been to section 231.2(1)(a). Paragraph 16 now reads:

[16] In his written argument, Mr. Drove, counsel for Mr. Carter, raised a number of issues, which were reframed by Federal Crown Counsel, Mr. Kaun, in his argument and are now restated by me as follows:

Was the tax liability of Carter subject to a genuine and serious inquiry by the Minister of National Revenue?

Did Carter exercise due diligence in filing his tax returns in response to the notices of requirement to file?

Is the imposition of a minimum penalty of $1,000 per count cruel and unusual punishment, thereby violating s. 12 of the Charter?

Is the decision of the Minister to proceed with charges of failure to comply with the notices pursuant to s. 231.2(1) and (1)(a) of the Act rather than with charges of failure to file within a reasonable time contrary to s. 150(1) and 162 cruel and unusual punishment contrary to s. 12 of the Charter?

"It's Against My Religion – and My Charter"

In Little v. R.[110] a taxpayer attempted to argue that it was against his religion to file tax returns in the face of s. 2 of the Charter. The New Brunswick Appeal Court spoke unequivocally on it with:

ROBERTSON J.A.

[1] Section 2(a) of the *Charter of Rights and Freedoms* provides that "everyone" has the fundamental freedom of "conscience and religion". This appeal asks whether those

[110] 2009 NBCA 53

Digitized by Google

who oppose abortion on grounds of "religion", or as a matter of "conscience", are relieved of the legal obligation to file annual tax returns and, by necessary implication, the obligation to pay taxes, because of this *Charter* right. The answer has to be no. The non-filing of annual returns, like the non-payment of taxes, does not qualify as a religious practice nor has it become the tenet of any religious faith. The refusals are simply acts of civil disobedience intended to bring about change in government policy, the law, or both. Admittedly, the refusals may be the product of an informed conscience, but the *Charter* was not intended to insulate such acts from the rule of law. Otherwise, everyone who disagrees with government policies and the expenditure of public monies in furtherance of those policies would be entitled to abandon their obligation to bear their proportionate share of the national debt while continuing to receive no-cost public benefits such as Medicare. This is not how a true democracy functions and this is one of the reasons why the appellant's appeal is doomed to failure. Moreover, these realties are not overtaken by the argument that Canada's taxation laws represent forced participation in the funding of abortions. The fact that a person files a tax return and pays taxes does not connote an expression of support for any government policy or expenditure. These obligatory acts are the annual price Canadians pay to ensure there is a continuing debate over the appropriateness of government policies and expenditures made in accordance with the existing law.

[2] The appellant, David Little, was charged under s. 238(1) of the *Income Tax Act* R.S.C. 1985, c. 1 (5th Supp.) for failing to file an individual income tax return for each of the years 2000, 2001 and 2002. The failure arose after the Minister of National Revenue issued a notice demanding compliance pursuant to s. 231.2(1)(a). At trial, Mr. Little admitted the essential elements for each of the three summary conviction offences, while raising two *Charter* defences. First, he argued that his s. 2(a) right to freedom of religion was infringed. The trial judge accepted that Mr. Little, a Roman Catholic, holds the sincere religious belief that abortion is wrong; a belief which is rooted in the tenets of his faith. The trial judge also found that Mr. Little had failed to establish any religious requirement to abstain from filing annual tax returns. **The trial judge further held that the obligation to file such returns did not interfere with Mr. Little's religious beliefs or practices and, therefore, s. 2(a) of the *Charter* was not engaged. Alternatively, the trial judge held that had s. 2(a) been engaged, Mr. Little had nevertheless failed to establish that the interference with his religious freedom was other than trivial or insubstantial. The trial judge went on to reject Mr. Little's discrimination argument based on s. 15(1) of the *Charter*.** A conviction was entered and the minimum $1000 fine was imposed for each of the three infractions. The trial decision is now reported as *R. v. Little (D.T.)* (2007), 328 N.B.R. (2d) 1, [2007] N.B.J. No. 495 (QL), 2008 NBPC 2.

[3] Mr. Little appealed the trial judge's decision. The summary conviction appeal court judge observed that Mr. Little had failed to cite any authority for the proposition that it is permissible to refrain from filing annual tax returns because one disagrees with government polices or expenditures. Unable to identify any error on the part of the trial judge, the appeal judge dismissed Mr. Little's appeal. The decision is now reported as *R. v. Little* (2008), 339 N.B.R. (2d) 151, [2008] N.B.J. No. 407 (QL), 2008 NBQB 348.

[4] Mr. Little's first ground of appeal challenges the sufficiency of the appeal judge's reasons for judgment. Admittedly they are brief, but understandably so. The issues raised in this case are essentially questions of law. In finding that the trial judge did not err in law or principle, it was open to the appeal judge to adopt the reasoning of the trial judge in disposing of Mr. Little's argument based s. 2(a) of the *Charter*. Hence, the issue before us is whether the appeal judge erred in failing to identify error on the part of the trial judge. In my respectful view, neither judge erred. My reasons respond to the fullness of the legal argument advanced in this Court. Admittedly, these reasons do not deal with all of the

Digitized by Google

issues raised. With respect to the discrimination argument based on s. 15(1) of the *Charter*, I say no more as it lacks merit. Moreover, I am not prepared to entertain Mr. Little's argument based on s. 7 of the *Charter.* That issue was not raised below and, with great respect, is no more deserving of consideration than his s. 15(1) argument. Self-represented litigants must understand that courts are not obligated to address arguments that are premised on misunderstandings of the law. I should also point out that the Crown opposed the granting of leave to appeal while asking us to embrace the approach adopted by the Ontario Court of Appeal in *R. v. R. (R.)* (2008), 90
O.R. (3d) 641, [2008] O.J. No. 2468 (QL), 2008 ONCA 497, in regard to applications for leave to appeal summary conviction offences. Bluntly stated, now is not the time to deal with the matters raised in that decision.

[5] It takes little prescience to anticipate the fallout from a legal precedent holding that s. 2(a) of the *Charter* provides a valid defence to those who refuse to file annual tax returns or to pay taxes because of a sincere belief that monies used to fund government programs which are objectionable, either on religious grounds or as a matter of conscience, is wrong. The federal and provincial governments would be deprived of substantial revenue needed to fund government programs which are universally accepted as furthering the public interest. This explains why the surrounding jurisprudence is inevitably brief but pithy. I propose to follow suit by examining only the main tenets of the *Charter* jurisprudence surrounding s. 2(a). Two decisions of the Supreme Court of Canada must be canvassed. I start with the Supreme Court's definition of religious freedom authored by Dickson C.J. in *R. v. Big M Drug Mart*, [1985] 1 S.C.R. 295, [1985] S.C.J. No. 17 (QL):

A truly free society is one which can accommodate a wide variety of beliefs, diversity of tastes and pursuits, customs and codes of conduct. A free society is one which aims at **equality with respect to the enjoyment of fundamental freedoms and I say this without any reliance upon s. 15 of the *Charter*. Freedom must surely be founded in respect for the inherent dignity and the inviolable rights of the human person. The essence of the concept of freedom of religion is the right to entertain such religious beliefs as a person chooses, the right to declare religious beliefs openly and without fear of hindrance or reprisal, and the right to manifest religious belief by worship and practice or by teaching and dissemination. But the concept means more than that.**

Freedom can primarily be characterized by the absence of coercion or constraint. If a person is compelled by the state or the will of another to a course of action or inaction which he would not otherwise have chosen, he is not acting of his own volition and he cannot be said to be truly free. One of the major purposes of the *Charter* is to protect, within reason, from compulsion or restraint. Coercion includes not only such blatant forms of compulsion as direct commands to act or refrain from acting on pain of sanction, coercion includes indirect forms of control which determine or limit alternative courses of conduct available to others. Freedom in a broad sense embraces both the absence of coercion and constraint, and the right to manifest beliefs and practices. Freedom means that, subject to such limitations as are necessary to protect public safety, order, health, or morals or the fundamental rights and freedoms of others, no one is to be forced to act in a way contrary to his beliefs or his conscience. [pp. 336- 337]

[6] The above passages reveal that religious freedom embraces three interrelated aspects: (1) the right to entertain religious beliefs without fear of hindrance or reprisal; (2) the right to manifest religious belief by worship, practice, teaching and dissemination; and (3) the absence of coercion or constraint. The latter embraces the notion that no one is to be forced to act in a way contrary to his or her beliefs, subject to such limitations as are

Digitized by Google

necessary to protect public safety, order, health or the fundamental rights and freedoms of others. In brief, s. 2(a) protects religious beliefs and practices. Laws which restrict or impede the right to adhere to a religious practice are suspect as are laws which force a person to act contrary to their religious beliefs. Of course, s. 2(a) does more than protect religious beliefs. It makes room for the conscientious objector whose judgment is informed by other sources.

[7] The Supreme Court's decision in *Syndicat Northcrest v. Amselem*, [2004] 2 S.C.R. 551, [2004] S.C.J. No. 46 (QL), 2004 SCC 47, is also important for two reasons. It outlines the analytical framework to be applied when dealing with a *Charter* argument based on freedom of religion. The decision also provides an expanded definition for the legal concept of "religious practice". At issue in the case was the right of orthodox Jews to build *succahs* (temporary dwellings) on the balconies of their condominium apartments. The *succahs* would be used for nine days, each year, during a religious festival. However, the condominium by-laws prohibited structures of any kind on balconies and the claimants knew this at the time they purchased their units. Though the Court was deeply divided, the majority of the Supreme Court upheld the rights of the claimants and in so doing defined "protected religious practice" in the broadest of terms. The practice need not be a part of an established belief system or even a belief shared by others. The claimant need only establish a sincere belief that the practice is "of religious significance". Of particular relevance to this appeal is the analytical framework the Supreme Court imposed in regard to *Charter* claims tied to infringement of the right to religious freedom:

Thus, at the first stage of a religious freedom analysis, an individual advancing an issue premised upon a freedom of religion claim must show the court that (1) he or she has a practice or belief, having a nexus with religion, which calls for a particular line of conduct, either by being objectively or subjectively obligatory or customary, or by, in general, subjectively engendering a personal connection with the divine or with the subject or object of an individual's spiritual faith, irrespective of whether a particular practice or belief is required by official religious dogma or is in conformity with the position of religious officials; and (2) he or she is sincere in his or her belief. Only then will freedom of religion be triggered. [para. 56]

[8] In brief, a claim of interference with one's freedom of religion has two components: the practice or belief must have a nexus with religion and the claimant must be sincere in his or her belief with respect to the religious practice. Once these criteria are met the claimant's s. 2(a) *Charter* right is "triggered". But *Amselem* goes one step further and imposes a third criterion. A court must ascertain whether the burden imposed on the religious practice is "non-trivial" or "insubstantial". In other words, the claimant must establish that the impugned legislative provision interferes with the ability to act in accordance with one's religious beliefs in a manner that is more than trivial or insubstantial. In brief, once the claimant establishes a nexus between the practice and the claimant's sincerely held religious beliefs and once it is shown that the interference with the religious practice is neither trivial nor insignificant, an infringement of s. 2(a) of the *Charter* has been established. At this juncture, the onus falls on the Crown to justify the infringement under s. 1 (see *Multani v. Commission scolaire Marguerite-Bourgeoys*, [2006] 1 S.C.R. 256, [2006] S.C.J. No. 6 (QL), 2006 SCC 6).

[9] Returning to the facts of the present case, I have been able to distil from Mr. Little's submissions two *Charter* arguments: (1) the provisions of the *Income Tax Act* requiring him to file annual tax returns interfere with his right to practice his religion; and (2) the same provisions require him to participate in a government scheme for the funding of abortions contrary to his religious beliefs. I shall deal with the issues in the order stated.

[10] With respect to Mr. Little's first *Charter* argument, one must first ask whether the

Digitized by Google

refusal to file annual income tax returns qualifies as a religious practice in the Catholic Church. The answer is self-evident: "no". To his credit, Mr. Little does not argue that his Catholic faith regards the filing of income tax returns as "sinful". Indeed one can take judicial notice of the fact that local parishes of the Catholic Church continue to issue annual tax receipts to parishioners who may claim a tax credit under the heading "charitable donations". As well, Mr. Little does not argue that the Catholic Church teaches that it is wrong to participate in a government taxation scheme that raises revenue to defray the cost of public expenditures because some of those tax dollars will "trickle down" and be used to defray the cost of public abortions. Within this context, the nonfiling of income tax returns does not qualify as a religious practice because there is no "nexus" between the so-called practice and religion. But the analysis must go one step further and apply the expanded definition of "religious freedom" outlined in *Amselem*. The expanded definition embraces sincerely held beliefs that are not necessarily in conformity with religious teachings. Mr. Little argues: "It is my sincere, personal religious belief, based on what the church teaches, that my Father in heaven does not want me to sign and file tax returns unless and until the law is overturned prohibiting tax funded abortion". The folly of this argument is adroitly addressed by the Crown. It is difficult to understand the assertion that something as profound and personal as a religious practice or belief, worthy of this country's constitutional protection, would disappear with a change of government policy. However, if Mr. Little's refusal to file his income tax returns is seen conceptually, not as a religious practice or belief, but rather as a strategy or tactic to compel change, the problem resolves itself as being merely the relationship between ends and means. This is why the refusal to file annual tax returns must be regarded as an act of civil disobedience, not a religious practice or belief.

[11] Mr. Little's second *Charter* argument is that the provisions of the *Income Tax Act* require him to participate in a federal scheme which funds public abortions contrary to his sincerely held religious belief that abortion is wrong. At the outset, let me say that the argument is problematic for the following reason. Mr. Little was charged with and convicted of failing to file annual income tax returns, not for failing to pay taxes properly assessed by the Canada Revenue Agency. Until such time as Mr. Little files these returns, the Agency is simply not in a position to assess whether Mr. Little is obligated to pay taxes. In truth, Mr. Little's true objection lies in the prospect of being required to pay taxes which in turn will trickle down and be used to defray the costs of funding abortions. But until such time as he files his annual tax returns, and until such time as it is determined that taxes are owing and there is a demand for payment and a refusal to pay, it is questionable whether Mr. Little's *Charter* "coercion argument" warrants consideration. This reality did not escape the Crown. On a preliminary motion, the Crown argued before the trial judge that the *Charter* claim was premature given the fact that Mr. Little was only required to file an income tax return and there had been no determination with respect to tax liability. However, the trial judge held there was sufficient evidence to allow the *Charter* defence to proceed. In the circumstances, I shall deal with Mr. Little's coercion argument. [12] I have already affirmed the finding below that the provisions of the *Income Tax Act* requiring the filing of annual returns and the payment of taxes do not pose an obstacle to one's right to entertain and manifest religious beliefs. The only question is whether the statutory scheme requiring taxpayers to contribute to the revenue stream used to fund all government programs, including abortion, amounts to impermissible "coercion" such that the *Charter* claimant is being forced to participate in something which he or she opposes based on religious beliefs or an informed conscience. Mr. Little's *Charter* coercion argument has two premises: (1) abortion is wrong; and (2) it is wrong to participate in a secular scheme intended to generate revenue used to defray the costs of abortions. No one questions that these

Digitized by Google

assertions qualify as sincerely held beliefs. Of course, the non-believer (the agnostic or atheist) would be entitled to make the same argument as s. 2(a) of the *Charter* also embraces freedom of conscience.

[13] This is not the first time a person has invoked the *Charter* as a defence to paying monies to be used for purposes viewed as objectionable on religious grounds or as a matter of conscience. In *Lavigne v. Ontario Public Service Employees Union*, [1991] 2 S.C.R. 211, [1991] S.C.J. No. 52 (QL), a unionized worker objected to paying union dues because of the union's expenditures of monies unrelated to collective bargaining activities. Specifically, the worker objected to payments to a political party and disarmament campaigns. He argued that compulsory membership in a union and payment of dues under the Rand formula breached his s. 2(b) right to freedom of expression and his s. 2(d) right to freedom of association. Ultimately the *Charter* claims were rejected, but the Court was divided on the underlying reasons. Some of the justices held that the union expenditures violated the worker's s. 2(d) right of freedom of association as the expenditures were not sufficiently related to the concerns of the bargaining unit, but that the legislation was saved under s. 1. Other members of the Court found no violation of s. 2(d). With respect to the *Charter* claim based on s. 2(b), the Court was unanimous. There was no infringement. I need only refer to passages from that decision relevant to this case. La Forest J. observed: "In short, the manner in which the Union expends its funds would properly be regarded as the expression of the opinions and positions of the Union *qua* corporate entity. It would not be regarded as an expression of the thoughts and opinions of the many individuals who contribute to the Union's coffers" (p. 340). With respect to whether the mandatory payment of union dues infringes s. 2(b), Wilson J. held:

"It seems axiomatic that the payment of taxes does not signify in the eyes of others support for the uses to which tax money is put or support for the political party in power, or indeed support for the idea of government at all" (p. 280). She further wrote: "The fact that the appellant is obligated to pay dues [...] does not inhibit him in any meaningful way from expressing a contrary view as to the merits of the causes supported by the Union" (pp. 280-281).

[14] No analogy is perfect. But, the facts of the present case and those in *Lavigne* share one common thread. In both cases, the *Charter* claimant was required to contribute monies to be used for one or more purposes which the claimant found objectionable. In *Lavigne* the Supreme Court held that this requirement did not infringe upon the claimant's right to freedom of expression because payment did not signify support for the causes represented by the expenditures. In a similar view, it can be argued that the payment of taxes ultimately used to defray the cost of a public expenditure (abortion) does not signify the taxpayer's support for that expenditure. Correlatively, if there is no infringement of the taxpayer's right to freedom of expression, how can there be an infringement of the same taxpayer's freedom of conscience? I pose the question because acts of sincere expression are invariably the product of an informed conscience. For example, had the claimant in *Lavigne* objected to a union expenditure to a pro-choice advocacy group, as opposed to a political party that supports such groups, why should the result have been any different? Perhaps it is unwise to compare, let alone conflate, the *Charter* freedoms of expression, religion and conscience. But there are cases where the claimant's s. 2(a) *Charter* argument has been rejected on the ground that the government's expenditure of tax dollars cannot reasonably be regarded as an expression of support for the expenditure. [15] The first of two cases to be discussed is *Prior v. Canada*, [1989] 2 C.T.C. 280 (F.C.A.), 101 N.R. 401, [1989] F.C.J. No. 903 (QL) leave to appeal to S.C.C. refused, 21709 (Sept. 20, 1990). In that case, the taxpayer sought a declaration that she was entitled to be repaid 10.5% of taxes paid because that was the percentage amount of the federal budget

Digitized by Google

allocated to military spending. The taxpayer's arguments, based on 2(a) and s. 15(1), were rejected by the motion judge who dismissed the application for declaratory relief as failing to disclose a reasonable cause of action. The Federal Court of Appeal affirmed that decision. Writing for the court, Marceau J.A. held:

I have no difficulty in saying with the motions judge that neither the payment of income tax nor the defence expenditures of the Government of Canada in any way affect, curtail, diminish or infringe the Appellant's conscience or religion within the meaning of paragraph 2(a) of the *Charter*. The income tax paid by her under the secular scheme of the Income Tax Act charging her business or employment income to tax, in no way identifies her with any of the functions of the Government of Canada be they political, social, economic, defence or for the Peace Order and Good Government of Canada.[QL]

[16] In *Petrini v. Canada* (1994), [1995] 1 C.T.C. 200 (F.C.A.), [1994] F.C.J. No. 1451 (QL), the Federal Court of Appeal was again required to deal with a taxpayer claiming that the use of tax revenues for government purposes, which offended the taxpayer's religious beliefs, was an infringement of *Charter* rights. Writing for the Court, Hugessen J.A. crafted a solitary paragraph that offers a practical response to Mr. Little's *Charter* arguments:

The underlying principle decided by *Prior* may be simply stated: the *Charter* guarantees of freedom of conscience and religion cannot operate to prevent the government from employing general tax revenues in ways which offend the religious beliefs or consciences of some of its citizens. The obligation that such citizens have to pay taxes to support the government (and therefore, indirectly, the programs which offend them) does not breach those freedoms. The taxpayer, so long as he or she is not compelled to agree with government policy or forbidden from advocating contrary views, has no justiciable complaint. The simple, if subjectively unpleasant, obligation to pay taxes to a government some or all of whose views and programs one opposes does not imply support of such views and programs or force the taxpayer to act contrary to his or her personal beliefs and convictions; on the contrary, it is an essential part of living in a democracy such as Canada.

There is no need to invoke section 1 to support this conclusion for it is inherent in the system of government which has existed in this country for over 125 years. [para. 3, (QL)]

[17] The subsequent jurisprudence of the Supreme Court in *Amselem* and *Multani* does not detract from the incisiveness of the above passage. The filing of annual income tax returns, like the payment of taxes, cannot reasonably be regarded as an expression of support for a particular government expenditure or policy so as to offend a claimant's *Charter* right to freedom of religion and conscience. Nor can it be characterized as coercion of the kind embraced by the concept of freedom of religion and conscience. A pacifist who resists compulsory military service may object on grounds that military service is contrary to his or her religious beliefs or objectionable as a matter of principle and conscience. Most certainly, forced participation in these circumstances triggers the application of s. 2(a) of the *Charter*. But the same pacifist cannot invoke that *Charter* provision as a valid basis for the refusal to file annual income tax returns and to pay taxes duly assessed. The same reasoning applies to those who object to public funding of abortions through the taxation system. The coercion of which Mr. Little complains is simply too remote to invoke his s. 2(a) *Charter* rights. Any perceived interference with his religious beliefs cannot be regarded as "substantial" within the meaning of the jurisprudence.

[18] I would deny the application for leave to appeal.

J. T. ROBERTSON, J.A.

We Concur:

LARLEE, J.A.

Digitized by Google

KATHLEEN A. QUIGG, J.A.

An Expanded Defence

In R. v. Maleki the Ontario Court Of Justice held, with respect to s. 238, without citing supporting authority on the expanded defences, that:

> Issues
>
> The offences alleged by the crown are of a strict liability nature. The crown must prove beyond a reasonable doubt that the defendant committed the prohibited act: *R. v. Sault Ste. Marie (City) [1978] S.C.J. No. 59 (S.C.C.).* In these types of offences, the prosecution need not prove the existence of mens rea; the doing of the prohibited act prima facie imports the offence, leaving it open to the defendant to avoid liability by proving that he took all reasonable care. The test is what a reasonable man would have done in the circumstances. **Once that crown has successfully established that the offences were committed, there are three defences available to the accused: 1) due diligence, 2) officially induced error and 3) necessity. The onus shifts to the defendant to establish one or the other of these defences on a balance of probabilities.**
>
> The primary issue in this case is whether the crown has proven beyond a reasonable doubt that Mozafar failed to comply with the Notices requiring him to file a completed personal income tax T1 for the relevant years. The issues raised by the defence in this regard are:
>
> defects in the affidavits filed by the crown;
>
> the mistaken address on the face of the Requirement;
>
> the scope of the searches conducted by Redvers to verify non-compliance;
>
> problems with initiating the prosecution; and
>
> the assertion that Mozafar in fact filed the returns demanded by the Requirement. I shall deal with each of these issues in turn.
>
> Defects in the Affidavits
>
> Mr. Lindsay submitted that there were mulitiple "serious" and "blatant errors" in the affidavits sworn by Mr. Redvers which rendered them, individually and collectively, a nullity and insufficient to establish guilt. Apart from the issues which I will discuss in more detail later, his concerns were about technical defects: the date the affidavits were sworn, that Redvers did not aver that the documents annexed thereto were "made by or on behalf of the Minister or a person exercising a power of the Minister;" that Redvers did not initial the Notices attached to the affidavits to ensure they were true copies; and that there are inconsistencies in the Requirement and the affidavits in their references to the "Toronto Centre Tax Services Office," the "Toronto Tax Services Office" and "Toronto District Office."
>
> With respect to the viability of the allegedly "technical defects," I make the following comments. Mr. Redvers swore the affidavits on August 11, 2003, approximately six weeks after the June 30, 2003 deadline given to Mozafar to file his returns. His Affidavit of Failure to Comply refers to his "examination and search of the appropriate records…up to and including July 25, 2003." Whatever the recommendation in the Taxation Operation Manuals (hereafter "TOM" or "TOMS"), these are administrative guidelines that have no legal significance. There can be no issue that an Information alleging failure to file "on or about the 1st day of July 2003" can be based on affidavits sworn and the searches made on the dates before this court. Similarly, the TOM may recommend placing one's initials on the true copy of the Requirement. Such initials are unnecessary, however, when the affiant swears that the copy attached is a true copy. I also find that any alleged problems with the lack of reference to the Minister and the different references to the Toronto Tax

Digitized by Google

Services Office were cured by the viva voce evidence heard on the trial.

Relying on *R. v. Dionne [1998] S.J. No 189 (Sask Q.B.),* Mr. Lindsay submits that as all the affidavits of Mr. Redvers indicate the same errors, the affidavits do not make out the crown's case. Unlike *Dionne supra*, however, this is not a case where the defence elected to call no evidence, nor where the crown was allowed to reopen its case to cure problems with the affidavits. The affidavits were admitted on consent (presumably subject to argument), and accepted prima facie on a motion for a directed verdict without the defendant raising the above allegedly technical defects. Where the affiant has subsequently been cross-examined and re-examined, and other witnesses have given viva voce evidence, I am bound to decide the case on the basis of all the evidence before the court, whatever the technical defects with respect to the affidavits: *R.v Lasruk [2006] O.J. No. 4621 (Ont. S.C., Belleghem J.).* Had the defence elected to call no evidence, so that the affidavits were the only evidence before the court, the weight to be accorded to the affidavits (or not) would have been substantially different than is the case before me at the conclusion of five days of evidence heard at trial. Mr. Lindsay's concerns about Redvers' Affidavits of Service is an example. There appear to be two Affidavits of Service sworn with respect to each count before the court. One sworn August 11, 2003 refers to an Affidavit attached hereto as Exhibit "B." That attachment was sworn on the same date, but the "Exhibit B" reference was sworn February 5, 2004. The affidavits of service may not have strictly complied with the requirements of s. 244(6) I.T.A. and the dates may be different but, on all the evidence before the court, there can be no doubt that Mozafar was properly served with the Requirements on the date indicated in the Affidavits of Service. In his viva voce evidence, Redvers confirmed his personal service to the defendant. The diary notes entered as an exhibit also indicate that, after making two previous attempts to serve him at his home unsuccessfully, Redvers spoke to Mozafar on the telephone and they agreed to meet. Redvers knew Mozafar from previous contacts and personally served him with the documents when they met. This evidence is uncontradicted.

Mistaken address on the Requirement There is no dispute that the CCRA Requirement to File shows a return address for the "Toronto Centre Tax Office 1 Front St. E., Toronto, Ontario M5J 2X6." The Requirement directs Mozafar to file the return at the "Toronto Centre Tax Services Office at the address shown above to the attention of Paul Redvers." The crown concedes that the Toronto Centre tax office "is located at 1 Front St. West, and that the Hummingbird Centre is located at 1 Front St. East."

I disagree with the submission that the typographical error on the Requirement return address renders the Notice of no force and effect. Redvers testified that the postal code on the return address was the correct postal code. Even if it were not, Mozafar knew where the Toronto tax office on Front Street in Toronto was located and where he could contact Mr. Redvers. On May 29 2001, Mozafar met CRA Collections Officer Judy Marshall at the tax office at 1 Front Street West. At that time, he served her with a Superior Court Statement of Claim that, on its face, included the address of the "Canada Custom and Revenue Agency, 1 Front Street West, Toronto. The Requirement also contained Mr. Redvers' correct telephone number. The uncontradicted evidence of Mr. Redvers is that Mozafar called him by telephone at that number several times.

I am satisfied that Mozafar could have filed his returns at the correct office and/or contacted Mr. Redvers had he chosen to do so. Where Mozafar had actual knowledge of the location of the Toronto tax office on Front Street and of Redvers' phone number, he cannot point to a typographical error on the face of the Requirement to claim officially induced error.

Scope of the Search to Verify Non-Compliance

Mr. Lindsay's most substantial submission is that Redvers search of the "adequate records" was insufficiently comprehensive to prove beyond reasonable doubt that Mozafar failed to file

Digitized by Google

a return as required anywhere in Canada. This submission is based on the two lines of jurisprudence noted previously. The first relates to proof that the SIN number used to do the examination and search of the CRA computer file was linked to Mozafar. The second questions the assertion that proof of a search of "the appropriate records in the Toronto District Office" is sufficient to establish that Mozafar did not file a return elsewhere.

Identification

Mr Lindsay submitted that as part of its obligation to show that a careful examination and search of appropriate records was performed, the crown was required to prove that Mozafar has a specific SIN number, that Redvers checked to see if that SIN actually identified Mozafar, and that he performed his search using that SIN number which resulted in a negative response. He further submitted that the search method used by Redfers was not authorized by CRA policy and fell short of what is required to prove non-compliance with the Requirement beyond a reasonable doubt.

These submissions are based on the evidence of Wallace Dove who worked for several years with Revenue Canada and is very familiar with the TOMS designed to instruct Revenue Canada officials on how to perform their duties. His evidence is that there is a SUDS computer system in place (Systeme Universal Delpac System) "to maximize the effectiveness and efficiency of the Non-Filer/Non-Registrant Program." The details of that computer program are set out in the Non-Filers/Non-Registrants Operations Manual-2002 filed as Exhibit 28. Dove testified that when he worked at Revenue Canada, inputing the name of the taxpayer was insufficient to guarantee accurate identification, so officers were required to use account numbers and then SIN numbers. Now all taxpayers are required to provide a SIN, pursuant to s. 237 of the I.T.A. and a taxpayers account number is his or her SIN number. It was his evidence that this SIN number has become the main identifier of taxpayers on the Revenue Canada computer database. With that SIN, Revenue Canada officers can access information on virtually any taxpayer in the country. In this case, Redvers testified that he did not use Mozafar's SIN number for his examination and search of the records. He testified that taxpayers are cross-indexed by name, address and SIN number. In his role as a field investigator in the non-registrant/nonfiler section of CCRA, he typically follows up on only a limited number of files, and typically does not search by SIN number but by name and address.

In this search, Redvers used the information on the file that he knew to be accurate. On June 5 2001, he had met Mozafar personally at the home address he had used when he filed his returns previously. Prior to serving Mozafar in May 2003, he attended at his home again and spoke with his wife. During his work on the file, he also checked multiple other sources of information, including Equifax and immigration files, to confirm his identity. These sources confirmed the address and SIN number on file with CRA. Redvers testified that, using the CRA computer database, he was able to verify that Mozafar Maleki is the only taxpayer with that name in all of Canada. He was not asked when he did the search, but I infer, from the timing of this evidence (on May4th in sur-crossexamination) and the fact that Redvers had not mentioned this previously, that he had done that computer search in the interval since he last testified in court. His evidence on this point has no relevance to the search he did before swearing his affidavit in 2003. Alicia Rawlins, the CRA Prosecution Liaison Officer, did a CRA computer search prior to swearing the Information before this court on September 30, 2004, to ensure that no filings were made in the interval since Redvers had sworn his affidavit. She searched the CRA computer mainframe system by Mozafar's name and SIN number. She testified that there was a second Mozafar Maleki on the computer system at that time but the reference was very old and she believed that he was deceased.

I take the evidence of Mr. Dove with a grain of salt. Notwithstanding my order for the exclusion of witnesses, Mr. Dove was present in court to hear the testimony of Mr. Redvers

Digitized by Google

for at least one day. He last worked at Revenue Canada in l990, did not have personal experience with TOM's outside his own area, and has no personal knowledge if Exhibit 28 was the current version or whether any amendments had been made since. More important, Dove's evidence about SIN numbers as the distinguishing identifier of taxpayers has most weight when searching a common name where there could be many taxpayers with the same name. Where there is evidence that the name Mozafar Maleki is relatively unique, and his identification can be verified by birthdates and addresses, the significance of the SIN number is greatly diminished. Given Redvers' personal knowledge of Mozafar and his file, there can be no doubt that the person identified as Mozafar Maleki on the Requirement is the same person whose records Redvers searched and who is the defendant before the court.

Scope of the Search

Redvers attested in his affidavit that he had made a "careful examination and search of the appropriate records in the Toronto District Office for Mozafar Maleki" and he was "unable to find" that a completed income tax return "had been made and filed or provided up to and including July 25, 2003, by the said Mozafar Maleki." In his viva voce evidence, he testified that he searched his files in his home and his Toronto office and the Ontario tax office in Sudbury, and that, given the system in place, he was satisfied that Mozafar never gave a return to him or anyone else.

It is the system in place that ensures that Redvers' search was sufficient. Once Mozafar's file was transferred to him in May 2001, the system required that he hold that file in his own filing system until he was satisfied that he had received the returns. He testified that the system of filing across Canada is based on residence, that each tax office is responsible for the postal codes in part of the country, and required to store returns from that area for a certain number of years. All filings for an Ontario resident such as Mozafar would be sent for processing and then stored in the Ontario tax office in Sudbury. On assuming carriage of the file, a note is made in the Sudbury office that any filing is to be sent to him. Once a Requirement is issued, that fact is entered onto the nationwide CRA computer and, thereafter, if a tax return comes in to anyone anywhere, the computer indicates that this is a "file under requirement" and provides the name of the person to whom it is to be sent. When a prosecution is approved, a "keep" code is also placed on the computer file, so that anyone receiving the return anywhere in Canada would receive a message that this file cannot be sent for assessment and must be forwarded to the field investigator responsible for the file. Alicia Rawlins confirmed the system in place to the effect that, where a Requirement has been issued, as soon as a return is received anywhere, the officer who receives the filing is required to update the computer system and contact the office responsible for the file. I put no weight on Mr. Lindsay's submission that, as Mr. Redvers did not personally examine the Sudbury files himself, the results of any search done for Mozafar's file in Sudbury is hearsay evidence. Redvers testified that everyone anywhere in the CCRA system would know that he was responsible for Mozafar's file and at least three different officers would have had to have ignored the "keep" code for him not to have received any possible filing by Mozafar. These would be the person who received the filing, the person who processed it in Sudbury, and his or her supervisor who alone could override the code. Having received no indication from Sudbury of any filing by Mozafar for the relevant years, nor any filed returns from any other office, I find that Redvers was entitled to rely on the system in place to verify the physical search of his own files, and that what he did constituted a "careful examination and search of the appropriate records."

Problems in initiating the prosecution

Mr. Lindsay submitted that the signature of the Director was required before Redvers was authorized to issue a Requirement, or commence a prosecution, and that there was no

Digitized by Google

evidence before the court that the Director gave this authorization. With respect, I put no weight whatsoever on this argument. The Requirements on their face was issued over the signature of Alice Shields, Director-Taxation, Toronto.

As for authority to commence a prosecution, the viva voce evidence of Alicia Rawlins was that she was employed by the CRA as a prosecution liaison officer on September 30, 2004 when she swore the Information before a Justice of the Peace. Section 244(1) of the I.T.A. is a complete answer to Lindsay's submission. It provides that "an information under the I.T.A. may be laid…by any officer of the Canada Customs and Revenue Agency…and, where an information purports to be laid or made under this Act, it shall be deemed to have been laid or made by a person thereto authorized by the Minister and shall not be called in question for lack of authority of the informant…." The Information before this court on its face indicates that Alicia Rawlins is an Officer of Canada Customs and Revenue Agency, and charges three counts of offences under the Income Tax Act.

Mr. Lindsay also submitted that the Information which alleged that the defendant "unlawfully failed to comply with the notice…in that he did not provide the Canada Customs and Revenue Agency, in the said Toronto Region, Province of Ontario, a completed Income Tax Form…" was "fatally defective" in that it did not allege an offence known to law. On his reading, the offence charged was a failure to comply with a notice to file a return at a specific address, whereas the offence was actually a charge of failing to comply with a notice to file a return, pursuant to s. 231.2 of the Act.

This is another argument without merit. The Requirement on its face indicates that the return was to be filed at the Toronto Centre Tax Services Office at the address indicated. The impugned words on the Information merely refer to the jurisdiction in which the offences occurred, and provide particulars for the offences that are also identified by the correct section of the I.T.A. in each count. I agree with Mr. Gilman that the defendant was never misled as to the gravamen of the offences charged: see *R. v. Cote (1977), 33 C.C.C. (2d)353(SCC):*

The golden rule is for the accused to be reasonably informed of the transaction alleged against him, thus giving him the possibility of a full defence and a fair trial. When, as in the present case, the information recites all the facts and relates them to a definite offence identified by the relevant sections of the Code, it is impossible for the accused to be misled. To hold otherwise, would be to revert to the extreme technicality of the old procedure.

Were the returns demanded by the Requirement in fact Filed by Mozafar?

Mr. Lindsay submitted that Redvers and Marshall both conceded that Mozafar did file returns for all the tax years at issue. This is clearly not the evidence before the court. The viva voce evidence of the CRA officers indicates that Mozafar had filed returns up to 1998, but not thereafter. The only evidence of a T1 return from Mozafar is a 1999 T1 form received at the Toronto tax office on April 23, 2001 and deemed "unacceptable" by CCRA officials.

The evidence before me indicates that Mozafar submitted a six-page tax form at that time with none of the prescribed information. Apart from his name and address, there was no SIN number, no numbers of any kind, no signature, and nothing that could be used to process the filing. The only markings on the document was the notation "n/a" on every line, several drawings including a stick figure being hanged, the notation that "this form does not seem to be authorized by the Minister of National Revenue" and the words "Restricted Information" in place of the SIN number. After consultation with her team leader, Judy Marshall concluded that this was not a valid tax return. When she transferred the file to Alan Redvers, he agreed.

The conclusion of the CRA officers is supported by the jurisprudence. An income tax return without any statement of income or assets is not a valid return: *R. v. Morgan [1995]*

Digitized by Google

O.J. No. 4725 (Ont. C.J. Prov. Div. Rawlins J.). "A demand to file a tax return is a request for financial information, and 'n/a' was not a response, but an evasion:" *R. v. Jacques [2000] B.C.J. No. 576 para 28-35 (B.C.S.C.) affirmed [2001] B.C.J. No 812 (B.C.C.A.),* and does not constitute compliance with section 238(1) of the I.T.A.: *R. v. Meikle* [2005] B.C.J. No. 2267 para 40 (B.C.S.C., Rice J.)

Mr. Lindsay submitted that because the crown did not disclose a copy of this l999 filing, Mozafar's Charter rights to full disclosure, make full answer and defence, and a fair hearing have been subject to "irremediable prejudice" and he seeks a stay of proceedings or a mistrial. Mr. Lindsay's assertion to the contrary, there is absolutely no evidence that Redvers destroyed the document. The evidence indicates that both Marshall and Redvers thought that the defaced invalid 1999 T1 filed by Mozafar was stored as a "permanent record," but it could not be found for the purposes of disclosure. Mr Lindsay submitted that Mozafar's opportunity to show his due diligence has been jeopardized by the loss of this 1999 T1 form, because it cannot be put before the court to assess the validity of the CRA's conclusion that it was "unacceptable."

I am satisfied that there is absolutely no merit to Mr. Lindsay's submissions about this document. The undisputed viva voce evidence of two CRA officials is more than enough to establish beyond a reasonable doubt that the T1 form filed by Mozafar in April 2001 was not a valid tax return. That being the case, there is no doubt that this filing could not qualify as a "completed" T1 for l999 "including a Statement of Assets and Liabilities and a Statement of Income and Expenses" as was demanded by the Requirement served in May 2003. There is absolutely no reason why the court must see the original document to validate the conclusions of the CRA officials on this issue.

Nor do I put any weight on the evidence of Wallace Dove that Mozafar showed him his l999, 2000 and 2001 tax returns before he put these returns in the mail. Since Mozafar was not available for cross-examination, I put no weight on anything Dove said that he told him. Dove, moreover, could not be certain that he actually saw the 2001 return and acknowledged that he didn't actually see any of the information on the forms. He testified that Mozafar put the returns in an envelope, sealed it and put it in the mail while they were attending a political party meeting together in London Ontario, but he couldn't say when this occurred. It is totally incredible to me that Mr. Dove offered this evidence in the closing minutes of his cross-examination by the crown, and that there was no mention of any such evidence during his lengthy direct examination by Mozafar. I consider this evidence neither credible nor reliable.

Much more significant is the evidence of Redvers that he was not aware of any other T1 forms (besides the 1999 form discussed previously) filed by Mozafar for the years at issue. Whatever concerns one may have had about the demeanour and deportment of Mr. Redvers at trial, I have absolutely no reason to doubt the veracity of his Affidavits sworn on August 11, 2003, nor the credibility and reliability of his viva voce evidence at trial. His evidence was generally corroborated by the other CRA officials, and particularly by Judy Marshall as to the nature of the alleged 1999 filing and by Alicia Rawlins who testified that, as of September 30, 2004, her computer search of the CRA database indicated that there was no filing from Mozafar for 1999, 2000 and 2001. Ms Rawlins, and the TOM entered as exhibit 28, also corroborated Redvers' evidence about the system in place to ensure that any filing by Mozafar anywhere else would be routed to him.

Having found that Mozafar filed no valid return for the years at issue, I do not have to deal with Mr. Lindsay's submission that s. 238(1) of the I.T.A. was not the proper charge in this matter, and that the proper charge, if at all, should have been under s. 162(5) of the I.T.A. for failure to provide complete information.

Conclusion

Digitized by Google

On all the evidence before this court, I find that Mozafar was personally served with three Requirements to file completed income tax returns for I999, 2000 and 2001 on or before June 30, 2003, and that Mozafar filed no such returns. I find that the crown has proven that Mozafar committed the offences beyond a reasonable doubt. Mozafar has offered no evidence of any valid defences. There will be a conviction on all three counts.

The Principal Evasion Charge, Sec 239(1)

Other offences and punishment - S. 239(1)
239. (1) Every person who has

(*a*) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation,
(*b*) to evade payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,
(*c*) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,
(*d*) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act, or
(*e*) conspired with any person to commit an offence described in paragraphs 239(1)(*a*) to 239(1)(*d*), is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to
(*f*) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or
(*g*) both the fine described in paragraph 239(1)(*f*) and imprisonment for a term not exceeding 2 years.

Offenses re refunds and credits
(1.1) Every person who obtains or claims a refund or credit under this Act to which the person or any other person is not entitled or obtains or claims a refund or credit under this Act in an amount that is greater than the amount to which the person or other person is entitled

(*a*) by making, or participating in, assenting to or acquiescing in the making of, a false or deceptive statement in a return, certificate, statement or answer filed or made under this Act or a regulation,
(*b*) by destroying, altering, mutilating, hiding or otherwise disposing of a record or book of account of the person or other person,
(*c*) by making, or assenting to or acquiescing in the making of, a false or deceptive entry in a record or book of account of the person or other person,
(*d*) by omitting, or assenting to or acquiescing in an omission to enter a material particular in a record or book of account of the person or other person,
(*e*) wilfully in any manner, or
(*f*) by conspiring with any person to commit any offence under this subsection, is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to
(*g*) a fine of not less than 50% and not more than 200% of the amount by which the amount of the refund or credit obtained or claimed exceeds the amount, if any, of the

Digitized by Google

refund or credit to which the person or other person, as the case may be, is entitled, or

(*h*) both the fine described in paragraph 239(1.1)(*g*) and imprisonment for a term not exceeding 2 years.

Prosecution on indictment

(2) Every person who is charged with an offence described in subsection 239(1) or 239(1.1) may, at the election of the Attorney General of Canada, be prosecuted on indictment and, if convicted, is, in addition to any penalty otherwise provided, liable to

(*a*) a fine of not less than 100% and not more than 200% of

(i) where the offence is described in subsection 239(1), the amount of the tax that was sought to be evaded, and

(ii) where the offence is described in subsection 239(1.1), the amount by which the amount of the refund or credit obtained or claimed exceeds the amount, if any, of the refund or credit to which the person or other person, as the case may be, is entitled; and

(*b*) imprisonment for a term not exceeding 5 years.

Offence with respect to confidential information

(2.2) Every person who

(*a*) contravenes subsection 241(1), or

(*b*) knowingly contravenes an order made under subsection 241(4.1) is guilty of an offence and liable on summary conviction to a fine not exceeding $5,000 or to imprisonment for a term not exceeding 12 months, or to both.

The Nature of the Offences

[62] As earlier indicated the accused are charges with offences contrary to ss. 239(1)(a) and239(1)(d) of the *Income Tax Act (Canada)*. The relevant portions of s. 239(1) are:

239(1) Every person who has

(a) made, or participated in, assented to or acquiesced in the making of,false or deceptive statements in a return, certificate, statement or answerfiled or made as required by or under this Act or regulation,...

(d) wilfully, in any manner, evaded or attempted to evade, compliancewith this Act or payment of taxes imposed by this Act, or

(e) conspired with any person to commit an offence described byparagraphs (a) to (d),

is guilty of an offence and, in addition to any penalty otherwise provided, is liableon summary conviction to

(f) a fine of not less than 25% and not more than double the amount of the tax that was sought to be evaded, or(g) both the fine described in paragraph (f) and imprisonment for a term not exceeding 2 years.

Wilfully Evading Payment of Taxes

[63] Each of the taxpayers is charged with "wilfully evading payment of taxes during namedtaxation years. A single count of tax evasion spanning a number of taxation years is notobjectionable: *R. v. Mah* (1974), 19 C.C.C. (2d) 210 (Alta. C.A.).

[64] Neither of the important terms set out in s. 239(1)(d) "wilful" or "evade" are defined inthe *Income Tax Act*. The meaning of the terms used this section is explained in a number ofauthorities cited by Mr. Davidson.

[65] In *R. v. Baker* (1973), 16 C.C.C. (2d) 126 (Nova Scotia District Court) McLellan, Co. Ct.J. said at p. 131:"With that finding I entirely agree, and would point out that the English authorities referred to above reinforce the conclusion reached by Her Honour --namely, that

Digitized by Google

where the evasion referred to is in a penal statute or is between citizen and Government, it is intended to included something like underhand dealing, or to use her words, it is intended to include some "element of artifice, craft or strategy."

[66] In *R. v. Paveley* (1976), 30 C.C.C. (2d) 483 (Sask. C.A.) all three members of the Courtmade comments about the meaning of "evade" or "wilfully evade". Woods J.A. followed *R. v.Baker, supra* and found that to fall within the section there needs to be a scheme or artifice withintent to deceive. Brownridge J.A. said at p. 488 that "wilfully" should be interpreted as "with an evil intention". At p. 492 Bayda J.A. said:"The word "wilfully" as used in the subsection under consideration, carries a distinct connotation of deliberate purpose and ulterior motive. To ascribe to the word a meaning which negates or overlooks that purpose or motive is to dilute the meaning of the word to a point where its use is rendered completely unnecessary.I have no hesitation in concluding that the offence with which the appellant is charged falls into the second class of offence mentioned by Ritchie J.

[acts done with a specific and ulterior motive]. It follows then that for a conviction to take place under s. 239(1)(d) of the Act there must be proof of the *actus reus*, the "manner", to use the word of the statute, in which the alleged offence was committed, and, also proof of a specific intent, that is to say, proof that the act which constitutes the "manner" was done with a particular purpose – the purpose of evading the payment of tax."

[67] In *The Queen v. Branch* (1976) 76 D.T.C. 6112 (Dist. Court Alta.) Medhurst J. observed at p. 6113:"In my opinion the word evade implies something of an underhanded or deceitful nature. In other words a deliberate attempt to escape the requirement of paying tax on income that had been earned. This intention can be inferred from acts of omission or commission."

[68] In *The Queen v. Landes* [1988] 1 C.T.C. 124 Scheter J. reviewed the law extensively relating to offences relating to s. 239(1)(a) and 239(1)(d) and concluded that both offences required *mens rea* that established actions that were secretive, deceitful or secretive in nature.

[69] In *R. v. D. Fisher* [1993] 1 C.T.C. 374 (Alta. Prov. Ct.) Hamilton P.C.J. held that the *mens rea* required for offences under s. 239(1)(a) or 239(1)(d) could be based upon the doctrine of wilful blindness.

[70] In *R. v. Dipasquale* (1993) 93 D.T.C. 5239 (Ont. Gen. Div.) Sheppard J. observed at p.5391:"With respect to the *mens rea* of the offence, a charge of wilful evasion is a specific intent offence. A court must find on the evidence beyond a reasonable doubt an intent to evade the payment of income tax. Carelessness or recklessness without knowledge of the facts constituting the offence is not sufficient. Wilful blindness may be equivalent of knowledge if the facts are such that a court can infer knowledge (see *R. v. Sandhu* 73 C.R. (3d) 162."

[71] In *R. v. Kleyson* [1996] M.J. No 69 [Man. Q.B.] Schwartz J. said:"It is sufficient, in my view, to convict an accused of evasion if the prosecution is able to establish beyond a reasonable doubt that the accused made false or deceptive statements in their tax returns with the intent of evading or attempting to evade the payment of taxes."

[72] Ms. Bottcher sought to distinguish the judicial consideration of the meaning of the terms "wilful" and "evade" on a factual basis. Her submission is that the majority of these cases deal with situations where the accused failed to file income tax returns for a number of years. The legal principles, in those cases, in the submission of the Crown are limited to those situations. I do not concur completely in that view; some of the principles are applicable. To be successful in a prosecution pursuant to s. 239(1)(d) of the *Income Tax Act*, where evasion of the payment of income tax is alleged, the Crown must prove beyond a reasonable doubt that the accused willfully evaded or attempted to evade payment of income taxes. A deliberate but intentional scheme to avoid tax payment even if it were not underhanded

Digitized by Google

would be sufficient. Carelessness or recklessness of a taxpayer in omitting information in a tax return will not be sufficient to prove the required *mens rea*. The Crown must prove that the accused deliberately omitted the income with the intent to avoid payment of taxes. Alternatively, the Crown can rely upon the doctrine that the accused was wilfully blind as to the supplying of that information. Proof by the Crown of a deceitful or underhanded scheme to avoid taxes would be sufficient to establish a deliberate intention.

[73] In the case at bar, the Crown theory is that the accused deliberately pocketed money from their cash businesses and failed to report the pocketing or skimming of the money on their income tax returns. If that theory has been proven beyond a reasonable doubt then the necessary *actus reus*, and *mens rea* would have been proven.

Making a False Statement

[74] Here, the taxpayers are charged with a number of offences that they did "make, participate in, assent to or acquiesce in the making of a false or deceptive statement" in an income tax return contrary to s. 239(1)(a) of the *Income Tax Act*.

[75] Frequently the Crown charges an accused with making a false statement and tax evasion in the same information, as they did in this case. In my view, the tax evasion charge is an alternative offence to the offences of making a false statement in the specific income tax year. The tax evasion charge arises out of the same delict as the false statement offences. Therefore, if the Crown has sufficient evidence to prove all of the offences beyond a reasonable doubt, a judicial stay ought to be entered on the less serious charges: *R. v. Kienapple* (1974), 15 C.C.C.(2d) 525 (S.C.C.); *R. v. Thetrault* (1976) C.T.C. 719 (Alta. Prov. Ct.); *R. v. Kolenhof* 66 D.T.C.5441. Should this be the result, Ms. Bottcher conceded the less serious offences are the false statement offences.

[76] Because of the frequency with which the Crown charges ss. 239(1)(a) and 239(1)(d)offences in the same information or indictment, often the judicial authorities often refer to *mens rea* for each being similar. Certainly that is the result of the analysis found in *R. v. Landes, supra* that the intention of each required some sort of deception.

[77] However, there is a some distinction between the two in that the term "wilfully" is not used in s. 239(1)(a). Therefore, reference to judicial interpretation of the word "wilfully" would be inapplicable to section 239(1)(a) offences.

[78] There are some cases where the *mens rea* of s. 239(1)(a) has been considered. In *Acme Slide Fastener Company Ltd. v. Thomas Edward Knott* (1962) C.T.C. 320 (Que. Sup. Ct.) Ouimet J. wrote at p. 326: "A distinction must be drawn, at the outset, between poor accounting practices, which might be difficult to unravel, and *false or deceptive statements* in an income tax return."

[79] In *R. v. Regehr* (1968) C.T.C. 122 (Yuk. C.A.) the Court held in effect that the trial judge's direction that omissions due to carelessness or negligence would not be sufficient to prove a s. 239(1)(a) offence.

[80] The *actus reus* or wrongful action of a s. 239(1)(a) *Income Tax Act* offence, is making, participating in, assenting to or acquiescing in the making of a false or deceptive statement. The *mens rea* of this offence is that the individual did so intentionally or at least with a wilfulblindness to the falsity or deceptiveness of the statement. Again carelessness will not suffice. The *mens rea* and *actus reus* of the offence must be proven by the Crown beyond a reasonable doubt. Here, the Crown's theory of the commission of this offence is the same as the theory relative to tax evasion set out above. If the Crown can prove that theory beyond a reasonable doubt these offences would have been proven.

Lesser Amount Proven

[81] Where the Crown proceeded by summary conviction it is imperative that the trial judge find that the taxpayer sought to evade a particular amount of taxes because the penalty assessed is dependent upon that finding: s. 239(1)(f). The Crown in this instance has

Digitized by Google

specified certain monetary amounts in each of the counts before the Court. If the Crown proves that lesser amounts were not reported or evaded, then the trial judge could find the accused guilty of that lesser amount and amend the information accordingly: *R. v. Century 21 Ramos Realty Inc.* (1987), 32 C.C.C. (3d) 353 (Ont. C.A.) at p. 369-70; *R. v. Cormier* (1986), 29 C.C.C. (3d) 481 (B.C.C.A.) at pp. 486-7.

In R. v. Topedge Investments Ltd.[111] the burdens were spoken of:

Analysis of the Law

[43] It should be stated at the outset that the Defence abandoned its argument of 'officially induced error.' Accordingly, the following case law was presented by Crown and Defence relating to the burden of proof in Section 239(1)(d) of the *Income Tax Act of Canada*: ***R. v. Baker*** (1973),16 C.C.C. (2d) 126; ***R. v. Paveley*** (1975) 76 DTC 6415 (Sask.C.A); ***R. v. Branch*** (1975) 76 DTC 6112 (AB.D.Ct.); ***R. v. Medicine Hat Greenhouses Ltd.*** [1981] C.T.C. 141 (ABCA); ***R. v. Pongratz*** [1982] F.C.J. No. 75 (Fed.Ct.); ***R. v. De Wolf*** (1982) 67 C.C.C. (2d) 43 (BCCA); ***Schwarz v. Canada (Minister of National Revenue - M.N. R.)***, [1991] T.C.J. No. 419***R. v. Jorgensen*** [1995] 4 S.C.R. 55 (SCC); ***R. v. Harding*** (2001), 57 O.R. (3d) 333 (Ont.C.A.); ***R. v. Jarvis*** [2002] 3 S.C.R. 757 (SCC); ***R. v. Klundert*** (2004),242 D.L.R. (4th) 644 (Ont. C.A.); ***v. Kennedy*** [2005] 1 C.T.C. 321 (BCCA); ***R. v. Mortensen*** 2004 ABPC 104 (ABPC); and ***R. v. Chahine- Badr*** [2006] 2 C.T.C. 243 (Ont. Ct. Just.).

[44] In ***Paveley***, *supra,* the Saskatchewan Court of Appeal held that for a conviction to take place, there must be proof of two ingredients: first, the 'manner' through which the evasion was accomplished (the actus reus), and second, the intention to accomplish an evasion of payment of taxes in the sense of accomplishing something forbidden by or in defiance of the law (mens rea). The court adopted the view that "willfully" means not merely to commit an act voluntarily, but to commit it purposely with an evil intention, to do so deliberately, intentionally and corruptly and without any justifiable excuse. It was said that "willfully" carried a distinct connotation of deliberate purpose and ulterior motive. In order to convict, the court may infer that the accused committed the actus reus with intent to evade payment of taxes. The presence of an artifice or scheme makes it easier to draw the necessary inference of intent to evade payment of taxes, but such artifice or scheme is not a necessary element of the offence created by the subsection.

[45] In ***Branch***, *supra,* which was decided after ***Paveley*** by the District Court in Calgary later in 1975, the court held that the definition of "evade" implies something of an underhanded or deceitful nature to escape the requirement of paying tax on income that had been earned. In that case, the accused therein, during the period in question, was having unspecified personal problems, was emotionally 'washed up,' did not destroy records, and was not secretive about his default. In these circumstances, he was found not guilty. Similarly this was the case in ***Schwartz,*** *supra,* where that accused essentially became an alcoholic, operating his business in an alcoholic haze. While filed late, he actually did file his tax returns. He was found not guilty of tax evasion. In ***Branch,*** *supra,* the Court found that the accused had not engaged in any artifice, craft or strategy. He had merely failed to file his tax returns and there were many redeeming circumstances to his situation, unlike the instant case.

[46] In the ***Medicine Hat Greenhouses,*** *supra,*case, the Alberta Court of Appeal noted that the Crown had the onus to establish 'willfulness' and 'evasion' beyond a reasonable doubt.

[47] The ***Pongratz****, supra,*case from the Federal Court of Appeal involved an accountant who postponed the preparation and filing of his own return to a time of the year when it was

[111] 2007 ABPC 230

Digitized by Google

more convenient to prepare it (*i.e.* outside of tax filing season). He had a good reason for the delay and always filed his return; it was simply late. He always paid the late filing fees and the taxes owing plus penalty. This is remarkably distinguishable from the instant case, where Edgelow has not filed tax returns for the last nine years and has no satisfactory reason for the delay. The case confirms that since the *Income Tax Act* is a penal statute it must be construed strictly against the taxing authority.

[48] The ***De Wolf,*** *supra,* case, however, is right on point. In that case, the accused was charged with willfully evading payment of taxes over a five year period by failing to declare income received by him. That accused failed to declare income received by him in the amount of $135,000. He had not filed income tax returns for a fifteen year period, believing he had no taxable income. However in the material time relating to the charge, like Edgelow, De Wolf believed he had received income upon which tax was payable, but he had difficulties: he was indebted and had numerous obligations and did not have the resources to pay the tax. Like Edgelow, De Wolf was delaying the filing of his tax returns in the hope that he would be able to raise sufficient funds to file the returns and pay the outstanding tax liability. He, like Edgelow, had prospects. Like Edgelow, the evidence was quite clear that when De Wolf was in funds sufficient to meet his liability to the income tax department, he made a deliberate choice to pay the funds elsewhere: a loan to the Royal Bank and funds to his wife for maintenance and support. Edgelow did the same, he allowed a foreclosure of his home that had equity in it and he settled a divorce action and property settlement with his wife. Like Edgelow, De Wolf had a motive in not filing his returns at that time: to do so would have alerted the tax authorities to the fact that he was paying creditors and making payments to his family rather than meeting his obligations with respect to his income tax liability. The British Columbia Court of Appeal held that "willfully" carried the connotation of deliberate purpose and ulterior motive. The question of his intent was affected by the background against which it is suggested that he did not pay tax, intended not to pay tax and intended to evade tax. The Court upheld the lower court finding that there was a deliberate purpose and ulterior motive in the non-payment, which together, established the willful evasion of payment.

[49] Neither the ***Jorgensen****, supra,* or ***Harding****, supra,* cases were particularly analogous or material to the instant case, ***Jorgensen*** discussing the concepts of 'knowingly' and "without lawful justification or excuse' in the context of selling obscene material and ***Harding*** discussing the concept of 'willful blindness' in the context of a willful promotion of hatred charge.

[50] The ***Klundert****, supra,* case was a situation where the taxpayer held the opinion the federal government did not have the legislative power to impose or collect income tax, so he stopped completing his returns and paying taxes owing under the *Income Tax Act*. In setting out the context, the Ontario Court of Appeal observed that the functioning of the *Income Tax Act of Canada* was dependent upon accurate self- assessment of tax owing through timely reporting of income and calculation of tax owing. This view was later confirmed in ***Jarvis****, supra,* where the Supreme Court of Canada stated at para 51: "It follows from the tax scheme's basic selfassessment and self-reporting characteristics that the success of its administration depends primarily upon taxpayer forthrightness." At para 56 the Court approved of the finding in ***Knox Contracting*** CanLII135 (SCC): "Those who do evade the payment of income tax not only cheat the State of what is owing to it, but inevitably increase the burden placed upon the honest taxpayers." In the ***Chahine-Badr****, supra,* case, the Ontario Supreme Court noted in para 23, that it is ". . . only where the encouragement to honesty fails and the taxpayer deliberately attempts to evade taxes may the authorities resort to criminal proceedings. They should be given every opportunity to first resolve taxpayer non-compliance through judicious use of their regulatory powers."

Digitized by Google

[51] It was noted that where tax is owed, the failure to conform as indicated "has the inevitable effect of avoiding, at least for a time, the payment of tax required under the Act." [para 42]. The Court also confirmed at para. 35, that the "the word 'evade' had two possible meanings: the act of deliberately avoiding something or the act of avoiding something in an underhanded or devious way. The Ontario Court of Appeal adopted the interpretation of Bayda, J.A. in ***Paveley***, *supra*, holding that the conduct component of the crime of evading tax contrary to s.239(1)(d) is made out "if the Crown proves that the accused voluntarily performed an act or engaged in a course of conduct that avoided or attempted to avoid payment of tax owing under the Act." At para. 41, Doherty, J.A. states:

[41] The authorities that require that the evasion be deceitful or underhanded confuse the conduct component of the crime of tax evasion with the fault component of that crime. Fault rests in the state of mind that accompanies the doing of the prohibited conduct. It is the culpable state of mind that distinguishes the legitimate tax planner from the dishonest tax evader. Both may engage in the same course of conduct that can aptly be described as a deliberate attempt to avoid payment of tax. The difference lies in their respective states of mind. Unlike the tax evader, the tax planner does not intend to avoid the payment of a tax that he or she knows is owed under the Act, but rather intends to avoid owing tax under the Act.

[52] In interpreting the word 'wilfully,' the Court held in para. 46 that:

[46] . . . culpability will follow only where the accused engages in conduct intended to avoid the payment of tax owing under the Act. More precisely, I think the fault component in s.239(1)(d) is twofold. First, the accused must know that tax is owing under the Act and second, the accused must intend to avoid or intend to attempt to avoid payment of that tax. An accused intends to avoid, or intends to attempt to avoid, payment of taxes owing under the act where that is his purpose, or where he knows that his course of conduct is virtually certain to result in the avoiding of tax owing under the act.

[53] In order to convict, Doherty stated at para. 47, that the trier of fact must be satisfied beyond a reasonable doubt that the accused knew there was tax owing and did something or engaged in a course of conduct that avoided or attempted to avoid the payment of the tax owing, or knowing that avoiding payment of tax imposed by the *Act* was a virtual certain consequence of his actions. Klundert, it was held, knew he owed tax and his false 'protester' belief that the federal government had no authority to collect tax afforded him no defence in law.

[54] Like Edgelow, Mr. Kennedy in the ***Kennedy***, *supra,* case, sold property and realized a substantial taxable capital gain. Like Edgelow, Kennedy consulted an accounting firm, discussed the tax implications of the sale and was fully aware a capital gain would accrue as a result of the sale and that he would have to pay taxes on same. Kennedy determined not to declare the income on the tax returns he did file. Like Klundert, Kennedy believed the federal government did not have the constitutional ability to tax individuals. In ***Kennedy***, the B.C. Court of Appeal quoted the case of ***M.N.R. v. Teodori*** (1997), 97 G.T.C. 7187, with approval, noting the most nearly comparable provisions of the Criminal Code are those relating to fraud. Relating to the *actus reus*, the Court suggested using corporate funds for personal purposes, nondisclosure of important facts, exploiting the weakness of another, unauthorized diversion of funds, and unauthorized arrogation of funds or property would all be relevant, and that it was not necessary for the prosecution to show that the accused personally profited. With respect to the *mens rea* element, the court suggested the relevant elements were deceit, falsehood or some other dishonest act that deprived another of what is or should be his; having a subjective awareness that one was undertaking a prohibited act which could cause deprivation in the sense of depriving another of property or putting that property at risk. The Court also noted that the personal feeling of the accused about the morality or honesty of the *Act* or its consequences was irrelevant.

Digitized by Google

[55] Of course, one is ever mindful of the case of ***R. v. W.(D.)***, [1991] 1 S.C.R. 742 (SCC), where the Supreme Court of Canada instructs on the issue of credibility as follows:
if the evidence of the accused is believed, he must be acquitted;
if the accused is not believed, but the judge is left in reasonable doubt by his testimony, the accused must be acquitted.
if the accused's testimony leaves the judge in no doubt, the judge must determine on the basis of the evidence that is accepted whether the Crown has proven its case beyond a reasonable doubt.

The Proper Forum as a Criminal Offence

The proper court to hear a tax offence case can only be a provincial court since it is a criminal case and these type of cases are always heard at the provincial level. This was the opinion in Sandra June Gibbs v. Regina[112]

Did the trial judge err in hearing the trial? Should it have been heard in Federal Court?

[34] Section 238 of the ***Act*** stipulates that failing to file is a summary conviction offence. The ***Criminal Code*** R.S.C. 1985, c. C-46 applies to summary conviction offences created by a federal statute. Section 34(2) of the ***Interpretation Act*** R.S.C. 1985, c. I-21 directs as follows:

All the provisions of the *Criminal Code* relating to indictable offences apply to indictable offences created by an enactment, and all the provisions of that *Code* relating to summary conviction offences apply to all other offences created by an enactment, except to the extent that the enactment otherwise provides.

Section 798 of the ***Criminal Code*** provides that summary conviction offences are to be heard by a summary conviction court. The Provincial Court of British Columbia is considered a summary conviction court.

Need of Existence of Mens Rea

Tax evasion is a species of fraud and is the statutory offspring of the common law offence of cheating the public revenue. Perhaps one of the most important cases that describes the elements of the act is R. v. Klundert[113] which is reproduced following.

I

Overview

[1] Dr. Klundert, an optometrist, carried on business for many years in Windsor, Ontario. Prior to 1993, with the help of an accounting service, he prepared and filed his tax returns as required under the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1 (the "Act"). By 1993, however, Dr. Klundert had formed the opinion that the federal government did not have the legislative power to impose or collect income tax. He stopped completing his returns and paying taxes owed under the Act.

[2] Not surprisingly, Dr. Klundert's position brought him into conflict with the Canada Customs Revenue Agency (the "CCRA"). Eventually, Dr. Klundert was charged with making a false statement in his 1993 tax return contrary to s. 239(1)(a) of the Act, and tax evasion between December 31, 1992 and June 13, 1998, contrary to s. 239(1)(d) of the Act.

---

[112] 2006 BCSC 481

[113] 2004 CanLII 21268 (ON CA)

Digitized by Google

The Crown proceeded by indictment and Dr. Klundert elected trial by jury. [3] Dr. Klundert acknowledged that he did not report his income or pay the taxes owing under the Act during the relevant years. He contended that his refusal to pay the taxes did not constitute an evasion but was instead an honest protest against what he believed to be unlawful governmental action.

[4] The jury convicted Dr. Klundert of making a false statement (count 1) and acquitted him on tax evasion (count 2). On count 1, the trial judge imposed a fine of $80,541.00 and placed Dr. Klundert on probation for two years.

[5] Dr. Klundert appeals his conviction and sentence on count 1. The Crown appeals the acquittal on count 2. [6] I would allow the Crown's appeal from the acquittal on count 2. The trial judge erred in law in instructing the jury that an honest belief that the Act was beyond the legislative power of the federal government was relevant to culpability on a charge of tax evasion. I would also allow Dr.Klundert's appeal from his conviction on count 1. The verdicts returned by the jury were, in the light of the instructions given by the trial judge, irreconcilably inconsistent. Since there must be a new trial on count 2 and the two charges are closely interrelated, I think it best to order a new trial on count 1 as well.

II

Facts

[7] Many of the relevant facts were agreed upon at trial. It was acknowledged that Dr. Klundert had substantial income in the years 1993 to 1998, that he owed tax under the Act, that he chose not to declare any of that income in his tax returns and that he did not pay his income taxes.

[8] Dr. Klundert partly completely his 1993 return. He completed the personal information component (step one) and the goods and services tax credit application (step two). He left the calculation of total income, the calculation of taxable income, and the calculation of total non-refundable tax credits, blank (steps three, four and five). Dr. Klundertleft step six, the calculation of tax owing or refund claimed, blank, except he showed a "0" balance owing. He signed and dated (April 27, 1994) the return immediately below the printed words:

I certify that the information given on this return and in any document attached is correct, complete and fully discloses my income from all sources.

[9] Above his signature, Dr. Klundert wrote:

Collecting income tax by the government is against the Constitution of Canada!

[10] Dr. Klundert's 1994 tax return was basically blank, except for some personal information such as Dr. Klundert's address and social insurance number. The return was not signed. In two places on the return, Dr. Klundert wrote:

It is against the Constitution of Canada to charge federal income tax!

[11] Dr. Klundert does not appear to have filed returns for 1995 and 1996, although he testified that he believed those returns were submitted along with many others by a tax protest organization known as Shareholders of Canada. Dr. Klundert acknowledged that his 1995 and 1996 returns, like his 1993 and 1994 returns, did not disclose any of his income, did not show any tax owing and raised the same objection to paying income tax as was raised in 1993 and 1994.

[12] Dr. Klundert's 1997 tax return also did not disclose any income or declare any tax owing. He filled in virtually every blank in the form with the entry "N/A" meaning "not applicable". The form was also stamped with the words:

Without prejudice, 'natural person' all rights reserved: B.N.A. s. 94 *Charter of Rights and Freedoms*s. 52(1) and s. 26.

[13] Dr. Klundert did not sign the return but did write on the form indicating that the federal government had no constitutional power to impose a "direct" tax. He also claimed a refund of

Digitized by Google

"all tax ever paid plus interest".
[14] It was agreed that Dr. Klundert's total unreported income for the years 1993 through 1997 was
$1,474,389.00. The federal tax owing on that amount was $348,231.00.
[15] Dr. Klundert testified that he knew that the CCRA would take steps to try to recover the tax owing under the Act and that it had broad powers to assist in that endeavour. He anticipated that the CCRA would pursue him aggressively. Dr. Klundert told OHIP, one of the main sources of his income, to forward his payments to an account in his wife's name in an effort to keep the funds out of the hands of the CCRA. He set up Canadian off-shore bank accounts in the Cayman Islands and Switzerland, for the same purpose.
[16] Dr. Klundert did not challenge the constitutionality of the Act at trial. He did, however, testify that by 1993 he had come to believe that the Constitution did not give the federal government the power to impose direct taxes and that the Act was unconstitutional. He maintained that belief at the time of trial, but said he could not afford the costs of a constitutional challenge. Dr. Klundert also testified that he believed he could not receive an impartial hearing on the issue before a judge who was paid by the federal government.
[17] It is unnecessary to detail the basis upon which Dr.Klundert came to his opinion as to the constitutionality of the Act. I accept for the purposes of the appeal that it was open to the jury to find that between 1993 and 1997 Dr. Klundert honestly believed that the Act was beyond the legislative power of the federal government.

III

The Crown Appeal

[18] The Crown contends that the trial judge misdirected the jury as to the essential elements of the crime of tax evasion. The Crown argues that the trial judge erred in telling the jury that:
tax evasion required proof of an intention to deceive and proof of an artifice scheme or strategy; and
a refusal to pay tax in protest based on an honest belief that the federal government did not have the power to impose the tax negated an intention to evade the payment of taxes and entitled Dr. Klundert to an acquittal.
[19] Section 239(1)(d) of the Act provides:
Every person who has …
wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act …
is guilty of an offence…
[20] As particularized in count 2 of the indictment, the Crown alleged that Dr. Klundert had wilfully evaded or attempted to evade payment of taxes owing under the Act between 1993 and 1998.
[21] In his initial charge, the trial judge instructed the jury:
In order to convict him of count 2 [tax evasion] you have to come to a conclusion beyond a reasonable doubt that he did so wilfully and wilfully in this case, among other things, means with a specific intention to evade payment of taxes as part of a craft, an artifice or a strategy. Well, we all know what craft, artifice, strategy is [emphasis added].
[22] The trial judge told the jury that an intention to protest the payment of taxes was inconsistent with an intention to evade the payment of taxes:
[F]ailure to either file tax returns or filing incomplete tax returns and not paying taxes for a number of years in succession might suggest to you an attempt to evade, but if it does suggest to you an attempt to evade you may nevertheless not find him guilty on this count [count 2] unless you conclude beyond a reasonable doubt that that was the purpose that he did it for, to evade taxes as opposed to protest. You do not have to choose one or the

Digitized by Google

other. You must, in order to convict, be sure that the Crown has satisfied you beyond a reasonable doubt of his guilt, including his specific intent [emphasis added].

[23] In summarizing Dr. Klundert's "protestor" defence, the trial judge again drew a distinction between an intention to evade income tax and an intention to protest the legality of the Act. He said:

Mr. Christie, as I have said, submits to you that there must be a specific intent to deceive as opposed to a specific intent to protest. I have already discussed that with you. He is absolutely right in that, that if you find beyond a reasonable doubt that his intent was to deceive then you can convict. Mr. Christie says if he had an honest intention to protest that is not knowingly making a false statement since it is only an opinion and he is entitled to be wrong and mistaken as long as he is honest in that belief. That is probably correct, if you do not take into account recklessness or wilful blindness [emphasis added].

We give scope to people who protest …

[24] After several hours of deliberation, the jury asked:

Can defence use tax protester as a defence? [25] The trial judge responded:

[B]eing a tax protester in and of itself is not a defence to either charge. However, if you are not satisfied beyond a reasonable doubt that the accused had the specific intention to evade income tax and he only did what he did to protest and not to evade or have a reasonable doubt on that issue then the Crown has not satisfied you beyond a reasonable doubt of his guilt as far as the mental element required [emphasis added].

[26] About two and a half hours later, the jury returned with three more questions about the mental element of the crime of tax evasion. The trial judge responded:

Please explain the mental elements about the evasion of taxes.

The word evade implies something of an underhanded or deceitful nature. In other words, a deliberate attempt to escape the requirement of paying tax on income that had been earned.

…

Please explain the relevance of being a tax protester.

There is no relevance as long as his belief is honest. You can't just get up and say I'm a tax protester, therefore I'm innocent. What the Crown has to prove is that his tax protest is a deceitful method of evading taxes and the Crown has to prove that beyond a reasonable doubt. You have heard Dr. Klundert. He said, I didn't intend to evade taxes, I just intended to protest.

If we find that he was honest in his beliefs, do we therefore find him innocent?

Well remember what I told you, if you believe what he said, if you believe his evidence, the Crown has not proved that he had the specific intent to evade taxes beyond a reasonable doubt. If you feel that he is honest, or if you have a reasonable doubt about it, in other words, I think he is honest, then the Crown has not proved that he had the intention to evade taxes beyond a reasonable doubt[emphasis added].

[27] After a brief discussion with counsel, the jury was recalled. The trial judge told the jury that he misspoke in his recharge when he was explaining the relevance of being a tax protestor. The trial judge corrected his previous instruction in these terms:

As to the answer to question two, please explain the relevance of being a tax protester in this case. You can be a tax protester in this case. You can be a tax protester but if the Crown proves beyond a reasonable doubt that your protest was for the purpose of evading taxes then you may find him guilty. If he is reckless about it and is honest then you would have a reasonable doubt that he did it for the purpose of evading tax. If he is dishonest about it then you may find that the Crown has proved his intent to evade tax beyond a reasonable doubt.

[28] The net effect of the trial judge's instructions was to tell the jury that a person who

Digitized by Google

refused to pay his or her taxes as a protest could not be convicted of evading the payment of taxes if that protest was made"honestly". Applied to Dr. Klundert's evidence the instruction became a direction that a refusal to comply with the Act based on an honest belief that the Act was beyond the powers of the federal government was a defence to a charge of wilfully evading taxes. The jury was told that Dr. Klundert should be acquitted of that charge unless the Crown could prove beyond a reasonable doubt that he did not have that honest belief.

IV

Analysis

[29] Counsel for Dr. Klundert does not challenge the constitutionality of the Act. The power of the federal government to impose and collect an income tax cannot be in any doubt.[1]

[30] The Crown appeal raises two questions:

Can a person be said to evade the payment of income tax when that person makes no attempt to deceive or trick the tax collector, but instead makes a straightforward refusal to pay?

Is an honest belief that the Act is unconstitutional relevant in determining whether an accused has the requisite culpable mental state?

[31] Both questions require analysis of the constituent elements of the offence of tax evasion.

[32] The Act contains several enforcement provisions ranging from those imposing civil penalties (ss. 162-163), to regulatory offences (s. 238), to criminal offences. The offences created by s. 239(1), including tax evasion, are true criminal offences: see *R. v. Knox Contracting Ltd.*,1990 CanLII 71 (SCC), [1990] 2 S.C.R. 338 at 346-348. Tax evasion is a species of fraud and is the statutory offspring of the common law offence of cheating the public revenue: see *R. v. Cardoso* 1999 CanLII 13250 (QC CA), (1999), 139 C.C.C. (3d) 430 at 436-437 (Que. C.A.), leave to appeal refused, [1999] S.C.C.A. No.

467. A determination of the constituent elements of the offence of tax evasion must be informed by the criminal law nature of that offence. For analytical purposes, the constituent elements of a crime are divided into the elements which describe the prohibited conduct (*actus reus*) and those which describe the requisite fault (*mens rea*). For most true crimes, the fault component consists of a culpable state of mind which must accompany the prohibited conduct and relate to some if not all of the elements of the prohibited conduct: see *R. v. Sault Ste. Marie* (1978), 40 C.C.C. (2d) 353 at 362 (S.C.C.).

[33] An analysis of the constituent elements of an offence must begin with the statutory language used to create the offence. For convenience, I will repeat that language:

Every person who has …

(d) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act …

is guilty of an offence …

The *Actus Reus*

[34] The components of the conduct requirement of the crime of tax evasion are captured by the words:

… in any manner evaded or attempted to evade … payment of taxes imposed by the Act.

[35] The offence requires proof of an act or course of conduct which has the effect of evading or attempting to evade payment of taxes actually owed under the Act**. In normal parlance, the word evade can refer to the act of deliberately avoiding something, or it can carry a sinister connotation meaning an underhanded or devious way of avoiding something.**

Digitized by Google

[36] Some courts, relying on the criminal nature of the offence of tax evasion and the need to distinguish between legitimate tax planning and the crime of tax evasion, have opted for the more sinister definition of evasion: see *Quebec (Deputy Minister of Revenue) v. Service Acier Inoxydable Couture Inc.* 1999 CanLII 13436 (QC CA), (1999), 141 C.C.C. (3d) 573 at 575 (Que. C.A.). For example, in *R. v. Baker* (1973), 16
(2d) 126 at 131 (N.S. Cty. Ct.), the court said:

[W]here the evasion referred to is in a penal statute or is between citizen and Government, it is intended to include something like underhanded dealing, or to use her words [the trial judge] it is intended to include some "element of artifice, craft or strategy".

[37] Support for the more benign definition of evasion is found in *R. v. Paveley* (1976), 30 C.C.C. (2d) 483 (Sask. C.A.). In *Paveley*the taxpayer had not filed tax returns for a number of years. He was acquitted partly because the trial judge concluded that the mere failure to file returns did not constitute a scheme or artifice and did not, therefore, amount to evasion under the Act.

[38] The appeal from the acquittal was unanimously dismissed, however, the court took varying views of the meaning of evasion under the Act. Woods J.A., at p. 486, supported the position taken by the trial judge. Brownridge J.A., at pp. 487-488, held that evasion did not necessarily require a craft, artifice or stratagem, but did require a wilful evasion. In his view, if a taxpayer refused to file tax returns with the intention of evading tax, the taxpayer was guilty of tax evasion regardless of whether his conduct amounted to an artifice or scheme.

[39] Bayda J.A. provided a helpful analysis of the elements of the offence of tax evasion. He first examined the meaning of the word "wilful" in arriving at the *mens rea* requirement. I will return to that analysis later. He then turned to the conduct component. He said at pp. 494-495:

I am not prepared to go so far as to say that only in those cases where there is an artifice or scheme can there be a conviction for evasion under this subsection. The presence of an artifice or scheme would tend to make it easier to draw the necessary inference of intent to evade payment of taxes, but in my respectful view it cannot be said that the existence of an artifice or scheme is a necessary element of the offence created by this subsection. Where the necessary intent is present, then the "manner" in which the intent is carried out is not important. The plain words of the subsection specify it may be done "in any manner" [emphasis added].

[40] I agree with the above interpretation of Bayda J.A. Section 239(1)(d), unlike other parts of s. 239, is not limited to specified conduct, but speaks in broad terms: see *R. v. Kidd* (1974), 6 O.R. (2d) 769 at 772 (H.C.). The conduct component of the crime of evading tax contrary to s. 239(1)(d) is made out if the Crown proves that the accused voluntarily[2] performed an act or engaged in a course of conduct that avoided or attempted to avoid payment of tax owing under the Act.

[41] The authorities that require that the evasion be deceitful or underhanded confuse the conduct component of the crime of tax evasion with the fault component of that crime. Fault rests in the state of mind that accompanies the doing of the prohibited conduct. It is the culpable state of mind that distinguishes the legitimate tax planner from the dishonest tax evader. Both may engage in the same course of conduct that can aptly be described as a deliberate attempt to avoid payment of tax. The difference lies in their respective states of mind. Unlike the tax evader, the tax planner does not intend to avoid the payment of a tax that he or she knows is owed under the Act, but rather intends to avoid owing tax under the Act .

[42] The conduct component of the crime of tax evasion, as I would describe it, was not in issue in this case**. Dr. Klundert did not declare his income or pay his income taxes**

Digitized by Google

owing under the Act for a number of years. He owed tax under the Act. The functioning of the Act depends on accurate self-assessment of tax owing through timely reporting of income and calculation of tax owing. Where tax is owed under the Act, a failure to report income and properly calculate the tax owing on that income has the inevitable effect of avoiding, at least for a time, the payment of tax required under the Act. As observed by the trial judge in the course of his instructions to the jury, Dr. Klundert's liability turned on his state of mind.

The *Mens Rea*

[43] The fault component of the crime of tax evasion as set out in s. 239(1)(d) is found in the word "wilfully". In *R. v. Docherty* reflex, (1989), 51 C.C.C. (3rd) 1 and 7 (S.C.C.), the Court described the word "wilfully" when used in a crime creating statutory provision as, perhaps the archetypal word to denote a *mens rea* requirement. It stresses intention in relation to the achievement of a purpose. It can be contrasted with lesser forms of guilty knowledge such as "negligently" or even "recklessly". In short, the use of the word "wilfully" denotes a legislative concern for a relatively high level of *mens rea* ... [emphasis added].

[44] While the word "wilfully" refers to a culpable mental state, the exact meaning of the word will depend on the context in which it is used: see *R. v. Buzzanga and Durocher* reflex, (1979), 49 C.C.C. (2d) 369 at 379-85 (Ont. C.A.); *R. v. Keegstra* 1990 CanLII 24 (SCC), (1990), 61 C.C.C. (3d) 1, per Dickson J. at p. 57-58, McLachlin J. at 118 (S.C.C.); *Ratzlaf v. U.S.* 114 S. Ct. 655 at 659 (1994).

[45] In *Docherty, supra*, the court indicated that wilfully "stresses intention in relation to the achievement of a purpose." Bayda J.A., in *Paveley* at p. 492, took a similar approach to the meaning of the word wilfully in s. 239(1)(d):

The word "wilfully" as used in the subsection under consideration, carries a distinct connotation of deliberate purpose and ulterior motive. To ascribe to the word a meaning which negates or overlooks that purpose or motive is to dilute the meaning of the word to a point where its use is rendered completely unnecessary. ... It follows then that for a conviction to take place under s. 239(1)(d) of the Act, there **must be proof of the *actus reus*, the "manner" to use the word of the statute, in which the alleged offence was committed, and, also proof of a specific intent, that is to say, proof that the act which constitutes the "manner" was done with a particular purpose – the purpose of evading the payment of tax [emphasis added].[3]**

[46] **Although I would avoid the use of the phrase "ulterior motive", I agree with Bayda J.A. that the word "wilfully" in s. 239(1)(d) signals that culpability will follow only where the accused engages in conduct intended to avoid the payment of tax owing under the Act. More precisely, I think the fault component in s. 239(1)(d) is twofold. First, the accused must know that tax is owing under the Act and second, the accused must intend to avoid or intend to attempt to avoid payment of that tax. An accused intends to avoid, or intends to attempt to avoid, payment of taxes owing under the Act where that is his purpose, or where he knows that his course of conduct is virtually certain to result in the avoiding of tax owing under the Act: see *Buzzanga, supra*, at 383-385.**

[47] **In most cases of tax evasion, the trial judge will adequately describe the elements of the offence by instructing the jury that they must be satisfied beyond a reasonable doubt that the accused:**

did something or engaged in a course of conduct that avoided or attempted to avoid the payment of tax imposed by the Act;

knew there was tax imposed by the Act;[4] and

engaged in the conduct for the purpose of avoiding or attempting to avoid payment of tax imposed by the Act or knowing that avoiding payment of tax imposed

Digitized by Google

by the Act was a virtual certain consequence of his actions.

[48] **The requirements of knowledge and purpose which together make up the fault component of the offence are closely related. A person who does not know that there is a tax imposed by the Act cannot do something for the purpose of evading payment of that tax. That same person may, however, know there is a tax imposed under the Act, and do something that has the effect of evading the payment of that tax without necessary having done so for the purpose of evading the payment of the tax.**

[49] The requisite knowledge or purpose may be negated by a mistaken belief. A taxpayer may through arithmetic error misstate the amount of tax owing, or she may be unaware of the statutory definition of income, or she may have come to a mistaken conclusion as to the application of that definition to her affairs. The first of these errors is factual, the second, legal, and the third is a mixture of both.

[50] Factual errors can negate the fault requirement of an offence requiring knowledge and purpose. Purely legal errors raise a more difficult problem. A mistake of law does not excuse the commission of a criminal offence: *Criminal Code*, R.S.C. 1985, c. C-46, s. 19. The fault element of a crime may, however, be defined so as to make various kinds of errors, including purely legal errors relevant to **the existence of the required culpable mental state: A. Mewett and M. Manning, *Criminal Law*,3rd ed. (Toronto: Butterworths, 1994) at pp. 389-391; H. Stuart, "Mistake of Law Under the Charter", (1998) 40 Crim. L.Q. 476 at 486-494. For example, where an offence requires that the Crown prove that an accused acted without "colour of right". Mistakes as to the applicable civil law can provide the basis for a "colour of right": *R. v. Demarco*(1973), 13 C.C.C. (2d) 369 at 372 (Ont. C.A.). In those cases the mistake of law is not advanced as an excuse for committing the crime but rather negates the existence of the required culpable state of mind: *R. v. Howson*,[1966] 3 C.C.C. 348 at 356 (Ont. C.A.). Similarly, where an offence requires proof that the accused intended to violate a court order, a mistake as to the legal effect of that court order can negate the required culpable state of mind: *R. v. Ilczyszyn* reflex, (1988), 45 C.C.C. (3d) 91 at 95-96 (Ont. C.A.).**

[51] In *Docherty*, *supra*, the accused was charged with wilfully breaching the term of his probation that required him to keep the peace and be of good behaviour. The charge arose out of his conviction on a charge of being in care and control of a motor vehicle while impaired. The accused, while impaired, was sitting behind the wheel of an automobile. He had no intention of driving the automobile. He testified that he thought the automobile was not in operating condition and for that reason, he believed that he was doing nothing wrong sitting behind the steering wheel. Under the relevant provisions of the *Criminal Code*, his conduct amounted to the crime of "care and control".

[52] Wilson J., in accepting that the accused's honest belief that he was not committing a criminal offence was relevant to the fault component of the offence said at page 13:

[P]roof of the *mens rea* would therefore require that the respondent intended to commit the criminal offence under s. 236 [care and control] when he sat behind the wheel in an intoxicated condition. …

In my view, where the *actus reus* of s. 666(1) [breach of probation] consist of the commission of a criminal offence, an honest belief on the part of the accused that he is not committing that offence means that the accused cannot be said to have willfully failed or refuse to comply with the probation order.

[53] As I read *Docherty*, the court held that the accused's conduct breached the term of his probation requiring him to keep the peace only because it was a criminal offence, otherwise there was nothing in the conduct which amounted to a failure to keep the peace.

Digitized by Google

Consequently, in these circumstances, he could only be said to have wilfully violated his probation order if he knew his conduct amounted to a criminal offence.

[54] **As the above cases demonstrate, ignorance, or mistake of law can negate the requisite culpable state of mind. Nothing said above should, however, be taken as suggesting that ignorance, or mistake of law will routinely negative the fault element in criminal offences. Most crimes do not require knowledge of the illegality, or certainly the criminality, of the conduct in issue to establish the requisite fault: see *R. v. Molis*,1980 CanLII 40 (SCC), [1980] 2 S.C.R. 355; *R. v. Théroux* reflex, (1993), 79 C.C.C. (3d) 449 at 459 (S.C.C.). The extent to which any mistake, including a legal mistake, can negate the fault requirement turns on an interpretation of the language of the statute in the legislative context in which it is used.**

[55] Section 239(1)(d) is part of an Act which is necessarily and notoriously complex. It is subject to ongoing revision. No lay person is expected to know all the complexities of the tax laws. It is accepted that people will act on the advice of professionals and that the advice will often turn on the meanings to be given to provisions in the Act that are open to various interpretations. Furthermore, it is accepted that one may legitimately structure one's affairs so as to minimize tax liability. Considered in this legislative context, I have no difficulty in holding that a mistake or ignorance as to one's liability to pay tax under the Act may negate the fault requirement in the provision, regardless of whether it is a factual mistake, a legal mistake, or a combination of both.

[56] Crown counsel accepts that an error in law may lead to a reasonable doubt as to whether an individual wilfully evaded tax. That concession is consistent with authority from this court, *R. v. Sihler* (1976), 31 C.C.C. (2d) 73 at 79 (Ont. C.A.), and authority from other jurisdictions: see *Donnelly v. Commissioner of Inland Revenue*, [1960] N.Z.L.R. 469 at 472 (S.C.); *Hefler*, *supra*.

[57] A strong line of American authority is also consistent with the concession made by the Crown. That authority defines "wilfully" in the provision creating the crime of tax evasion as meaning: "a voluntary intentional violation of a known legal duty": *U.S. v. Bishop*, 93 S. Ct. 2008 at 2017 (1973); *U.S. v. Pomponio*, 97 S. Ct. 22 at 23 (1976); *U.S. v. Cheek*, 111 S. Ct. 604 at 610-611 (1991). In *Cheek*, **White J., at pp. 610-611, described the relevance of legal error to the required mental state in this way:**

But carrying this burden requires negating a defendant's claim of ignorance of the law or a claim that because of a misunderstanding of the law he had a good faith belief that he was not violating any of the provisions of the tax laws. This is so because one cannot be aware that the law imposes a duty upon him and yet be ignorant of it, misunderstand the law, or believe that the duty does not exist. In the end, the issue is whether based on all the evidence, the Government has proved that the defendant was aware of the duty at issue, which cannot be true if the jury credits a good-faith misunderstanding and belief submission, whether or not the claimed belief or misunderstanding is objectively reasonable [emphasis added].

[58] **Can Dr. Klundert's belief that the Act is beyond the powers of the federal government and, therefore invalid, constitute a mistake of law negating the fault component of the crime of tax evasion? The answer must be "no". Section 239(1)(d) refers to the "payment of tax imposed by the Act". Dr. Klundert knew full well that he owed tax imposed by the Act. His mistake did not go to knowledge of his obligation to pay taxes owing under theAct but rather to the government's right to impose that obligation on him. He did not assert that he was doing his best to comply with the law but, through ignorance or mistake, failed to do so. To the contrary, he acknowledged the obligation to pay under the Act and made a considered decision to refuse to pay because of a belief that the law requiring him to**

Digitized by Google

pay was invalid.

[59] A person's mistaken belief that a statute is invalid or is otherwise not applicable to that person's conduct is a mistake of law. It is, however, a mistake of law that is irrelevant to the existence of the fault requirement in s. 239(1)(d). Nor can that kind of mistake of law provide a freestanding excuse for the commission of a crime: *Criminal Code*, s. 19; *R. v. Jones* 1991 CanLII 31 (SCC), (1991), 66 C.C.C. (3d) 512 at 516-517 (S.C.C.); *R. v. Watson* 1999 CanLII 13906 (NL CA), (1999), 137 C.C.C. (3d) 422 at 431-33 (Nfld. C.A.).

[60] There are solid policy reasons for drawing a distinction between an accused who mistakenly believes that he or she is complying with the Act and an accused who knowingly violates the Act, but mistakenly believes that the Act is invalid. The former is trying to comply with the law. Particularly where the law is complex, a mistake concerning the applicable law can logically negate the blameworthiness of the person's conduct. The latter is not trying to obey the law, but is instead deciding which laws should be obeyed. An acquittal based on a mistaken belief as to the validity of a law would undermine the rule of law.

[61] There can be no suggestion that a person who honestly believes that the Act is invalid has no option but to evade the payment of taxes and then defend a charge of tax evasion on the basis of a belief that the Act is invalid. As Dr. Klundert acknowledged, there were mechanisms in place whereby he could have challenged the validity of the Act without evading payment of taxes owed under the *Act*. He chose not to pursue any of those avenues. Indeed, even in this case, he did not defend the charge, as he clearly could have, by asking the judge to declare s. 239(1)(d) invalid.

[62] My conclusion that Dr. Klundert's belief that the Act was invalid is irrelevant to his liability under s. 239(1)(d) is consistent with the conclusion in *Cheek*, *supra*, a case involving a tax protestor who refused to pay his income tax claiming that the Act was unconstitutional. In holding that the accused's belief as to the validity of the Act was irrelevant on the charge of wilfully evading income tax, White J. said, at 612-613:

Claims that some of the provisions of the *tax code* are unconstitutional are submissions of a different order. They do not arise from innocent mistakes caused by the complexity of the Internal Revenue Code. Rather, they reveal full knowledge of the provisions at issue and a studied conclusion, however wrong, that those provisions are invalid and unenforceable. …

We do not believe that Congress contemplated that such a taxpayer, without risking criminal prosecution, could ignore the duties imposed upon him by the Internal Revenue Code and refuse to utilize the mechanisms provided by Congress to present his claims of invalidity to the courts and to abide by their decisions. …

We thus hold that in a case like this, a defendant's views about the validity of the tax statutes are irrelevant to the issue of willfulness and need not be heard by the jury, and, if they are, an instruction to disregard them would be proper. For this purpose, it makes no difference whether the claims of invalidity are frivolous or have substance [emphasis added].

[63] **Dr. Klundert's evidence as to his beliefs concerning the validity of the Act were irrelevant to his liability under s. 239(1)(d). The jury should not have heard that evidence. Having heard it, the trial judge should have told the jury that it was irrelevant to Dr. Klundert's culpability.**

[64] It was also submitted that apart entirely from a defence based upon an honest belief as to the invalidity of the Act, Dr.Klundert's evidence that he did not declare his income, and refused to pay tax owing under the Act in protest, was relevant to whether he acted for the purpose of evading tax owing under the Act. As I understand this submission, a

Digitized by Google

straightforward refusal to pay tax owing under the Act, as a protest, is inconsistent with a finding that the refusal to pay was made for the purpose of evading tax owing under the Act. This submission confuses motive and purpose. **On Dr. Klundert's own evidence, he made a considered decision not to pay tax that he knew was owing under the Act. In furtherance of that decision, he did not report income, did not calculate the tax owing under the Act and did not pay the tax. He also took steps to put his assets beyond the reach of the CCRA. On his own evidence, he clearly intended not to pay tax that he knew was owing under the Act. The fact that he made no attempt to conceal this intention or purpose made him a somewhat unusual tax evader, but did not detract from his own evidence as to his purpose. His evidence that he acted in protest is evidence as to his motive; it is his explanation for why he decided to avoid paying taxes that he knew he owed under the Act. Dr. Klundert's motive, that is to protest the validity of the Act, was, in fact, cogent evidence that he had the requisite culpable state of mind. He knew full well his obligations under the Act and set out to avoid those obligations to protest the government's power to impose those obligations.**

V

The Appropriate Order

[65] The instructions to the jury reveal error in law. That error went to the heart of the only issue in dispute on the tax evasion charge. The acquittal cannot stand.

[66] The acquittal was entered by a court composed of a judge and jury. Having concluded that the Crown appeal must be allowed, this court's only option is to order a new trial: *Criminal Code*, s. 686(4)(b)(ii).

[67] At the new trial, Dr. Klundert will not be allowed to advance the "protestor" defence as I have held it is not a defence in law to the charge. That was the only defence advanced at his first trial. On the retrial, however, Dr. Klundert can advance any defence that is legally available to him.

VI

Dr. Klundert's Appeal

[68] Dr. Klundert was convicted of making a false statement in his 1993 tax return contrary to s. 239(1)(a) of the *Criminal Code*. The relevant part of that section reads:

Every person who has … (a) made …false or deceptive statements in a return … is guilty of an offence …

[69] Where the Crown proceeds by indictment, s. 239(2)provides that the accused is subject to a fine calculated by reference to the amount of tax evaded and imprisonment for a term not exceeding five years. [70] I have described the contents of Dr. Klundert's 1993 tax return above (paras. 8, 9). He did not declare his income, showed a "0"balance owing, and signed the return.

[71] The trial judge, over the objection of Crown counsel at trial, instructed the jury that they could convict on count one only if the Crown proved that Dr. Klundert intended to evade the payment of tax by making a false statement. He told the jury:

You must find in order to convict him of count one, that he did it specifically for the purpose of evading income tax.

[72] On the trial judge's instructions, the same intention to evade the payment of tax was required to convict Dr. Klundert on counts one and two. The "protestor" defence was equally open on both, in the light of the trial judge's instructions. In fact, the trial judge told the jury that:

The elements of count two are literally the same as the elements of count one.

Digitized by Google

[73] He also told the jury:
If you believe Dr. Klundert's evidence that he only did this to protest with no intention to evade then you must acquit him on both counts. Even if you don't believe Dr. Klundert's evidence, if it might reasonably be true, if it leaves you with a reasonable doubt about his guilt or about an essential element of the offence, either offence, you must find him not guilty.
[74] I confess considerable difficulty understanding why an intention to evade the payment of tax is an essential element of a charge under 239(1)(a): see W.I. Innes, *Tax Evasion*, *supra*, at pp. 1-13, 4-45 to 4-51; *Hefler*, *supra*, at p. 288.[5] On appeal, the Crown did not take issue with the correctness of this instruction. In any event, for the purposes of considering Dr. Klundert's argument that the verdicts are irreconcilably inconsistent, the correctness of the instruction is not important. I need not determine whether the instruction was correct.
[75] Inconsistent verdicts cannot stand where the appellant demonstrates that the verdicts are so at odds that no reasonable jury who understood the evidence and followed the legal instructions could have arrived at those verdicts: *R. v. McShannock* reflex, (1980), 55 C.C.C. (2d) 53 at 55-56 (Ont. C.A.); *R. v. Varga* 2001 CanLII 8610 (ON CA), (2001), 159 C.C.C. (3d) 502 at 526-27 (Ont. C.A.).
[76] The appellant has met that onus here. The "protestor" defence advanced by Dr. Klundert was exactly the same on count one and count two. It was the only defence advanced on count two. The jury's acquittal on that count indicates that the "protestor" defence gave rise at least to a reasonable doubt as to Dr. Klundert's guilt. The conviction on count one, however, indicates that the jury rejected exactly the same defence on count one. The verdicts smack of a compromise, which while perhaps understandable, is legally unacceptable.
[77] It is arguable that despite the irreconcilable inconsistencies in the verdict, the conviction on count one should stand. On this argument, the "protestor" defence should not have been left on either count and the inconsistency flowing from the uneven application of that defence to the two counts results in no substantial wrong or miscarriage of justice. This argument is not without merit, however, since there must be a new trial on count two, and the charges are closely interrelated, I think the administration of justice is best served by quashing the conviction on count one and ordering a new trial on that count, as well.
[78] Although it is not necessary for the purposes of determining the outcome of the appeal, I will address one other argument made on behalf of Dr. Klundert as it may arise if there is a new trial. Counsel argued that the trial judge should have put the defence described in s. 39(1)of the *Criminal Code*, to the jury. That provision provides:
Everyone who is in peaceable possession of personal property under a claim of right, and everyone acting under his authority, is protected from criminal responsibility for defending that possession, even against a person entitled by law to possession of it,if he uses no more force than is necessary [emphasis added].
[79] Section 39(1) by its terms plainly speaks to the use of force to protect property by a person in peaceable possession of personal property under a claim of right. It has no application here. To the extent that a person charged under s. 239(1) can advance a "claim of right" defence, that claim is a denial of the requisite culpable state of mind. I have addressed the scope of the fault requirement in my reasons dealing with the Crown's appeal.

VII

Conclusion

[80] I would allow the Crown's appeal from the acquittal on count two, set aside the acquittal

Digitized by Google

and order a new trial. I would allow Dr.Klundert's appeal from the conviction on count one, set aside the conviction and order a new trial.

RELEASED: "DD" "AUG. 30 2004"
"Doherty J.A."
"I agree S.T. Goudge J.A."
"I agree Cavarzan J. per Doherty J.A."

[1]Section 91(3) of the *Constitution Act, 1867*, assigns to the federal government the power of "the raising of money by any mode or system of taxation". In *Re Anti-Inflation Act* 1976 CanLII 16 (SCC), [1976] 2 S.C.R. 373 at 390, Chief Justice Laskin referred to the federal taxing power as "apparently limitless". See also P. Hogg, Constitutional Law of Canada, 4th ed. (looseleaf) (Thomson Canada Ltd.: Toronto, 1997) at pp. 30-2;
MacDonald, "Taxation Power in Canada" (1941) 19 C.B.R. 75 at 76-77.
[2]I use voluntary as meaning a conscious and willed act. See D. Stuart *Canadian Criminal Law: A Treatise*, 4thed. (Carswell Toronto: 2001) at pp. 103-107.
[3]The interpretation of Bayda C.J. has gained support in other judicial and academic quarters: see *R. v. de Wolf* 1982 CanLII 347 (BC CA), (1982), 67 C.C.C. (2d) 43 at 45, 48 (B.C.C.A.); *R. v. Pongrantz*, [1982] CTC 259 at 261(FCA); *R. v. Hefler* (1980), 42 N.S. R. (2d) 276 at 288-290 (N. S. Ct. Cty.);
W.I. Innis, *Tax Evasion* (Toronto: Carswell, 1995) at p. 4-10 to 4-15.
[4]Wilful blindness is the legal equivalent of knowledge: see *R. v. Harding*2001 CanLII 21272 (ON CA), (2001), 160 C.C.C. (3d) 225 at 240-243 (Ont. C..A.). Wilful blindness was not an issue in this case.
[5]The fact that an accused who files a false return is subject to a fine calculated by reference to the amount of tax evaded would not appear to make an intention to evade tax an element of the offence created by s. 239(1)(a). Even if there is no tax evaded, a person convicted under s. 239(1) would still be liable to imprisonment.

In R. v. Therrien[114] the court had to ascertain whether there was enough evidence to prove both actus reus and mens rea when the taxpayer had simply hoarded and used others purchase invoices and failed to properly instruct his return compilers or make corrections when they source documents went into the mix. It held:

Analysis of Legal Issues

What is the requisite *actus reus* and *mens rea* for theses charges and have they been established by the Crown's evidence?

Does the use of the word "wilfully" in section 239(1)(a) import an additional aspect to the Crown's burden on the count alleging wilful evasion of taxes, beyond that necessary to prove the counts involving the making of false or deceptive statements in tax returns?

[75] The *actus reus* of the offence under section 239(1)(a) is making, participating in, assenting to or acquiescing in making a false or deceptive statement in an income tax return (*Derose*). The *mens rea* of the offence is that the taxpayer did so intentionally, or with wilful blindness, as to the falsity or deceptiveness of the statements (*Derose*).

[76] Mr. Therrien provided a list of "expenses" to the people who prepared his returns. The fuel expenses were totaled by Mr. Therrien's assistant at his direction from receipts in a box in Mr. Therrien's office. Mr. Therrien had kept all these receipts, although there was apparently no legitimate reason to do so. He kept and had his assistant total receipts that

[114] 2005 CanLII 22808 (MB PC)

Digitized by Google

included what were obviously receipts for expenses paid by the dealership, credit card purchases made by his wife, many receipts for what were obviously "middle expenses" and duplicate receipts. The totals of those receipts and the drivers' wages were then given to the individuals who prepared the returns. Those totals contained false or deceptive information. Even if Mr. Therrien was entitled to claim expenses he bore, Mr. Therrien did not bear the whole of the drivers' wages - yet he claimed the total. Nor did he bear any of the "first fill" gas expenses - as they were billed to a sundry account and not to the sale of particular vehicles. However, Mr. Therrien had his assistant total thousands of dollars of "first fill" expenses, using duplicate receipts. These totals were included in the returns.

[77] Mr. Therrien's brother Wayne and Ken Nault prepared the returns. They answered the questions on the income tax form in a false or deceptive manner, based on the information provided to them by Mr. Therrien. For example, in response to the direction on the1997 form "Statement of Employment Expenses", in response to the direction "Total kilometres driven in taxation year to earn income", Wayne Therrien filled in "21,500". In 1998, in response to the direction "Enter the kilometres you drove in the taxation year to earn employment income", the entry was "35,575". Obviously Mr. Therrien, who worked mainly in the office, did not drive that many kilometres in order to earn income.

[78] Mr. Rick Therrien then signed at the end of the returns, "I certify that the information given on this return and in any documents attached is correct, complete and fully discloses all my income." The 2000 return filed by Mr. Nault is somewhat different in that it was filed electronically and was not signed by Mr. Therrien. However, it also was prepared based on a breakdown of expenses provided by Mr. Therrien. A completed 2000 return was sent to Mr. Therrien on April 6, 2001 with a letter stating, "We have prepared your return based on the information you have provided to us. Please review the return carefully to ensure that it is accurate and complete..." Neither in Mr. Therrien's evidence, nor in argument, was any distinction made between the 1997-1999 and the 2000 returns.

[79] It is difficult to separate the *actus reus* and the *mens rea* as, in my mind, the deliberate and fraudulent intent came before the preparation of the returns - in the gathering of and provision of information to the preparers of the returns. However, Mr. Therrien did have reminders and opportunities to rectify the situation. In the returns signed by him, there was a warning, below the place for his signature, stating, "It is a serious offence to make a false return." He was sent the 2000 return and asked to review and sign it. He also had the opportunity to reconsider what he had done a number of times during the audit and again when he agreed to a formal interview. Instead he lied to the auditor both on the telephone and, later, in a letter he typed himself.

[80] Mr. Therrien's "defence" - that he thought he was entitled to claim a portion of the expenses because his income had been reduced by a portion of the delivery expenses - although it may have qualified as a defence, is not, when the evidence is examined, believable. I believe Mr. Therrien intentionally provided information which he knew would result in false or deceptive statements being made on his return. He was at least wilfully blind to the falsity or deceptiveness of the statements. However, to say though that Mr. Therrien was only "wilfully blind" would be erroneous. In his testimony he stood by the claims made in his return – he did not say that his brother or Mr. Nault had made a mistake, that he had not read the forms, or that there was any kind of misunderstanding.

[81] In terms of the amounts alleged, I find that Mr. Therrien misrepresented and sought to evade at least the amounts alleged in the Information, with the exception of the 1997 return, where his brother apparently claimed more in drivers' wages than the documentation provided by Mr. Therrien indicated - $18,023 as opposed to Mr. Therrien's figure of "12,072".

[82] The defence quoted *Hefler* at paragraphs 37 to 39 - "an honest belief in a course of

Digitized by Google

action, although mistakenly based upon an error of law, is a defence to a crime of fraudulent intent or other specific intent of an analogous nature". Unfortunately for Mr. Therrien, the evidence does not reveal such an "honest belief". To the contrary.

[83] In regards to an offence under section 239(1)(d) - "wilfully, in any manner, evaded or attempted…to evade payment of taxes imposed by this Act", the *Paveley* judgment of the Saskatchewan Court of Appeal is apparently definitive on this issue (at page 492). Justice Bayda wrote:

The word "willfully" as used in the subsection under consideration, carries a distinct connotation of deliberate purpose and ulterior motive. To ascribe to the word a meaning which negates or overlooks that purpose or motive is to dilute the meaning of the word to a point where its use is rendered completely unnecessary…It follows then that for a conviction to take place under s. 239(1)(d) of the *Act*, there must be proof of the actus reus, the " manner", to use the word of the statute, in which the alleged offence was committed, and also proof of a specific intent, that is to say proof that the act which constitutes the "manner", was done with a particular purpose--the purpose of evading the payment of tax.

[84] Justice Bayda then concluded at page 493:

… in those cases where a particular purpose or a specific intent is an essential element of the offence, then proof of the act the natural consequence of which would be a certain result and no explanation is given, entitles, but does not bind, the court hearing the matter, to find the accused guilty of doing the act with the necessary intent.

[85] Mr. Therrien, in his evidence, did not testify that a mistake of some kind was made. Rather he testified that he believed he was entitled to a make a claim for expenses that he did not personally pay, but that he did it in a certain way for convenience sake. After a close review of the evidence, Mr. Therrien's explanation is incapable of belief.

[86] I believe the Crown has established the requisite *actus reus* and *mens rea* for all offences. I do not, therefore, find it necessary to decide whether the addition of the word "wilfully" creates a higher onus on the Crown.

Beyond a Reasonable Doubt

To convict a tax cheat, or even send one to trial, there must exist that there was a tax offence provable beyond a reasonable doubt at trial. This was reviewed in R. v. Yelle[115] where the court held:

Issues

[4] The overarching issue is: has the test for a directed verdict has been met by the applicants (i.e., could the evidence before me allow a reasonable jury, properly instructed in the law, conclude that the elements of the offences have been proven beyond a reasonable doubt)?

[5] The thrust of the application brought by the three accused is that it is an essential element of the offences charged that the accused persons have a tax liability under the *Income Tax Act*, and that the Crown has failed to lead evidence upon which a jury could find such a tax liability. Accordingly, it is necessary to identify the elements of the offences charged.

Facts

[6] Since this is a directed verdict application, the evidentiary portion of the trial is not yet necessarily concluded. Accordingly, there is simply evidence before me, and there cannot yet be conclusive findings of fact. It is therefore more convenient to deal with the

[115] 2010 ABPC 94

Digitized by Google

evidence, and its impact on the directed verdict application, in the section of these Reasons headed “Law and Analysis”.

Law and Analysis

[7] In an application for a directed verdict, the Court is to assume that the trier of fact will believe the evidence which has been tendered by the Crown. The judge in a directed verdict application is not to weigh the direct evidence before him or her. However, with respect to circumstantial evidence before the Court, the judge will engage in a limited weighing exercise for the sole purpose of determining whether a properly instructed trier of fact could reasonably draw from the evidence whatever inferences are necessary to conclude beyond a reasonable doubt that the accused is guilty. The law was summarized by McLachlin,

C.J.C. in *R. v. Arcuri (G.)* (2001), 274 N.R. 274 (S.C.C.) at paragraphs 21-25 and 29-32:

[21] The question to be asked by a preliminary inquiry judge under s. 548(1) of the Criminal Code is the same as that asked by a trial judge considering a defence motion for a directed verdict, namely, “whether or not there is any evidence upon which a reasonable jury properly instructed could return a verdict of guilty”: Shephard, supra, at p. 1080; see also R. v. Monteleone, [1987] 2 S.C.R. 154; 78

N.R. 377; 23 O.A.C. 241, at p. 160. Under this test, a preliminary inquiry judge must commit the accused to trial “in any case in which there is admissible evidence which could, if it were believed, result in a conviction”: Shephard, supra, p. 1080.

[22] The test is the same whether the evidence is direct or circumstantial: see R. v. Mezzo, [1986] 1

S.C.R. 802; 68 N.R. 1; 43 Man.R.(2d) 161, at p. 842-43; Monteleone, supra, at p. 161. The nature of the judge’s task, however, varies according to the type of evidence that the Crown has advanced. Where the Crown’s case is based entirely on direct evidence, the judge’s task is straightforward. By definition, the only conclusion that needs to be reached in such a case is whether the evidence is true: see Watt’s Manual of Criminal Evidence (1998), at § 8.0 (“[d]irect which evidence is evidence which, if believed, resolves the matter in issue”); McCormick on Evidence (5th Ed. 1999), at p. 641;

J. Sopinka, S.N. Lederman and A.W. Bryant, The Law of Evidence in Canada (2nd Ed. 1999), at s. 2.74 (direct evidence is witness testimony as to “‘the precise fact which is the subject of the issue on trial’”). It is for the jury to say whether and how far the evidence is to be believed: see Shephard, supra, at pp. 1086-87. Thus if the judge determines that the Crown has presented direct evidence as to every element of the offence charged, the judge’s task is complete. If there is direct evidence as to every element of the offence, the accused must be committed to trial.

[23] The judge’s task is somewhat more complicated where the Crown has not presented direct evidence as to every element of the offence. The question then becomes whether the remaining elements of the offence - - that is, those elements as to which the Crown has not advanced direct evidence - - may reasonably be inferred from the circumstantial evidence. Answering this question inevitably requires the judge to engage in a limited weighing of the evidence because, with circumstantial evidence, there is, by definition, an inferential gap between the evidence and the matter to be established - - that is, an inferential gap beyond the question of whether the evidence should be believed: see Watt’s Manual of Criminal Evidence, supra, at § 9.01 (circumstantial evidence is “any item of evidence, testimonial or real, other than the testimony of an eyewitness to a material fact. It is any fact from the existence of which the trier of fact may infer the existence of a fact in issue”); McCormick on Evidence, supra, at pp. 641-472 (“circumstantial evidence ... may be testimonial, but even if the circumstances depicted are accepted as true, additional reasoning is required to reach the desired conclusion”). The judge must

Digitized by Google

therefore weight the evidence, in the sense of assessing whether it is reasonably capable of supporting the inferences that the Crown asks the jury to draw. This weighing, however, is limited. The judge does not ask whether she herself would conclude that the accused is guilty. Nor does the judge draw factual inferences or assess credibility. The judge asks only whether the evidence, if believed, could reasonably support an inference of guilt.

[24] The principles described above are well settled. In Metropolitan Railway Co. v. Jackson (1877), 3 App. Cas. 193, at p. 197, Lord Cairns wrote:

"The judge has a certain duty to discharge, and the jurors have another and a different duty. The Judge has to say whether any facts have been established by evidence from which [the matter in issue] may be reasonably inferred; the jurors have to say whether, from those facts ... [the matter in issue] ought to be inferred." (Emphasis omitted)

We reaffirmed the traditional common law rule in Shephard, supra. As I noted in Charemski, supra, the same rule applies in England, in Australia, and in the United States: see Cross and Tapper on Evidence (8th Ed. 1995), at pp. 190-92; Peter Gillies, Law of Evidence in Australia (2nd Ed. 1991), at pp. 206-8; Curley v. United States (1947), 160 F.3d 229, at p. 232 (the judge "must determine whether upon the evidence ... a reasonable mind might fairly conclude guilt beyond a reasonable doubt").

[25] Notwithstanding certain confusing language in Mezzo[,] supra, and Monteleone[,] supra, nothing in this court's jurisprudence calls into question the continuing validity of the common law rule: see M. Bloos and M. Plaxton, An Almost-Eulogy for the Preliminary Inquiry: "We Hardly Knew Ye" (2000), 43 Crim. L.Q. 516, at p. 256. In Mezzo, supra, the issue was whether the Crown had proffered sufficient evidence as to identity. McIntyre, J., writing for the majority, stated that a trial judge can direct an acquittal only if there is "no evidence' as to an essential element of the offence: Mezzo, supra, at pp. 840-43. He also stated that the judge has no authority to "weigh and consider the quality of the evidence and to remove it from the jury's consideration": Mezzo, supra, at p. 842. Those statements, taken alone, might be understood to suggest that a preliminary inquiry judge must commit the accused to trial even if the Crown's evidence would not reasonably support an inference of guilt. However, as the dissent in Charemski, supra, discusses (at para. 27), the remainder of McIntyre, J.'s, reasons make clear that by "no evidence capable of supporting a conviction," and by "weighing" McIntyre, J., was referring to the ultimate determination of guilt (a matter for the jury), as distinguished from the determination of whether the evidence can reasonably support an inference of guilt (a matter for the preliminary inquiry judge). His concern was to reject the argument that the judge must determine whether guilt is the only reasonable inference. His reasons cannot be read to call into question the traditional rule, namely, that the judge must determine whether the evidence can reasonably support an inference of guilt.

[8] More recently, the test was set out by L-V. D'Auteuil, J. in *R. v. Captain M. Savaria*, 2009 CarswellNat 1106; 2009 CM 3001 (Can. Ct. Martial) at paragraphs 5-9:

A motion of this kind, made immediately after counsel for the prosecution declares his evidence closed, is different from a motion requesting acquittal on the basis of a reasonable doubt. The latter argument is to the effect that there is some evidence concerning all the essential elements of a charge and on which a reasonable jury, properly instructed could return a verdict of guilty, but that is insufficient to establish guilt beyond a reasonable doubt. Since the concept of reasonable doubt does not come into play until all the evidence has been adduced, the concept of reasonable doubt cannot be considered here unless the accused has decided not to adduce evidence or has declared his case closed, which is not the case here.

I do not have to assess the quality of the evidence in determining whether or not counsel for the prosecution has adduced some evidence concerning each of the essential elements

Digitized by Google

of the offence in the third, fourth and fifth counts, on the basis of which a reasonable jury, properly instructed in the law, could return a verdict of guilty.

The test for a directed verdict was set out by Justice Ritchie in *United States of America v. Shephard*, [1997] 2 S.C.R. 1067, at page 1080, and reads as follows:

... whether or not there is any evidence upon which a reasonable jury properly instructed could return a verdict of guilty.

It is important to note that the burden of proof lies with the accused to establish, on a balance of probabilities, that the test has been met.

The Supreme Court confirmed that test at paragraph 9 of its decision in *R. v. Moteleone*, [1987] 2 S.C.R. 154, in the following terms:

Where there is before the court any admissible evidence, whether direct or circumstantial, which, if believed by a properly charged jury acting reasonably, would justify a conviction, the trial judge is not justified in directing a verdict of acquittal.

The test is the same, whether the evidence is direct or circumstantial. The application of this test will vary with the kind of evidence adduced by the prosecution. When the prosecution's case is based entirely on direct evidence, the application of the test is simple. If the judge determines that the prosecution has adduced some direct evidence on each of the essential elements of the offence, the motion must be dismissed. The only issue that will remain relates to the truth of the evidence, and this aspect will have to be considered by the trier of fact. However, where the evidence of an essential element of the offence is based on circumstantial evidence, the question to be decided relates not merely to the truth of this evidence. To the extent that the evidence is accepted as truthful, there is also the issue of whether the inferences based on this evidence, as proposed by the prosecution, can be drawn as suggested. The judge must weigh the evidence by determining whether there is a reasonable likelihood that this evidence will support the inferences proposed by the prosecution. The judge does not ask whether he or she personally would draw such inferences and does not determine the credibility thereof. The only question is whether the evidence, if it is believed, may reasonably support an inference of guilt.

[9] Sections 239(1)(a) and 239(1)(d) of the *Income Tax Act* read as follows:

Every person who has

made, or participated in, assented to or acquiesced in the making of, false or deceptive statements in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation,

. . . .

(d) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act,

. . . .

... is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

a fine of not less than 50% and not more than 200% of the amount of the tax that was sought to be evaded, or

both the fine described in paragraph (f) and imprisonment for a term not exceeding 2 years.

Elements of the Offence

[10] With respect to the offences charged under section 239(1)(a), the Crown has alleged that each of the accused persons:

"made, acquiesced in, participated in or assented to the making of a false or deceptive statement" in various Income Tax Returns by "understating [his or her] taxable income"; and

"made, acquiesced in, participated in or assented to the making of false or

Digitized by Google

deceptive statements in the Returns of Income for one or more of the taxation years 1991 to 1998 inclusive, of the partners of the S.R.O. Partnership by providing to the partners false information and documentation to wit: the Capital Cost Allowance allocated to each partner for the S.R.O. Partnership's 1994 and 1995 fiscal periods ending December 31st with respect to computer software acquired by the S.R.O. Partnership".

[11] With respect to the offences charged under section 239(1)(d), the Crown has alleged that each of the accused persons:

for various taxation years, wilfully evaded the payment of taxes imposed by the *Income Tax Act*; and

for various taxation years, "wilfully evaded or attempted to evade compliance with the *Income Tax Act* or payment of taxes imposed by the *Income Tax Act* ... of the partners of the S.R.O. Partnership by providing to the partner false information and documentation to wit: the Capital Cost Allowance allocated to each partner for the S.R.O. Partnership's 1994 and 1995 fiscal periods ending December 31st with respect to computer software acquired by the S.R.O. Partnership".

[12] As I understand the theory of the Crown, the accused persons wilfully misrepresented in various documents filed with the Canada Revenue Agency (or its predecessors) the Capital Cost Allowance in respect of computer software purchased by the S.R.O. Partnership. To put it in very summary fashion, the Crown alleges that the accused persons orchestrated an agreement between the S.R.O. Partnership ("S.R.O.") (as purchaser) and a company trading as Balmoral Holdings ("Balmoral") (as vendor) under the terms of which S.R.O. purchased certain computer software for a price of $4,000,000.00 The Crown alleges that the price of $4,000,000.00 was far in excess of the fair market value of the software, and that the entire transaction was created for the improper purpose of creating an inflated capital cost allowance which was then distributed to the partners who had purchased units in S.R.O. The allocation of the inflated capital cost allowance, so alleges the Crown, permitted the taxpayers to whom the allocations were made to evade the payment of taxes properly owing from the taxpayers to Her Majesty.

[13] With respect to the charges of making false statements and evading the payment of taxes, Counsel on behalf of the accused persons submitted that it is fundamental to the Crown's allegations against their clients that the Crown prove that there was tax owing for the taxation years noted in the Information. Defence counsel submitted that if the capital cost allowance calculated by S.R.O. and allocated to its partners was calculated and allocated in accordance with the provisions of the *Income Tax Act*, then no false statements had been made, no taxes were owing, and, consequently, there was no evasion of payment of taxes.

[14] The Crown summarized its position as follows:

One further comment on law, and then I will get into the factual situation. If I understand my learned friend's argument properly, the elements that the Crown would have to prove under 239 would, from case to case, be a moving target. In other words, depending upon whatever scheme is alleged to have been committed by a particular accused, you have to go into various technical provisions in the *Income Tax Act* and introduce those particular technical sections into 239 and prove each one of those beyond a reasonable doubt in order to prove that there had been tax evasion. My submission is the criminal law, as far as I know, I am not aware of any case that supports that proposition. The elements that we need to prove here are the elements of fraud, dishonesty and deprivation, and the deprivation, of course, relates to Her Majesty's purse.

[15] Though counsel vigorously submitted that their two approaches to the question of what the Crown must prove were different, upon reflection, I do not think they were significantly at odds.

Digitized by Google

[16] The Crown alleges that the representations made by the accused persons about the S.R.O. capital cost allowance were dishonest, and that as a result Her Majesty was wrongly deprived of tax revenue. The accused persons say that there can be no dishonesty if there is no tax owing under the provision of the *Income Tax Act*.

[17] The Crown alleges that tax was owing because the amount claimed as capital cost allowance was knowingly inflated through an inflated purchase price for the software.

[18] The Defence submits that one must look to the provisions of the *Income Tax Act* to first determine whether the purchase price upon which the claimed capital cost allowance was calculated must be accepted as stated by S.R.O. or whether it is open to attack. The Defence says that in the case at bar the Canada Revenue Agency must accept the stated purchase price in calculating the capital cost allowance unless the transaction between S.R.O. and Balmoral was a non-arm's length transaction. The Defence agrees that if transaction through which S.R.O. purchased the computer software was non-arm's length, and if the fair market value of the software was less than the stated purchase price, then the capital cost allowance must be calculated using the fair market value of the software. The Defence agrees that there is evidence before the Court to the effect that the fair market value of the software was much less than $4,000,000.00.

[19] In my view, the Crown and Defence are basically saying the same thing. The Crown submitted that the elements of the offences which it must prove are dishonesty and deprivation. The Defence submitted that the Crown must prove that tax is owing by showing that the capital cost allowance claimed was higher than it should have been, and that that can only be done by showing that S.R.O. and Balmoral engaged in a non- arm's length transaction in the purchase of the computer software. That is simply a particularization of dishonesty (knowingly claiming a false capital cost allowance) and deprivation (reducing tax owing by relying on a falsely claimed capital cost allowance).

[20] The end result is that the Crown must prove that tax which was properly owed to Her Majesty was not paid because the accused persons in a non-arm's length transaction misrepresented the purchase price of the computer software with the result that they misrepresented the capital cost allowance. I rely on Judge Bruce's comments in *R. v. Bromley*, [2004] 3 C.T.C. 58 (B.C. Prov. Ct.) at paragraph 110:

Addressing first the issue of taxability, [it] is apparent that this is an element of the offences charged and, accordingly, must be proven by the Crown beyond a reasonable doubt. The Court must ask whether the Crown has proved beyond a reasonable doubt that the income sought to be taxed is properly subject to tax according to tax law and that each deduction sought to be disallowed is properly disallowed in accordance with tax law.

Is there evidence before the Court in relation to the elements of the offences?

[21] In approaching this question, I have been greatly aided by, and am grateful for, the tax analysis set out in the submissions of Messrs. Haymour and Misutka on behalf of the accused Viccars.

[22] The concept of capital cost allowance and its role in computing income tax has been generally set out in *Halsbury's Laws of Canada*, First Edition, *Income Tax (General)*, (Markham, LexisNexis Canada Inc., 2008) at paragraphs HTG-152 and HTG-153:

. . . .

... Deduction of capital cost allowance. A taxpayer cannot deduct expenditures on account of capital outlays, depreciation, obsolescence or depletion. The prohibition against the deduction of depreciation and similar expenses flies in the face of accounting principles. The *Income Tax Act* does, however, allow for the deduction of capital cost allowance ("CCA") in lieu of such expenses: in computing income from a business or property, a taxpayer may deduct such part of the capital cost to the taxpayer of property, or such amount in respect of the capital cost to the taxpayer of property, if any, as is allowed by

Digitized by Google

regulation. Thus, a taxpayer cannot deduct depreciation calculated for financial statement purposes, but may claim a deduction for capital cost allowance, according to prescribed rules.

Capital cost allowance system. The basic concept underlying the capital cost allowance system is fairly straightforward: CCA is a deduction from income that is intended to allocate the approximate cost of capital assets over their useful lives. Thus, in a sense, the CCA system is nothing more than statutory depreciation at pre-determined rates. ...

. . . .

The CCA allows a taxpayer to deduct the actual cost of depreciable assets over a period of time. ... [Footnotes Omitted]

[23] In the case at bar, the capital cost allowance claimed was based on the $4,000,000.00 purchase price for the computer software as set out in the agreement between S.R.O. and Balmoral Holdings.2 That purchase price must be accepted for tax purposes if the agreement between S.R.O. and Balmoral Holdings was an arm's length transaction: *Downey v. R.* (2006), 355 N.R. 84 (Fed. C.A.).

[24] However, if the transaction between S.R.O. and Balmoral Holdings was a non-arm's length transaction, then section 69(1)(a) of the *Income Tax Act* applies. That section reads:

69. (1) . . .

Except as expressly otherwise provided in this Act, (a) where a taxpayer has acquired anything from a person with whom the taxpayer was not dealing at arm's length at an amount in excess of the fair market value thereof at the time the taxpayer so acquired it, the taxpayer shall be deemed to have acquired it at that fair market value; ...

[25] In *McLarty v. Minister of National Revenue* (2008), 374 N.R. 311 (S.C.C.), Justice Rothstein, speaking for himself and six other members of the Court, said at paragraph 43:

[43] It has long been established that when parties are not dealing at arm's length, there is no assurance that the transaction "will reflect ordinary commercial dealing between parties acting in their separate interests" (Swiss Bank Corp. v. Minister of National Revenue, [1974] S.C.R. 1144, at 1152). The provisions of the Income Tax Act pertaining to parties not dealing at arm's length are intended to preclude artificial transactions from conferring tax benefits on one or more of the parties. Where the parties are found not to be dealing at arm's length, the taxpayer who has made an acquisition is deemed to have made the acquisition at fair market value regardless of whether the amount paid was in excess of fair market value. ...

[26] It is the partnership (i.e., S.R.O.) which is the taxpayer referred to in section 69(1)(a): section 96 of the *Income Tax Act*, and *Deptuck v. Minister of National Revenue*, (2003) 303 N.R. 250 (Fed. C.A.) at paragraph 14.

[27] Consequently, in calculating the capital cost allowance in respect of the computer software purchased by S.R.O., if the purchase was a non-arm's length transaction, and if the fair market value of the software was less than the purchase price, then it is the fair market value (as opposed to the purchase price) which would have to be used in calculating the capital cost allowance.

[28] The question which must now be addressed is whether there is evidence before the Court which would allow a reasonable trier of fact, properly instructed in the law, to conclude that the agreement by S.R.O. to purchase the computer software from Balmoral Holdings was a nonarm's length transaction. It is conceded for the purposes of this application that there is evidence before me that the fair market value of the computer software was less than the purchase price set out in the agreement.

[29] The *Income Tax Act* does not define the terms "arm's length" or "non-arm's length". However, the concepts are discussed by the Supreme Court of Canada in *McLarty v. Minister of National Revenue*, *supra*. At paragraphs 44-45, Justice Rothstein said;

Digitized by Google

[44] Arm's length is not defined in the Income Tax Act. However, s. 251(1) provides: "(1) For the purposes of this Act, related persons shall be deemed not to deal with each other at arm's length;
it is a question of fact whether persons not related to each other were at a particular time dealing with each other at arm's length."
[45] The parties in this case were not related. It is therefore a question of fact whether they were dealing at arm's length.
[30] Likewise, in the case at bar, the parties were not related,3 and whether they were dealing at arm's length is a question of fact.
[31] At paragraph 62, Rothstein, J. said;
62 The Canada Revenue Agency Income Tax Interpretation Bulletin IT-419R2 "Meaning of Arm's Length" (June 8, 2004) sets out an approach to determine whether the parties are dealing at arm's length. Each case will depend on its own facts. However, there are some useful criteria that have been developed and accepted by the courts: see for example *Peter Cundill & Associates Ltd. v. R.,* [1991] 1 C.T.C 197 (Fed. T.D.), aff'd [1991] 2. C.T.C. 221 (Fed. C.A.). The Bulletin provides:
. . . By providing general criteria to determine whether there is an arm's length relationship between unrelated persons for a given transaction, it must be recognized that all encompassing guidelines to cover every situation cannot be supplied. Each particular transaction or series of transactions must be examined on its own merits. The following paragraphs set forth the CRA's general guidelines with some specific comments about certain relationships.
The following criteria have generally been used by the courts in determining whether parties to a transaction are not dealing at "arm's length":
was there a common mind which directs the bargaining for both parties to a transaction;
were the parties to a transaction acting in concert without separate interests; and
was there "de facto" control.
[32] In *Gestion Yvan Drouin Inc. v. R.*, [2001] 2 C.T.C. 2315 (T.C.C. [General Procedure]), Justice Archambault summarized the law on determining whether a transaction was "arm's length", and proposed a test. At paragraphs 73-75, the learned trial judge said:
Having analyzed the legal context in which the arm's length concept is applied, we shall now examine its interpretation in the case law. My colleague Judge Bonner had to deal with the concept in *McNichol v. R.* (1997), 97 D.T.C. 111 (T.C.C.), at pages 117 and 118:
Three criteria or tests are commonly used to determine whether the parties to a transaction are dealing at arm's length. They are:
the existence of a common mind which directs the bargaining for both parties to the transaction,
parties to a transaction acting in concert without separate interests, and
"de facto" control.
The common mind test emerges from two cases. The Supreme Court of Canada dealt first with the matter in *Minister of National Revenue v. Sheldon's Engineering Ltd.* At pages 1113-14 Locke J., speaking for the Court, said the following: Where corporations are controlled directly or indirectly by the same person, whether that person be an individual or a corporation, they are not by virtue of that section deemed to be dealing with each other at arm's length. Apart altogether from the provisions of that section, it could not, in my opinion, be fairly contended that, where depreciable assets were sold by a taxpayer to an entity wholly controlled by him or by a corporation controlled by the taxpayer to another corporation controlled by him, the taxpayer as the controlling shareholder dictating the terms of the bargain, the parties were dealing with each other at arm's length and that s. 20(2) was inapplicable.

Digitized by Google

This decision of Cattanach, J. in *Minister of National Revenue v. T R Merritt Estate* is also helpful, At pages 5156-66 he said: In my view, the basic premise on which this analysis is based is that, where the "mind" by which the bargaining is directed on behalf of one party to a contract is the same "mind" that directs the bargaining on behalf of the other party, it cannot be said that the parties were "dictating" the "terms of the bargain" on behalf of both parties, it cannot be said that the parties were dealing at arm's length.

The acting in concert test illustrates the importance of bargaining between separate parties, each seeking to protect his own independent interest. It is described in the decision of the exchequer Court in *Swiss Bank Corporation v. Minister of National Revenue*[.] At page 5241 Thurlow J. (as he was then) said:

To this I would add that where several parties - - whether natural persons or corporations or a combination of the two - - act in concert, and in the same interest, to direct or dictate the conduct of another, in my opinion the "mind" that directs may be that of the combination as a whole acting in concert or that of any of them in carrying out particular parts or functions of what the common object involves. Moreover as I see it no distinction is to be made for this purpose between persons who act for themselves in exercising control over another and those who, however numerous, act through a representative. On the other hand if one of several parties involved in a transaction acts in or represents a different interest from the others the fact that the common purpose may be to so direct the acts of another as to achieve a particular result will not by itself serve to disqualify the transaction as one between parties dealing at arm's length. The *Sheldon's Engineering* case [*supra*], as I see it, is an instance of this.

Finally, it may be noted that the existence of an arm's length relationship is excluded when one of the parties to the transaction under review has *de facto* control of the other. In this regard reference may be made to the decision of the Federal Court of Appeal in *Robson Leather Company Ltd. v. Minster of National Review*, 77 D.T.C. 5106. [Emphasis added]

In my opinion, although Judge Bonner (like many others) sets out three separate tests for identifying arm's length dealing, they constitute essentially just one test that may be summarized succinctly as follows: is there control of one party by the other? What the three tests are intended to determine is the existence of a relationship between persons who are parties to a given transaction where one of the parties exercises over the other an influence such that this other party is no longer free to participate in the transaction in an independent manner.

With respect to the second test - - acting in concert without separate interests, which is the one relied on by the Minister in this case - - one can say that it will be met where a person merely participates in a transaction, not for his own benefit but for someone else's or, even if he is acting for his own benefit, if he is also acting for someone else in a context of reciprocity. That person is acting without a separate interest and not independently in his own interest.

[33] In the course of his very helpful submissions, Mr. Haymour, on behalf of the defendant Viccars, submitted that since the question is whether the sale of the computer software4 was a non-arm's length transaction, one must determine when that transaction occurred (so that one may determine who were the directing minds of the two parties at that time). Following up on that theme, I asked the assembled Defence counsel the date on which when they contend that the transaction occurred. Mr. Lord replied on behalf of all accused. He reviewed a number of the documentary exhibits, and said "one cannot know when the transaction occurred". Mr Lord submitted that "the only evidence is inferential, and it occurs at both ends of the transaction." He took the position that a trier of fact "couldn't conclude that SRO Partnership, with any certainty, got the software any later than mid November of '94."

Digitized by Google

[34] Mr. Befus, on behalf of the Crown, in equally helpful submissions, pointed to evidence which could lead to the inference that the source codes for the software were not delivered to Balmoral by the company from which Balmoral bought the programme until sometime in 1995, and that, therefore, Balmoral could not have delivered them to S.R.O. until sometime in 1995.

[35] Upon further reflection, I think efforts spent in determining the date on which S.R.O. actually received the software do not bear directly on the relevant question. Section 69(1), in saying, "where a taxpayer has acquired anything from a person with whom the taxpayer was not dealing at arm's length", is referring to the time of the "dealing" as opposed to the time when the acquisition (transfer of property) actually occurs.

[36] In my view, the state of the evidence leads to these conclusions:

The date of the "dealing" between Balmoral Holdings and S.R.O. (as that term is used in section 69(1) of the *Income Tax Act*) will have to be determined by way of inference from the evidence. The documents constitute some, but not all, of the evidence on the point. The entirety of the events leading up to the ultimate allocation of the capital cost allowance to the partners of S.R.O. will have to be considered by the trier of fact in order to determine when the "dealing" between Balmoral Holdings and S.R.O. occurred.

Ruling

Until one knows the date of the "dealing" between Balmoral Holdings and S.R.O. (which, on the state of the evidence before me, is a matter which must be left to the trier of fact), one does not know at which date one must determine whether S.R.O. was dealing with Balmoral Holdings at arm's length.

It must be remembered that the question of whether S.R.O. was "dealing" with Balmoral Holdings at arm's length is a question of fact. While the law has set out various factors a trier of fact should consider in determining whether the taxpayer (S.R.O) was dealing with Balmoral Holdings at arm's length, at the end of the day the question is not solely about the factors, rather, the ultimate question remains: Was the taxpayer dealing with Balmoral Holdings at arm's length? The answer to that ultimate question involves the concept of control, both in its commonality and degree. The answer to that ultimate question can only be determined when the trier of fact considers all the evidence surrounding the "dealing", together with the inferences which may be properly drawn from that evidence. It is for the trier of fact to consider matters such as the events surrounding the creation of S.R.O., the role the defendant Viccars played in creating S.R.O. and his role in Balmoral Holdings, the role the defendant Viccars played in creating the cascading legal arrangements which resulted in Balmoral acquiring the computer software at a cost of $42,500.00 U.S. as recorded in a written agreement bearing the date of January 13, 1994, and, S.R.O. acquiring the computer software8 at a cost of $4,000,000.00 CDN as recorded in a written agreement bearing the date of January 14, 1994. In my view, if the trier of fact accepted the Crown's evidence as it exists in this trial, and drew from that evidence the possible inferences favourable to the Crown's case, the trier of fact could conclude that S.R.O. did not deal with Balmoral Holdings at arm's length.

If the trier of fact concludes that the dealing between S.R.O. and Balmoral Holdings was not at arm's length, then the trier of fact could conclude that the evidence, including but not limited to the significant difference between the price at which Balmoral Holding acquired the software and the price at which it sold the software to S.R.O., supports beyond a reasonable doubt the conclusion that the defendants did commit the offences with which they are charged.

Digitized by Google

[37] The application of the defendants for a directed verdict is dismissed.

Knowingly Non-Payment Enough

See also the earlier case of R. v. De Wolf[116] where the BC Appeal Ct. opined on a case where the taxpayer knew he had income taxes coming due, contacted the CRA about them, but had made no payment towards them when he could have, preferring to extinguish personal debts:

> [33] LAMBERT J.A. (orally):—I agree with the reasons of my brother presiding. I would like to make two short observations.
>
> [34] The first relates to the wording of the charge under s. 239(1)(*d*) of the *Income Tax Act,* 1970-71-72 (Can.), c. 63. The charge is one of wilfully evading the payment of taxes. I am concerned that the cases under that section are tending to give rise to a web of synonyms which might be taken to express the only test.
>
> [35] The test that was used in *R. v. Paveley* (1975), 30 C.C.C. (2d) 483, 70 D.L.R. (3d) 237, [1976] 3 W.W.R. 577, by Mr. Justice Bayda was an appropriate one for that case and, in my view, was an appropriate one for this case. That is, that there was a deliberate purpose in the non-payment and an ulterior motive in the non- payment which, together, would establish the wilful evasion of payment.
>
> [36] I wish to make it clear, as I understand my brothers do, that this is not in our view the only test for this offence.
>
> [37] The second point that I wish to make is that the evidence established that the appellant had not filed any income tax returns for the period from 1963 to 1978, though the offence with which he was charged related only to 1974, 1975, 1976, 1977 and 1978. The question of his intent in those last five years is affected by the background against which it is suggested that he did not pay tax and intended not to pay tax and, indeed, to evade tax.
>
> [38] I would grant leave to appeal, but I would dismiss the appeal.

Poor Record Keeping Not a Defence

A taxpayer who refuses to simply maintain and advise herself accurately of the net income and consequently income taxes that are due has no defence to an argument for tax evasion as was described in R. v. MacNeil[117] where another doctor delegated accounting to his spouse and made estimates of both income and expenses. It was held that:

> [1] The accused, John Peter MacNeil earned professional income as a doctor. However, his accounting or recording of income and expenses was inadequate. Hence, a Revenue Canada Agency audit disclosed that there were discrepancies between the income he claimed and the amount he actually received. He had underreported his income and had exaggerated his expenses. As a result, the Canada Revenue Agency added the undisclosed and underreported amounts to his income and adjusted the expenses.
>
> [2] Additionally, they have charged him with four counts of failure to include additional taxable income. The charges are based upon his making false and deceptive statements in the filing of his 1998, 1999, 2000 and 2001, T1 Income Tax and Benefit Returns for those stated years. They also have charged him with wilfully evading the payment of taxes by failing to report the additional taxable income between December 31, 1997 and November 13, 2002.

---

[116] 1982 CanLII 347 (BC CA)

[117] 2007 NSPC 23

Digitized by Google

…
[4] It was also apparent that he did not emphasize proper bookkeeping or accounting methods nor paid close attention to financial details as he lacked adequate books of accounting and supporting documentation. He habitually estimated his annual income by determining his income for a portion of the year and then converting that to an annual total. He also estimated his expenses. There was also evidence that he was experiencing financial difficulties as he was heavily in debt with cash flow problems.
[5] For the taxation years 1998 to 2000 he did not file a formal statement of income and expenses. Likewise, he claimed the full spousal deduction for his then spouse and claimed her income to be zero for the taxation years 1998, 1999 and 2000 and to be $100.00 for 2001. However, he claimed that he paid his spouse an honorarium for her assistance in the amount of $1200.00 in the taxation years 1999 and 2001 and $32,
000.00 in 2000. His spouse did not file a tax return for those relevant years.
[6] The Canada Revenue Agency investigated, audited and reassessed the accused for the taxation years 1998-2001. As a result of the audit the accused has admitted that he had additional taxable income and should have paid additional federal taxes. He, however, has submitted that his conduct did not rise to the level of any criminality as the surrounding circumstances including the state of his mind could have impacted on his action.
Issue
[7] Having admitted to the fact that he filed the statements and the evidence supports the filing of the documents the real issue therefore is whether the statements were simply errors of omissions or, gross negligence or fraud with the intention to evade the payment of taxes.
Position of the Parties
[8] In the Crown's view, as a medical doctor where, professionally, accuracy is required and necessary, we have someone who because of his inauspicious financial circumstances was determined to reduce his taxable income by any means possible. Thus, by his system of estimations of his income and expenses, if he did not knowingly fail to report all of his income and overstated his expenses for the subject years, he was wilfully blind as to his actual income and expenses that could have been easily obtained from accessible bank statements and MSI and, he at least acted so negligently that it amounted to his being grossly negligent. Being sloppy was not criminal but one has to consider the frequency of these errors and omissions to see whether they were done consciously or inadvertently.
[9] On the other hand, the accused pointed to the various sections of the *Tax Act* and emphasized that on the various degrees of culpability he was at least negligent but neither criminally fraudulent nor conduct amounting to a scheme of evasion. Significantly, however, he does not deny making the incorrect statements. In short, he did not wilfully or intentionally evade the payment of taxes.
Analysis
[10] It seems to me that the Crown only put questions to the accused about the errors and omissions which he said were correct or confirmed what he did. But, he was not asked the reasons for doing what he did in order to assess his motives or mind set. The suggestion was that he should be penalized criminally because he guessed his income and expenses and was very cavalier in his approach to tax preparation and reporting without consulting any tax specialists. However, the questioning did not elicit from him a rational or valid reason for his errors, save the reference of a busy practice and household problems.
[11] However, were the estimates reasonable? I gathered from his testimony that he was not contesting that he filed the statements and that the information was not quite accurate. In fact, he has made that admission. He, however, is saying that he did not wilfully evade the payment of taxes. Thus, he has presented the proposition and it seems to me that, in a

Digitized by Google

proper case, it is conceivable that one could make inaccurate statements in their tax return but did not intend to evade the payment of taxes in the sense that one did not deliberately set into motion a scheme or a plan with the sole intent to evade the payment of taxes although the net effect is not paying the proper amount of taxes. See: *R.v. Hefler*, [1980] N.S.J.111 (Co. Ct.), *R.v. Klundert*, 2004 D.T.C. 6609 (Ont. C.A.)

[12] Nonetheless, I agree with the submission of Crown counsel on the submission that it would have been a simple matter for the accused to obtain his bank statements to ascertain his true income in the same way as did the auditors. In the audit, material amounts were found not to be included as income and significant amounts were disallowed as expenses as they were either unreasonable or unsupported.

[13] With respect to his expenses, it was obvious that some could not be considered as legitimate in computing professional income. In particular, for the taxation year 2000, when he was aware that his spouse was not assisting in doing any work for his practice, he claimed he paid her a salary of $32,000.00 but on his T1 he showed that she earned no income and claimed the maximum spousal non refundable credit. The net effect was to lessen his tax liability. Moreover, for the years 1999 and 2000 he filed no expense statements but submitted a global estimate for expenses that upon investigation he could not justify and which resulted in a large portion being disallowed.

[14] Thus, it would appear, and I conclude and find that the accused casually went about the business of reporting his income and expenses. Further, he gave no regard to the correct way of reporting his income and expenses and, as he sought no professional advise on these pertinent issues, he appeared to have interpreted the tax laws to his benefit. Moreover, I find that he, as a reasonable, intelligent, professional person, fully aware of all the facts and information available to him, and in his position, knew or ought to have known that he could have obtained his income particulars from the MSI and from his bank statements.

[15] Moreover, I find that he knew or must have known that he did not pay his spouse the amounts that he indicated that he did and as a result did not incur those expenses. For example, presuming that he could simply deduct the full amount of the spousal credit while at the same time claiming a salary expense that had the effect of diminishing further his tax liability, I find was reckless to the point of being fraudulent. Additionally, I find that there were no mistakes as to the facts that would have been supportable, no honest belief was asserted and, he gave no plausible explanations for the misleading statements.

[16] I therefore think that the accused quandary is due to the manner in how he handled his reporting responsibilities for the subject years. In any event, I find that notwithstanding any sentiments to the contrary, he knew that he was making false statements that with a minimum amount of inquiry could have been rectified. The reasonable inference is that he anticipated and knew that the Canada Revenue Agency would rely upon those statements to assess is tax liability. The Canada Revenue Agency did rely upon these deliberately untrue statements as if they were true and thereby lost potential tax revenues. As a result, I conclude and find that the statements he made on his tax returns for the subject years were false and deceptive.

[17] Even so, the Canada Revenue Agency has determined that he not only made false and deceptive statements in his tax returns for the subject years, which he does not dispute and which I have found, but that he also wilfully evaded the payment of taxes, to which assertion he strongly objects. Therefore, on the facts, did he wilfully evade the payment of taxes?

[18] By allowing some expenses to be deducted I find that the Canada Revenue Agency is acknowledging that the accused was required to pay his own expenses. The issue really was the reasonableness of the expenses which the accused is entitled to contest before

Digitized by Google

another forum. He has testified that he actually incurred expenses that he believed to be reasonable and proper and which were for the purpose of him earning an income. These expenses that could affect his tax liability, I understand, are the basis of objections that he has filed and has yet to be determined. It may yet be determined in his favour.

[19] Therefore, I do not think that the Crown, has laid the proper foundation for me to conclude beyond a reasonable doubt that the taxes are indeed payable and that, criminally, he wilfully avoid payment by showing factors from which I could draw a reasonable inference that there existed, in fact, elements of an artifice, craft or strategy. I find support for this view in the words of Bergeron J., in *R v. Redpath Industries Ltd., et al* (1984) 84 D.T.C. 6349 (Q.S.C.), at 6351:

A criminal court is not the forum to determine income taxability and to make determinations as to rights to tax assessment or absence of rights of assessment involved. In a tax evasion charge, it must appear prima facie from the evidence that the taxability is clear-cut, obvious, indisputable, unquestionable from lack of reporting, before entering the examination of the other facts of the charge, e.g. whether the undisputable taxability, based on income gained proven and undeclared, leads to a conclusion beyond a reasonable doubt that it was wilfully omitted by a taxpayer in his tax returns. If such basis is not present and there exists an obligation to enter into the examination of the merit of a possible assessment in respect of a declared income in order to weigh whether a taxpayer is susceptible to taxation or not, may or may not take advantage of claimed exemptions a criminal court usurps its function and appropriates itself of a jurisdiction which it does not possess.

[20] However, in considering the accused manner of operating, particularly his failure to have supporting vouchers for his expenses and inadequate bookkeeping concerning his income, I find him to be negligent but not grossly negligent. Even so, I find him to be genuinely at a loss concerning how to report properly his income and expenses and that he arranged his affairs in a manner so as to attract the least tax liability by what he thought to be lawful means.

[21] Furthermore, even though, as he argued, that this was a case that could have been dealt with by way of reassessment rather than the laying of criminal charges which is undoubtably correct, there is the questionable method of calculation of income and expenses that over the subject period made it understandable why the Canada Revenue Agency would have decided to proceed in the manner as they have. However, this is a case, where in my analysis of the evidence, and on hearing the accused, I have some doubts that malicious intent, or deliberate planning, was present in his overall behaviour. See: *R.v. Hefler*, [1980] N.S.J. No. 111. (Co.Ct.), *R.v. Baker* (1973), 16 C.C.C. (2d) 126 at 131 (N.S. Co.Ct.), *R.v. Coffen*, [1993] O.J. N). 4157 (O.C.J. (Prov.Div.)).

Conclusion

[22] Consequently, I am not satisfied that the Crown has proved beyond a reasonable doubt that the accused wilfully evaded the payment of taxes as alleged. In the result, I find him guilty of the four counts of filing false and deceptive statements as alleged but not guilty of wilfully evading the payment of taxes as alleged.

Honest Mistake as Defence

Digitized by Google

In R. v. Sydel[118] a taxpayer charged attempted to argue that she had availed herself of what she thought was insight to reduce her taxes legally and that she had made an honest mistake in interpreting how the ITA applied to her structuring. The Provincial Court Of British Columbia provided however:

> The Lack of Mens Rea and Mistake of law or Mixed Fact and Law Argument
> [11] These two defences are unique to this case. Of course, every individual Accused person is different and the facts of every case are different. These defences have to be analysed in light of Dr. Sydel's personal background, her actions and her intentions, in order to decide whether the Crown have proven beyond a reasonable doubt, the required Mens Rea and wilful intent required to find her guilty of any or all of the charges against her.
> [12] Defence counsel argued that Dr. Sydel did not "wilfully" make false statements in her T1 filings, nor did she wilfully evade the payment of income tax. Counsel argued that using due diligence, Dr. Sydel engaged in extensive study and then honestly concluded, that if she arranged her business affairs so that income came to her as "a natural person", as opposed to as a "taxpayer" or as "the legal representative of the taxpayer", she would not be obliged to pay income tax under the provisions of the ***Income Tax Act***. Counsel argued that the Accused simply engaged in the lawful activity of income tax avoidance, as opposed to income tax evasion. Counsel argued that when the Accused filed her T1 Reports with Canada Customs and Revenue, she declared that neither the taxpayer nor any legal representative of the taxpayer received income, "to the best of my knowledge" and "without understanding". Counsel argued that was not intentionally deceitful, nor was it the result of "wilful blindness" on her part. Counsel argued that the Accused came to the honest belief that no income was earned by the taxpayer or their legal representative after she had structured her affairs based upon her studies and a variety of reasonable sources of information. She studied, she questioned and thought long and hard about the subjects of income tax, natural persons, taxpayers, historical legislation, and comparative legislation and the rights and freedoms guaranteed by the laws of Canada.
> [13] Counsel argued that if the Accused were mistaken, it was an honest mistake of law or mixed fact and law, based upon reasonable inquiries that she had made in order to ascertain what exactly were her legal obligations to pay or not to pay income taxes.
> [14] The Crown argued that even if she honestly believed what she did (and the Crown did not concede this), she was "wilfully blind". The Crown argued that she started out to find a way to evade paying taxes and purposefully shut her eyes to all the obvious clues indicating that the theory she was studying was a sham – an illogical and misinformed method of evading the payment of income taxes. The Crown argued that filing T1 Reports, stating that no taxes were payable by the Accused as "a natural person" or as "the taxpayer" or "the legal representative of the taxpayer", were deliberate false and deceptive statements that she made for the sole purpose of tax evasion. Between the years 1998 to 2002, the Accused earned close to three quarters of a million dollars and paid no income tax. The case of *Kennedy v. CCRA* [2000] OJ No. 3313, stands for the proposition that the required element of the Accused's "knowledge" that income tax was payable, can be shown by proof that the Accused was "wilfully blind".
> [15] The cases of *R. v. Klundert* (2004) 187 CCC (3rd) 417 (Ont. CA; leave to appeal to the SCC refused, [2004] SSCA No. 463) and *R. v. Kennedy* (supra) stand for these statements of the law:
> "1. a person's mistaken belief that a statute is invalid or is otherwise not applicable to their conduct, is a mistake of law;
> their mistake of law is irrelevant to the fault requirement required by s. 239(1)(d) of the

[118] 2006 BCPC 0346

Digitized by Google

Income Tax Act; a mistake of law cannot provide a free standing excuse for the commission of a crime (also see:
R. v. Jones (1991) 66 CCC (3rd) 512 (SCC); *R. v. Watson* (1999) 137 CCC (3rd) 422 (Nfld. CA); and
a mistake of law, however in very limited circumstances, can provide a defence to tax evasion. That very limited circumstance is set out by Doherty, J.A.A in *R. v. Klundert* (supra) at page 11:
[54] As the above cases demonstrate, ignorance, or mistake of law can negate the requisite culpable state of mind. Nothing said above should, however, be taken as suggesting that ignorance, or mistake of law will routinely negative the fault element in criminal offences. Most crimes do not require knowledge of the illegality, or certainly the criminality, of the conduct in issue to establish the requisite fault: see *R. v. Molis*, [1980] 2 S.C.R. 355; *R. v. Théroux* (1993), 79 C.C.C. (3d) 449 at 459 (S.C.C.). The extent to which any mistake, including a legal mistake, can negate the fault requirement turns on an interpretation of the language of the statute in the legislative context in which it is used.
[55] Section 239(1)(d) is part of an Act which is necessarily and notoriously complex. It is subject to ongoing revision. No lay person is expected to know all the complexities of the tax laws. It is accepted that people will act on the advice of professionals in the Act that are open to various interpretations. Furthermore, it is accepted that one may legitimately structure one's affairs so as to minimize tax liability. Considered in this legislative context, I have no difficulty in holding that a mistake or ignorance as to one's liability to pay tax under the Act may negate the fault requirement in the provision, regardless of whether it is a factual mistake, a legal mistake, or a combination of both.
[56] Crown counsel accepts that an error in law may lead to a reasonable doubt as to whether an individual wilfully evaded tax. That concession is consistent with authority from this court, *R. v. Sihler* (1976), 31 C.C.C. (2d) 73 at 79 (Ont. C.A.), and authority from other jurisdictions: see *Donnelly v. Commissioner of Inland Revenue*, [1960] N.Z.L.R. 469 at 472 (S.C.); *Hefler, supra*.
[57] A strong line of American authority is also consistent with the concession made by the Crown. That authority defines "wilfully" in the provision creating the crime of tax evasion as meaning: "a voluntary intentional violation of a known legal duty". *U.S. v. Bishop*, 93 S. Ct. 2008 at 2017 (1973); *U.S. v. Pomponio*, 97 S. Ct. 22 at 23 (1976); *U.S. v. Cheek,* 111 S. Ct. 604 at 610- 611 (1991). In *Cheek*, White J., at pp. 610-611, described the relevance of legal error to the required mental state in this way:
But carrying this burden requires negating the defendant's claim of ignorance of the law or a claim that because of a misunderstanding of the law he had a good faith belief that he was not violating any of the provisions of the tax laws. This is so because one cannot be aware that the law imposes a duty upon him and yet be ignorant of it, misunderstand the law, or believe that the duty does not exist. In the end, the issue is whether based on all the evidence, the Government has provided that the defendant was aware of the duty at issue, which cannot be true if the jury credits a good-faith misunderstanding and belief submission, whether or not the claimed belief or misunderstanding is objectively reasonable [emphasis added]."
[16] In the *R. v. Jones and Pamajewon* [1991] 3 S.C.R. 110 case, the appellants argued that they should not be convicted because they believed that the laws in relation to conducting gaming operations did not apply to casinos. The Supreme Court of Canada stated: "The Appellants mistaken belief that the Code did not apply to them is no answer to the charges".
[17] The defence raised in the *R. v. Ricci*, Oct 14, 2004 (Ont. CA) case, was similar to Dr. Sydel's defence in the case at bar. The Ontario Court of Appeal, in dismissing the defence, stated at pages 1 and 2:

Digitized by Google

"The facts in relation to the second issue, whether the appellant lacked the necessary *mens rea* for the offence of tax evasion, can be briefly stated. The appellant was a sales representative. Between the years 1995 and 1998 he had income tax deducted at source and filed a tax return with respect to commission income in Canada. He did not report income he received from certain commissions in the United States during this period. He also did not file a tax return for the years 1999 and 2000 when he operated as a self-employed person. When the Canada Customs and Revenue Agency (CCRA) informed the appellant that he was under criminal investigation, he wrote the a letter saying that he was not a person included in the *Income Tax Act* but a "natural person of commoner status" and not subject to payment of income tax. The appellant did not testify at trial.

The appellant submits that he did not attempt to evade income tax. He was open and forthright in what he was doing. He submits he held an honest belief that he was not a person subject to the *Income Tax Act*. Even if the appellant was mistaken, it was his honestly held belief that he was not a "person" under the *Act* and therefore could not have had the *mens rea* required for the offence.

The trial judge concluded that the appellant intentionally disregarded his obligations under the Act thereby finding that the requisite *mens rea* for the offence had been made out. In our opinion it was open to him to do so. *R. v. Klundert* made it clear that a person is not exempt from paying taxes based on his political, religious, philosophical or moral beliefs. Doherty J.A., on behalf of the court, stated at para. 59: A person's mistaken belief that a statute is invalid or is otherwise not applicable to that person's conduct is a mistake of law. It is, however, a mistake of law that is irrelevant to the existence of the fault requirement in s. 229(1)(d). Nor can that kind of mistake of law provide a freestanding excuse for the commission of a crime: *Criminal Code*, s. 19; *R. v. Jones* (1991), 66 C.C.C. (3d) 512 at 516-517 (S.C.C.); *R. v. Watson* (1999), 137 C.C.C. (3d) 422 at 431-33 (Nfld. C.A.).

We would dismiss this ground of appeal."

[18] It is my finding, that the Accused's mistake was the direct result of her own wilful blindness. The Accused's mistake was not a result of the "notoriously complex" nature of the ***Income Tax Act***, but rather, from a very basic mistaken belief about one of the most basic, straightforward and uncomplicated features of the ***Income Tax Act*** – that human beings are "persons" and persons who earn income, have to pay income taxes. I also find that the Accused did not use the procedures which were available to her under the ***Income Tax Act,*** to test and determine the validity of her beliefs. Procedures for appealing her Tax Assessments were available to her to use. Instead of using these procedures, she decided to simply refuse to pay the taxes, be criminally charged and then raise the defence of mistake of law or mistake of mixed fact and law at her criminal trial. She deliberately chose her route.

[19] In my view, Dr. Sydel was clearly "wilfully blind" and the defences of lack of Mens Rea, lack of wilful intent and mistake of law or mixed fact and law, cannot succeed. The Accused must be convicted of all nine charges.

[20] These are the reasons that lead me to the conclusion that the Crown had proved beyond a reasonable doubt, that Dr. Sydel was wilfully blind:

Dr. Sydel is an intelligent and well educated 39 year old woman. As early as junior high school, she excelled and received an International Baccalaureate standing (Edmonton, Alberta). She went on to obtain a Bachelor of Arts degree at the University of Alberta. Following her B.A. she enrolled in the School of Dentistry at the University of Alberta. She graduated with a DDS degree in 1991.

Dr. Sydel is not a naïve or unworldly person. She was brought up in Austria, Germany and Canada. She has travelled throughout two continents over the years. As an adult, she resided in both Germany and Canada. She speaks several languages. As a child, family

Digitized by Google

conversations and discussions frequently revolved around world politics, the discussions being led by her father, who was also an educated professional person (a Master Electrician).

Dr. Sydel had years of experience operating as an independent business woman. After becoming a dentist in 1991, she worked almost continuously, as an independent contractor for seven different dentists. Her arrangements in each of those dental offices, was as an independent contractor who would be paid a percentage of the fees she billed and collected for the dental work she did. The idea to be an independent contractor as opposed to an employee, originally came from discussions with her father and a chartered accountant friend with whom she had consulted early in her career. Being an independent contractor of course means running your own business. In her case, Dr. Sydel's business was a high volume dental practice, she was responsible for paying her own insurance fees, buying her own expensive dental equipment, paying for her own dental supplies, submitting and checking invoices, and managing everything else typically involved in running one's own business.

Dr. Sydel had experience in corporate and tax matters above and beyond her dental businesses. During the early 90's when she was married to her first structure their personal tax affairs. A tax accountant assisted them with this "off shore" method of tax planning. When she worked in Germany or in Canada, at least during 1991 to 1997, she had consultations with at least three different accountants, seeking advice as to how best to structure her business and financial affairs. Between 1991 to 1997, she also consulted with at least two different lawyers, one with respect to the off-shore company and one with respect to her Petition for Bankruptcy in British Columbia in 1997. There was no evidence one way or the other, whether she had consulted with yet another lawyer in connection with her divorce.

Dr. Sydel testified that she first became aware of the concepts of "natural persons", "artificial persons", "corporate soles" and "taxpayers", when she read an article in a naturalist magazine called "Shared Visions". By coincidence, the author came into her office as a patient a short while later. She spoke with him about his concepts and theories and then began attending a variety of seminars on the topic of not having to pay income tax. She attended approximately five to seven full day seminars, at a cost of $20.00 per seminar. She testified that she was intrigued by the author and the seminar leaders' philosophy as to why governments did not have the right to interfere with a person's privacy, human rights or their basic freedoms. Two matters struck me: (1) the only human "right" that either Dr. Sydel or her lecturers were concerned about, was the right not to pay income taxes. Neither Dr. Sydel nor any of the lecturers seemed at all concerned with the other types of rights listed as inalienable rights in our ***Chart of Rights*** legislation – the right to freedom of religion, expression, press, peaceful assembly, association, just to name a few; and (2) Dr. Sydel's sudden interest in tax matters arises, by coincidence, just one year after her Petition for Bankruptcy, which involved writing off a considerable past indebtedness to Revenue Canada ($25,000).

Dr. Sydel testified that between 1998 and 2003, she did not consult tax lawyers or tax accountants for four reasons: (1) she viewed them all as part of the (tax) establishment who had vested interests in maintaining the status quo interpretations of income tax laws and would therefore be disinclined to think "outside of the box", so to speak; (2) in the past, on one occasion she had received what she believed to be incorrect tax advice from an accountant and also, previously two accountants had given her conflicting advice; (3) the lecturers at the seminars struck her as extremely knowledgeable, well researched and credible; and (4) in 1996 and 1997, when she began practicing dentistry with Dr. Peter Brawn, she came to realize that her dental college professors either withheld or were

Digitized by Google

ignorant of "alternative" and more natural ways to do dental work. This led her to distrust all professionals. Her reasons are not believable when one considers her testimony that she was intrigued, curious and really wanted to truly understand both the logic and validity of the lecturer's opinions and that is what kept her going to the seminars. The reasons she gave for refusing to seek out professional opinions from tax accountants or tax lawyers, who are the only people allowed by Canadian law, to provide tax advise, are spurious. To avoid consultation and hearing opinions from such professionals would be akin to a dentist refusing to seek instruction from qualified dentists and insisting on taking classes and instructions, only from lay persons. I should point out that on three separate occasions in her testimony, she did comment that she had put some weight on what she believed to be tax law opinions from both Dr. Elmajian's lawyer and his accountant. She and Dr. Elmajian testified that Dr. Elmajian's lawyer apparently had said that the written contract for services between Dr. Sydel as a "natural person" and Dr. Elmajian, appeared "different but was okay to sign". She regarded this as a seal of legal approval for the concept of "a natural person" and the content of her contract. She also asked Dr. Elmajian's accountant during a short meeting with him, Dr. Elmajian and others (concerning disclosure of privileged information to CCRA) if he knew much about structuring one's affairs as "a natural person" so as to avoid paying taxes. He responded with words to the effect, if you find out a way not to pay taxes, let me know! Dr. Sydel also told the Court that one time, she casually and in passing, did ask a chartered accountant attending one of the seminars, what he thought about the whole thing. He apparently told her that the ideas seemed intriguing and that he didn't think it was illegal. These three incidents simply represent small opportunities to seek tax opinions and or advice, from tax professionals, albeit not independent ones, but on those occasions, she only dared ask casual one line questions and avoided making any in depth inquiries of these accredited tax professionals.

At the tax seminars most of the lecturers used aliases, as opposed to their real names. Dr. Sydel said that anyone was free to use whatever name they chose. She testified that the reason given by the lecturers for using aliases was to protect their privacy. She did not regard this as suspicious or unusual, even though one of the lecturers went by the alias, "Sir Larry Loophole". How could an intelligent, well educated, worldly, 39 year old professional, not be suspicious?

At the beginning of each of the five lectures presented by Mr. Porisky, the following caution was given: "In no way should this be construed as either legal or financial advice. You should consult a competent expert". Mr. Porisky frankly told the attendees at his lectures that "I am in the building trade. I am not a lawyer. I can't give legal advice. I am not an accountant. I can't give accounting or financial advice. I am just a guy banging nails". He also said, 'I strongly recommend you consult a competent expert on this subject matter". Dr. Sydel chose to ignore Mr. Porisky's advice, even though it was loud and clear. She decided not to seek out a professionally trained tax lawyer or tax accountant. She chose to remain wilfully blind.

Dr. Sydel knew that each and every lecturer was not a tax lawyer or tax accountant. Every lecturer was "up front" about their lack of accreditation. Nonetheless, they talked about the law, the statutes, the interpretation of the law and the statues, they discussed court cases and reported court judgments. Dr. Sydel accepted their views as "experts" who were imparting accurate information and opinions as to what the Canadian law was. She said that she could not recall if she questioned any of the lecturers during the seminars, she said that she did not research any court cases they referred to, she did not go "on line" or to the law library. She was told that there were decided and reported legal cases throughout Canada relating to the issues under discussion. To not have read any of these cases for herself, or even so much as to ask the lecturers for copies of the cases they said were directly on

Digitized by Google

point, is evidence of her wilful blindness.
At the early lectures by Detax and Untax, Dr. Sydel was asked why, if the Lt. Governor of British Columbia, The Queen and the Bishop of Victoria, had all established themselves as "corporation soles" and thereby avoided the payment of taxes, why wouldn't any other resident of Canada be able to do so, also? She accepted this rhetorical question and answer and placed an advertisement in the Westender newspaper, announcing that she now was a "corporate sole". How could an intelligent, educated person not seriously question this rhetorical question? The answer is: she was being deliberately blind. Later on, after attending the Porisky lectures, she realized that this hypothesis had no legitimate basis. However, this realization still failed to motivate her to obtain some tax advice from traditional, accredited and qualified tax specialists. Instead, she continued only to attend more seminars given by Mr. Porisky, who you recall, had clearly cautioned her and the others to seek qualified tax advice, before relying or acting on what he was saying.
Dr. Sydel asked her father to attend one of the tax lectures with her. He walked out in the middle of the lecture. She testified that she didn't ask him why. She did say though, that her father and her sister became "estranged" as a result of disagreements over her views regarding taxation. Dr. Elmajian testified that he had told Dr. Sydel on one occasion that he thought that "she was being brainwashed by a bunch of losers who don't work". These were two or three key people in her life and yet, their contrary views still did not cause her to seek some independent tax advice. As far back as January of 2000, Mr. Morrison of the CCRA, told Dr. Sydel, that if she refused to file tax returns she would be prosecuted. I see each of these instances, as examples of Dr. Sydel's wilful blindness. She chose to ignore each of these people when they gave her direct or implied warnings. In addition, Mr. Miller, an Assistant Commissioner for Revenue Canada, wrote to Dr. Sydel in December 1999, telling her that she was receiving incorrect and misleading advice as to the validity of the "natural person argument". She ignored his letter. She didn't take it to a tax professional, nor did she take it to her father or her sister, who were not yet estranged from her. She basically chose to ignore the caution from a person whom she knew to be in a high level position at the CCRA.
In addition, some specific troublesome contradictions arose during Dr. Sydel's testimony. They were as follows:
she testified that each year she wrote approximately $120,000 in cheques to her husband because she was too busy to go to the bank during the work day and because she didn't think that one was able to write a cheque with the payee being "CASH". The Crown then produced four cheques which she had written to "CASH" as the payee. The cheques were for $6,013.80, $7,762.50, $15,000 and $3,000. It was also brought out that the Canada Trust / TD Bank just down the street from her practice, was usually open until 8:00 p.m. week days; (2) when she filed her Notice of Objections, she never mentioned anything at all about being a "natural person" or that she was "the legal representative of the taxpayer / artificial person", yet that is what she testified was always behind her actions in the year 1998 to 2003; (3) she testified that she preferred to use a post office box number for receiving mail, rather than her office or home. She said that decision was made purely for the convenience of having all her mail delivered to one place. The logic as to why a post office box down the street would be more convenient than having mail delivered either to her home or office only, escapes me; (4) she testified that she did not pursue her case in the Tax Court, to challenge CCRA's views, because she did not want to waste the court's valuable time. She rejected the Crown's suggestion that perhaps her decision to avoid the courts, was because she didn't want to allow a court to specifically have the opportunity to say that her beliefs were incorrect and ill founded; (5) Dr. Sydel was taken through some definitions in several statutes, some of which

Digitized by Google

had been mentioned at the seminars. For example, she was asked about the definition of "person" in section 2 of the ***Criminal Code*** which outlines who can be convicted of crimes and section 229 of the ***Criminal Code*** (the murder section) which uses the word, "includes". "Includes" was a word that her lecturers said was important to their theory as to why "natural persons" were not subject to the ***Income Tax Act***. The absurdity of the lecturer's analysis of the word "includes", became obvious. Similar demonstrations were presented to Dr. Sydel with respect to the definition of "animal" in the ***Health of Animals Act***. The definition of "animal" was that it "includes an embryo and a fertilized egg or ovum". The definition of "animal", did not specifically mention dogs, cats, pigs, etc. Once again, the interpretation of the word "includes", as opined by the lecturers, became absurd; (6) Dr. Sydel insisted that her original purpose for attending the seminars, was not to avoid or evade paying taxes, but rather, to be educated, expand her mind and learn more about her human rights. The "human rights" which were discussed however, rarely ventured into any area beyond the human right not to have to pay taxes. She said, that not having to pay income taxes was a "side effect" of her quest for knowledge, as opposed to being the goal of the quest; (7) Dr. Sydel testified that she and her husband spent all the money that she earned as a dentist. She said that "they lead a very expensive lifestyle". She kept nothing in reserve, as if there could not even be a remote chance, that she might be wrong in her tax beliefs and would eventually have to pay taxes. This clearly was more evidence of her being wilfully blind.

[21] In conclusion, I find that Dr. Sydel was wilfully blind. The finding of wilful blindness precludes a successful argument that the Crown failed to prove the required Mens Rea. It also defeats the argument that she did not wilfully commit the nine offences charged in the Information.

[22] When she made the false and deceptive statements in her T1 Forms (the subject of counts 1 to 4), they were made due to her choice to be wilfully blind. Her addition of the words, "to be best of my knowledge" and "without understanding" actually adds to the evidence of her being wilfully blind. She need not have remained "without understanding". She need not have left herself in the position of having to qualify her state of knowledge about the tax issues, as being "to the best of my knowledge". She could have and she should have, chosen to clear up any concerns or misunderstandings that she had, by seeking independent professional tax accounting and / or legal advice. For Dr. Sydel to say that it was up to CCRA to provide her with detailed written arguments as to how they justified taxing people, is a totally unreasonable position for her to have taken. Had she not been operating from a position of wilful blindness, she would have sought her own independent advise or utilized the methods of dispute and appeals available within the tax department and thereafter in the Tax Courts. The ***Income Tax Act*** outlines the legal procedures to be taken by people who disagree with the CCRA Assessments. Dr. Sydel, it appears, never even looked at the **Income Tax Act** to see if there were appeal procedures and she never inquired of anyone (professional or not), as to whether such procedures existed as part of a person's rights under Canadian law. She chose instead to be willfully blind and must be found guilty on Counts 1, 2, 3 and 4 of the Information.[119]

Natural Person and "Right to Enjoy Property" as Defence

In ancient ITAs there was an exemption granted to natural persons that allowed them to be exempt from tax on their income. It was legislated out of existence years ago. The case of R. v.

[119] See also R. v. Thompson, 2008 BCPC 0022, for another less commented on argument of honest mistake, again, all in one direction, that **didn't** prevent conviction.

Digitized by Google

Douglas Preston Amell, Heidi Lynne Keyzer and Robert Lawrence Amell[120] it was held:

The Natural Persons Defence

[152] At the outset of the trial, each of the Defendants claimed to be a "natural persons" and claimed the rights of natural persons. In argument, Mr. Amell asserted that the income of natural persons was not caught by the *Income Tax Act*, and that natural persons were not taxable. I gather that this argument is based upon some interpretation of provisions of a prior income tax act. However, I need not go further into the history of these provisions or further elaborate upon the argument. If there ever was a natural persons exemption from income tax, that exemption has long since been abolished by Parliament, and any such exemption is now dead. The following cases all stand for the proposition that there is no natural persons exemption.

[153] Because there are so many of these decisions, I did not know what order to put them in. I have arranged them in chronological order:

Kennedy v. Canada (Customs and Revenue Agency), [2000] O.J. No 3313 (Ont. S.C.)
R. v. Dick, 2003 BCPC 13
~~*R. v. Sargent*, [2004] O.J. No~~. 5389 (Ont. Court of Justice)
R. v. Nagora, [2004] O.J. No. 6039 (Ont. Court of Justice)
R. v. Sydell, 2006 BCPC 346
R. v. Turnnir, 2006 BCPC 460
M.N.R. v. Camplin, 2007 DTC 5165
Hovey Ventures Inc. v. Canada, 2007 DTC 617
R. v. Lindsay, 2008 BCPC 203
R. v. Loosdrecht, 2008 BCPC 400
Canada (M.N.R.) v. Stanchfield, 2009 FC 72 and 2009 FC 99
Kion v. Canada, 2009 DTC 1304

[154] In addition there is a trio of decisions in the case *R. v. Gavin Lemieux and Lemieux Trenching Ltd.*, 2007 SKPC 135; affirmed on appeal at Estevan QB 36/07; further affirmed on appeal at C.A. No. 1573 on November 6, 2007.

[155] In addition, there is a trio of decisions in the case of *R. v. Klundert*, cited as follows: 1) *R. v. Klundert*, [2004] O.J. No. 3515 (CA)
2) *R. v. Klundert*, [2008] O.J. No. 4522 (CA) affirmed at [2008] S.C.C.A. No. 522

The *Canadian Bill of Rights*

[156] Mr. Amell argues that the *Canadian Bill of Rights* guarantees him the right to enjoyment of property. Further, that the *Income Tax Act* cannot contravene the *Bill of Rights*. Further, that the *Income Tax Act* deprives him of his right to property contrary to the *Bill of Rights.*

[157] The simple answer to this argument is contained by reading the entire provision contained in the *Bill of Rights*. That provision reads as follows:

It is hereby recognized and declared that in Canada there have existed and continue to exist...the right of the individual to life, liberty, security of the person and enjoyment of property, and the right not to be deprived thereof, except by due process of law...

The *Income Tax Act* is valid federal legislation, passed by the Canadian Parliament. That legislation establishes what is to be taxed, the rate of taxation, the process for collection, and processes for appeals. In short, it establishes an entire legal process for the assessment and collection of taxes. The result is that to the extent that taxation deprives an individual of his property, the individual is so deprived by due process of law. This legislation does not breach or infringe upon the *Canadian Bill of Rights*, and this defence must fail.[121]

---

[120] 2010 SKPC 107

[121] On the issue of whether the Federal Government has the authority to collect an income tax you merely has to examine Sandra June Gibbs v. Regina, 2006 BCSC 481, where it was provided:
*Did the trial judge err in finding the **Act** intra vires the federal government?*

Digitized by Google

R. v. Porisky & Gould, 2012 BCSC 67 (CanLII), Another Person Trying to Argue the Natural Person Argument – It's Amazing in Canada What Some will Try and Develop Argument Not to Pay Tax

Related decisions Court of Appeal
R. v. Gingras, 2012 BCCA 522 (CanLII) - 2012-12-17
R. v. Gingras, 2012 BCCA 467 (CanLII) - 2012-11-20
R. v. Porisky, 2012 BCCA 371 (CanLII) - 2012-09-19
R. v. Gingras, 2012 BCCA 370 (CanLII) - 2012-09-05
R. v. Porisky, 2012 BCCA 309 (CanLII) - 2012-07-12
R. v. Gould, 2012 BCCA 308 (CanLII) - 2012-07-12
Supreme Court of British Columbia
R. v. Porisky, 2012 BCSC 771 (CanLII) - 2012-05-10
R. v. Porisky, 2012 BCSC 68 (CanLII) - 2012-01-18
R. v. Gingras, 2012 BCSC 230 (CanLII) - 2012-01-09
Thomas v. British Columbia, 1999 CanLII 5274 (BC SC) - 1999-11-12
Wageman, Bailey v. Cardinal Management Ltd., 1997 CanLII 4413 (BC SC) - 1997-12-17
Legislation cited (available on CanLII)
Constitution Act, 1982, The, Schedule B to the Canada Act 1982 (UK), 1982, c 11 Criminal Code, RSC 1985, c C-46 — 21(1);368(1);380;380(1);464
Excise Tax Act, RSC 1985, c E-15 — 327(1);332(3)
Income Tax Act, RSC 1985, c 1 (5th Supp) — 3;231.2;239;239(1);244(3)
Decisions cited
Lewis v. The Queen, 1979 CanLII 19 (SCC)
R. v. Alexander Street Lofts Development Corporation Inc., 2007 ONCA 309 (CanLII)
R. v. Amell, 2010 SKPC 107 (CanLII)
R. v. Cancor Sorftware Corp.,
R. v. Cormier, 1986 CanLII 1178 (BC CA)
R. v. De Wolf, 1982 CanLII 347 (BC CA)
R. v. Gonzague,
R. v. Hamilton, 2005 SCC 47 (CanLII)

---

[31] The appellant submits that the ***Act*** is *ultra vires* the federal government, and that income tax in Canada is a provincial matter. She submits that income tax is only a matter under federal jurisdiction when it is the subject of a special tax or levy pursuant to the ***War Measures Act***.

[32] The legislative authority to levy income tax is conferred on the federal government by s. 91(3) of the ***Constitution Act***, *1867*. This section confers jurisdiction on the federal government to enact laws relating to the "raising of Money by any Mode or System of Taxation".

[33] The authority of the federal government to levy income tax has been clearly established by our courts. This issue was considered by the Court of Appeal in ***Bruno v. Canada Customs and Revenue*** (2002), 162 B.C.A.C. 293, 2002 BCCA 47 at para. 14:

The argument now advanced on behalf of Mr. Bruno is substantially the same argument as was rejected by the Privy Council in the *Caron* decision. At p. 108 of that decision (D.L.R.), Lord Phillimore said as follows:

Upon my view there is nothing in s.92 to take away the power to impose any taxation for Dominion purposes which is *prima facie* given by s.91(3). It is therefore not *ultra vires* on the part of The Parliament of Canada to impose a Dominion Income Tax for Dominion purposes; and the first point must therefore be decided against the appellant.

Mr. Bruno is not the only litigant to attempt to argue against the *Caron* decision. Of course, that decision is binding on this Court until such time as the issue might be revisited by the Supreme Court of Canada with a differing result. Therefore, I find it unnecessary to refer to the several cases that followed and applied the *Caron* decision.

This court is similarly bound by this authority.

Digitized by Google

R. v. Jeffers, 2012 ONCA 1 (CanLII)
R. v. Kelly, 2004 ONCJ 320 (CanLII)
R. v. Kennedy, 2004 BCCA 638 (CanLII)
R. v. Klundert, 2004 CanLII 21268 (ON CA)
R. v. Klundert, 2008 ONCA 767 (CanLII)
R. v. Sharpe, 2001 SCC 2 (CanLII)
R. v. Sydel, 2006 BCPC 346 (CanLII)
R. v. Thatcher, 1987 CanLII 53 (SCC)
R. v. Théroux, 1993 CanLII 134 (SCC)
R. v. Turnnir, 2006 BCPC 460 (CanLII)
United States of America v. Dynar, 1997 CanLII 359 (SCC)

Editor's Note: Corrigendum released on January 25, 2012. Original judgment has been corrected with text of corrigendum appended.

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: R. v. Porisky & Gould, 2012 BCSC 67

Date: 2012 01 18

Docket: 25339-8 Registry: Vancouver Regina

v.

Russell Anthony Porisky Elaine Gould

Before: The Honourable Mr. Justice Myers

Corrected Judgment: The judgment was corrected at paragraph 80 on January 25, 2012

Reasons for Judgment

Table of Contents Paragraph Range

THE CHARGES [1] - [8]

COUNT 1 – TAX EVASION BY MR. PORISKY RE: HIS OWN INCOME [9] - [72]
Legal principles regarding tax evasion [11] - [18]
Jurisdiction [19] - [19]
Identification [20] - [21]
Actus reus [22] - [69]
The Crown's Evidence [22] - [36]
Mr. Porisky's Evidence [37] - [41]
Mr. Porisky's Argument [42] - [56]
Analysis – Did Mr. Porisky commit the act of tax evasion? [57] - [69]
E. Intent [70] - [72]
COUNT 2 – TAX EVASION BY MS. GOULD RE: HER OWN INCOME [73] - [76]
COUNTS 1 AND 2 – TAX EVASION BY MS. GOULD AND MR. PORISKY THROUGH AIDING AND ABETTING
COUNT 3 – EVASION OF GOODS AND SERVICES TAX BY MR. PORISKY AND MS. GOULD[77] - [79]

[80] - [82]
COUNT 4 – COUNSELLING BY MR. PORISKY [83] - [125]
Is income tax evasion fraud? [86] - [91]
The conduct and mental elements of counselling [92] - [95]
Actus reus - did Mr. Porisky counsel income tax evasion and therefore fraud? [96] - [115]
Mr. Porisky's Evidence [99] - [109]

Digitized by Google

The Canadian Illusion books and DVDs [110] - [111]
Analysis re: the conduct of counselling [112] - [115]
D. Intent [116] - [124]
E. Conclusion on counselling [125] - [125]
SUMMARY [126] - [130]
APPENDIX
QUOTES FROM THE CANADIAN ILLUSION BOOKS AND DVDS
Part 1 – It's All About You
Part 2 – The Illusion
Part 3 – The Tax Game -
Part 4 – Your Right to Contact -
Part 5 – Freedom-Free-For-All -
The Canadian Illusion DVDs – PowerPoint Slides -

The charges

[1] The Crown alleges that Mr. Porisky and Ms. Gould conducted business under the name The Paradigm Education Group, which gave seminars and sold materials urging others to structure their affairs as a "natural person, working in his own capacity, under a private contract, for his own benefit". Paradigm taught that money earned under this arrangement was exempt from income tax.

[2] Between December 31, 2003 and December 4, 2008, the business is alleged to have earned a net income of $1,127,185 in respect of which no income tax was paid by either of the accused. Mr. Porisky and Ms. Gould each stand charged with evading both their own income taxes and those of the other, contrary to
s. 239(1)(d) of the Income Tax Act, R.S.C., 1985, c. 1 (5thSupp.). The income tax evasion counts read as follows:

Count 1

Russell Porisky and Elaine Gould, being of the City of Chilliwack, Province of British Columbia, between December 31, 2003 and December 4, 2008, did wilfully evade or attempt to evade the payment of taxes imposed by the Income Tax Act, by failing to report taxable income of Russell Porisky in the amount of
$555,782.00, and did thereby evade the payment of $112,611.00 in income tax, contrary to section 239(1)(d) of the Income Tax Act.

Count 2

Russell Porisky and Elaine Gould, being of the City of Chilliwack, Province of British Columbia, between December 31, 2003 and December 4, 2008, did wilfully evade or attempt to evade the payment of taxes imposed by the Income Tax Act, by failing to report taxable income of Elaine Gould in the amount of
$555,782.00, and did thereby evade the payment of $112,611.00 in income tax, contrary to section 239(1)(d) of the Income Tax Act.

[3] Mr. Porisky and Ms. Gould have lived together since March 1998.

[4] The charges apportion the income of Paradigm equally between Mr. Porisky and Ms. Gould. In particulars, the Crown further explained these counts as follows:

In Count 1, Porisky is charged as a principal (the taxes evaded were on his income). Gould is charged as a party to that offence, both by not filing her own tax returns (which would

Digitized by Google

alert the Canada Revenue Agency to the existence of Porisky's income) and by other means.
Similarly, in Count 1 (sic), Gould is charged as a principal (the taxes evaded were on her income) and Porisky is charged as a party to that offence, both by not filing his own tax returns and by other means.
Although the second paragraph refers to Count 1, I take it to actually refer to Count 2.
[5] Ms. Gould and Mr. Porisky are also charged under s. 327(1)(c) of the Excise Tax Act, R.S.C., 1985, c. E- 15, for failing to collect and remit Goods and Services Tax on sales for the same period. The amount of GST that the Crown says should have been remitted is $66,133.45.
[6] Finally, Mr. Porisky (alone) is charged under s. 464(a) of the Criminal Code with counselling others to commit fraud by evading the payment of income tax. The period encompassed in the charge is between December 31, 2000 and December 4, 2008.
[7] The charges were laid in December 2009 after a search of the accuseds' residence on December 3, 2008. Up until June 2, 2011 Mr. Porisky was represented sequentially by two counsel, with a short gap between them. Ms. Gould was represented by counsel up until October 12, 2011. Mr. Porisky and Ms. Gould represented themselves at the trial.
[8] Mr. Porisky testified on his own behalf. He acknowledged that Paradigm was his alter-ego (his "representative", to use his own word), so that is not in issue. Ms. Gould did not testify or call any other evidence.

Count 1 – Tax evasion by Mr. Porisky re: His Own Income [9] Section 239.(1)(d) of the Income Tax Act states:
239.(1) Every person who has…
wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act…
is guilty of an offence…
With respect to the GST count, s. 327(1)(c) of the Excise Tax Act is similarly worded:
Every person who has
(c) wilfully, in any manner, evaded or attempted to evade compliance with this Part or payment or remittance of tax or net tax imposed under this Part,
is guilty of an offence…
[10] The Crown acknowledges that these offences are true criminal offences and that it is required to prove all the elements of the offences beyond a reasonable doubt. For both income tax and GST evasion, the elements are jurisdiction, identification, the requisite conduct (actus reus) and the requisite mental element or intent (mens rea).

Legal principles regarding tax evasion
[11] I start by setting out some of the relevant legal principles with respect to the charge of tax evasion.
[12] Although the exact amount of tax evaded is relevant to sentencing, the courts have noted that it is not an essential element of the offence: see R. v. Alexander Street Lofts Development Corporation Inc., 2007 ONCA 309 (CanLII), 2007 ONCA 309; R. v. Cormier 1986 CanLII 1178 (BC CA), (1986), 29 C.C.C. (3d)
481(B.C.C.A.); and R. v. Kelly, 2004 ONCJ 320 (CanLII), 2004 ONCJ 320.
[13] The conduct which the Crown is required to prove is:
… that the accused voluntarily performed an act or engaged in a course of conduct that avoided or attempted to avoid payment of tax owing under the [Income Tax] Act.
R. v. Klundert 2004 CanLII 21268 (ON CA), (2004), 187 C.C.C. (3d) 417, 242 D.L.R. (4th) 644 (Ont. C.A.) at

Digitized by Google

654 (“Klundert #1”).
[14] Turning to intent, the Ontario Court of Appeal in Klundert #1 stated, at para. 46:
Although I would avoid the use of the phrase "ulterior motive", I agree with Bayda J.A. that the word "wilfully" in s. 239(1)(d) signals that culpability will follow only where the accused engages in conduct intended to avoid the payment of tax owing under the Act. More precisely, I think the fault component in s. 239(1)(d) is twofold. First, the accused must know that tax is owing under the Act and second, the accused must intend to avoid or intend to attempt to avoid payment of that tax. An accused intends to avoid, or intends to attempt to avoid, payment of taxes owing under the Act where that is his purpose, or where he knows that his course of conduct is virtually certain to result in the avoiding of tax owing under the Act: see Buzzanga, supra, at 383-385.
In the following paragraph the Court of Appeal set out a jury charge for both the actus reus and mens rea:
In most cases of tax evasion, the trial judge will adequately describe the elements of the offence by instructing the jury that they must be satisfied beyond a reasonable doubt that the accused:
did something or engaged in a course of conduct that avoided or attempted to avoid the payment of tax imposed by the Act;
knew there was tax imposed by the Act; and
engaged in the conduct for the purpose of avoiding or attempting to avoid payment of tax imposed by the Act or knowing that avoiding payment of tax imposed by the Act was a virtual certain consequence of his actions.
[15] The Court of Appeal in Klundert #1 held that an incorrect belief that the Income Tax Act was constitutionally invalid does not negate intent.
[16] The British Columbia Court of Appeal applied Klundert #1 in R. v. Kennedy, 2004 BCCA 638 (CanLII), 2004 BCCA 638. At para. 14 of Kennedy, Hall J.A. stated:
The Provincial Court judge found that although the appellant had received advice from his accountants that he owed tax, the appellant still decided to file nil returns because of his belief that the Income Tax Act was constitutionally invalid. The Provincial Court judge found that the appellant intentionally stated in his 1996 and 1997 personal income tax returns that he had nil income knowing that he did in fact have income in each of those years. In my opinion, Klinger P.C.J. correctly held that the appellant was required to disclose that income tax in his return regardless of any belief he may have had as to the constitutional right of the federal government to levy or collect income taxes. Having reached this conclusion about the appellant's duty to report income, it seems to me that the trial judge was bound to find the appellant guilty on count 3 in the Information. No additional mental element was required: R. v. Paveley (1976), 30 C.C.C. (2d) 483, 70 D.L.R. (3d) 237 (Sask. C.A.); R. v. de Wolf 1982 CanLII 347 (BC CA), (1982), 67 C.C.C. (2d) 43, 84 D.T.C. 6033
(B.C.C.A.). I consider that the trial judge fell into error by requiring the Crown to prove some additional element against the appellant.
[17] Mr. Klundert came back before the Ontario Court of Appeal after a second trial: 2008 ONCA 767 (CanLII), 2008 ONCA 767 (“Klundert #2”). At his second trial, Mr. Klundert argued that he did not have the requisite mens rea because he believed that the Act did not apply to him since he was a “natural person”. The Court of Appeal held that this was a mistake of law that did not vitiate intent. I will refer to this decision in greater detail later, together with other cases that have reached the same conclusion.
[18] I will now review each of the elements as they apply to the case at bar.

Jurisdiction

Digitized by Google

[19] The jurisdiction of the Court is provided by s. 244(3) of the Income Tax Act and s. 332(3) of the Excise Tax Act. The evidence establishes that the accused were resident and found within British Columbia.

Identification

[20] There is no issue as to identification. A number of Canada Revenue Agency ("CRA") officers identified both accused while searching the accuseds' residence at 45354 Creekside Drive, Chilliwack, British Columbia. In addition, Mr. Porisky acknowledged that Paradigm was a name he used to carry on his activities which are the subject of the charge. Jumping out of sequence to the counselling charge, Mr. Porisky appears in almost all of the DVDs which are the subject of that charge and he acknowledged that he was the author of the written material which I will discuss when I come to deal with that charge.

[21] These findings on jurisdiction and identification also apply to the other counts.

Actus reus

The Crown's Evidence

[22] The vast bulk of the evidence in this case results from a search which the CRA executed on December 3, 2008 at the accuseds' residence. With respect to the tax evasion charges, that evidence consists of financial and business records, including contracts with Paradigm "educators", bank records and invoices. [23] Neither Paradigm nor Mr. Porisky kept any books or accounting records. Therefore, a CRA investigator, Mr. Brunke, reviewed the records retrieved from the house and reconstructed the financial statements of Paradigm. Although Mr. Brunke is a Certified General Accountant, he gave his evidence not as expert opinion but, rather, as a fact witness summarising the financial evidence and applying the tax tables to the numbers.

[24] An early and often-cited case on the admissibility of summary evidence is R. v. Scheel (1978), 42 C.C.C. (2d) 31 (Ont.C.A.). In this case, summaries were prepared by a chartered accountant, based on exhibits, an agreed statement of facts, testimony at trial, and evidence given at the preliminary hearing read in at the trial. Martin J.A. found that the summaries were properly admissible to assist the jury in understanding the entire picture represented by the voluminous documentary evidence. At pp. 35-36 he said:

The introduction of the summaries did not offend against the rule that requires the production of original documents, since the documents which were the primary source of the summaries were in evidence. It is accordingly unnecessary in this case to invoke the exception to the rule referred to by Wigmore in the following passage:

"Where a fact could be ascertained only by the inspection of a large number of documents made up of very numerous detailed statements—as, the net balance resulting from a year's vouchers of a treasurer or a year's accounts in a bank ledger—it is obvious that it would often be practically out of the question to apply the present principle by requiring the production of the entire mass of documents and entries to be perused by the jury or read aloud to them. The convenience of trials demands that other evidence be allowed to be offered, in the shape of testimony of a competent witness who has perused the entire mass and will state summarily the net result. Such a practice is well established to be proper.

Most courts require, as a condition, that the mass thus summarily testified to shall, if the occasion seems to require it, be placed at hand in court, or at last be made accessible to the opposing party, in order that the correctness of the evidence may be tested by inspection if desired, or that the material for cross-examination may be available:" (Wigmore 4th ed. Vol. IV at p. 535).

[25] The accused were provided with Mr. Brunke's spreadsheets ahead of his testimony.

Digitized by Google

The alternative to admitting the summary evidence in this case would have had Mr. Brunke referring line by line to each bank statement and doing the arithmetic "real-time" on the witness stand. That would have taken a good many days and would have been almost impossible to absorb.

[26] Mr. Brunke first reviewed the bank statements and determined that a total of $1,843,298 was deposited into Mr. Porisky's and Ms. Gould's bank accounts from December 31, 2003 to December 31, 2008. He then deducted from this:

all cash deposits, other than those that could be matched to a seized Paradigm document that confirmed that the deposit was income;

all deposits for which no cheque was available; and

payments from the accuseds' family.

Mr. Brunke treated the balance of $1,415,127 as Paradigm's gross revenue for 2004-2008.

[27] Included in the above revenue were deposits by cheque made out to Mr. Porisky which did not contain any reference to Paradigm material or services and could not be cross-referenced to a seized document, from payees who were not known to be Paradigm educators or students. Mr. Brunke included this because there was no indication that Mr. Porisky and Ms. Gould had any other source of income other than Paradigm. He estimated that less than 5% of the cheques fell into this category.

[28] Mr. Brunke then deducted the expenses of Paradigm which are summarised as follows:

Category of Expense	2004-2008 total
Meals & Entertainment (50%)	$7,252.29
Business Use of Home (20%)	$10,430.87
Motor Vehicle (100%)	$56,327.89
Office Supplies - General	$43,352.55
Office Supplies - Minuteman Press	$76,934.09
Professional Fees - Legal	$15,000.00
Subcontract - Sherri Adams	$5,910.44
Unaccounted Credit Card Payments	$14,019.71
Hotel / Conference	$51,892.66
Travel	$3,798.73
Bank Fees	$1,500.23
Interest	$1,523.17
Total Allowed Expenses	$287,942.63

Expenses which were obviously personal, such as fitness memberships and groceries, were not included. [29] None of the above evidence was challenged by Mr. Porisky in cross-examination or in his own evidence. [30] Neither Ms. Gould nor Mr. Porisky was paid a salary from Paradigm. Rather, all of the money received from the operation of Paradigm was deposited into two bank accounts in the joint names of both the accused, and two accounts in Mr. Porisky's name.

[31] The above resulted in a net business income of $1,127,185 for the 2004 to 2008 taxation years.

[32] Mr. Brunke allocated the netincome evenly between the accused and then reduced the amount to factor in Canada Pension Plan contributions. This resulted in the following net taxable income for each of the accused:

	2004	2005	2006	2007	2008	Total
Taxable Income	$37,202.76	$123,762.00	$169,976.72	$137,226.79	$87,613.32	$555,781.58

[33] Finally, Mr. Brunke applied the tax rates set out in the Income Tax Act and calculated that Mr. Porisky and Ms. Gould each owed $112,611 in federal income tax for the 2004 to 2008 taxation years.

[34] With respect to GST, Mr. Brunke assumed that every expense would result in an

Digitized by Google

input credit and calculated that $66,133 GST was payable.
[35] I accept Mr. Brunke's calculation of the gross and net revenue of Paradigm; if anything it underrated the gross revenue and overrated deductible expenses and input credits, and that would benefit the accused.
[36] The CRA records show that:
Mr. Porisky failed to file income tax returns for the 2005 to 2008 taxation years.
Ms. Gould failed to file income tax returns for the 2004 to 2008 taxation years.
Mr. Porisky and Ms. Gould failed to report any income from 2004 to 2008.
Mr. Porisky and Ms. Gould failed to remit any GST from 2004 to 2008.
Mr. Porisky did file a return for 2004 in which he disclosed a nil income.
Mr. Porisky's Evidence
[37] As stated above, Mr. Porisky acknowledged that Paradigm was the name he used to conduct his endeavour, and the evidence is overwhelming in that regard. In his testimony, he minimised Ms. Gould's involvement, saying that she provided minor services and accompanied him on the seminars to keep him company. Apart from that she was a stay-at-home mother. I will deal with Ms. Gould separately, after I reach my conclusions with respect to Mr. Porisky.
[38] Since 1999, Mr. Porisky has dedicated himself to finding out, to use his words, "what the tax system was about". He founded what he eventually called The Paradigm Education Group to "create a structure that everyone could work together in to save the country from a foreign parasite". The foreign parasites were the international bankers who were, directly or indirectly, responsible for the income tax system. I will explain the teachings of Mr. Porisky more fully later in these reasons.
[39] Paradigm sold books, written materials and instructional DVDs on its web site, Naturalperson.com. Mr. Porisky acknowledged that he was the author of the materials. Mr. Porisky conducted seminars which were fee-based. The DVDs feature him lecturing at the seminars. The books and DVDs largely overlap in content. [40] Mr. Porisky qualified "educators "to teach the Paradigm materials. Those educators, including Mr. Porisky, offered consulting services to assist people in setting themselves up as natural persons, working in their own capacity, under a private contract, for their own benefit, and thereby – supposedly – be exempt from tax. I will deal with the legal validity of that position later. The educators generally charged 7% of a contracting party's income over two years for the consulting service, and a portion of that revenue was remitted to Paradigm.
[41] The balance of Mr. Porisky's evidence primarily concerned the charge of counselling, and I therefore deal with it in that section.
Mr. Porisky's Argument
[42] On its face, the net revenue earned by Paradigm and Mr. Porisky was, under s. 3 of the Income Tax Act, income which should have been reported and which would have resulted in taxes being payable.
[43] Mr. Porisky argues otherwise. It is difficult to set out his line of argument with cogency because it lacks logic, coherence and consistency. His oral closing argument was a political statement.
[44] I will start with Mr. Porisky's brief written argument. He says he was not obliged to file tax returns because:
I had no taxable income
I did not want to apply for the available benefits associated with filing a T1 General Income Tax Return.
I did not receive a request to file T1 General Income Tax Return from the Canada Revenue Agency. It continues:
I respectfully submit that the evidence supports my submission that the particular activity I

Digitized by Google

carried on in a business-like manner as Paradigm Education Group, as well as other related particular activities, be it as a mentor, presenter, author, etc., were, with conscious awareness, carried on with no intent to profit, as personal endeavours and non-commercial activities.

[45] Although not referred to specifically in the written argument, the first two of the above points seem to hinge on Mr. Porisky's "natural person" theory or argument, which is one of the keystones of what, for lack of a better word, I will refer to as the "Paradigm view".

[46] The law has long recognised the distinction between a natural person and an artificial person, such as a corporation. And it has recognised a corporation sole which applies to an office, such as a bishop. However, Mr. Porisky twists that into something that the law does not recognise. The Paradigm view is that an individual person may be either a natural person or an artificial person. If one is a natural person, one can act for one's own benefit and not for profit.

[47] The Paradigm materials make frequent references to the definitions of "person", "taxpayer" and "legal representative of a taxpayer" in the Income Tax Act. The definitions in s. 248 of the Act are:

"person", or any word or expression descriptive of a person, includes any corporation, and any entity exempt, because of subsection 149(1), from tax under Part I on all or part of the entity's taxable income and the heirs, executors, liquidators of a succession, administrators or other legal representatives of such a person, according to the law of that part of Canada to which the context extends;

"taxpayer" includes any person whether or not liable to pay tax;

"legal representative" of a taxpayer means a trustee in bankruptcy, an assignee, a liquidator, a curator, a receiver of any kind, a trustee, an heir, an administrator, an executor, a liquidator of a succession, a committee, or any other like person, administering, winding up, controlling or otherwise dealing in a representative or fiduciary capacity with the property that belongs or belonged to, or that is or was held for the benefit of, the taxpayer or the taxpayer's estate;

[48] From this, Mr. Porisky concludes that the following theory has been proven:

A person as defined in the Act is not the "taxpayer" but has some kind of legal relationship to the "taxpayer" requiring the "person" to fulfill certain obligations for the "taxpayer", such as filing tax forms and paying the income tax on the "taxable income" of the "taxpayer" from the "income of the taxpayer".

The Canadian Illusion – The Tax Gamep. 106

[49] It then follows, according to the Paradigm view, that:

A "person" is a "legal representative", and a "legal representative" is of a "taxpayer". Therefore, the "person" is not the "taxpayer".

and:

That only the "taxpayer's income" is taxable. Ibid.

Supposedly, a taxpayer is an artificial person. If one takes care to not establish oneself as an artificial person, such as by not taking government benefits, then one does not have to pay taxes, because natural persons are not taxed under the Income Tax Act.

[50] What underlies the "not for profit" argument is Mr. Porisky's use of the concept that, to use his words, "a man is worth his labour". A natural person can value his labour at whatever he wishes. Profit is first considered without the deduction of the person's own labour; when the value of the labour is factored in, the profit is reduced to zero. There is therefore no net income or profit to report and no taxes are payable; money earned by a natural person is supposedly not income and therefore not subject to tax.

[51] On the other hand, if one does not structure themselves as a natural person working for their own benefit and not for profit, then they are the "legal representative of a federally

Digitized by Google

created artificial person known as a taxpayer". It is only the latter who must pay income taxes.
[52] The natural person does not earn salary; rather, he earns "private compensation".
[53] The distinction, to Mr. Porisky, is one of choice or intent. I canvassed an example with Mr. Porisky in which two people get the identical job with the same employer at the same hourly rate. Person A states that he is taking the job in his capacity as a natural person acting for his own benefit and without intent to profit; Person B does not. According to Mr. Porisky, what is paid to Person A is not income and is not taxable. It is the opposite for Person B.
[54] Acting as a natural person is referred to as "the forgotten option". Not doing so is referred to as the "common option for the disadvantaged". A natural person's identification requires his name; a non-natural person's identification requires a social insurance number: Your Right to Contract, p. 99.
[55] In one of the Canadian Illusion DVDs, Mr. Porisky teaches that "only humans have first names and last names. Artificial persons have last names and first names". He says:
If they get us to use our artificial person name in applications they are – through the legal concept of joinder
– joining the two.
Joinder must be voluntary; otherwise it is enslavement [56] Ms. Gould adopted Mr. Porisky's arguments.
Analysis – Did Mr. Porisky commit the act of tax evasion?
[57] When I express my opinion of Mr. Porisky's argument and the Paradigm view – as I am about to do – I do not mean any disrespect to him. However, since he has taught this theory over many years and there have been several convictions of Paradigm students for following it, I think it is important to state the view of the Court in the clearest possible terms so that current and potential future students of Mr. Porisky know what they are or might be dealing with.
[58] Mr. Porisky's theory not only does not bear any legal logic but it also fails to accord with common sense. It is a failed attempt at word magic and has no validity.
[59] The absurdity of the supposed distinction between a natural person and a non-natural person (and I do not mean to refer to a corporation here) was shown by several things that arose during the course of the trial. [60] At the close of the Crown's case I asked Mr. Porisky and Ms. Gould whether they wished to call any evidence. Mr. Porisky said he could not make that decision unless he understood whether he was to give evidence in his "inherent personality as a natural person with no intent to profit". He wanted to tell the truth in the stand but the capacity he was to testify in would make a difference to his evidence. A few minutes later in the dialogue he said:
I need to know if I make the decision to get into the stand, from which perspective can I speak? Like therefore I need to know, in the eyes of the law, if one man is two persons, the natural or the legal, okay, which one can I speak as, or does it matter -- am I have the liberty to speak the truth and qualify it so I can speak to everything? Because what it -- they have commingled a lot of stuff, and for me to properly address it, I'm going to have to be able to speak to everything to properly address it.
And later:
Again, I feel like I'm being railroaded because I'm asking for clear answers. I came here with a full intention on defending my -- my rights and -- and not having things being converted into something they're not, and I don't know how to do that if nobody's going to give me a straight answer. I thought Crown had a duty -- I read their web page and they talk about honour and integrity, and now I'm been led one thing -- and for me to speak to everything, I'm going to need to be able to speak to it from my starting point of my existence.

Digitized by Google

I didn't make it up. Sir John Salmond I think is a highly respected man. The Supreme Court relies on him. I didn't make it up that one man's two persons in the eyes of the law. And so from that perspective, I need -- that's why I tried to be as honourable and as open in the development of this, so that I could speak the truth and the whole truth from the proper perspective, so it does not get misconstrued or mislabelled or presumed to be something it's not. And that's what I need to know. If I make the decision and I go in that box, which person, in the eyes of the law am I?
THE COURT: You are Mr. Porisky.
THE ACCUSED PORISKY: Am I Russell Anthony Porisky in my inherent personality as a natural person, or am I a sovereign-granted personality?
THE COURT: You're Russell Porisky.
THE ACCUSED PORISKY: That's fairly misleading because that's not clear enough for me, Your Honour.
....
THE COURT: ... Let's assume you get into the stand... and the Crown asks you, "What did you have for breakfast today?" Would it make a difference as to what capacity you were in?
THE ACCUSED PORISKY: For me, it would, Your Honour, yes.
[61] A final example will suffice. When asked by the Crown to confirm the identity of a Paradigm educator in the public gallery, Mr. Porisky said it depended on the capacity the Crown was asking about.
[62] The courts have rejected the natural person argument in several tax evasion cases. In R. v. Klundert (No. 2), 2008 ONCA 767 (CanLII), 2008 ONCA 767; leave to appeal to the Supreme Court of Canada refused ([2004] S.C.C.A. No. 463), MacFarland J.A., stated:
[11] ... he [the accused] explained his failure to pay taxes as arising from his belief that he was not obligated to pay taxes. Klundert took the position that he was not obligated to pay income tax because he believed the Act does not apply to him. Klundert testified that he is neither a “person” nor a “taxpayer” as defined in the Act.
...
[15] In essence, Klundert’s evidence was that as a natural person he had no obligation to pay taxes because he didn’t owe any. The respondent did not consider himself to meet the definition of “person” as that term is defined in the Act. According to the respondent, he had the option to act as a natural person – to whom the Act does not, in his view, apply, or to submit to the Act as a taxpayer. Because the respondent considered himself to be earning income in his individual capacity for himself as a natural person and not as a taxpayer, he did not believe he was under any obligation to pay income tax.
...
[19] Unfortunately for the respondent, the Act does not distinguish between persons and natural persons. The definition of “person” in the Act includes human beings of which specie the respondent belongs.
[63] The courts have rejected similar “natural person” arguments and rendered convictions in three other cases where the accused have taken courses from Mr. Porisky: R. v. Sydel, 2006 BCPC 346 (CanLII), 2006 BCPC 346; R. v. Turnnir, 2006 BCPC 460 (CanLII), 2006 BCPC 460; and R. v. Amell, 2010 SKPC 107
(CanLII), 2010 SKPC 107.
[64] In Kennedy v. Canada (Customs and Revenue Agency), [2000] O.J. No. 3313; 2000 D.T.C. 6524 (Ont. S.C.J.), Sedgwick J. also rejected this argument in the context of a challenge to a CRA Requirement to Pay. [65] The argument that Mr. Porisky makes under the rubric that “a man is worth his labour” is fundamentally flawed. At the end of a year, money is left in the hands of a person and that is taxable. The argument comes down to

Digitized by Google

what the Ontario Court of Appeal in Klundert No. 2, at para. 20, characterised as: "the Act does not apply to me because I choose to have it not apply to me."
[66] Also woven into the Paradigm view is the notion that benefits such as the Canada Pension Plan are not mandatory: because natural persons choose not to participate in any government benefit programmes, they are not subject to income tax. Apart from various programmes being mandatory, the flaw in that reasoning is that there is no linkage in the Income Tax Act between being eligible for the benefits and the obligation to pay income tax.
[67] Mr. Porisky's analysis picks and chooses snippets from various statutes and cases, and attempts to create logical links where none exist. It is, in effect, legal numerology.
[68] In short, there is no legal merit to any of Mr. Porisky's arguments.
[69] There can be no doubt that Mr. Porisky earned income from his endeavours as Paradigm – the only issue is what share is his and what, if any, is Ms. Gould's. That income was taxable and Mr. Porisky chose not to report it or to pay taxes on it. The Crown has made out the actus reus of the offence.

Intent
[70] Mr. Porisky's views are, at best, a mistake of law. The cases I have referred to previously establish that that does not vitiate what would otherwise be an intention to evade taxes on it.
[71] It is not necessary for me to find that Mr. Porisky was wilfully blind in coming to his views. Nevertheless I find that to be the case. Mr. Porisky was well-aware of prior decisions in which the natural person argument was rejected. Kennedy v. Canada (Customs and Revenue Agency) was the subject of comment by Mr. Porisky in The Canadian Illusion – The Tax Game (p. 46). Mr. Porisky also published a lengthy commentary on the Sydel decision, which I discuss below at para. 118. Mr. Porisky attempted to distinguish these cases out of existence.
[72] I therefore find Mr. Porisky guilty of Count 1, namely tax evasion with respect to his own income.

Count 2 – Tax Evasion by Ms. Gould re: Her Own Income
[73] The extent of Ms. Gould's involvement in Paradigm is not as clear as that of Mr. Porisky's; nevertheless, what is clear is that she did perform services for the endeavour. As argued by the Crown, Ms. Gould dealt with or assisted in administrative matters such as making payment arrangements with students or educators and processing orders for educational materials.
[74] Ms. Gould also accompanied Mr. Porisky on a number of his seminars. Mr. Porisky says that was just to keep him company, but I do not accept that evidence. In any event, Mr. Porisky acknowledges she did minor organisational tasks.
[75] As I said earlier, funds generated by the Paradigm activities were deposited into four bank accounts, two of which were in the joint names of Ms. Gould and Mr. Porisky. In 2005 Mr. Porisky gave Ms. Gould money to purchase a townhome in Chilliwack. In 2007 Mr. Porisky gave Ms. Gould money to purchase another property.
[76] It was certainly open to Mr. Porisky to give gifts to Ms. Gould, and no doubt some of these transactions can be explained on that basis. Nevertheless, given the fact that Ms. Gould worked in the endeavour, the only logical inference is that some of the money she received was compensation for those services and was taxable income which she failed to report. In order to convict, it is not necessary for me to determine the exact amount of that income or taxes avoided. I therefore find Ms. Gould guilty of tax evasion with respect to her own income.

Digitized by Google

Counts 1 and 2 – Tax Evasion by Ms. Gould and Mr. Porisky through aiding and abetting

[77] I previously set out the nature of these charges and the Crown theory underlying them. In its argument, the Crown says:

The means by which each accused was a party to the other's evasion was by not filing his or her own tax returns, in order to avoid alerting the Canada Revenue Agency to the existence of the other's income, and by engaging in a common design to earn income and evade tax on that income.

[78] Section 21(1) of the Criminal Code provides: Parties to offence

21. (1) Every one is a party to an offence who

actually commits it;

does or omits to do anything for the purpose of aiding any person to commit it; or

abets any person in committing it.

In R. v. Thatcher, 1987 CanLII 53 (SCC), [1987] 1 S.C.R. 652 at p. 690, the Supreme Court pointed out that this section makes the distinction between the direct commission of a crime and the aiding or abetting a crime irrelevant.

[79] Mr. Porisky and Ms. Gould were each responsible for filing their own income tax returns, and I have held that they are both criminally responsible for failing to do so. However, I do not think that there is sufficient evidence to convict them of aiding and abetting each other in that crime. The evidence is equally consistent with two possible alternatives, the first being that they each held similar views as to their obligations and the second being that Mr. Porisky counselled Ms. Gould to evade her taxes. Neither of these is sufficient to convict either Ms. Gould or Mr. Porisky as a party to the other's offence. There is certainly no evidence that they did not file their own returns so as to not alert the CRA to the other's activities.

Count 3 – Evasion of Goods and Services Tax by Mr. Porisky and Ms. Gould

[80] The services and goods sold by Paradigm were subject to GST under the Part IX of the Excise Tax Act. The GST should have been charged and remitted, less applicable input credits. That was not done. Once again, the only reason for that can be Mr. Porisky's "natural person" theory.

[81] Both the facts and the analysis that I have applied to Mr. Porisky's income tax evasion are equally applicable to this count, and I find Mr. Porisky guilty of this offence.

[82] While it is clear that Paradigm is Mr. Porisky's alter-ego, there is insufficient evidence to come to the same conclusion regarding Ms. Gould. The fact that she received payment for services performed for Mr. Porisky does not go so far as to show that she was responsible for the failure to report and remit GST. Whereas there is no doubt that Mr. Porisky was the guiding mind of Paradigm, that is not the case for Ms. Gould. Accordingly, I acquit her of this count.

Count 4 – Counselling by Mr. Porisky

[83] Mr. Porisky is charged with counselling others to commit fraud in excess of $5,000 between December 31, 2000 and December 4, 2008. The fraud being counselled was the evasion of income taxes. The counselling is alleged to have been done by Mr. Porisky in his Paradigm lectures, books and videos.

[84] The offence of counselling is set out in s. 464 of the Criminal Code:

464. Except where otherwise expressly provided by law, the following provisions apply in respect of persons who counsel other persons to commit offences, namely,

every one who counsels another person to commit an indictable offence is, if the offence is not committed, guilty of an indictable offence and liable to the same punishment to which a

Digitized by Google

person who attempts to commit that offence is liable; and
every one who counsels another person to commit an offence punishable on summary conviction is, if the offence is not committed, guilty of an offence punishable on summary conviction.
[85] Counselling is defined inclusively in s. 22(3) of the Code:
22.(3) For the purposes of this Act, “counsel” includes procure, solicit or incite.

Is income tax evasion fraud?
[86] The first question that arises is whether income tax evasion is equivalent to fraud.
[87] I have already set out the elements of the offence of tax evasion when dealing with the tax evasion charges. The indictable offence of fraud is set out in s. 380 of the Criminal Code:
380. (1) Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service,
(a) is guilty of an indictable offence and liable to a term of imprisonment not exceeding fourteen years, where the subject-matter of the offence is a testamentary instrument or the value of the subject-matter of the offence exceeds five thousand dollars; …
[88] The elements of fraud were set out in R. v. Théroux, 1993 CanLII 134 (SCC), [1993] 2 S.C.R. 5, by McLachlin J. (as she then was) at p. 20:
These doctrinal observations suggest that the actus reus of the offence of fraud will be established by proof of:
the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk.
Correspondingly, the mens rea of fraud is established by proof of:
subjective knowledge of the prohibited act; and
subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim's pecuniary interests are put at risk).
[89] In an extradition application, Watt J. concluded that if the elements of tax evasion have been made out, then the elements of fraud are also satisfied. He said, at para. 172:
The submission of a tax return that is false in a material particular, the amount of income received, is an act of deceit and a falsehood. At the very least, the pecuniary interests of the tax collector are put at risk by the falsehood and deceit of the taxpayer. The taxpayer who knows of this prohibited conduct and that it will put the economic interests of the collector at risk has the mens rea of fraud.
Germany (Federal Republic) v. Schreiber, 184 C.C.C. (3d) 367 (Ont. S.C.J.). [90] The Ontario Court of Appeal agreed. Sharpe J.A. said:
The extradition judge further found that the evidence of fraud, deception and falsification was sufficient to support domestic committal not only on the offence of income tax evasion contrary to s. 239(1)(d) of the Income Tax Act but also on the offences of making false or deceptive statements in an income tax return contrary to s. 239(1)(a) of the Income Tax Act, defrauding the government of income tax revenues contrary to s. 380(1)(a) of the Criminal Code, and uttering a forged document contrary to s. 368(1)(b) of the Criminal Code. It has been held that the offence of income tax evasion may also constitute fraud contrary to the Criminal Code: see R. v. Cancor Software Corp. et al. reflex, (1990), 58 C.C.C. (3d) 53 (Ont. C.A.)...
Germany (Federal Republic) v. Schreiber, 264 D.L.R. (4th) 211 at para. 57.
[91] It is open to the Crown to charge an accused under the Income Tax Act or the Criminal

Digitized by Google

Code. In R. v. White, 32 O.R. (3d) 722 (C.A.), the Court of Appeal dismissed appeals against the appellants' convictions for defrauding the public of income tax owing to Revenue Canada by making false claims on their tax returns. Dismissing the appellants' argument that the Crown's decision to substitute charges of fraud under the Criminal Code for charges of tax evasion under the Income Tax Act was an abuse of process, the Court said at pp. 753-754:

In R. v. Cancor Software Corp. reflex, (1990), 40 O.A.C. 122, also a case in which the accused defrauded Revenue Canada using the SRTC program, this court approved adding Criminal Code fraud and forgery charges to income tax evasion charges at the end of the preliminary inquiry, 19 months after the original tax charges were laid, in order to expose the accused to more severe penalties if convicted.

Like the accused in Cancor, White faced a more serious sentence under the Criminal Code than under the Income Tax Act. But as McKinlay J.A. observed in Cancor at p. 128:

The major complaints of the appellants are the more severe penalties possible on conviction on the Criminal Code charges, and their contention that the Crown pursued the Criminal Code charges for an improper purpose, i.e., to make an example of the accused. If it was otherwise proper to commit the accused on the Criminal charges, the nature of the penalty is surely not a complaint available to them - although the laying only of charges with possibly inadequate penalties, given the nature of the Crown's allegations against the accused, might raise public criticism against the Crown.

In short, the Crown's exercise of its prosecutorial discretion in substituting fraud charges did not amount to an abuse of process.

The conduct and mental elements of counselling

[92] The Supreme Court of Canada most recently dealt with counselling in R. v. Hamilton, 2005 SCC 47 (CanLII), 2005 SCC 47. The accused in that case offered software for sale on the internet, the purpose of which was to generate credit card numbers. The trial judge concluded that Mr. Hamilton committed the act of counselling, but acquitted him on the basis that he did not have the requisite intent. Although only the ruling on intent was appealed, the Court did address what conduct must be proved for counselling. As in the present case, the Crown did not adduce evidence that someone committed a crime as a result of the counselling.

[93] At para. 29, Fish J. summarised the actus reus and mens rea components of counselling:

In short, the actus reus for counselling is the deliberate encouragement or active inducement of the commission of a criminal offence. And the mens rea consists in nothing less than an accompanying intent or conscious disregard of the substantial and unjustified risk inherent in the counselling: that is, it must be shown that the accused either intended that the offence counselled be committed, or knowingly counselled the commission of the offence while aware of the unjustified risk that the offence counselled was in fact likely to be committed as a result of the accused's conduct.

[Emphasis in original]

[94] Earlier in his judgment, at para. 22, Fish J. provided further guidance as to the act of counselling:

In their relevant senses, the Canadian Oxford Dictionary (2nd ed. 2004) defines "counsel" as "advise" or "recommend (a course of action)"; "procure" as "bring about"; "solicit" as "ask repeatedly or earnestly for or seek or invite", or "make a request or petition to (a person)"; and "incite" as "urge". "Procure" has been held judicially to include "instigate" and "persuade": R. v. Gonzague reflex, (1983), 4 C.C.C. (3d) 505 (Ont. C.A.).

Those who encourage the commission of crimes in any of these ways are criminally responsible for their conduct by way of "secondary liability".

Digitized by Google

[95] Charron J., for the minority, addressed the conduct component of the offence, referring to the Court's earlier judgment in R. v. Sharpe, 2001 SCC 2 (CanLII), [2001] 1 S.C.R. 45. She said, at para. 74:

Hence, as held in Sharpe, nothing short of active inducement or encouragement will suffice to make out the actus reus of the offence of counselling. In other words, when viewed objectively, the communication must be one that actively seeks to persuade the person counselled to commit the crime. In this way, the scope of targeted activity is not extended to the mere possibility of planting a seed in the recipient's mind; it is limited to those communications that are likely to cause that seed to sprout, creating a resolve to commit the crime. It is only then that the potential risk justifies the criminal prohibition. However, it is well established that it is not necessary that the person counselled be in fact persuaded: R. v. Walia (No. 1) (1975), 9 C.R. (3d) 293 (B.C.C.A.), at pp. 293-95; R. v. Glubisz (1979), 47 C.C.C. (2d) 232 (B.C.C.A.), at pp. 235 and 241-42; R. v. Gonzague reflex, (1983), 4 C.C.C. (3d) 505 (Ont. C.A.), at pp. 508-9. The focus on a prosecution for counselling is on the counsellor's conduct and state of mind, not that of the person counselled.

Actus reus - did Mr. Porisky counsel income tax evasion and therefore fraud?

[96] The materials seized at Mr. Porisky's home and which were entered into evidence were voluminous. They included DVDs of Mr. Porisky's lectures and written materials sold by him. I advised the parties that I would review what they drew my attention to and that I should not be expected to review every other exhibit entered into evidence. By agreement of the parties I reviewed this material on my own outside of the courtroom.

[97] Because of the volume of materials and the difficulty in knowing which students read which material, I will base my judgment on Paradigm's core work – The Canadian Illusion –which formed the basis of the courses conducted by Mr. Porisky. The complete set of these were sold to individuals. The Canadian Illusion consisted of five written volumes titled:

It's All about You
The Illusion
The Tax Game
Your Right to Contract
Freedom-Free-For-All

Each of these was accompanied by a DVD of the same title, showing Mr. Porisky delivering a seminar to a live audience. There is a substantial overlap amongst all of the written and video material.

[98] Each of the books and DVDs begin with the following disclaimer:

Disclaimer: I, Russell Anthony Porisky, present this information in my capacity as a natural person, as an exercise of my rights and freedoms. As such the information contained herein is for educational purposes only and should, in no way, be construed as either legal or financial advice. Therefore, before relying on any conclusions expressed herein or applying any of the information in your own life, I strongly recommend that in addition to thoroughly studying the information yourself you consult a competent expert on this subject matter to determine the veracity of what has been presented.

I will deal with this disclaimer when I discuss Mr. Porisky's intent, although it is also potentially relevant to the conduct component of the counselling charge.

Mr. Porisky's Evidence

[99] Mr. Porisky worked in the construction industry beginning in approximately 1982. In the early 1990s he began to study the taxation system. By 2001 he had decided to dedicate himself full time to studying and propagating his theories. He found he could not "educate every person one at a time", and that a structure was needed to "save the country from a

Digitized by Google

foreign parasite". He therefore established The Paradigm Education Group in 2000-2001.
[100] In 2002 Mr. Porisky met with a nucleus of people, some of whom later became Paradigm educators. [101] Students heard of Paradigm though its website or word of mouth. In addition, Mr. Porisky did some advertising for his seminars. If someone wanted to do more than attend a seminar, Mr. Porisky referred them to the closest educator. If the student wished, he or she would meet with the educator, discuss the Paradigm view, buy materials and perhaps sign an agreement with the educator to engage in further study and obtain Paradigm support to "restructure" their affairs.
[102] Eventually Mr. Porisky set up a structure to the Paradigm courses. First, a student would take the Paradigm Introductory Course, which involved taking initial tests, purchasing printed materials and DVDs, and participating in study groups or pursuing home study.
[103] Next, a student could take the Intermediate Course, for which there was a manual and a DVD. The manual contained questions that the student was expected to answer. Educators used teacher's manuals supplied by Mr. Porisky that contained the answers to the questions in the student manual to both mark the students' answers and guide the students.
[104] Students took an Intermediate Exam. This was designed so that students had to take the "data" they had learned and write longer paragraph or essay-length answers. Mr. Porisky stated that this was intended to introduce them to the advanced materials.
[105] After passing the Intermediate Course, students wishing to take the Advanced Course bought the five- volume Canadian Illusion set and the corresponding five-DVD set.
[106] After completing The Canadian Illusion, a student became an alumni student. Alumni could apply to become an educator, although for a period of time Mr. Porisky imposed a "moratorium" on new educators as he had discovered that some educators were attempting to pass off Paradigm material as their own or were trying to sell their own material using the Paradigm name. These educators were either "terminated" by Mr. Porisky or agreed to stop their offending practices.
[107] In cross-examination, Mr. Porisky was asked what would happen if a student or educator reviewed the materials and came to the conclusion that they had to pay their taxes. He responded that this had never happened.
[108] Crown counsel showed Mr. Porisky a hand drawn diagram (Binder 13, Tab 2, pg 2). He agreed he had drawn this as an example of the Paradigm view. The diagram showed an "AP" ("artificial person") on the upper left side and the steps that Mr. Porisky and Paradigm recommended a person should take to restructure their affairs (quit their job and be re-hired using a Paradigm Contract for Hire) so that they became a "NP" ("natural person") who did not have to pay income tax.
[109] The Paradigm materials contained precedents of Contracts of Hire for someone as a "natural person". Mr. Porisky stated that Paradigm did not draft the contract for the students; rather, the students were to educate themselves to the point where they could do it on their own.

The Canadian Illusion books and DVDs
[110] In the Appendix to this judgment, I set out extensive quotes from The Canadian Illusion books along with two examples of PowerPoint slides used by Mr. Porisky in his lectures captured on DVD.
[111] By way of broad summary, these materials make the following points:
Payment of tax is voluntary, because if one arranges one's affairs as a natural person, no tax is payable;
The tax and benefit systems are illusions;

Digitized by Google

A contract should be drawn up to document that one is earning money in the capacity of a natural person;
The underground economy is not illegal;
Bureaucrats working for the CRA are deceiving the public into believing that benefit programmes are mandatory;
It is unlikely that someone following the Paradigm recommendations will be prosecuted for tax evasion;
In any event, a conviction for tax evasion is unlikely because the required mens rea will not be found;
Payment of tax is tantamount to slavery or serfdom;
The taxation system is contrary to the Bill of Rights;
Why would anyone want to pay taxes when they have the option not do so?;
Paradigm offers education and services to further enable people to avoid taxes though structuring their affairs as"natural persons";
"quit working for the taxpayer" (from "The TaxGame" DVD).

Analysis re: the conduct of counselling
[112] The Canadian Illusionsets out a legal view that I, and other courts, have concluded is incorrect. That does not in itself amount to counselling fraud. It further sets out a political view about the income tax system. That is something that anyone is at liberty to advocate, and is, of course, protected by the Canadian Charter of Rights and Freedoms, Part 1 of the Constitution Act, 1982, beingSchedule B to the Canada Act, 1982 (U.K.), 1982, c. 11. Mr. Porisky's political views are not on trial. There must, as described by Fish J. in Hamilton, be an encouragement to commit the offence. As noted in Sharpe (a case which dealt with the constitutionality of the offence of possession of material that counsels sexual activity with persons under 18) at para. 56:
The mere description of the criminal act is not caught. Rather, the prohibition is against material that, viewed objectively, sends the message that sex with children can and should be pursued.
[113] To paraphrase the test in Sharpe, does The Canadian Illusion send the message that the Paradigm view should be followed, or does it merely state a valueless legal opinion or a legitimate political viewpoint? I think it is the former: it exhortsand goads people to free themselves from the shackles of "serfdom" and"slavery" supposedly imposed by the income tax system. It instructspeople to do this by exercising the "forgotten option" of structuring their arrangements as so-called natural persons and thereby consider their income as nil. Those who do not do this have chosen the "Common Option for the Disadvantaged". Paradigm and Mr. Porisky offer further education, mentoring and counselling to achieve this result. The Canadian Illusion does not urge people to act by lobbying for a change in the taxsystem; rather, it encourages them to illegally avoid the system altogether. The audience in "The Tax Game" DVD is urged to "quit working for the taxpayer" – namely, in their capacity as a natural person, to not pay taxes.
[114] In Hamilton, the accused was found guilty of counselling for offering, in a "teaser" e-mail, the sale of software that could fraudulently generate credit card numbers. The e-mail contained statements such as: IMAGINE THE THINGS THAT YOU COULD DO WITH THIS PROGRAM, AND THE VALID CREDIT CARD NUMBERS IT GENERATES!!
As characterised by Fish J., at para. 1, this and similar statements "extolled"the software's use for fraudulent purposes. The Canadian Illusion goes as far as this does and at greater length and depth. Anyone reading the materials or attending the lectures would take it that they were being urged to declare themselves as "natural persons"and treat their income as nil.

Digitized by Google

[115] Looking at the materials as an objective observer, I am not left with any reasonable doubt that The Canadian Illusion and, therefore, Mr. Porisky encouraged the fraud of incometax avoidance.

Intent

[116] It is clear to me that Mr. Porisky fully intended that Paradigm students follow his teachings by arranging their affairs as natural persons and avoid paying income tax. Given the offering of Paradigm's consulting and mentoring services it would be impossible to conclude otherwise.

[117] The books and DVDs began with the disclaimer that I set out above at para. 98. I do not think this detracts from my conclusions on either the conduct or the intent components, because it is lost in a sea of material that is presented with 100% certainty.

[118] Further, the disclaimer was qualified in a later publication. I referred above to R. v. Sydel, a decision of Judge Meyers of the Provincial Court. Dr. Sydel was a Paradigm student. In his evidence, Mr. Porisky said that he prepared Dr. Sydel's legal argument. Dr. Sydel was convicted of income taxevasion and Mr. Porisky prepared a detailed "analysis" of the judgment in which he referred to the disclaimer which had been mentioned in the judgment. It stated, at p. 33:

Apparently, Judge Meyers has made a few assumptions of his own in regards to the intended meaning of the words I deliberately chose to use in the disclaimer that appeared at the bringing [sic] of each of the five videos of the original version of the "Canadian Rights and Freedom Foundation" course, which is now more commonly known as the "Intermediate"course since the release of the second edition.

Although Judge Meyers is correct in stating I provided the following caution, "In no way should this be construed as either legal or financial advice. You should consult a competent expert", his assumption that my deliberate use of the words "competent expert" included, or was even limited to, professionally trained tax lawyers or tax accountants is simply that, an assumption, or more appropriately, a false assumption.

Mr. Porisky then set out some dictionary definitions and continued:

… unless someone, be it a tax professional or not, was willing to spend the time to study the theory presented throughout Paradigm's educational material enough to be adequately capableof either confirming the theory with additional insight or disproving the theory with a parallel theory of their own, or someone, especially a taxprofessional, who was not even willing to even consider the theory in its entirety, would not qualify as a "competent expert" in regards to consulting on the subject matter for which these words were deliberately used.

…

The main reason being is because I personally believe, and as time has shown, that regardless of whether the issue at hand relates to the topic of income taxes or not, when someone spends the time to fully understand who they really are, and how that relates to this legal system and to their private life as a whole, they will undoubtedly realize that the only one they can truly rely on as a "competent expert" is their self. After all, isn't that why we've been given the ability to think?

[119] This conveys the message that if someone gets a legal or accounting opinion that contradicts the Paradigm view, then the opinion is worthless.

[120] I also agree with the following comment of Judge Kovatch in Amell, at para. 176:

It is interesting to note that in the materials, Mr. Porisky has a disclaimer that he is not a lawyer or an accountant, and that an individual should seek expert advice. It seems to me however, that these individuals are attempting to have matters both ways. By advancing this disclaimer, they are clearly attempting to avoid being held liable or accountable for the advice they are providing. However, if they are not to be held liable or accountable for such

Digitized by Google

advice, then why are they selling it? Why did these three accused pay Mr. Lewry [the Paradigm educator] $15,499.85 to act as a consultant and provide advice? Why did the accused pay Mr. Porisky to prepare contracts for hire that were utilized and relied upon in this case? These individuals were clearly selling their advice as professional advice. I have already commented on how bad and ridiculous that advice was. …

The judge's comment on the advice, at para. 169, was:

The Paradigm materials and the teachings of Mr. Porisky have no credibility. In my view, they are nothing more than the proverbial "snake oil salesmen".

[121] It is significant to both the conduct and intent components, that, as acknowledged by Mr. Porisky in his evidence, he did not change his teaching or materials after Dr. Sydel's conviction. In fact, to the contrary, the analysis he prepared essentially disagreed with the judgment, misinterpreted it, and found ambiguity where none existed. As the following passages from the conclusion indicate, the analysis was a further exhortation for people to follow the Paradigm view:

My Conclusion

So where does this leave us? I guess we now have to make a choice. Do we accept his Reasons for Judgment at face value, albeit grossly ambiguous, merely because it came from a Judge and therefore must be true, as our social programming has taught us?

Or do we accept the possible reality that when it comes to dealing with such a socially sensitive subject as income taxat the lowest level of court in this country, we shouldn't have expected any other conclusion than the one that has presented itself?

…

Or, were there enough questionable ambiguities to consider the fact that maybe we are free, living in an Illusion of slavery, and his Reasons for Judgment, as many suggest, is just another desperately needed bowl of propaganda pabulum for public consumption, to keep the masses asleep and enslaved to the belief that what ever they earn in their natural capacity for their own benefit, the government has a higher inalienable right to take what ever portion they feel is appropriate at the time?

Ultimately, this question is one each we each are going to have to answer for ourselves, and we have a choice. We can take the easy road, and remain blanketed in programmed fear waiting for headlines from mainstream media or the bottom-line of ambiguous court cases to tell us how and what to think.

Or we can think for ourselves and release this programmed fear …

[122] Neither side put motive in issue. In Hamilton, Fish J. found that the trial judge erred in confounding motive with intent. He quoted the following passage from United States of America v. Dynar, 1997 CanLII 359 (SCC), [1997] 2 S.C.R. 462, at para. 43:

It does not matter to society, in its efforts to secure social peace and order, what an accused's motive was, but only what the accused intended to do. It is no consolation to one whose car has been stolen that the thief stole the car intending to sell it to purchase food for a food bank".

Two paragraphs later Fish J. continued:

The trial judge's conclusion that Mr. Hamilton did not intend to induce the recipients to use those numbers is incompatible with the plain meaning of the "teaser" e-mail and with her other findings of fact, including her finding that Mr. Hamilton well understood that use of the generated numbers was illegal. Her assertion that "[h]is motivation was monetary" immediately after her reference to these facts demonstrates an error of law as to the mens rea for counselling the commission of a crime, and warrants a new trial.

[123] However, in a recent decision on counselling to commit murder (by way of publishing posters), the Ontario Court of Appeal said that the trial judge incorrectly determined that motive was irrelevant. The Court said, at para. 35:

Digitized by Google

However, as evidence motive is always relevant to the issue of intention and this case is no different: see Lewis v. The Queen, 1979 CanLII 19 (SCC), [1979] 2 S.C.R. 821. The existence of a motive makes it more likely that a person committed the crime. Persons do not usually act without a motive. Mr. Jeffers had no motive to want Councillor Thompson murdered. The councillor had helped him in the past and had never done him any harm. Mr. Jeffers lack of motive to want Councillor Thompson killed is a strong piece of circumstantial evidence that he never intended to encourage his murder.
R. v. Jeffers, 2012 ONCA 1 (CanLII), 2012 ONCA 1.
[124] Given the clarity of the written materials in this case and my findings of fact, I do not think motive is relevant. However, for the sake of completeness, Mr. Porisky made it clear that one of his motives for encouraging and teaching people to not comply with their tax obligations was his antipathy to the tax system. A second motive was monetary.

Conclusion on counselling
[125] I find Mr. Porisky guilty of counselling as charged.

Summary
[126] On Count 1 (evasion of taxes on Mr. Porisky's income), I find Mr. Porisky guilty and Ms. Gould not guilty.
[127] On Count 2 (evasion of taxes on Ms. Gould's income), I find Ms. Gould guilty and Mr. Porisky not guilty. [128] On Count 3, evasion of GST, I find Mr. Porisky guilty and Ms. Gould not guilty.
[129] On Count 4, counselling, I find Mr. Porisky guilty. Ms. Gould was not charged with that offence.
[130] I have not dealt with the allocation of income between Ms. Gould and Mr. Porisky. I will deal with that at the sentencing stage after hearing submissions on it.
E.M. MYERS, J.

Net Worth Evidenced Evasion

Net worth assessments leading to evasion cases are difficult to prove due to the jurisprudence on the ability of the taxpayer to provide alternative answers to increases in wealth that are not derived from hidden income.

In R. v. Derose[122] the Trial Court held concerning net worth assessment based s. 239(1) prosecutions that:

Net Worth Assessments
[112] In simple terms a net worth assessment for unreported income tax is an indirect method whereby the unreported taxable income is identified. For each taxation year the net assets and expenditures of an individual are determined. The net assets are calculated by determining the value of an asset and subtracting any liability to determine that income, e.g. a loan or mortgage. Once the net assets and expenditures are determined for any taxation year certain types of deductions must be made so that items not subject to taxation are removed. The first is the net assets on hand at the beginning of the period. The second are gains not subject to taxation. Assets that gain in value for market reasons such as stocks or residences are not subject to income consideration until sold. A gain in the value of a principal residence is not subject to taxation. A gain in the value of a rental property or certain stock is subject to capital gains. The third type of deduction is income not subject to taxation. These would include G.S.T. rebates, gifts and lottery winnings. The fourth type of deduction are those resulting from the conversion of the

[122] 2001 ABPC 146

Digitized by Google

opening assets to other assets. An example is a loan repayment. An unpaid loan is an asset. When it is paid the loan has simply changed form. It is also important to remember that loans in the hands of the borrower are not taxable income. Finally, the income tax reported by the taxpayer must be deducted. Once all of the deductions are made then the income subject to prosecution can be calculated.

Use of Net Worth Assessments in Income Tax Prosecutions

[113] The use of net worth assessments as a basis for prosecution of income tax offences including income tax evasion has been judicially recognized in both Canada and the United States: *Holland v. United States* (1954) 348 U.S. 121 (U.S. Sup. Ct.); *R. v. Lowe* (1976), 26 C.C.C. (2d) 346 (Ont. Prov. Ct.); *R. v. Nicholson*
(1975) 75 D.T.C. 5095; *R. v. McCallum* (unreported) April 1983 (N.S. Prov. Ct.); *R. v. Adams* (1992) B.C.J. No. 2553; *R. v. Ross* (1997) N.S.J. No. 370 (N.S. Prov. Ct.).

[114] The leading case in the United States is *Holland v. United States, supra*. Clarke J. noted that although net worth assessments could be used for income tax purposes the limitations of the methodology must be carefully considered so as to maintain the onus of proof on the prosecution. Let me refer to some of the comments of Clarke J. which are applicable to the case at bar:

"¶23 In a typical net worth prosecution, the Government, having concluded that the taxpayer's records are inadequate as a basis for determining income tax liability, attempts to establish an "opening net worth" or total net value of the taxpayer's assets at the beginning of a given year. It then proves increases in the taxpayer's net worth for each succeeding year during the period under examination and calculates the difference between the adjusted net values of the taxpayer's assets at the beginning and end of each of the years involved. The taxpayer's nondeductible expenditures, including living expenses, are added to these increases, and if the resulting figure for any year is substantially greater than the taxable income reported by the taxpayer for that year, the Government claims the excess represents unreported taxable income. In addition, it asks the jury to infer willfulness from this understatement, when taken in connection with direct evidence of "conduct, the likely effect of which would be to mislead or to conceal." ...

¶24 Before proceeding with a discussion of these cases, we believe it important to outline the general problems implicit in this type of litigation. In this consideration we assume, as we must in view of its widespread use, that the Government deems the net worth method useful in the enforcement of the criminal sanctions of our income tax laws. Nevertheless, careful study indicates that it is so fraught with danger for the innocent that the courts must closely scrutinize its use.

¶25 One basic assumption in establishing guilt by this method is that most assets derive from a taxable source, and that when this is not true the taxpayer is in a position to explain the discrepancy. The application of such an assumption raises serious legal problems in the administration of the criminal law. Unlike civil actions for the recovery of deficiencies, where the determinations of the Commissioner have prima facie validity, the prosecution must always prove the criminal charge beyond a reasonable doubt. This has led many of our courts to be disturbed by the use of the net worth method, particularly in its scope and the latitude which it allows prosecutors...

…

¶34 While we cannot say that these pitfalls inherent in the net worth method foreclose its use, they do require the exercise of great care and restraint. The complexity of the problem is such that it cannot be met merely by the application of general rules... Trial courts should approach these cases in the full realization that the taxpayer may be ensnared in a system which, though difficult for the prosecution to utilize, is equally hard for

Digitized by Google

the defendant to refute. Charges should be especially clear, including, in addition to the formal instructions, a summary of the nature of the net worth method, the assumptions on which it rests, and the inferences available both for and against the accused. Appellate courts should review the cases, bearing constantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation...

…

¶40 Establishing a Definite Opening Net Worth.

¶41 We agree with petitioners that an essential condition in cases of this type is the establishment, with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets. The importance of accuracy in this figure is immediately apparent, as the correctness of the result depends entirely upon the inclusion in this sum of all assets on hand at the outset...

…

¶43 The Government's Investigation of Leads.

¶44 ...When the Government fails to show an investigation into the validity of such leads, the trial judge may consider them as true and the Government's case insufficient to go to the jury. This should aid in forestalling unjust prosecutions, and have the practical advantage of eliminating the dilemma, especially serious in this type of case, of the accused's being forced by the risk of an adverse verdict to come forward to substantiate leads which he had previously furnished the Government. It is a procedure entirely consistent with the position long espoused by the Government, that its duty is not to convict but to see that justice is done...

…

¶46 Net Worth Increases Must be Attributable to Taxable Income.

…

¶49 ...Increases in net worth, standing alone, cannot be assumed to be attributable to currently taxable income. But proof of a likely source, from which the jury could reasonably find that the net worth increases sprang, is sufficient. ...here the disclosed business of the petitioners was proven to be capable of producing much more income than was reported and in a quantity sufficient to account for the net worth increases."

[115] In *R. v. Ross, supra* Stroud P.C.J. adopted many of the passages as authoritative.

[116] Subsequently, the United States Supreme Court in *United States v. Massei* [1958] 355 U.S. 595 (U.S. Sup. Ct.) clarified that a likely source of income need not be proven in all cases as they had said in *Holland v. United States*:

"¶1 In a tax-evasion prosecution based on the net-worth method of proof sustained in Holland v. United States, 348 U.S. 121, proof of a likely source of the defendant's net-worth increases is not essential if all possible sources of nontaxable income are negatived by the evidence.

¶2 The Court of Appeals has based its remand in part on the absence of "proof of likely source," which it regards as an "indispensable" element of the net worth method, citing Holland v. United States, 348 U.S. 121, in support of its conclusion. In Holland we held that proof of a likely source was "sufficient" to convict in a net worth case where the Government did not negative all the possible nontaxable sources of the alleged net worth increase. This was not intended to imply that proof of a likely source was necessary in every case. On the contrary, should all possible sources of nontaxable income be negatived, there would be no necessity for proof of a likely source. The above explanation must be taken into consideration in applying the Holland doctrine to this case. A new trial being permissible under the terms of the order of the Court of Appeals, we affirm its judgment."

Digitized by Google

[117] Therefore, I am mindful of the dangers inherent in net worth assessments. Ms. Bottcher acting for the Crown has submitted that net worth assessments are a last resort for tax officials. That may be so; however, in using the net worth methodology the court must be careful not to ignore the dangers of that methodology thereby placing the onus upon the taxpayer to prove his or her innocence. The evidence must be of sufficient cogency to prove beyond a reasonable doubt that the excess money attributed to the taxpayer is accurate. I realize that the Crown need not prove a likely source for that income beyond a reasonable doubt. However, the Crown must negative all possible nontaxable sources beyond a reasonable doubt.

…

Findings

[154] The standards applicable to the prosecution of these offences is the ordinary criminal standard. That is, the Crown must prove each element of the offences charged beyond a reasonable doubt. The standard is inextricably intertwined with the presumption of innocence. The burden of proof in criminal prosecutions rests upon the prosecution; it never shifts to the defence. A conclusion that the taxpayers are probably guilty or a civil standard of proof to the balance of probabilities would not be sufficient: *R. v. Lifchus*, [1997] 3 S.C.R. 320 (S.C.C.) at p. 335.

[155] Where the evidence of the prosecution is insufficient to prove the case beyond a reasonable doubt the accused taxpayers must be acquitted.

[156] This standard of proof is applicable to each and every element of the offences the taxpayers face.

[157] To prove the offence contrary to s. 239((1)(a) of the *Income Tax Act*, the Crown is required to prove that the taxpayers "made, acquiesced, participated in, assented to, or acquiesced in the making of a false statement or deceptive statement in an income tax return for the years specified. Also, the Crown would have to prove that they did these acts deliberately or with wilful blindness. [158] The elements of the offence of s. 239(1)(d) of the *Income Tax Act* the Crown would need to prove that the taxpayers failed to report income in their income tax returns for the years specified in the information and they did so to wilfully evade or in an attempt to wilfully evade the payment of taxes. Wilful evasion can be proven by the Crown showing that the taxpayers did this deliberately with intent to avoid taxes or the taxpayers were wilfully blind as to supplying that information in their tax returns.

[159] The Crown's evidence to prove these allegations is circumstantial. It is based upon a net worth as an indirect method of proof. The classic formula applicable to circumstantial evidence was from Hodge's case that the evidence needs to prove the accused's guilt and be inconsistent with any other rational conclusion: *R. v. Comba* [1938] S.C.R. 396 (S.C.C.); *R. v. McIver* (1965), 4 C.C.C. 182 (Ont. C.A.). However, in 1977 the Supreme Court held that the rule in Hodge's case was not a necessary jury instruction: *R. v. Cooper* (1977), 34 C.C.C. (2d) 18 (S.C.C.). In reality the rule in Hodge's case is simply another manner of expressing the need to prove the Crown's case beyond a reasonable doubt**. In a circumstantial case the evidence is to be examined in its totality and not in a piecemeal fashion. The inferences to be drawn are from proven facts. An inference is a deduction that may be reasonably drawn from a fact or group of facts established in a proceeding. The trier of fact must be careful to separate permissible inference from impermissible speculation.**

[160] Here, Revenue Canada began with a theory that Sam and Maria Derose were living a lifestyle incompatible with their reported income. Mr. Niven did some preliminary inquiries and decided that their lifestyle ought to be examined in detail and sought an audit. Mr. Tees was given carriage of the audit and did some preliminary investigation that led to his belief that the suspicions of Mr. Niven were warranted. He sought answers to his

Digitized by Google

inquiries. In the words of Mr. Fazackerley, the accountant to whom he was referred by the taxpayers, he had thousands of questions. Eventually, Mr. Tees obtained bank documents which still did not explain the discrepancies between the taxpayers' lifestyle and their reported income. **He did an initial net worth assessment that led him to believe that the taxpayers in which he attributed hundreds of thousands of dollars of income had not been reported in their income tax returns. Pursuant to policy he referred the matter to Special Investigations and Ms. Prudhomme for investigation for tax evasion. Ms. Prudhomme reviewed Mr. Tees' work and believed an investigation was warranted. After a lengthy audit and even lengthier investigation, both the auditor, Mr. Cameron Tees, and Ms. Prudhomme concluded that the sole source of the income attributed to the taxpayers in their net worth assessments was the cash businesses operated by them in the tax years in question. The sole source then would have been the Pasta Deli operation at West Edmonton Mall for Sam and Maria Derose. The sources of the income attributed to Antonio Derose were from his management of a Fila outlet at West Edmonton Mall, and his Pasta Deli business at Kingsway Garden Mall.** Much of the Crown case was led to prove that theory. Proof of the theory is based upon certain observations made by Ms. Prudhomme and Revenue Canada in 1997 and 1998. The net worth assessment attributed hundred of thousands of dollars of undeclared income to the Derose family members.

[161] I have no doubt of the sincerity of the belief of Ms. Prudhomme and her colleagues in the discrepancy between the lifestyle of the taxpayers and their declared income. Nor do I have any doubt that they believe that the income was from only one source, the cash businesses operated by the Derose family members. Certainly considerable time and effort was expended by Revenue Canada auditors and investigators here. In the same vein, a great deal of effort was expended by the Crown in marshalling the evidence and providing written material. **While one may admire these efforts, the issue to be determined is whether the Crown has proven the elements of the offence beyond a reasonable doubt.**

[162] However, the theory has not been proven beyond a reasonable doubt. I have set out those reasons in great detail earlier in this judgment.

[163] Ms. Bottcher properly submitted that the failure to prove a likely source of the income attributed to a taxpayer is not fatal. This had been thought to have been the effect of the United States Supreme Court decision in *Holland v. the United States, supra. Massei v. the United States, supra* clarified that if all possible sources of nontaxable income are negatived there is no necessity for proof of a likely source.

[164] When the Crown relies upon a net worth assessment the trier of fact must realize that there any many pitfalls involved in the use of the net worth assessment. The calculations which attribute income must be carefully assessed. Net worth assessments are both difficult for the prosecution to utilize and the taxpayer to refute. The difficulties of its utility for the prosecution cannot relieve the prosecution of the fundamental requirement of proving a charge beyond a reasonable doubt.

[165] The determination whether the Crown has met its burden to negative all sources of nontaxable income and has proven its case beyond a reasonable doubt are factual matters to be determined in the circumstances of the individual case.

[166] I have examined the evidence in its totality to determine if the Crown has led the proof to find the taxpayers guilty of any of the offences.

[167] The proof of the guilt of the taxpayers is dependent upon the reliability of their net worth assessments. [168] The defence takes issue with the joint net worth assessments set out in exhibits 346B (Sam and Maria Derose) and exhibit 450 (Antonio and Kerry Derose). The issues relate to the opening net worth attributed to those families on December 31, 1992

Digitized by Google

and the particulars of the monies acquired in the income tax years attributed by the increase in the value of net assets. I have outlined these at some length in my judgment to this point.

[169] When the evidence is considered in its totality, a reasonable doubt exists that the Crown has negatived all nontaxable sources of income available to Sam and Maria Derose. The failure to prove this opening net assets with reasonable certainty is fatal to the Crown case against Maria and Sam Derose. Because assets were not captured by Revenue Canada with a reasonable degree of certainty, then a doubt exists that assets of some nature were available for the Deroses to use in subsequent years. The conversion of these assets would not give rise necessarily to taxable income in those subsequent years.

[170] Moreover, the method of calculating the personal expenditures and assets obtained by income of Maria and Sam Derose is also suspect. The calculations of the cost to build the house at Wilson lane are especially troublesome. The amount for that construction has not been proven with any degree of certainly. The expenditures for real estate have not been properly removed from the personal expenditures so that there is a reasonable doubt that there has been double counting. Loan payments may have been made by Antonio Derose by his father and this attributed to Maria and Sam Derose as income. At the end of day, I cannot be certain that any of the calculations made in the net worth assessment of Sam and Maria Derose are reliable so that they represent proof beyond a reasonable doubt. On all of the evidence it is my view that the Crown has failed to prove Maria and Sam Derose guilty of the offences.

[171] The methodology of Revenue Canada in relation to Antonio Derose also leaves me with a reasonable doubt that the income attributed to him in exhibit 450 are accurate. I have outlined the difficulties in some length above.

[172] At the end of the day I am left in a state whereby I am left with some suspicion that the Deroses might have been living above their means. A suspicion of this nature does not amount to proof beyond a reasonable doubt.

This method of proving s. 239(1) offences was commented on in R. v. Zuk[123] where the taxpayer was again charged under s. 239(1)(a) and (d) and the Trial Ct. held:

In this case, the Crown has attempted to prove the offences by means of a net worth assessment. The United States Supreme Court in *Holland v. United States [1954] 348 U.S. 121 (l954)*, and again in *United States v Massei [1958] 355 U.S. 595,* has set out the basic principles applicable to net worth assessments in tax evasion cases. These principles can be summarized as follows:

Increases in net worth, standing alone, cannot be assumed to be attributable to taxable income. But proof of a likely source, from which the jury could reasonably find that the net worth springs, is sufficient.

The government may not disregard explanations of the defendant reasonably susceptible of being checked, but where relevant leads are not forthcoming, the government is not required to negate every possible source of nontaxable income, a matter peculiarly within the knowledge of the defendant.

Proof of a likely source of the net worth increases is not essential if the evidence negates all possible sources of non-taxable income.

These principles have been adopted in Canada, in *R. v. Derose [2001] A.J. No. 1117 (Allen Prov. J),* and *R. v. Akl [1991] O.J. No. 3524 (Belanger Prov. J.)* The use of net worth assessments has also been approved as an accepted method for supporting income tax prosecutions in other cases including: *R. v. Ross [1998] N.S.J. No. 62 (N.S.S.C.)* and *R. v*

[123] 2005 ONCJ 428

Digitized by Google

Lowe (1975) 26 C.C.C. (2d) 345 (Ont. Prov. Ct.)

...

The allegations against Mr. Zuk are derived from a net worth assessment of Mr. Zuk's assets and liabilities from December 31, l996 to December 31, l997 performed by Revenue Canada investigator Peter Zisis. A net worth assessment is an indirect method to estimate the net income an individual should have declared on their income tax based on a review of their financial circumstances during a particular point in time. There is no dispute that the correct net worth methodology is as described by forensic accountant Bruce Webster, the defence expert, as follows: 1) Estimate the individual's net worth at the beginning of the period (ensuring that all assets and liabilities are included); 2) Estimate the individual's net worth at the end of the period; 3) Calculate the change in net worth during the period by subtracting the net worth at the start of the period from the net worth at the end of the period; 4) Add any expenses not deductible for income tax purposes (eg. personal living expenses) to the change in net worth during the period; 5) Subtract any amounts received during the period that are from non-taxable sources (eg. gifts, loans, inheritance); and 6) Review whether the increase in the individual's net worth during the period is consistent with the level of income reported on their income tax return for the same period.

…

b) Onus on the Crown

In civil tax matters, if Revenue Canada does an audit and a reassessment, the onus shifts to the taxpayer to disprove the government's conclusions about the amount of tax owing. The self-reporting system that is the basis of the income tax scheme imposes a duty on the taxpayer to keep records to substantiate claims. There is an obligation on the taxpayer to come forward with documentation to rebut any government reassessment. Mr. Frost submitted that, in this case, there was little if any evidence of the type of "cogent leads furnished by the taxpayer," that would impose upon Revenue Canada the duty to investigate. In his view, suggestions made to witnesses during the course of the trial would not meet the standard set by the United States jurisprudence. He relied on *U.S. v. Potts (1971) 321 F. Supp 717 (Wisconsin Dist Ct.),* and *U.S. v. Mackey (l965) 345 F. 2d 499 (U.S.C.A. 7th Cir.).* In the former case, the only issue was that the opening net worth failed to include the value of a cheese inventory stored elsewhere because the prosecution failed to check the "lead." The court found, however, that the "leads" were "remote, vague and indefinite" and that the defendant had not introduced sufficient evidence to refute the government's opening net worth. In *Mackey*, the court held that whether the defendant had substantial sums of cash at the starting point is a matter within his knowledge and, where the government conducts a thorough investigation and fails to uncover evidence of cash on hand, the burden is on the defendant to come forward with evidence of cash or he remains quiet at his peril. The court went on to say that the government is required to investigate and negate "reasonable explanations by the taxpayer inconsistent with guilt" but where the defendant did not furnish any explanation which would attribute his increased net worth to other than taxable income, the defendant has a right to remain silent but he did so "at his peril." Mr. Frost provided no Canadian jurisprudence that takes the position adopted by the American courts above. He did rely on *R. v. McIver (1965), 4 C.C.C. 182 (Ont. C.A.), aff'd (1966), 2. C.C.C. 289 (S.C.C.)* that in a case founded in whole or in part upon circumstantial evidence the Crown is not required to negative suggestions or hypotheses of innocence which are not founded on proven facts. In his view, the "leads" upon which Mr. Murphy relied were not "evidence" upon which the court could make the finding that Mr. Zuk received income from non-taxable sources. He further submitted that where there is no evidence

Digitized by Google

that the accused received any non-taxable income during the relevant period of time, the Crown need not negative any or all speculations and conjectures that some of the unreported income as disclosed by the net worth analysis was from a non- taxable source.

In my view, however, there is a distinction to be made between a careless driving case (as in *McIver)* and the case before this court. In *McIver*, the appeal court upheld the conviction where there was evidence upon which the inference could be drawn that the accused was driving carelessly, and no explanation for the accident. In a tax evasion case where the Crown seeks a conviction based on the circumstantial evidence of a net worth assessment, the Crown bears the special burden set out in *Holland* and *Massei supra*, including the burden to investigate "any explanations reasonably susceptible of being checked…." Where the Crown puts into evidence documents that raise questions on their face and where there are means available for further investigation, the Crown cannot assume that the income is taxable and expect that to be sufficient for proof beyond a reasonable doubt.

This is particularly true when the defence calls an expert forensic accountant who testified that the net worth analysis done by Revenue Canada was incomplete, and that neither he nor the Crown could determine if particular transactions into the accounts are from a taxable or nontaxable source. In *Mackey,* there was an expert witness for the government and the court found that "such evidence and explanatory testimony is admissible in cases of this type to aid the jury in understanding a complex fact situation." In this case, the fact situation was exceedingly complex, and the lack of an expert witness for the Crown a significant lacuna in the evidence. I agree with Allen Prov. Ct. J. in *Derose, supra, para 108-111* that

The application of net worth assessments are generally technical in nature. In many circumstances, ordinary persons would be unlikely to form a correct judgment without the assistance of persons with specialized knowledge. There may be prosecutions where ordinary persons would be likely to form a correct judgment without expert assistance; this is not such a case.

…. Where the Crown is met with expert testimony that attacks the methodology used by its witnesses in the application of a net worth assessment, it may be put to a distinct disadvantage if the expert witness is credible.

Mr. Frost also submitted that "many of the alleged leads were only capable of investigation by questioning the accused" and "a defendant who chooses to remain quiet does so at his peril." With respect, I disagree. It is a fundamental principle of Canadian criminal law and the Canadian Charter of Rights and Freedoms that the onus of proof in a criminal matter lies with the Crown. The defendant has a right to remain silent and require the Crown to prove its case beyond a reasonable doubt: *R. v. Chusid, [2002] O.J. No. 4644 para 20 (Ont. S.C.J.)*. In the civil tax context, the onus shifts to the taxpayer.

In the criminal context, the onus never shifts. The defendant has to prove nothing: *R. v. Campbell (1977) 38 C.C.C. (3d) 6 at p. 22 (Ont. C.A.); R. v. Robert [2000] O.J. No. 688 paras.14-25(Ont. C.A.).* Any evidence called by the defence need only raise a reasonable doubt, and no adverse inference can be drawn from a defendant who asserts his right to remain silent. In certain situations, there may be an evidentiary burden on the defendant to call some evidence. In this case, the forensic accountant called by Mr. Zuk met that burden. His function was not to prove that Mr. Zuk obtained the disputed transactions from a non-taxable source, but only to raise a doubt about the reliability of the assumptions underlying the Crown's net worth assessment. Requiring Mr. Zuk to provide an explanation would be to shift the onus, such that his position before the criminal court would be no different than it would be in civil tax litigation. For these reasons, I decline to follow the rather dated

Digitized by Google

jurisprudence from the United States that, in my view, may well be inconsistent with the principles of fundamental justice protected by s. 7 of our Charter.

The quality of the net worth analysis.

Revenue Canada investigator Peter Zisis prepared the net worth analysis of Robert Zuk based on original evidence obtained from all his banks, brokerage houses, government filings, and from materials seized upon execution of search warrants at his residence, business premises, and the office of his accountant. Mr. Zisis prepared thirteen binders of exhibits and the index of their contents. James Locke, the original investigator, had initiated a series of working papers that Mr. Zisis completed as schedules to his net worth analysis. Mr. Zisis reviewed all his bank accounts, brokerage accounts, real properties, credit card accounts, everything seized under the search warrants, to determine if there were any other assets and liabilities. On the basis of this material, he was satisfied that he has sufficient information to do a net worth analysis. With the significant qualification I will discuss later, I agree.

The investigation of Robert Zuk had been a spinoff of an earlier investigation initiated into the affairs of James Hunter, and the Revenue Canada decision to do a net worth analysis had been made before Mr. Zisis was assigned the file. He testified that the net worth analysis was necessary because Mr. Zuk's increase in assets was not consistent with the income reported that year, and there were too many shares coming in and out of the accounts for which there was no value assigned. As the cost base for so many of the shares was missing, he lacked the documentation necessary to compute income using the direct method. I agree.

In doing his analysis, Mr. Zisis also considered the assets and accounts of Mr. Zuk's spouse and company. As well as the banking and brokerage records, Mr. Zisis had access to her income tax returns, and to the tax returns and financial statements of his company. The total body of documentation allowed Mr. Zisis to trace the movement of stocks and funds in and out of all the accounts. There is evidence that the affairs of Mr. Zuk and his spouse were commingled, that the proceeds of her personal investment accounts were transferred to his corporation, and that payments and stocks from the corporation went to their personal accounts. Mr. Zisis indicated that each brokerage account maintained in the name of Louise Zuk (L'Abbe) was treated as a Chinggis corporate account during the filing of the corporate tax return, and he treated her accounts the same way. Ultimately, Mr. Zisis made adjustments to accommodate her personal holdings and to reduce the liability attributed to Mr. Zuk.

Joint assets (house and bank accounts) were attributed to Robert Zuk, as were all the expenses of the household. He did, however, exclude from the opening net worth the value of Louise Zuk's cottage which she had been purchased several years previously, just as he excluded the value of the cottage from the net worth at the end. He did include as expenses the property taxes on the cottage, the mortgage payments and the over $85,000 used to pay off the outstanding balance of the mortgage in l997 from their joint credit line. Although there were concerns expressed by Mr. Murphy during the course of the trial about how Mr. Zisis dealt with the assets and accounts of Mr. Zuk's spouse, the defence expert took no issue with Mr. Zisis' approach to the income of Louise Zuk. Mr. Zisis also had available Mr. Zuk's records seized from the offices of his accountants. These documents are the contents of the accountant's file for Mr. Zuk's company, Chinggis Capital Corporation. As I indicated previously, the importance of these working papers from his accountant increased as the trial evolved.

Much of the evidence about the nature of Mr. Zuk's assets is uncontroverted. During the l997 tax year, Robert Zuk was able to purchase a $1.2 million house, pay Land Transfer

Digitized by Google

Tax of $20,525.00 and payments on a mortgage of $680,000. He paid $62,684.94 as a down payment on the lease of a Mercedes Benz 610V automobile. He made a R.R.S.P. contribution of $27,145.00. Without even incorporating standard estimates of personal expenditures, Mr. Zisis was able to document actual expenditures of $290,051.25. Mr. Zuk's shareholders account at Chinggis Capital Corporation changed from a deficit of $(208,077.41) to a balance in his favour of $41,794.19. Mr. Zisis did an exhaustive analysis of the accounts and records he reviewed. He developed schedules for each account based on the original documentation at his disposal, was able to cross-reference transfers in and out of all the accounts, and was able to develop a picture based on a correlation between sets of documents from different sources. I found that he was very careful about his calculations, alert to double counting and discrepancies, and very knowledgeable about the details of records he had reviewed.

Bruce Webster, the defence expert, agreed that a net worth analysis is a reliable method that he had used in several contexts where there was a lot of money at stake. He agreed that if the net worth at the beginning and the end were different, it is possible to conclude that the amount reported could be wrong, if the assumptions are 100% correct and the methodology accurate. He also generally approved of the methodology undertaken by Mr. Zisis in doing his analysis. He also acknowledged that he had not seen any accounts that Revenue Canada had not included. His one concern was that there were numerous transactions where there was nothing in the record to indicate the source, and more investigation was needed to determine if the deposit or transaction was taxable or not. It is this concern that is the basis for the defence.

The most significant difficulty is that Mr. Zisis relied on the documentation at his disposal and did no follow up investigation about particular problems or issues that arose in his review of the materials, or in the course of the trial. Michael Zuk, the brother of Robert Zuk, testified at trial about loans he and others were alleged to have to Robert Zuk. Mr. Zisis did no investigation about those alleged loans. Nor did he investigate the cash deposit of $400,000. from a Lance Dunlop into the Canaccord brokerage account of Mr. Zuk in October 1997 notwithstanding there was a direction in the file from Mr. Dunlop providing the name of his company and a phone number. Although he had a copy of share certificates for 300,000 Dura shares in the name of Swallowdale Investments that came into Mr. Zuk's Action Direct account in June l997, he did not investigate to determine what Swallowdale was, nor the nature of the transaction. These lapses in the investigation, and others which Mr. Webster identified, provided fodder for the defence claim that the Crown has not negated all possible sources of non-taxable income. I will discuss the evidence relating to these particular issues later.

Another difficulty is the fact that Mr. Zisis was unable to assess the value of certain shares coming into Mr. Zuk's accounts from unknown sources, for the purposes of determining their value at December 31, l996. In these circumstances, Mr. Zisis saw that the accountant had given them a zero value, and he did the same. He said that he gave them a "$1.00" value for the sole purpose of indicating that they existed. He did this with the 68,000 World Wise Shares held in Mr. Zuk's Canaccord 419-584A-7 account on December 31, l996, and also the 10,000 Dura shares held in Robert Zuk's Nesbitt Burns account 410-89239-2 on the same date. Mr. Murphy contended that the opening net worth of Mr. Zuk is incorrect because Mr. Zisis failed to include in Mr. Zuk's opening assets the actual value of these shares. Mr. Zisis agreed that had he been able to determine the actual cost of these shareholdings, the calculation of Mr. Zuk's assets in his brokerage accounts at the time would have to be adjusted upward, thereby lowering to the same extent the increase attributed in his unreported income. Mr. Webster testified that, as the cost of these shares is unknown, the upward adjustment necessary in the opening net worth is also unknown.

Digitized by Google

There is a similar concern with respect to the value of share certificates that Mr. Zuk may have been holding in street form on December 31, l996. Mr. Zisis had no knowledge of any such share certificates, and there is no evidence before the court that Mr. Zuk actually held any share certificates in street form on that date. The entire prosecution, however, is based on the fact that multiple transactions went through his brokerage accounts during l997 in which large blocks of shares came into his accounts with no indication as to any cost paid, and with no identifiable source. As I will discuss more fully hereafter, the Crown's theory of the case is that he must have been holding share certificates for Transway/Dura in street form which he then deposited into his brokerage accounts as the value of the shares climbed.

If the Crown's theory is correct, the issue becomes the value of those share certificates for the purposes of determining his true opening net worth. Mr. Frost asserts that, if any such certificates existed, they properly had no value because they were shares gifted to Mr. Zuk in previous years. Mr. Murphy submits that these gifted shares would have been out of his portfolio by December 31, l996, and any share certificates he held then must be valued at the cost he paid to purchase them. As I will discuss more fully later, on the evidence before me, I cannot determine this issue either way.

Mr. Webster indicated that neither he nor Mr. Zisis knew that cost, but that it could have been ascertained by further investigation. He said that, had all the l996 records been available, they might have indicated if Robert Zuk held stock certificates in street form, but "if he received them over the counter" they may not show up in his brokerage accounts. Apart from asking Robert Zuk or his accountant, he said that an investigator looking into the issue of whether Robert Zuk held stock certificates in street form at the end of l996 may have gleaned information from the records or officers of Transway/Dura Products. Mr. Webster agreed that when someone is in the business of stock promotion as a livelihood, it is reasonable to investigate if he held shares in certificate form. As a layperson, it also strikes me that the brokerage houses which issued particular share certificates (eg. Midland Walwyn) may have had information relevant to actual sources and prices. The papers and records of James Hunter and Michael Zuk, witnesses in this trial and before the courts on similar charges, may have had relevant information. None of this investigation was done in this case.

Mr. Zisis had never done a net worth prosecution previously, and knew no one who had done so. He was totally candid in his cross-examination, admitting quite openly problems identified by Mr. Murphy and later confirmed by Mr. Webster. After all his very extensive analysis of Mr. Zuk's affairs, Mr. Zisis ultimately admitted that he could not say how much taxable income Mr. Zuk received from the buying and selling of shares in l997. He also admitted that the inference of unreported income would be stronger if Revenue Canada had investigated the unidentified transactions and the potential loans.

Although the court retains the capacity to adjust the net worth to what is actually proven by the Crown beyond a reasonable doubt: *R. v. Century 21 Ramos Realty Inc. (1987), 32 C.C.C. (3d) 353 (Ont. C.A.),* this concession by the Revenue Canada investigator has to be given great weight. If he who knows the file better than anyone else cannot say how much taxable income has been misreported, and therefore how much tax has been evaded, how is a trier of fact, without any expertise in accounting or taxation, to find otherwise beyond a reasonable doubt?

Has the Crown proven a likely source of his unreported income?

The theory of the Crown's case is that the increase in wealth evident from the net worth analysis of Mr. Zuk is attributable to a taxable source, his business of stock promotion. To be more specific, the Crown asserts the Mr. Zuk received approximately 200,000 shares,

Digitized by Google

and later a portion of 3.3 million more shares, from James Hunter in a company called Transway (known later as Dura Products). He also received warrants to purchase several million more shares at 20 cents per share to be exercised before December 31, l996 These shares and the warrants to purchase more shares were given to Mr. Zuk as part of a merger in l995 between Mr. Hunter's public company and another company owned by Mr. Zuk's sister-in-law. In exchange for the Transway shares, Mr. Robert Zuk was to promote the shares and the company. There is evidence that Robert Zuk was very successful in his efforts, and that the shares increased in value from under 20 cents to more than $5.00 per share. There is also evidence that he was never paid by Transway/Dura Products for his services, and that his remuneration for promoting the stock was to be the increase in the value of the shares. It is this increase in the value of these shares which the Crown asserts accounts for the increase in Mr. Zuk's assets. Much of the Crown's case consisted of Mr. Zisis' evidence about his net worth analysis and the documentation on which it was based. Other Revenue Canada investigators gave evidence of statements made by Mr. Zuk, which were admitted in evidence after a voir dire, and also of documents obtained through execution of search warrants on Mr. Zuk's home, business premises, and the offices of his accountant.

Several officials of stock brokerage firms gave evidence of practices in the industry and of the specific nature of Mr. Zuk's accounts. In addition, the Crown called under subpoena two individuals facing similar charges: Michael Zuk, the brother of Robert Zuk, and James Hunter, a business associate of the Zuks.

On February 7, l998 Robert Zuk told Revenue Canada investigator Michael Arthur that James Hunter had gifted 200,000 Transway shares to him, as he was acting as promoter of the company, to assist in maintaining the share price of the company. Mr. Zuk also told the investigator that Mr. Hunter "had made quite a bit of money from his shares in Transway." After further review of T5008 information filed with the department identifying a high volume of Transway share sales, Mr. Arthur wrote Robert Zuk on June 1, 1998 to advise that he too was under investigation. Robert Zuk called him three days later, and again said that Hunter "had made a lot of money" on the Transway stock.

At the time of this conversation, Revenue Canada was conducting an investigation of James Hunter. Robert Zuk's statements do establish that he had received 200,000 Transway shares at no cost to himself, and with the expectation that the remuneration for his efforts in promoting the stock would come from the increase in the value of the shares. It is a reasonable inference that if Mr. Hunter "made a lot of money" on the Transway stock, Robert Zuk did as well. The admission, however, only extends to 200,000 shares. Robert Zuk said nothing to the investigators about millions of other Transway shares other witnesses said he had also acquired from Mr. Hunter. James Hunter, as President of Transway in March 1994, testified that he held more than five million Transway common shares and five million share purchase warrants. He testified that when Transway acquired Cantech in November l995, he needed help to promote the company, and, to that end, he entered into an unwritten agreement with "the Zuks" whereby Robert was to promote the stock and bring in shareholders, while his brother Michael arranged financing. Hunter testified that the agreement with Robert Zuk "as to how he would be retained" was that Hunter "delivered some stock freely, I think …about two 500,000 shares, I don't recall exactly, just to get him started, and then later I delivered, I think about 3.3 million shares." He then said that "the first batch he got was about two to 500,000" which Hunter "gave to (them)…he didn't pay anything." Hunter said that he gave the initial batch of shares to Robert Zuk before November 7, 1995. He later said that he "gave about 3.3 million (of his initial shares) to the Zuks…and I think I gave them an extra two or five, I don't recall exactly…." He insisted that that he "delivered them…to both of them I just gave them to the Zuks. I don't know how they

Digitized by Google

split them up, I didn't care." He again reiterated that "they didn't pay anything" but "later" he received some remuneration for those shares as "I had about a million two left, and as a result when they appreciated in value, that's the remuneration that I received." As he indicated, the incentive to promoting the stock was the appreciation in its value.

James Hunter also testified that he delivered to the Zuks in November 1995 the right to exercise the warrants. He said that he delivered five million warrants to the Zuks and "they must have exercised them by December 31st, 1996 at 20 cents per share." He indicated that he never exercised the warrants himself.

In cross-examination, Mr. Hunter said that when he gave the 3.3 million shares to the Zuks, the price was "around 25 cents, 30 cents, something like that." At the time, he said the warrants "had no intrinsic value." He indicated that he was happy with Mr. Zuk's later performance as "the stock went from 25 cents up to five dollars." He testified that his own adjusted cost base for the 1.6 million shares he had remaining "comes out to about 97 cents." Mr. Hunter indicated that Transway "morphed into Dura Products" and was "one of the busiest trading vehicles on the stock exchange." He testified that "all the directors made a lot of money…A lot of individuals, people that had options, had the warrants and they sold them, they got out of it" and when people had stock to sell, they called Robert Zuk "because you made it liquid. You'd pick up all the stock, you'd buy it all."

The Crown relies on this evidence from James Hunter to establish that Mr. Zuk was given millions of shares, at no cost, in exchange for his services promoting the stock and for which he would be paid by the increase in the value of the stock. There are, however, significant difficulties with Hunter's testimony. He also is currently facing tax evasion charges in the Superior Court. It was the investigation of his affairs that led to the investigation and charges against Robert Zuk. Although James Hunter enjoys the presumption of innocence, Mr. Hunter's credibility is a concern. There is also evidence from other statements attributed to Robert Zuk by Mr. Arthur that there are hard feelings between Mr. Zuk and Mr. Hunter. This animosity between them may well affect Hunter's credibility before this court. More important, Mr. Hunter's evidence is decidedly vague and contradictory. He is not certain about how many shares he originally gave to Robert Zuk. He says that he gave the much larger block of shares to "the Zuks" and he didn't know how they divided them between them. On the basis of this evidence, it is impossible for this court to determine how many shares James Hunter actually gave to Robert Zuk. There is also no evidence whether Mr. Hunter gave these shares to Robert Zuk in his personal capacity, or to Robert Zuk's corporation, Chinggis Capital. Michael Zuk confirmed that James Hunter was originally the largest shareholder in Transway (with five million shares and five million warrants), but his evidence as to what happened to those shares differed markedly from that given by Hunter. He said that he received 500,000 shares and 250,000 purchase warrants in the name of his wife. He said Transway was not actively traded in l996 and was valued at eight to fifteen cents, less than the warrants. He said that Robert Zuk "may have had a few hundred thousand shares" as he was engaged by Hunter to do investor relations. He also indicated that Hunter transferred three million shares in street form to him and other investors who promised additional funding down the road. He said he retained approximately "a half a million" of those shares. He later said that he had "no idea" if Robert received any other shares from Hunter "I would suspect not," and, at this point, he wasn't even "sure" about the couple thousand he had spoken of previously. He insisted that he "never received any shares for free or otherwise, all of which I paid for."

He agreed, however, that the expectation that the value of his shareholdings would improve was an important consideration in the work he was doing. He indicated that when Transway took over Cantec, there were maybe 500 to 1000 shareholders, "all small…like 100, 200 share lots." "By the end of l997, we had approximately…5000 shareholders, of

Digitized by Google

which half were in the US, 40 percent Canada, 10 percent elsewhere....we had four or five major investors that the company did not have before....and we were probably one of the most admired little companies out there for what we have done and, in fact, probably begat Robert a number of jobs." Michael Zuk confirmed that Hunter had given him and his brother the option of exercising four million warrants at 20 cents a share. Both he and Robert exercised those warrants in July or August 1996. He gave several different renditions of how Robert Zuk could afford to exercise the warrants. He first said Chinggis had put money into the company and "I would have topped that up, so he could have bought his shares and then he would have repaid me later on." First, he said that this "topping up" loan was repaid within six months (before the end of l996). Later he testified that there was still "$10,000, $15,000, so 210, 205, 200" cash still owing on this loan on January 1, 1997. Still later, he returned to his position that this loan had been "paid back, sometime...relatively close, close proximity." Ultimately, he said that "in fact, the full amount might have been my money, I'm not sure at that point in time because Robert owed me money from time to time, and other things." He testified that "those shares might have been in street form." Michael Zuk is also charged with similar offences in another proceeding before this court. In my view, he was a poor witness, inconsistent and contradictory in his rendition of what occurred, and vague about times and details. I do not accept his evidence about the quantity of shares initially given to Robert Zuk by James Hunter, nor about the three million additional shares transferred to him "and other investors," nor that he paid for all these shares. Although Mr. Hunter Michael Zuk differed as to the actual number of warrants the Zuks received, I do accept that James Hunter gave Robert Zuk, and his brother, warrants to purchase at least four million shares of Transway at a cost of twenty cents, and that these options were exercised in July or August l996. Michael Arthur testified that the sales of Transway shares he was investigating in early l998 "were as a result of options that were exercised at 20 cents a share...and sold at significantly higher than 20 cents." Both James Hunter and Michael Zuk readily testified about the existence of the warrants, although Mr. Hunter had no first hand knowledge of when they were exercised.

Michael Zuk's contradictory renditions of how the options was financed do not detract from the essential fact that the options were exercised for each to acquire at least two million more Transway common shares in l996. It is a reasonable inference from the evidence of Michael Zuk generally that these options were transferred to the Zuks in street form, although there is no direct evidence before the court to confirm this.

The Crown relies on this evidence to establish that Robert Zuk obtained two million Transway shares at twenty cents per share in l996 that he later sold at a substantial profit that was part of his unreported income. There are two difficulties with this theory. The first is that I cannot find, on the evidence before this court, whether Robert Zuk acquired the two million shares in his personal capacity, or whether the shares went into his Chinggis accounts. Secondly, to the extent Robert Zuk still retained "cheap" shares at the end of 1996 in his personal capacity, the cost of these shares at twenty cents per share should have been included in his opening net worth. Mr. Zisis testified that he never spoke to Mr. Hunter about the matter, and he didn't conduct any investigation to find out if Robert Zuk still had any of the Hunter shares on December 31, l996.

He indicated, in cross-examination, that he was not aware of how many shares Mr. Zuk had disposed of in l996 because the records were not complete. Only at the conclusion of the trial did both counsel agree to the admission of a chart tracing pre-l997 Transway sales (Exhibit 24) taken from the brokerage firm records filed with the court previously.

Although there was no witness to explain the chart or to answer questions about its use, the chart provided the court with useful information. The parties agree that, based on the available records, Mr. Zuk sold over 2.7 million Transway shares prior to 1997. One

Digitized by Google

inference Mr. Murphy urged me to draw from this material is that all the free shares Mr. Zuk would have acquired from James Hunter in l995 and l996 would have been sold before the beginning of the 1997 tax year. Mr. Frost, by contrast, submitted that, since the total number of Transway shares sold included Transway shares Mr. Zuk would have bought during that period, there remained many million more free or cheap shares unaccounted for which remained in his possession.

The difficulty is that the great bulk of the sales shown in Exhibit 24 related to Transway sales by Chinggis and by Louise Zuk (treated as Chinggis), a total of 2,286,100 shares sold. Transway sales by Robert Zuk, apart from those of his company, pre-l997 amounted to 449,800 shares, only 16.4% of the total. As the income and tax liability of Chinggis is not before this court, it is hard to know what inferences can properly be drawn from this evidence. The issue is whether Robert Zuk (in his non-corporate capacity) had disposed of all (or most of) his free or cheap shares before 1997. Since I do not know how many shares he actually received, and whether these shares went into his company or to him personally, it is impossible to draw any conclusions at all from this material except that Mr. Zuk did sell very substantial numbers of Transway shares during the period.

Mr. Zisis admitted he conducted no other investigation than that which was apparent in the brokerage records provided to Revenue Canada. Nor did he investigate whether Mr. Zuk held any share certificates or cashed in any shares in certificate form.

He acknowledged that it was possible Mr. Zuk still held Transway shares in street form from Mr. Hunter, or from the exercise of his warrants, on December 31, l996. If so, he agreed, they would be an asset valued at their historical cost that should be included as an asset in the net worth analysis as of December 31, l996. If the shares were a gift, they would be valued at zero. If Mr. Zuk had paid for them, even at 20 cents per share on the exercise of the warrants, that cost would need to be reflected in the value. Several witnesses from Mr. Zuk's brokerage houses gave evidence substantiating the large number of Transway/Dura transactions by Mr. Zuk, his wife and his company during the relevant time, and the pattern of share certificates coming into Mr. Zuk's personal and corporate accounts with no value attached and no indication as to source. Stephen Leacock identified accounts held by Merit Investments. At December 31, 1996, Transway shares were trading at 85 cents a share. During l997, the market value of those shares fluctuated from $1.70 in January to $3.70 in December l997. In his view, the accounts indicated that Mr. Zuk was doing a "fair amount of free riding." This means that Mr. Zuk had trades of substantial amounts without actually settling his trades with cash.

James Doyle had worked at C.M. Oliver in l997. He gave evidence about the activity of Mr. Zuk's Chinggis Capital Corp account. Again the account indicates substantial activity in Transway/Dura shares, and the significant increase in the value of the shares during the l997 year. These accounts show clearly the extent to which share certificates were moved into Mr. Zuk's accounts with no value attached. Mr. Doyle also testified that, in l997, third parties were allowed to deliver stocks into accounts and clients were under no obligation to inform their broker where the stocks came from. Similarly, a third party could lend stocks to the account holder. Mr. Doyle testified that this account indicated Robert Zuk was trading on equity in his account and was engaging in "very high risk" trading practices.

Chris Schaule identified and produced the records of Taurus Capital Accounts held by Robert Zuk, his wife Louise L'Abbe and by Chinggis. It is unnecessary for me to relate here the details of these accounts. Having reviewed them in detail, however, I conclude that they well illustrate the complexity of this prosecution as it was originally conceived and presented by the Crown. It is clear that Robert Zuk was the directing mind for his corporation, for his wife, and on his own behalf. For the purpose of tracing the movement of transactions between the accounts, Mr. Zisis looked at all the accounts Robert Zuk

Digitized by Google

controlled. For the purpose of the net worth analysis, however, Mr. Zisis only considered those accounts in Robert Zuk's name. It is clear from this evidence of how these particular accounts operated that Transway/Dura shares (and other shares as well) came into the accounts at no cost and from no recorded source, were sold for substantial profit, and the proceeds channeled back primarily to the corporation or to Louise L'Abbe (treated as the corporation for tax purposes).

Given this pattern of activity in late l996 and in l997, I consider it a reasonable inference that Robert Zuk was holding share certificates in Transway/Dura at the end of l996 that he subsequently deposited into his accounts. On Michael Zuk's evidence, as corroborated by at least one copy of a direction for the transfer, some share certificates also came into his trading accounts from his brother. On the evidence before me, and given my findings of credibility with respect to Michael Zuk, I cannot determine which when. It strikes me, however, that the great bulk of those certificates were deposited into his corporate accounts or the accounts of his wife. On the evidence before me, it is impossible to know how many share certificates Robert Zuk held in his personal capacity on December 31, l996, how many he actually deposited into his personal accounts, and what values should be attached to them.

The l997 income tax returns of Louise L'Abbe (Zuk) and the corporation were entered as exhibits before the court without commentary or explanation. According to Mr. Zisis, there are no problems with those returns. With respect to the Chinggis return, however, he only looked at the shareholders account, and the year end financial statements for Chinggis in September l997 and September l998. Those financial statements show that the assets of Chinggis more than doubled between 1996 and l997, and more than doubled again between l997 and l998. According to the corporate balance sheet, $1,243,840 was due to Robert Zuk in his shareholder account on September 30, l998, compared to $184,000 the previous year.

It is clear that Mr. Zuk made a substantial profit from his business of buying and selling shares in l997 and l998. It is also clear that he made a significant profit from the sale of Transway/Dura shares. Since so much of the activity relating to Transway/Dura shares, however, was conducted through the accounts of his business (including those of his spouse), I am not satisfied that the Crown has proven that his alleged unreported income came from his personal business of buying and selling Transway/Dura shares in l997. Evidence that 1.7 to 1.9 million shares of Transway/Dura were deposited into his accounts in l997 does not differentiate between accounts he held personally, and accounts of his corporation. The fact that Mr. Webster knew nothing about Robert Zuk's corporation, looked at none of his corporate accounts, and identified in his personal accounts only a relatively few (sixteen) share transactions where the source was not known suggests that the great bulk of the transactions involving Transway/Dura share certificates, unknown sources, and unknown values were in the context of his corporate activities. Again, the assistance of an expert forensic accountant for the Crown would have been useful.

The theory of the Crown is that Mr. Zuk made a much higher income than he reported from the sale of Transway/Dura shares at increasingly higher values. Although this is likely, or even highly probable, the Crown has failed to prove beyond a reasonable doubt that Mr. Zuks increased income in l997 was from the sale of Transway/Dura shares, nor how much he failed to report.

I cannot find beyond a reasonable doubt exactly how many Hunter shares were given to Robert Zuk, how many of those shares were sold through his corporate accounts, and how many he retained for himself. That large proportion of shares that went into his corporate accounts were presumably dealt with in the books of his corporation; the tax liability of his

Digitized by Google

corporation is not the subject of this prosecution. If he did retain Transway/Dura shares in street form as of December 31, l996, an inference that I can reasonably draw on the evidence before me, it cannot be assumed that these shares were the "gifted" shares (having a zero) value as opposed to "cheap shares" he obtained through exercising the Hunter warrants at twenty cents per share earlier in l996. If the latter case, the actual cost of these "cheap shares" would need to be added to his assets in December 31, l996, thereby reducing the amount of the unreported income he is alleged to have made that year. On the other hand, the fact that his accountant dealt with all his brokerage accounts, and assigned a zero value to most of the unidentified share deposits into the accounts, and a value of $1.18 to others, means that the profits and losses from the purchase and sale of those transactions were included in the income tax return he filed with Revenue Canada. Mr. Zisis and Mr. Webster agreed that all the accounts were included in the Revenue Canada analysis, and transactions between the accounts of Mr. Zuk, his spouse and his company did not change Mr. Zuk's net worth, as they were shuffles between accounts. On the evidence before me, without the assistance of an expert forensic accountant for the Crown, the Crown has not proven beyond a reasonable doubt the source of his alleged unreported income.

Has the Crown negated all sources of non-taxable income?

The only evidence tendered by the defence was a report and viva voce evidence of Mr. Bruce Webster, a forensic accountant whose qualifications were conceded by the Crown. Mr. Webster reviewed five of thirty accounts in this matter, those making up 85% of the cash assets and share holdings of Mr. Zuk at the end of l997. Mr. Webster did a spreadsheet of all transactions in these accounts, compared his spreadsheets with similar spreadsheets prepared by Mr. Zisis, and compared both to the work product of Mr. Zuk's accountant.

.

He concluded that apart from one transaction on December 4, l997 (involving Galavu shares sold for $9,618.00), he was unable to identify any l997 sale or purchase transaction on the Revenue Canada working papers that was not included in Mr. Zuk's personal income tax return. He indicated that the one exception, coming late in the year, could possibly have been reported in l998, but that could not be checked without seeing his l998 tax return. Mr. Webster concluded that this fact suggests that Robert Zuk did not intentionally withhold documents with respect to share sales and purchases from his accountant for the purpose of underreporting.

As I indicated previously, Mr. Webster's primary concern with the net worth statement related to transfers of cash or shares in and out of Mr. Zuk's accounts with no indication as to source or purpose. With respect to these transactions, he concluded that the Canada Revenue Agency followed, but did not complete, the net worth analysis methodology, and, without further information, neither he nor they could conclude that the entire increase in Mr. Zuk's holdings came from a taxable source. Without further information, he indicated that he could not say what amount should be attributed to Robert Zuk's taxable sources, and what should be attributed to non-taxable sources. In all, he identified twenty-two transactions where further information was necessary. I shall deal hereafter with the transactions identified by Mr. Webster as problematic (including his concern about Mr. Zuk's shareholder account which arose at trial). I will then discuss other sources of potential non-taxable income raised by the defence: loans of share certificates and personal loans from Michael Zuk, other potential personal loans, and other potential non-taxable sources.

Digitized by Google

Deposit into Canaccord account

A deposit of $400,000 into the Canaccord account (#419-584A-7) on October 7, 1997 was the primary reason for the increase in the value of this account (as calculated by Revenue Canada) from $34,236. at the start of l997 to $438,925 at the end of the year. The account statement indicates that this payment was used to purchase 119,300 Dura shares at values from $2.80 to $3.00. This substantial cash infusion into the account is reflected in the increased value of the Dura share holdings in this account on the net worth statement as of December 31, 1997.

Mr. Webster testified that the CRA working papers do not indicate what work was performed, if any, to verify the source of this deposit, and whether it was taxable or nontaxable. Using the information available to him, he was unable to say one way or the other. From a direction included in the exhibits, this amount appears to be a transfer from a Lance Dunlop who wrote on the letterhead of Land Mining Res., a Division of 741204 Ont. Ltd., with an address in Longford Mills Ontario and telephone number (705) 327- 2697. Mr. Zisis testified that "we assumed it was income" as it had come into his business account, Robert Zuk treated it as his own, and there was no evidence of any loan agreement, any repayment or reciprocal transfer of those funds or shares back to Dunlop during the year. He admitted that no one called Lance Dunlop and that he personally did not verify why the funds came into the account.

Mr. Zisis and Mr. Webster agree that the $400,000 did not show up in the working papers of the accountant, nor in his income tax return, except indirectly through the subsequent sale of shares. Both agreed that it also did not show up as a loan. Mr. Webster noted, however, that the fact the accountant did not include it in Mr. Zuk's income is consistent with the amount being a loan, as for the purposes of a tax return, the proper approach is that his accountant not list his liabilities.

Since this one transaction accounts for more than one half of Mr. Zuk's brokerage holdings in the concluding net worth, it is incomprehensible why further investigation of this transaction was not undertaken. Mr. Frost submitted that the absence of any documentation or paper trail that is customary in loan transactions is evidence that the deposit was income. There is a certain appeal to this submission, particularly in the face of substantial documentation in the seized records indicating that there was an ongoing business relationship between Robert Zuk and Lance Dunlop. There is, for example, a share purchase agreement dated March 12, l997, with a payment schedule, and signed by both Robert Zuk as the purchaser and Lance Dunlop as the seller. There is a memo from Lance Dunlop to Robert Zuk dated August l997 re a wire transfer of funds to a Barklays Bank in the Bahamas. There are two Chinggis Corp. cheques to Lance Dunlop signed by Robert Zuk, presumably for payments on the share purchase agreement. In the face of such a track record of documentation, one would expect that any loan transaction between Robert Zuk and Lance Dunlop would be supported with some documentation. There is, however, no documentation whatsoever about the purpose of this very large $400,000 deposit.

In the circumstances, the onus remains on the Crown to prove beyond a reasonable doubt that its "assumption" that this was income is correct. Where there has been no investigation, notwithstanding information readily available as to the source, the benefit of the doubt must go to Mr. Zuk. In oral argument, Mr. Frost conceded as much, indicating that if the court was not satisfied that this amount was income, then it should be deducted from the closing net worth. In my view, this is the correct approach to this particular amount.

Deposits of $110,000 into Royal Bank account

On July 31, 1997, Mr. Zuk and his wife purchased a residence at 13 Queen Mary's Drive valued at $1.2 million. Mr. Zisis testified that the house purchase was financed by a

Digitized by Google

mortgage for $680,000 to the Royal Bank that shows up in the liabilities on his net worth. Mr. Zisis also testified that more than $500,000 came into Robert and Louise Zuk's account for the purchase of their house which he could not account for from the materials available. More precisely, he noted that there were two deposits on July 31, l997 into the Royal Bank account of Louise and Robert Zuk, one for $165,000 and the other for $591,000, for which he could not identify the source of $523,000. Mr. Webster reviewed the same brokerage accounts and bank accounts. With respect to the deposit of $165,000, he could not determine the source of three cheques totaling
$70,000. Of the four cheques totaling $591,495, he was unable to trace only one cheque for $40,000. Given his professional qualifications, I would accept Mr. Webster's evidence on this issue over that of Mr. Zisis. Again, Mr. Webster found that the CRA working papers do not indicate what work was performed, if any, to verify whether the source of these deposits was taxable and, using the information available to him, he was unable to identify whether these deposits were taxable or not. When asked what else could have been done to determine where these amounts came from, his response was to ask Robert Zuk or his accountant. Robert Zuk did not testify, and there is no evidence how his accountant treated these transactions for tax purposes. As the court cannot determine whether these amounts are from a taxable or nontaxable source, the court is left with a doubt that must be resolved in favour of Mr. Zuk. Again, as Mr. Frost conceded in oral argument, if there is any doubt the $110,000. would need to be deducted from his closing net worth.

Payment to Dura Products

Mr. Webster also identified a payment of $55,022.50 to Dura Products on October 22, l997 from Mr. Zuk's Canaccord account (#419-58A-7). He indicated again that the CRA working papers do not indicate what work was performed, if any, to verify the use of this payment, and he could not identify whether this payment relates to a taxable or non-taxable use. He acknowledged that CRA treated this payment as a reduction in Mr. Zuk's net worth (a position favourable to the taxpayer), but he could not say if this approach is correct or not. Neither can I.

300,000 Transway shares and 250,000 Galavu shares into Action Direct

Two deposits of large shareholdings came into the Royal Bank Action Direct account in the name of Mr. Zuk and Louise l'Abbe in June l997 with no indication of any source or cost. These were 300,000 Transway shares on June 4, l997, and 25,000 Galavu shares on June 9, l997. The source and cost of these shares became key issues. As Mr. Zisis had given no value to these shares and Mr. Zuk's accountant gave both blocks of shares a cost of $1.18 per share, Mr. Murphy asserted that the combination of the two blocks of holdings would account for $649,000 of the alleged unreported income. As Revenue Canada did not investigate the source of these shares, it could not be assumed that the shares came from a taxable source, and the cost of the shares should be deducted from Mr. Zuk's net worth. Mr. Frost submitted that the accountant's treatment of the shares was evidence that they came from a taxable source. As there was no evidence indicating how the accountant arrived at his valuation, Mr. Frost also insisted that the effect of assigning those stock holdings that value was to reduce the capital gain that would have otherwise accrued by $649,000. In my view, they are both wrong.

I will deal first with the issue of whether the shares were from a taxable source. Mr. Webster initially found that as the CRA working papers did not indicate what work was performed, if any, to verify the source of these share transfers or the assigned value, he could not determine whether these shares were from a taxable or non-taxable source. Mr. Webster initially testified that, if the investigator did not know where those shares came from,

Digitized by Google

the conservative approach would have been to reduce Mr. Zuk's net worth by their value. He also testified that further investigation should have been done, through discussions with Mr. Zuk, his accountant, or reviewing his income tax return to see how the transfer was handled for income tax purposes. At trial, Mr. Webster learned that copies of the Transway share certificates from Swallowdale Investments had been found at Mr. Zuk's business address. He acknowledged that Mr. Zuk's accountant had treated these blocks of shares as from a taxable source, given them a value of $1.18, and included them in Mr. Zuk's l997 income tax return. When confronted in cross-examination with these circumstances, Mr. Webster then changed his position. Then, he testified that if Robert Zuk spent $649,000 in actual expenditures for these shares, the effect on the net worth analysis would depend on when he bought them, and their actual cost. lf before the beginning of year, the opening net worth should include an asset of that value. lf bought earlier in the year, one would need an explanation for how he afforded that purchase; either something was missed in the opening balance, or from extra income, or he got them at no cost. lf he sold them, they would not be in the ending net worth unless he used them to purchase an asset, in which case they would be included in his assets and expenditures. Later, he said that the values put on these shares by the accountant are consistent with how the accountant might have treated a potential short selling transaction.

The absence of documentation in the records led Mr. Zisis to believe that this Action Direct account did not exist in December l996. The records indicated there were no share holdings in the account on December 31, l997. Since this was the case, Mr. Zisis had no need to put any value on these shares, nor to investigate the account further, and he did not. Mr. Zisis candidly admitted that, apart from the fact that copies of the 300,000 Transway share certificates from Swallowdale Investments Ltd. were seized from Mr. Zuk's Chinggis Capital office, he had no idea where they came from. He noted, however, that the accountant had given them a value of $1.18 a share and that the accountant found that Mr. Zuk had made money on the Dura shares and lost money on the Galavu shares. He assumed that, as the accountant had included the Action Direct account in Mr. Zuk's brokerage summary, funds within that account were considered part of his business income. The records of that account indicates that these shares were traded and sold, with significant funds transferred out to an RBC account which Mr. Zisis testified was used to purchase Mr. Zuk's home, furniture and the leased car.

As for the cost attributed to the shares, there is no evidence to show how the accountant arrived at the value. Ex. 12-9 p. 80 of the accountant's working papers is a note that, on its face, the person who made the note (Mr. Zuk's accountant?) indicates that he is to "discuss with Robert and determine share unit price with him for those shares directly purchased from companies and received by brokers without cost." It is not clear whether this is reference to the Swallowdale shares, or others, or all the shares without identifiable sources and costs. The implication of Mr. Frost's submissions is that Mr. Zuk provided his accountant with an inflated value, which the accountant used to reduce his reportable taxable income.

On the evidence before me, I make the following findings. 1. Prima facie, the fact that the accountant treated them as from a taxable source and gave them a value is evidence that they were considered part of his taxable income. Subject to my caveat earlier about the weight to be given to the accountant's papers, it is a reasonable inference that they were from a taxable source but, absent investigation, the court cannot be certain. 2. Mr. Zisis testified that he had no evidence that the value assigned to the shares by the accountant was incorrect, and admitted it was "possible his treatment was correct." There is absolutely no evidence from the Crown to prove any other cost, notwithstanding the implication of Mr. Frost's submission that the actual cost must have been zero. The Crown relied on values used by the accountant in other contexts. What is sauce for the goose is sauce for the

Digitized by Google

gander. If there is "a possibility" that the share value is accurate, the benefit of the doubt must go to Mr. Zuk.

Ex. 1-30 is an itemized listing of all the transactions in and out of this account. Five hundred and fifty thousand shares were transferred into this account in early June l997 and, on a rough calculation, over $650 thousand were transferred out of the account in the next seven months to various bank accounts of Robert and Louise Zuk. It strikes me that this account may well have been a key source of how Mr. Zuk accumulated the assets he did during the year. That being the case, the account is highly relevant to the issue of a likely source of Mr. Zuk's alleged unreported income. Yet Revenue Canada the Crown did no investigation of the source of these large blocks of shares and has no evidence to prove that they had any value other than that assigned by Mr. Zuk's accountant.

This is particularly concerning as Revenue Canada had true copies of the three 100,000 Transway share certificates from Swallowdale Investments Ltd. that were seized from Mr. Zuk's Chinggis office on execution of the search warrant. These were found in a file labelled "Action Direct: Zuk, L'Abbe." In the file was a yellow post it note directing that these share certificates be deposited "in our action direct account." On the face of the Swallowdale share certificate (Ex. 11-12 p. 126) there is an indication that these shares were the property of Swallowdale Investments Ltd. on February 12, 1997. There is also the notation that the Transfer Agent and Registrar of the Corporation was the R-M Trust Company, Toronto Ontario. Given the ultimate importance of this account to the prosecution, it is incomprehensible why Revenue Canada did not investigate the nature of Swallowdale Investments, the provenance of the shares, when Mr. Zuk acquired them (presumably after February l997), and at what cost. On its face, these shares do not come from James Hunter as part of the package of gifted shares or options acquired in 1995 and l996. Swallowdale Investments is another source that remains unidentified. Galavu shares were not part of the original transactions. As Mr. Wilson testified, the effect on the net worth analysis depends on when these shares were acquired, and the actual cost. In the absence of investigation by the Crown, the benefit of the doubt must go to Mr. Zuk.

Other Schedule I Transactions

There were other transactions in Mr. Webster's Schedule I for which he was unable to identify whether from a taxable or nontaxable source, or for a taxable or nontaxable use. Two of those transactions were transfers into Mr. Zuk's accounts of numbered certificates totaling 80,000 Dura/Transway shares registered to Midland Walwyn. As Michael Zuk testified he used Midland Walwyn, these transactions could be some of the share certificates he said he lent to his brother (see discussion to follow). As the actual certificate numbers are in the records, Revenue Canada could have investigated the source of these certificates through Midland Walwyn and did not do so. The remaining eleven transactions identified in Mr. Webster's Schedule I were a substantial number of shares going out (171,000) with no indication of where they went or what Mr. Zuk was paid for them. The August 14 Intel Action account was not included in accountant's schedule in his working papers, nor was it identified by Revenue Canada as owned or operated by Robert Zuk. He testified that Mr. Zuk's accountant treated these shares going out with a value of zero. Mr. Webster indicated that it is important to know where the shares went and why. If the shares were valued at zero, they would be worth zero. If shares were paid for, the net worth would have to be increased by that cost. If Mr. Zuk held shares in his pocket, they are not taxable yet because he hasn't sold them. Mr. Webster couldn't say what adjustment should be made in the net worth unless he knew what the shares were used for and where they went. If the shares were lent to someone else, they would become a receivable asset that, if still current at end of year, would be added to his net worth. If Mr. Zuk gave them away,

Digitized by Google

they are no longer his and there would be a deemed disposition at fair market value if non arm's length. If sold, one would expect to see money coming in. Ultimately, Mr. Webster admitted that by not making adjustments for these 171,000 shares that left in the course of the year, possibly Revenue Canada may have undervalued his net worth. Again, however, the lack of further investigation about these transactions makes it impossible for this court to know how to deal with these transactions.

Shareholder Account

Mr. Webster had not been asked to review the shareholders account prior to his testimony in court. He looked at the Ex 12-8 spreadsheet with respect to Chinggis for the year end September 30, l997, and noted that the shareholders account was credited with $115,000 which Robert Zuk reported to Revenue Canada as his dividend from the corporation that year. Mr. Webster also identified that two deposits in September l997 into the Chinggis bank account, in the amounts of $140,000 and $187,000 from a Augustino Capista, that were credited to Robert Zuk's shareholders account. Mr. Webster testified that he would add these deposits to his Schedule l of transactions where neither he nor Revenue Canada can determine whether the source is taxable or not. I put no weight on this evidence that arose as an afterthought at trial. As Mr. Webster did not know anything about Chinggis and did not review any of the Chinggis accounts, he does not know the context and can say nothing about Mr. Capista. Mr. Frost, in his written submissions, directed me to documents before the court that he said would suggest that Mr. Capista was a client of Chinggis. Without explanation from a witness, however, I decline to make any finding one way or another. As I indicated previously, the relationship between Mr. Zuk and Chinggis is very complex, and I am not satisfied that Revenue Canada has dealt with it with the precision and clarity it requires.

Loans from Michael Zuk

Michael Zuk testified that he had loaned shares to his brother during l997, and that those loans were still outstanding at the end of that year. Echoing his evidence, Mr. Murphy submitted that Michael Zuk lent Robert Zuk 1,075,000 shares in l997 that were not paid back by the end of the year, and that these shares were valued at $2.00 to $2.20 a share in March l997. In his view, in December l997 Robert Zuk had a liability of over $2 million to Michael Zuk that Revenue Canada did not consider in doing their net worth assessment. As I indicated previously, I did not find Michael Zuk to be a precise or accurate witness. Such was also the case with respect to his evidence of these loans. Initially, he testified that "on one or two occasions" he loaned securities to his brother Robert, on the understanding that he would give those shares back to him in kind at a later date. Then he testified that that he lent his brother shares from time to time, "probably some small transfers in '96….and (in) March or April (1997)…"a larger chunk of shares." Later, he testified that he transferred 75,000 shares from his account to Chinggis on July 31, l997….he didn't differentiate between Robert and Chinggis…." Later, he testified that he lent Robert one million Dura shares in March l997 "That would have been one or two share certificates, I think or maybe five times 200,000….They were in street form, (or) if they weren't in street form, I would have put a power of attorney on them." He testified that these shares would have been "a small amount from Levesque Beaubien…what Hunter gave…and the other ones would either have been in Midland Walwyn, or Levesque. I can't remember." When he lent these shares to Robert, the shares would have been valued "about two dollars to $2.2 per share In total, Michael Zuk said he loaned Robert "maybe, well a million, plus 75 and there might have been some others." Michael Zuk also indicated that there would be a record "to the extent some of them would have come out of

Digitized by Google

the brokerage account. To the extent of me going to my drawer, pulling them out, handing them to him, none…other than, a quick handshake and I do my accounting on an ongoing basis with him." He was inconsistent as to whether these share loans were repaid. He said Robert never paid these shares back and the loans remain outstanding. Earlier he said that these loans were "paid back….probably closer to 24 months (later)." He was consistent, however, that he "did not want to be paid back in cash. He wanted the stock."

There is documentation in the exhibits indicating that Michael Zuk did direct C.M. Oliver to deliver 75,000 Dura shares from his account to Robert Zuk's Chinggis Capital account. These shares are shown as coming into the Chinggis account on August 1st at no cost. The Chinggis Capital Corp accounts with C.M. Oliver and Taurus Capital that I discussed previously show a significant number of transfers into the accounts from Midland Walwyn with no indication from whom. These could well substantiate some of Michael Zuk's testimony. The difficulty, however, is that these are Chinggis corporate accounts and have no relevance to Robert Zuk's personal business accounts and to his net worth. Michael Zuk testified that he treated Robert Zuk and Chinggis Capital as one and the same. Any shares loaned to Robert Zuk's corporation are not liabilities to be subtracted from Robert Zuk's personal net worth.

The only share loans that could have any potential relevance are transfers into Robert Zuk's personal trading accounts. The two share certificates from Midland Walwyn identified by Mr. Webster in his Schedule I could be from Michael Zuk. If so, they may create a liability. Mr. Zisis admitted that he did not investigate the source of these transfers into these accounts, and therefore he has no evidence to contradict that of Michael Zuk. Without investigation, it cannot be assumed that these came from a nontaxable source. Mr. Webster testified that the practice of loaning large blocks of shares with the expectation that the shares will be returned in kind is called short selling. In these circumstances, the shares are valued at their fair market value on the day of the loan. The person who obtains the loaned shares has a liability for that value but, as he is obligated to return the shares in kind, what he actually pays for them on return of the shares will determine if he makes a profit or loss on the short selling transaction. In my view, this discussion of short selling was a red herring. Michael Zuk testified that he would transfer shares to his brother when Robert Zuk was undermarginalized or under-collateralized. He made no mention of short selling. On the evidence of the witnesses from the brokerage houses, Robert Zuk was frequently engaging in "high risk" trading practices, consistent with the reason Michael Zuk gave for any loans to his brother. Mr. Webster also testified that short selling is only advantageous if there is an expectation that the stock would decline in value. During the period at issue, Robert Zuk was actively engaged in promoting the shares, and, on all the evidence, he did so successfully. It was their joint expectation that the value of the Transway/Dura shares would increase. In these circumstances, it makes no sense that Michael Zuk loaned shares to his brother for the purpose of short selling Mr. Webster, on cross-examination, initially testified that he saw nothing in the accountant's papers to indicate that the accountant was aware of any short selling transactions. Later he testified that the accountant's treatment of the June 1997 Transway/Galavu share transactions is consistent with short selling. Without more explanation, however, I put no weight on Mr. Webster's changed position.

Other personal loans?

Michael Zuk also testified that he had loaned Robert money over the years and that Robert had always paid him back. When Robert bought his first house in l995, Michael said he provided $125,000 to $135,000 for the closing. It was an unsecured interest-free loan for which "there may or may not be (a record)." He initially said that Robert had not repaid any

Digitized by Google

of that loan by January 1, 1997. Later he said that he "may have paid me $5,000 or $10,000 or something....I don't know....possibly." Michael Zuk also testified that Robert bought a lot of shares from people who were leaving. As employees exercised their options, Robert bought them. Although he said he "was not aware of (Robert's) trading activities, except when he "asked for a loan," he testified that he was aware of three to five loans from Lance Dunlop (worth $400-500 thousand); a loan from Mike Palermo for $75,000; $500,000 U.S. owed to David Siegel from Florida (the subject of a lawsuit in l998), and another $75-100 thousand to Max Berletta. On his evidence, Robert Zuk owed in excess of $4 million in loans at the end of l997 (including the 1,075,000 shares Robert owed to him "valued at $3.70 a share") In re-examination, Michael Zuk admitted that he really knew "nothing" about the loan to Lance Dunlop except that it was for $400 thousand or more. He also indicated that he "didn't know" what the loan from Mr. Palermo was for, nor when it was incurred, nor what were the terms of repayment. He denied any knowledge about the claim from David Siegel as "it had nothing to do with me." The loan from Max Berletta he learned about at the race track. Ultimately, he could not say whether these were "about a loan, or about a bad business deal."

I put no weight on any of this evidence. As I indicated previously, Michael Zuk was an unreliable witness, imprecise and vague. His evidence with respect to his brother's loans from third parties is clearly based on hearsay and of no evidentiary value. I am also not satisfied that there is any credible evidence that Robert Zuk owed his brother personal loans during l997.

Mr. Zisis testified initially that neither he nor the previous investigator found evidence of any loans, so they felt no need to investigate cheques found in the files. Mr. Zisis did follow up with Robert Zuk's trustee in bankruptcy and received a list of creditors. He did not recall, however, if any of the claims extended back to l997, nor if there was any letter from Michael Zuk to the trustee (as Michael Zuk said in his testimony). . He did not conduct any further examination to determine if anyone on the list of creditors had debts dating from l997.

Although I put no weight on the evidence of Michael Zuk about these loans, the failure of Revenue Canada to follow up on the information it had at its disposal is a lacuna in the evidence. This is particularly true as there is some evidence in the accountant's working papers and in the corporate documentation that Mr. Zuk's company did have outstanding loans, from the bank and from other sources. These loans are not relevant to the proceedings unless the corporate loans could be traced to the individuals mentioned above, in which case that evidence could perhaps have been used by the Crown to negative this potential source of non-taxable income.

Other Non-Taxable Sources to explain increased assets?

Peter Zisis readily admitted that he did not investigate other sources that could have contributed to Robert Zuk's increase in assets. He admitted that he had "no idea" if Robert Zuk had received any gifts, inheritances, lottery or gambling winnings, or transfers from abroad. In my view, these sources are distinguishable from the unidentified transfers in and out of his brokerage accounts that are fundamental to the Crown's case, and from the "leads" that were available in the documents which were not followed up by Revenue Canada. Where there was no evidence to suggest any of these other potential sources, and no leads from the defendant, there is no obligation on the Crown to investigate: *Holland, Massei, supra*.

Ultimately, with the assistance of a forensic accountant expert in net worth analyses, it strikes me that this case became much less complex than originally conceived and presented by the Crown. Mr. Webster found relatively few transfers in and out of Mr. Zuk's personal accounts where the source could not be identified. The evidence indicates that a

Digitized by Google

very substantial portion (but not all) of the increase in Robert Zuk's assets in l997 could be traced to a few very large cash and share transactions into his brokerage accounts. That this was not recognized ab initio meant that Revenue Canada may have misidentified the source of his unreported income, and became diverted attempting to prove a source (the Hunter shares) that ultimately may not have been so relevant to his personal holdings. The failure of Revenue Canada to investigate the transactions which became the focus of the trial means that the Crown has not negated other potential nontaxable sources of income that are highly relevant to the increase in assets. When at the conclusion of the trial the court knows nothing about key transactions, it cannot be said that the Crown has identified a likely source and/or investigated to establish that the entries are from a taxable source and the values are otherwise than as Mr. Zuk reported in his income tax return.

Has the Crown proven the mens rea?

There is no dispute that the taxpayer is responsible for the information included in his income tax return, even though he may rely on his accountant to determine what tax is owing. The courts have recognized that the *Income Tax Act* is "necessarily and notoriously complex…(such that) no lay person is expected to know all the complexities, … (and) will act on the advice of professionals:" *Klundert, supra. para. 55.* Clearly, Robert Zuk relied on his accountant to determine what taxes he owed in 1997. The issue is whether there is any evidence that Mr. Zuk failed to provide all the information his accountant needed to prepare an accurate return. Evidence that he failed to do so could lead to the inference that he had the mens rea necessary for these charges. . Mr. Webster agreed that, if information is missing, it is appropriate for the accountant to ask his client, and that the person responsible for the figures is the taxpayer who files the return. He agreed that the accountant relies on information from the taxpayer or his own enquiries including from source documents, publicly available information, and professional judgments. Mr. Webster's expert opinion was that Revenue Canada was working from the same brokerage accounts as was Mr. Zuk's accountant and he was unable to identify any other accounts. With the one exception I discussed previously, he was unable to identify any l997 share transaction in the Revenue Canada working papers that was not included in Mr. Zuk's income tax return. Mr. Zisis agreed that he did not think Mr. Zuk had failed to provide anything to his accountant. Mr. Webster concluded that these circumstances were an indication that Mr. Zuk did not have the mens rea to commit the offences. There is no evidence upon which I could come to any other conclusion. The Crown tendered client account applications Mr. Zuk provided to various brokerage houses to indicate Mr. Zuk's perceptions of his own increasing net worth. These self declarations increased from $50,000 on June 31, l996, to $500,000 (excluding real estate) in February and March l997, to $700,000 in June 1997, to $1.8 million on January 21, l998. The Crown has tendered these self-assessments, presumably to show that Mr. Zuk knew his income was considerably higher than what he reported to Revenue Canada. Presumably, the court is to draw the inference that Mr. Zuk did not provide all the relevant information to his accountant. As Mr. Murphy submitted, however, in the Taurus Capital New Client Application Form dated August 1, l995, Mr. Zuk indicated that his net worth at that time was an estimated $1.1 million. Clearly, that is not a figure that would support the opening net worth determined by Revenue Canada. In the circumstances, I give little weight to the self-reports on the brokerage applications. These would have been provided for another purpose unrelated to Robert Zuk's tax liability, and, in my view, are of questionable reliability.

Conclusion

Digitized by Google

> Common sense would dictate that, given his asset position at the end of l997, Robert Zuk must have earned income in excess of that reported in his l997 income tax return. Common sense, however, is not proof beyond a reasonable doubt. A conviction on these offences requires that the Crown prove Mr. Zuk earned taxable income that he knew was taxable and that he failed to report to Revenue Canada. When a net worth analysis is the tool for the prosecution, the jurisprudence requires that the Crown prove beyond a reasonable doubt either a likely source of the alleged unreported income or disprove beyond a reasonable doubt all non- taxable sources. In this case, I find that the Crown has not met its onus on either head of the required test.
>
> Decision
> For these reasons, Mr. Zuk will be acquitted on both charges.

In the Ontario Appeal case of R. v. Hunter[124] the taxpayer was not successful in maintaining a net worth based acquittal when he was not able to prove that the opening balances were grossly miscalculated. The court held:

> [3] The trial judge acquitted the respondent, however, because she was not able to calculate the amount of income tax that the respondent had not paid. At para. 39 of her reasons, she inferred that the opening net worth statement understated the respondent's assets because no amount was attributed to take into account the possibility that the value of the shares owned by the respondent in December 1995 exceeded the $8,005 indicated.
> [4] While the burden of proof remains on the Crown, the taxpayer is required to keep proper books and records. The opening net worth statement represented all of the tax payor's existing assets based on the documentation that had been seized. The statement was an approximation because the respondent did not keep proper records and did not testify as to his net worth. The appellant submits that it is only if a net worth statement was so inaccurate that it totally undermined the conclusion that any tax was owed that the respondent should have been acquitted on the evidence. We have no evidence that the net worth statement here are is grossly inaccurate.
> [5] The Crown tendered evidence that the taxpayer had a certain amount of assets as of a particular date and had increased his net worth as a result of taxable income that had not been disclosed. The taxpayer offered no evidence by way of explanation. In these circumstances, the Crown is not required to negate every possibility respecting the amounts put forward especially when the matters in issue are peculiarly within the knowledge of the taxpayer.
> [6] Accordingly, the appeal is allowed, the acquittals are set aside and convictions entered. The matter is remitted to the trial judge for sentencing.

In the Ontario Court of Appeal case of R. v. Valovic[125] the Court held:

> No broader significance to the administration of justice
> [6] The appellants claim that the proposed appeal would be the first time a provincial appellate court in Canada has specifically dealt with the issue of what sort of evidence, in addition to a discrepancy demonstrated by a net worth analysis, is required to prove the *actus reus* of tax evasion. A net worth analysis calculates the taxpayer's net worth at the beginning and at the end of the period under review. Where the taxpayer's declared income and other sources of money cannot account for the increase in the taxpayer's net worth, a discrepancy is demonstrated and may lead to the inference that the taxpayer

[124] 2005 ONCJ 428
[125] 2011 ONCA 320

Digitized by Google

earned income that was not reported to the tax authorities.

[7] We do not give effect to this submission. That issue was recently addressed in *R. v. Hunter*, 2008 ONCA 103, where this court held at paras. 4-5 that in the appropriate case, a discrepancy alone is sufficient to prove the *actus reus*. In the present case, this is precisely what the trial judge concluded. **The conclusion was open to him based on the extent of the discrepancy, the appellants' failure to keep proper books and records, the absence of any evidence explaining the discrepancy, and the evidence as to the accuracy of the net worth calculations relied on by the Crown.**

Régent Lacroix v. Her Majesty The Queen, 2008 FCA 241, Net Worth Assessments with 'Civil' Penalties for Incredible Assertions – Not Statute Barred for Reassessment When No Evidenced Support

INTRODUCTION

[1] In the case of any reassessment beyond the normal reassessment period (the statutory period), as in the case of the assessment of a penalty, the *Income Tax Act* requires that the Minister prove that there was misconduct on the part of the taxpayer in filing his or her tax return. How does the Minister discharge this burden of proof where the reassessment, or the assessment of the penalty, results from the application of the net worth method? Can the Minister conclude, based on the discrepancy between a taxpayer's assets and the income reported in his or her tax return, on the one hand, and on the lack of a credible explanation for this discrepancy, on the other hand, that there is an error warranting an out-of-time reassessment or the assessment of a penalty? The Tax Court of Canada judge concluded that the Minister could. Was the judge correct?

THE FACTS

[2] In the year 2001, the Canada Revenue Agency (the Minister) asked Régent Lacroix and his spouse to prepare their personal balance sheets for each taxation year from 1995 to 2000. Mr. Lacroix's balance sheet reported liquid assets totalling $500,000 from the 1995 taxation year. This led to a more in-depth review of Mr. Lacroix's affairs. The Minister conducted this review using the net worth method, which revealed a significant discrepancy between the Mr. Lacroix's opening balance and closing balance. This discrepancy was deemed to be income. The Minister concluded that Mr. Lacroix had unreported income totalling $145,667 for the 1997 taxation year, $231,570 for the 1998 taxation year, $156,333 for the 1999 taxation year and $26,103 for the 2000 taxation year. The Minister made reassessments for the taxation years in question, adding these amounts to Mr. Lacroix's income. However, two of these reassessments were made outside the statutory period. Furthermore, the Minister did not confine himself to simply increasing Mr. Lacroix's income; he assessed penalties against him because Mr. Lacroix, it would appear, knowingly, or under circumstances amounting to gross negligence, filed false tax returns.

[3] In so doing, the Minister rejected Mr. Lacroix's explanation as to the source of the $500,000 in cash appearing in his balance sheet. According to Mr. Lacroix, the cash came from a loan made to him by Gilles Pronovost. The two men first met when Mr. Lacroix saved Mr. Pronovost 's son from drowning. This was the beginning of a friendship between the two men. In the course of this relationship, Mr. Lacroix told Mr. Pronovost about his dream of setting up a real estate investment portfolio for himself. Feeling ever grateful to Mr. Lacroix for having rescued his son, Mr. Pronovost agreed to loan him $500,000, which he gave him in several instalments over a period of two or three years beginning in 1993. All

Digitized by Google

of these payments were made in cash. Mr. Lacroix states that he kept the money locked in a safe at his home. According to his balance sheet for 1995, Mr. Lacroix let this cash build up for several years before he began setting up his real estate portfolio. In 1996, he started acquiring properties, becoming the owner of 20 buildings, according to his personal balance sheet for the year 1999.

[4] The Minister reassessed Mr. Lacroix's tax returns, and Mr. Lacroix wasted no time in contesting those reassessments. When the Minister confirmed the reassessments, Mr. Lacroix filed a notice of appeal for each of the taxation years in question, namely 1997, 1998, 1999 and 2000. All of those appeals were brought to trial before Justice Bédard of the Tax Court of Canada, who dismissed each appeal: see *Lacroix v. Canada*, 2007 TCC 376, [2007] T.C.J. No. 216. After setting out the evidence and citing long passages from the testimonies of Mr. Lacroix and Mr. Pronovost in support, the judge stated his findings with regard to credibility:

> 12. The assessment of the credibility of the appellant and of Mr. Pronovost have played an important role in my decision, given the almost complete lack of documentary or objective evidence as to how the appellant used the $500,000 in cash or where the $500,000 in cash allegedly held by Mr. Pronovost came from. I would like to point out that I attach little probative value to the testimonies of the appellant, his spouse and Mr. Pronovost . . . .

[5] The judge listed, one after the other, the numerous implausibilities supporting his findings with regard to the witnesses' credibility. Finally, the judge writes the following:

> 20. My analysis of the evidence leads me to find that it is more likely than not that these loans never existed and that the notes (Exhibit A-4), the request for repayment (Exhibit A-8) and the cheques made out to Mr. Pronovost were merely a sham to hide the truth. Accordingly, it is difficult to arrive at any other conclusion than that the appellant deliberately failed to report $516,000 in income. In my opinion, the Minister has discharged the burden of proof on him and was therefore entitled to impose penalties under subsection 163(2) of the Act on the appellant's unreported income. Since the Minister's burden of proof is less under subsection 163(2) of the Act than under subsection 152(4), I am also of the opinion that the Minister was entitled to make reassessments. Finally, I note that the Minister does not, in my opinion, have to identify the source of the appellant's unreported income when this income is established using the net worth method.

[6] The appellant challenges the judge's conclusions, which are merely findings with regard to the credibility of the witnesses who appeared before him. The judge never determined the true source of the funds in question or how they were applied, nor did he determine the true nature of the relationship between Mr. Lacroix and Mr. Pronovost. He simply stated that he did not believe their testimony and that the evidence they submitted had been fabricated. Therefore, there was no evidence before the judge that would have allowed him to conclude that the discrepancy detected using the net worth method was not income.

Digitized by Google

[7] The appellant submits that, notwithstanding the great deference that a court of appeal must afford to a trial judge's findings of fact, we must intervene because the judge rejected out of hand all of the evidence supporting the appellant's version of the facts. The appellant notes, for example, that there is evidence of a number of certified cheques made to the order of Mr. Pronovost from a trust controlled by Mr. Lacroix. According to the appellant, this proves that there was a loan and that it was repaid, except for $70,000. The appellant draws the Court's attention to other evidence that the judge wrongly failed to consider or to which he did not give appropriate weight in assessing the appellant's credibility.

[8] The assessment of credibility is the task of the trial judge. There is nothing surprising in the fact that some evidence supports the version of the facts proposed by one party while other evidence undermines it. The trial judge is in a better position to assess the true value of these disparate elements and draw the proper conclusions. In the case at bar, the judge duly noted the evidence which the appellant raises but deemed it to be fabricated and dismissed it. There is nothing in the evidence or in the I*ncome Tax Ac*t, R.S. 1985, c. 1 (5th Supp.), (the Act) that would warrant this Court's intervention. The debate in this appeal is at another level.

ANALYSIS

[9] The rejection of Mr. Lacroix's explanation for the discrepancy between his reported income and his net worth does not in itself justify a reassessment beyond the statutory period or warrant the assessment of a penalty. There are therefore two issues that remain to be decided:

> 1. Was the Minister required to prove the source of the income detected through the application of the net worth method to justify the inclusion of this income in the taxable income of Mr. Lacroix?
>
> 2. Did the Minister discharge the burden of proof on him under subparagraph 152(4)(*a*)(i) and subsection 163(2) before, first, making a reassessment beyond the statutory period and, second, assessing a penalty against the taxpayer?

[10] It should be noted that these are two distinct questions. The question of the source of the income attributed to Mr. Lacroix in applying the net worth method must be raised even when the Minister attempts to make a reassessment within the statutory period. The first question therefore cannot be answered by relying on case law that only addresses the second.

1- Was the Minister required to prove the source of the income detected through the application of the net worth method to justify the inclusion of this income in the taxable income of Mr. Lacroix?

[11] Mr. Lacroix contests the judgment of the judge of the Tax Court of Canada on the basis of case law of that court holding that the Minister, in applying the net worth method, must not only show that the discrepancy between the taxpayer's assets and his reported income leads to the conclusion that the taxpayer earned unreported income, but also demonstrate that the source of this income can be determined:

> 77. The Minister has the initial onus of proving that a taxpayer made a misrepresentation in filing the tax return. It is insufficient for the Minister to refer to a net worth statement showing discrepancies between available income and reported income. The Minister must prove that this additional income was from

Digitized by Google

a source that should have been included in the taxpayer's return. The onus on the Minister will be greater if the taxpayer presents plausible explanations showing a non-taxable source of this additional income.

[Emphasis added]
[*Dowling v. Canada*, [1996] T.C.J. No. 301, [1996] 2 C.T.C. 2340, at paragraph 77 (*Dowling*).]

[12] In *Dowling*, a professional golfer's tax returns for a number of taxation years were reassessed using the net worth method. Two of the years reassessed by the Minister fell outside the statutory period. The passage cited above, upon which Mr. Lacroix relies, is taken from the analysis of the burden of proof on the Minister where the Minister attempts to make a reassessment beyond the statutory period.

[13] Just as in the instant case, Mr. Dowling had an explanation for the discrepancy detected using the net worth method. The Court rejected this explanation but also considered the Minister's theory as to the source of the unreported income, namely an underestimation of the income generated by Mr. Dowling's golf pro shop. The Court conducted this analysis to determine whether the Minister had proven that Mr. Dowling had knowingly misrepresented the facts in his tax return. The Court then scrutinized the evidence with great care and concluded that Mr. Dowling's golf pro shop had a profit margin of 60%, not 15% as he claimed. From this, the Court concluded as follows at paragraph 95:

95. Since the respondent (the Crown) showed that the appellant misrepresented his income from his business, the next step was to show that this misrepresentation was due to negligence, carelessness, or wilful default. A number of cases have held that a failure to keep adequate business records will constitute negligence. In the present case, the appellant failed to keep the cash register tapes as supporting documentation of his sales. As well, the appellant combined his personal finances with those of his business in one bank account. These actions amounted to negligence on the part of the appellant . . . .

[14] Upon reading the reasons of the Court, it becomes clear that the Court had considered the question of the source of the income in order to decide if the taxpayer had been negligent in respect of this source, or if had acted knowingly or under circumstances amounting to gross negligence. The question of the income's source was raised in the context of evidence of misconduct on the part of the taxpayer.

[15] The same problem arose in *Corriveau v. Canada*, 97-767 (IT)I, [1998] T.C.J. No. 1112. The net worth method did not reveal a significant discrepancy between the income reported in the taxpayer's tax return and the additions to his assets during the period in question. The Tax Court of Canada was not satisfied with the evidence adduced by the Minister regarding the source of this income, in that the Court still had doubts as to whether the taxpayer's conduct amounted to negligence, carelessness or wilful omission:

31. If I cannot be specific as to Mr. Corriveau's gross negligence, I cannot find that the conditions for the application of section 163 of the Act have been met.

[*Corriveau*, at paragraph 31.]

[16] Again, the question of the source of the unreported income was raised wholly in

Digitized by Google

the context of evidence of the taxpayer's misconduct in filing his tax return.

[17] The Court conducted the same analysis in *Léger v. Canada*, 96-4799 (IT)G, [2000] T.C.J. No. 911, at paragraphs 48 to 51.

[18] In my view, this jurisprudence does not establish a rule to the effect that the Minister may not use the net worth method to add unreported income to a taxpayer's income unless the Minister can establish the source of the unreported income. Our tax collection system is based on the taxpayer's self-reporting of the income he or she has earned during a taxation year. Should the Minister doubt, for whatever reason, the accuracy of the taxpayer's return, the Minister may conduct an investigation in such manner as deemed necessary. The Minister may then make a reassessment. If the taxpayer appeals the reassessment, the Minister does not have to prove the facts giving rise to the reassessment. In the reply to the notice of appeal, the Minister need only set out the presumptions of fact used in the reassessment. The onus is on the taxpayer, who knows everything there is to know about his or her own affairs, to "demolish" the Minister's assumptions; otherwise, they are presumed to be true.

[19] The Supreme Court has endorsed this approach on a number of occasions, including in *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336, to name just one example. In that case, the Court stated the following at paragraphs 92-93:

> 92 . . . The Minister, in making assessments, proceeds on assumptions (*Bayridge Estates Ltd. v. M.N.R.*, 59 D.T.C. 1098 (Ex. Ct.), at p. 1101) and the initial onus is on the taxpayer to "demolish" the Minister's assumptions in the assessment (*Johnston v. Minister of National Revenue*, [1948] S.C.R. 486; *Kennedy v. M.N.R.*, 73 D.T.C. 5359 (F.C.A.), at p. 5361). The initial burden is only to "demolish" the exact assumptions made by the Minister but no more: *First Fund Genesis Corp. v. The Queen*, 90 D.T.C. 6337 (F.C.T.D.), at p. 6340.
>
> 93 This initial onus of "demolishing" the Minister's exact assumptions is met where the Appellant makes out at least a prima facie case: *Kamin v. M.N.R.*, 93 D.T.C. 62 (T.C.C.); *Goodwin v. M.N.R.*, 82 D.T.C. 1679 (T.R.B.) . . . . The law is settled that unchallenged and uncontradicted evidence "demolishes" the Minster's assumptions: see for example *MacIsaac v. M.N.R.*, 74 D.T.C. 6380 (F.C.A.), at p. 6381; *Zink v. M.N.R.*, 87 D.T.C. 652 (T.C.C.) . . . .

[20] Applying the net worth method changes nothing in this method of proof. Where the Minister presumes that the income detected using the net worth method is taxable income, the onus is on the taxpayer to demolish this presumption. If the taxpayer presents credible evidence that the amount in question is not income, the Minister must then go beyond these assumptions of fact and file evidence proving the existence of this income.

[21] In the case at bar, the assumptions of fact on which the Minister relied included the following:

> [TRANSLATION]
> 22. . . .
>
> (l) The appellant did not report all of his income in his tax returns for the years 1997, 1998, 1999 and 2000;

Digitized by Google

(m) After conducting an audit using the net worth method, the Minister found that the appellant had underestimated his taxable income, in the following amounts . . .

1997	$145,667
1998	$231,570
1999	$156,333
2000	$26,103

[Emphasis added]

[22] The amount and the nature of the unreported income having been alleged by the Minister in his assumptions of fact, the onus was on the taxpayer to prove to the judge of the Tax Court of Canada that the amounts detected using the net worth method were not taxable income.

[23] In the case at bar, Mr. Lacroix did not deny that he had access to a source of funds in addition to his reported income; however, he argued that these funds were not income because they were merely loans that had been extended to him by his friend, Mr. Pronovost. The judge of the Tax Court of Canada rejected this explanation, which means that the Minister's assumptions of fact, including the one regarding the taxable nature of the income earned by Mr. Lacroix, are presumed to be true. The Court could therefore conclude that Mr. Lacroix had underestimated his taxable income in the amounts set out in the reply to the notice of appeal for each of the taxation years in question.

[24] This reasoning in no way places an unfair burden on the taxpayer. The taxpayer is aware of the facts and has the means to prove them. It would be most unrealistic to have the Minister bear the onus of uncovering a source of income whose existence can be detected only indirectly, that is, using the net worth method.

2. Did the Minister discharge the burden of proof on him under subparagraph 152(4)(*a*)(i) and subsection 163(2) before, first, making a reassessment beyond the statutory period and, second, assessing a penalty against the taxpayer?

[25] The provisions in question read as follows:

152.(4) The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of	152.(4) Le ministre peut établir une cotisation, une nouvelle cotisation ou une cotisation supplémentaire concernant l'impôt pour une année d'imposition, ainsi que les intérêts ou les pénalités, qui sont payables par un contribuable en vertu de la présente partie ou donner avis par écrit qu'aucun impôt n'est payable pour l'année à toute personne qui a produit une déclaration de revenu pour une année d'imposition. Pareille cotisation ne peut être établie après l'expiration de la période normale de nouvelle

Digitized by Google

the year only if	cotisation applicable au contribuable pour l'année que dans les cas suivants:
(*a*) the taxpayer or person filing the return	*a*) le contribuable ou la personne produisant la déclaration:
(i) has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or in supplying any information under this Act, or	(i) soit a fait une présentation erronée des faits, par négligence, inattention ou omission volontaire, ou a commis quelque fraude en produisant la déclaration ou en fournissant quelque renseignement sous le régime de la présente loi,
…	[…]
163.(2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of $100 and 50% of the total of…	163.(2) Toute personne qui, sciemment ou dans des circonstances équivalant à faute lourde, fait un faux énoncé ou une omission dans une déclaration, un formulaire, un certificat, un état ou une réponse (appelé «déclaration» au présent article) rempli, produit ou présenté, selon le cas, pour une année d'imposition pour l'application de la présente loi, ou y participe, y consent ou y acquiesce est passible d'une pénalité égale, sans être inférieure à 100 $, à 50 % du total des montants suivants:…
	[…]
…	

[26] Although the Minister has the benefit of the assumptions of fact underlying the reassessment, he does not enjoy any similar advantage with regard to proving the facts justifying a reassessment beyond the statutory period, or those facts justifying the assessment of a penalty for the taxpayer's misconduct in filing his tax return. The Minister is undeniably required to adduce facts justifying these exceptional measures.

[27] In *Richard Boileau v. M.N.R.*, 89 D.T.C. 247, Judge Lamarre Proulx stated as follows, at page 250:

> Indeed, the Appellant was unable to contradict the basic elements of the net worth assessments. However, in my view, this is not sufficient for discharging

Digitized by Google

the burden of proof which lies on the Minister. To decide otherwise would be to remove any purpose to subsection 163(3) by reverting the Minister's burden of proof back onto the Appellant.

[28] In a similar vein, in *Farm Business Consultants Inc. v. Her Majesty the Queen*, [1994] 2 C.T.C. 2450, 95 D.T.C. 200, Judge Bowman wrote the following at paragraph 27:

> 27 A court must be extremely cautious in sanctioning the imposition of penalties under subsection 163(2). Conduct that warrants reopening a statute-barred year does not automatically justify a penalty and the routine imposition of penalties by the Minister is to be discouraged . . . . Moreover, where a penalty is imposed under subsection 163(2) although a civil standard of proof is required, if a taxpayer's conduct is consistent with two viable and reasonable hypotheses, one justifying the penalty and one not, the benefit of the doubt must be given to the taxpayer and the penalty must be deleted . . . .

[29] This last passage highlights the dialectic specific to certain reassessments made using the net worth method. In the case at bar, the Minister found undeclared income and asked the taxpayer to justify it. The taxpayer provided an explanation that neither the Minister nor the Tax Court of Canada found to be credible. Accordingly, there is no viable and reasonable hypothesis that could lead the decision-maker to give the taxpayer the benefit of the doubt. The only hypothesis offered was deemed not to be credible.

[30] The facts in evidence in this case are such that the taxpayer's tax return made a misrepresentation of facts, and the only explanation offered by the taxpayer was found not to be credible. Clearly, there must be some other explanation for this income. It must therefore be concluded that the taxpayer had an unreported source of income, was aware of this source and refused to disclose it, since the explanations he gave were found not to be credible. In my view, given such circumstances, one must come to the inevitable conclusion that the false tax return was filed knowingly, or under circumstances amounting to gross negligence. This justifies not only a penalty, but also a reassessment beyond the statutory period.

[31] Paragraph 20 of Justice Bédard's reasons for decision, cited above, sets out precisely this situation, which amply justifies his conclusions with regard to the penalties and the reassessment beyond the statutory period.

[32] What, then, of the burden of proof on the Minister? How does he discharge this burden? There may be circumstances where the Minister would be able to show direct evidence of the taxpayer's state of mind at the time the tax return was filed. However, in the vast majority of cases, the Minister will be limited to undermining the taxpayer's credibility by either adducing evidence or cross-examining the taxpayer. Insofar as the Tax Court of Canada is satisfied that the taxpayer earned unreported income and did not provide a credible explanation for the discrepancy between his or her reported income and his or her net worth, the Minister has discharged the burden of proof on him within the meaning of subparagraph 152(4)(*a*)(i) and subsection 162(3).

[33] As Justice Létourneau so aptly put it in *Molenaar v. Canada*, 2004 FCA 349, 2004 D.T.C. 6688, at paragraph 4:

> 4. Once the Ministère establishes on the basis of reliable information that there is a discrepancy, and a substantial one in the case at bar, between a

Digitized by Google

taxpayer's assets and his expenses, and that discrepancy continues to be unexplained and inexplicable, the Ministère has discharged its burden of proof. It is then for the taxpayer to identify the source of his income and show that it is not taxable.

[34] For these reasons, I would dismiss the appeal with costs.

"J.D. Denis Pelletier"
J.A.

"I concur.
M. Nadon J.A."

"I concur.
Johanne Trudel J.A."

Michel Guibord v. Her Majesty The Queen, 2011 FCA 344, Net Worth Argument and an Issue of Credibility

REASONS FOR JUDGMENT MAINVILLE J.A.

[1] This concerns five appeals from five judgments of V. Miller J. of the Tax Court of Canada (the "Judge"):

The individual appellants Michel Guibord (appeal file A-351-10), Mei Guibord (appeal file A-352-10) and George Szeto (appeal file A-354-10) seek to overturn the judgments of the Tax Court of Canada which partially allowed their appeals from reassessments issued by the Minister of National Revenue (the "Minister") under the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) for the 1995, 1996 and 1997 taxation years.

The corporate appellant, George S. Szeto Investments Ltd., seeks to overturn a judgment of the Tax Court of Canada which allowed in part its appeal from reassessments issued by the Minister under the *Income Tax Act* for its taxation years ending October 31, 1995, October 31, 1996 and October 31, 1997 (appeal file A-353-10)

Finally, the corporate appellant George S. Szeto Investments Ltd. also seeks to overturn a decision of the Tax Court of Canada which allowed in part its appeal from reassessments issued under the *Excise Tax Act*, R.S.C. 1985, c. E-15 in respect to GST for the period of November 1, 1994 to October 31, 1997 (appeal file A-360-10).

All these appeals were consolidated by order of this Court dated December 17, 2010.

[2] Siblings Mei Guibord and George Szeto are the sole shareholders of George S. Szeto Investments Ltd. which itself owns and operates the Ruby King Restaurant. The corporate appellant shall be referred to in these reasons as "Ruby King". Mei Guibord is also the spouse of Michel Guibord. During the years reassessed, Mei Guibord and George Szeto were salaried employees of Ruby King. Michel Guibord was not directly employed by Ruby King. Rather, he worked for the Department of National Defence as a computer specialist. However, until February 1997, he was the bookkeeper for Ruby King. In that capacity, he received the daily sales receipts for Ruby King and he periodically made deposits to Ruby King's bank account.

[3] In 1995, 1996 and 1997, Michel Guibord reported employment income of $43,933, $49,111 and $48,779 respectively; Mei Guibord reported employment income of

Digitized by Google

$10,600, $10,400 and $10, 400 respectively; and George Szeto reported income of $10,600, $10,400 and $10,400 respectively. Ruby King reported losses for all relevant periods; however, in each of the relevant years, the financial statements prepared for Ruby King indicated large amounts as "Due to Shareholders".

[4] The Minister audited Ruby King and found its records to be unreliable and incomplete. This resulted in additional investigations by the Minister into the income reported by the individual appellants. A net worth method was finally used by the Minister to reassess Ruby King and the three individual appellants. The Minister further relied on subsection 152(4) of the *Income Tax Act* to reassess the appellants beyond the three-year limitation period. In addition, he assessed all of the appellants with penalties under subsection 163(2) of the *Income Tax Act* and Ruby King with additional penalties under subsection 298(4) of the *Excise Tax Act*.

[5] The appellants appealed to the Tax Court of Canada. Their appeals were decided on common evidence following thirteen days of hearings. The Judge was satisfied that the Minister was justified in opening the three statute barred taxation years for all the appellants because she found that they had made misrepresentations relating to their income which, at minimum, were attributable to neglect and carelessness. The Judge went on to make various corrections to the appellants' net worth statements. She then set aside the penalties imposed upon the individual appellants while confirming the penalties assessed on Ruby King. The issue of costs was reserved. After receiving written submissions on costs, the Judge issued reasons and an order with respect to costs. That order is the subject of separate appeals, and is not dealt with in these reasons.

[6] The appellants appeal to this Court on various grounds. The principal grounds of appeal may be restated as follows:

The Judge erred when failing to put her mind as to whether or not, in the circumstances, the net worth reassessments should be vacated because they were not completed in a principled and rational manner and because they were done in an arbitrary fashion.

The Judge erred by (i) failing to identify the legal test which the appellants had to meet in order to demolish the Minister's assumptions, (ii) failing to determine whether the facts satisfied the legal test for each of the appellants, and (iii) failing to consider all the relevant evidence when considering the test for each of the appellants.

The Judge erred in apportioning a part of the income of Michel Guibord to his spouse Mei Guibord.

The Judge erred when she failed to vacate George Szeto's reassessment on the principle of *de minimus*.

[7] *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 sets out the standard of review in an appeal from a judgment of the Tax Court of Canada. The standard of review on a question of law is correctness, while findings of fact are not to be disturbed unless it can be established that the trial judge made a palpable and overriding error. The application of a legal standard to a set of facts is a question of mixed fact and law which is also subject to deference unless an extricable question of law can be identified. The appellants' grounds of appeal challenge the Judge's findings of fact or the application by the Judge of a legal standard to a set of facts. Consequently, unless an extricable question of law can be identified, the standard of review which applies in these appeals is that of a palpable and overriding error.

Did the Judge err by failing to put her mind as to whether or not, in the circumstances, the net worth reassessments should be vacated because they were not completed in a principled and rational manner and because they were done in an arbitrary fashion?

[8] In certain appropriate circumstances, the Minister may use the net worth

Digitized by Google

methodology to assess a taxpayer. This methodology has been described as follows by Bowman J. in *Bigayan v. R.* (1999), 2000 D.T.C. 1619:

The net worth method, as observed in *Ramey v. The Queen*, 93 D.T.C. 791, is a last resort to be used when all else fails. Frequently it is used when a taxpayer has failed to file income tax returns or has kept no records. It is a blunt instrument, accurate within a range of indeterminate magnitude. It is based on an assumption that if one subtracts a taxpayer's net worth at the beginning of a year from that at the end, adds the taxpayer's expenditures in the year, deletes non-taxable receipts and accretions to value of existing assets, the net result, less any amount declared by the taxpayer, must be attributable to unreported income earned in the year, unless the taxpayer can demonstrate otherwise. It is at best an unsatisfactory method, arbitrary and inaccurate but sometimes it is the only means of approximating the income of a taxpayer.

[9] Though it is an arbitrary and imprecise approximation of a taxpayer's income, the perceived unfairness of a net worth assessment is somewhat resolved by the fact the taxpayer is in the best position to know his or her own taxable income. Where a factual basis of the Minister's estimation is inaccurate, it should be a simple matter for the taxpayer to correct the Minister's error to the satisfaction of the Court: *Hsu v. The Queen*, 2001 FCA 240; [2001] 4 C.T.C. 1; 2001 D.T.C. 5459, at paragraph 30.

[10] The appellants assert that the use of the net worth method was arbitrary in that the Minister could have used another audit method. They add that the Minister's net worth reassessments were unprincipled since the CRA auditor responsible for the audits attributed the "Due to shareholders" in Ruby King to the individual appellants - rather than as unreported earnings of Ruby King - when he knew (and later acknowledged) that this assumption was questionable. The appellants thus conclude that their reassessments should be vacated on this basis.

[11] In my view, this ground of appeal should fail.

[12] The Judge found that the systems used by the appellants for sales and daily cash reconciliations in Ruby King were haphazard and questionable: Reasons at paragraphs 31 and 64. She further found that large amounts attributable to sales at Ruby King's were not rung into the cash register, and that Michel Guibord treated his duties as bookkeeper and the Ruby King's monies "in a cavalier and frivolous manner": Reasons at paragraph 64. She further did not believe Michel Guibord's explanation that any discrepancies between declared revenues and his and his spouse's net worth assessments were attributable to his alleged large casino gambling gains: Reasons at paragraphs 55 to 58. All these findings support the position of the Minister that a net worth method was justified in these circumstances.

[13] Moreover, the financial statements of Ruby King set out large amounts as "Due to shareholders". Though these amounts were subsequently found by the Judge to relate to unreported sales in Ruby King, the appellants cannot take issue with the fact that the Minister used an assumption which they themselves set out in the financial statements they submitted to the Minister.

Did the Judge err by (i) failing to identify the legal test which the appellants had to meet in order to demolish the Minister's assumptions, (ii) failing to determine whether the facts satisfied the legal test for each of the appellants, and (iii) failing to consider all the relevant evidence when considering the test for each of the appellants?

[14] Under subsection 152(7) of the *Income Tax Act*, the Minister is not bound by a return or information supplied by a taxpayer and may assess the taxpayer using

Digitized by Google

any method that is appropriate in the circumstances. Subsection 158(8) of the *Income Tax Act* sets out that these assessments are deemed to be valid. The onus is therefore upon the taxpayer to disprove the assumptions of the Minister by making out a *prima facie* case. Once the Minister's assumptions have been "demolished", the onus shifts to the Minister to rebut the *prima facie* case made out by the taxpayer and to prove the assumptions.

Ruby King

[15] Ruby King asserts that since the Judge found that there was no evidence that its sales exceeded the deposits in its bank accounts (Reasons at paragraph 64 *in fine*), this finding "demolished" the Minister's net worth assumptions, and its appeals should thus be granted. It further argued that it was improper for the Judge to refer the matter back to the Minister for reassessment on a net worth basis.

[16] I find this argument somewhat disingenuous in light of the findings of the Judge that Ruby King maintained a deficient and frivolous accounting system resulting in hundreds of thousands of dollars in unreported sales during the three years in question. There is consequently no merit to this argument.

Mei and Michel Guibord

[17] Mei and Michel Guibord assert that the Judge failed to consider that they had "demolished" the Minister's assumption that the increase in their net worth came from undeclared cash revenues in Ruby King. They say that this assumption was "demolished" when the Judge found that the amounts "Due to shareholders" reported in the financial statements were in fact unreported sales in Ruby King, and that only these amounts had been unreported as revenues in Ruby King. In their view, had the Judge considered the evidence, she would have been compelled to conclude that the onus had shifted to the Minister to prove the source of their income which explained their net worth. Since the Minister did not present any such evidence, they claim that their appeals against the reassessments should have been allowed.

[18] They add that in any event, their testimony and the other evidence they tendered demonstrated at least on a *prima facie* basis that Michel Guibord was a very lucky "slot machine" gambler.

Consequently, his gains from "slot machine" gambling explained *prima facie* the discrepancies between their net worth and their declared taxable incomes.

[19] This ground of appeal fails to consider that the Minister's assumptions were not necessarily tied to revenues obtained by Mei and Michel Guibord in Ruby King. The proceedings in the Tax Court show that the Minister's assumptions were that Mei and Michel Guibord had undeclared taxable revenues from a source other than their declared income. Moreover, this ground of appeal is largely predicated on the assumption that the evidence submitted in support of the gambling revenue source was uncontroversial and credible. It was not.

[20] The Judge found Michel Guibord's testimony on this issue not to be reliable, his recollection to be incorrect and self serving, and the evidence submitted to be unpersuasive. She further found that much of the evidence simply did not support his version of events: Reasons at paragraphs 55 to 58. [21] I have not been persuaded that the Judge made a palpable and overriding error in reaching these findings. The record before us shows that there was ample evidence before the Judge to allow her to conclude as she did. There was clear evidence of substantial withdrawals from bank accounts and credit cards which contradicted the assertion that all large US dollar deposits by the couple were from gambling wins. Moreover, no record or tracking of the gambling

Digitized by Google

wins or losses was supplied. Nor was any evidence tendered as to the amounts spent to make the alleged gambling wins.
[22] The issue here is simply one of credibility. The Judge did not find the testimony as to the extent of the claimed gambling wins either reliable or credible. Consequently, neither Mei nor Michel Guibord made out a *prima facie* case disputing the Minister's assumptions. Barring a palpable and overriding error, this Court should not intervene.

Did the Judge err in apportioning a part of the income of Michel Guibord to his spouse Mei Guibord?
[23] The Minister applied the net worth assessment analysis to the family unit comprised of both Mei and Michel Guibord, and apportioned as taxable income the unexplained increases in the net worth equally between Mei and Michel Guibord. Mei Guibord asserts as an additional ground of appeal that the Judge erred in confirming this apportionment when the evidence showed that the additional income was essentially attributable to Michel Guibord.
[24] The parties confirmed at the oral hearing before this Court that this ground of appeal had not been raised in the Tax Court of Canada. Consequently, the Judge did not address it in her Reasons. Since the issue was not pleaded and put in issue before the Tax Court, it is now too late to raise the issue.

Did the Judge err when she failed to vacate George Szeto's reassessment on the principle of de minimus?
[25] Under the doctrine of *de minimus*, a fact or thing may be so insignificant that a court may overlook it in deciding an issue or case: *Black's Law Dictionary*, Eight Edition.
[26] George Szeto asserts that since the results of the Minister's net worth analysis were substantially reduced by the Judge, she should have accordingly found - on the *de minimus* doctrine **- that the Minister had not established that he had made misrepresentations that were attributable to neglect, carelessness or wilful default. Accordingly, the Judge erred when she found that the Minister was justified in reassessing Mr. Szeto for the statute barred years.**
[27] **The Crown contends that the *de minimus* doctrine does not apply in the Tax Court of Canada in light of the limited statutory jurisdiction of that Court. We need not decide this issue.**
[28] Indeed, whether the doctrine applies or not, there was ample evidence before the Judge demonstrating that George Szeto was grossly negligent in regard to his and Ruby King's tax returns. I note in particular the findings of the Judge at paragraph 26 of her reasons that Mr. Szeto "signed both his and Ruby King's income tax returns without asking any questions" and that he did not review the financial statements. In addition, the Judge further found at paragraph 38 of her reasons that the "evidence submitted at the hearing does not totally support George's testimony with respect to the bank accounts". The Judge also noted discrepancies in his testimony concerning the net worth statement items relating to a Honda Civic and certain household goods. There were consequently ample reasons and evidence for the Judge to conclude that the Minister was justified in reassessing George Szeto for the concerned years.

Other grounds of appeal
[29] Though not emphasizing these issues in their oral arguments, the appellants have also raised numerous other grounds of appeal concerning notably the cash on hand which the Guibord couple held, certain personal assets and personal expenditures of Mr. Szeto,

Digitized by Google

the ownership of certain bank accounts, etc. All these grounds seek to challenge the assessment of the evidence by the Judge. The appellants have not convinced me that the Judge committed a palpable and overriding error on any of the challenged findings.

Conclusions

[30] I would consequently dismiss these appeals. I would also award the costs of these appeals to the respondent. However, there should be only one set of costs for the appeal files A-351-10, A-352-10, A-353- 10, A-354-10 and A-360-10.

"Robert M. Mainville"

J.A.

"I agree.
Eleanor R. Dawson
J.A."

"I agree.
Johanne Trudel J.A."

The Charter, Special Investigations and Disclosures/RFIs and Warrants

Based on Jarvis there are considerable instances that limit CRA's power to obtain, and have qualified for court admissibility, evidence from the taxpayer. The Jarvis precedent is a high mark for distinguishing when a taxpayer does not have to respond to questioning when a regulatory audit turns into a special investigation leading to penal processes described in s. 238-9.

When the audit function starts to be used as an aspect of the criminal investigation "the music stops" and counsels can argue that Charter s. 7 – 8 protections against self-incrimination come into effect. Where that line is was commented on in Jarvis when the Supreme Court held:

> Where the predominant purpose of an inquiry is the determination of penal liability, there exists an adversarial relationship between the taxpayer and the state. To determine whether the predominant purpose of an inquiry is the determination of penal liability, one must look to all factors that bear upon the nature of the inquiry. Apart from a clear decision to pursue a criminal investigation, no one factor is determinative. Even where reasonable grounds to suspect an offence exist, it will not always be true that the predominant purpose of an inquiry is the determination of penal liability. The following factors assist in ascertaining whether an inquiry's purpose is to investigate penal liability:
>
> **Did authorities have reasonable grounds to lay charges or could a decision have been made to proceed with a criminal investigation?**
>
> **Was the general conduct of the authorities consistent with a criminal investigation?**
>
> **Did the auditor transfer his or her file to the investigators?**
>
> **Was the auditor's conduct such that he or she was acting as an agent for the investigators?**
>
> **Does it appear that the investigators intended to use the auditor as their agent?**
>
> **Is the evidence relevant to taxpayer liability generally or only to penal liability? and,**
>
> **Do other circumstances or factors suggest that an audit became a criminal investigation?**

Digitized by Google

R. v. Alberta Hot Oil Services Ltd., 2007 ABQB 155, Small Owner-Operations and Close-Knit Environments that Give Rise to Tax Evasion on Personal Expenses (it just doesn't happen with NYC hotel magnates)

Overview Facts Issues
Standard of Review Analysis
Did the trial Judge apply the wrong test to Joe Rinas's application for non-suit?
Did the trial Judge misdirect himself when he stated "[t]his is not a complex conspiracy"?
Did the trial Judge err in his application of the law relating to the rule in *Hodge's Case*? 4. Did the trial Judge err in his application of the law relating to wilful blindness5. Did the trial Judge err by taking judicial notice that the purpose of some of the items claimed was a personal purpose?
Did the trial Judge err by failing to consider all of the defences available to Joe Rinas and the Corporation, particularly that Joe Rinas and the Corporation were victims of Darlene Rinas?
Did the trial Judge err by failing to provide reasonably intelligible reasons to permit meaningful appellate review of his decision
Did the trial Judge err in his application of the law relating to shareholder's benefits under the Income Tax Act?
Did the trial Judge err in his application of the law relating to input tax credits under the *Excise Tax Act?*
Conclusion

Overview
[1] At the time of trial the corporate appellant Alberta Hot Oil Services Ltd. [the "Corporation"] was a tightly held corporation. The individual appellants Ronald Rinas ["Joe Rinas"] and Darlene Rinas were the sole shareholders, directors and officers of the Corporation and each had signing authority for the corporate bank account. The Corporation and the two individuals were all convicted of tax related offences relating to the taxation years 2001 and 2002. All three appeal their convictions.

Facts
[2] The Corporation's business was primarily the provision of hot oil services to the petroleum industry in Alberta. In addition to filing corporate T2 tax returns and financial statements for each year, the Corporation was a registered collector of GST and reported its net GST on a quarterly basis based on its year end.
[3] Joe Rinas was a 50% shareholder of the Corporation and the president of the company. His role in the operations of the Corporation was to oversee the work of employees, to look after equipment and to run the external work of the Corporation. Darlene Rinas was the other 50% shareholder of the Corporation. She was the secretary-treasurer of the Corporation and maintained the books of the company. There were no other directors or officers of the Corporation.
[4] In May of 2003 the Canada Revenue Agency ("CRA") conducted an audit on the Corporation for the taxation years 2001 and 2002 and concluded that several expenses of a personal nature had been deducted in the corporate records, including expenses of the Rinas's two adult children, Ryan and Liberty Rinas. In July of 2003 the Special Investigation Division of the CRA became involved and commenced a further investigation, finally determining to proceed with prosecution.
[5] In February, 2006 Judge H.W.A. Fuller of the Alberta Provincial Court convicted the

Digitized by Google

appellants of a total of 18 tax offences including tax evasion and making false statements on tax returns.

Issues

[6] The following issues arise on appeal:

Did the trial Judge apply the wrong test to Joe Rinas's application for a non-suit?

Did the trial Judge misdirect himself when he stated "[t]his is not a complex conspiracy"?

Did the trial Judge err in his application of the law relating to the rule in ***Hodge's Case***?

Did the trial Judge err in his application of the law relating to wilful blindness?

Did the trial Judge err by taking judicial notice that the purpose of some of the items claimed was a personal purpose?

Did the trial Judge err by failing to consider all of the defences available to Joe Rinas and the Corporation, particularly that Joe Rinas and the Corporation were victims of Darlene Rinas?

Did the trial Judge err by failing to provide reasonably intelligible reasons to permit meaningful appellate review of his decision?

Did the trial Judge err in his application of the law relating to shareholder's benefits under the *Income Tax Act*?

Did the trial Judge err in his application of the law relating to input tax credits under the *Excise Tax Act*?

Standard of Review

[7] For questions of law, the standard of review is correctness and no deference is given to the trial Judge's decision: ***Housen* v. *Nikolaisen***, [2002] 2 S.C.R. 235 at para. 8. However, appellate courts must give deference to a trial Judge's findings of fact. The standard of review for findings of fact is whether the trial Judge made a "palpable and overriding error": *ibid* at para. 10. This standard requires an appellate court to provide a high level of deference to the trial Judge's findings and not to re-try the matter. Where there is a question of mixed law and fact, the standard of palpable and overriding error applies unless there is an extricable principle of law which will require the standard of correctness: ***Murphy Oil Company Ltd.* v. *Predator Corporation Ltd.***, 2006 ABCA 69 at para. 23; ***Double N Earthmovers Ltd.* v. *Edmonton***, 2005 ABCA 104 at para. 17.

[8] In this case, issues 1-6 are questions of law. Issues 8 and 9 are questions of mixed law and fact. Issue 8 is more factually driven since it required a finding that the Corporation conferred a benefit on Joe Rinas and Darlene Rinas. Issue 9 is a question of mixed law and fact in which there is an extricable principle of law.

[9] Therefore, I apply the standard of correctness to the trial Judge's decision for issues 1-6 and 9. Where findings of fact are disputed as a sub-issue within these issues, I give considerable deference to the findings of the trial Judge unless there is a palpable and overriding error. Likewise, I give deference to the trial Judge's findings in issue 8 in the absence of a palpable and overriding error.

[10] Issue 7 relates to the adequacy of reasons in a judgment. This issue was addressed thoroughly by the Supreme Court of Canada in ***R.* v. *Shepperd***, [2002] 1 S.C.R. 869. The standard of review for adequacy of reasons is whether the reasons are reasonably intelligible to the parties and provide the basis for meaningful appellate review of the correctness of the trial Judge's decision, having regard to the particular circumstances of the case: *ibid* at 897. I apply this standard to Issue 7.

Analysis

Did the trial Judge apply the wrong test to Joe Rinas's application for non-suit?

Digitized by Google

[11] At the conclusion of the Crown's case at trial, Joe Rinas brought a motion for a directed verdict on the basis there was insufficient evidence against him upon which a properly instructed jury could convict. **He suggested there was no evidence of his knowledge of the Corporation's understatements of revenue and overstatements of deductions. The trial Judge rejected this submission and observed: On the principles set forth in the *Charemski* and *McCullough* cases, the Court has to determine in the motion for non-suit, whether the prosecution has established some evidence on all essential elements of each count before the Court. The Crown is not required to establish beyond a reasonable doubt on a non-suit motion. The argument which was very ably put forward by Mr. Forer, is in my view, premature, as I would have to weigh the evidence and consider various matters which at this stage of the trial would not be proper. I have concluded that the Crown has met this test and accordingly the application for non-suit is dismissed.**

[12] Joe Rinas submits this direction amounted to an error of law. The test for non-suit was outlined by the Supreme Court of Canada in ***R.* v. *Charemski***, [1998] 1 S.C.R. 679. At paras. 19- 21 the Supreme Court observed:

¶ 19 The test on a motion for a directed verdict has been clear for over a century...The test is whether a properly instructed jury could reasonably convict on the evidence...

¶ 20 ...To determine whether this could occur, the Judge on the motion for a directed verdict must ask whether some or all of the admissible evidence is legally sufficient to permit the jury to find guilt beyond a reasonable doubt. In doing so, the trial Judge is determining the sufficiency of the evidence.

¶ 21 While some Judges have referred to a distinction between "no evidence" and "some evidence", this distinction is nonsensical. The question on a motion for a directed acquittal always relates to the ability of the evidence to support a verdict of guilt, that is, whether there is sufficient evidence to permit a properly instructed jury to reasonably convict...

[13] **In a directed verdict motion or non-suit application the trial Judge is not required to determine that the Crown has established guilt beyond a reasonable doubt since the final determinations with respect to actual inferences to be drawn from the evidence or assessments of credibility of witnesses are determinations left to the jury. Rather, the trial Judge must determine whether the evidence, if proven, could support a finding of guilt beyond a reasonable doubt. In circumstantial cases this will require determination whether , "...assuming the circumstantial facts are proved, it would be reasonable to make the inference necessary to establish the facts in issue": *Charemski* at para. 22.**

[14] In this sense the trial Judge must perform a limited weighing of the evidence: ***Charemski*** at para. 23; ***R.* v. *Arcuri***, [2001] 2 S.C.R. 828 at para. 23. In ***Arcuri*** at para. 23 McLachlin C.J.C. explained:

... The question then becomes whether the remaining elements of the offence -- that is, those elements as to which the Crown has not advanced direct evidence -- may reasonably be inferred from the circumstantial evidence. Answering this question inevitably requires the Judge to engage in a limited weighing of the evidence because, with circumstantial evidence, there is, by definition, an inferential gap between the evidence and the matter to be established... The Judge must therefore weigh the evidence, in the sense of assessing whether it is reasonably capable of supporting the inferences that the Crown asks the jury to draw. **This weighing, however, is limited. The Judge does not ask whether she herself would conclude that the accused is guilty. Nor does the Judge draw factual inferences or assess credibility. The Judge asks only whether the evidence, if believed, could reasonably support an inference of guilt.**

Digitized by Google

[15] In this case, the evidence against Joe Rinas was entirely circumstantial evidence. Therefore, the trial Judge was required to assess whether the circumstantial evidence, if proven, could lead a properly instructed jury to a reasonable inference that Joe Rinas had knowledge of the reporting deficiencies. He was required to weigh the evidence to a limited degree.

[16] In this case the trial Judge correctly directed that the Crown must establish "...some evidence on all essential elements of each count before the Court." Later in that same paragraph he concluded that "the Crown has met this test". **However, the trial Judge also suggested it was improper to weigh the evidence. It is this aspect that is troubling. Although the trial Judge should not weigh the evidence to determine the ultimate outcome of the trial, he must consider the circumstantial evidence to determine whether a reasonable inference of guilt could be drawn in a limited weighing of the evidence.** It is unclear from the reasons of the trial Judge whether he correctly directed himself not to predetermine factual findings or whether he misdirected himself against any weighing of the evidence whatsoever.

[17] The Crown concedes in oral argument that the reasons of the trial Judge on this point are deficient. Nevertheless, I accept the Crown's submission that even if the trial Judge misdirected himself there was no substantial wrong or miscarriage of justice which should result in a new trial or an acquittal. **There was evidence before the Court which could give rise to a reasonable inference that Joe Rinas had the requisite knowledge to meet the requirements of the specific intent offences so alleged.**

[18] Joe Rinas was the president and one of two sole shareholders of the Corporation. He and his wife were the deciding minds of the Corporation; they were the owners; they were the directors; they were the officers; they were the shareholders. In short, they were the Corporation. Similarly, Joe Rinas had signing authority on the Corporation's bank account and was the recipient of considerable benefits from the Corporation. Further, there was evidence that Joe Rinas engaged in the purchase of some of the personal items deducted as expenses from the income of the Corporation. Several examples show this active involvement in the acquiring of personal items. First, there are three half day rentals of skidoos when family came to visit during the Christmas season. Second, there are flowers sent on Mother's Day to Joe Rinas's mother. Third, Joe Rinas purchased a washer and dryer on the corporate account. Further, there was evidence that Joe Rinas attended meetings with the Corporation's accountants.

[19] While these pieces of evidence on their own might not be sufficient to support an inference that Joe Rinas had knowledge, together this circumstantial evidence does create a web of information which would allow the trier of law to determine that a properly instructed jury could conclude that an inference may be drawn that Joe Rinas knowingly participated in the misconduct alleged by the Crown.

Did the trial Judge misdirect himself when he stated "[t]his is not a complex conspiracy"?

[20] Near the beginning of the trial decision at para. 8 the trial Judge observed: This is not a complex conspiracy and the main issue before the Court is whether the accused knowingly understated income and overstated expenses.

[21] The appellants submit that the trial Judge made an error in characterizing the issues before him as a conspiracy. The appellants argue this error is revealed throughout the judgment wherever the trial Judge refers to a scheme or schemes. Further, they contend that the trial Judge's alleged conclusion that this was a conspiracy caused him to lump together the appellants rather than consider their individual guilt. **The Crown, on the other hand, submits the trial Judge did not characterize the issues before him as a**

Digitized by Google

conspiracy but rather distinguished between a complex conspiracy to which special rules apply and the relatively simple issues in this case. The Crown also argues that the trial Judge's references to schemes throughout the judgment do not reflect that the trial Judge considered this to be a conspiracy case. I accept the position of the Crown on this issue.

[22] The main issue before the trial Judge was whether the appellants knowingly understated income and overstated expenses. Essentially, the issue boiled down to, "did the Corporation claim its shareholders' personal expenses as business expenses"? When the trial Judge made this statement about a complex conspiracy, he did so to describe the relative ease with which the trial issues could be appreciated. This was a relatively simple case as opposed to a complex conspiracy prosecution which involves specialized procedures and evidentiary rules. Conspiracy was never raised by the Crown or by the appellants at trial.

[23] Although the plain meaning of the word "scheme" does have some similarity to the concept of a conspiracy, "scheme" is a word used to describe the essential elements of the crime of tax evasion in the relevant jurisprudence: see for example ***R.* v. *Klundert*** (2004), 242 D.L.R. (4th) 644 (Ont. C.A.) at paras. 36,

39. Therefore, the use of the word "scheme" throughout the reasons of the trial Judge was simply a way of using language consistent with applicable case law and nothing more. It was not an implicit attempt to infer that there was a conspiracy. The trial Judge did not apply the co-conspirator's exception to the hearsay rule. [24] The trial Judge was aware of the need to consider each appellant separately in determining guilt. At para. 77 the trial Judge addressed the reasons for finding that both Joe Rinas and Darlene Rinas "knowingly made false statements in their respective Income Tax Returns and GST Return." Although he dealt with the individual appellants collectively, the language in para. 77(3) in particular suggests he considered their culpability separately. The trial Judge articulated at para. 77(3) that both Joe Rinas and Darlene Rinas were actively engaged in acquiring personal items through the corporate account. Further, at para. 77(3) he distinguished Joe Rinas's role in the Corporation from Darlene Rinas's bookkeeping role but nevertheless found that Joe Rinas's "involvement and personal knowledge" created the requisite knowledge and intent for the alleged offences.

Did the trial Judge err in his application of the law relating to the rule in *Hodge's Case*?

[25] **The appellants contend the trial Judge misstated the law established in *Hodge's Case* (1838), 2 Lewin 227, 168 E.R. 1136 by suggesting a reversal of the onus of proof such that each of the appellants had to prove an absence of knowledge rather than the obligation of the Crown to prove knowledge or wilful blindness. The appellants refer to paragraph 60 of the trial judgment in this regard: In dealing with circumstantial evidence one must be mindful that the Court cannot make a finding of reasonable doubt on non-existent evidence.**

[26] **The Crown submits this statement must be taken in context and that there was no error of law. I agree. The trial Judge properly articulated and applied the law relating to circumstantial evidence.** [27] **The rule in *Hodge's Case* developed to deal with the differences between direct and circumstantial evidence. A Court faced with direct evidence must only address whether that evidence is to be believed. In contrast, circumstantial evidence requires a multi-layered approach since the Court must ask both whether the evidence is to be believed and what inferences may be drawn from the evidence. The rule in *Hodge's Case* addresses a potentially latent danger in circumstantial evidence by requiring that in convictions based on circumstantial evidence alone that guilt must be the only rational inference from the**

Digitized by Google

evidence.

[28] The trial Judge explained the rule in ***Hodge's Case*** by reference to the Ontario Court of Appeal decision ***R.* v. *McIver***, [1965] 1 O.R. 306. The quoted passage from ***McIver*** in the trial judgment accurately reflects the notion that all rational inferences must be fully supported by the evidence. **The trial Judge then goes on to state that "the Court cannot make a finding of reasonable doubt on non-existent evidence." He cites *R.* v. *Torrie* (1967), 3 C.C.C. 303 (Ont. C.A.) at 306 for this proposition. The appellants suggest the trial Judge erred in instructing himself on this point since a reasonable doubt can always be found on the basis that there was an absence of evidence**: ***R.* v. *P.C.W.***, 1998 ABCA 180 at para. 12. [29] **The rule in *Hodge's Case* was aptly explained in *McIver*: Before you can find the prisoner guilty you must be satisfied beyond a reasonable doubt that the circumstances are consistent with the prisoner having committed the act and you must also be satisfied beyond a reasonable doubt that the facts are such as to be inconsistent with any other rational conclusion than that the prisoner was the guilty person**. The trial Judge had that before him and was aware of the rule. He explained that the rule was summarised in ***McIver***: trial decision at para. 60. He then proceeded to explain a further aspect of the rule. His comment at para. 60 of the trial decision reflects some of the discourse in ***McIver*** following that Court's explanation of the rule in ***Hodge's Case***.

[30] In ***McIver*** the Court emphasized that inferences must be rational conclusions based upon proven facts, not speculative suggestions. The Court provided examples in the context of a motor vehicle accident such as the possibility that a passenger in the vehicle touched the steering wheel, causing the vehicle to swerve, or that a child was playing in the road and the driver swerved to miss the child. **Since there was no evidence to suggest that either of those possibilities occurred, both of these possibilities are entirely speculative; inferences that either of these situations occurred cannot be drawn in the absence of evidence. This conclusion is in line with the *Torrie* case which the trial Judge cited.**

[31] Had the trial Judge's comment at para. 60 of his decision been made in isolation it would amount to an error of law. However, given this context, there was no error of law. The trial Judge clearly recognized the correct burden of proof at para. 76. His statement with respect to the law regarding circumstantial cases does not detract from the fundamental principle that the Crown must establish guilt beyond a reasonable doubt. The trial Judge correctly pointed out that an inference to support a **conclusion alternative to the guilt of the accused must be a rational inference drawn from proven facts. In the context as outlined above, the trial Judge did not suggest that guilt could be found where the Crown has not met its burden of proof.**

Did the trial Judge err in his application of the law relating to wilful blindness?

[32] At para. 77(3) of the trial decision, the trial Judge observed: Joe and Darlene Rinas:...

[w]ere both engaged in acquiring personal articles or incurring personal expenses or allowing such expenses to be paid by the Corporation if incurred by a third party. Although Joe Rinas was not actively involved in maintaining the corporate records, his involvement and personal knowledge made him an intrinsic part of the three schemes. At the very least he was wilfully blind and this is the legal equivalent of knowledge.

[33] Joe Rinas argues the trial Judge erred in his application of the law concerning wilful blindness since, he submits, there were no triggering events that should have called for further inquiry. **Joe Rinas further contends the trial Judge may have applied a standard of vicarious liability to him rather than consider his individual *mens rea*.**

[34] The Supreme Court of Canada explained the doctrine of wilful blindness in ***R.* v.**

Digitized by Google

Sansregret, [1985] 1 S.C.R. 570 at para. 22: ...
[W]ilful blindness arises where a person who has become aware of the need for some inquiry declines to make the inquiry because he does not wish to know the truth...The culpability **in...wilful blindness...is justified by the accused's fault in deliberately failing to inquire when he knows there is reason for inquiry.**
[35] Similarly, the Quebec Court of Appeal observed that wilful blindness requires more than that the accused should have known; rather, the accused's suspicions should have been actually aroused: ***R.* v. *Barbeau*** (1996), 110 C.C.C. (3d) 69 (Que. C.A.) at 95. **There are therefore two aspects to the doctrine of wilful blindness. First, the person must become aware of some need to make an inquiry, and, second, the person deliberately does not make the inquiry. The first step is what the defence refers to as a** "triggering event".
[36] In this case the trial Judge correctly set out the law respecting wilful blindness at para. 57 of the trial decision by reference to ***R.* v. *Harding*** (2001), 160 C.C.C. (3d) 225 (Ont. C.A.). That citation clearly reveals that wilful blindness has a high standard of proof including that "[a] Court can properly find wilful blindness only where it can almost be said that the defendant actually knew": ***Harding*** at para. 62.
[37] Counsel for Joe Rinas submits there was insufficient evidence before the trial Judge to convict Joe Rinas of having actual knowledge or of having had actual suspicions and deliberately not making further inquiries. I do not agree. The following summary of the evidence before the trial Judge confirms that the trial Judge had sufficient evidence to convict Joe Rinas on the basis of actual knowledge or on the basis of wilful blindness:
Joe Rinas is listed as the purchaser of personal items identified at trial, which personal items were purchased through the corporate account. As stated above, these include invoices for ski-doos and a washer and dryer set.
Joe Rinas was present for and actively participated in yearly meetings with the Corporation's accountant who confirmed that he advised that personal items expensed through the Corporation should not be deducted by the Corporation.
Joe Rinas signed his Information Return for Electronic Filing, thereby confirming a full disclosure of income from all sources. He signed the engagement letter with the firm of accountants which confirmed the completeness and accuracy of all information provided.
Joe Rinas was the president of the Corporation and one of two shareholders and directors. He was listed as management on the corporate ledger. With his wife he controlled the affairs and operations of the Corporation.
[38] The triggering events in this case were Joe Rinas's involvement in the purchase of personal items by the Corporation. At that point Joe Rinas must have been aware of the need to make an inquiry to ensure that the expenses were not being deducted in the books of the Corporation. He did not make such an inquiry and later signed tax returns confirming the accuracy of the information contained therein. He was also involved in the review of the shareholders' loan accounts but did not inquire about the absence of certain expenses. The only inference that can be drawn is that he deliberately did not inquire because he did not want to know how the personal expenses would be recorded in the books of the Corporation.
[39] Accordingly, I conclude that the trial Judge did not err in his application of law relating to wilful blindness. [40] Joe Rinas also suggests that the trial Judge erred by reversing the onus of proof on the issue of wilful blindness when he stated at para. 77(12) of the trial decision that there "was no evidence before the Court which gave any indication or explanation as to why or how the items under review should or could be regarded as an appropriate corporate expense". Although no adverse inference can be drawn where an accused does not call evidence, an accused may wish to contradict strong circumstantial

Digitized by Google

evidence as part of the defence's strategy or tactics: ***Steinberg* v. *The King*** (1931), 56 C.C.C. 9 (S.C.C.). In this case there was sufficient circumstantial evidence to convict and no offer of explanation provided. **This was not a matter of a shifting onus, it was simply a matter of tactics. The appellants made a tactical decision to call no evidence and that is all there is to it.** This was not an instance where the trial Judge erred by reversing the onus of proof on that issue.

Did the trial Judge err by taking judicial notice that the purpose of some of the items claimed was a personal purpose?

[41] Section 18 of the *Income Tax Act*, R.S.C. 1985, c. 1 ["ITA"] provides the general limitation against deducting certain expenses. Section 18(1)(a) provides that only expenses that are incurred for the purpose of gaining or producing income from the business are deductible. Similarly, s. 18(h) prohibits taxpayers from deducting personal or living expenses.

[42] In convicting all three of the appellants, the trial Judge concluded that numerous expenses deducted in the Corporation's ledger were personal expenses rather than legitimate business expenses. The appellants submit it was improper for the trial Judge to come to this finding in the absence of expert evidence.

[43] The characterization of an expense is a question of fact to be determined considering all the circumstances. Before making the findings of fact that the expenses were personal in nature, the trial Judge heard 15 witnesses testify over several days and he reviewed seven binders of documents. The trial Judge was careful to note in his reasons that all of the extensive evidence before him was considered in coming to his conclusions.

[44] At para. 66 of the trial decision the trial Judge observed that he "considered all of the testimony and reviewed the supporting documentation in light of the guidelines in ***Symes* v. *Canada***, *supra*, and particular the nature of the business carried on by [the Corporation]." Although a civil case, ***Symes* v. *Canada***, [1993] 4 S.C.R. 695 provides important guidance with respect to the purpose of expenditures. The factors the Supreme Court of Canada considered in ***Symes*** with respect to the question of whether child care was an allowable business deduction align with the considerations of the trial Judge in this case. At para. 63 the trial Judge outlined his thorough considerations: **The Court was required to objectively and fairly assess each individual item presented by the Crown to determine if it was an expense which properly related to the nature of the business operated by AHOSL. The Court took into consideration what are regarded as relevant factors which, without restriction to the generalities of the foregoing, included:**

Whether the Expense is Deductible According to Generally Accepted Accounting Principles.

Whether the Expense is Normally Incurred by Others in the Particular Business.

Whether the Expense Would Have Been Incurred by The Taxpayer if He or She Had Not Been Earning Income From a Business.

Whether the Taxpayer Could Have Avoided the Expense Without Affecting Gross Income.

Other Facts and Circumstances From Which to Infer the Taxpayer's Purpose in Incurring an Expense.

Dual Purpose Expenses.

[45] The trial Judge heard detailed evidence regarding the business activities of the Corporation. This assisted him in characterizing expenses as legitimate business expenses or as personal expenses based on the ***Symes*** criteria. An accountant testified whether certain deductions were ordinarily allowed as business expenses. This evidence supported the trial Judge's characterization of the disputed expenses. Similarly, former employees of the Corporation testified regarding the nature of the business premises, the daily

Digitized by Google

activities and employee appreciation initiatives. This evidence further supported the trial Judge's characterization of the disputed expenses. **Additionally, vendors testified of the reason for certain purchases if it was known. By way of example, a retailer testified that a wedding cake and flowers were purchased on the Corporation's account for the wedding of Joe and Darlene Rinas's daughter, Liberty Rinas.**

[46] Given the extensive testimony of the numerous witnesses regarding the nature of the business, accounting practices generally, and particular purchases in addition to the careful considerations of the ***Symes*** criteria for each allegedly personal item, the trial Judge did not require expert testimony to establish whether certain items were personal or business related. Further, the trial Judge correctly set out the legal test respecting judicial notice and properly applied that test to the source documents in evidence. He engaged in a detailed analysis of the evidence in characterizing each expense.

[47] Although the trial Judge notes that he had to take judicial notice of the purpose of some items, he only did so after considering all of the evidence and the considerations in ***Symes***. At para. 64 of the trial decision, the trial Judge explained: The Court has reviewed the various authorities and the arguments put forth by Defence counsel. The *actus reus* or the "purpose test" contained in s. 18(1)(a) ITA does require further comments and in particular the criteria set forth in the Supreme Court of Canada in *Symes*, *supra*. **These principles are well summarized in Hogg, Magee and Li, (Fifth Edition), *Principles of Canadian Income Tax*, at ch. 8.3(b)(i). The Court has carefully considered theses principles in reaching its decision and was particularly mindful of the overlap between the "personal circle" and the "income producing circle." On any given item the Court has been generous in its interpretation of the "income producing circle" and also disallowed any items where the Crown failed to satisfy their burden of proof. In the final analysis, "purpose" is really a question of fact determined after considering all relevant factors. It is really a test of "logic and experience." <u>This was the proper approach to assessing the evidence.</u>** [48] The appellants assert that although some of the items are normally considered personal expenses, it is possible that a normally personal expense can be a business expenditure in certain circumstances. Darlene Rinas presented two examples to illustrate this point. In one example toilet paper could be construed as a personal expense. However, since toilet paper is requisite in the effective running of an office it can be a legitimate business expense. Likewise, the purchase of an ice cream cone would normally be seen as a personal expense. Nevertheless, when it is used as business promotion to sweeten the tooth of Bill Gates as a potential client, it may be deductible.

[49] While I accept that there may be apparently personal expenses which are in actuality valid business expenditures and that a trial Judge should approach the characterization of these items with caution, I do not accept that the trial Judge in this case was not alive to the issue. He carefully considered all of the extensive evidence in light of the ***Symes*** criteria. The trial Judge did not accept all of the assessments of the Crown witnesses blindly. Rather, he engaged in his own analysis of the true character of each expense. This is clear from his determination that the Crown failed to establish its burden of proof regarding some of the questioned expenses.

[50] It is clear from the reasons of the trial Judge that he performed an analysis for each expenditure pursuant to the criteria identified in *Symes* and in light of the evidence of numerous witnesses. To the extent that he took judicial notice of any particular matter, it was in light of these considerations and I do not find an error.

Did the trial Judge err by failing to consider all of the defences available to Joe Rinas and the Corporation, particularly that Joe Rinas and the Corporation were

Digitized by Google

victims of Darlene Rinas?

[51] Joe Rinas and the Corporation submit the trial Judge failed to consider their possible defences that Darlene Rinas committed a fraud against them when she deducted improper expenses in the Corporation's books. I do not agree and accept the position of the Crown on this point. The defence that Joe Rinas and the Corporation were victims of bookkeeping fraud was referred to at trial. The trial Judge rejected this possibility for each of these appellants.

[52] The trial Judge rejected the defence that Joe Rinas was a victim of fraud when he found that Joe Rinas knowingly made false statements and evaded tax beyond a reasonable doubt. He clearly set out in his reasons that Joe Rinas was an integral part of the three schemes of tax evasion alleged by the Crown. The trial Judge did not fail to consider the defence but rather rejected it outright.

[53] Similarly, the trial Judge rejected the argument that the Corporation was a victim of fraud when he found that the Corporation knowingly made false statements and evaded tax beyond a reasonable doubt. He set out 5 factors in support of that finding. This was not an issue that the trial Judge missed but rather one that he considered and dismissed.

[54] Further, where an individual offender is a directing mind of a corporation, the Corporation will be liable as an offender: *R.* v. *Hwang*, 2007 BCCA 68 at para. 6; *R.* v. *Canadian Dredge & Dock Co.*, [1985] 1 S.C.R. 662. This liability arises since the individual and the Corporation are considered to be one and the same when the directing mind acts within the scope of his or her authority, was not totally in fraud of the Corporation and the acts were at least partly for the benefit of the company: *Canadian Dredge*. The trial Judge found that Darlene Rinas was a directing mind of the Corporation: see for example trial decision at para. 44. Therefore, the Corporation's criminal liability coincides with Darlene Rinas's culpability.

Did the trial Judge err by failing to provide reasonably intelligible reasons to permit meaningful appellate review of his decision?

[55] Joe Rinas submits the trial Judge's reasons are deficient with respect to the finding that "at the very least [Joe Rinas] was willfully blind". He contends the trial Judge does not identify any evidence that is or can be capable of supporting this conclusion. To a large extent this is a repetition of issue 4 discussed above. In paragraph 37 of my reasons above I outline the evidence against Joe Rinas as explained in the trial decision.

Clearly there was evidence and the trial Judge considered all of it. I am satisfied that the reasons of the trial Judge allow for meaningful appellate review as was contemplated by ***R.* v. *Sheppard***, [2002] 1 S.C.R. 869 at paras. 46, 52 and 55.

Did the trial Judge err in his application of the law relating to shareholder's benefits under the Income Tax Act?

[56] Section 15(1) of the ITA requires that where a corporation confers a benefit on a shareholder in a given year, the shareholder must include that benefit in his, her or its income for the year. The trial Judge held that both Darlene Rinas and Joe Rinas failed to compute significant benefits they received from the Corporation in their income.

[57] Darlene Rinas submits that at trial the Crown did not adduce any evidence that the Corporation did not resort to an alternative treatment of the questioned expenses. Therefore, she submits, the trial Judge erred by concluding that the personal items were conferred as benefits to Joe and Darlene Rinas. Specifically, Darlene Rinas submits there was a possibility expenses could have been reported by way of employee T4. In my view, there was no evidence to suggest this was a possibility.

Digitized by Google

[58] Section 15(1) of the ITA requires a two-part analysis asking first whether the benefit was conferred and, second, whether the benefit was conferred upon the shareholders by reason of their being a shareholder: ***Del Grande* v. *Canada***, [1993] 1 C.T.C. 2096 (T.C.C.) at 2101. The trial Judge clearly set out this test at para. 72 of the trial decision. Although this is a question of mixed law and fact since it involves the application of a statutory provision, the question raised by Darlene Rinas is essentially a factual one respecting the trial Judge's findings. At paras. 72 and 75 the trial Judge found as facts both that the Corporation conferred benefits on Joe and Darlene Rinas and that the benefit was conferred by virtue of their role as shareholders. In the absence of palpable and overriding error I decline to interfere in the factual findings of the trial Judge.

Did the trial Judge err in his application of the law relating to input tax credits under the *Excise Tax Act*?

[59] The trial Judge held that the Corporation overstated input tax credits in its GST returns which returns were signed by Darlene Rinas on behalf of the Corporation. The result was that GST payments were evaded. Pursuant to s. 221(1) of the *Excise Tax Act*, R.S. 1985, c. E-15 ["ETA"], the Corporation was required to collect GST on taxable supply. Similarly, s. 169(1) of the ETA allowed the Corporation to claim input tax credits on property or services used in the course of commercial activities. However, these input tax credits had to be reasonable given the nature of the commercial activities of the GST registrant: ETA s. 170(2). The trial Judge held that the Corporation used personal expenses as input tax credits on its GST return contrary to s. 169(1).

[60] The appellants suggest that had the trial Judge applied s. 170(1)(c) of the ETA , the trial Judge may not have come to this conclusion. Section 170(1)(c) of the ETA is a restriction which applies "where input costs that would ordinarily give rise to an input tax credit have a significant personal consumption element": Peter H. Wood, *The Complete Guide to the Goods and Services Tax*, vol. 1, 14th ed. (Canadian Institute of Chartered Accountants, 2006) at 179. I accept the Crown's submissions that this section does not apply to this matter. The personal expenses claimed by the Corporation would not ordinarily give rise to an input tax credit.

[61] Similarly, s. 170(1)(c) does allow for input tax credits of personal expenditures but only if certain conditions are met. One of those conditions is where an expense is supplied to a shareholder or relative of a shareholder, the recipient of the expense must pay fair market value for the expense to the Corporation. In this case the personal expenses were benefits conferred by the Corporation to Joe Rinas and Darlene Rinas for no consideration. Therefore, the Corporation would be unable to claim input tax credits for the personal expenses incurred by its shareholders under s. 170(1)(c).

Conclusion

[62] The appeals are dismissed.

Heard on the 25th - 30th day of January, 2007

Dated at the City of Edmonton, Alberta this 26th day of March, 2007.

D.R.G. Thomas J.C.Q.B.A.

ITA Sec. 231.2 Requirement or C.C. Sec. 487.01 Warrant to Obtain Evidence?

ITA Sec. 231.2 allows CRA to approach and get a production order from a judge of a Superior Ct, while Canadian Criminal Code Sec. 487.01, allows for the same.

The route the tax authorities take to realize evidence is important in this setting since a s. 231.1-.2 request for documents cannot be used if the instance has been handed over to Special Investigations and a charge of tax evasion is being evaluated, rather than mere audit. And the

Digitized by Google

taken will then relate to whether the documentary evidence realized is admissible in the face of Charter infringements.

An important case to consider in this regard is R. v. Zuk[126] where CRA sent s. 231.2 RFIs (Request for Information) to numerous 3rd parties in respect of a taxpayer, without using s. 487.01 CC search warrants for additional documentary evidence in his control/possession. On the question of whether Charter rights had been violated the Ontario Court Of Justice held:

> Evidence Heard on the Voir Dire
>
> Mr. Zuk first came to the attention of Revenue Canada in the context of an investigation of another third party, Jonathan James Hunter, in l997-l998. In February l998, Michael Arthur, a Revenue Canada investigator, first met with Mr. Zuk to enquire about his relationship with Mr. Hunter and, more particularly, about the transfer of 200,000 Tramway shares from Mr. Hunter to Mr. Zuk. On June 1st, l998, Revenue Canada advised Mr. Zuk that his own income tax affairs were under investigation. By August l3, 1999, Revenue Canada had reasonable and probable grounds to believe that Mr. Zuk had committed offences contrary to the Income Tax Act. That day, Justice Paris authorized Criminal Code search warrants on four addresses related to Mr. Zuk. These warrants were executed on August l8, 1999 against his personal residence, the personal residence of his former wife, his business premises, and the business premises of his accountant. Investigator James Locke of Revenue Canada reviewed all the material seized pursuant to the search warrants. In order to fill gaps in the information obtained pursuant to the search warrants and to get a complete picture of Mr. Zuk's affairs, Mr. Locke thereafter issued a series of Requirements to Provide Information and Documents to brokerage houses, banking institutions and other agencies known to have had accounts with Mr. Zuk, his wife, and his companies. The Requirements were issued pursuant to the powers set out in s. 231.2(1)(a) and (b) of the Income Tax Act "for purposes related to the administration and enforcement of the Act."
>
> On October 22, l999, twenty-four Requirements were sent to stock brokerage houses and banking institutions. On December 7, l999, eight further Requirements were sent, several to the same institutions as previously under a different name. On April 28, 2000, Mr. Locke sent two further Requirements. Peter Zisis who assumed carriage of the investigation in November 2000 issued three further Requirements on which the crown relies to Visa Centres on April 26, 2001.
>
> Peter Zisis used information obtained from these Requirements to prepare the Net Worth Statement upon which the crown relies to prove its case against Mr. Zuk. The fruits of the Requirements go both to his income and to his expenses during the period under investigation. Without this evidence, it is not clear that the prosecution could proceed.
>
> The Revenue Canada investigators testified that these Requirements were used in accordance with policies and procedures defined by Revenue Canada on the advice of the federal Department of Justice. A Communique issued by the Investigations Directorate on June 27, l997 about obtaining information from third parties specified that
>
> *"Requirements will not be used where a person under investigation has a reasonable expectation of privacy in the information or documents held by a third party once an investigator has reasonable grounds to believe that an offence has been committed. At that point, a search warrant or general warrant should be obtained to seize such evidence from a third party.*
>
> That policy changed. On April 9, l999, the Assistant Director of Investigations issued a further Memorandum on obtaining information from third parties. That Memorandum provided that
>
> *As a result of advice received from the Department of Justice following the Supreme*

[126] 2004 ONCJ 246

Digitized by Google

Court of Canada decision in the Del Zotto case, the practice of using section 487 and s. 487.01 warrants under the Criminal Code can be discontinued and replaced with the use of requirements under s.
231.2 of the Income Tax Act. S. 289, s. 289(1) of the Excise Tax Act or s. 43 of the Customs Act, as appropriate. Requirements can be used with respect to all third parties and may be used at any stage of an audit or an investigation but only up to the point where charges are laid.
Any warrants that have been served upon a financial institution or other third party and are currently outstanding should be completed. All new applications for warrants should be replaced with requirements. The requirements should be served on the bank branch where the accounts for which information is sought are located, in the same manner as existed for warrants.
This was the policy in effect when the majority of requirements in the matter before this court were issued. The Revenue Canada Manual dated March 30, 2001 set out detailed instructions for the use of Requirements to obtain information and the production of documents from third parties. The Chapter relating to these instructions is over fifty pages in length. It provided details of procedures with respect to different types of third party institutions and individuals, and reiterated what had been set out in the April l999 Memorandum. This was the policy in effect at the time the last requirements in the matter before this court were issued.
Apart from the policy directives, the evidence also indicates that the use of requirements was subjected to internal checks and controls. Investigators seeking to use requirements were required to prepare Case Profiles and a Director's Summary indicating why the requirements were necessary, and to obtain the approval of their team leader and the Assistant Director. The Requirements went out under the signature of the Director of the Toronto Office.
James Locke, the investigator who issued the majority of the requirements before me, testified that, at the time the search warrants were executed, in August l999, he had reasonable and probable grounds to believe the Mr. Zuk had committed offences. At the time he issued the requirements, he also had reasonable and probable grounds to secure search warrants to obtain the same information. Pursuant to the prevailing policy at Revenue Canada, however, he used the requirements, and did not consider using search warrants. He testified that, had the l997 Communique still been in effect, he would have used Criminal Code search warrants or general search warrants. He also testified that, as judicial approval had been obtained already to enter Mr. Zuk's dwelling house, it would have been his expectation that search warrants for the banking institutions and brokerage houses would have received judicial approval as well.
He had done a "down and dirty" net worth analysis to provide the grounds to obtain the search warrants in August. Notwithstanding what had been obtained through the search warrants, and from his own investigations of public filings and third party calls, he needed the additional information available from the banks and stock brokerage houses to prepare a formal net worth statement upon which the prosecution could proceed. He was looking for information to determine the adjusted cost base of shares, and the income and expenditures of Mr. Zuk. In cross-examination, he indicated that a search warrant was used to get the information from Mr. Zuk's accountant for several reasons. Unlike the banks and financial institutions, he wanted to secure the originals of any documents and working papers that the accountant may have had on hand. The search warrant provides an element of surprise, and enables the investigator to seize the documents and take them away. Requirements are issued to large institutions with complex archiving systems. In the case of requirements, originals are not important. Copies of the accounts

Digitized by Google

are sufficient. Generally, it takes some time for the institutions to comply.

Analysis

Mr. Frost conceded that the decisions of the Supreme Court of Canada in *R. v. Jarvis, supra* and *R. v. Ling, supra*, both rendered November 21, 2002, indicated that Revenue Canada's prevailing policy about using requirements in criminal investigations violated the Charter. He agreed that the use of the requirements in the criminal investigation against Mr. Zuk was a breach of his s. 7 and s. 8 Charter rights. He also conceded that there was a sufficient relationship between the Charter infringement and the evidence that the crown seeks to tender in this voir dire. He further indicated that, as the requirements were also directed to the accounts of Mr. Zuk's wife and his companies, ordinarily he might argue that Mr. Zuk has no standing to assert his wife's Charter rights, and that companies have no rights under the Charter. Mr. Frost conceded, however, that I need not consider these arguments as the case for the crown cannot proceed on the evidence obtained relating only to Mrs. Zuk or the corporation.

The sole issue for my determination is whether the evidence obtained as a result of the requirements should be excluded under s. 24(2) of the Charter. The mere fact that a breach of the Charter exists does not mean that the evidence obtained pursuant to the Charter breach must automatically be excluded. In *Jarvis supra para. 105*, the Supreme Court of Canada held that the evidence obtained from unconstitutional use of requirements was to be excluded. I agree with Mr. Justice Romilly in *R. v. Wilder [2003] B.C.J. No. 3081 (B.C. S.C.) paras 25, 32 and 29-23,* however, that the Supreme Court in *Jarvis* followed its traditional position of deferring to the s. 24(2) analysis of the trial judge and cannot be taken to have held that a Charter breach based on the unconstitutional use of requirements mandated exclusion in all cases. This interpretation of *Jarvis* is consistent with what the Supreme Court did in *Ling, supra, para. 32*, where it indicated that the s. 7 and s. 8 breaches in that case would need to be considered in light of a s. 24(2) analysis at the new trial.

It is well established that a s. 24(2) analysis requires consideration of three factors:

trial fairness,

the seriousness of the Charter breach, and

the effects of the admission of the evidence on the administration of justice:

R. v. Collins (l987), 33 C.C.C. (3d) 1 (S.C.C.).

Trial Fairness

The Supreme Court of Canada in *R. v Stillman (l997), 113 C.C.C. (3d) 321, para 119* set out the steps required in the analysis of trial fairness:

Classify the evidence as conscriptive or non-conscriptive based upon the manner in which it was obtained. If the evidence is non-conscriptive, its admission will not render the trial unfair and the court will proceed to consider the seriousness of the breach and the effect of the exclusion on the repute of the administration of justice.

If the evidence is conscriptive and the Crown fails to demonstrate on a balance of probabilities that the evidence would have been discovered by alternative nonconscriptive means, then its admission will render the trial unfair. The Court, as a general rule, will exclude the evidence….

If the evidence is found to be conscriptive and the Crown demonstrates…that it would have been discovered by alternative non-conscriptive means, then its admission will generally not render the trial unfair. However, the seriousness of the Charter breach and the effect of exclusion onf the repute of the administration of justice will have to be considered.

Evidence is said to be conscriptive when an accused is compelled to incriminate himself at the behest of the state by means of a statement, the use of the body or the production of

Digitized by Google

bodily samples*: Stillman, supra para.*

80. Evidence cannot be conscriptive unless it is compelled by the unconstitutional conduct of a state agent; there is no conscription of it is given voluntarily. Evidence is otherwise discoverable if there were alternative nonconscriptive means compliant with the Charter through which the state would have obtained the evidence, or the evidence would inevitably have been discovered.

The evidence obtained by the requirements at issue are the personal banking and brokerage records of Mr. Zuk secured from banking institutions and stock brokerage firms. These are the types of records in which Mr. Zuk has a reasonable expectation of privacy. It is well-established that a reasonable expectation of privacy attaches to the banking records of an individual. Presumably, brokerage accounts also are of a "personal and confidential nature," going to the "biographical core of personal information", including information about "intimate details of lifestyle and personal choices of the individual" which the s. 8 right to privacy is intended to protect: *R. v. Plant (1993), 84 C.C.C. (3d) 203 (S.C.C.) at para. 19.*

They are, however, pre-existing documents which were created voluntarily by Mr. Zuk and the institutions with whom he did business, independent of any state compulsion. These are not the type of documents which generally attracts the principle against self-incrimination: *Thomson Newspapers Ltd. v. Canada (1990), 54 C.C.C. (3d) 417, pp 554-556, pp.538-539; R. v. D'Amour (2002), 166 C.C.C. (3d) 477 (Ont. C.A.), 477, pp. 489-91.*

Mere use by authorities of documents created by the defendant prior to a Charter violation is not the kind of compelled participation that will render the after-acquired evidence conscriptive: *R. v. Church of Scientology of Toronto (l997), 116 C.C.C. (3d) 1 (Ont. C.A.), leave to appeal refused.*

The Supreme Court of Canada confirmed in *R. v Law (2002), 160 C.C.C. (3d), 449 at p. 465* that business records are not conscriptive evidence, as they neither emanate directly from the defendant, nor are they derived from the defendant's compelled cooperation with the state. The originals exist independently of any Charter violation and were reproduced without any participation by the defendant. Other courts dealing with the use of requirements to obtain banking records in cases similar to that before this court have concluded that banking records are non-conscriptive evidence: *R. v. Chusid (2001), 57 O.R. (3d) 20 at para 65 (Ont. S.Ct.); R. v. Wilder supra at paras 252-255; Dwyer v. R. (2003) 110 C.R.R. (2d) 114 at para 95 (Fed C.A.) .*

I find that Mr. Zuk's banking and brokerage records obtained pursuant to the requirements before me are non-conscriptive, and they were otherwise discoverable by legal means. It follows that admission of these records as evidence in this trial does not affect trial fairness.

Seriousness of the Breach

The second step in the s. 24(2) analysis concerns the seriousness of the Charter breach. Factors to be considered include:

good or bad faith? deliberate, willful or flagrant?

an isolated incident or a larger pattern of disregard for Charter rights? the availability of other lawful, investigatory techniques?

which Charter right or rights were breached?

was it a significant departure from the Charter standard?

the justification for the breach? the evidentiary basis for the justification? any reliance on earlier judicial precedent or statutory provisions?

any abuse of process or breach of statute? any urgency or imminent danger?

Breach minimally intrusive.

Clearly Mr. Zuk did have a reasonable expectation of privacy in these types of records. Nevertheless, the jurisprudence indicates that an order for the production of banking records and business records is minimally intrusive. The jurisprudence indicates that a

Digitized by Google

demand to a third party for production of documents is considered by the courts as one of the least intrusive methods to obtain information: *MacKinlay Transport, supra. p 648; Levitt and Branch, supra. para 40; Del Zotto, supra p. 147 (Strayer J.A.)*

The Existence of Reasonable and Probable grounds

I am satisfied that the documents were otherwise discoverable by constitutional means. These records existed independently of Mr. Zuk in a usable form independent of any Charter violation. They could have been obtained by subpoena and affidavit and admitted into evidence pursuant to the provisions of s. 29 of the Evidence Act relating to records of financial institutions, and s. 30 of the Evidence Act relating to business records made in the ordinary and usual course of business.

There was no dispute during this voir dire that these requirements were issued long after the Revenue Canada officials had reasonable and probable grounds to believe that Mr. Zuk had committed offences. Mr. Locke obtained judicial authorization for search warrants to enter and search Mr. Zuk's home, his place of business, the residence of his first wife, and the business premises of his accountant in August 1998, well before these requirements were issued. I agree with investigator James Locke who testified that a judge who authorizes a search warrant for entry into a dwelling house would likely approve a search warrant for banking and brokerage records. I am satisfied that had Revenue Canada investigators thought search warrants were necessary to obtain these records in this case, search warrants would have been secured to obtain the records and documents at issue before this court.

I agree with Romilly J. in *Wilder supra* that the situation in the case before me, as in *Wilder*, is analogous to that in *R. v. Sieben [1987] 1. S.C.R. 295* where the police used a writ of assistance instead of a search warrant to search the dwelling house of the accused. Lamer J. for the Supreme Court ruled that the evidence should not be excluded because "one of the police officers had reasonable grounds to enter and search the premises, thus satisfying an obviously desirable requirement of the statute. The only reason that they did not obtain a search warrant is that they believed in good faith that a writ of assistance was sufficient. At that time, the statute authorizing a search under a writ of assistance had not been declared to be inconsistent with the Charter."

Good Faith of Investigators

The evidence clearly establishes that the Revenue Canada investigators used requirements instead of search warrants to obtain the information they desired because the policies and procedures then prevailing at Revenue Canada dictated that procedure. The June l997 Communique indicated that requirements were not to be used in these circumstances. That policy changed on April 9, 1999.

Thereafter, the departmental Memorandum provided that requirements could be used with respect to all third parties at any stage of an audit or investigation but only up to the point when charges are laid. That policy was codified in Manual Chapter 11 dated March 31,2001, with the added proviso that requirements were to be used only up to the point when the case is referred to the Department of Justice or charges are laid. These were the policies in effect at Revenue Canada at the time the requirements in this matter were issued. There is no evidence before the court as to when the case was actually referred to the Department of Justice. A Memo to File from Patrick Cowley, Senior Investigations Officer, Ottawa dated June 20, 2001, indicates that he called the investigator Peter Zsis to indicate that Headquarters could not support his request for an Indictment letter to Justice on Mr. Zuk's file as his case did not meet the criteria for indictment. The Prosecution Report dated July 20, 2001 was a recommendation from the Investigation unit that charges be laid summarily against Mr. Zuk. The charges before this court were laid on August 10, 2001. On the basis of this evidence, I find that the case was not referred to the Department of Justice

Digitized by Google

prior to April 26, 2001 when the last requirement the crown is tendering in this voir dire was issued. I find, therefore, that the use of requirements rather than search warrants to obtain the banking and brokerage information was done in good faith conformity with Revenue Canada policy as it existed at that time.

Good faith of Revenue Canada and the Department of Justice.

Throughout this period, the Investigation branch of Revenue Canada was relying on advice provided to them by the Department of Justice. It was the Department of Justice that, on the basis of the Supreme Court of Canada decision in *R. v. Del Zotto (l999) 131 C.C.C, (3d) 353 (January l999),* advised that requirements could again be used. The Supreme Court decision in *Del Zotto* dealt with s. 231.4 of the Income Tax Act, authorizing inquiries into the administration or enforcement of the Act with the power to subpoena witnesses and require the production of documents. The Supreme Court adopted the dissenting reasons of J.A. Strayer of the Federal Court of Appeal *(l997), 116 C.C.C. (3d) 123* without elaboration. Justice Strayer's judgment relied heavily on the previous Supreme Court decisions in *Thompson Newspapers Ltd. v. Canada (1990), 54 C.C.C. (3d) 417* and *R. v. McKinlay Transport Ltd. (l990), 55 C.C.C. (3d) 530*. Both decisions had emphasized the regulatory nature of the Income Tax Act, the minimally intrusive nature of a demand to produce documents, and the reduced expectation of privacy connected with the administration of the Income Tax Act.

The Supreme Court of Canada decision in *Del Zotto* did not deal with the requirement power under s. 231.2 of the Income Tax Act. Mr. Zuk submitted that the decision should be limited to its facts, a preemptive challenge to the inquiry power in the context of gathering evidence for regulatory administration, compliance and enforcement before the establishment of any reasonable grounds to believe by the investigators that an offence had been committed. The import of Mr. Zuk's submission is that it was unreasonable for the Department of Justice to assume that the Supreme Court endorsement of Justice Strayer's decision necessarily extended to analogous powers under the rest of the Income Tax Act after reasonable and probable grounds existed. He characterized their broad interpretation of *Del Zotto*, as incorporated in the April l999 Memorandum, as a rash expedient for the convenience of Revenue Canada to extend their powers notwithstanding a trend in the courts to enhancing Charter protections at earlier stages in the audit/investigation process. He submitted that their interpretation was an example of institutional bad faith that "creates a recipe for repeated violations of the Charter."

Mr. Zuk tendered a transcript from submissions of crown counsel in the 2001 case of *R. v Chusid* to show that, notwithstanding Revenue Canada's official policy, that particular counsel from the Department of Justice was already advising investigators to use search warrants instead of requirements after they had reasonable and probable grounds to believe an offence had been committed. Mr. Zuk submitted that this crown's advice to use search warrants was of probative value for two reasons: 1) it showed that the official Revenue Canada policy was unreasonable and perhaps contrary to the law, and 2) it showed that the Department of Justice was applying its policy inconsistently. Mr. Frost submitted that there can be no finding of bad faith when the investigators were acting pursuant to Revenue Canada policies, and where there is nothing patently unreasonable about the advice they were getting from their superiors or from the Department of Justice. The issue is whether the advice of the Department of Justice following *Del Zotto* was patently unreasonable, or whether it contravened what the Department of Justice and Revenue Canada might have expected the law to be at the time.

It is clear that, when the Supreme Court of Canada decided *Del Zotto* and thereafter, there had been a plethora of cases before the courts which were attempting to deal with the Charter consequences of drawing the line between audits and investigations for income tax

Digitized by Google

purposes. In the wake of *Del Zotto*, many jurists required to interpret the Supreme Court decision disagreed with the interpretation of that case provided by the Department of Justice: *R.v Bjellebo [l999] O.J. No. 965 (Ont. Gen. Div. Chapnick J.) April 1999; Gorenko et. al. v. The Queen et. al, unreported July l7, 1997 (Que. Sp. Ct.), appeal dismissed by the Quebec Court of Appeal (unreported February 23, l999); R. v. Pheasant [2001} G.S.T.C. 8 (Ont. C. J. Lane J.) November 2000; R. v. Saplys (l999), 132 C.C.C. (3d) 515 at p. 527 (Ont. C. Gen. Div., McKenzie J.); R. v. Dial Drug Stores Ltd. (2001), 52 O.R. (d) 367 (Ont. C.J., Lenz J.); R. v. Chusid (2002) 57 O.R. (3d) 20 (Ont. S. Ct., Beaulieu J.) at para. 28 November 2001* Counsel for the Department of Justice, however, interpreted *Del Zotto* and, its reaffirmation of the principles discussed in *McKinlay Transport,* to conclude that *"Requirements survive the (Del Zotto) tripartite analysis. It is clear that there should not be a reasonable and probable grounds precondition for the use of Requirements. Similarly, on our reading of McKinlay and Del Zotto we conclude that reasonable and probable grounds is not an appropriate cut-off point for the use of Requirements. A reasonable and probable grounds limitation is inconsistent with the analysis in McKinlay and is not mandated by the tripartite test in Del Zotto." "Warrantless Techniques of Compelling Evidence: The Unique Rules of the Regulatory Universe" by Ivan Bloom Q.C., Steve Aubin, Gordon Campbell and Scott McCrossin, National Journal of Constitutional Law, Vol 13, No. 1, September 2001, p. 79-116, at p. 93. .*

This opinion is different from that which I had had in *Pheasant, supra*. and which other trial jurists also articulated. The difference may be attributed to our differing interpretations of the meaning of "the availability of judicial supervision," the third factor in the test articulated by Strayer J.A. in *Del Zotto*. Whereas I thought that the words referred to the availability or not of reasonable and probable grounds, the Department of Justice lawyers interpreted these words to refer to the fact that judicial review procedures in the Federal Court of Canada were available to challenge Requirements. As it ultimately turned out, both interpretations were wrong. Until the Supreme Court released their decisions in *Jarvis, supra* and *Ling, supra*, in November 2002, the law was not clear.

In this context, it cannot be said that the interpretation of the Department of Justice was unreasonable. *Del Zotto* was the most recent Supreme Court decision dealing with a controversy that had been raging in the lower courts for many years. At the time, it appeared as if the Supreme Court had returned to the principles it itself had articulated nine years previously in *Thompson Newspapers, supra*. and *McKinlay Transport, supra*. Notwithstanding the decisions emanating from the lower trial courts, it was not unreasonable for the Department of Justice to consider that their position had the stamp of approval of the Supreme Court of Canada. In the hierarchy of Canadian courts, a Supreme Court of Canada decision trumps all others.

In this context, the broad interpretation of the Department of Justice as it manifest itself in the Revenue Canada policy statement with respect to requirements is not unreasonable nor is it any evidence of institutional bad faith. The fact that a particular crown attorney recommended that investigators use search warrants after they have reasonable and probable cause, notwithstanding departmental policy saying that such warrants were unnecessary, is not evidence of unequal treatment before the law nor that the policy was incorrect. Mr. Goldstein as counsel for the Department of Justice in both *Pheasant, supra*. and *Chusid supra*., provided written argument to the court consistent with the departmental policy (see *Chusid, supra. para 28*). That he recommended the use of search warrants as a practical matter was perhaps a conservative counsel of caution that reflected his personal experience before these lower trial courts. This is yet another illustration of the fact that, prior to the Supreme Court of Canada decisions in *Jarvis, supra* and *Ling, supra*, the law was not clear.

Digitized by Google

The jurisprudence is clear that where a state agent acts in accordance with what he or she reasonably believes to be the law at the time of the action, good faith will be established: *R. v. Jacoy (l988), 45 C.C.C. (3d) 46, p. 55*. Put another way, police do not act in bad faith when they mistakenly believe that they were relying on statutory or other legal authority for their actions*: R. v. Wiley (1993), 84 C.C.C. (3d) 161 (S.C.C.); R. v. Plant (1993), 84 C.C.C. (3d) 203 (S.C.C.); R. v. Duarte (1990), 53 C.C.C. (3d) 1 (S.C.C.).* In *Duarte*, the evidence gathered in violation of s. 8 was nevertheless admitted because the breach "stemmed from an entirely reasonable misunderstanding of the law by the police officers who would otherwise have obtained the necessary evidence to convict the accused in any event." *R. v. Fliss (2002), 161 C.C.C. (3d) 225 (S.C.C.)* It also does not constitute bad faith on the part of the police when they act under a bona fide misunderstanding of an unclear legal principle. An honest though mistaken belief may not show good faith but it will generally refute a finding of bad faith: *R. v. Chau (2000), 150 C.C.C. (3d) 504 (Ont. C.A.)*

For these reasons, I find that the seriousness of the breach in this case was not such as to compel exclusion of the evidence obtained by the requirements.

Effect of admission on the administration of justice

Under the third branch of the *Collins* test, the onus is on the applicant to show on a balance of probabilities that admission of the evidence would bring the administration of justice into disrepute. The purpose of s. 24(2) is not to sanction state misconduct, but to prevent having the administration of justice brought into further disrepute by the admission of the evidence in this proceeding. It is the long-term consequences of the regular admission or exclusion of such evidence on the repute of the administration of justice which must be considered. The standard to be applied is that of the "reasonable man" as defined by Lamer J. in *Collins, supra:* "Would the admission of the evidence bring the administration of justice into disrepute in the eyes of a reasonable man, dispassionate and fully apprised of the circumstances of the case?" In addition to the factors I have discussed previously, I must consider the fact that income tax evasion and making false statements on income tax returns are very serious charges that, if proven, strike at the heart of the self-reporting income tax system on which the government relies. As Beaulieu J. noted in *Chusid, supra, p. 4*5, "given the tremendous burden of monitoring a system that depends on self-assessment and voluntary reporting, prosecutions under the Act take on special significance as statements of our society's values." As he indicated, "the administration of justice demands enforcement of the Canadian income tax regime, so that citizens will honour their responsibilities to society as a whole, and will rest assured that those who choose to evade their responsibilities are held accountable."

On balance, I find that a reasonable man apprised of all the circumstances in this case would conclude that admission of the evidence would not bring the administration of justice into disrepute. On the contrary, greater harm would be done to the administration of justice if the evidence obtained by the use of the requirements in this case were excluded, and the crown were precluded from pursuing this prosecution on its merits. The non-conscriptive nature of the evidence, that it could have been obtained by means which did not violate the Charter, that it was obtained in good faith at a time when the law was uncertain, that the breach was minimally intrusive, that there is no reason to expect, post-*Jarvis* and *Ling*, that Revenue Canada will use such procedures in similar circumstances in the future, the seriousness of the charges, and the deleterious effect on the administration of justice and on society at large if such charges are not heard on their merits: all these factors lead me to conclude that admission of the evidence obtained by use of the requirements would not bring the administration of justice into disrepute.

Ruling

For these reasons, I find that the applicant has not met his onus under s. 24(2) of the Charter

Digitized by Google

of showing that the evidence obtained by use of the requirements at issue in this proceeding ought to be excluded. Accordingly, the evidence obtained by use of the total of thirty-seven requirements sent October 22, 1999, December 7, 1999, April 28, 2000, and April 21, 2001 will be admitted.

In R. v. Bath[127], on an issue of the Excise Act realization of evidence through a production order almost identical to s. 231.2 of the ITA, through instituted contemporarily to the pronouncement of Jarvis the court further provided:

INTRODUCTION

[1] The Canada Revenue Agency (the CRA[128]) has broad powers to require any person to produce any information or document for any purpose related to the administration or enforcement of the *Excise Tax Act* and the *Income Tax Act.* During its investigation of the accused persons and others for large-scale frauds
relating to GST credits, the CRA used those powers dozens of times, including in September and December, 2001 when it issued three Requirement Notices to require three financial institutions to produce numerous banking records which the Crown now proposes to tender in the trial.[164]

[2] Later, in November 2002, the Supreme Court of Canada released its decisions in *R. v. Jarvis*, 2002 SCC 73, [2002] 3 S.C.R. 757, and *R. v. Ling,* 2002 SCC 74, [2002] 3 S.C.R. 814, and made clear that the CRA cannot lawfully use its requirement powers when its predominant purpose in doing so is to further a criminal investigation, rather than to conduct an audit.

[3] It is common ground that the CRA's predominant purpose, in issuing the three Requirement Notices, was to further the criminal investigation which led to the present *Criminal Code* charges. With *Jarvis* and *Ling*, it is clear that the seizures, through the Requirement Notices, were unlawful, violating Mr. Khangura's privacy rights as guaranteed by s. 8 of the *Charter*.

[4] The *voir dire* concerned only whether the evidence obtained should be excluded under s. 24(2) of the
Charter on the basis that its admission would bring the administration of justice into disrepute.

[5] I announced on December 11, 2009 my decision that the evidence will not be excluded on that basis, and indicated that reasons would follow. These are the reasons.

THE APPROACH TO THE APPLICATION OF s. 24(2) OF THE *CHARTER*

[6] The Supreme Court of Canada reformulated the approach to the exclusion of evidence under s. 24(2) of the *Charter* in *R. v. Grant*, 2009 SCC 32, [2009] 2 S.C.R. 353. Section 24(2) of the *Charter* provides as follows: 24(2) Where . . . a court concludes that evidence was obtained in a manner that infringed or denied any rights or freedoms guaranteed by this Charter, the evidence shall be excluded if it is established that, having regard to all the circumstances, the admission of it in the proceedings would bring the administration of justice into disrepute.

[7] The Court in *Grant* noted that fundamentally s. 24(2) protects the justice system's overall and long-term repute. The inquiry under s. 24(2) is objective, and asks whether a reasonable person, informed of all relevant circumstances and the values underlying the *Charter*, would conclude that the admission of the evidence in issue would bring the administration of justice into disrepute (*Grant,* para. 68).

[8] The reformulated approach to the application of s. 24(2) thus rests on the assessment of the

---

[127] 2011 BCSC 251

[128] The Canada Customs and Revenue Agency was previously Revenue Canada and is now the Canada Revenue Agency (commonly called the CRA). Although the changes involved more than name and took place over the course of the events under discussion, the changes are not material to the issues in the *voir dire*. For convenience and brevity I will use "the CRA" to refer to all three bodies.

Namely, Requirement Notices issued to: (1) the State Bank of India, on September 4, 2001; (2) the Bank of Montreal, on December 12, 2001; and (3) the Khalsa Credit Union, on December 12, 2001.

Digitized by Google

public interests engaged by s. 24(2), as viewed in long-term perspective. It engages three avenues of inquiry, concerning:
the seriousness of the *Charter*-infringing state conduct
the impact of the breach on the *Charter*-protected interests of the accused, and
society's interest in the adjudication of the case on its merits.
[9] A court applying s. 24(2) will balance the assessments it makes in relation to each of these lines of inquiry, in order to determine whether unlawfully obtained evidence will nonetheless be admitted. The analysis therefore requires, first, the consideration of each of the three areas of concern, in light of the circumstances of this case, and then a balancing of the assessments made in relation to each. That is the approach that these reasons will take.

THE SERIOUSNESS OF THE *CHARTER*-INFRINGING STATE CONDUCT
[10] This line of inquiry requires the court to assess whether the admission of the evidence would bring the administration of justice into disrepute by sending the message to the public that the courts "effectively condone state deviation from the rule of law by failing to dissociate themselves from the fruits of that unlawful conduct" (*Grant,* para. 72).
[11] It follows that the more severe or deliberate the state conduct that led to the breach, the greater the need for the courts to dissociate themselves from it in order to preserve public confidence in and ensure state adherence to the rule of law (*Grant,* paras. 72-74):
[74] State conduct resulting in *Charter* violations varies in seriousness. At one end of the spectrum, admission of evidence obtained through inadvertent or minor violations of the *Charter* may minimally undermine public confidence in the rule of law. At the other end of the spectrum, admitting evidence obtained through a wilful or reckless disregard of *Charter* rights will inevitably have a negative effect on the public confidence in the rule of law, and risk bringing the administration of justice into disrepute.
[12] The parties' positions, concerning the seriousness of the CRA's *Charter* offending conduct, requires the consideration of three issues:
whether the national policy under which the CRA acted was based on a reasonable interpretation of the law at the time
whether the availability of lawful means to seize the documents made the conduct less serious, and
whether the CRA improperly issued the Requirement Notices without regard to the particular circumstances.
[13] Each of these issues requires some detailed discussion. I will address them in turn.

Did the CRA Rely on a Reasonable Interpretation of the Law at the Time?
[14] Mr. Greenbank submits in part that the state conduct that led to the breach of Mr. Khangura's s. 8 rights was not particularly serious, because in issuing the Requirement Notices the CRA acted under a written national policy based on an interpretation of the law that, though now known to be erroneous, was reasonable given the state of the law at the time.
[15] Mr. Enright responds that the CRA's national policy was not reasonable, as originally made and as maintained over time, because it overstated the effect of the law on which it purported to be based, and was blind to developments in the law that warned of the eventual result in *Jarvis/Ling*.
[16] When the CRA served the three Requirement Notices, it did so under its national policy issued in April 1999. The policy is entitled "Obtaining Information From Third Parties" and reads, in its material portion, as follows:
This is further to Communiqué SI 97-02 and the series of E-Mails concerning the use of either a s. 487 or
487.01 warrant under the Criminal Code to obtain records from financial institutions and other third parties. The Communiqué stated that warrants should be used where a person under investigation

Digitized by Google

has a reasonable expectation of privacy in the information held by third parties and an investigator has reasonable grounds to believe that an offence has been committed. As a result of advice received from the Department of Justice following the Supreme Court of Canada decision in the Del Zotto case, the practice of using section 487 and section 487.01 warrants under the Criminal Code can be discontinued and replaced with the use of requirements under s. 231.2 of the Income Tax Act, s. 289.(1) of the Excise Tax Act or s. 43 of the Customs Act, as appropriate. Requirements can be used with respect to all third parties and may be used at any stage of an audit or an investigation but only up to the point when charges are laid.

[17] The April 1999 policy significantly relaxed the CRA's previous policy about obtaining documents from third parties because it authorized the use of Requirement Notices at any stage of an audit or investigation before charges are laid. The previous policy, issued in June 1997, had directed investigators to seek a search warrant or a general warrant, and not to issue Requirement Notices, once investigators had reasonable and probable grounds to believe that an offence had been committed.

[18] As the evidence and the policy itself (as quoted above) indicated, the April 1999 policy allowed for an increased use of Requirement Notices because of the Supreme Court of Canada's decision in *Del Zotto v. Canada*, [1999] 1 S.C.R. 3, released in early 1999. There, the Supreme Court of Canada had adopted without additional commentary the dissenting reasons of Strayer J.A. of the Federal Court of Appeal in *Del Zotto v. Canada (C.A.),* [1997] 3 F.C. 40 at paras. 1-35 (F.C.A.) concluding that there was no basis for declaring constitutionally invalid the CRA's powers under s. 231.4 of the *Income Tax Act* to conduct an inquiry, including by summoning witnesses and requiring them to provide oral and documentary evidence.

[19] The parties disagree first about whether, as the April 1999 policy appears to assume, the reasoning in *Del Zotto* applied also to the exercise of others of the CRA's administrative powers (namely its requirement powers to compel third parties to produce evidence); and second, if it did, whether it indicated that *Charter* privacy interests necessarily merit little consideration even where the CRA exercises those powers for a criminal investigation.

[20] Mr. Greenbank submits that *Del Zotto* was reasonably read as supporting both propositions, because of its key determinations that offences under the *Income Tax Act* are regulatory in their essential character, and therefore that the protections of s. 7 and s. 8 of the *Charter* had less application in the CRA's investigations of offences under that *Act* than they have in the investigation of true criminal charges. He submits that *Del Zotto* was therefore reasonably interpreted to mean that the exercise of the CRA's investigative powers, including its requirement powers, under that *Act* would not trigger an "unreasonable search or seizure" contrary to s. 8.

[21] Mr. Greenbank submits that this interpretation derived naturally from Strayer J.A.'s reliance (see paras. 10-11) on *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission),* [1990] 1 S.C.R. 425 and *R. v. McKinlay Transport Ltd.,* [1990] 1 S.C.R. 627, where the Supreme Court of Canada found the compelled production of documents and testimony not to infringe s. 8 of the *Charter* because, in the regulatory contexts of those compulsions, the expectation of privacy and the intrusiveness of the investigative procedures were relatively low.

[22] Mr. Greenbank submits that this reading is supported by the fact that numerous courts in several cases after *Del Zotto* evidently read Strayer J.A.'s reasons similarly: see, for example, *R v. Viccars* (2000), 259
A.R. 48, [2000] 7 W.W.R. 90, *R. v. Wilder,* 2000 BCCA 29 and the B.C. Court of Appeal's reasons in *Ling* at 2000 BCCA 562. He submits that, indeed, the Nova Scotia Court of Appeal in *R. v. Wilcox,* 2001 NSCA 45 at paras. 101-102 expressly doubted the survival, after *Del Zotto*, of an analysis that measures the constitutionality of investigative measures, in a regulatory context, according to whether the investigator was engaged in an auditing function or, rather, in criminal

Digitized by Google

investigation; as we now know, that impugned analysis ultimately prevailed in *Jarvis* and *Ling*,

[23] In my view, Strayer J.A's reasons are more nuanced than Mr. Greenbank's submission suggests. The challenge in *Del Zotto* was based on s. 24(1) of the *Charter*, and not on s. 24(2). It impugned the constitutionality of the statutory provision that authorized inquiries, and not the exercise of the inquiry powers or, more pertinently to the present analysis, the later use in criminal proceedings of evidence obtained by means of those powers. Strayer J. A. declined to declare, under s. 24(1), that the inquiry and its statutory basis were constitutionally invalid, because, he concluded, the statutory powers under attack were capable of constitutional exercise; however, he repeatedly allowed for later challenges based on particular uses of evidence obtained through the challenged powers.

[24] This distinction permeates Strayer J. A.'s analysis (see, for example, paras. 2, 28, 30-1), and appears perhaps the most explicitly in the following (at paras. 3 and 34:

[3] ... If particular uses of the subpoena power by such an inquiry, or particular subsequent uses of evidence obtained through such subpoenas threaten to endanger section 7 or 8 rights, it is only then that those rights should be invoked.

. . .

[34] In short if there are circumstances in which the use of this inquiry power, or the subsequent use of evidence derived from it, may impinge on constitutional rights there will be opportunities to assert those rights at the time when an intrusion is imminent and demonstrable. ...

[25] Mr. Enright submits also that in any event, legal developments following *Del Zotto* but before the Supreme Court of Canada's decisions in *Jarvis* and *Ling* ought to have led the CRA to reconsider its policy, and to exercise more caution than it did when applying the policy to issue the Requirement Notices in question.

[26] For example, shortly after *Del Zotto* the Ontario Court of Appeal in *R. v. Saplys* (1999), 132 C.C.C. (3d) 515, 60 C.R.R. (2d) 272 concluded that the CRA had breached the accused's rights under sections 7 and 8 of the *Charter* when it conducted an audit at the behest of a CRA investigator and relied on the result of the audit as grounds for search warrants. The decisions in *R. v. Chen*, 2007 ONCJ 177 and *R. v. Tiffin,* 2008 ONCA 306 (per Laforme J.A. in minority reasons at para. 80) similarly recognized potentially serious constitutional implications to the exercise of the CRA's inquiry powers.

[27] And, the successive decisions in the *Ling* case itself, as it proceeded toward the Supreme Court of Canada, spoke both of the perceived effect of *Del Zotto* and of an increasing need for caution in relying on the interpretation the CRA gave to that decision in issuing its April 1999 policy. In its decision in *Ling*, issued on October 19, 2000, well **before the CRA issued the Requirement Notices**, the B.C. Court of Appeal confirmed the order of the Summary Conviction Appeal court ([1999] 3 C.T.C. 386) remitting the *Ling* case to trial for an assessment of the application of s. 24(2) of the *Charter* (at para. 82): this surely indicates that the Court considered *Charter* protections potentially to apply, even in the regulatory context. Moreover, in its submissions to the Court of Appeal in *Ling*, the Crown relied on *Del Zotto* only to support its submission that the *Income Tax Act* was regulatory in character, and did not rely on it to dispute the analysis (which was ultimately applied by both the Court of Appeal and the Supreme Court of Canada) by which *Charter* rights constrain the exercise of the CRA's regulatory powers as soon as the CRA predominant purpose moves from audit into investigation.

[28] The evidence in the *voir dire* established that most of the senior CRA officials who formulated the national policy or who acted under it were aware of the growing body of law by which the CRA could not lawfully use its requirement powers once it moved from audit to investigation.

[29] We all know that hindsight may distort our perception of what must have been recognized and what was reasonable at an earlier time. With the *Jarvis/Ling* analysis now firmly entrenched in our constitutional law, one must be wary of viewing past jurisprudence as either inevitably or obviously

Digitized by Google

moving in that direction. For all the signs that it was doing so, some of which are discussed above, there were signs that it was not.

[30] This is evident from a review of the academic literature published between *Del Zotto* and the Supreme Court of Canada's decisions in *Jarvis* and *Ling*. The academic literature provides some indication of how the law between *Del Zotto* and *Jarvis/Ling* may reasonably have been understood at the time by those well informed in the area.

[31] Some of the literature supports Mr. Enright's position that the CRA's interpretation of *Del Zotto* overreached in taking *Del Zotto* as having given *carte blanche* to the use of the CRA's administrative powers to gather evidence for possible prosecution.

[32] For example, David M. Porter, in "A Contextual Analysis of Section 8 Charter Rights in Regulatory Audits"[129], predicted (at p. 359) that the Supreme Court of Canada would "likely apply a contextual analysis of the section 7 and 8 Charter rights of taxpayers during regulatory audits . . . [to conclude] that tax audits should be restricted to the limited purpose for which they were upheld in *McKinlay Transport* – the regulation
of taxpayers through audit inspection and possible subsequent civil reassessment of tax liability". He argued persuasively that "a proper contextual analysis, which places an appropriate emphasis on the serious individual liberty interests at stake in the investigation of criminal offences under the *Income Tax Act*, supports the view that administrative audit powers of search and seizure cannot be used to assist in a criminal investigation" (at p. 343).

[33] Mr. Porter evidently did not read *Del Zotto* as making that analysis unnecessary. He mentioned *Del Zotto* only in passing (footnote 25, p. 349-50), in order to note that Strayer J.A.'s reasons and other authorities distinguished "regulatory" offences under the *Income Tax Act* from true crimes, without, he wrote, apparent regard for Cory J.'s majority reasons in *Knox Contracting Ltd. v. Canada,* [1990] 2 S.C.R. 338. In *Knox,* Cory J. found that the *Income Tax Act* and many other "regulatory" statutes create indictable (or at least hybrid) offences with full *mens rea* and liability for substantial fines or imprisonment, thus requiring
Charter s. 8 privacy interests to be assessed in that light.

[34] However, other writings lend support to the Crown's position that the CRA reasonably understood *Del Zotto* as holding that taxpayers have little or no expectation of privacy in documents held by third parties, such that the CRA may lawfully exercise its administrative powers even to gain evidence in a criminal investigation.

[35] For example, the authors of "Taxpayer Information: Administration and Enforcement Procedure under the Income Tax Act (Canada)"[130] read Strayer J.A.'s reasons in *Del Zotto* as indicating that the taxpayer could have no reasonable expectation of privacy in the information held on his behalf by the third party (see
p. 122). The authors therefore appear to have read Strayer J.A.'s reasons as foreclosing reliance on s. 8 of the *Charter* as a basis for excluding, from the subsequent trial of the taxpayer, evidence obtained in the course of an inquiry.

[36] The authors therefore concluded that *Del Zotto* had broad effect (at p. 120):

"[i]n the wake of [*Del Zotto*] . . . it would be reasonable to assume that the inquiry provisions will be resorted to by the [CRA] more readily than in the past, since the use of the procedure without prior judicial authorization in the criminal context has been sanctioned by the Supreme Court of Canada".

[37] The analysis in "Warrantless Techniques of Compelling Evidence: The Unique Rules of the Regulatory Universe"[131] was similarly encouraging to the position the CRA professes. The authors described Strayer J.A.'s reasons as applying a tripartite test to assess whether the inquiry powers infringed s. 8 of the *Charter,*

---

[129] (2002) 46 Crm L.Q. 341

[130] Susan Van Der Hout, Robert Goldstein & Angelina Fisher, (2000) 23 Advoc. Q. 84. 167 Ivan S. Bloom, Q.C. *et al.,* (2001) 13 Nat'l J. Const. L. 79

[131] Robert W. Hubbard & Peter DeFreitas, (1999) 42 Crim. L.Q. 412

Digitized by Google

examining: (1) the legislative scheme, which, in the case of the *Act* is regulatory; (2) the intrusiveness of the powers, which is not major because "taxpayers have a low expectation of privacy *vis-à-vis* the Minister of National Revenue" (see p. 86); and (3) the availability of judicial supervision. They concluded that the requirement powers will survive the first two parts of that test, for the same reasons as did the inquiry powers. They concluded that the third part of the test is met through the availability of judicial supervision, through judicial review, to challenge requirements.

[38] In their discussion of *Del Zotto*, the authors draw no distinction between the analysis of the constitutional (s. 8) validity of the inquiry (and requirement) powers themselves, and the use in criminal proceedings of evidence obtained through the use of those powers. Hence their conclusion (at p. 92):

Inquiry subpoenas are similar in effect to Requirements. Accepting these similarities between Inquiries and Requirements, we assert that the analysis fo the Inquiry power by Strayer J.A. in *Del Zotto* is applicable to the use of Requirements even when prosecutions are contemplated. Indeed, the reasons of Wilson J. in *McKinlay* explicitly support that proposition. *Del Zotto* does not change the conclusion in *McKinlay* that Requirements are a form of discovery that does not infringe on section 8 of the *Charter*; *Del Zotto* builds on that conclusion. [footnote references omitted]

[39] The authors of "Administrative Revenue Searches: Can They Be Utilized in Aid of Criminal Investigations and Prosecutions?"[168] recognized a role for determinations under s. 24(2) of the *Charter* as to whether evidence obtained through the use of administrative powers will be admissible in a criminal trial (see p. 441). However, any such determination would, as the authors read *Del Zotto*, recognize only a "minimal, if any, expectation of privacy in connection with investigations and searches under the revenue collection statutes" (p. 441).

[40] It is clear from this brief review that some, though not all, of the academic literature following *Del Zotto* and before *Jarvis* and *Ling* shared the CRA's stated understanding of the law at that time. The CRA's April 1999 policy, which was based on that understanding, therefore cannot be characterized as an unreasonable one at the material time.

[41] This conclusion will bear on the overall seriousness of the *Charter*-infringing conduct.

Does the Option of a Search Warrant Make the Breach Less Serious?

[42] Mr. Greenbank submits that CRA's *Charter*-infringing conduct is less serious also because the CRA had ample grounds to support search warrants for the same records as were sought and seized under the Requirement Notices, and could therefore have overcome Mr. Khangura's rights under s. 8 of the *Charter* by unquestionably lawful means.

[43] Mr. Enright does not disagree that the CRA had the necessary grounds to support warrants for the records in issue, but submits that this fact cuts two ways. The situation was not urgent, and the CRA demonstrated little regard for Mr. Khangura's privacy rights, Mr. Enright submits, by avoiding the higher demands of the judicial authorization process.

[44] Mr. Enright's submission would carry more weight had the Requirement Notices not been based on a written national policy grounded, I have concluded, in a reasonable, if erroneous, understanding of the law. It was not unreasonable for the CRA to have relied on that policy and to have thereby avoided the more demanding requirements of the search warrant procedures. I note also that the CRA did seek and obtain search warrants, in the course of this investigation, in numerous circumstances that fell outside the scope of the national policy.

[45] Nor am I persuaded that Jim Lawson, who issued the Requirement Notices, should be held to a higher standard because he was personally aware of conflicting legal views and case authorities about whether the CRA policy was constitutionally sound. Within the CRA's administrative structure, as it was described in the evidence, Mr. Lawson, even with delegated authority to

Digitized by Google

exercise the requirement powers, was properly expected to act in accordance with the CRA's national policy. Responsibility to review or remake that policy lay at CRA headquarters, and not with particular officials, such as Mr. Lawson, in the field.

[46] I therefore agree with Mr. Greenbank that the existence of grounds sufficient to support search warrants to seize the material for which the Requirement Notices issued makes the *Charter*-infringing conduct less serious than it would otherwise have been.

Did the CRA Improperly Issue The Requirement Notices Without Regard to the Particular Circumstances?

[47] But Mr. Enright submits that the seriousness of the *Charter*-infringing conduct increased through the fact that Mr. Lawson applied the written policy in a "rubber stamp" fashion, and issued the Requirement Notices without any real exercise of discretion.

[48] Subsection 289(1) of the *Excise Tax Act* confers authority to issue requirement notices "for any purpose related to the administration or enforcement of . . . [the *Act*]":[132]

(1) Despite any other provision of this Part, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of a listed international agreement or this Part, including the collection of any amount payable or remittable under this Part by any person, by notice served personally or by registered or certified mail, require that any person provide the Minister, within any reasonable time that is stipulated in the notice, with

any information or additional information, including a return under this Part; or

any document.

[49] The purpose for which requirement powers may be used is thus very broad. However, it does not follow that Requirement Notices may issue without regard for whether, as drafted, they respond logically and appropriately to such a purpose. The very fact that requirement powers are conferred only on the Minister, (and are available only to officials, such as Mr. Lawson, if the Minister delegates the authority) implies that the *Act* contemplates their careful exercise, with due attention to the scope of the statutory authority and the circumstances of the particular situation.

[50] The evidence and the face of the Requirement Notices themselves disclose no consideration of the particular circumstances of each Requirement Notice. There are some indications in the evidence that little, if any, such consideration was given.

[51] Understandably, Mr. Lawson had no specific recollection of individual requirement notices, and could testify only in general terms about his practice and his state of knowledge at the time of the three Requirement Notices now in issue. Nonetheless, from the evidence as a whole in the *voir dire*, I agree with Mr. Enright that in issuing numerous requirement notices during the course of the investigation, Mr. Lawson relied largely on his general knowledge of the investigation as a whole, and did not usually consider the individual merits of the situations in which he was asked to exercise the requirement powers. He relied heavily on the investigator, Donna MacMillan, and to some extent her team leaders, to have determined that the preconditions applied and that the particular requirement notice should properly issue.

[52] But it is not clear that those people made any such determinations on which Mr. Lawson could rely. On many occasions – and it was not entirely clear from the evidence whether this was true of the three Requirement Notices in issue – the scope of the requirement notice (as to the information and documents sought, and the list of people and bodies about which they were sought) as sought and issued was repeated from previous requirement notices without regard to whether or how they might apply in the next situation. Also, the various CRA investigators who sought and issued the Requirement Notices held rather different understandings about the

---

[132] Section 231.2(1) of the *Income Tax Act* provides almost identical authority for purposes related to that *Act*. Although the Requirement Notices refer to that authority, as well as to the authority in s. 289(1) of the *Excise Tax Act*, the Crown appears not to rely on it and I will confine the following discussion to the authority in the *Excise Tax Act* unless I indicate differently.

Digitized by Google

preconditions for the issue of such notices.
[53] As I find, Mr. Lawson appears to have issued requirement notices relating to this case without attention to the features and circumstances of the particular situation. I therefore agree with Mr. Enright that the CRA's somewhat cavalier approach to the exercise of its far-reaching coercive powers adds to the seriousness of the breach.

Conclusion (Seriousness of the *Charter*-Infringing Conduct)
[54] On one hand, the CRA did not deliberately or knowingly set about to violate taxpayers' s. 8 *Charter* rights through the April 1999 policy, or in acting under it to issue the Requirement Notices in issue here. The national policy on which it acted was based on a reasonable – albeit now known to be erroneous – understanding of the law at the time.
[55] Also, grounds existed to support warrants to seize the material for which the Requirement Notices issued. The seizures that since *Jarvis/Ling* have been known to be unlawful could in any event have been lawfully seized.
[56] These conclusions reduce the seriousness of the CRA's *Charter*-infringing conduct.
[57] But on the other hand, in issuing the Requirement Notices the CRA was aggressive and cavalier toward even the modest statutory preconditions to the exercise of the requirement powers. This increases the seriousness of the *Charter* infringing conduct.
[58] Overall, I would describe the CRA's *Charter*-infringing conduct as more than minimally serious.

THE IMPACT OF THE BREACH ON THE ACCUSED'S *CHARTER* PROTECTED INTERESTS
[59] This inquiry calls for an evaluation of the extent to which the breach actually undermined the interests protected by the right infringed: "[t]he more serious the impact on the accused's protected interests, the greater the risk that admission of the evidence may signal to the public that *Charter* rights, however high- sounding, are of little actual avail to the citizen, breeding public cynicism and bringing the administration of justice into disrepute" (*Grant*, para. 76).
[60] The inquiry thus requires an examination of the *Charter* interest protected, and the degree to which the violation impacted on those interests (*Grant*, para. 77). In relation to breaches of s. 8 of the *Charter*, an unreasonable search that intrudes on an area in which the individual reasonably enjoys a high expectation of privacy, or that demeans his or her dignity, will be more serious than one that does not (*Grant*, para. 78).
[61] The records produced in response to the Requirement Notices include banking records such as account-opening documents, monthly statements, deposit slips, cheques, and debit memos, and included both biographical and financial information. It is common ground that Mr. Khangura enjoyed a right of privacy in them, regardless of the facts that the records were in the hands of "third parties" and that, at the time of the Requirement Notices, the CRA was already aware of much of their content.
[62] However, the privacy interest in the records is not as strong as that which obtains in many other circumstances where s. 8 of the *Charter* is at play. The Requirement Notices were considerably less intrusive of Mr. Khangura's privacy rights than would have been, for example, a bodily search, a residence search, or wiretap interceptions.
[63] Also, Mr. Khangura's privacy interest in the records could in any event have been lawfully overridden to allow seizures by way of search warrant, because the CRA had the necessary grounds to support judicial authorization. And, had the CRA been engaged only in an audit, and not an investigation, the Requirement Notices could have compelled the financial institutions to produce the records for the audit, with no constitutional violation at all.
[64] In all of these circumstances, the intrusion into Mr. Khangura's right of privacy was real, but not major.

SOCIETY'S INTEREST IN THE ADJUDICATION OF THE CASE ON ITS MERITS

Digitized by Google

[65] This line of inquiry asks whether the truth-seeking function of the criminal trial process would be best served by admission of the evidence, or by its exclusion. The court must consider not only the negative impact of admission of the evidence on the repute of the administration of justice, but also the impact of failing to admit the evidence (*Grant*, para. 79).
[66] The reliability of the evidence is an important factor in this line of inquiry, because to admit unreliable evidence serves neither the accused's interest in a fair trial, nor the public interest in uncovering the truth (para. 81). Conversely, to exclude relevant and reliable evidence tends to undermine the truth-seeking function of the justice system (*Grant*, para. 81). The evidence obtained through the Requirement Notices is relevant and is entirely reliable, in the sense that it existed independently of the *Charter* breach and was unaffected by it.
[67] In this line of inquiry, the seriousness of the alleged offence may be a valid consideration, but it has the potential to cut both ways (*Grant*, para. 84):
… Failure to effectively prosecute a serious charge due to excluded evidence may have an immediate impact on how people view the justice system. Yet, as discussed, it is the long-term repute of the justice system that is s. 24(2)'s focus. As pointed out in *Burlingham*, the goals furthered by s. 24(2) "operate independently of the type of crime for which the individual stands accused" (para. 51). And as Lamer J. observed in *Collins*, "[t]he *Charter* is designed to protect the accused from the majority, so the enforcement of the *Charter* must not be left to that majority" (p. 282). The short-term public clamour for a conviction in a particular case must not deafen the s. 24(2) judge to the longer-term repute of the administration of justice. Moreover, while the public has a heightened interest in seeing a determination on the merits where the offence charged is serious, it also has a vital interest in having a justice system that is above reproach, particularly where the penal stakes for the accused are high.
[68] Mr. Enright notes in this regard that, unlike in many of the case authorities involving *Charter* violations during urgent or developing police investigations "on the street", nothing here required an aggressive or risk- taking approach: the CRA investigators had the luxury of time and the support of teams of lawyers and other expert advisers at its headquarters to monitor both individual investigations and to revise the CRA's national policy as necessary. He submits that, as *Grant* makes clear, the court should recognize the serious implications of allowing the state to push the boundaries of the *Charter*, especially when, as is the Crown's own position, alternative and lawful means were available to the CRA.
69] The charges arise from very serious allegations of huge frauds on the public. With others, Mr. Bath and Mr. Khangura are said to have created twenty companies falsely purporting to export shake and shingle products between about 1994 and 1997, and to have fraudulently claimed and received GST refunds totaling more than $23 million on the companies' behalf. Although the case will continue even if the proposed evidence is excluded, the evidence is significant to the Crown as it is said to link Mr. Khangura to the proceeds of the frauds and to the companies by which the frauds are said to have taken place.
[70] In my view the seriousness of the charges weighs heavily in the assessment of the long-term implications of exclusion. The potential countervailing effect, discussed above, has less application than it might in other circumstances because, as I have found, the breach did not have a significant impact on Mr. Khangura's privacy.
[71] Society's interest in the adjudication of the case on its merits thus strongly favours the admission of the evidence.

CONCLUSION

[72] The CRA's *Charter*-infringing conduct was more than minimally serious. The effect on Mr. Khangura's constitutional right to privacy, though a real effect, was not a major one. But to the extent that these factors favour exclusion of the evidence, their effect is outweighed, in my assessment, by society's strong interest in the adjudication of the case

Digitized by Google

on its merits. Given, in particular, the nature and gravity of the charges, and the reliability (in the sense I have described) of the evidence, a reasonable person, informed of all the relevant circumstances and the values underlying the *Charter*, would not conclude that the admission of the evidence would bring the administration of justice into disrepute.

[73] In all the circumstances, it is not established that the admission of the evidence would bring the administration of justice into disrepute.

[74] The application to exclude the evidence therefore fails.

Digitized by Google

R. v. Ling, [2002] 3 S.C.R. 814, 2002 SCC 74, The *Jarvis* Principles Applied on Audit realized Evidence Before, and After, Interrogation and Advice of Rights to Counsel

2002: June 13; 2002: November 21.
Present: McLachlin C.J. and L'Heureux-Dubé, Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour and LeBel JJ.
on appeal from the court of appeal for british columbia

Income tax — Administration and enforcement — Audits and investigations — Whether distinction can be drawn between audit and investigation under Income Tax Act — If so, circumstances in which tax official's inquiry constitutes penal investigation — Whether evidence obtained during audit pursuant to ss. 231.1(1) and 231.2(1) of Income Tax Act can be used to further investigation or prosecution of offences under s. 239(1) of the Act without violating taxpayer's Charter rights — Canadian Charter of Rights and Freedoms, ss. 7, 8 — Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 231.1, 231.2.

Constitutional law — Charter of Rights — Exclusion of evidence — Tax evasion — Statements and documents obtained during inquiry by tax auditors pursuant to ss. 231.1(1) and 231.2(1) of Income Tax Act transferred to investigator — Investigator obtaining further information with requirement letters to various banks — Taxpayer charged with tax evasion — Whether evidence against taxpayer obtained in violation of his rights under Canadian Charter of Rights and Freedoms — If so, whether evidence should be excluded — Canadian Charter of Rights and Freedoms, s. 24(2).

Revenue Canada audited the appellant taxpayer with respect to his claim for farm losses for the taxation years 1990 through 1993. The auditors met the taxpayer's accountant and examined books and records. They also met the taxpayer and obtained receipt books from which they deduced that income had not been reported. More meetings and further requests by the auditors led to the production of more information, including financial records and bank documents. On December 18, 1995, the auditors questioned the taxpayer extensively and he admitted to mistakenly failing to report income. A month later, the taxpayer's file was transferred to the Special Investigations Section of Revenue Canada, which is responsible for criminal enforcement. Special investigations officials carried out further inquiries, interviewing witnesses and sending requirement letters to four banks and the taxpayer's accountant. They then met the taxpayer, informed him that he was under investigation and cautioned him as to his rights. The taxpayer declined to answer any questions. He was later charged under s. 239(1) of the *Income Tax Act* with tax evasion and making false or deceptive statements in income tax returns. The trial judge found that the evidence gathered by the auditors was not obtained in violation of the taxpayer's rights under the *Canadian Charter of Rights and Freedoms* and denied a motion to exclude the evidence under s. 24(2) of the *Charter*. The taxpayer was convicted. The summary conviction appeal judge set aside the convictions. He held that the investigation began after the December 18 meeting and ordered a new trial in which the court would consider whether the auditors' evidence gathered after that meeting should be excluded under s. 24(2). The Court of Appeal

Digitized by Google

affirmed the decision.

Held: The appeal should be dismissed.

In light of the principles set out in *R. v. Jarvis*, [2002] 3 S.C.R. 757, 2002 SCC 73, Revenue Canada did not commence an investigation into the taxpayer's penal liability until after the December 18 meeting. The evidence gathered prior to and during that meeting in the proper exercise of an audit function could be shared with the Special Investigations Section and used in the subsequent prosecution of the taxpayer for s. 239(1) offences. After the December 18 meeting, the predominant purpose of the inquiry was the determination of the taxpayer's penal liability. All evidence gathered after that meeting pursuant to the requirement powers was obtained as part of an investigation and in violation of the taxpayer's *Charter* rights. The admissibility of this evidence, and the evidence derived therefrom, will have to be considered in light of s. 24(2) of the *Charter*.

Cases Cited

Followed: *R. v. Jarvis*, [2002] 3 S.C.R. 757, 2002 SCC 73.

Statutes and Regulations Cited

Canadian Charter of Rights and Freedoms, ss. 7, 8, 24(2).

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 231.1(1), 231.2(1), 239(1), (2).

APPEAL from a judgment of the British Columbia Court of Appeal (2000), 149 C.C.C. (3d) 127, 144 B.C.A.C. 92, 236 W.A.C. 92, [2000] B.C.J. No. 2082 (QL), 2000 BCCA 562, affirming a judgment of Millward J., [1999] 3 C.T.C. 386, [1998] B.C.J. No. 1512 (QL), setting aside the taxpayer's convictions for tax offences and ordering a new trial. Appeal dismissed.

Craig C. Sturrock and *Thomas M. Boddez*, for the appellant.

S. David Frankel, *Q.C.*, *Bruce Harper* and *Janet Henchey*, for the respondent.

Trevor Shaw, for the intervener the Attorney General for Ontario.

Gilles Laporte and *Monique Rousseau*, for the intervener the Attorney General of Quebec.

Scott K. Fenton, for the intervener the Criminal Lawyers' Association (Ontario).

The judgment of the Court was delivered by

IACOBUCCI AND MAJOR JJ. —

I. Introduction

1 This appeal is determined by the principles set out in *R. v. Jarvis*, [2002] 3 S.C.R. 757, 2002 SCC 73, an appeal heard concurrently. It raises a similar question, namely, in what circumstances an inquiry by an official of the Canada Customs and Revenue Agency ("CCRA"), formerly Revenue Canada, constitutes an investigation that implicates the *Charter* rights of the taxpayer. In *Jarvis*, we describe the circumstances in which an inquiry constitutes a criminal investigation as those that engage the adversarial relationship between the individual and the state, and we will use that phrase in the same context here. *Jarvis* establishes that this relationship is engaged where the predominant purpose of an inquiry is the determination of a taxpayer's penal liability under s. 239 of the *Income Tax Act*, R.C.S. 1985, c. 1 (5th Supp.) (the "Act").

2 In performing an audit, the auditor may use the requirement powers, pursuant to ss. 231.1(1) and 231.2(1) of the Act. These sections give the auditor the power to: (a) enter a taxpayer's place of business or place of record

Digitized by Google

keeping; (b) require the taxpayer and third parties to answer questions put to them; and (c) require the taxpayer and third parties to furnish information and documents upon request.

3 If the audit reveals that the taxpayer has filed an incorrect tax return, he or she may be subject to reassessment and civil penalties. In cases where the taxpayer has wilfully made false or deceptive statements or entries or attempted to evade the payment of a tax, he or she may be guilty of an offence pursuant to s. 239(1) of the Act for which the punishments include fines and imprisonment for a maximum of five years.

4 The issue here as in *Jarvis* is when, if ever, can evidence obtained pursuant to the requirement powers of an audit be used to further an investigation or prosecution for a s. 239(1) offence without violating the suspect's *Charter* rights? This question is answered by *Jarvis*.

5 Though the factual circumstances and issue raised in the present appeal are less complicated than in *Jarvis*, the question of law is the same. Evidence gathered by the CCRA pursuant to ss. 231.1(1) and 231.2(1), in the proper exercise of its audit function, may be used in a subsequent investigation or prosecution for a s. 239(1) offence. However, where the predominant purpose of a question or inquiry is the determination of penal liability, CCRA officials relinquish the authority to use ss. 231.1(1) and 231.2(1). Obtaining evidence under the requirement powers for such a purpose is a violation of a suspect's *Charter* rights. Such evidence may thus be excluded from the prosecution of an offence.

6 The question, then, is in what circumstances is the predominant purpose of a question or inquiry the determination of penal liability? In *Jarvis*, at para. 93, we held that no one factor is determinative but that the trial judge must assess the totality of the circumstances. Applying the *Jarvis* test, we agree with Millward J. that the CCRA did not exercise its investigative function until after the meeting between Revenue Canada officials and the appellant on December 18, 1995.

7 Once the CCRA began to exercise its investigative function, the parties were put in an adversarial relationship. The appellant is not entitled to immunity from evidence obtained pursuant to the requirement power prior to and during the December 18 meeting, or evidence derived therefrom. However, the appellant is entitled to a new trial in which the court will consider the admissibility of evidence obtained under the requirement power for the predominant purpose of determining penal liability, and evidence derived therefrom, in accordance with s. 24(2) of the *Canadian Charter of Rights and Freedoms*. The appeal is dismissed and the order for a new trial is confirmed.

II. Facts

8 Following an audit, Revenue Canada disallowed the appellant taxpayer's claimed farm losses for the years 1987 through 1989. The appellant's taxes for those years were reassessed on the basis that his farming operations were a personal endeavour, not a business. In 1994, James Edward Thatcher, a technical advisor with the Business Audit Section of Revenue Canada in Vancouver, conducted a computer check which revealed that the appellant claimed the same farming losses for the taxation years 1990 through 1993. As a result, Thatcher selected those returns for a routine follow-up audit.

Digitized by Google

9 In November 1994, Thatcher informed the appellant, who was a doctor in Kitimat, B.C., that he was conducting an audit and would be there in the spring of 1995 to review his farming operations and medical practice. Arvind Pacheco, of the Verification and Enforcement Division of Revenue Canada, was assigned to work on the audit with Thatcher.

10 On June 5, 1995, Pacheco and Thatcher met with the appellant's accountant, Carlyle Shepherd, at Shepherd's office to examine the appellant's books and records. In reviewing those records, Thatcher determined that fees paid by the Medical Service Plan ("MSP") were deposited directly to the appellant's accounts twice each month. There were other deposits into the same accounts which could not be identified by them.

11 On June 7, 1995, Pacheco and Thatcher met with the appellant at the appellant's office in the Kitimat General Hospital. Complying with a request by the auditors, the appellant produced two receipt books. Comparing the receipt books to the bank records, the auditors deduced that office income had not been reported.

12 Pacheco wrote to the appellant on June 21, 1995, requesting additional information and, on July 27, 1995, he wrote again stating that if the information was not forthcoming, requirements demanding it or a reassessment based on the information currently available would be issued.

13 Pacheco met with the appellant at his farm in Delta, British Columbia on August 9, 1995. On September 5 and 19, Shepherd provided further information to Pacheco on behalf of the appellant.

14 On November 20, 1995, Pacheco telephoned the appellant to set up a meeting for December 18, 1995. He also questioned the appellant about the unidentified deposits that he had proposed to include in income. The appellant responded that they were loans.

15 Pacheco wrote to the appellant on December 7, 1995, asking him to provide further information and asking him to identify certain deposits before the December 18 meeting.

16 The auditors met with the appellant on December 18 at the Vancouver District Office of Revenue Canada for over three hours. The appellant was questioned extensively about the unidentified deposits and unreported income. In the course of this meeting, the appellant admitted that he had mistakenly failed to report certain amounts as income.

17 At no point did the auditors inform the appellant of any concern about tax evasion or about any rights he might have under the *Charter* in relation to the inquiries being made of him. The following documents and information had been obtained in the course of the audit:

(a) the appellant's filed income tax returns;
(b) the working papers of the Revenue auditor who had previously examined the appellant's farming loss claim for 1987-89;
(c) two boxes of financial records at the appellant's accountants;
(d) a receipt book kept at the appellant's office;
(e) a journal recording cheques and cash received and petty cash, kept at the appellant's office;
(f) bank statements and bank deposit slips, some kept by the appellant and some obtained from the banks;
(g) cheques from the Workers' Compensation Board to the appellant, obtained from the Board;
(h) oral and written responses by the appellant's accountants to specific

Digitized by Google

queries and requests for documents, including handwritten income and expense statements;

(i) statements made by the appellant to the auditors in telephone conversations and in interviews on June 7 and December 18, 1995.

18 Following a meeting on December 29, 1995, the auditor, with the appellant's consent, obtained documents from certain brokerage firms and chartered banks.

19 After December 18, 1995, but before January 18, 1996, Pacheco met with Mr. Fleming, his group head, and Mr. Richard Olney, of Special Investigations, the criminal enforcement branch of Revenue Canada. The outcome of the meeting was a referral of the appellant's file to Special Investigations on January 18, 1996, pursuant to instructions of Pacheco's supervisor.

20 On February 26 and 27, 1996, Olney and Fleming interviewed two witnesses who had previously been interviewed by the auditors. Requirement letters were served on four banks and on the appellant's accountant. On February 28, 1996, Olney and Fleming met the appellant at his office. They read him a caution from a card advising him generally that he was not obliged to make any statements but if he did so they might be used in evidence and that he had a right to retain and instruct a lawyer. The appellant declined to answer any questions. On February 28, 1996, a Prosecution Report was prepared. The appellant was charged with six counts of committing an offence contrary to s. 239(1) of the Act on August 26, 1996.

III. Relevant Statutory and Constitutional Provisions

21 *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)

231.1 (1) An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act,

(*a*) inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act, and

(*b*) examine property in an inventory of a taxpayer and any property or process of, or matter relating to, the taxpayer or any other person, an examination of which may assist the authorized person in determining the accuracy of the inventory of the taxpayer or in ascertaining the information that is or should be in the books or records of the taxpayer or any amount payable by the taxpayer under this Act,

and for those purposes the authorized person may

(*c*) subject to subsection (2), enter into any premises or place where any business is carried on, any property is kept, anything is done in connection with any business or any books or records are or should be kept, and

(*d*) require the owner or manager of the property or business and any other person on the premises or place to give the authorized person all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act and, for that purpose, require the owner or manager to attend at the premises or place with the authorized person.

Digitized by Google

. . .

231.2 (1) Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,

(*a*) any information or additional information, including a return of income or a supplementary return; or

(*b*) any document.

. . .

239. (1) Every person who has

(*a*) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation,

(*b*) to evade payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,

(*c*) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,

(*d*) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act, or

(*e*) conspired with any person to commit an offence described in paragraphs (*a*) to (*d*),

is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

(*f*) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or

(*g*) both the fine described in paragraph (*f*) and imprisonment for a term not exceeding 2 years.

(2) Every person who is charged with an offence described in subsection (1) may, at the election of the Attorney General of Canada, be prosecuted on indictment and, if convicted, is, in addition to any penalty otherwise provided, liable to

(*a*) a fine of not less than 100% and not more than 200%, of the amount of the tax that was sought to be evaded; and

(*b*) imprisonment for a term not exceeding 5 years.

Canadian Charter of Rights and Freedoms

7. Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.

8. Everyone has the right to be secure against unreasonable search or seizure.

24. (1) Anyone whose rights or freedoms, as guaranteed by this Charter, have been infringed or denied may apply to a court of competent jurisdiction to obtain such remedy as the court considers appropriate and

Digitized by Google

just in the circumstances.

(2) Where, in proceedings under subsection (1), a court concludes that evidence was obtained in a manner that infringed or denied any rights or freedoms guaranteed by this Charter, the evidence shall be excluded if it is established that, having regard to all the circumstances, the admission of it in the proceedings would bring the administration of justice into disrepute.

IV. Judicial History

A. *Provincial Court of British Columbia* — July 21, 1997

22 Graham Prov. Ct. J. denied the appellant's motion for a stay of proceedings, or, in the alternative, for an order under s. 24(2) of the *Charter* that evidence obtained from the appellant by auditors of Revenue Canada be excluded because the appellant's *Charter* rights had been breached.

23 The trial judge found that the audit was continued throughout Pacheco's involvement with the file and that he had not reached any conclusion that the appellant had evaded taxes before he was told by his supervisor to refer the file to Special Investigations after the December 18 meeting. The appellant was found guilty of each count of tax evasion.

B. *Supreme Court of British Columbia*, [1999] 3 C.T.C. 386

24 The appellant sought an order under s. 24(2) that all evidence obtained directly or indirectly through an audit conducted under the *Income Tax Act* was inadmissible in a criminal proceeding.

25 The summary conviction appeal judge found that there was no direct adversarial relationship between the taxpayer and the state prior to December 18, 1995 and that the information requested by Revenue Canada up to that date was pre-existing business documents to which little *Charter* protection applied. He pointed out that, if information gathered in an audit could not be used in a later prosecution, the tax evasion provisions would be ineffective to the point that even a search warrant might not be obtained.

26 On the issue of whether the actions of Revenue Canada were part of an audit or an investigation, Millward J. noted that the parties were in agreement, supported by case law, that the appropriate test to apply was whether the predominant purpose of Revenue Canada's actions was to further an audit or an investigation but he found the test to be artificial and inappropriate in these circumstances.

27 Millward J. disagreed with the trial judge's finding that an investigation had not commenced even after the December 18 meeting because Thatcher thought it was premature to refer the file to Special Investigations until the audit was completed. Instead, Millward J. found that the predominant purpose of the auditor's actions after the December 18 meeting was to gather information to be used in their criminal investigation. He allowed the appeal, set aside the convictions and ordered a new trial on all counts and in particular to consider the evidence obtained after the December 18 meeting in light of s. 24(2) of the *Charter*.

C. *Court of Appeal for British Columbia* (2000), 149 C.C.C. (3d) 127

28 Rowles J.A., for the court, dismissed the appellant Ling's appeal that Millward J. had erred in failing to make an order excluding all evidence obtained pursuant to the *Income Tax Act* requirement power for use in criminal proceedings

Digitized by Google

against the appellant.

V. Issue

29 This appeal raises a single issue:

> Can the appellant claim use immunity for the compelled statements and derivative use immunity for the "product" of his compelled testimony?

VI. Analysis

A. *Application of Jarvis Principles*

30 The answer to the above question hinges on whether Revenue Canada was conducting an investigation into the commission of an offence under the Act when it gathered evidence from the appellant pursuant to the requirement power. At what point did the adversarial relationship crystallize? As stated in *Jarvis*, an audit and an investigation are not mutually exclusive. Revenue Canada may conduct both concurrently. Revenue Canada must be careful, however, not to use the requirement power of the audit to gather further evidence for an investigation after it has commenced. If it does so it violates the *Charter* rights of the investigated taxpayer.

31 Applying the factors set out in *Jarvis* to determine the commencement of an investigation, we come to the following conclusions based on the trial record:

(a) The authorities did not have reasonable grounds to lay charges before December 18, 1995.

(b) It did not appear prior to the December 18 meeting that a decision to proceed with a criminal investigation could have been made.

(c) The general conduct of the tax authorities was not such that it had decided the taxpayer was under investigation for s. 239 offences.

(d) The auditors had not transferred their files and materials to the investigators until January 18, 1996.

(e) The decision to proceed with a criminal investigation had only been made after December 18, 1995.

(f) The conduct of the auditors was not such that they were effectively acting as agents for the investigators.

(g) It does not appear that the investigators intended to use the auditors as their agent in the collection of evidence.

B. *Conclusion*

32 We conclude, as did Millward J., that the audit was conducted properly as an audit and not as an investigation up to and including the December 18 meeting. However, after that meeting the officials began to investigate the appellant's penal liability. The information gathered pursuant to the requirement power on December 29, 1995 was gathered as part of an investigation and in violation of the appellant's ss. 7 and 8 *Charter* rights. All evidence gathered prior to and during the meeting of December 18 was properly obtained as part of the audit process and could be shared with the Special Investigations Section. All evidence gathered subsequent to that meeting from the appellant prior to warning him that he was the subject of an investigation for the purpose of furthering the investigation or prosecution for s. 239(1) offences violates the appellant's *Charter* rights and will have to be considered in light of s. 24(2) in the new trial as ordered by Millward J. and confirmed by the Court of Appeal.

Digitized by Google

VII. Disposition

33 The appeal is dismissed and the order for a new trial is confirmed.

Appeal dismissed.

Solicitors for the appellant: Thorsteinssons, Vancouver.

Solicitor for the respondent: The Department of Justice, Vancouver.

Solicitor for the intervener the Attorney General for Ontario: The Ministry of the Attorney General, Toronto.

Solicitor for the intervener the Attorney General of Quebec: The Department of Justice, Sainte-Foy.

Solicitor for the intervener the Criminal Lawyers' Association (Ontario): Scott K. Fenton, Toronto.

R. v. Caul, 2008 ONCJ 353, A Proper Audit that Caused Proper Auditor Disengagement, that Promptly Caused SI to Act

MCKAY J.:

Background

[1] Kelvin and Shelly Caul are husband and wife. They reside in the Fort Frances area. Kelvin Caul operates a sole proprietorship known as Kelvin Caul Logging. Shelly Caul has some involvement in that business in terms of record keeping. Mr. and Mrs. Caul are charged with a variety of offences under the Income Tax Act and Excise Tax Act related to the evasion of payment of taxes and the making of false and deceptive statements in income tax returns and goods and services tax returns. The charges are a result of an investigation by Canada Revenue Agency ("CRA"). CRA interacts with taxpayers with respect to both civil penalties and criminal proceedings. Accordingly, there is an audit section of the CRA, and an investigation section of the CRA. The audit section deals with compliance with the legislation and the civil scheme of a taxpayer's obligations. The investigative section deals with criminal investigations which may lead to charges under the legislation.

[2] Certain powers are bestowed upon the CRA for purposes of administration of both the Income Tax Act and Excise Tax Act. Taxpayers are bound to cooperate with CRA auditors for tax assessment purposes. Sections of the legislation allow CRA employees performing audits for compliance to have access to a wide range of information related to the taxpayer. The taxpayer is required to cooperate, and in essence to provide any information required to justify the accuracy of the return filed by the taxpayer. An unfavourable audit may result in the imposition of regulatory penalties on the taxpayer.

[3] The powers available to the auditor are not available to investigators pursuing possible criminal charges. Once an authorized agent of CRA has reasonable grounds to believe that an offence has been committed under the legislation, an application can be made for a search warrant to obtain evidence for the prosecution of offences. Similarly, production orders can be obtained. However, judicial authorization, upon proof of reasonable grounds to believe an offence has been committed, is a requirement faced by investigators.

[4] In this case, as is often the case, the examination of the Cauls' tax situation began with an audit. The auditor involved eventually referred the file to the

Digitized by Google

investigations section. It was accepted for investigation and the investigator subsequently swore Informations to obtain search warrants on the Caul residence and two other locations where there was information related to their tax returns. Documentation was subsequently seized pursuant to the warrants and production orders. Many of the details contained in the Information to obtain the search warrant were obtained from the auditor.

[5] Prior to the trial in this matter, the defence filed an application pursuant to the Charter alleging violations of Sections 7 and 8 of the Charter of Rights. Such an application is known as a *Jarvis* application, so named after the leading Supreme Court of Canada decision on the issue, *R. v. Jarvis [2002] 3 S.C.R. 757.* The defence asks that the evidence obtained pursuant to the search warrants and production orders be excluded from a trial. This is a ruling on the Charter application.

Evidence

[6] Jodi Case was the auditor that the Caul matter was originally referred to. She received the file from her team leader. A full audit was to be conducted because losses shown on tax returns resulted in a net income so low that the obvious question was how this family sustained itself from an economic perspective. For example, for the 2002 tax year, without any capital cost allowance claimed, the tax return showed a loss of approximately $100,000.00. For 2003, again before any capital cost allowance claimed, the tax returns showed a loss of $27,000.00.

[7] Ms. Case initially made contact with Mr. and Mrs. Caul by telephone on April 13, 2005. She informed them that a full audit was being conducted. A little more than a week later she telephoned them again and set up a meeting on May 9. She advised that a letter would be forwarded by her which would outline the documents which needed to be provided to her. She indicated that it was a standard request for documentation.

[8] She met with Mr. and Mrs. Caul on May 9, 2005, for approximately an hour. She obtained some of the documents and discussed many of the documents which had not been provided by Mr. and Mrs. Caul. She completed a questionnaire with Mr. and Mrs. Caul.

[9] Fairly quickly, Ms. Case noted what she referred to as “gross discrepancies”. There were additional deposits to the business bank account that she could not confirm a source for. She requested additional information in order to complete the bank deposit analysis. There was further interaction in which she requested by fax responses to questions which she had regarding bank transactions. Those responses were subsequently provided by Cauls.

[10] Ms. Case then completed the bank deposit analysis and noted large unexplained cash deposits. On February 1, 2006, she prepared a referral to the investigation section. After that point she had no further contact with Mr. and Mrs. Caul.

[11] It should be noted that a referral to investigators is not the norm for an auditor to follow. Ms. Case testified that she has done more than 100 audits as an employee of CRA. From that number she has referred six to the investigation section. Only two of those, including the referral related to Mr. and Mrs. Caul, were actually accepted for investigation.

[12] Lawrence Stroud also gave evidence. He has worked with Canada Revenue Agency since 1991. In 1993 he began working as an auditor. In 2003 he moved to the investigation section. He received the referral for investigation related to the Cauls in late February or early March. As a result, he interviewed Ms. Case on March 8,

Digitized by Google

2006, to obtain an understanding of the file. That was his first contact with Ms. Case regarding Mr. and Mrs. Caul. The Caul file was actually accepted for investigation on April 14, 2006.

[13] Once the Caul file was accepted for investigation, Mr. Stroud reviewed Ms. Case's file notes, and the Cauls' tax returns. Based upon what he saw, he decided to expand the investigation to include the taxation year 2004. In May of 2006, he prepared his primary report. In June of 2006, his supervisor "signed off" on his report. Accordingly, he prepared the documentation required to obtain the search warrants and production orders.

[14] Mr. Stroud did his own bank analysis for the years 2002 to 2004. He also forwarded correspondence to the sources of deposits to the Cauls' bank account to determine whether the deposits were income. The civil side of the audit was finalized. The search warrants were executed on July 11, 2006. At the time the warrant was executed, Mr. and Mrs. Caul were cautioned and their right to counsel was provided to them. There were no statements made by them at that point. The charges were subsequently laid.

The Law

[15] As indicated, the *Jarvis* decision is the leading decision in this area of the law. In that decision, the Supreme Court of Canada held that the taxing authority's audit function gave way to an adversarial role at the point that the inquiry becomes a penal investigation. The difficulty, of course, is determining at what point that happens. In paragraph 88 of the decision the court in *Jarvis* indicated the following:

"In our view, where the predominant purpose of a particular inquiry is the determination of penal liability, CCRA officials must relinquish the authority to use the inspection and requirement powers under Section 231.1(1) and 231.2(1). In essence, the officials "cross the Rubicon" when the inquiry in question engages the adversarial relationship between the taxpayer and the State…"

[16] The court made it clear that an auditor who merely suspects wrongdoing has not crossed the threshold into criminal investigation for that reason alone. At paragraph 89 of the decision, the court noted:

"To begin with, the mere existence of reasonable grounds that an offence may have been committed is in itself insufficient to support the conclusion that the predominant purpose of an inquiry is the determination of penal liability. Even where the reasonable grounds to suspect an offence exists, it will not always be true that the predominant purpose of an inquiry is the determination of penal liability. In this regard, courts must guard against creating procedural shackles on regulatory officials; it would be undesirable to "force the regulatory hand" by removing the possibility of seeking the lesser administrative penalties on every occasion in which reasonable grounds existed of more culpable conduct…"

[17] The court in *Jarvis* also noted that the mental element, intent, is a necessary aspect of evidence before charges can be laid. Paragraphs 90 and 91 of the judgment the court indicated the following:

"…the test cannot be set at the level of mere suspicion that an offence has occurred. Auditors may, during the course of their inspections, suspect all manner of taxpayer wrongdoing, but it certainly is not the case that, from the moment such suspicion is formed, an investigation has begun. On what evidence could investigators ever obtain a search warrant if the whiff of suspicion were enough to freeze auditorial fact

Digitized by Google

finding. The state interest in prosecuting those who wilfully evade their taxes is of great importance, and we should be careful to avoid rendering nugatory the State's ability to investigate and obtain evidence of these offences.
The other pole of the continuum is no more attractive. It would be fiction to say that the adversarial relationship only comes into being when charges are laid. Logically this will only happen once the investigators believe that they have obtained evidence that indicates wrongdoing. Because the Section 239 offences contain an element of mental culpability, the state will, one must presume, usually have some evidence that the accused satisfied the *mens rea* requirement before laying an Information or preferring an Indictment. The active collection of such evidence indicates an adversarial relationship has been engaged, since it is irrelevant to the determination of tax liability…"

Submissions of the Parties

[18] The defence takes the position that by May 9, 2006, CRA had all of the documents which it needed for reasonable and probable grounds to obtain a search warrant. The argument is that this was a simple business, and the CRA commenced a full audit looking for sources of income while wondering how people existed with negative income. By May 9, 2006, they were looking for an explanation regarding $300,000.00 worth of deposits over a period of two years. Given the large amounts of money involved, it was a large red flag, and sufficient information was in their hands that charges could have been laid. The defence position is that, given an assessment of the factors enunciated in paragraph 94 of *Jarvis*, the relationship had become adversarial, the reality of what was occurring was an investigation into criminal charges.

[19] The Crown argues that until the auditor obtained all the bank statements involved, and the explanation of some of the banking transactions which was provided in December of 2005, the auditor not have any knowledge of what the deposits related to, and whether they would have anything to do with business income. Essentially, the auditor provided the taxpayers with an opportunity to explain the **transaction s. The Crown's argument is that reasonable and probable grounds would only exist if the taxpayers were unable to explain the transactions. *Mens rea* would not be an issue until an auditor became aware that there was no explanation for the transactions.**

[20] The Crown further takes the position that the predominant purpose of the auditor was determining tax liability and determining whether there was an explanation for the bank deposits in question. The Crown pointed out that the auditor did not pass the documentation which she obtained onto the investigator. The investigator eventually obtained those documents pursuant to the search warrant.

Decision on the Application

[21] In my view, the Crown has correctly pointed out that the predominant purpose of the audit was to determine tax liability, and not to investigate criminal charges. **Very early in the audit, it was obvious that there was a question about significant bank deposits. However, bank deposits can come from any number of sources. At that point, in my view, CRA would not be in a position to obtain a search warrant simply because it could show that there were significant deposits to a bank account which were not reported as income. Deposits do not necessarily always relate to income. An auditor is entitled to**

Digitized by Google

find out the source of those deposits, whether they relate to income, and whether there would be any tax liability for those deposits. Even if there was suspicion of wrongdoing, that would not change the predominant purpose of the auditor's inquiries.

[22] In this case, the auditor used the powers available to an auditor under the legislation for the predominant purpose of obtaining an explanation as to the source of the bank deposits, and determining whether there was tax liability. At the point that she received an explanation which was unsatisfactory to her, she ceased having contact with Mr. and Mrs. Caul, and referred the file to the investigation section. The investigation section then reviewed the matter, accepted the file for investigation, met with Ms. Case to obtain an understanding of the file, and then conducted their own investigation, using the legislative provisions to obtain search warrants and production orders.

[23] The *Jarvis* decision notes that a taxpayer has very little privacy interest in records required to be kept pursuant to taxation legislation. The court also noted that there is nothing preventing auditors from passing to investigators files containing validly obtained audit information.

[24] In this case, the evidence has not established a breach of either Section 7 or Section 8 of the Charter, and accordingly the application is dismissed. The evidence obtained pursuant to the search warrants and production orders is admissible.

Released: August 5, 2008.

Signed:

"Justice McKay"

Her Majesty The Queen v. Ostrowski, Ontario Superior Court Of Justice, CR-06-0309, 2008 CanLII 35698 (ON SC), Another Clear Cut Between Auditor and Investigator with *Jarvis* Interpreted

Madam Justice H.M. Pierce Reasons On Appeal

Introduction

[1] The respondent, Arnold Ostrowski, was charged with offences under the *Income Tax Act* and the *Excise Tax* Act. Specifically, he was alleged to have made false or deceptive statements in his tax returns for 2000, 2001, and 2002 **by understating his income for those years**. In addition, he was charged with wilfully evading the payment of tax by failing to report business income for the same years. Finally, he was charged with wilful evasion of the payment of GST by failing to report taxable supplies for periods encompassed by 2000 – 2002.

[2] The Public Prosecution Service of Canada, which I will refer to as the Crown, appeals from a decision of the Honourable Mr. Justice R. Clarke of the Ontario Court of Justice dated November 19, 2007. **The learned trial judge ruled inadmissible evidence obtained by auditors for Canada Customs and Revenue Agency (CCRA) pursuant to search warrants and third party requirements for information. He found that the respondent's right to remain silent, as encompassed by s. 7 of the *Charter of Rights and Freedoms,* and his right not to be subjected to unreasonable search and seizure under s. 8 of the *Charter* were violated. Upon that finding, the Crown had no further evidence to offer. As a result, the charges against Mr. Ostrowski were dismissed.**

[3] On this summary conviction appeal, the appellant seeks an order that the

Digitized by Google

evidence be admitted and a new trial ordered. In support of its argument the Crown relies on the reasoning in *R. v. Jarvis* [2002] S.C.J. No. 76 (S.C.C.). In *Jarvis,* the Supreme Court of Canada considered the demarcation between audit and investigative functions of the tax authorities. The application of those principles to the facts of this case is the issue on appeal.

[4] **As the court noted at para. 100 of *Jarvis,* whether an inquiry constitutes an audit or an investigation is a question of mixed fact and law. Accordingly, a degree of deference to the trial judge is required.**

The Facts

[5] In 2003, Ms. Yvonne Franzen, an auditor with CCRA, was assigned to do a limited scope audit of the respondent to verify payments made to subcontractors between 1999 and 2001. Mr. Ostrowski was then the sole proprietor of A.J. Garages. When the respondent's expenses did not match amounts claimed, Franzen noted discrepancies between the expenses reported on the respondent's tax return and the records he provided the auditor. She recommended a full scope audit for 2001 – 2002.

[6] In a full scope audit, all revenue and expenses are examined. This expanded audit was assigned to Mona Klein who was then part of the underground economy section of the audit department. The underground economy auditors focus on businesses involved in cash transactions and unreported income.

[7] The audit department is separate from the investigative arm of the CCRA.

[8] When the scope of the audit was expanded, Ms. Franzen advised Ms. Klein that the respondent had few books or records, and that there were discrepancies in his expenses, though not in income.

[9] When she began the audit in October of 2003, Ms. Klein had no suspicion that the respondent had filed a fraudulent tax return.

[10] Mr. Ostrowski advised Klein that he did not always charge customers GST as some of his competitors did not. However he could not recall whether he remitted GST. Consequently, she could not reach any conclusions about his compliance with GST regulations.

[11] Ms. Klein examined the respondent's business bank statements and noted that most of the bank deposits were for even amounts. She determined that he had no listing of revenue. When the deposits in the respondent's business account were tallied, they were less than the declared income. The respondent could not explain the difference.

[12] Next, Ms. Klein decided to do an analysis of the respondent's personal bank statements in keeping with audit procedure for sole proprietorships or partnerships with gross revenue less than one million dollars.

[13] The respondent had no books and incomplete records. All the contracts the respondent provided totalled less than the reported income, which led Klein to believe the list of contracts provided was incomplete.

[14] As a result of these deficiencies, Klein embarked on a net worth analysis. A net worth audit is a determination of a taxpayer's assets less liabilities at the end of the audited period as compared to the beginning. The auditor must compare the taxpayer's personal expenses with income. It was Ms. Klein's practice not to draw conclusions about a net worth audit until she was certain that all assets, liabilities and all personal expenditures were accounted for. She commented that if one asset or liability were missing, the conclusion would be inaccurate.

[15] Ms. Klein testified that she did not have suspicion with respect to the

Digitized by Google

respondent's income, though she had some indication that it may not have been correct. She stated that she could not verify his income or expenses on a factual basis as would normally be done. Consequently, she conducted a global analysis rather than an audit where income and expenses are each verified. Klein did not note any apparent discrepancies between the taxpayer's lifestyle and the income claimed.

[16] Klein also examined cancelled business cheques. In the course of her analysis, she noted cash expenditures of about $30,000 in 2002. Klein testified that she probably had some suspicion on June 14, 2004 after she examined bank withdrawals and found a discrepancy of $30,000 for 2002. She explained that a discrepancy meant the difference between all cash withdrawn and any business and personal expenses paid in cash.

[17] On June 18, 2004, Ms. Klein asked Ms. Ostrowski to identify the cash expenditures. At this point, she had some suspicion of criminal activity but was hoping for an explanation. The explanation given was that the money was used to pay subcontractors in cash; however, Mr. Ostrowski refused to provide a list of those paid or other supporting documentation.

[18] On July 5, 2004, Ms. Klein advised Ms. Ostrowski that without particulars, the $30,000 in unexplained cash would be disallowed as a business expense. The file was referred to the investigations unit that day when there was no explanation for the cash expenses claimed. Klein testified that until this point, she had no suspicion of tax evasion on Mr. Osteowski's part.

[19] The audit report was completed on July 7, and the penalty recommendation report on July 8, 2004. There was no further audit activity after this time.

[20] Ms. Klein testified that she had no contact with the investigations unit while her audit was ongoing. She also stated that when she took over the file, she was not suspicious of the taxpayer simply because of the lack of books and records. She stated it is common for auditors to find discrepancies, but these files are not all referred for investigation. For example, she stated that over a three year period, the underground economy audit department would have conducted 135 audits. Of that number, 24 cases were referred to the investigation department, and 5 were accepted for investigation.

[21] Klein also explained that an investigator looks for intent and the amount in question when conducting an investigation. She may rely on third party information to support intent, altered or fabricated documents, or conduct of the taxpayer. However she stated that to an auditor, intent is irrelevant. The auditor is only interested in the taxable income, compared with reported income and revisions to reported income. A lie by the taxpayer might however be relevant in penalty recommendations.

[22] The investigator, Helena Strandberg, testified. The Ostrowski file was accepted for investigation on November 15, 2004.

[23] She prepared an information to obtain a search warrant for the taxpayer's records. The warrant was executed on January 5, 2005. Mr. Ostrowski was cautioned at that time. She stated she did not look at the documents in the audit file at the time she swore an information for a search warrant. Her information derived from Klein's notes in the audit file, information from Ms. Franzen, and the tax return filed. The two auditors, Franzen and Klein audited the period from January 28, 2003 to July 5, 2004.

[24] It was only after the execution of the search warrant that Strandberg examined the documents obtained in the audit, which were by then subject to seizure pursuant

Digitized by Google

to the search warrant. Strandberg interviewed the respondent after the warrant was executed and again cautioned him and gave him his rights to counsel before interviewing him. She added that she cautioned him before each subsequent contact.
[25] Ms. Strandberg stated that the charges against Mr. Ostrowski were laid based on an analysis of the documents seized, third party interviews, and information she obtained from the bank accounts. It was her evidence that the Klein audit covered only two years, 2001 and 2002. However, Strandberg expanded the scope of the investigation to include 1999 and 2000. Accordingly, it was necessary to do additional analysis as part of the investigation.

The Decision Under Appeal
[26] The trial judge summarized the issue before him as follows: "The question to be asked in this case is whether the audits conducted by Ms. Franzen and Ms. Klein became an investigation and if so, when?"
[27] He held that Mr. Ostrowski's right to silence under s. 7 of the *Charter of Rights and Freedoms* was violated because he was not cautioned before being interviewed during the audits. He also determined that the respondent's right to be free from unreasonable search or seizure as guaranteed by s. 8 of the *Charter* was violated, as he supplied documents and made statements to the auditor without being cautioned.
[28] The judge cited the principles enunciated in *R. v. Jarvis* and concluded that inculpatory statements and admissions made by the respondent during the audit without being cautioned; the evidence of the auditors; the audit report of Ms. Klein; and her penalty recommendation report were obtained illegally and must be excluded.
[29] He also found that the information to obtain the search warrant was based on all of the information that the auditors obtained. After excising that information, the judge concluded that the remainder did not form the basis for reasonable and probable grounds to issue the warrant. Therefore, he ruled inadmissible any evidence obtained pursuant to the search warrant.
[30] The trial judge decided that an adversarial relationship crystallized between the respondent and CCRA as of July 7, 2004. However, he concluded that the adversarial relationship existed throughout the audits by Klein and Franzen, "and was based on their findings or lack thereof." As proof of the adversarial relationship, the judge pointed to the audit team leader's direction to Franzen in September of 2003 to expand the scope of the previously limited audit.
[31] Referring to the CCRA, the judge observed, "Its use of the audit power to obtain incriminating evidence, which it did in this case, in my judgment, is an unjustifiable use of its audit powers…."
[32] The appellant argues that the trial judge erred in two ways: • By finding that the auditors were conducting a criminal investigation, such that their evidence should be excluded; and • By applying a dictionary definition of "investigation' instead of applying the *Jarvis* test.
[33] The respondent submits that the *Jarvis* test was appropriately applied, and that in any event, the trial judge is owed deference.

The *Jarvis* Case
[34] In *R. v. Jarvis,* the Supreme Court of Canada considered the distinctions between audit and investigative functions under the *Income Tax Act.* Particularly, the court discussed the extent to which information obtained about a taxpayer during an audit

Digitized by Google

under the Act can be used to investigate the taxpayer.
[35] The *Jarvis* case involved an audit of a taxpayer based on a tip that he had not declared income from the sale of his late wife's paintings. The taxpayer was informed of the planned audit by letter and was requested to produce his records. Before he did so, the auditor identified certain art galleries that had purchased works from the taxpayer created by his late wife. Her inquiries confirmed the amount of these sales in two calendar years, as well as the taxpayer's banking arrangements.
[36] Subsequently, the taxpayer's accountant spoke with the auditor, explaining that the taxpayer's books and records were likely in disarray. The taxpayer preferred to deal with the auditor directly, and a meeting was arranged at which the auditor interviewed him. She did not caution him; nor did she disclose that she had made inquiries of the art galleries as to his sales.
[37] The taxpayer answered the auditor's questions about the sale of art and, to a lesser extent, about his farming operations. One of the documents she requested was an inventory of art at the date of the artist's death; her purpose was to compare the taxpayer's records with the information from her earlier inquiries at the art galleries.
[38] In due course, the taxpayer supplied many of the records the auditor requested. The auditor calculated whether all income related to art sales had been reported. She concluded there was a discrepancy of approximately $700,000.
[39] Rather than complete the audit, the auditor immediately referred the case to the investigative unit of what was then Revenue Canada. Along with the referral, she sent her entire file, which included records of contacts made, interviews conducted, and calculations. The taxpayer was unaware that the file had changed its status from audit to investigation, and forwarded additional bank statements that had been requested.
[40] The investigator met with the auditor concerning the file. Later, she reviewed the auditor's file, performed her own analysis, and gathered further information from internal sources to determine whether there were reasonable and probable grounds for a search warrant related to charges of tax evasion.
[41] The auditor misled the accountant when he asked about the status of the file and did not reveal for several months that the file had been referred to the investigative unit.
[42] Before the taxpayer was advised about this turn of events, the investigator obtained a search warrant based on information in the audit file and the investigator's own analysis. The search warrant covered the taxpayer's residence, his accountant's records, and the records in possession of the tax authorities as a result of the audit. After the warrant was executed, requirement letters were issued to the taxpayer's banking institutions to obtain records.
[43] In due course, the taxpayer was prosecuted for making false or deceptive statements in an income tax return and tax evasion.
[44] On appeal, the Supreme Court of Canada ruled that, notwithstanding the auditor's deception in failing to advise that the file had been referred for investigation, information obtained by the auditor did not violate the taxpayer's s. 7 rights under the *Charter,* with the exception of information obtained after the case had been referred for investigation. The latter could not be admitted on the trial.

The Law
[45] As the court noted in *Jarvis,* the taxing authority's auditory function gives way to an adversarial role when the inquiry becomes a penal investigation. At par. 84, the

Digitized by Google

court observed:
"Although the taxpayer and the CCRA are in opposing positions during an audit, when the CCRA exercises its investigative function they are in a more traditional adversarial relationship because of the liberty interest that is at stake.... It follows that there must be some measure of separation between the audit and investigative functions within the CCRA...."
[46] The court concluded, at par. 88, that the test is whether the predominant purpose of the taxing authority's inquiry is penal liability: "In our view, where the predominant purpose of a particular inquiry is the determination of penal liability, CCRA officials must relinquish the authority to use the inspection and requirement powers under ss. 231.1(1) and 231.2(1). In essence, officials "cross the Rubicon" when the inquiry in question engages the adversarial relationship between the taxpayer and the state...."
[47] The court commented at length on the nature of the auditor's role in ensuring compliance with self- reporting by taxpayers. Specifically, the court cautioned about setting the bar too low - at the level of mere suspicion – in deciding when an offence had been committed. At par. 89, the court noted:
"To begin with, the mere existence of reasonable grounds that an offence may have occurred is by itself insufficient to support the conclusion that the predominant purpose of an inquiry is the determination of penal liability. Even where the reasonable grounds to suspect an offence exist, it will not always be true that the predominant purpose of an inquiry is the determination of penal liability.
In this regard, courts must guard against creating procedural shackles on regulatory officials; it would be undesirable to "force the regulatory hand" by removing the possibility of seeking the lesser administrative penalties on every occasion in which reasonable grounds existed of more culpable conduct...."
[48] In describing the adversarial relationship between taxing authority and taxpayer, the court observes that mental culpability is a necessary component of the evidence before charges can be laid. The contrast between audit and investigation is set out at pars. 90 – 91 of the judgment:
"...the test cannot be set at the level of mere suspicion that an offence has occurred. Auditors may, during the course of their inspections, suspect all manner of taxpayer wrongdoing, but it certainly not be the case that, from the moment such suspicion is formed, an investigation has begun. On what evidence could investigators ever obtain a search warrant if the whiff of suspicion were enough to freeze auditorial fact-finding? The state interest in prosecuting those who wilfully evade their taxes is of great importance, and we should be careful to avoid rendering nugatory the state's ability to investigate and obtain evidence of these offences. The other pole of the continuum is no more attractive. It would be a fiction to say that the adversarial relationship only comes into being when charges are laid. Logically, this will only happen once the investigators believe that they have obtained evidence that indicates wrongdoing. Because the s. 239 offences contain an element of mental culpability, the state will, one must presume, usually have some evidence that the accused satisfied the *mens rea* requirements before laying an information or preferring an indictment. The active collection of such evidence indicates an adversarial relationship has been engaged, since it is irrelevant to the determination of tax liability...."
[49] At par. 94, the court suggested some factors to guide the trial judge's inquiry. These factors were recited in this case:
"Did the authorities have reasonable grounds to lay charges? Does it appear from the

Digitized by Google

record that a decision to proceed with a criminal investigation could have been made?
Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?
Had the auditor transferred his or her files and materials to the investigator?
Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?
Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?
Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea,* is the evidence relevant only to the taxpayer's penal liability?
Are there any other circumstances or factors that can lead the trial judges to the conclusion that the compliance audit had in reality become a criminal investigation?"

Analysis
[50] In view of the principles set out in *R. v. Jarvis,* I have concluded the learned trial judge's ruling excluding the auditors' evidence from the information to obtain a search warrant, and thus the information obtained under the search warrant, is unreasonable. The following are the reasons.
[51] In making his ruling, the learned trial judge compared an audit to an investigation by referring to their dictionary definitions. In doing so, he overlooked that an audit is a type of investigation mandated by ss. 231.1(1) and 231.2(1) of the *Income Tax Act.* By this analysis, the trial judge diluted the test to be applied. [52] The logical extension of the judge's reasoning is that the CCRA would be deprived of its audit powers prescribed by the *Income Tax Act.* In effect, each audit would constitute a criminal investigation requiring *Charter* protections because the tax regulator and the taxpayer would be in an adversarial role from the outset of an audit. This interpretation of the test effectively insulates each taxpayer from audit verification by the tax authorities. This is the notional "shackling of the regulator" referred to in *Jarvis.*
[53] The trial judge also overlooked the direction of the Supreme Court in *Jarvis* that suspicion by an auditor that an offence has been committed is not enough to halt an audit or trigger *Charter* protections.
[54] The evidence before the trial judge did not establish that the auditor had reasonable and probable grounds to believe that an offence had been committed until July 5, 2004 when the taxpayer refused to disclose the names of the persons receiving cash payments. That is the first occasion when the evidence might suggest *mens rea* by the taxpayer in relation to tax evasion. Until that time, there was merely a discrepancy in figures that was capable of explanation. The explanation could include arithmetic error, or legitimate expense, or a failure to report income. See: *R. v. Dial Drug Stores*
[2003] O.J. No. 754 (Ont. Sup. Ct.), paras 57 and 58.
[55] Until an explanation for the discrepancy was called for, auditors Klein and Franzen were engaged in an examination of Mr. Ostrowski's books and records to determine his tax liability. This is a function mandated by ss. 231.1(1) and 231.2(1) of the *Income Tax Act.* The predominant purpose was to determine tax payable, not penal liability. Without some evidence of *mens rea,* commencement of a prosecution would have been improper. As Klein put it, the intention of the taxpayer with respect to tax evasion is irrelevant to the auditor. [56] The general conduct of the authorities before July 5, 2004 was consistent with an audit, not a criminal investigation. At first,

Digitized by Google

a limited scope audit was undertaken. It was inconclusive. Then the scope of the audit was expanded due to the lack of books and records of the taxpayer. The audit consisted of an analysis of the taxpayer's books and records. There was no attempt to question third parties.

[57] When the conventional audit could not be conducted because of the lack of records, the auditor embarked upon a net worth audit to approximate the taxpayer's income and expenses. Klein testified that she could not reach a conclusion on the audit until she had all the numbers as it would be inaccurate.

[58] With respect to GST, Ms. Klein reached no conclusion about Mr. Ostrowski's compliance.

[59] Auditor Klein forwarded a report to the investigative branch for consideration after her last contact with the taxpayer in July of 2004. **There was no overlap between audit and investigation.** Klein's report and some limited investigation by the investigator formed the basis of the information to obtain a search warrant. The investigator did not review the auditor's file or the taxpayer's documents until they were seized pursuant to the search warrant.

[60] It cannot be said that either auditor acted as an agent for the investigator. There was no request for an investigation until the audit was completed. The investigation branch would have been wholly unaware of the file until it received Klein's request at the conclusion of her audit. Indeed, it did not accept the Ostrowski file for investigation until November of 2004. Only a fraction of requests for investigation are accepted.

[61] **The information to obtain a search warrant was not prepared until December of 2004. The investigator did not ask the auditor to obtain materials or conduct interviews or otherwise act on her behalf after the auditor made her request for an investigation.**

[62] **The conduct of the limited scope audit and the expanded audit was consistent with determining tax liability generally. In the course of examining the tax payer's business operation, the auditors did not seek information as to the taxpayer's intention to evade tax. Ms. Klein testified that she did not have suspicion with respect to whether additional tax was owed until she completed her audit, but that an explanation might be forthcoming. She stated that a discrepancy discovered during the audit must be material: not insignificant.**

[63] **The trial judge failed to consider that the investigator expanded the scope of her investigation to encompass two years that were not examined by either auditor. In my view, the expanded scope of investigation supports the appellant's contention that the audit process operated distinctly from the investigative branch. The auditor formulated charges based on the documents seized, interviews with third parties and information from the taxpayer's bank accounts.**

[64] For all of these reasons, the appeal must be allowed. A new trial is ordered with the excluded evidence to be admitted.

_"original signed by"

The Hon. Madam Justice H.M. Pierce

Released: May 23, 2008

Ciglen v. R., [1970] S.C.R. 804, The Recognition of what Income has to be evaded (characterization) and other Issues on Errors in Law

Digitized by Google

Date: 1970-03-20
Samuel Ciglen *(Plaintiff) Appellant;*
and
Her Majesty the Queen *(Defendant) Respondent.*
1969: October 21, 22, 23, 24, 27; 1970: March 20.
Present: Cartwright C.J. and Fauteux, Abbott, Martland, Judson, Ritchie, Hall, Spence and Pigeon JJ.
ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO.
Criminal law—Conspiring to evade payment of tax—Suppression of profits—Allocation of appellant's transactions to company—Duty of determining whether transactions resulted in taxable income or capital gain—Income Tax Act, R.S.C. 1952, c. 148, s. 132.
Appeal—Criminal law—Jurisdiction—Appeal by Crown to Court of Appeal—Question of law alone—Criminal Code, 1953-54 (Can.), c. 51, ss. 584(1)(a), 597(2)(a).

The appellant was acquitted at trial on a charge of conspiring to wilfully evade payment of taxes by suppressing taxable income, contrary to s. 132(1)(*e*) of the *Income Tax Act,* R.S.C. 1952, c. 148. The reasonable doubt which the trial judge expressed as giving rise to his acquittal of the appellant was based on three questions: (1) his view as to the proper definition of the word "suppressing" appearing in the indictment; (2) that the Minister had not made any decision fixing the character of the profits as being income and that unless such decision has been made the accused could not be convicted of conspiracy to evade the payment of tax on income; and (3) on his view of the auditors' reports. On appeal by the Crown, the Court of Appeal directed a conviction of the appellant. He appealed to this Court and submitted that the Court of Appeal had gone beyond its jurisdiction.

Held (Cartwright C.J. and Hall J. dissenting): The appeal should be dismissed.

Per Fauteux, Abbott, Martland and Judson JJ.: The trial judge erred in law in his interpretation of the meaning of the word "suppression" when he held that a falsification of the true facts, by attributing transactions which were the appellant's to a company would not be sufficient; only a total failure to account would be enough. He also erred in law in holding that the determination as to whether the profits were income or capital gains was for the Minister, and beyond the purview of the Court. While the judge has stated that he was unable to establish, by inference from the evidence, an agreement to conspire as charged in the indictment, he has, in his own reasons, shown that what he considered to be necessary to establish such an agreement was based upon an erroneous conception of the law. This was an error of law and therefore subject to appeal by the Crown.

Per Ritchie and Pigeon JJ.: The trial judge's finding of reasonable doubt was founded in error at law and on a misapplication of the law to the evidence. His judgment was therefore the proper subject of an appeal under s. 584(1) (*a*) of the *Criminal Code.*

Per Spence J.: The Court of Appeal, in considering the three questions upon which the trial judge had professed to have based his reasonable doubt, were considering questions of law alone and they had jurisdiction to come to their own decision on those questions of law and to differ from the trial judge, using alone his findings of fact. The meaning in law to be given to a word which appears in an indictment or in a section of the Code is purely a question of law and the Court of Appeal had the jurisdiction to differ from the opinion of the trial judge as to the meaning in law of the word "suppressing". To hold that the decision that the payments

Digitized by Google

received by the appellant were income was a decision necessary for the trial judge himself to make and was not a decision to be made by the Minister is certainly a decision upon a question of pure law. Again the Court of Appeal has the jurisdiction to come to such a decision in law. The Court of Appeal found that the reports upon which the trial judge based his finding of reasonable. doubt could not, in evidence, supply a reasonable doubt. This was a finding on pure law and was within the jurisdiction of the Court of Appeal.

One may not rely on such vague words as "for these and other reasons" to determine that the trial judge relied on any general presumption of innocence which favoured the accused. The trial judge found that general presumption of innocence had been rebutted apart from the three reasons in law for which he, in error, assigned his reasonable doubt.

Per Cartwright C.J. and Hall J., *dissenting:* The judgment of the trial judge was based on one or more distinct grounds that do not involve questions of law alone. The Court of Appeal should have dismissed the Crown's appeal. A ground which is *ex facie* one of fact or mixed fact and law may prove to be vitiated by an error in law in the strict sense, for example, if the trial judge acquits because the evidence does not satisfy him beyond a reasonable doubt and he has mistakenly excluded a piece of vital and legally admissible evidence duly tendered by the Crown. In such a case the Court of Appeal would have jurisdiction to set aside the judgment of acquittal.

In the case at bar, it was essential for the prosecution to prove that the moneys were taxable income. The trial judge did not base his finding that he was not satisfied that the moneys in question were taxable income on the failure of the Minister to assess the profits as income but on the view which he took of the evidence as a whole. The question whether his conclusion was right or wrong is not one of law alone.

It appears from the reasons of the trial judge read as a whole that he based his decision on the following two grounds amongst others (i) that he was not satisfied beyond a reasonable doubt that the appellant acted with a guilty mind and (ii) that he was not satisfied beyond a reasonable doubt that the moneys were taxable income. These were distinct grounds for his decision and in neither was the question whether his view was right or wrong a question of law alone.

APPEAL from a judgment of the Court of Appeal for Ontario[1], setting aside a verdict of acquittal and directing a conviction of the appellant. Appeal dismissed, Cartwright C.J. and Hall J. dissenting.

George D. Finlayson, Q.C., and Burton Tait, for the appellant.
W.B. Williston, Q.C., P.A. Hess, Q.C., and W.C. Graham, for the respondent.

The judgment of Cartwright C.J. and of Hall J. was delivered by

THE CHIEF JUSTICE (*dissenting*)—The wording of the indictment charging the appellant and Morris Black and the course of the proceedings in the Courts below are set out in the reasons of my brother Spence, which I have had the advantage of reading, and as far as possible I will refrain from repetition.

On December 26, 1966, at the end of a trial before His Honour Judge Rogers without a jury which lasted 115 days judgment was reserved. On February 28, 1967, His Honour delivered oral judgment as follows:

> In the matter of Samuel Ciglen and Morris Black, as set out in my Reasons for Judgment, which consist of one hundred and seventeen pages, and which are available at the Judges' Secretary's office, I am unable to establish, by inference from the conduct of the accused and the cumulative effect of the

Digitized by Google

evidence, any agreement to conspire as charged in the indictment. The accused Ciglen and Black are acquitted.

Early in his reasons the learned Judge summarized the Crown's case as follows:

> The charge is against Ciglen and Black, they are the only persons charged in the indictment and the charge is a single conspiracy to commit one offence, that is to evade the payment of income tax for the year 1956 by suppressing taxable income of the said Samuel Ciglen and Morris Black. The Crown alleges that the accused made substantial profits in the sale of Great Sweet Grass and Kroy shares as a result of obtaining shares in the following deals:
>
> (*a*) The Pitt Deal.
> (*b*) The Depositors Mutual Deal.
> (*c*) The Kroy-Fulton Deal.
> (*d*) The Kroy-Coronet Deal.
>
> The basis of the Crown's case is that the profits made in the sale of the shares belonged to the accused and that to evade payment of taxes thereon, they designated the corporations and the trusts as the persons entitled to the bulk of the profits, and then contrived to retain the profits for themselves and any profits not so designated were suppressed.

The phrase "the corporations and the trusts" refers to some of those named as co-conspirators in the indictment or in the particulars given by the Crown.

The Court of Appeal[2] upheld the acquittal of Black and found itself unable to reverse the conclusions arrived at by the learned trial Judge in regard to the Pitt Deal, the Depositors Mutual Deal and the Kroy-Coronet Deal. It based its allowance of the Crown's appeal and the entering of a verdict of guilty against Ciglen on the findings of the learned trial Judge in regard to the transactions involved in the Kroy-Fulton Deal and the disposition of the profits arising therefrom. In the view of the Court of Appeal the reasons of the learned trial Judge dealing with this phase of the matter contained serious errors in law and when these errors were corrected the facts as found by him led inevitably to the conclusion that Ciglen was guilty as charged.

This Court in *The Queen v. Warner*[3] decided that when a judgment of acquittal is based on distinct grounds, one of which involves a question which is not one of law alone, an appellate court whose jurisdiction to entertain an appeal from an acquittal is limited to grounds of appeal that involve a question of law alone is powerless to interfere with the judgment of acquittal although other of the distinct grounds on which that judgment was based do involve questions of law alone. In applying this rule it must be borne in mind that a ground which is *ex facie* one of fact or mixed fact and law may prove to be vitiated by an error in law in the strict sense. To give a simple example, a decision worded "I acquit the accused because the evidence does not satisfy me of his guilt beyond a reasonable doubt" may be successfully attacked on the ground that the trial Court had mistakenly excluded a piece of vital and legally admissible evidence duly tendered by the Crown. In such a case no doubt the Court of Appeal would have jurisdiction to set aside the judgment of acquittal and direct a new trial. The differences of opinion in this Court in *The Queen v. Warner* were not as to the scope of the rule but as to the interpretation of the judgment of the Court below.

In the case at bar counsel for the appellant contends that the decision of the learned trial Judge was based on several distinct grounds of fact or of mixed fact and law and that for this reason the Court of Appeal should have dismissed the appeal. Whether or not this contention is well founded is, of course, a question of law on which an appeal to this Court lies under s. 597 (2) (*a*) of the *Criminal Code.*

In view of the wording of the charge, to establish the guilt of the accused it was

Digitized by Google

incumbent upon the Crown to prove beyond a reasonable doubt (i) that the profits from the sale of shares of Great Sweet Grass Oils Limited and Kroy Oils Limited for the taxation year 1956 were properly attributable to the accused, (ii) that such profits were taxable income, (iii) that Ciglen conspired to suppress this taxable income and (iv) that he did so to evade payment of taxes imposed in respect of such income by the *Income Tax Act*.

If it were proved that Ciglen agreed with another or others to wilfully evade payment of such taxes the offence charged would be complete even though the carrying out of the agreement was thwarted; but to support a conviction it was necessary for the Crown to establish that the agreement if carried out would have resulted in the commission of the offence created by s. 132(1) (*d*) of the *Income Tax Act*. As is often the case in the trial of a charge of conspiracy, there is no direct evidence of the making of the agreement charged in the indictment. The Crown asks that its making be inferred from the fact that, as it alleges, the offence contemplated was actually committed.

At p. 106 of his reasons the learned trial Judge makes the following statement:

> …If I am to look at this case in its broadest terms from the standpoint of a conspiracy to do an illegal act, in my view, it would be incumbent upon the Crown to demonstrate that there would be an evasion of a tax liability. On the evidence I am unable to say whether the moneys are subject to tax.

He expresses the same conclusion elsewhere in his reasons; at p. 102:

> …Under the circumstances, this Court is unable, on the evidence before it, and taking the case for the Crown at its highest, to determine whether the profits so derived are, beyond a reasonable doubt, income in the hands of the two accused as opposed to capital gains.

and at p. 114:

> …It seems to this Court that it would be incumbent upon the Crown to demonstrate that there would be an evasion of tax liability by suppression. I am, however, unable to determine on all of the evidence whether the moneys are subject to tax and for this reason, amongst others, I can draw no conclusive inference.

As has been pointed out above it was essential for the prosecution to prove that the moneys in question were taxable income and the finding of the learned trial Judge that the evidence does not satisfy him of this is on its face fatal to the Crown's case.

In the view of the Court of Appeal, however, this finding was vitiated by an error of law in that the learned trial Judge in effect directed himself that it was necessary that there should be a determination by the Minister of National Revenue as to whether the profits were capital gains or income subject to tax before a prosecution could proceed successfully. Had the learned trial Judge so directed himself it would clearly have been an error in law, but, as I read his reasons, he did not do so. He does seem to say that had there been an assessment by the Minister treating the profits as taxable income the onus of proving the contrary would have fallen upon the accused. While that would be true in civil proceedings it would not be true in a criminal prosecution but since there was in fact no assessment the question need not be pursued.

In my opinion the following passage at pp. 82 and 83 in the reasons of the learned trial Judge makes it clear that he rejected the submission of counsel for the accused that it was necessary for the Crown to show that an assessment had been made:

> Counsel for the accused Ciglen advanced an argument that there could be no offence under Section 132(1)(*d*) of the Income Tax Act of wilfully evading the payment of taxes imposed by the Act unless an assessment had been made,

Digitized by Google

> i.e. that the only crime envisioned by the Income Tax Act was one of evading payment of taxes which had been actually assessed. The two words 'taxes imposed' are not defined in the Income Tax Act and consequently their meaning must be found elsewhere. Section 139(1)(*ba*) defines the term "tax payable by taxpayer" as meaning the tax payable by him as fixed by assessment or re-assessment subject to variation on objection or on appeal, if any, in accordance with the relevant appeal provisions of the Act.
>
> The facts in this case are that at no time were Ciglen and Black assessed for the profits from the sale of Kroy and Great Sweet Grass shares in issue herein and, in my view, the ordinary meaning of "imposed" does not necessarily carry with it the connotation or ingredient of "assessment" or calculation of amount. It is simply the liability to taxation.

It is obvious that if the learned trial Judge had accepted the submission of counsel for Ciglen on this point he would have dismissed the charge and reasons of over one hundred pages would have become unnecessary. As I read his reasons, the learned trial Judge did not base his finding that he was not satisfied that the moneys in question were taxable income on the failure of the Minister to assess but on the view which he took of the evidence as a whole. The question whether his conclusion was right or wrong is not one of law alone.

Another ground on which the learned trial Judge based his decision to acquit appears in his reasons at p. 114, where he says:

> Having dealt with the P.O.G.N. reports, which in law are evidence both for and against the accused Ciglen, I am of the opinion that these reports have raised a reasonable doubt in my mind as to the guilt of the accused Ciglen for the offence of conspiracy as charged.

The Court of Appeal criticized this finding on the ground that having found that Ciglen had a beneficial interest in the shares from which the profits realized in the Kroy-Fulton deal were derived and had used those shares as his own property, the learned trial Judge could not rely on the POGN reports allocating such profits to Torny Financial Corporation Ltd. as raising a doubt as to the guilt of the accused. If it be agreed that the POGN reports could not be relied on to raise a doubt as to Ciglen's beneficial interest in the shares in question they might yet raise a doubt as to Ciglen's guilty intention to evade payment of tax. In the view of the learned trial Judge the allocation of the profits to Torny was not necessarily inconsistent with the existence of a noncriminal intention on the part of Ciglen and was as consistent with an intention to avoid tax, that is lawfully to so arrange matters as not to attract tax, as with an intention to evade tax. Once again the question whether this view was erroneous is not a question of law alone. The "well known and very important distinction between avoidance and evasion in relation to the law of taxation" has recently been emphasized in the unanimous judgment of the Court of Appeal for the Yukon Territory, delivered by MacFarlane J.A., in *The Queen v. Regehr*[4], in which it was held that a count charging that the accused "did wilfully avoid a payment of taxes imposed by the *Income Tax Act* in that he failed to report all of his income contrary to para. (*d*) of Subsection (1) of Section 132 of the said Act" did not charge an offence known to the law, and leave to amend by changing the word "avoid" to "evade" was refused.

The Court of Appeal was further of opinion that the learned trial Judge erred in law in defining "suppression" as a total failure to account. The passage criticized appears at pp. 109 and 110 of the reasons of the learned trial Judge. It is as follows:

> …The Crown has clearly made out a prima facie case of an agreement betwen

Digitized by Google

> Samuel Ciglen and Torny Financial Corporation Limited to treat these matters as having been Torny transactions. Whether such an allocation can be equated with an intention to evade tax payable through suppression or in the light of its disclosure in the P.O.G.N. reports albeit as a Torny transaction as an attempt to attract no tax is open to serious doubt. In my view, suppression denotes something more than an allocation and is a total failure to account. It is for this reason that the explanations put forth in the P.O.G.N. reports by way of adjusting entries must be shown as false.

Proof that an accused allocated income of his own to a third party if shown to be done with the intention of evading payment of income tax imposed upon him by the *Income Tax Act* would support a finding that he was guilty of a breach of s. 132(1)(*d*); but when the passage quoted is read in the light of the reasons as a whole it appears that the learned trial Judge in distinguishing between "allocation" and "total failure to account" was pointing out that the former is more consistent with an innocent intention than is the latter. I cannot find in the passage quoted an error of law which vitiates the judgment of acquittal.

It is clear that *mens rea* is an essential element of an offence against s. 132(1)(*d*) of the *Income Tax Act;* the use of the word "wilfully" in the clause puts this beyond question. It is trite law that a taxpayer is free to so arrange his affairs as to attract as little liability to tax as possible provided that in so doing he does not employ unlawful means. Of course guilty intent may be inferred from the actions of an accused but the question whether or not the guilty intent exists is one of fact. This is expressly stated in the judgment of this Court in *Lampard v. The Queen*[5].

The learned trial Judge ended his reasons as follows:

> Since a taxpayer is entitled to adopt a position that will not attract any tax as opposed to wilfully evading payment of tax imposed by the Act, and if such a course of conduct is open to a taxpayer, it has a direct bearing on the issue of a guilty mind.
>
> I am unable to establish by inference from the conduct of the accused and the cumulative effect of the evidence herein, any agreement to conspire as charged in the indictment, the accused Samuel Ciglen is acquitted.

It appears from the reasons of the learned trial Judge read as a whole that he based his decision on the following two grounds amongst others (i) that he was not satisfied beyond a reasonable doubt that Ciglen acted with a guilty mind and (ii) that he was not satisfied beyond a reasonable doubt that the moneys in question were taxable income. In my opinion these were distinct grounds for his decision and in neither was the question whether his view was right or wrong a question of law alone.

The right of appeal given by s. 584(1) (*a*) of the *Criminal Code* to the Attorney General or counsel instructed by him, was unknown to the Common Law. No similar right exists in England although it does exist in some other jurisdictions in the Commonwealth. It is the creature of statute and is strictly limited in scope. The power of the Court of Appeal to set aside a judgment of a court of competent jurisdiction acquitting an accused of an indictable offence extends only to grounds of appeal that involve questions of law alone. It is, I suggest, of the utmost importance that the Courts should guard against extending this power by judicial decision to cases, not falling strictly within the terms of the statute creating it, in which the Court of Appeal is satisfied that the judgment of acquittal is clearly wrong. When an appeal is brought from a conviction of an indictable offence the Court of Appeal has power to allow the appeal if "it is of the opinion that the verdict should be set aside on the ground that it is unreasonable or cannot be supported by the evidence"; but that Court has no

Digitized by Google

corresponding power in an appeal from an acquittal; such a power could be conferred only by Parliament; its creation would be without precedent in the Commonwealth.
For the reasons set out above it is my opinion that the judgment of the learned trial Judge acquitting the appellant was based on one or more distinct grounds that do not involve questions of law alone and that this case is governed by our decisions in *The Queen v. Warner, supra,* and *Lampard v. The Queen, supra.* It follows from this that the Court of Appeal should have dismissed the Crown's appeal.
I would allow the appeal, set aside the judgment of the Court of Appeal and restore the judgment at trial acquitting the appellant.
The judgment of FAUTEUX, ABBOTT, MARTLAND and JUDSON J.J. was delivered by
MARTLAND J.—I am in agreement with the view expressed by Aylesworth J.A., who delivered the reasons for judgment of the Court of Appeal[6], that the trial judge erred in law in his interpretation of the meaning of the word "suppression", which appeared in the indictment in the phrase "by suppressing taxable income of the said Samuel Ciglen." I agree with him, also, that there was error in law in attributing to the Minister the duty of determining whether the impugned transactions resulted in taxable income or capital gain.
The trial judge found as a fact, in connection with the "Kroy-Fulton deal":

> At this point, however, I would find as a fact that, at the time of the delivery of the shares to the Bank of Nova Scotia, March 19th, 1956, Ciglen exercised such control over the said shares that it is a reasonable inference he had a beneficial interest in the same. He used the shares as if they were his own property. I would also find as a fact that the rewritten General Ledger of Torny was a falsification of the facts as they occurred at the time of the Fulton deal.

Later in his reasons he said this:

> …the Crown has clearly made out a prima facie case of an agreement between Samuel Ciglen and Torny Financial Corporation Limited to treat these matters as having been Torny transactions. Whether such an allocation can be equated with an intention to evade tax payable through suppression or in the light of its disclosure in the P.O.G.N. reports albeit as a Torny transaction as an attempt to attract no tax is open to serious doubt. In my view, suppression denotes something more than an allocation and is a total failure to account. It is for this reason that the explanations put forth in the P.O.G.N. reports by way of adjusting entries must be shown as false.

This is a statement of the understanding of the trial judge as to what evidence was necessary to establish a suppressing of taxable income. A falsification of the true facts, by attributing transactions which were his own, to Torny, would not be sufficient. Only a total failure to account would be enough.
This was an error in law, and his conclusion as to the guilt of the appellant has to be considered in the light of that error. That conclusion is expressed later, as follows:

> Having dealt with the P.O.G.N. reports, which in law are evidence both for and against the accused Ciglen, I am of the opinion that these reports have raised a reasonable doubt in my mind as to the guilt of the accused Ciglen for the offence of conspiracy as charged.

As Aylesworth J.A. has pointed out, the P.O.G.N. reports, which were auditors' reports, were based, and had to be based, on Torny's ledger, which, the trial judge had already found, had been rewritten and was a falsification of the facts of the Kroy-Fulton deal.
They did disclose an allocation of income to Torny. The trial judge, even though they

Digitized by Google

disclosed an allocation which he himself had found to be false, felt that they created a reasonable doubt as to the appellant's guilt. But in so holding he was applying an erroneous concept as to what evidence was necessary to establish suppression.

The trial judge also erred in law when considering whether the impugned transaction resulted in taxable income to the appellant. I cite the following passages from his judgment:

> Traditionally, profits derived from the sale of stocks and bonds have not been treated as income by the Department of National Revenue even though it is conceded that this is an anomaly under the law relating to the distinction between capital gains and income. It does not appear to me to be within the purview of this Court to determine whether the profits received here are income as proceeds of a business or a capital gain.

It is in the discretion of the Minister of National Revenue and he has not seen fit to make such a designation in this case. Were he to do so, this issue would be subject to review by the Income Tax Appeal Board and/or the Exchequer Court in the manner provided for in the Income Tax Act. Under the circumstances, this Court is unable, on the evidence before it, and taking the case for the Crown at its highest, to determine whether the profits so derived are, beyond a reasonable doubt, income in the hands of the two accused as opposed to capital gains.

* * *

If I am to look at this case in its broadest terms from the standpoint of a conspiracy to do an illegal act, in my view, it would be incumbent upon the Crown to demonstrate that there would be an evasion of a tax liability. On the evidence I am unable to say whether the moneys are subject to tax.

* * *

However, I am of the view that, unless there is a statutory onus, and there is none in the Income Tax Act, nothing displaces the ordinary law in relation to a criminal case, which is that the Crown must establish the guilt of the accused beyond a reasonable doubt and whether these transactions are capital gain or not are matters that should be determined by the Minister, and are not facts peculiarly within the knowledge of the accused. Had the Minister made an assessment, then the duty of explanation would arise.

The trial judge erred in law in holding that the determination as to whether the profits were income or capital gains was for the Minister, and beyond the purview of the Court, and that he was unable to make a decision on the evidence before him.

As Aylesworth J.A. points out, the trial judge had actually made a finding of fact on this point, when he said:

> There does not seem to be much doubt on the evidence that both Ciglen and Black, through the assistance of various individuals and companies, actively engaged in the promotion and sale and thus in the trading of shares of Great Sweet Grass and Kroy.

In the penultimate paragraph of his judgment, the trial judge, dealing with the issue of a guilty mind, said this:

> Since a taxpayer is entitled to adopt a position that will not attract any tax as opposed to wilfully evading payment of tax imposed by the Act, and if such a course of conduct is open to a taxpayer, it has a direct bearing on the issue of a guilty mind.

He approaches that issue by relying upon the proposition which was stated by Lord Tomlin in *The Commissioners of Inland Revenue v. The Duke of Westminster*[7]:

> Every man is entitled if he can to order his affairs so as that the tax attaching

Digitized by Google

> under the appropriate Acts is less than it otherwise would be.

But in relation to the Kroy-Fulton deal, that can have no relevance, when, on the trial judge's own finding, records were deliberately falsified in order to allocate profits accruing to the appellant to Torny.

The trial judge concluded his reasons by saying, immediately after the paragraph above quoted:

> I am unable to establish by inference from the conduct of the accused and the cumulative effect of the evidence herein, any agreement to conspire as charged in the indictment, the accused Samuel Ciglen is acquitted.

For the appellant it is urged that this is a finding of fact or of mixed fact and law, and, therefore, not subject to appeal by the Crown. But when the trial judge reached that conclusion, for the reasons already outlined, he was considering the evidence under a misconception of law as to what was necessary to be proved in order to establish the Crown's case. The error in this case was as to the legal effect of facts which he had found, and that is an error of law. Chief Justice Anglin, in *Belyea v. R.*[8], said this:

> The right of appeal by the Attorney-General, conferred by s. 1013 (4), *Cr.* C., as enacted by c. 11, s. 28, of the Statutes of Canada, 1930, is, no doubt, confined to "questions of law." That implies, if it means anything at all, that there can be no attack by him in the Appellate Divisional Court on the correctness of any of the findings of fact. But we cannot regard that provision as excluding the right of the Appellate Divisional Court, where a conclusion of mixed law and fact, such as is the guilt or innocence of the accused, depends, as it does here, upon the legal effect of certain findings of fact made by the judge or the jury, as the case may be, to enquire into the soundness of that conclusion, since we cannot regard it as anything else but a question of law,—especially where, as here, it is a clear result of misdirection of himself in law by the learned trial judge.

I do not regard the judgment of this Court in *Warner v. R.*[9], as affecting the application of that principle to the circumstances of this case. In that case, on an appeal by the accused from a conviction of murder, the Chief Justice of Alberta, delivering the unanimous reasons of the Appellate Division, on appeal, said:

> I am strongly of the opinion that the verdict of murder cannot be supported by the evidence. But I feel I must go further, and set out other reasons for setting aside the conviction.

The majority of this Court, on a five to four division, dismissed the Crown's appeal from this judgment.

Chief Justice Kerwin said, at p. 147:

> I read the first sentence as meaning that the Chief Justice considered that the evidence was not sufficient to support a conviction,—which is a question of fact.

Cartwright J., as he then was, delivering the reasons of himself and two other members of the Court, held that this first ground of decision was a distinct ground, upon which the judgment was based, and was a ground raising no question of law in the strict sense.

Under s. 592 (1) of the *Criminal Code* the Appellate Division, on an appeal against conviction, was empowered to allow the appeal where the verdict could not be supported by the evidence, as well as where the verdict, at trial, involved a wrong decision on a question of law. Under s. 597, on appeal from the Appellate Division, this Court was only empowered to allow an appeal from the decision of the Appellate Division on a question of law.

Digitized by Google

Cartwright J. said, at p. 149:

> So far as the judgment of the Appellate Division is based on the first ground mentioned, this Court is powerless to interfere with it. The question whether the Appellate Division was right in proceeding on this ground is not a question of law in the strict sense. It is a question of fact or, at the best from the point of view of the appellant, a mixed question of fact and law.

At p. 152 he said:

> I conclude that the Appellate Division quashed the conviction on the ground *inter alia* that it cannot be supported by the evidence, that this was a distinct ground on which its judgment was based, that it is a ground raising no question of law in the strict sense and that it is *nihil ad rem* that the judgment was based also on other grounds raising such points of law.

No opinion was expressed by the majority of the Court as to what the situation would have been if the decision expressed by the Appellate Division that the verdict could not be supported by the evidence had been based upon a mistaken view as to the law applicable. That issue did, however, arise in *R. v. Lemire*[10], a case in which, on an appeal from conviction, the appellate court had held that certain evidence created a reasonable doubt as to the guilt of the accused. At p. 192, the view of the majority of this Court on that issue was expressed as follows:

> In my opinion, on an appeal from a conviction, if an appellate court allows the appeal on the ground that certain specified evidence creates a reasonable doubt as to the guilt of the accused, when, on a proper view of the law, that evidence is not capable of creating any doubt as to his guilt, there is an error in law.

In the present case, the situation is that, while the trial judge has stated that he was unable to establish, by inference from the evidence, an agreement to conspire as charged in the indictment, he has, in his own reasons, shown that what he considered to be necessary to establish an agreement to conspire, as charged in the indictment, was based upon an erroneous conception of the law.

I would dismiss the appeal.

The judgment of Ritchie and Pigeon J.J. was delivered by

RITCHIE J.—I share the opinion, as expressed in the reasons for judgment of my brothers Martland and Spence, that the learned trial judge's finding of reasonable doubt as to the guilt of the appellant was founded in error at law and on a misapplication of the law to the evidence; his judgment was therefore in my view the proper subject of an appeal by the Attorney General of Canada under the provisions of s. 584 (1)(*a*) of the *Criminal Code.*

I would accordingly dismiss this appeal.

SPENCE J.—This is an appeal from the judgment of the Court of Appeal for Ontario[11] pronounced on January 7, 1969. By that judgment, the Court of Appeal for Ontario allowed an appeal from the judgment of Rogers, Co. Ct. J., pronounced on February 28, 1967, in which he acquitted the appellant and his co-accused Morris Black, and directed a conviction of Ciglen in lieu thereof.

The Attorney General for Canada had appealed to the Court of Appeal from the acquittal of both accused. The Court of Appeal, in its judgment, confirmed the acquittal as to the accused Black and there is no further appeal as to that accused.

The appellant and his co-accused, Morris Black, were charged in the indictment as follows:

> That during the years 1955, 1956 and 1957, at the said Municipality of Metropolitan Toronto, and at other divers places, did, unlawfully, conspire

Digitized by Google

> together, the one with the other and with Torny Financial Corporation Ltd., Compania de Inversiones Amcub, S.A., otherwise known as Amcub Investment Company Incorporated, Ontario Cobalt Mines Limited, Glenrich Uranium Mines Limited, Albontec Development Company Limited and Americana Trading Company Limited and with persons unknown or with someone or more of them, to wilfully evade payment of taxes imposed on the said Samuel Ciglen and the said Morris Black by the Income Tax Act, R.S.C. 1952, c. 148, by suppressing taxable income of the said Samuel Ciglen and the said Morris Black from the sale of common shares of Great Sweet Grass Oils Limited and Kroy Oils Limited for the taxation year 1956, in violation of Section 132(1) (*d*) of the said Act, contrary to Section 132(1) (*e*) of the said Act.

The charges were based upon an exceedingly complicated series of transactions in reference to the shares in two corporations, Great Sweet Grass Oils Limited et Kroy Oils Limited. A la suite abortive trial, lasting 68 days and terminated by the unfortunate death of the first trial court judge, the second trial took 115 days before His Honour Judge Rogers in the County Court of the County of York. The accused called no evidence. At the first trial, in response to a demand for particulars of the "persons unknown" referred to in the indictment, the Crown named 32 co-conspirators. At the new trial, 14 additional co-conspirators were named. The argument on appeal required 24 days. The material is most voluminous—over 1500 exhibits, several of them consisting of many documents, were filed.

At trial, four different so-called deals or series of transactions were examined. Those deals were known as the Pitt deal, the Depositors Mutual Deal, the Kroy-Fulton Deal, and the Kroy-Coronet Deal. As I have said, the learned trial judge acquitted both accused in reference to all four deals. The judgment in the Court of Appeal for Ontario was given by Aylesworth J.A. in a very detailed and carefully worked out set of reasons which cover 39 printed pages. In those reasons, Aylesworth J.A. affirmed the acquittal of the accused Black and accepted the trial judge's acquittal of the accused Ciglen as to the Pitt deal, the Depositors Mutual deal, and the Kroy-Coronet deal, although the learned justice in appeal was very puzzled by the learned trial judge's findings of fact involved in the acquittal of the accused Ciglen as to any one of those three deals. Aylesworth J.A. said:

> There remains for consideration the effect of the evidence and findings made by the trial Judge with respect to the Kroy-Fulton deal so far as they affect Ciglen and the position in law of the respondent Black in the appeal as a whole. I have quoted earlier the finding of the trial Judge that the Kroy-Fulton deal was Ciglen's own deal and that ex post facto by falsification of records an attempt was made in agreement with Torny to treat the deal as a Torny deal. Moreover, as the trial Judge found, Ciglen, in his personal amended income tax return for 1956, claimed as a deduction bank interest on an overdraft he had been allowed by his bank in connection with his financing of the deal. The trial Judge found that—
>
> > Insofar as the back-dating is concerned, I have already dealt with this and it is not a piece of evidence from which I can infer the guilt of the accused as inconsistent with his innocence and that such is not an unusual practice in any office when the purpose of it is to document what in fact has occurred so that back-dating in itself is a neutral piece of evidence.
>
> I should not like to think that in these observations the trial Judge was directing his mind to the falsification of documents which he found to have occurred with respect to the Kroy-Fulton deal. Falsification of documents for one's own

Digitized by Google

benefit surely is the most cogent evidence of the existence of the benefit itself—in this case, the existence of profits and profits in "trading in shares" as found by the trial Judge—and the suppression of those profits as personal to the accused Ciglen.

Again, I find it difficult in the extreme to follow the trial Judge's reasoning in acquitting Ciglen. Given the finding he made, what possible inference can be drawn other than Ciglen's guilt as charged? He is shown to have been engaged in the business of trading in the Great Sweet Grass and Kroy shares, to have made a profit, to have conspired with Torny wilfully to evade payment of taxes for which he personally became liable by depicting the profits as those of Torny; the profits as profits of Torny would be subject to different rates and tax considerations than would be the case relative to taxation of Ciglen's personal profits. He "suppressed" his taxable income in conspiracy with Torny by falsely attributing that income to Torny. The trial judge expressed his views in part thus:

> Whether such an allocation can be equated with an intention to evade tax payable through suppression or in the light of its disclosure in the P.O.G.N. reports albeit as a Torny transaction, as an attempt to attract no tax is open to serious doubt. In my view, suppression denotes something more than an allocation and is a total failure to account. It is for this reason that the explanation put forth in the P.O.G.N. reports by way of adjusting entries must be shown as false.

He also declared:

> However, I am of the view that, unless there is a statutory onus, and there is none in the Income Tax Act, nothing displaces the ordinary law in relation to a criminal case, which is that the Crown must establish the guilt of the accused beyond a reasonable doubt and whether these transactions are capital gain or not, are matters that should be determined by the Minister, and are not facts peculiarly within the knowledge of the accused. Had the Minister made an assessment then the duty of explanation would arise.

And finally:

> It seems to this Court that it would be incumbent upon the Crown to demonstrate that there would be an evasion of tax liability by suppression. I am, however, unable to determine on all of the evidence whether the moneys are subject to tax and for this reason, amongst others, I can draw no conclusive inference.
>
> Having dealt with the P.O.G.N. reports, which in law are evidence both for and against the accused Ciglen, I am of the opinion that these reports have raised a reasonable doubt in my mind as to the guilt of the accused Ciglen for the offence of conspiracy as charged.

The finding of fact made by the trial judge as to the Kroy-Fulton deal, which Aylesworth J.A. refers to in the portion of the judgment I quoted above, was also quoted by Aylesworth J.A. in his reasons for judgment and is as follows:

> I think it necessary to indicate that if certain shares were alleged by Ciglen to have been purchased by various individuals from Torny, then one would expect the purchaser would be entitled to the difference between the cost and the sale. However, the evidence does not bear this out with respect to some of the purchasers who as mentioned were very vague, and in some instances, the purchasers did not seem to know what it was all about. In my view this is

Digitized by Google

> evidence of an agreement between S. Ciglen and Torny to treat the Fulton deal as being a Torny deal, which agreement was made after December, 1956 and before November 5th, 1957, and while it is cogent evidence of an attempt to allocate the proceeds of a deal to diminish the incidents of tax liability as it is to evade tax, since it is set forth in the P.O.G.N. reports I shall deal with it in relation to these reports as evidence for and against the accused Ciglen. At this point, however, I would find signé ce fait, je le traiterai à la lumière de ces rapas a fact that, at the time of the delivery of the shares to the Bank of Nova Scotia, March 19, 1956, Ciglen exercised such control over the said shares that it is a reasonable inference that he had a beneficial interest in the same. He used the shares as if they were his own property. I would also find as a fact that the re-written general ledger of Torny was a falsification of the facts as they occurred at the time of the Fulton deal.

It will be seen therefore that the reasonable doubt which the learned trial judge expressed as giving rise to his acquittal of the accused Ciglen was based on three different questions. The first of those questions dealt with the learned trial judge's view as to the proper definition of the word "suppressing" appearing in the indictment. It was the view of Aylesworth J.A., with which I agree, that there could be no such limitation on the allocation of income to another person, in the present case, one of those associated, to avoid the payment of income tax by attributing income which the taxpayer has received merely as receipts by a trustee or agent for another person. When that attribution is false, it is a suppression of the taxpayer's income for the purpose of evading tax.

The second reason for expressing reasonable doubt was that the Minister had not made any decision fixing the character of the profits on these shares as being income and that unless such decision has been made the accused could not be convicted of a conspiracy to evade the payment of tax on income. As to that view, Aylesworth J.A. said, and again, with respect, I agree with him:

> Likewise, he erred in law in attributing to the Minister the duty of determining whether the impugned transactions resulted in taxable income or capital gain. This was for the trial Judge himself and he does not seem to realize that he did determine it when he found as a fact—
>
> > There does not seem to be much doubt on the evidence that Ciglen and Black, through the assistance of various individuals and companies, actively engaged in the promotion and sale and thus in the trading of shares of Great Sweet Grass and Kroy.

The third question upon which the learned trial judge based his finding of a reasonable doubt was the position of the auditors' report filed by the accused with the Department in the year 1960, that is, many months after the end of the conspiracy charged. Those reports were known throughout the trial as P.O.G.N. reports. The trial judge had already found that the Crown bad proved that Ciglen had conspired with the Torny Financial Corporation Limited to show that Ciglen's Kroy-Fulton profits were those of the Torny Corporation and had done so even by falsification of the books of the Torny Corporation. That falsification of books by reason of such a conspiracy then provided the working material on which the auditors drew up the auditors' reports, i.e., the P.O.G.N. reports. As Aylesworth J.A. notes, "under such circumstances those reports merely echo the result of the conspiracy as found and, in law, could not be relied upon to raise a reasonable doubt". (The underlining is my own.) Aylesworth J.A. concluded his consideration of the guilt of the accused in reference to the Kroy-Fulton deal in these words:

Digitized by Google

> When the serious errors in law to which reference has been made are corrected, the facts as found by the trial Judge in the Kroy-Fulton deal lead inevitably to one conclusion—the guilt of the accused Ciglen as charged.

(The underlining is my own.)

All the members of the Court of Appeal concurred in the reasons given by Aylesworth J.A., McLennan J.A. having expressed his concurrence in conference although his unfortunate death occurred prior to the delivery of the reasons. It is submitted on behalf of the appellant in this court that in making the finding of guilt as to the accused Ciglen in reference to the Kroy-Fulton deal the Court of Appeal for Ontario went beyond the jurisdiction conferred upon it. The appellant cites the two recent decisions in this court: *Regina v. Sunbeam Corporation of Canada Limited*[12] and *Lampard v. The Queen*[13].

The appeal by the Crown to the Court of Appeal for Ontario is governed by the provisions of s. 584 (1) of the *Criminal Code.* Subsection (1)(*a*) of that section provides:

> 584. (1) The Attorney General or counsel instructed by him for the purpose may appeal to the Court of appeal
>
> (*a*) against a judgment or verdict of acquittal of a trial court in proceedings by indictment on any ground of appeal that involves a question of law alone,

It will be seen, therefore, that the right of appeal given to the Crown is limited to a question of "law alone". I am of the opinion that the three questions which the Court of Appeal was called upon to consider as to the guilt of the accused in reference to the Kroy-Fulton deal were all questions of law and that, therefore, when Aylesworth J.A. said, "when the serious errors in law to which reference has been made are corrected, the facts as found by the trial Judge in the Kroy-Fulton deal lead inevitably to one conclusion—the guilt of the accused as charged" he was giving a conclusion on questions of law. The first of those three questions was as to the meaning of the word "suppressing" as it appeared in the indictment. Surely the meaning in law to be given to a word which appears in an indictment or in a section of the Code is purely a question of law and the Court of Appeal had the jurisdiction to differ from the opinion of the learned trial judge as to the meaning in law of the word "suppressing". The second question considered by the Court of Appeal for Ontario was the argument that it was impossible to convict the accused of an attempt to evade the payment of income tax without demonstrating that income tax was due by having the Minister declare that the payments received by the accused on the profits from trading in these shares were income. The view that such a decision was a decision necessary for the trial judge himself to make and was not a decision to be made by the Minister is certainly a decision upon a question of pure law and again the Court of Appeal has the jurisdiction to differ from the opinion of the learned trial judge thereon.

In *Belyea & Weinraub v. The King*[14], this court considered an appeal by an accused person from a conviction rendered in the appellate division of the Supreme Court of Ontario after an acquittal at trial. The appellants and others had been charged with conspiracy contrary to the provisions of the then s. 498, subs. (1) (*a*), (*b*) and (*e*) of the *Criminal Code,* and the trial judge had found that the conspiracy existed but he had refused to convict these two appellants on the ground that no overt acts following the making of the agreement had been proved against them. The Appellate Division and this Court were both of the opinion that the Crown need not prove such overt acts. Anglin C.J.C. said at p. 296:

> But we cannot regard that provision as excluding the right of the Appellate Divisional Court, where a conclusion of mixed law and fact, such as is the guilt

Digitized by Google

> or innocence of the accused, depends, as it does here, upon the legal effect of certain findings of fact, made by the judge or the jury, as the case may be, to enquire into the soundness of that conclusion, since we cannot regard it as anything else but a question of law,—especially where, as here, it is a clear result of misdirection of himself in law by the learned trial judge.

I am of the opinion that the statement of the Chief Justice in that case applies exactly to the question as to the necessity of first obtaining a declaration from the Minister that the profits accruing to the accused on the trading in these shares were, in law, income.

The third question considered by the Court of Appeal was the professing to find a reasonable doubt based on the P.O.G.N. reports. These reports, as pointed out by Aylesworth J.A., were simply the echo of the conspiracy which the learned trial judge had found and, therefore, those reports could not, in evidence, supply a reasonable doubt. Again, I am of the opinion that this was a finding on pure law and was within the jurisdiction of the Court of Appeal under s. 584(1) (*a*) of the Code.

For these reasons, I am of the opinion that the Court of Appeal, in considering the three questions upon which the learned trial judge had professed to have based his reasonable doubt, were considering questions of law alone and that they had jurisdiction to come to their own decision on those questions of law and to differ from the learned trial judge, using, of course, alone his findings of fact.

One other problem arises which does not seem to have been considered in the Court of Appeal. In *The Queen v. Warner*[15], this court considered an appeal by the Crown. The accused had been found guilty of murder at trial, but the Appellate Division of the Supreme Court of Alberta reversed that conviction and substituted therefor a conviction for manslaughter. In coming to this conclusion, the Appellate Division had assigned two reasons for allowing an appeal: firstly, that the verdict of guilty of murder should be set aside on the ground that it could not be supported by the evidence; and, secondly, that there had been errors in law in the charge of the learned trial judge. This court, by a majority judgment, refused to consider the appeal holding that the Appellate Division had the power to make the first finding, which is undoubtedly a finding of fact, by virtue of s. 592(1) (*a*) of the *Criminal Code* but that no such power existed in this Court and, therefore, were this Court to have found that the errors in law in the charge of the learned trial judge, which had been found by the Appellate Division, did not, in fact, exist, the result would still have been the dismissal of the Crown's appeal. It was, of course, sufficient to justify the decision of the Appellate Division reducing the conviction to one for manslaughter to have found the first ground of appeal alone.

So, in the present case, it is submitted that the learned trial judge had expressed a reasonable doubt not only on the three propositions of law, with which I have dealt, but for other reasons and that reasonable doubt was not within the consideration of the Court of Appeal, it not being a question of law alone.

It is true that the learned trial judge said in one portion of his judgment:

> It seems to this Court that it would be incumbent upon the Crown to demonstrate that there would be an evasion of tax liability by suppression. I am, however, unable to determine on all of the evidence whether the moneys are subject to tax and for this reason, <u>amongst others,</u> I can draw no conclusive inference.

(The underlining is my own.)

It is also true that on the immediately preceding page of his reasons for judgment the learned trial judge said:

Digitized by Google

> That the burden of proof rests and remains upon the Crown and never shifts is trite law yet if the Crown produces evidence which, if unanswered, and believed, is sufficient to raise a prima facie case, the Crown has discharged its burden and the accused may be convicted unless he counteracts the effect of that evidence, and the presumption of innocence cannot be displaced by evidence which merely tends or inclines in the direction of guilt. The making out of a prima facie case against the accused does cast a burden upon him to the extent that, if no further evidence is given, the jury will be entitled to convict him but the extent of that burden is not to prove his innocence but merely to raise a reasonable doubt in the minds of the jury.

Therefore, in my view, the learned trial judge has recognized the general presumption of evidence of innocence in favour of the accused but he did, in fact, deal with it when he made the finding of fact that the evidence showed that there was an agreement between the accused and Torny Financial Corporation Limited to treat the Fulton deal as being a Torny deal although it was a deal solely for the benefit of the accused and the profits therefrom were the property of the accused. In short, the learned trial judge did find there was a prima facie case adduced by the Crown which rebutted the general presumption of innocence in favour of an accused. Since no evidence was given on behalf of the defence, there was nothing to discharge the burden which, as the learned trial judge pointed out, was, under such circumstances, put on the defence. I, therefore, have concluded that one may not rely on such vague words as "for these and other reasons" to determine that the learned trial judge relied on any general presumption of innocence which favoured the accused. On the other hand, I am of the opinion that he found that general presumption of innocence had been rebutted apart from the three reasons in law for which he, in error, assigned his reasonable doubt.

I would, therefore, dismiss the appeal.

Appeal dismissed, CARTWRIGHT C.J. and HALL J. dissenting.

Solicitors for the appellant: McCarthy and McCarthy, Toronto.

Solicitor for the respondent: The Attorney General of Canada, Ottawa.

---

[1] (1969), 69 D.T.C. 5045.
[2] (1969), 69 D.T.C. 5045.
[3] [1961] S.C.R. 144, 34 C.R. 246, 128 C.C.C. 366.
[4] (1967), 68 D.T.C. 5078, [1968] 3 C.C.C. 72, 3 C.R.N.S. 163, 66 D.L.R. (2d) 78.
[5] [1969] S.C.R. 373, 3 C.C.C. 249, 4 D.L.R. (3d) 98.
[6] (1969), 69 D.T.C. 5045.
[7] [1936] 1 A.C. 1 at 19.
[8] [1932] S.C.R. 279 at 296, 57 C.C.C. 318, 2 D.L.R. 88.
[9] [1961] S.C.R. 144, 34 C.R. 246, 128 C.C.C. 366.
[10] [1965] S.C.R. 174, 4 C.C.C. 11, 51 D.L.R. (2d) 312.
[11] (1969), 69 D.T.C. 5045.
[12] [1969] S.C.R. 221, 2 C.C.C. 189, 1 D.L.R. (3d) 161.
[13] [1969] S.C.R. 373, 3 C.C.C. 249, 4 D.L.R. (3d) 98.
[14] [1932] S.C.R. 279, 57 C.C.C. 318, 2 D.L.R. 88.
[15] [1961] S.C.R. 144, 34 C.R. 246, 128 C.C.C. 366.

Digitized by Google

R. v. Alberta Hot Oil Services Ltd., 2009 ABQB 11 (CanLII), 2009-01-22, [2009] 4 CTC 38, Sentencing Issues on Straight-Forward Evasion

Reasons for Decision- Sentencing Appeal of the
Honourable Mr. Justice D.R.G. Thomas

A. Introduction..... Page: 3
B. Facts..... Page: 3
C. Standard of Review..... Page: 5
D. Issues on Appeal..... Page: 5
Issue 1 - Alleged error in principle - no distinction between Joe **and Darlene Rinas**..... Page: 6
Issue 2 - Alleged error in principle - failure to consider a **non-custodial sentence**..... Page: 6
Issue 3 - Alleged failure to consider relevant factors, namely the **good character of Joe and Darlene Rinas**.....Page: 8 **Issue 4 - Alleged failure to consider the totality principle**..... Page: 9 **Issue 5 - Were the sentences imposed demonstrably unfit?**..... Page: 9
F. Disposition..... Page: 11

Introduction

[1] After a lengthy trial in the Alberta Provincial Court, the two individual appellants ("Joe and Darlene Rinas") and the corporate appellant Alberta Hot Oil Services Ltd. ("the Corporation") were found guilty of 18 tax offences, including tax evasion and the making of false statements in tax returns. The Corporation was sentenced on one count of income tax and G.S.T. evasion and ordered to pay a fine totalling 125% of the tax evaded. Joe and Darlene Rinas were each sentenced on one count of tax evasion and ordered to pay a fine totalling 125% of the tax sought to be evaded and a 6 month Conditional Sentence Order ("the C.S.O.") was imposed. Judicial stays of proceeding were entered on all of the remaining counts.

[2] All of the Appellants appealed both their convictions and sentences. The appeals from conviction were dismissed in ***R.* v. *Alberta Hot Oil Services Ltd.***, 2007 ABQB 155 (CanLII), [2007] A.J. No. 352 (Alta. Q.B.); 2007 ABQB 155. The sentence appeals were deferred for further written submissions and oral argument.

Facts

[3] I repeat the background facts from my decision on the unsuccessful appeals against conviction as found in ***R.* v. *Alberta Hot Oil Services***, *supra.*

The Corporation's business was primarily the provision of hot oil services to the petroleum industry in Alberta. In addition to filing corporate T2 tax returns and financial statements for each year, the Corporation was a registered collector of G.S.T. and reported its net G.S.T. on a quarterly basis based on its year end.

Joe Rinas was the president, a director and 50% shareholder of the Corporation. His role in the operations of the Corporation was to oversee the work of its employees,

Digitized by Google

to look after equipment and generally run the external activities of the Corporation. Darlene Rinas was the other 50% shareholder, a director and the secretary-treasurer of the Corporation. Her role was to maintain the books of the company. There were no other directors or officers.
In May, 2003 the Canada Revenue Agency ("C.R.A.") conducted an audit on the Corporation for the taxation years 2001 and 2002 and concluded that several expenses of a personal nature had been deducted from the income of the Corporation, including expenses of their two adult children, Ryan and Liberty Rinas. In July, 2003 the Special Investigation Division of the C.R.A. became involved, commenced a further investigation and finally proceeded with prosecutions of the three parties.
In February, 2006 Judge H.W.A. Fuller of the Alberta Provincial Court convicted the Appellants of a total of 18 tax offences including tax evasion and making false statements on tax returns.
[4] Convictions for income tax evasion, on summary conviction, require a minimum fine of 50% of the tax evaded to a maximum of 200% of the tax evaded. Imprisonment for a term not exceeding 2 years **may also be imposed. Convictions for excise tax evasion, on summary conviction, also require a minimum fine of 50% of the tax evaded to a maximum of 200% of the tax evaded. Imprisonment for a term not exceeding 2 years may also be imposed.**
[5] The Crown sought sentences of a fine totalling 125% of the tax evaded for each Appellant and a
C.S.O. ranging from 6 - 12 months for the individuals Joe and Darlene Rinas.
[6] The Appellants requested imposition of fines totalling no more than 75% of the tax evaded by the three parties.
[7] The amount of income tax evaded was $14,780.38 for Joe Rinas and $14,088.50 for Darlene Rinas. The Corporation evaded $29,136.00 in income tax and $8,934.12 in excise tax, for a total tax evaded of $38,070.12.
[8] On count 17 (income tax evasion) Joe Rinas was sentenced to pay a fine totalling 125% of the tax evaded ($18,475.47) and a 6 month C.S.O was imposed. In addition to the mandatory conditions, the
C.S.O. required Joe Rinas to abide by a curfew, complete 50 hours of community service work and carry a copy of his C.S.O. on his person when away from his residence.
[9] In respect to Joe Rinas a judicial stay of proceedings was entered on counts 13 and 14 (making false statements).
[10] On count 18 (income tax evasion), Darlene Rinas was sentenced to pay a fine totalling 125% of the tax evaded ($17,610.62) and a 6 month C.S.O. was imposed. In addition to the mandatory conditions, the
C.S.O. required Darlene Rinas to abide by a curfew, complete community service work and carry a copy of her C.S.O. on her person when away from her residence.
[11] In respect to Darlene Rinas a judicial stay of proceedings was entered on counts 15 and 16 (making false statements).
[12] On count 1 (income tax evasion) and count 12 (excise tax evasion) the Corporation was sentenced to pay a fine totalling 125% of the tax evaded, $36,420.00 for income tax evasion and $11,167.65 for excise tax evasion for a total of $47,587.65.
[13] In respect to the Corporation a judicial stay of proceeding was entered on counts 2 and 4 to 11 inclusive. [14] None of the Appellants had prior criminal records.

Standard of Review

Digitized by Google

[15] **An appellate court may intervene to vary a sentence imposed at trial where the sentence is demonstrably unfit, or where there has been an error in principle, a failure to consider a relevant factor, or an overemphasis of the appropriate factors. This standard of review applies to both the length and the type of sentence imposed. *R.* v. *M.(C.A.)*1996 CanLII 230 (SCC), (1996), 105 C.C.C. (3d) 327 (S.C.C.) at 374; *R.* v. *McDonnell*(1997), 114 C.C.C. (3d) 437 (S.C.C.) at para. 46.**

[16] **The approach to be taken in reviewing the fitness of a sentence is one of deference. An appellate court cannot modify a sentencing order "... simply because it feels that a different order ought to have been made". The sentencing order must be found to be demonstrably unfit; i.e. "clearly unreasonable", " clearly excessive or inadequate", "falling outside the ' acceptable range' of orders", etc. as stated by the Supreme Court of Canada in *R.* v. *M. (C.A.)*:**

... a court of appeal should only intervene to minimize the disparity of sentences where the sentence imposed by the trial judge is insubstantial and a marked departure from the sentences customarily imposed for similar offenders committing similar crimes. *R.* v. *Shropshire*, 1995 CanLII 47 (SCC), [1995] 4 S.C.R. 227 at 429-50

***R.* v. *M.(C.A.)*, *supra* at 375; *R.* v. *McDonnell*, *supra* at para. 16.**

Issues on Appeal

[17] The questions raised on appeal are:

Did the sentencing Judge **err in principle** by failing to distinguish between Joe and Darlene Rinas in determining the appropriate sentence?

Did the sentencing Judge **err in principle** by failing to consider lesser forms of punishment prior to imposing a custodial sentence upon Joe and Darlene Rinas?

Did the sentencing Judge **fail to give sufficient emphasis** to the evidence of the prior good character of Joe and Darlene Rinas?

Did the sentencing Judge **fail to consider** the totality principle?

Did the sentencing Judge impose a sentence which was **demonstrably unfit**? (Emphasis added.)

[18] The errors alleged fall into three of the categories described in ***R.* v. *M. (C.A.)***, *supra*, namely that the sentences are demonstrably unfit (Issue No. 5), there are errors in principle (Issue Nos. 1, 2 and 4) and there has been a failure to consider a relevant factor (Issue No. 3).

Analysis

Issue 1 - Alleged error in principle - no distinction between Joe and Darlene Rinas

[19] Joe and Darlene Rinas argue that the sentencing Judge failed to distinguish between them as individuals.

[20] Joe and Darlene Rinas were fined for evading income tax on their personal 2001 and 2002 income tax returns by understating taxable incomes. They were each solely responsible for the completion and submission of these personal tax returns.

[21] Both Joe and Darlene Rinas were fined an amount equal to 125% of the income tax evaded on their respective personal income tax returns. Given that their respective degrees of responsibility and culpability for their own personal income tax returns is the same, the sentencing Judge did not make an error in imposing similar sentences upon these individual Appellants.

Digitized by Google

[22] In addition, the quantum of understated income on their personal income tax returns was based upon the amount of personal benefits improperly conferred on them as per section 15(1) of the *Income Tax Act* ("*I.T.A.*") and added as taxable income to their respective personal income tax returns. This attribution was correct and the sentencing Judge properly treated the individual Appellants in imposing sentence on them as the sole and **equal** shareholders of the Corporation pursuant to this provision of the I.T.A.

Issue 2 - Alleged error in principle - failure to consider a non-custodial sentence

[23] The sentencing Judge was on solid legal ground in imposing the equivalent of a custodial sentence through the imposition of a C.S.O. Offences involving the evasion of tax and the making of false statements are serious offences which should attract terms of imprisonment. In that regard, I adopt and endorse the comments of Hope, J. in ***R.* v. *Kresanowski***(1982), 83 D.T.C. 5393 at p. 5398:

… The effect of false returns is visited upon all taxpayers in Canada. To put it bluntly, a person who is instrumental in reducing the income tax of one person is simply not only being unfair to his fellow Canadians, because he is not acting honestly, but he is making those other Canadians, perhaps his neighbours and friends, pay more than their fair share. Certainly tax evasion is to be punished to an extent that it will deter others from acting likewise.

It is in my view almost a certainty that tax evasion will be visited by a term of prison. Perhaps the only matter that is really to be decided is how long that prison term will be.

[24] This view is reinforced by the comments of the Alberta Court of Appeal in ***R.* v. *Howe***,[2002] A.J. No. 1443 at para. 3. Therefore, from a legal perspective, the sentencing Judge was on solid legal ground in imposing the equivalent of a custodial sentence.

[25] Further, a review of his reasons indicates that the sentencing Judge both considered and rejected the appropriateness of lesser forms of punishment, i.e. a fine alone, prior to sentencing Joe and Darlene Rinas to each pay a fine and abide by a 6 month C.S.O. He recognized the need for a fine and a custodial term to properly implement the primary sentencing principles of deterrence and denunciation:

... the principles of denunciation and deterrence are of paramount importance in the offences of tax avoidance and evasion and sentencing must focus on the circumstances of each case and the particular offender.

To send a clear, unequivocal, message to the public, who might be tempted to defraud the government by a similar scheme, or any other fraudulent mechanism, **a fine alone cannot send that message.**

(Emphasis added.)

I am satisfied, considering all the factors, that a six month gaol term in addition to the fine, is required, to reflect and reinforce the principles of deterrence and denunciation.

Having decided that a gaol term is required I must now consider if this case is one where the sentence could be served in the community. In this regard I refer to section 743(1) of the Code which provides in such instances as this the sentence could be served in the community.

I am therefore satisfied that a conditional sentence order would be appropriate in these instances. Joseph and Darlene Rinas could serve their gaol sentence in the community and they would not cause any danger to the safety of the community.

[26] Counsel for Darlene Rinas referred to many decisions in the tax jurisprudence in Canada over many years to demonstrate that punishments short of imprisonment could and should be imposed on offenders under tax statutes. While this presented an interesting catalogue of decisions, all they demonstrated is that there have been

Digitized by Google

many different sentences customized to the particular circumstances of the offences and the offenders listed. This is common to all sentences in the criminal law field. **In any event, a review of** these many decisions does not detract from the overarching legal principle that denunciation and deterrence are a core principle in determining sentences for cheating on the reporting of personal and corporate tax liabilities.

[27] Finally, Joe Rinas argued that denunciation and deterrence would be achieved by a suspended sentence and a monetary penalty. I agree with the Crown that such a sentence would be illegal and, in the circumstances of this case, inappropriate.

Issue 3 - Alleged failure to consider relevant factors, namely the good character of Joe and Darlene Rinas

[28] Joe and Darlene Rinas allege that the sentencing Judge failed to fully consider a relevant factor, namely their prior good character. Upon my review it is clear that the sentencing Judge considered and gave weight to the good character of both of the individual Appellants as a mitigating factor and articulated this during an exchange with counsel during sentencing submissions and also in his reasons for decision.

[29] He made specific reference to the several "character references" filed on behalf of Joe and Darlene Rinas and stated that there was "no doubt that both of these parties were active and well regarded members of their community." During the course of submissions on behalf of Darlene Rinas, the sentencing Judge stated, "Counsel, I can assure you that those letters of reference have an impact here."

[30] Darlene Rinas argued that the sentencing Judge did not properly consider a neuropsychological report and her personal and emotional difficulties. The fact is that the sentencing Judge did have the particular report in mind and, in his reasons, made numerous references to the clinical findings in that report. While he did speculate on the cause of her depression ultimately he said this:

... her emotional stress is only a factor as it relates to sentencing as it offers no explanation or excuse for the offence of tax avoidance or tax evasion.

[31] The long and the short of all of these reasons is that he did consider the expert's report and her emotional distress in reaching a conclusion on an appropriate sentence. The issue of the previous good character of both Joe and Darlene Rinas and the materials bearing on this issue were squarely before him and he took them into account and his reasons reflect that he did so.

[32] Accordingly, there is no error made out on this ground.

Issue 4 - Alleged failure to consider the totality principle

[33] **The totality principle ensures that the cumulative sentence of an offender ordered to serve consecutive sentences for multiple offences does not exceed the overall culpability of the offender. The aggregate sentence must be just and appropriate.**

[34] Here each of the parties were convicted as a separate offender for separate offences. **The totality principle does not apply to reduce the cumulative sentence of separate offenders.** The Corporation was convicted in relation to tax evaded on specific corporate T2 income tax returns and G.S.T. returns. Joe and Darlene Rinas were convicted in relation to tax evaded on their individual and personal income tax returns. Those returns had nothing to do with the Corporation, they were personal returns which they had falsified. **In the result, the totality principle does not apply to reduce the cumulative sentence of separate offenders and no error was committed by the sentencing Judge in respect to the application of the totality principle.**

Digitized by Google

Issue 5 - Were the sentences imposed demonstrably unfit?

[35] In reviewing the appropriateness of the sentences imposed here I must examine whether the purpose and principles of sentencing as set out in s. 718.2 of the *Criminal Code of Canada* were respected, the nature of the offences committed and the personal circumstances of the offenders. **In addition, I must examine the fitness of a sentence for a particular offender in relation to all aggravating and mitigating** factors considered by the sentencing Judge. To ensure just proportion, "a sentence should be similar to sentences imposed on similar offenders for similar offences committed in similar **situations."**

[36] The paramount sentencing principles which must be considered when sentencing for tax evasion offences are denunciation and deterrence. As was stated in ***R.* v. *J.I.L.M. Enterprises and Investments Ltd.***, [2004] G.S.T. C. 20 at paras. 29 and 30:

The Canadian taxation system relies on self-reporting by taxpayers. The honesty and integrity of those taxpayers is critical to the assessment and collection of taxes. In any self-reporting system, there will be a temptation to take advantage of the system for financial gain.

The sentencing provision of the Income Tax Act and the Excise Tax Act proscribe a significant penalty that will denounce such conduct and deter not only the offender, but others who would behave in a like fashion.

[37] I have considered the summaries of the facts of the following cases which were referred to by counsel for the Respondent, namely ***R.* v. *Sawatsky,*** also known as ***Florence Elizabeth McLeod*** (24 February 2005), Vancouver 132641-1 (B.C. Prov. Ct.), ***R.* v. *Schatz,*** Information and Endorsements (March 8, 2005 in Alberta Provincial Court - no transcript available), ***R.* v. *Poon,*** Information and Endorsements (April 18, 2005 in Alberta Provincial Court - no transcript available), ***R.* v. *Boule,*** Certificate of Conviction (September 4, 2007 in Alberta Provincial Court -no transcript available), ***Re Hanna***, [2005] BCPC 240, and ***R.* v. *Brown***, [2003] BCPC 537.

[38] A review of these summaries provides some guidance as to the type and range of sentences to be imposed intax evasion cases in Canada, including the imposition of terms of probation and conditional sentence orders. The application of the principles of denunciation and deterrence underlies all of these decisions.

[39] I agree with the Respondent that there were a number of aggravating factors which weighed in favour of the imposition of a greater punishment in this case and those factors include:

The tax evasion schemes were planned and deliberate and involved all of the Appellants. The schemes were not impulsive or isolated and required some time to arrange in an effort to avoid detection. (***R.* v. *Bracegirdle***, [2004] A.J. No. 827 at para. 40 (Alta. C.A.)).

The offences were of a continuing nature over 3 years and involved the filing of 14 tax returns, all of which included false statements. There was a conscious and deliberate choice to engage in serious misconduct by all of the Appellants.

The commission of the offences conferred a personal benefit on the individual Appellants through payment of a number of their personal expenses. The schemes resulted in the evasion of over $66,000.00 in tax by all three of the Appellants and these factors heighten the gravity of the offence. (***R.* v. *Whale***, [2005] O.J. No. 3946 at para. 15 (Ont. Ct. Jus.)).

The evasion of the excise tax by the Corporation, a registered collector of G.S.T., equates to a breach of trust. Once collected G.S.T. is to be remitted to the

Digitized by Google

C.R.A. and upon collection is impressed with a trust to that effect. Therefore, failure to remit G.S.T. collected amounts to a breach of trust. This factor is aggravating as the administration of justice depends upon fidelity and honesty by those in positions of trust. (***R.* v. *Onkar Travels Inc.***,[2003] O.J. No. 2939 at paras. 18-20, 34 (Ont. S. Ct.) and ***R.* v.*McIvor***, 1996 ABCA 154 (CanLII), (1996), 106 C.C.C. (3d) 285 at p. 2 (Alta. C.A.)).

[40] It is the Respondent's position that the only mitigating factor to be considered is the payment by the Appellant of their civil assessments provided to them by the C.R.A.

[41] Upon a review of the reasons of the sentencing Judge it is apparent that he was aware of all mitigating factors, including the payment by the Appellants of their civil assessments. In addition, the sentencing Judge also took into account the prior good character and absence of any criminal record on the part of the individual Appellants. All appropriate mitigating factors were taken into account by the sentencing Judge.

[42] Considering the nature and gravity of the offences committed by all of the Appellants over several years, the paramount sentencing principles and the aggravating and mitigating factors, it is my view that the sentences imposed were fit, proper and not outside the range of sentences for similar offences.

Disposition

[43] All of the sentence appeals are dismissed. The sentences imposed by the sentencing Judge are confirmed and shall commence as of the date of this judgment.

Heard on the 17th day of January, 2008.

Dated at the City of Edmonton, Alberta this 22nd day of January, 2009.

D.R.G. Thomas J.C.Q.B.A.

R. v. Leo-Mensah, 2010 ONCA 139 (CanLII), 2010-02-24, Too Light a Sentence for Considerable Tax Evasion Appealed and Granted

[1] Mr. Leo-Mensah operated a business through which he, or those whom he employed, prepared and submitted his clients' income tax returns. As part of the tax services that he provided, Mr. Leo-Mensah provided false charitable donation receipts to his clients. He either submitted the receipts to the CRA upon request or provided them to his clients.

[2] In 2003, 2004 and 2005, he submitted 801 tax returns claiming approximately $11.7 million in false charitable donations. As a result of these false claims, tax refunds in the amount of approximately $3.28 million were paid out by the CRA to Mr. Leo-Mensah's clients.

[3] Mr. Leo-Mensah failed to report the income that he derived from his fraudulent activity. As a result, he evaded income tax of $42,457.00 in 2004 and $103,309.00 in 2005. He failed to file an income tax return for 2006.

[4] Mr. Leo-Mensah pleaded guilty to one count of fraud (*Criminal Code*, s. 380(1)(a)) and two counts of income tax evasion (*Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1, s. 239(1)(d)). After being given credit on a two-for-one basis for 11 months of pre-

Digitized by Google

trial custody, he was sentenced to one day in jail and fined $145,766.00, concurrent on all charges (the "global fine").
[5] **The Crown seeks leave to appeal sentence and, if leave is granted, asks that the sentence be increased. It argues that the sentence imposed was manifestly unfit given the seriousness of the offences.**
[6] **Mr. Leo-Mensah responds by arguing that he was not the mastermind behind the scheme, that others participated in it and should be held accountable, and that he was duped by pastors into believing that the scheme resulted in money being given to needy children in Africa.**
[7] **For the reasons that follow, I would grant leave to appeal and allow the appeal.**

ANALYSIS
[8] In my view, the sentencing judge erred in three respects.
[9] First, it appears that she failed to consider, as an aggravating factor, that the value of the fraud committed exceeded $1,000,000. This she was obliged to do pursuant to s. 380.1(1)(a) of the *Criminal Code*.
[10] Second, the sentencing judge appears to have placed significant emphasis on Mr. Leo-Mensah's childcare obligations when determining his sentence. She likened his circumstances to those of the accused in *R. v. Pierce* 1997 CanLII 3020 (ON CA), (1997), 32 O.R. (3d) 321 (C.A.), leave to appeal to S.C.C. refused, [1997] 3 S.C.R. xiii. Unlike the situation in *Pierce*, however, in the present case there was no evidence before the court on the extent of the respondent's childcare obligations. At the time of his arrest, the respondent was separated from his spouse and his four children continued to live with their mother.
[11] Third, given the magnitude of the fraud, the breach of trust, blatant abuse of the charitable donations scheme under the *Income Tax Act* and Mr. Leo-Mensah's pivotal role in the scam, the sentence imposed falls below the range that has been established by this court for large-scale fraud cases. The amount and duration of the fraud perpetrated by the respondent is significant, amounting to almost $3.28 million over a three-year period and involving hundreds of fraudulent tax returns. In ***v. Bogart* 2002 CanLII 41073 (ON CA), (2002), 61 O.R. (3d) 75 (C.A.), leave to appeal to S.C.C. refused, [2003] 1 S.C.R. vi, this court established that a penitentiary sentence is the norm, not the exception, in cases of large-scale fraud and in which there are no extraordinary mitigating circumstances.**
[12] **I would note, as well, that in accordance with *R. v. Ward* reflex, (1980), 56 C.C.C. (2d) 15 (Ont. C.A.), separate fines are to be imposed for each offence and such fines are not to be made concurrent.**
[13] **It will be apparent that I do not accept that Mr. Leo-Mensah was but a dupe in this matter. The sentencing judge found that he planned and organized the scheme in order to defraud the government of Canada. She stated that Mr. Leo-Mensah "was the instigator and the primary participant in this scheme and his degree of moral culpability or responsibility for the offences is very high".**
[14] I see no reason to interfere with these findings. If there are other people who participated in the fraudulent activity, the respondent is free to provide that information to the authorities who may take legal action against them. **The fact that others may also be guilty of offences does not diminish the respondent's culpability, however.** There is an inadequate record to determine the veracity of the respondent's claim that he was motivated by a desire to help needy

Digitized by Google

children in Africa. Assuming that to be the case, however, it does not justify or excuse the wrongdoing that he committed.
[15] While this court has been reluctant to re-incarcerate an offender who has served the sentence originally imposed and been released into the community, reincarceration is warranted where the original sentence was so far below that which was required that the interests of justice require the court intervene: see *R. v. D.G.F.*, 2010 ONCA 27 (CanLII), 2010 ONCA 27 at paras. 33-34. In my view, this is such a case and a period of reincarceration is necessary.

DISPOSITION
[16] Accordingly, I would grant leave to appeal sentence and allow the appeal. I would sentence the respondent to a further two year period of incarceration and substitute for the global fine, separate fines for each of the two income tax offences, namely, a fine of $42,457.00 for the conviction for income tax evasion in 2004 and a fine of $103,309.00 for the conviction for income tax evasion in 2005.
RELEASED: February 24, 2010 (“E.E.G.”)

“E.E. Gillese J.A.”
“I agree K.M. Weiler J.A.”
“I agree J. MacFarland J.A.”

Her Majesty The Queen v. Norman Jurchison et al, 2001 FCA 126, Discoverability on Charter-Excluded Evidence for Civil Penalties

SEXTON J.A.**REASONS FOR JUDGMENT**

The individual respondent, Norman Jurchison is the principal shareholder and operator of the corporate respondent, Norway Insulation Inc. In 1991, during a routine audit, a Revenue Canada auditor discovered what he believed to be evidence that both taxpayers had unreported income for the 1990 taxation year and that offences under the *Income Tax Act* might have been committed. The auditor referred the file to the Special Investigations Unit. Following a preliminary review, the SIU referred the matter back to the Audit Section with requests for further information. This information formed the basis upon which a number of search warrants were obtained and searches conducted. Eventually, the taxpayers were reassessed for unreported income in the 1990 taxation year and charged with tax evasion under the *Income Tax Act*.
The criminal charges came before the courts first. Prior to the commencement of the trial, the taxpayers brought applications for the exclusion of evidence, alleging breaches of s. 8 of the *Canadian Charter of Rights and Freedoms*. Whetung J. of the Ontario Court (Provincial Division) held that Mr. Jurchison's right to be secure against unreasonable search and seizure had been infringed by the additional investigation by the Audit Section. He excluded the evidence obtained by the additional investigation for the purposes of the criminal trial and quashed the search warrants. In the result, the taxpayers were acquitted, although it is not clear whether any of the evidence developed in the initial audit was placed before the Court or not. The Crown's appeal was dismissed by the Ontario Court of Justice (General Division). The reasons for judgment in those Courts do not clearly set out the nature

Digitized by Google

of the evidence obtained in breach of the *Charter*.

The current appeals arise out of preliminary motions brought in the taxpayers' appeals of their reassessments. The taxpayers brought motions under Rule 58 of the *Tax Court of Canada Rules (General Procedure)*, which allows the Court to determine a question of law raised by a pleading in a proceeding where the determination of the question may lead to more efficient use of the Court's resources. They relied upon the *Charter* rulings of Whetung J. upheld on appeal by La Forme J. and moved for orders vacating the reassessments or, in the alternative, excluding the evidence collected following the initial audit. The Crown brought motions for orders compelling Mr. Jurchison to attend for discovery with respect to both appeals.

The Tax Court Judge considered the motions together. He held that he could entertain the taxpayers' motions under Rule 58. On the basis of the reasons for judgment of the Ontario Courts, he concluded that the evidence tainted by the breaches to Mr._Jurchison's *Charter* rights should be excluded. He refused, however, to vacate the reassessments entirely, noting that there remained untainted evidence developed from the initial audit that might support Revenue Canada's assessment. Under the circumstances, he held that the usual presumption at trial that the reassessments were correct was no longer appropriate and ordered that the onus be placed on the Crown to establish their validity.

With respect to the Crown's motions to compel Mr. Jurchison to attend for discovery, the Tax Court Judge held that:

... an examination of Mr. Jurchison would almost certainly have the result of compelling him to respond to a line of inquiry whose genesis lies in inadmissible evidence ... that evidence would be a road map to guide the examination of Mr. Jurchison.

He ordered that Mr. Jurchison was not to be examined for discovery.

The various appeals and cross-appeals to this Court can be divided into two areas: First, the Crown appeals the orders excluding the evidence of all but the initial audit. The taxpayers cross-appeal, arguing that the judge below erred in not going further and vacating the assessments. Second, the Crown appeals from the Tax Court Judge's order that Mr Jurchison not be examined for discovery. I will deal with the two areas in sequence.

The issue of the admissibility of evidence and the impact of this evidence upon the validity of the reassessments came before the Court on the motions of the taxpayers. As I have noted above, these motions were brought under Rule 58 of the General Procedure. The relevant portion of the Rule reads as follows:

58(1): A party may apply to the Court,

for the determination, before hearing, of a question of law raised by a pleading in a proceeding where the determination of the question may dispose of all or part of the proceeding, substantially shorten the hearing or result in a substantial saving of costs ...

There are certainly sound policy reasons for the existence of this rule. However, as the Tax Court noted in *Carma Developers Ltd.* v. *The Queen*, 96 D.T.C. 1803, the Rule "is not intended as an easily accessible alternative to a trial for the disposition of complex and contentious disputes about the rights and liabilities of litigants." Thus, the rule is only applicable if a number of conditions are met. Of specific relevance to this case is the requirement that the question of law to be determined be one that is raised by the pleadings.

In the case at bar, the Tax Court judge below found that "The *Charter* violation and its consequences are not referred to in the notices of appeal in either of [the] appeals"

Digitized by Google

before him. Nor were those issues raised in the Crown's replies. Even so, he decided to deal with the motions. In doing so, he erred. The questions were not raised by the pleadings of either party. As a result, he was without authority to determine them pursuant to Rule 58.

Normally, the admissibility of evidence is a matter best left to the Trial Judge who, having all the circumstances and evidence before him can make the most informed decision. Of course, there are situations such as that before Bowman J. in *O'Neill Motors Ltd.* v. *The Queen*, 96 D.T.C. 1486, which particularly lend themselves to such determination before trial. It must be kept in mind, however, that in that case, the question to be determined came before the Court by agreement of the parties under s. 173 of the *Income Tax Act* which provides for determination of questions of law, fact or mixed law and fact upon agreement between the Minister and the taxpayer. Unlike the present case, there was an agreed statement of fact by the parties.

It is necessary in deciding whether the evidence obtained in breach of the taxpayers' *Charter* rights in the present case is admissible, to consider the different standards for search and seizure for the purposes of criminal prosecution and for the purpose of civil enforcement of the *Income Tax Act* as set forth by the Supreme Court of Canada in *R. v. McKinlay Transport*, [1990] 1 S.C.R. 627. It is conceivable that the evidence might be inadmissible for purposes of a criminal prosecution, but admissible for purposes of a civil trial. See *Donovan v. The Queen*, [2000] 4 F.C. 373 (C.A.). Such a determination would require an examination of the impugned evidence and the method by which it was obtained, an inquiry into the seriousness of any *Charter* breach and a consideration of whether the evidence was already in possession of the Crown or would have been discovered in any event. See *R.* v. *Stillman*, [1997] 1 S.C.R. 607 at 664. It would appear impossible to make such a **determination in the absence of a factual base. In the present case, there is no agreement between the parties as to the relevant facts.**

Thus, I would allow the appeal and dismiss the cross-appeal with respect to the motions brought under Rule 58. The questions regarding the admissibility of evidence and upon whom the onus rests with respect to the validity of the assessments are to be left to the judge hearing the appeals of the reassessments.

I would, however, express the view that, in any event, the Tax Court Judge did not err in refusing to vacate the assessments entirely, correctly noting that the Crown was to be given the opportunity to make its case with the untainted evidence collected by the initial audit.

I turn now to the Crown's appeal of the Order disallowing the examination for discovery of Mr. Jurchison. The material in the record before us, including the judgments with respect to the tax evasion charges, demonstrates the strong possibility that the judge in the reassessment appeal may exclude at least some of the evidence collected by Revenue Canada auditors and investigators. It is impossible to know at this point exactly what that evidence might be. The details of the evidence obtained in breach of the taxpayers' rights is not before us, nor is the evidence which the Crown already had in its possession. It may well be that certain questions on discovery could be seen to have a genesis in the evidence taken in breach of the taxpayers' rights. However, until such questions are asked no such determination can be made. The Crown has the right to discovery and this right should not lightly be extinguished. In my view, it is preferable to allow the discovery to proceed with the taxpayer being given the right to object to

Digitized by Google

any questions which are felt to have their genesis in the impugned evidence. Then a Motions Judge will be in a better position to assess the propriety of the question.

It is worth noting that counsel for the taxpayer had indicated in a letter to the Crown, prior to the hearing of the motions in question, that he was prepared to have his client examined for discovery in the event he failed in his Rule 58 motion. Thus, the Crown did not call the evidence it might have in order to meet a claim that the Crown had lost its right to discovery because of a *Charter* breach. In these circumstances, it would be unfair to deprive the Crown of its right to discovery.

Therefore, I would allow the Crown's appeal with respect to the order that Mr. Jurchison not be examined for discovery subject to the right of the taxpayer to object to any questions which are felt to have their genesis in evidence if taken in breach of their *Charter* rights.

It is clear that the Tax Court Judge had the highest of motives in disposing of the case as he did. As case management judge, he was concerned about unnecessary delays and obviously wished to have settled before trial some very contentious issues. These are laudable motives and it may well be that in the end that the Trial Judge will consider that the remedies imposed by the Tax Court Judge were appropriate. We do not want to be taken as expressing any view to the effect that the taxpayer does not have a legitimate complaint with respect to breach of his *Charter* rights.

In the result, the appeal with respect to the motions brought under Rule 58 is allowed and the cross-appeal dismissed. The appeal with respect to the order that Mr. Jurchison not be examined for discovery is allowed. The Crown will have one set of costs for these appeals.

"J. E. Sexton" J.A.

George Alexander Madraga v. Her Majesty The Queen In Right Of Canada, 2001 SKQB 53, Non-Payment of Fine Leads to Committal with Consideration

Milliken J.

[1] This is an appeal by George Alexander Madraga of the order of His Honour Judge H. W. Goliath made on February 18, 2000, that Warrants of Committal under s. 734.7 of the *Criminal Code,* R.S.C. 1985, c.C-46, should issue for the failure of Madraga to pay two fines levied under the provisions of s. **239.1 of the *Income Tax Act,* R.S.C. 1985, c.1 (5th Supp.); and also an appeal of Goliath P.C.J.'s refusal to exercise his discretion under s. 734.3 of the *Criminal Code* to change the terms of the order made by His Honour Judge R. C. Finley on March 14, 1996, in which Finley, P.C.J. ordered that Madraga in respect to count 1 in Information 43981013 pay a fine of $72,700 with a default of 18 months if the fine was not paid by April 15, 1996, with the right to apply for payment by installments if no appeal was taken and in respect to count 5 of the Information to a fine of $18,700, to be paid by April 15, 1996, with a default of 18 months, consecutive to the default under count 1 with a right to apply for payment by installments if no appeal was taken.**

[2] An appeal was taken of both the conviction and the sentence but the appeal was dismissed for want of prosecution on November 25, 1997, and no application was made for payment by installments of either fine to the Provincial Court.

[3] An application was made by the Crown on February 23, 1999, under the

Digitized by Google

provisions of s.734.7 of the *Criminal Code,* to Provincial Court at Prince Albert for issuance of warrants of committal for default of payment of the fines imposed.

[4] Counsel for Madraga, before Goliath, P.C.J. contended that the Crown had not complied with the provisions of s. 734.5 and s. 734.6 of the *Criminal Code,* therefore warrants of committal should not be issued. In the alternative counsel for Madraga requested that the Provincial Court Judge under the provisions of s.734.3 change the default provision from incarceration in jail to a conditional sentence under the provisions of s. 742.1 of the *Criminal Code,* and if this was not possible then to reduce the 18 month default period, and the consecutive requirement to conform with other default time sentences imposed under the *Income Tax Act,* R.S.C. 1985, c.1 (5th Supp.).

[5] The Crown submitted evidence by an affidavit filed by Ellen Griffin that after Madraga's appeal had been dismissed for want of prosecution on November 27, 1997, that a demand letter was sent to him on February 27, 1998, demanding payment of the outstanding fine. That on October 14, 1998, certificates of convictions were registered in the Court of Queen's Bench Judicial Centre of Prince Albert and writs of execution were issued on October 19, 1998.

[6] Madraga testified before Judge Goliath, on June 11, 1999, at which time Madraga stated he had started business in 1986 under the name of Madraga's Deals on Wheels which later was incorporated under the name of Madraga Distributors Ltd. with Madraga and his uncle, Stanley, as shareholders. The business operated at civic address 4189 2nd Avenue West, in Prince Albert and was involved in the sale of recreational vehicles and used cars. In 1993 Madraga and his uncle got into a dispute and Madraga bought out Stanley Madraga for $35,485. The land upon which Madraga Distributors operated was owned by Madraga's father, George Madraga Sr. The buildings and inventory were owned by the company.

[7] Madraga stated the reason the appeal of his conviction under the *Income Tax Act* was not carried through was that he could not pay the costs of the transcripts in the amount of $20,000.

[8] Madraga stated that he had separated from his wife in 1995 and he had been ordered to pay her $1,000 per month for support and $750 per month support for his daughter on September 26, 1996, which amounts he is still paying each month.

[9] Madraga stated he had been sued by his uncle after the conviction under the *Income Tax Act* in March of 1996 and his father George Madraga Sr. paid out Stanley Madraga and obtained a judgment against Madraga for $40,502 and against Madraga Distributors for $121,955.

[10] Madraga continued to operate Madraga Distributors until October, 1997, at which time he sold the buildings to his father for $150,000 and Madraga sold the inventory to 620357 Saskatchewan Ltd., a company owned by his father. Madraga stated the monies received by the company were used to pay off creditors, other than Revenue Canada. It appears that the value of the inventory was $185,000.

[11] In March of 1998, Madraga sold all his farm lands to his father for $326,934.00, in the agreement Madraga acknowledges he owes his father a total of $185,000 which reduced the balance owing to
$141,934, which was to be paid off in ten installments commencing April 1st, 1999, with interest at 7.8%.

[12] In July of 1998, Madraga voluntarily filed an assignment in bankruptcy showing the only assets as
$276,932 and his debts at $671,057.00. Which debts were in respect to income tax payable and his fines owing to the Crown. Madraga was discharged from bankruptcy

Digitized by Google

in April, 1999.
[13] Madraga stated his monthly income is $3500 and has been since he sold the inventory and building to his father. Madraga acts as a sales person for his father's company and his daughter, Carrie, is the general manager.
[14] Madraga stated he did not believe he had evaded any income tax and if he had the funds he would pay the fines rather than going to jail.
[15] Madraga stated that he had made no attempt to work off the fines as he was working six days a week and he had no time available to work off his fines.
[16] Section 734.7(1) of the *Criminal Code* which states as follows: 734.7 (1) Warrant of Committal -- Where time has been allowed for payment of a fine, the court shall not issue a warrant of committal in default of payment of the fine (a) until the expiration of the time allowed for payment of the fine in full; and (b) unless the court is satisfied (i) that the mechanisms provided by sections 734.5 and 734.6 are not appropriate in the circumstances, or (ii) that the offender has, without reasonable excuse, refused to pay the fine or discharge it under section 736.
[17] Judge Goliath in his judgment decided that in view of the fact Madraga had devised himself of all his assets and gone bankrupt, he had wilfully without a reasonable excuse refused to pay fines and therefore the mechanisms provided under s. 734.5 and 734.6 were not appropriate in the circumstances to collect the fines.
[18] It is clear from a reading of the transcript of Madraga's testimony before Judge Goliath that Madraga feels no remorse for the taxation evasion for which he has been found guilty.
[19] In my opinion the only conclusion that can reasonably be drawn from Madraga's actions is that he has without reasonable excuse refused to pay the fines, which in my opinion i s sufficient under the provisions of
s. 734.7(1) (ii) to allow an order for the issuing of a warrant of committal under s. 734.7 as the time for payment has expired and therefore the appeal, in respect to issuing of warrants of committal, is dismissed. [20] Now in respect to the appeal from the ruling of Goliath, P.C.J. that he did not have the jurisdiction under
to change the terms of the order of Finley, P.C.J. of March 14, 1996, and his refusal to make any order under s.734.3
[21] Judge Goliath in his judgment held that Madraga was not fined under section 734.1 as this section was not in force in March of 1996, and that s. 734.3 cannot refer to changes to periods of imprisonment since the fine orders under the new regime do not contain default sentences. Judge Goliath also held that while a sentence of imprisonment which was imposed prior to the coming into force of the new sentencing provisions, may be varied on appeal, to be served in the community. However, in his opinion, a judge of the same court cannot deal with the matter as it is tantamount to an appeal of the sentence.
[22] The applicable sections of the *Criminal Code* are as follows:
734.(1) **Power of court to impose fine** -- Subject to subsection (2), a court that convicts a person, other than a corporation, of an offence may fine the offender by making an order under section 734.1
if the punishment for the offence does not include a minimum term of imprisonment, in addition to or in lieu of any other sanction that the court is authorized to impose; or
if the punishment for the offence includes a minimum term of imprisonment, in addition to any other sanction that the court is required or authorized to impose.
Offender's ability to pay -- Except when the punishment for an offence includes a minimum fine or a fine is imposed in lieu of a forfeiture order, a court may fine an offender under this section only if the court is satisfied that the offender is able to pay

Digitized by Google

the fine or discharge it under section 736.

Meaning of default of payment -- For the purposes of this section and sections 734.1 to 737, a person is in default of payment of a fine if the fine has not been paid in full by the time set out in the order made under section 734.1.

Imprisonment in default of payment -- Where an offender is fined under this section, a term of imprisonment, determined in accordance with subsection (5), shall be deemed to be imposed in default of payment of the fine.

Determination of term -- The length, in days, of the term of imprisonment referred to in subsection (4) is the lesser of

a fraction, rounded down to the nearest whole number, of which

the numerator is the unpaid amount of the fine plus the costs and charges of committing and conveying the defaulter to prison, calculated in accordance with regulations made under subsection (7), and

the denominator is equal to eight times the provincial minimum hourly wage, at the time of default, in the province in which the fine was imposed, and

the maximum term of imprisonment, expressed in days, that the court could itself impose on conviction. . . .

Application to other law -- This section and sections 734.1 to 734.8 and 736 apply to a fine imposed under any Act of Parliament, except that subsections (4) and (5) do not apply if the term of imprisonment in default of payment of the fine provided for in that Act or regulation is

calculated by a different method; or

specified, either as a minimum or a maximum.

Terms of order imposing fine -- A court that fines an offender under section 734 shall do so by making an order that clearly sets out

the amount of fine;

the manner in which the fine is to be paid;

the time or times by which the fine, or any portion thereof, must be paid; and

such other terms respecting the payment of the fine as the court deems appropriate. . ..

734.3 Change in terms of order -- A court that makes an order under section 734.1, or a person designated, either by name or by title of office, by that court, may, on application by or on behalf of the offender, subject to any rules made by the court under section 482, change any term of the order except the amount of the fine, and any reference in this section and sections 734, 734.1, 734.2, and 734.6 to an order shall be read as including a reference to the order as changed pursuant to this section. . . .

734.8(2) Reduction of imprisonment on part payment -- The term of imprisonment in default of payment of fine shall, on payment of a part of the penalty, whether the payment was made before or after the execution of a warrant of committal, be reduced by the number of days that bears the same proportion to the number of days in the term as the part paid bears to the total penalty.

[23] It is my opinion that section 734 clearly replaces 718 of the *Criminal Code* which section was in force in March of 1996, and that section 734 provides under 734(8) that s. 734 and s. 734.1 to 734.8 and 736 apply to a fine imposed under any Act of Parliament, except that subsections (4) and (5) do not apply if the term of imprisonment in default of payment of the fine provided for in that Act is calculated by a different method, or specified, either as a minimum or maximum.

[24] Section 734.3 allows the court which imposed a fine to change any terms of the order except the amount of the fine. In my opinion Goliath, P.C.J. erred in law by refusing to consider any changes to the terms of Judge Finley's order. There were

Digitized by Google

two requests made by Madraga that Goliath, P.C.J. failed to consider, firstly, the request to change the period of imprisonment to a conditional sentence under s. 742.1 of the *Criminal Code*; secondly, the request to change the period of imprisonment from 18 months to a lesser amount on the basis that a period of 36 months imprisonment for the non-payment of fines totalling $81,400 was well beyond the range of defaults for offences under s.239.1 of the *Income Tax Act*.

[25] Now dealing firstly with the request to have the default changed to a conditional sentence to be served in the community under s.742.1. The cases seem to indicate that when a time to pay a fine is given, that a conditional sentence cannot be used for a period of default. (See: *R. v. Savard,* (Qué. C.A.) 500-10-001619-996, September 14, 2000; *R. v. Lazare* [2000] Q.J. No. 4701; and *R. v. Noseworthy* [2000] N.J. No. 255.

[26] **Even if a conditional sentence could be substituted for default of imprisonment, I am of the view in this case that the actions of Madraga, since the fines were imposed, are a deliberate attempt to deplete his resources so that he is unable to pay any of the fines, such behaviour must be taken into consideration by the courts and therefore a term of imprisonment upon default of payment of the fines is necessary.**

[27] **I have reviewed the material submitted to me by counsel and I come to the conclusion that the default imposed of 18 months consecutive is beyond the range of defaults for offences under the *Income Tax Act*. A default in respect to both fines should, in my view, in total equal 12 months. (See: *Regina, v. Artinian*, (1995) 26 (O.R.) 640). While I could send the matter of the 734.3 order back to the Provincial Court, I have decided that I have the power to make such and order and I therefore order that the order of Finley, P.C.J. in respect to the default in respect to both counts, be changed as follows:**

Count 1 a fine of $62,700 to be paid by April 15, 1996, in default of payment 9 months consecutive to count 5;

Count 5 a fine of $18,700 to be paid by April 15, 1996, in default of payment 3 months consecutive to count 1.

[28] I would like to point out that the Certificate of Conviction issued in 1998 does not comply with the wording of the offences contained in counts 1 and 5. Those counts were amended at trial, and the wording of the certificates does not comply with the finding of the trial judge as contained in his judgment date March 14, 1996, nor does it comply with the amendments as shown on the Information.

[29] I would also like to point out the material before me indicates that Revenue Canada has received the sum of $8,911.70 from Madraga's trustee in bankruptcy and this amount I find should be allocated to payment of the fines and therefore the period of default should be reduced under the provisions of s.734.8(2) of the *Criminal Code.*

J.

THE COURT OF APPEAL FOR SASKATCHEWAN, 2001 SKCA 98,

CAMERON J.A. (Orally)

[1] **Following a lengthy trial in early 1996, George Madraga was convicted of two counts of income tax evasion, contrary to section 239 of the *Income Tax Act*. In consequence he was fined $62,000 in relation to the first count, and $18,700 in relation to the second. The trial judge went on to impose a term of**

Digitized by Google

imprisonment of 18 months in default of payment of each of the fines. Mr. Madraga then appealed, appealing his conviction and sentence, but abandoned his appeal a year and a half later.

[2] In the meantime, he did not pay the fines. Nor did he do so for several months after that, prompting the Crown to attempt to collect them. During its attempts Mr. Madraga declared bankruptcy, and the Crown, while ultimately recovering $8,911.70 toward outstanding taxes (amounting by then to some $500,000), failed to collect the fines. Mr. Madraga, it was later found, had simply refused to pay them.

[3] Having failed in its attempts to collect the fines, the Crown then applied in early 1999 for a warrant of committal pursuant to section 734 of the *Criminal Code*. Mr. Madraga opposed the application, and following a hearing which extended over several months, His Honour Judge H.W. Goliath, decided to issue the warrant. In doing so, he declined to alter the sentences imposed by the trial judge, either by varying the amount of the fines or by reducing the periods of imprisonment in default of payment. Neither he, nor the trial judge, it might be noted, were much impressed by Mr. Madraga. He was taken to have been calculating and manipulative.

[4] Mr. Madraga then appealed to the Court of Queen's Bench. The appeal was heard by Mr. Justice Milliken, who decided to alter the sentences by reducing the periods of imprisonment in default of payment of the fines, reducing the periods to nine months in the case of the first, and three months in the case of the second. In addition, he directed that the sum of $8,911.70 recovered by the Crown in the bankruptcy proceedings be allocated toward payment of the fines. The effect was to reduce the total amount of the fines to $71,788.70.

[5] The Crown then sought leave to appeal to this Court, contending as a matter of law that Milliken J. was not empowered to so alter the sentences and, even if he was, that no tenable basis for the exercise of such power existed. Mr. Madraga cross-appealed, taking issue with a number of findings of fact or of mixed fact and law. In the meantime, Mr. Madraga paid the fines in the reduced amount of $71,788.70.

[6] This is but a mere sketch of the circumstances underlying the matter, but it will suffice for the purposes at hand.

[7] We may say at the outset that we are persuaded to grant the Crown's application for leave to appeal, as raising qualifying questions of law, but not that of Mr. Madraga. His proposed grounds of appeal, as set forth in his notice of appeal, are largely factual in nature and in our view do not qualify for, or warrant, leave to appeal.

[8] Turning, then, to the Crown's appeal, we are all of the opinion Milliken J. erred in altering the sentences as he did. Even if he had the power to vary the terms of imprisonment imposed in default of payment of the fines, which is highly doubtful, there was, in our judgment, no tenable basis for doing so. Neither the amount of the fines, nor the periods of imprisonment in default exceeded the powers of the trial judge. They fell within the scope of his power, which constituted a discretionary power of punishment. And he exercised that power with the advantage—a concrete and distinct advantage in the circumstances of this case—of having presided over a lengthy trial during which he had the opportunity of hearing and seeing from all concerned, including Mr. Madraga. In exercising his power, including his power to prescribe periods of imprisonment in default of payment of the fines, he was no doubt moved by the scale and nature of the accused's evasion of tax. To second guess him, in the circumstances of this case, was to interfere with the exercise of his discretion without an adequate basis in law or fact to do so.

[9] Moreover, Mr. Madraga had appealled the sentence, as well as his conviction, immediately following its imposition, only to later abandon the appeal. That being so,

Digitized by Google

it was as though the proceedings in the Queen's Bench were treated as a revival of that appeal, long after it lay dead.

[10] In making the order he did, Mr. Justice Milliken not only varied the periods of imprisonment in the event of default in the payment of the fines, he effectively varied the amount of the fines by allocating the amount of outstanding tax recovered in the bankruptcy proceedings toward the payment of the fines. This was misconceived, in the sense the tax owing was one thing, the fines quite another. More importantly, perhaps, this was beyond the power of the Court. There is no power in the Court in proceedings under section 734 of the *Criminal Code* to alter the amount of a fine. Indeed this is expressly prohibited.

[11] For essentially these reasons, then, we have decided to allow the Crown's appeal and to set aside the order made in the Court of Queen's Bench.

[12] We may add in closing that, even though we have denied leave to appeal in relation to the cross- appeal, we considered the one question of law that was raised in the notice of appeal, namely that Milliken J. erred in finding that he had no authority in law to substitute a conditional sentence for that imposed in the first instance. In fact, Milliken J. did not decide this issue on that basis. He made it clear that even if empowered to do so, he would not turn the sentence into a conditional one in light of all of the circumstances.

Her Majesty The Queen v. Yu Wu, Court Of Appeal For Ontario C35987, 2001 12 12, Imprisonment on Inability to Pay Fine (Excise Act) – Certain Considerations

On appeal from the order of Justice Cheryl Robertson dated February 16, 2001, dismissing a summary conviction appeal from the sentence imposed by Judge Gilles Renaud dated March 9, 2000.

SHARPE J.A.:

[1] The respondent was convicted of possession of contraband tobacco contrary to s. 240(1) of the *Excise Act*, R.S. 1985, c. E-14. Parliament has prescribed a minimum fine for this offence. The trial judge imposed the minimum fine, in this case $9,600, gave the appellant no time to pay the fine, and imposed a 75-day conditional sentence in default of payment. The Crown's summary conviction appeal against the sentence was dismissed. The Crown seeks leave to appeal and, if leave is granted, appeals the sentence on the ground that a conditional sentence is not available in default of payment of a fine.

FACTS

[2] After a three-day trial, the respondent was convicted of possessing 300 cartons of contraband tobacco contrary to the *Excise Act*, s. 240(1). The trial judge sentenced the respondent to the minimum fine calculated pursuant to s. 240(1.1) and totalling $9,600. Although no evidence was called at the sentencing stage concerning the respondent's ability to pay the fine, the trial judge found that the respondent did not have sufficient means to pay it. The respondent had testified during the trial that he was unemployed due to an injury, that he received $965.00 a month in benefits, and that he was responsible for the support of his sixteen year-old daughter.

[3] In his reasons for sentence, the trial judge stated that but for the minimum fine, he

Digitized by Google

would have imposed a suspended sentence. The respondent, he noted, was "a first offender having been involved in very minimal behaviour." **However, in view of the statutory minimum fine, the trial judge held that he had no option but to impose a fine, stating that "that is Parliament's wish and I have to give effect to that wish." The trial judge explicitly regretted the fact that Ontario did not make provision for offenders to "work off" fines and observed that even if he did impose a short custodial sentence, it was likely that the respondent would be released "within a matter of days" due to the limited availability of custodial resources.**

[4] The trial judge concluded that given the circumstances of the offence and the offender, a custodial sentence was not required and that a conditional sentence would be the appropriate penalty. The respondent, he held, was not a danger to the community. On the other hand, the trial judge felt that the sentence should reflect the fact that the community was "bedevilled" by smuggling, an activity arising from a "criminal undercurrent which attacks our respect for law and order and which attacks the community itself." The trial judge noted that "a conditional sentence with appropriate, severe conditions is a significant deterrent and denunciatory penalty", echoing the words of the Supreme Court of Canada in *R. v. Proulx*, [2000] 1 S.C.R. 61. Accordingly, the trial judge imposed the mandatory fine but gave the respondent no time to pay. In default of payment, the trial judge imposed a 75-day conditional sentence that included house arrest between the hours of 6:00 p.m. and 6:00 a.m. subject to narrowly defined exceptions for employment, medical care or religious observance.

[5] The Crown's appeal to the Superior Court of Justice was dismissed on the ground that the trial judge's disposition of the matter was in accord with the decision of the Quebec Court of Appeal in *R. c. Savard* (2000), 38 C.R. (5th) 152, discussed below.

ISSUE

[6] The following issue arises on this appeal:

Is there a discretion to impose a conditional sentence in default of payment of the minimum fine prescribed by s. 240(1) of the *Excise Act* where no time is provided for payment of the fine?

LEGISLATION

Excise Act, R.S. 1985, c. E-14

Unlawful sale or possession of manufactured tobacco or cigars

240. (1) Subject to subsections (2) and (3), every person who sells or offers for sale or has in the person's possession any manufactured tobacco or cigars, whether manufactured in or imported into Canada, not put up in packages and stamped with tobacco stamps or cigar stamps in accordance with this Act and the ministerial regulations,

is guilty of an indictable offence and liable to

a fine of not less than the amount determined under subsection (1.1) and not more than the amount determined under subsection (1.2), or

both the fine described in subparagraph (i) and imprisonment for a term not exceeding 5 years; or

is guilty of an offence punishable on summary conviction and liable to

a fine of not less than the amount determined under subsection (1.1) and not more than the lesser of $500,000 and the amount determined under subsection (1.2), or

Digitized by Google

both the fine described in subparagraph (i) and imprisonment for a term not exceeding two years.
Minimum amount
(1.1) The amount determined under this subsection for an offence under subsection (1) in relation to manufactured tobacco or cigars is the greater of
The total of
$0.16 multiplied by the number of cigarettes, if any, to which the offence relates,
$0.11 multiplied by the number of tobacco sticks, if any, to which the offence relates,
$0.11 multiplied by the number of grams of manufactured tobacco, if any, other than cigarettes or tobacco sticks, to which the offence relates, and
$0.16 multiplied by the number of cigars, if any, to which the offence relates, and
$1,000 in the case of an indictable offence and $500 in the case of an offence punishable on summary conviction.
Maximum amount
(1.2) The amount determined under this subsection for an offence under subsection (1) in relation to manufactured tobacco or cigars is the greater of
The total of
$0.24 multiplied by the number of cigarettes, if any, to which the offence relates,
$0.16 multiplied by the number of tobacco sticks, if any, to which the offence relates,
$0.16 multiplied by the number of grams of manufactured tobacco, if any, other than cigarettes or tobacco sticks, to which the offence relates, and
$0.50 multiplied by the number of cigars, if any, to which the offence relates, and
$1,000 in the case of an indictable offence and $500 in the case of an offence punishable on summary conviction.
…
Imprisonment in default of payment
Where a fine is imposed under subsection (1), a term of imprisonment may be imposed in default of payment of the fine, but no such term shall exceed
where the fine is imposed under paragraph (1)(*a*), five years in addition to any other term of imprisonment imposed on the person under that paragraph; and
where the fine is imposed under paragraph (1)(*b*), two years in addition to any other term of imprisonment imposed on the person under that paragraph.
Criminal Code, R.S.C. 1985, c. C-46.
Imposing of conditional sentence
Where a person is convicted of an offence, except an offence that is punishable by a minimum term of imprisonment, and the court
imposes a sentence of imprisonment of less than two years, and
is satisfied that serving the sentence in the community would not endanger the safety of the community and would be consistent with the fundamental purpose and principles of sentencing set out in sections 718 to 718.2, the court may, for the purpose of supervising the offender's behaviour in the community, order that the offender serve the sentence in the community, subject to the offender's complying with the conditions of a conditional sentence order made under section 742.3.

ANALYSIS
[7] **The Quebec Court of Appeal has considered the use of conditional sentences in default of mandatory minimum fines in three recent decisions. In *R. v. Giroux* (1999), 141 C.C.C. (3d) 67, the accused was convicted of offences under the *Customs Act*, R.S.C. 1985, c. 1 (2nd Supp.) and under the *Excise Act*. The mandatory minimum fine of $369,620 was imposed and in**

Digitized by Google

default of payment, the accused was sentenced to 18 months' imprisonment followed by another six months less a day. The Court allowed a sentence appeal and substituted a conditional sentence pursuant to which the appellant would serve the sentence of imprisonment in default of payment in the community under relatively strict conditions. The Court observed at p. 73 that "while providing for substantial fines, [the legislation] did not provide for minimum sentences in default of payment of those fines." The Court held that a conditional sentence was appropriate as the appellant, who had no criminal record, was "a small cog in the operation" and there appeared to be little danger that he would re-offend.

[8] The Quebec Court of Appeal revisited the issue in *R c. Savard*, *supra*. There, the accused was sentenced to 18 months' imprisonment, together with the minimum fine of $967,919. The accused was given 12 months' to pay the fine, and in default of payment, was sentenced to an additional 20 months imprisonment. He appealed the sentence, arguing that both the 18-month term of imprisonment and the 20-month term in default of payment should be changed to a conditional sentence. The appeal was allowed, and given the circumstances of the appellant, the Court substituted a conditional sentence for the 18-month term of imprisonment and set aside the period of imprisonment in default of payment of the fine.

[9] *Savard* qualified the availability of conditional sentences in default of payment of a fine. Proulx J.A., writing for the Court, referred to a long line of authority holding that where a fine is imposed, the fine is the punishment, not the sentence of imprisonment in default of payment which merely serves as a mode of enforcement of the fine: see *Regimbald v. Chong Chow* (1925), 38 Que. K.B. 440; *R. v. Steeves* (1914), 24 C.C.C. 183 (N.B.C.A.); *R. v. Tomlinson* (1971), 2 C.C.C. (2d) 97 (B.C.S.C.). It **followed, held Proulx J.A., that when a court imposes a term of imprisonment in default of payment of a fine, it does not actually impose a "sentence of imprisonment" within the meaning of s. 742.1 of the *Criminal Code*, and accordingly the court does not have the option of imposing a conditional sentence as an alternative to imprisonment.** Proulx J.A. thus stated at p. 161 that

> [q]uand le législateur prévoit … une amende minimale, soit-elle exagérée ou non et au-delà les moyens du contrevenant, le tribunal doit considérer le délai de paiement, les modalités et, les cas échéant, la clause d'emprisonnement à défaut de paiement." [1]

[10] *Savard* distinguished, however, between two classes of conditional sentences in default of payment of a fine: those where the offender is given time to pay the fine and those where the offender is given no time to pay. Proulx J.A. observed that s. 734.7(2) of the *Criminal Code* allows for "immediate committal" of an offender in default of payment of a fine where no time is given to pay the fine, provided that the court states its reasons for immediate commital. Proulx J.A. noted that the court's reasons for preferring immediate committal were significant, since they directly affected the character of the sentence imposed. In particular, he stated at p. 159 that

> dans la hypothèse où … il apparaîtrait au tribunal que l'inculpé ne pourrait pas acquitter l'amende considérable imposée, il serait difficile de considérer que l'imprisonnement ordonné à défaut de paiement soit « *une mesure incitative de paiement* »: dans la réalité des choses, cet imprisonnement constituterait la « *peine* » infligée. [2]

[11] Proulx J.A. held that since in these circumstances the decision not to give an offender any time to pay a fine amounts to an immediate sentence of imprisonment, the availability of a conditional sentence under s. 742.1 of the *Criminal Code* had to be

Digitized by Google

considered. As Proulx J.A. stated at p. 163:
Il me paraîtrait conforme au principe général d'interprétation des lois … que cette periode d'incarcération immédiate à laquelle est condamné le delinquant incapable de payer, puisse être couverte par l'art. 742.1 C.cr: il ne serait pas contraire aux principes directeurs de la détermination de la peine que la personne condamnée de fait à l'emprisonnement puisse bénéficier de cette mesure. [3]
[12] He thus held that *R. v. Giroux*, *supra*, a case in which the offender was unable to pay the fine and the conditional sentence in default of payment of the fine was imposed immediately, was rightly decided.
[13] A subsequent decision of the Quebec Court of Appeal, *R. c. Bisson*, [2000] J.Q. No. 3273 followed this line of reasoning and affirmed that a conditional sentence may be imposed in default of payment of a mandatory minimum fine where the convicted party is given no time to pay the fine.
[14] In this province, the availability of conditional sentences in default of payment of fines was considered by Blenus Wright J. in *R. v. Lettroy* (2000), 47 O.R. (3d) 517. The accused pleaded guilty to income tax evasion. He was fined $218,678, an amount equivalent to the tax evaded, more than the minimum fine but less than the maximum stipulated by s. 239(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.). **He was given no time to pay and sentenced to 12 months in default of payment, to be served conditionally, together with 12 months probation. The Crown appealed on the ground that the accused should have been given time to pay and that a conditional sentence was not available for a term of imprisonment in default of payment of a fine. Blenus Wright J. allowed the Crown's appeal on the ground (at p. 520) that "[b]y giving no time to pay the fine the judge effectively wiped out the mandatory fine provisions" of the *Income Tax Act*.**
[15] Blenus Wright J. held at p. 521 that a conditional sentence was not available: The term of imprisonment in default of payment of a fine is made with reference to the future and in relation to the possibility that the fine will not be paid. The imprisonment in default of payment of the fine does not relate to the conviction for the offence of tax evasion but relates to the failure to pay the sentence of a fine. Therefore, in my view the imprisonment in default of payment of the fine was not part of the sentence.
[16] **Blenus Wright J. allowed the Crown's appeal, but in view of the respondent's lack of means to pay the fine, he substituted a reduced fine of 50% of the amount of tax evaded, gave the respondent a year to pay the fine, and set aside the term of imprisonment in default, expressly noting that the Crown should be left to its civil remedies to collect the fine if it were not paid.**
[17] **In my view, in the circumstances of the present case, the trial judge did have the discretion to impose a conditional sentence in default of payment of the mandatory minimum fine. I would adopt the analysis of the Quebec Court of Appeal that it is legally possible to impose a conditional sentence in default of payment of a fine where the offender is given no time to pay.**
[18] **I agree with the Quebec Court of Appeal that there is a difference between imposing an immediate sentence of imprisonment in default of payment of a fine with no time to pay the fine, and imposing a conditional sentence in default of payment where the offender is given time to pay. Where no time is given to pay the fine, the court has determined, then and there, that the appropriate sanction for the offender's conduct is either immediate payment or immediate imprisonment. As the legal and practical effect of the sentence is to send the offender directly to jail, it seems to me that the court is imposing a sentence**

Digitized by Google

of imprisonment and I see no reason in law to eliminate the possibility of ordering that the sentence be served in the community pursuant to the terms of s. 742.1 of the *Criminal Code*.

[19] **As well as being supportable in law, this analysis also has the practical advantage of affording judges a desirable measure of flexibility to arrive at an appropriate sentence. The circumstances of the present case prove the point. The trial judge concluded that in view of his limited means, the respondent was unable to pay the required fine. The trial judge also concluded that given the respondent's minimal level of involvement in smuggling and his personal circumstances, a sentence of incarceration was not appropriate. The trial judge was required to impose a fine, but he was not required to impose a term of imprisonment in default of payment as s. 240(4) of the *Excise Act* is discretionary. The imposition of a fine of $9,600 that could not and would not be paid would amount to a hollow sentence that would fail to adequately sanction the respondent's wrongful conduct. The imposition of a conditional sentence in default of immediate payment of the fine allowed the trial judge to arrive at a sentence that respected the letter of the law, was closely tailored to the circumstances of the offender, and gave appropriate emphasis to the goals of deterrence and retribution.**

[20] **I would, however, add the following caveat. I agree with the views expressed by Blenus Wright J. in *Lettroy* to the following extent. First, it is well established that ordinarily, a convicted party should be given time to pay a fine. The circumstances in which no time is given to pay a fine are bound to be exceptional. Second, sentencing judges should avoid dispositions that in effect evade Parliament's direction that for certain offences, mandatory fines must be imposed. It hardly needs to be said that sentencing judges must respect the will of Parliament. If a sentencing judge were to impose a fine, give no time to pay and impose a conditional sentence in default of payment as a means of avoiding the impact of the mandatory fine, such a sentence would amount to an improper exercise of the sentencing judge's discretion. Where it is doubtful that the mandatory fine will be paid, and where the circumstances of the offence or the offender do not justify a period of imprisonment in default, imposition of the fine with time to pay and without a period of imprisonment in default will often be the appropriate sentence.**

[21] For the reasons I have given, I cannot accept the appellant's submission that the sentence imposed here effectively defeated Parliament's intention that a minimum fine be imposed. In my view, the trial judge did his best to impose a sentence that appropriately sanctioned the respondent's wrongful conduct in keeping with the statutory scheme and applicable legal principles and in a manner consistent with the respondent's level of criminal involvement and personal circumstances.

[22] Finally, I note that s. s. 734 of the *Criminal Code*, providing for the calculation of the term of imprisonment to be imposed in default of payment of a fine, has no application to the circumstances of this case. Accordingly, I do not address here the relevance or applicability of conditional sentences under that scheme, leaving that question to another day when the issue does arise.

CONCLUSION

[23] For these reasons, I would grant leave to appeal and dismiss the appeal. "Robert J. Sharpe J.A."

Digitized by Google

"I agree
J.M. Simmons J.A."

DOHERTY J.A. (Dissenting):
[24] I have read the persuasive reasons of my colleague, Sharpe J.A. I come to a different conclusion. As I read s. 742.1 of the *Criminal Code*, a conditional sentence is not available where a term of imprisonment is imposed upon default of the payment of a fine.

I
[25] **The respondent was convicted under the *Excise Act*, R.S.C. 1985, c. E-14. Section 34(2) of the *Interpretation Act*, R.S.C. 1985, c. I-21 makes the provisions of the *Criminal Code* applicable to prosecutions under the *Excise Act* "except to the extent that the enactment otherwise provides". There is nothing in the *Excise Act* about conditional sentences. Section 742.1 of the *Criminal Code*, therefore, governs the availability of conditional sentences for persons convicted under the *Excise Act*.**
[26] Section 742.1 reads:
742.1 Where a person is convicted of an offence, except an offence that is punishable by a minimum term of imprisonment, and the court
imposes a sentence of imprisonment of less than two years, and
is satisfied that serving the sentence in the community would not endanger the safety of the community and would be consistent with the fundamental purpose and principles of sentencing set out in sections 718 to 718.2, the court may, for the purpose of supervising the offender's behaviour in the community, order that the offender serve the sentence in the community, subject to the offender's complying with the conditions of a conditional sentence order made under section 742.3. [Emphasis added.]
[27] In *R. v. Proulx*, [2000] 1 S.C.R. 61 at 93, Lamer C.J.C. identified three prerequisites to the availability of a conditional sentence:
the offender must be convicted of an offence that is not punishable by a minimum term of imprisonment;
the court must impose a term of imprisonment of less than two years;
the safety of the community would not be endangered by the offender serving the sentence in the community; …
[28] It is the second of these prerequisites which is germane to this appeal. That requirement flows directly from the words of s. 742.1(a). **A conditional sentence is only available where the court "imposes a sentence of imprisonment of less than two years".**
[29] Section 742.1(a) sets the standard by which those offenders who are not candidates for a conditional sentence are identified: *R. v. Proulx, supra*, at pp. 96-98. Offenders for whom imprisonment is an inappropriate punishment and offenders for whom a penitentiary term is an appropriate punishment are not eligible for conditional sentences. **Offenders who fall between these two categories, that is, offenders for whom a term of imprisonment of less than two years is an appropriate punishment are candidates for a conditional sentence. If the offender is eligible for a conditional sentence, the court must go on to determine, according to s. 742.1(b), whether a conditional sentence should be**

Digitized by Google

imposed.

[30] In *R. v. Proulx, supra*, at p. 98, the Chief Justice referred to the drawing of the distinction between offenders who were eligible for a conditional sentence and those who were not eligible as a "preliminary determination" to be made upon a consideration of the fundamental purpose and principles of sentencing to the extent necessary to "narrow the range of sentence" by placing the offender in one of the three categories described above.

[31] When the "preliminary determination" described by the Chief Justice is made in this case, the respondent falls into one of the categories of offenders for whom a conditional sentence is not available. The trial judge found, and it is not challenged on appeal, that imprisonment was not an appropriate punishment. He indicated that but for the minimum fine, he would have imposed a suspended sentence. Once the trial judge decided that a minimum fine was the appropriate sentence and that imprisonment was an inappropriate disposition, s. 742.1 was no longer a sentencing option.

[32] I cannot agree that the imposition of a term of imprisonment in default of payment of a fine is the same thing as the imposition of a term of imprisonment as a sanction for the commission of an offence. Imprisonment as punishment for the commission of an offence is appropriate only where a blending of the principles of sentencing to achieve the fundamental purpose of sentencing described in s. 718 of the *Criminal Code* compels the conclusion that imprisonment is the correct sanction. **Imprisonment imposed for failure to pay a fine is not determined by reference to those principles of sentencing or the fundamental purpose of sentencing, but rather by reference to the need to enforce payment of the monetary penalty imposed by the court. It has long been recognized that imprisonment in default of payment of a fine is not punishment for the offence, but is a means of enforcing the punishment which is the fine: *R. c. Savard* (2000), 38 C.R. (5th) 152 at paras. 19, 36 (Que. C.A.); *R. v. Lettroy* (2000), 47 O.R. (3d) 517 at 522 (Ont. S.C.J.); *R. v. Tomlinson* (1971), 2 C.C.C. (2d) 97 at 98 (B.C.S.C.); *Regimbald v. Chong Chow* (1925), 38 Que. K.B. 440 at 445 (K.B.).**

[33] **The enforcement nature of a term of imprisonment imposed for nonpayment of a fine is made clear by several provisions of the *Criminal Code*. Sections 734(4) and 734(5) provide that the period of incarceration to be served for default in payment of a fine is determined by the unpaid amount of the fine.** [4] **Section 734.7 provides that except where no time is allowed to pay a fine, the offender should be imprisoned for non-payment of the fine only where the other enforcement mechanisms set out in the *Criminal Code* (s. 734.5, s. 734.6) are inappropriate, or the offender has refused without reasonable excuse to pay the fine.** [5] Section 734.8 directs that an offender who has been imprisoned for not paying a fine may have that term of imprisonment reduced or eliminated entirely by paying part or all of the fine. Finally, s. 787(2) and s. 809 recognize that imprisonment may be imposed for non-payment of monetary orders other than fines (eg. costs). Clearly, imprisonment in these circumstances has nothing to do with sentencing the offender for an offence and everything to do with enforcing court orders.

[34] The enforcement purpose behind the imposition of a jail term for nonpayment of a fine does not change depending on whether the offender is given time to pay the fine. In either situation, the punishment deemed appropriate for the offence is the fine. Where no time is given to pay the fine, that is because it is deemed appropriate to enforce immediate payment of the fine with the threat of a jail term. Because

Digitized by Google

imprisonment is a means of enforcing the fine and not an alternative sanction for the commission of the crime, it is wrong in principle to impose a default prison term with no time to pay the fine absent proof that an offender has the ability to pay the fine immediately: *R. v. Natrall* (1972), 9 C.C.C. (2d) 390 at 397 (B.C.C.A.); *R. v. Zink* (1992), 13 B.C.A.C. 241 (C.A.).

[35] Counsel for the respondent referred to s. 732 of the *Criminal Code* in support of her submission that a sentence of imprisonment in default of payment of a fine is still "a sentence of imprisonment" and, therefore, one for which a conditional sentence may be imposed under s. 742.1. Section 732 provides for intermittent sentences and reads in part:

Where the court imposes a sentence of imprisonment of ninety days or less on an offender convicted of an offence, whether in default of a payment of a fine or otherwise, …

[36] I think the presence of the phrase "whether in default of payment of a fine or otherwise" in s. 732 and the absence of that phrase in s. 742.1(a) supports the conclusion that conditional sentences are not available when imprisonment is imposed for failure to pay a fine.

II

[37] My colleague writes that his interpretation of s. 742.1 affords judges "a desired measure of flexibility to arrive at an appropriate sentence". I agree wholeheartedly that flexibility is important when judges are trying to tailor a sentence to the offence and the offender. With respect, however, I think that my colleague's interpretation of s. 742.1 will lead to inappropriate sentences.

[38] A conditional sentence is a term of imprisonment, albeit one which is served in the community. Most offenders who are subject to a conditional sentence undergo substantial deprivation of their liberty. The relatively recent overhaul of the *Criminal Code* provisions relating to fines recognizes that as a matter of principle imprisonment for non-payment of fines should be used as a last resort, or where there is no reasonable excuse for non-payment. Parliament envisioned resort to imprisonment primarily, if not exclusively, in situations where the offender who had defaulted on payment had the means to pay. The slamming of the jail door was seen as an incentive to make the offender who had the means to pay the fine do so.

[39] I think the principle that limits resort to imprisonment as a means of enforcing fines has equal application to imprisonment served in custody or in the community. In either case, the offender should not suffer a deprivation of his or her liberty for non-payment of a fine except where other enforcement techniques are inappropriate or the offender has wilfully refused to pay the fine. As I see it, the real danger in reading s. 742.1 to permit conditional sentences for nonpayment of fines is that trial judges will resort to conditional sentences in circumstances where they would not impose a custodial term of imprisonment for non-payment of fines. This will result in unwarranted reliance on imprisonment as a means of enforcing the payment of fines.

[40] This case provides an example of the inappropriate use of imprisonment to enforce the payment of a fine. The trial judge was satisfied that the crime committed by the respondent did not call for imprisonment.

He was also satisfied that the respondent did not have the ability to pay the minimum fine. Despite these two findings, the trial judge imposed a conditional sentence, which included a "house arrest" provision, for non- payment of the fine and required that the fine be paid immediately. [6] By doing so, he effectively imposed a term of

Digitized by Google

imprisonment, albeit within the community, not as punishment for the crime, but because the respondent did not pay a fine that he was unable to pay. I think it is just as much an error in principle to impose a conditional sentence in these circumstances as it would have been to impose a custodial sentence. Both amount to deprivation of liberty, not as a fit sanction for the offence committed, but because the offender is unable to pay a fine. Economic imprisonment whether in jail or in the community is offensive to the present provisions of the *Criminal Code* relating to fines. The judge's interpretation of s. 742.1 led him to impose an inappropriate sentence in this case. I do not think he would have imposed a custodial term of imprisonment had that been the only imprisonment option open to him.

[41] The absence of any reference to imprisonment upon default of payment of the fine in s. 742.1 is consistent with Parliament's determination that imprisonment should not be used as a means of enforcing fines save in very limited circumstances. In those limited circumstances, custodial imprisonment is better suited to achieve the enforcement purpose than non-custodial imprisonment.

III

[42] The trial judge was faced with a difficult sentencing problem. As he observed, his difficulty stemmed in large measure from the absence of any approved fine option programs in Ontario. Those programs permit an offender to discharge his fine obligation by performing work in programs authorized by the Lieutenant Governor in Council and are clearly aimed at offenders of limited means for whom a fine is the appropriate disposition: *Criminal Code*, s. 736.

[43] In the absence of a fine option program, the trial judge had two options. He could have declined to make any order for imprisonment upon default of payment of the fine and left it to the Crown to enforce the fine through other enforcement mechanisms available to it. This is an appropriate disposition where there is no realistic possibility that an offender can pay the appropriate fine within a reasonable time: *R. v. Natrall, supra*, at pp. 397-98. [7]

[44] The trial judge also could have imposed a term of imprisonment upon default of payment of the fine, but allowed the respondent a reasonable time to pay that fine. Had he chosen this option, the trial judge could have provided that certain modest minimum payments were to be made within the allotted time: *Criminal Code*, s. 734.1. If the fine was not paid in the allotted time, the trial judge could have considered an application to extend the time for payment: *Criminal Code*, s. 734.3. If the respondent did not seek an extension and defaulted on the payment of the fine, the trial judge would then have had to determine whether to issue a warrant for the committal of the respondent. In making that decision, he would have looked at s. 734.7 which makes imprisonment the enforcement mechanism of last resort. If the respondent had made genuine efforts to pay as much of the fine as he reasonably could and was not able to pay the remainder of the fine, imprisonment would be an inappropriate order under s. 734.7.

[45] At the sentencing proceedings, the trial judge did not make any specific inquiry into the respondent's ability to pay the minimum fine. On appeal, the Crown counsel argued that the evidence did not support the conclusion that the respondent was unable to pay the fine. While a more detailed inquiry into the respondent's financial means would have been helpful, the evidence at trial did establish that the respondent had a very limited income and was raising a teenaged daughter.

[46] As the conditional sentence has been served, I do not think that anything would be gained at this late juncture by a more detailed inquiry into the respondent's

Digitized by Google

ability to pay the fine. Justice is best served by accepting the trial judge's conclusion that the respondent did not have the ability to pay the fine in the reasonably foreseeable future. Considered in that light, there should have been no order for imprisonment upon default of payment of the fine. I would vary the sentence by deleting the term of imprisonment imposed on default. The Crown may resort to the other enforcement mechanisms available to it to try to collect the fine.

"D.H. Doherty J.A."

RELEASED: December 12, 2001

[1] [TRANSLATION] "[w]hen the law prescribes a minimum fine … be it appropriate or excessive and beyond the means of the offender, the court must consider the period allotted for payment, the terms of payment, and if necessary, the provision for imprisonment in default of payment."

[2] [TRANSLATION] "in the event … that it seemed to the court that the accused could not pay the heavy fine, a custodial sentence imposed in default of payment could hardly be regarded as 'encouragement to pay the fine', for in reality, this imprisonment would constitute the 'penalty'".

[3] [TRANSLATION] "[It] would be compatible with the general principle governing the interpretation of statutes … that the immediate committal of the offender who is incapable of paying the fine may be covered by s. 742.1 CC; it would not be inconsistent with general sentencing principles for the person who has in effect been sentenced to a term of imprisonment to be able to benefit from this measure."

[4] As my colleague points out, these sections of the *Criminal Code* are not applicable to a fine imposed under the *Excise Act* because that *Act* provides for a maximum term of imprisonment upon default of payment of the fine: See s. 734(8). However, I think it is helpful to look at these sections as informing the enforcement purpose underlying the imposition of imprisonment upon failure to pay a fine.

[5] Presumably, if no time is allowed to pay the fine, the determination has been made that the offender has the ability to pay the fine immediately. Imprisonment for non-payment is, therefore, appropriate.

[6] In fairness to the trial judge, he ordered the fine paid immediately at the request of counsel for the respondent.

[7] Under the relevant provisions of the *Criminal Code*, the term of imprisonment, if any, to be served is fixed by a formula at the time of committal and not when the sentence is imposed. These provisions do not apply here. See *supra*, note 1.

R. v. Wu, [2003] 3 S.C.R. 530, 2003 SCC 73, Supreme Court Conditional Sentencing Issues Pronouncement when Fines Not Paid

Her Majesty The Queen *Appellant v.*
Yu Wu *Respondent*
and
Charter Committee on Poverty Issues *Intervener*
Indexed as: R. *v.* Wu
Neutral citation: 2003 SCC 73.
File No.: 29053.
2003: June 4; 2003: December 18.
Present: McLachlin C.J. and Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour,

Digitized by Google

LeBel and Deschamps JJ.
on appeal from the court of appeal for ontario

Criminal law — Sentencing — Conditional sentence —Possession of contraband cigarettes — Accused unable to pay minimum financial penalty mandated by Excise Act — Whether prison appropriate — Whether trial judge erred in imposing conditional sentence — Criminal Code, R.S.C. 1985, c. C-46, s. 742.1 — Excise Act, R.S.C. 1985, c. E-14, s. 240(1).

The accused was convicted of possession of 300 cartons of contraband cigarettes. Section 240(1.1)(*a*)(i) of the *Excise Act* carried a minimum penalty of $0.16 per cigarette, which amounted to $9,600. The trial judge concluded that the accused was not now and would not in the foreseeable future be able to pay such a heavy fine. The trial judge was also of the view that imprisonment for any length of time would not be a fit sentence in this case. He said he was "satisfied that, but for the minimum fine provisions [in the *Excise Act*], this would be a case for a suspended sentence". In the absence of a regime in Ontario "permitting offenders to work off the fines", and believing that incarceration of the accused in default of paying the fine would not be just, he concluded that a conditional sentence would be appropriate. Accordingly, the accused was fined $9,600, given no time to pay, and in default of payment was immediately given a conditional sentence of 75 days to be served in the community (i.e., at home) subject to a curfew from 6 p.m. to 6 a.m. every day except for absences required"for employment, medical, dental or worship". He was allowed two hours extra liberty on either Saturday or Sunday.

Both the summary conviction appeals judge and the majority of the Court of Appeal upheld the sentence. At issue in this appeal is whether the conditional sentence was validly imposed.

Held (Deschamps J. dissenting): The appeal should be allowed.

Per McLachlin C.J. and Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour and LeBel JJ.: The trial judge erred in law in imposing a conditional sentence. Conditional sentences are not "probation under a different name" but rather sentences of imprisonment served in the community. In this case, the statutory conditions precedent to a conditional sentence were not met in two important respects. **First, the trial judge's explicit finding that this was a proper case for a suspended sentence and probation, and that imprisonment was not warranted, puts this case outside the scope of a conditional sentence. Second, nowhere in the *Criminal Code* is it suggested that conditional sentences are available to enforce unpaid fines.**

The purpose of imposing imprisonment in default of payment is to give serious encouragement to offenders with the means to pay a fine to make payment. Genuine inability to pay a fine is not a proper basis for imprisonment. A conditional sentence is a form of imprisonment. **Unless, in the terms of s. 734.7(1), the Crown can establish that such a defaulter has "without reasonable excuse, refused to pay", a warrant of committal should not be issued.**

If an offender does not have the means to pay a fine immediately, he or she should be given a reasonable time to pay. The offender may also be eligible for provincial fine option programs in which the fine may be discharged "in whole or in part by earning credits for work performed during a period not greater than two years" (s. 736). **In the event of default, the Crown can resort to a number of civil remedies such as**

Digitized by Google

suspending licences or other instruments until the fine is paid in full or registering the fine owing with the civil courts. The option of jail for default is fenced in with important restrictions. A fine default is not punishable by committal unless the other statutory remedies, including licence suspensions and civil proceedings, are not appropriate in the circumstances (s. 734.7(1)(*b*)(i)), or the offender has, without reasonable excuse, refused to pay the fine or discharge it under s. 736 (s. 734.7(1)(*b*)(ii)). *Where the offender's reasonable excuse for failure to pay a fine is simple poverty, it is not open to a court to jail him or her under s. 734.7(1)(b)(i). Here, a functioning fine option program was not available in Ontario and there was no evidence as to what, if any, federal permits or licences were held by the accused.*

It cannot be assumed that the financial circumstances of an offender at the date of the sentencing will necessarily continue into the future**. An immediate committal order should only be made in exceptional circumstances, which did not exist here.** The facts were simply that the accused was on welfare and lacked the ability to pay. **An offender's inability to pay is precisely the reason why time is allowed, not a reason why it should be altogether denied. While it would have been appropriate to impose the minimum fine plus time to pay plus 30 days in jail in default of payment, the trial judge erred in jumping directly from imposition to committal without passing through the intermediate stages of alternative collection procedures, default, and, only if the Crown thinks it has grounds to proceed, a s. 734.7(1) committal hearing.**

The conditional sentence should therefore be set aside. However, since the accused has served his conditional sentence, which, if properly imposed, would bar all further collection procedures, further collection procedures are stayed.

Per Deschamps J. (dissenting): The trial judge did not err in imposing a conditional sentence in default of the payment of a fine. It is impossible to reconcile, in the case of an impecunious person, all of the sentencing principles contained in the *Criminal Code* with a provision prescribing a minimum fine. In principle, a sentence must take into account all aggravating and mitigating circumstances relating to the offender's situation. The judge must consider that an offender should not be deprived of liberty if less restrictive sanctions may be appropriate in the circumstances. A minimum fine does not allow the particular circumstances of the offender to be taken into account. Given that in Ontario there is no organized scheme for community service, the judge who seeks an alternative solution, or even a means of encouraging payment of the fine, has little room to manoeuvre. The *Criminal Code* confers discretion on the judge to impose imprisonment in default of payment of a fine when he or she knows that imprisonment is, in practice, the sanction actually imposed for the offence committed. The judge is not obliged to allow time for payment. In this case, the trial judge did not really ever contemplate imposing the minimum fine along with a time for payment and a period of imprisonment in the event of default. He wanted to impose a realistic and suitable punishment and did not believe that incarceration was necessary. His decision to impose a conditional sentence in default of payment was enlightened and sensitive to the particular circumstances of the case. It also respected the principles of gradation of sentences and properly balanced the relevant penological goals.

Knowing that the offender did not have any money, the judge could order imprisonment in default of payment of the fine. While such an order, at first glance, seems to punish the poor more severely and appears contrary to Parliament's intent,

Digitized by Google

the adjustment required in the sphere of sentencing to take into account the poverty of an offender cannot be reduced to a concern for ensuring that absence of means does not become a reason for imprisonment. All of the effects of a sentence and the different impact that certain sentences may have on different individuals must be taken into account. In this case, a conditional sentence could not be ruled out on any policy grounds.

Cases Cited
By Binnie J.

Considered: *R. v. Proulx*, [2000] 1 S.C.R. 61, 2000 SCC 5; **referred to:** *R. v. M. (C.A.)*, [1996] 1 S.C.R. 500; *R. v. R.A.R.*, [2000] 1 S.C.R. 163, 2000 SCC 8; *R. v. Snider* (1977), 37 C.C.C. (2d) 189; *Regimbald v. Chong Chow* (1925), 38 Que. K.B. 440; *R. v. Andrews*, [1974] 2 W.W.R. 481; *R. v. Brooks*, [1988] N.S.J. No. 94 (QL); *R. v. Beaton* (1984), 49 Nfld. & P.E.I.R. 15; *R. v. Tessier* (1957), 21 W.W.R. 331; *Attorney General of Canada v. Radigan* (1976), 33 C.R.N.S. 358; *R. v. Natrall* (1972), 9 C.C.C. (2d) 390; *R. v. Zink* (1992), 13 B.C.A.C. 241; *R. v. Gladue*, [1999] 1 S.C.R. 688; *R. v. Hebb*(1989), 69 C.R. (3d) 1; *R. v. Zachary*, [1996] R.J.Q. 2484; *R. v. MacFarlane* (1997), 121 C.C.C. (3d) 211; *Clergue v. H. H. Vivian and Co.* (1909), 41 S.C.R. 607; *Re International Woodworkers of America, Local 2-306 and Miramichi Forest Products Ltd.* (1971), 21 D.L.R. (3d) 239.
By Deschamps J. (dissenting)
R. v. Proulx, [2000] 1 S.C.R. 61, 2000 SCC 5; *R. v. Gladue*, [1999] 1 S.C.R. 688.
Statutes and Regulations Cited
Criminal Code, R.S.C. 1985, c. C-46 [am. 1995, c. 22], ss. 718, 718.2(*a*), (*d*), (*e*), 718.3, 734, 734(2) [repl. 1999, c. 5, s. 33], 734.5 [*idem*, s. 34], 734.6, 734.7, 736 [am. 1997, c. 18, s. 107], 738, 742, 742.1 [am. 1997, c. 18, s. 107.1].
Excise Act, R.S.C. 1985, c. E-14, s. 240(1) [repl. 1994, c. 29, s. 15], (1.1)(*a*)(i) [ad. *idem*; am. 1999, c. 17, s. 144(1)(z.20)].
O. Reg. 925/93.
Provincial Offences Act, R.S.O. 1990, c. P.33.
Provincial Offences Act, S.N.L. 1995, c. P-31.1, s. 38.
R.R.O. 1990, Reg. 948 (Fine Option Program).
Authors Cited
Ashworth, Andrew. *Sentencing and Criminal Justice*, 3rd ed. Markham: Butterworths, 2000.
Canada. Canadian Centre for Justice Statistics. *Adult Correctional Services in Canada 2000-2001*. Ottawa: Canadian Centre for Justice Statistics, 2002.
Canada. Canadian Sentencing Commission. *Sentencing Reform: A Canadian Approach Report of The Canadian Sentencing Commission*. Ottawa: The Commission, 1987.
Canada. *House of Commons Debates*, vol. 133, 1st Sess., 35th Parl., September 20, 1994, p. 5873. Canada. National Council of Welfare. *Justice and the Poor.* Ottawa: The Council, 2000.
Elliott, Robin, and Jennifer Airs. *New Measures for Fine Defaulters, Persistent Petty Offenders and Others: The Reports of the Crime (Sentences) Act 1997 Pilots*. London: Home Office, 2000.
Hudson, Barbara. “Punishing the Poor: Dilemmas of Justice and Difference”, in William C. Heffernan and John Kleinig, eds., *From Social Justice to Criminal Justice: Poverty and the Administration of Criminal Law*. New York: Oxford University Press,

Digitized by Google

2000, 189.
Innes, Joanna. "The King's Bench prison in the later eighteenth century: law, authority and order in a London debtors' prison", in John Brewer and John Styles, eds., *An Ungovernable People: The English and their law in the seventeenth and eighteenth centuries*. New Brunswick, N.J.: Rutgers University Press, 1980, 250.
Manson, Allan. *The Law of Sentencing*. Toronto: Irwin Law, 2001. Ontario. Ministry of Transportation. *Driver Control Statistics*, 2003.
Pettit, Philip. "Indigence and Sentencing in Republican Theory", in William C. Heffernan and John Kleinig, eds., *From Social Justice to Criminal Justice: Poverty and the Administration of Criminal Law*. New York: Oxford University Press, 2000, 230.
Sullivan, Ruth. *Sullivan and Driedger on the Construction of Statutes*, 4th ed. Markham: Butterworths, 2002. APPEAL from a judgment of the Ontario Court of Appeal (2001), 160 C.C.C. (3d) 321, 48 C.R. (5th) 183, 152 O.A.C. 300, [2001] O.J. No. 4885 (QL), affirming a judgment of the Superior Court of Justice affirming a judgment of the Ontario Court of Justice. Appeal allowed, Deschamps J. dissenting.

Peter DeFreitas and *Marie Comiskey*, for the appellant.
Lawrence Greenspon, *Blair Crew* and *Trevor Brown*, for the respondent.
Vincent Calderhead and *Roger Burrill*, for the intervener.

The judgment of McLachlin C.J. and Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour and LeBel JJ. was delivered by

BINNIE J. — In this appeal we are asked to consider whether a conditional sentence was validly imposed on the respondent offender for possession of contraband cigarettes. The offender might otherwise have been sent to jail for 30 days for non-payment of a mandatory $9,600 fine. In the trial judge's view, jail was not appropriate for this offender. On the other hand, the offender simply had no means to pay the fine. The trial judge thought a conditional sentence to be served by the offender in his home offered a way to avoid jail. I agree with the trial judge's initial conclusion that this was not an appropriate case for jail. I disagree with his sentencing solution. **The *Criminal Code*, R.S.C. 1985, c. C-46, properly interpreted, offered the sentencing judge a range of alternative solutions for this offender but a conditional sentence was not amongst them.**
Debtors' prison for impoverished people is a Dickensian concept that in civilized countries has largely been abolished. Imprisonment for civil debt was abolished in Ontario by the end of the 19th century. In its 1996 sentencing reforms, Parliament decreed that jail should be reserved for those whose conduct deserves to put them there. Here, the trial judge thought a fit sentence would be a suspended sentence with probation, but this was not possible under the Act. **Yet debtors' prison "in the community", which is what a conditional sentence amounts to, is repugnant in the case of an individual who is undeserving of jail yet who simply cannot pay.**
As will be seen, the purpose of imposing imprisonment in default of payment is to give serious encouragement to offenders with the means to pay a fine to make payment. Genuine inability to pay a fine is not a proper basis for imprisonment. **A conditional sentence is a form of imprisonment. Therefore, a conditional sentence is not an appropriate sentence to impose on an offender simply because he or she has no means to pay a fine. Nothing in the *Code* authorises a**

Digitized by Google

conditional sentence to be used for collection purposes. Unless, in the terms of s. 734.7(1), the Crown can establish that a defaulter has "without reasonable excuse, refused to pay", a warrant of committal should not be issued.

The conditions precedent to the imposition of a conditional sentence were accordingly not met. The sentencing judge commented that "hard cases make bad law and this is a hard case". In my view, with respect, it also made bad law. I would allow the appeal.

Facts

The respondent, Yu Wu, was convicted of possession of 300 cartons of contraband cigarettes. The *Excise Act*, R.S.C. 1985, c. E-14, s. 240(1.1)(*a*)(i), carried a minimum penalty of $0.16 per cigarette, which amounted to $9,600. The circumstances, as related by the accused, were curious. He explained that he had injured his back in 1994, had been unemployed since then, and was supporting himself and his 16-year-old daughter in Toronto on welfare payments of $965 per month. He went to gambling casinos three to five times a week. At the Niagara Falls Casino in late May or early June 1998, he had struck up an acquaintance with a man he identified only as "Mike". In July 1998, he agreed to help "Mike" drive to Montreal to gamble. They took Mike's car. Along the way, Mike pulled into a house in Cornwall. In this stranger's house, Mr. Wu waited for almost 8 hours. Finally, the owner of the house told Mr. Wu that Mike had left and that he should drive Mike's car back to Toronto. On the way home to Toronto in Mike's car, the respondent was stopped by police. He testified that it was only when the police pulled him over that he realized that the back seat of the car contained 300 cartons of contraband tobacco.

Mr. Wu conceded that he did not know "Mike's" last name, phone number, or address. The only way that he could contact Mike would be if he happened to run into Mike at an Ontario casino. Otherwise, Mr. Wu would have to wait for Mike to call Mr. Wu's pager or come to Mr. Wu's home. Apparently, they did not meet and "Mike" never did call.

The accused was prosecuted under s. 240(1) of the *Excise Act* for possession of contraband tobacco.

Court Proceedings

Ontario Court of Justice — Renaud J.

After considering the facts, the trial judge stated that imprisonment for any length of time would not be appropriate in this case. He was "satisfied that, but for the minimum fine provisions [in the *Excise Act*], this would be a case for a suspended sentence". The accused "is an individual with very little to be said of him, positive or negative. [He] is someone who has not demonstrated a tendency to engage in any [anti]-social behaviour and [he] is someone who should respond positively to a period of probation." However, in view of the minimum fine provisions of the *Excise Act*, the trial judge concluded that probation or a conditional discharge were not available sentencing options.

Referring to the decision of this Court in *R. v. Proulx*, [2000] 1 S.C.R. 61, 2000 SCC 5, the trial judge commented that it was clear that "jail should be reserved for those individuals who are a danger to the community. This individual is not a danger to the community".

That said, the mandatory fine scheme "evidences Parliament['s] wish that smuggling be deterred". The Cornwall area "is plagued by smuggling" and the Court of Appeal had warned trial judges "to steel themselves to be harsh in imposing

Digitized by Google

sentences on very sympathetic individuals" because the smuggling rings deliberately recruited runners who would be seen by the courts as sympathetic people.
The sentencing judge concluded that the respondent was not now and would not in the foreseeable future be able to pay such a heavy fine. In the absence of a regime in Ontario "permitting offenders to work off the fines", and believing that incarceration of the accused in default of paying the fine would not be just, he concluded that a conditional sentence would be appropriate.
Accordingly, the accused was fined $9,600, given no time to pay, and in default of payment was immediately given a conditional sentence of 75 days to be served in the community (i.e., at home) subject to a curfew from 6 p.m. to 6 a.m. every day except for absences required "for employment, medical, dental or worship". He was allowed two hours extra liberty on either Saturday or Sunday.
Superior Court of Justice — Robertson J.
The summary conviction appeals judge concluded that the trial judge had not erred in imposing a sentence "particular to the specific facts of this case". The Crown's appeal was dismissed.
Ontario Court of Appeal (2001), 160 C.C.C. (3d) 321
Sharpe J.A. for the majority
The trial judge had given the accused no time to pay, which indicated that he "ha[d] determined, then and there, that the appropriate sanction for the offender's conduct is either immediate payment or immediate imprisonment"(para. 18). As the "legal and practical effect of the sentence is to send the offender directly to jail" (para. 18), Sharpe J.A. concluded that the conditions precedent to a conditional sentence were satisfied. While the trial judge was required to impose a fine, he was not required to impose a term of imprisonment in default of payment. However, "[t]he imposition of a fine of $9,600 that could not and would not be paid would amount to a hollow sentence that would fail to adequately sanction the respondent's wrongful conduct"(para. 19). Accordingly, in the majority view, the imposition of a conditional sentence in default of immediate payment of the fine allowed the trial judge to arrive at a sentence that "respected the letter of the law, was closely tailored to the circumstances of the offender, and gave appropriate emphasis to the goals of deterrence and retribution" (para. 19).
Doherty J.A., dissenting
Doherty J.A. took the view that once the trial judge had decided that imprisonment would not be an appropriate sentence, the statutory conditions precedent for a conditional sentence were not met. Further, the conditional sentence was imposed here not by reason of the offence, but to enforce the non-payment of the fine (at para. 40):
I think it is just as much an error in principle to impose a conditional sentence in these circumstances as it would have been to impose a custodial sentence. Both amount to deprivation of liberty, not as a fit sanction for the offence committed, but because the offender is unable to pay a fine. Economic imprisonment whether in jail or in the community is offensive to the present provisions of the *Criminal Code* relating to fines.
He would therefore have allowed the Crown's appeal.

Analysis
The principles of sentencing include Parliament's direction that "an offender should not be deprived of liberty, if less restrictive sanctions may be appropriate in the circumstances", and "all available sanctions other than imprisonment that are

Digitized by Google

reasonable in the circumstances should be considered for all offenders" (s. 718.2(*d*) and (*e*) of the *Code*(emphasis added)).

Applying these principles, the trial judge concluded very firmly that the respondent should not go to jail for what was seen as a relatively minor role in this cigarette smuggling operation. The respondent did not bring the goods across the border. He had no previous record for such an offence. He was no danger to the community. He was the sole support for his teenage daughter. Yet, in default of payment of a mandatory minimum $9,600 fine, which the judge believed the respondent had no ability to pay, he felt obliged to consider a significant period of incarceration. Indeed, the Crown Attorney at trial calculated that under s. 734(5) the statutory formula would "deem" the period of imprisonment in default of payment of a $9,600 fine to be 174 days. (The Crown conceded the formula was inapplicable to a fine imposed under the *Excise Act*.) The judge found he retained a discretion to order a shorter sentence and would have sentenced the respondent to 30 days in jail in default of payment were a conditional sentence not an available option.

That said, the trial judge concluded that a conditional sentence *was*available. The following exchange occurred at the sentencing hearing:

[DEFENCE]: So it would make sense to me, if I can just get this off my chest, it would make sense to me that if you can give a conditional sentence . . .

THE COURT: For a manslaughter

[DEFENCE]: . . . for a manslaughter or for anything else when jail is an appropriate sentence, surely on a fine situation, for a tax [evasion], surely, it would be logical to say that you can give a conditional sentence in that circumstance.

. . .

THE COURT: . . . Why would a non-violent offender actually be detained in a custodial facility while a violent offender does not, if [he or she] doesn't threaten the safety of the community. . .

Ordinarily, of course, the appellate courts will defer to the sentence considered appropriate by the trial judge, who "possesses the unique qualifications of experience and judgment from having served on the front lines of our criminal justice system": *R. v. M. (C.A.)*, [1996] 1 S.C.R. 500, at para. 91; see also *R. v. R.A.R.*, [2000] 1 S.C.R. 163, 2000 SCC 8, at para. 19. Moreover, "the sentencing judge will generally have a better knowledge of the community in which the offences occurred and is therefore in a better position to craft an appropriate sentence" (*R.A.R.*, *supra*, at para. 19). In this case, however, the Crown argues that the trial judge made an error of law in concluding that a conditional sentence was an available option. I agree.

The Crown has a very practical interest in the subject matter of this appeal. Imprisonment **terminate s the Crown's power to pursue civil enforcement remedies to collect the money (s. 734.7(4) of the *Code*). Some individuals with savings in the bank might prefer spending 75 days under house arrest rather than paying $9,600.** In this case, however, the evidence is that the respondent's poverty left him with no choice in the matter.

The Mandatory Minimum Fine

Parliament is quite specific about the range of penalties in s. 240 of the *Excise Act*:

240. (1) Subject to subsections (2) and (3), every person who sells or offers for sale or has in t he person 's possession any manufactured tobacco or cigars, whether manufactured in or imported into Canada, not put up in packages and stamped with tobacco stamps or cigar stamps in accordance with this Act and the ministerial

Digitized by Google

regulations

. . .

is guilty of an offence punishable on summary conviction and liable to

a fine of not less than the amount determined under subsection (1.1) and not more than the lesser of $500,000 and the amount determined under subsection (1.2), or

both the fine described in subparagraph (i) and imprisonment for a term not exceeding two years. [Emphasis added.]

The trial judge could, in a proper case, have concluded that a fit sentence would include both the mandatory minimum fine *and* a period of imprisonment. He emphatically decided that imprisonment was not a fit punishment. Indeed, as stated, his preference would have been to impose no more than a suspended sentence with probation. Yet in *Proulx* itself, Lamer C.J. stated, at para. 55:

At one end of the range, Parliament denied the possibility of a conditional sentence for offenders who should receive a penitentiary term. At the other end, Parliament intended to ensure that offenders who were entitled to a more lenient community measure — such as a suspended sentence with probation — did not receive a conditional sentence, a harsher sanction in this legislative scheme. [Emphasis added.]

A mandatory minimum fine of $9,600 imposed irrespective of the offender's means to pay is a legislated exception to the usual sentencing principles. **Even before the 1996 sentencing reforms, the correct rule was that a fine should be assessed having regard to "the offender's ability to pay" (*R. v. Snider* (1977), 37 C.C.C. (2d) 189 (Ont. C.A.), at p. 190). It was quite open to** Parliament to impose a minimum fine, but Parliament's amendments did not require that inability to pay should necessarily land the offender in jail. Indeed, the 1996 amendments show that Parliament did not intend to send the impoverished to jail by reason only of their inability to pay.

Availability of Conditional Sentences

Conditional sentences were introduced with the 1996 sentencing reforms of the *Code*. The Minister of Justice explained the purpose of his bill as follows:

A general principle that runs throughout Bill C-41 is that jails should be reserved for those who should be there. Alternatives should be put in place for those who commit offences but who do not need or merit incarceration.

(*House of Commons Debates*, vol. 133, 1st Sess., 35th Parl., September 20,1994, p. 5873) The conditional sentencing regime is dealt with in s. 742.1 of the *Code* which provides as follows:

742.1 Where a person is convicted of an offence, except an offence that is punishable by a minimum term of imprisonment, and the court imposes a sentence of imprisonment of less than two years, and

is satisfied that serving the sentence in the community would not endanger the safety of the community and would be consistent with the fundamental purpose and principles of sentencing set out in sections 718 to 718.2,

the court may, for the purpose of supervising the offender's behaviour in the community, order that the offender serve the sentence in the community, subject to the offender's complying with the conditions of a conditional sentence order made under section 742.3.

In *Proulx*, *supra*, it was held that the requirement that the court impose "a sentence of imprisonment of less than two years" was intended to identify the type of offenders who could be entitled to a conditional sentence (para. 55). Specifically,

Digitized by Google

Parliament did not intend conditional sentences to be "probation under a different name" (para. 28). A conditional sentence is a sentence of imprisonment, albeit the sentence is served in the community. It is imprisonment without incarceration. **Only when the sentencing judge has rejected other sentencing options, such as a conditional discharge, a suspended sentence, probation or a fine, and has concluded that a term of imprisonment of less than two years is required by the gravity of the offence and the degree of responsibility of the offender, does a conditional sentence arise for consideration. At that point, the question is where the term of imprisonment is to be served, in a penal institution or, under punitive conditions, in the community. "It is this punitive aspect that distinguishes the conditional sentence from probation"** (*Proulx*, *supra*, at para. 22).

The trial judge's explicit finding that this was a proper case for a suspended sentence and probation, and that imprisonment was not warranted, puts this case outside the scope of a conditional sentence. As stated in *Proulx*, at para. 37: "Sentencing judges should always be mindful of the fact that conditional sentences are only to be imposed on offenders who would otherwise have been sent to jail" for the offence that gave rise to the conviction.

The statutory conditions precedent to a conditional sentence were not met in two important respects:

The trial judge, with the best of intentions, stood the *Proulx* reasoning on its head. **He was searching for a mechanism to deal with an offence that in his view did not warrant imprisonment at all. He thought justice would be served by keeping the respondent, if at all possible, *out* of jail entirely. But the conditional sentencing regime is predicated on a finding in a particular case that jail for less than two years would be a fit sentence. The effect of the trial judge's approach would be to widen the net of the conditional sentencing regime to imprison in their homes offenders under punitive conditions purely on the basis of their inability to pay a fine. Net widening is repugnant to the conditional sentence regime**: *Proulx*, *supra*, at para. 56. What is more, if the punitive conditions are breached, the offender would face the prospect of serving the balance of the sentence in an institution without possibility of parole (*Proulx*, at paras. 42-44), thereby adding further to the high rates of incarceration that the 1996 sentencing reforms were designed to alleviate.

Conditional sentences are presented in s. 742.1 of the *Code* as a sentencing option, if the conditions precedent are met, for the *original* offence, as Doherty J.A. emphasized in the present case. The distinction between sentencing provisions and enforcement of sentences is of long standing: *Regimbald v. Chong Chow* (1925), 38 Que. K.B. 440, at p. 445. Section 240 of the *Excise Act* permits the sentencing judge to send an offender to jail on summary conviction for up to two years. The trial judge rejected jail as a fit punishment for this offence. **Jail only entered his calculation as a default provision for non-payment. As such, jail was triggered by the default, not the offence. No default, no jail. The decision of the judge to collapse the sentencing hearing into a default of payment hearing was done for administrative convenience, apparently, but it did not eliminate the fact that legally there was a shifting of gears from sentence to default to consideration of the appropriate sentence for default to committal. The conditional sentence is a creature of statute and nowhere in s. 742.1 or elsewhere in the *Code* is it suggested that conditional sentences are available to enforce unpaid fines.**

Digitized by Google

The Trial Judge's Dilemma

The trial judge's dilemma was that he was required by the *Excise Act* to impose a *minimum* fine of
$9,600, rising to a *maximum* of $14,400 based on a mechanical formula applied to the quantity of contraband cigarettes found in the offender's possession. The trial judge did not dispute the logic of the minimum mandatory fine because in his view contraband is a serious problem in the community. His concern was the perceived inevitability of incarceration that would arise from enforcement action consequent on the respondent's inability to pay.

The error in the trial judge's approach, with respect, was his conclusion that, in the case of this respondent, the only alternative to a conditional sentence was actual jail time.

As a matter of law, there was nothing inevitable about incarceration in the event the respondent was simply unable to pay the $9,600 fine by reason of his poverty.

No Time Given for Payment

As stated, the trial judge gave the respondent no time to pay. This was in accordance with a request from the defence, which sought to lay the basis for a conditional sentence. But it was an error**. If it is clear that the offender does not have the means to pay immediately, he or she should be given time to pay:** see *R. v. Andrews*, [1974] 2 W.W.R. 481 (B.C.S.C.), and *R. v. Brooks*, [1988]
N.S.J. No. 94 (QL) (C.A.). The time should be what is reasonable in all the circumstances: *R. v. Beaton* (1984), 49 Nfld.& P.E.I.R. 15 (P.E.I.C.A.), and *R. v. Tessier* (1957), 21 W.W.R. 331 (Man. Co. Ct.). In *Attorney General of Canada v. Radigan*(1976), 33 C.R.N.S. 358, the Quebec Court of Appeal allowed the offender to pay a fine of $5,000 through semi-annual instalments of $625. The courts have considerable flexibility to respond to the particular facts of an offender's situation. **It is wrong to assume, as was done in this case, that the circumstances of the offender at the date of the sentencing will necessarily continue into the future.**

Here, the trial judge issued a committal order forthwith. The *Code* provides that "[w]here no time has been allowed for payment of a fine and a warrant committing the offender to prison for default of payment of the fine is issued, the court shall state in the warrant the reason for immediate committal" (s. 734.7(2)). This language suggests that only in exceptional circumstances that call for judicial explanation should an immediate committal order be made. Here there were no exceptional circumstances. The reason given was simply that the respondent was on welfare and lacked the ability to pay.

An offender's inability to pay is precisely the reason why time is allowed, not a reason why it should be altogether denied: *R. v. Natrall*(1972), 9 C.C.C. (2d) 390 (B.C.C.A.), at p. 397; *R. v. Zink* (1992), 13 B.C.A.C. 241. **It is true that the fine could not have been paid immediately, and perhaps never in full, but the mandatory minimum fine scheme imposed by Parliament was effectively nullified by immediately shifting the penalty from the respondent's financial interest to his liberty interest. Parliament clearly intended that an economic punishment be imposed for an economic offence.** The Crown in its factum says that tobacco smuggling results in an estimated $1 billion loss in tax revenue per year. As noted, committal of an offender for default of payment terminated the operation of all other enforcement mechanisms to collect the fine (s. 734.7(4)). It is often difficult to predict with certainty whether an offender will in future acquire the means

Digitized by Google

to pay the fine, whether through his or her own labour, or perhaps a windfall.

Imprisonment for Debt

The trial judge of course put his finger on a serious problem. Debtors'prison, a dreadful institution excoriated by Charles Dickens in *Little Dorrit*, is no longer with us. **But according to the most recent report from Statistics Canada, 17 percent of all people in custody in provincial or territorial institutions in 2000-2001 were jailed for default on unpaid fines, i.e., at least one of the causes for their committal arose from a fine default: see Canadian Centre for Justice Statistics, *Adult Correctional Services in Canada, 2000-2001* (2002), at Table 7. The numbers are fairly steady, if in slight decline, from 20 percent in 1998-1999 to 19 percent in 1999-2000.**

A similar picture was presented by the National Council of Welfare in its report *Justice and the Poor* (2000), at p. 76. The Council says that in 1989-1990, fine default "played a major role" in the imprisonment of women, especially of Aboriginal women in the Prairie provinces. At the time, 47 percent of female prisoners in Saskatchewan were admitted for fine default. On a provincial basis, the Council noted of the Quebec system, at pp. 76-77, for example:

A 1994 Quebec survey found that 35 percent of the imprisoned defaulters had been fined for offences under the Criminal Code or other federal criminal laws (average fine of

$262 or, in case of default, average of 26 days in prison), 10 percent for both federal and provincial offences (average $1,366 or 50 days), and 55 percent for violations of provincial laws (average $342 or 13 days) or municipal bylaws (average $116 or 8 days). The vast majority (65 percent) of the fines had been issued for driving/traffic offences, mostly under provincial laws (45 percent). The rest of the fines were for thefts and other property offences under the Criminal Code (5 percent), violations of drug laws and other federal statutes (3 percent), assaults and other offences against the person (2 percent), illegal hunting, poaching and other violations of provincial laws (2 percent), failure to appear in court and other Criminal Code violations (15 percent) as well as unspecified municipal offences (8 percent).

It is curious that, while a force behind the 1996 sentencing reforms to the *Code* was a reaction to the overuse of prison as a sanction (*R. v. Gladue*, [1999] 1 S.C.R. 688, at para. 57), prison as an enforcement mechanism for unpaid fines remains at such a high level. In its 1987 report, the Canadian Sentencing Commission had observed that "[t]he imposition of a 'semi-automatic' prison term for fine default has been the subject of relentless criticism in the sentencing literature. There is statistical evidence to support the conclusion that the imprisonment of fine defaulters without reference to their ability to pay discriminates against impoverished offenders": *Sentencing Reform: A Canadian Approach — Report of the Canadian Sentencing Commission* (1987), at p. 380. The Commission recommended that "a quasi-automatic prison term not be imposed for fine default and that offenders only be incarcerated for *wilful* breach of a community sanction" (p. 381), meaning probation or fines (p. 347). In its 1996 sentencing reforms, Parliament took these views into account.

I do not overlook the corollary problem that poverty should not become a shield against any punishment at all. Otherwise, smugglers will simply be encouraged to redouble their efforts to recruit impoverished people as runners. Nor is it suggested that jail is never a fit sentence for people in the respondent's position. In this case, however, we are confronted with a specific finding

Digitized by Google

by the sentencing judge, not unreasonable in the circumstances, that jail was not a fit sentence for *this* offender.

It is one thing if the judge forms the view that jail is a fit sentence, albeit one from which the offender can extricate him- or herself by payment of a fine. It is another thing altogether where the judge, as here, concludes that jail time is not appropriate.

Encouragement to Pay

The appellant Crown states in its factum on the present appeal, "[t]he purpose of a term of imprisonment in default is to encourage fine payment; it is not punishment for an offence." "Encouragement" presupposes the offender has the wherewithal to somehow organize payment. If, as the collection lawyers say, you cannot get blood from a stone, no amount of "encouragement" is going to cause the stone to bleed.

The Crown's submission finds an echo in late 18th century England. A leading scholarly study of the King's Bench debtors' prison points out that what creditors wanted was, above all, the power to *threaten* imprisonment. A debtor who was brought to court, even if he could put up bail, received a forceful reminder of his perilous situation. Court appearance might well induce a debtor with resources to re-order his priorities and settle outstanding claims. Even a debtor without resources might find himself able, under the shadow of the law, to dredge up sufficient funds from friends and relatives. [Emphasis in original.]

(J. Innes, "The King's Bench prison in the later eighteenth century: law, authority and order in a London debtors' prison", in J. Brewer and J. Styles, eds., *An Ungovernable People: The English and their law in the seventeenth and eighteenth centuries* (1980), 250, at p. 254)

Debtors' prison was used to enforce civil debts. In this case, we are dealing with debts owed to the Crown. One of the ideas underlying the 1996 sentencing reforms is that it was no more appropriate to use jail as a general collection agency for debts owed to the Crown than it is for debts owed to ordinary citizens.

It is true, of course, that some of those serving jail time in default of payment even today are doing so for reasons of personal preference, a matter of choice, as documented in a recent study for the British Home Office: R. Elliott and J. Airs, *New Measures for Fine Defaulters, Persistent Petty Offenders and Others: The Reports of the Crime (Sentence) Act 1997 Pilots* (2000), at pp. 32-35, 44 and 68- 69.

However, the illusory nature of the "choice" between fine or imprisonment in many situations was noted by Kelly J. in *R. v. Hebb*(1989), 69 C.R. (3d) 1 (N.S.S.C. (T.D.)), at p. 13:

It is irrefutable that it is irrational to imprison an offender who does not have the capacity to pay on the basis that imprisonment will force him or her to pay. If the sentencing court chooses a fine as the appropriate sentence, it is obviously discarding imprisonment as being unnecessary under the particular circumstances. However, default provisions may be appropriate in circumstances where the offender may *choose* not to pay, presumably on principle, and would elect to spend time incarcerated rather than make a payment to the state. For the impecunious offenders, however, imprisonment in default of payment of a fine is not an alternative punishment — he or she does not have any real choice in the matter. At least this is the situation until fine option programs or related programs are in place. In effect, imprisonment of the poor in default of payment of a fine becomes a punishment that would not otherwise be imposed except for the economic limitations of the convicted person. [Underlining added.]

It was to address some of these weaknesses in the sentencing options that the

Digitized by Google

Minister of Justice subsequently introduced Bill C-41, proclaimed in force on September 3, 1996.

No Constitutional Question Raised

Both the respondent and the intervener Charter Committee on Poverty Issues expressed the view that a *Charter* challenge *ought* to have been taken against the mandatory fine provision of the *Excise Act*. In particular, the Charter Committee on Poverty Issues contended that the law operates unequally as between the rich and the poor. A similar *Charter*challenge was made and rejected in *R. v. Zachary*, [1996] R.J.Q. 2484 (C.A.), and *R. v. MacFarlane* (1997), 121 C.C.C. (3d) 211 (P.E.I.C.A.).

In the absence of a successful *Charter* challenge, we take the law as Parliament has passed it. This was accepted by the trial judge who rightly felt he had no option but to impose a $9,600 fine.

The 1996 Sentencing Reforms

The 1996 amendments made a number of important clarifications in this area of the law.

Firstly, Parliament rejected in general the notion that a fine should be set without regard to an offender's ability to pay. A means inquiry is now a condition precedent to the imposition of a fine except where otherwise provided by law. Section 734(2) of the *Code* now provides:

734. . . .

(2) Except when the punishment for an offence includes a minimum fine or a fine is imposed in lieu of a forfeiture order, a court may fine an offender under this section only if the court is satisfied that the offender is able to pay the fine or discharge it under section 736.

In this case, of course, Parliament did impose a minimum fine which, in his present circumstances, the respondent was unable to pay.

Secondly, in s. 734(2), Parliament cross-referenced s. 736 which introduced into the *Code* recognition of provincial "fine option programs" in which, assuming such a plan exists and the offender is eligible for it, the fine may be discharged "in whole or in part by earning credits for work performed during a period not greater than two years".

Thirdly, Parliament provided that a defaulting offender should not be sent to jail unless he or she has "without reasonable excuse, refused to pay the fine or discharge it under s. 736" (see s. 734.7(1) of the *Code*).

The Court of Appeal expressed concern that a fine that is not backed up with the threat of jail might be seen as a "hollow" sentence. The 1996 amendments make it clear, however, that while impoverished offenders are not to be jailed simply because of an inability to pay, they are nevertheless subject to available collection methods short of jail, including an obligation to work off their debts where a fine option program is in place. **Moreover, the sentencing judge can certainly impose a fine plus a period of jail in default of payment to encourage payment. The problem here was that the sentencing judge moved directly from imposition to committal without passing through the intermediate stages of default and a s. 734.7(1) committal hearing.**

If no "fine option program" is in place and the offender defaults, the Crown has a number of civil remedies, including refusal to "issue or renew or may suspend [any] licence, permit or other instrument until the fine is paid in full" (s. 734.5 of the *Code*), or the criminal court order may be filed as a judgment in a court of civil

Digitized by Google

jurisdiction, with all the usual civil law collection remedies (s. 734.6). A third option is committal to jail for default, but, as will be seen, this option is fenced in with important restrictions.

The Lack of a Functioning Fine Option Program in Ontario

The trial judge in this case made it clear that if a fine option program had been available in Ontario, he would have enrolled the respondent to work off the debt over a period of time through community service. "[I]f there was a regime in this province permitting offenders to work off the fines", he said, "this entire discussion would be obviated".

All provinces and territories have a fine option program in place except for British Columbia, Newfoundland and Labrador, Nunavut and Ontario. Of these four jurisdictions, Newfoundland and Labrador has enabling legislation in place to allow the program, but has not promulgated a regulation to create the program: see *Provincial Offences Act*, S.N.L. 1995, c. P-31.1, s. 38. Nunavut is in the process of drafting legislation to create a program. British Columbia does not at present have a statute that allows for the creation of such a program.

Ontario has a regulation in place that establishes such a program in designated areas, but, as part of budget cuts, it has dismantled the administrative apparatus required to support it. Specifically, the Fine Option Program, R.R.O. 1990, Reg. 948, made pursuant to the *Provincial Offences Act*, R.S.O. 1990, c. P.33, contemplated a fine option program in Ontario, but while the regulation has never been repealed, the administrative apparatus essential to administer the program was eliminated in 1994: see O. Reg. 925/93.

Licence Suspension and Revocation

Enforcement options available to the Crown include the suspension or revocation of licences and permits held by the respondent. In the present case, the fine was imposed under the federal *Excise Act*. There is no evidence of what federal permits or licences, if any, were held by the respondent. It is possible that he possessed a Canadian passport.

In most cases, revocation or suspension of permits is a potent collection tool, especially where the fine is owed to the provincial Crown. Anyone who has tried to renew a driving licence despite an unpaid fine is familiar with the procedure. While suspension or revocation do not themselves produce payment of the fine, they put pressure on the offender to find the money. This remedy is frequently resorted to. It appears that in 2002 there were 95,909 driving permits in Ontario suspended as a result of default in the payment of fines: Ontario, Ministry of Transportation, *Driver Control Statistics* (2003). Apart from driving licences, suspension or revocation would be available provincially in respect of registration of vehicles, taxicab licences, hunting permits, work permits, timber cutting permits, mineral exploration licences, building permits and the full range of activities touched by the apparatus of the regulatory state.

It may be that suspension of federal permits and licences would not have produced any significant payment in the respondent's case, but nevertheless, where applicable, it would be a punishment less restrictive of his liberty than house arrest.

Civil Enforcement

Governments use collection agencies. If there is money to be found, these people are nothing if not persistent.

Under s. 734.6, the Crown can register the unpaid sentence as a civil judgment. Providing the civil judgment is renewed at appropriate intervals, it carries on

Digitized by Google

indefinitely. The fact the respondent was impoverished on the day of his sentencing does not mean he will be ever thus.

Committal Proceedings

Under the *Code*, a fine default is not punishable by committal *unless* the other statutory remedies, including licence suspensions and civil proceedings, are "not appropriate in the circumstances", or "the offender has, without reasonable excuse, refused to pay the fine or discharge it under section 736 [fine options program]" (emphasis added). Section 734.7(1) of the *Code* provides:

734.7 (1) [Warrant of committal] Where time has been allowed for payment of a fine, the court shall not issue a warrant of committal in default of payment of the fine
until the expiration of the time allowed for payment of the fine in full; and
unless the court is satisfied
that the mechanisms provided by sections 734.5 and 734.6 are not appropriate in the circumstances, or
that the offender has, without reasonable excuse, refused to pay the fine or discharge it under section 736.

Where the offender's "reasonable excuse" under subpara. (ii) for failure to pay a fine is poverty, the question is whether it is nevertheless open to a court to jail him or her under subpara. (i) because the self-same poverty makes it "not appropriate", i.e., futile, to resort to civil collection methods or permit suspensions. In my view, such a reading of s. 734.7, despite the drafter's use of the word "or" at the end of s. 734.7(1)(*b*)(i), would be absurd.

Courts have not infrequently read "or" as "and" where the legislative context so requires: *Clergue v. H. H. Vivian and Co.* (1909), 41 S.C.R. 607, *Re International Woodworkers of America, Local 2-306 and Miramichi Forest Products Ltd.* (1971), 21 D.L.R. (3d) 239 (N.B.C.A.), and *Sullivan and Driedger on the Construction of Statutes* (4th ed. 2002), at pp. 66-69. See also, on this specific point, A. Manson, *The Law of Sentencing* (2001), at p. 249.

If poverty were to be upheld as a stand-alone justification for a committal court to find collection methods other than jail "not appropriate",then the "without reasonable excuse" limitation in s. 734.7(1)(*b*)(ii) would afford poor people no protection at all. Yet it was the concern about overuse of jail for poor people for unpaid fines that was an important impetus behind the 1996 sentencing reforms.

Use of the word "refused" in s. 734.7(1)(*b*)(ii) indicates a parliamentary expectation that the offender's particular circumstances allow him or her a choice. In this case, at least at the date of the sentencing, the respondent had no choice.

The Crown, in its factum, fully accepted that committal proceedings are governed by the principle in s. 734.7(1)(*b*)(ii) that "the offender has, without reasonable excuse, refused to pay the fine or discharge [the debt]" (emphasis added). For example, the Crown argues:

By operation of the warrant of committal provisions in s. 734.7 of the *Criminal Code*, there must be a judicial determination that an offender has "without reasonable excuse, refused to pay the fine" before he or she is ordered into custody.

. . .

. . .

. . .

While the "slamming of the jail door" is the incentive to make offenders with means pay their fines, no one will go to jail for their genuine inability to pay.

Digitized by Google

However, as will be discussed below, where a sentencing judge chooses to impose a default term of imprisonment, the warrant of committal provision in s. 734.7 of the *Criminal Code* operates to ensure that only those who wilfully evade payment will be incarcerated.

If the judge was satisfied that the Respondent was not wilfully evading the payment of the fine, there would be no basis for issuing a warrant of committal and the Respondent would not go to jail. [Emphasis in original.]

Parliament has imposed a mandatory minimum fine in s. 240 of the *Excise Act*, but it has with equal authority provided in s. 734.7(1) of the *Code* that the offender should not go to jail for failure to pay it unless it is shown that he or she has "without reasonable excuse, refused to pay". That was not the position of the respondent when he was sentenced. He ought not to have been sentenced to serve a "term of imprisonment" in an institution *or* in the community.

I. *The Proper Order*

In my view, the trial judge ought to have proceeded with his initial instinct to impose the mandatory minimum fine of $9,600 plus a reasonable time to pay and 30 days in default. If, as the trial judge expected, the respondent went into default despite the Crown's resort to available remedies short of committal, the Crown would then have had the choice whether to proceed further or not.

If, as the trial judge anticipated, the respondent had continued simply to be unable to pay, the Crown, on its own acknowledgement to this Court, would not have sought such a committal.

If, on the other hand, the respondent had come into money to pay all or part of the debt, he should quite properly have been required to do so.

IV. Disposition

The appeal is allowed. As the respondent has served his conditional sentence, which would bar all further collection procedures under s. 734.7(4) of the *Code*, the Crown ought not to take any further collection procedures as a result of the conditional sentence's being set aside. A stay is therefore entered against any further collection procedures. As the appeal was brought by the Crown as a test case, the respondent should have his costs in this Court.

English version of the reasons delivered by

DESCHAMPS J. (dissenting)— I can appreciate the Cartesian logic of my colleague Binnie J., but in my opinion, **a more nuanced approach is necessary.**

The difficulty of this case arises from the impossibility of reconciling, in the case of an impecunious person, all of the sentencing principles contained in the *Criminal Code*, R.S.C. 1985, c. C-46, with a provision prescribing a minimum fine. In principle, according to s. 718.2(*a*) and (*d*), a sentence must take into account all aggravating and mitigating circumstances relating to the offender's situation. The judge must consider that an offender should not be deprived of liberty if less restrictive sanctions may be appropriate in the circumstances. A minimum fine does not allow the particular circumstances of the offender to be taken into account. **Given that in Ontario there is no organized scheme for community service, the judge who seeks an alternative solution, or even a means of encouraging payment of the fine, has little room to manoeuvre.** I therefore propose a purposive

Digitized by Google

sentencing approach, like the one adopted by the Court in *R. v. Proulx*, [2000] 1 S.C.R. 61, 2000 SCC 5, at paras. 55 and 127, in order to determine if imposing a conditional sentence in default of the payment of a fine is an error in principle. As the following reasons will make clear, I find that it is not.

Comparison Between Fines and Conditional Sentences

In *Proulx*, *supra*, the Court established a gradation of sentences. At one end of the spectrum are restorative sentences and at the other, punitive sentences. Lamer C.J. described restorative justice as follows (at para. 18):

A restorative justice approach seeks to remedy the adverse effects of crime in a manner that addresses the needs of all parties involved. This is accomplished, in part, through the rehabilitation of the offender, reparations to the victim and to the community, and the promotion of a sense of responsibility in the offender and acknowledgment of the harm done . . . .

Thus, in *R. v. Gladue*, [1999] 1 S.C.R. 688, at para. 43:

Restorative sentencing goals do not usually correlate with the use of prison as a sanction.

Releases and suspended sentences are therefore classified as restorative sentences.

In *Proulx*, *supra*, the Court discusses two punitive sentences, namely, incarceration and conditional sentences, insisting that the latter form of sentence is also consistent with the objectives of restorative justice (at para. 22):

The conditional sentence incorporates some elements of non-custodial measures and some others of incarceration. Because it is served in the community, it will generally be more effective than incarceration at achieving the restorative objectives of rehabilitation, reparations to the victim and community, and the promotion of a sense of responsibility in the offender. However, it is also a punitive sanction capable of achieving the objectives of denunciation and deterrence. [Emphasis omitted.]

The analysis developed in *Proulx* did not concern fines, but it seems obvious to me that the imposition of a fine has little in common with restorative justice. In fact, while the offender is allowed to go free, and while this type of sentence promotes a sense of responsibility in the offender, fines do not help to repair the harm caused to the victim. In contrast, when an offender is subject to a probation order in the context of a remedial order, the court can order that he or she make restitution to the victim on one or a number of counts (s. 738 *Cr. C.*). Furthermore, there is no follow up that can ensure that an individual ordered to pay a fine will develop a sense of his or her responsibility. Finally, in the case of an impecunious offender, the restorative objective of rehabilitation will perhaps never be achieved if he or she does not manage to pay the fine. A fine imposed on the offender, especially on one of limited means, is therefore nothing other than a punishment.

A fine is, nevertheless, the least severe sanction to qualify as punitive justice, just like conditional sentences. In the *Criminal Code*, the provisions concerning fines (s. 734) are found before those dealing with conditional sentences (s. 742). In terms of the gradation of sentences, and if all the necessary nuances are made to take into consideration the offender's wealth or poverty and the terms that can be imposed on conditional sentences, these two forms of punishment, when combined, give the judge the latitude necessary to tailor the sentence when a punitive order must be given. Thus they naturally coalesce.

The issue raised in this case is whether a judge can use the discretion at his or her

Digitized by Google

disposal (s. 718.3(1) *Cr. C.*) in sentencing to order a conditional sentence in default of payment of a fine.

Conditional Sentences in Default of Payment of Fines

It is accepted that the sentencing judge has the discretion to impose imprisonment in default of payment of a fine (ss. 718.3 and 734.7 *Cr. C.*). It is just as indisputable that the judge is not obliged to allow time for payment (s. 734.7(2) *Cr. C.*). The issue is thus limited to determining the power of the judge to impose imprisonment in default of payment when he or she knows that imprisonment is, in practice, the sanction actually imposed for the offence committed.

If this were a well-to-do smuggler who had concealed his assets beyond the reach of justice and who had informed the court of his intention not to pay, I believe that the judge could, without risk of criticism, make such an order. There are circumstances in which imprisonment in default of payment of a fine is, in practice, the only way to punish an offender. Such an order does not therefore amount to a travesty of Parliament's intent.

The sentencing options given by Binnie J. in his opinion are not alternative solutions to payment of the fine. They are but methods for encouraging payment. A refusal to issue or renew a licence or a permit, or a decision to suspend them, remains in force "until the fine is paid in full". They do not, therefore, replace the fine (s. 734.5 *Cr. C.*). Similarly, civil enforcement of a debt (s. 734.6 *Cr. C.*) is often impossible when the offender is, as in this case, impecunious. In such a case, repeated visits by the bailiffs are only incentives, admittedly oppressive ones, but serve no truly penological purpose.

The court can always order the offender to submit to an organized community service scheme enabling him or her to repay the fine (s. 736 *Cr. C.*). However, no scheme of this kind exists here. Further, just as with the refusal or suspension of licences and civil enforcement, this option could restrict the offender's liberty even more than a conditional sentence that is flexible and tailored to the circumstances, such as the one imposed in this case, at least from the offender's point of view.

The *Criminal Code* therefore confers discretion on the judge to impose imprisonment in default of payment of a fine when he or she knows that imprisonment is, in practice, the sanction actually imposed for the offence committed. With the existence of this discretion established, it must now be asked if it could be used here to tailor the sentence imposed on an indigent offender.

The Judge's Order

First, one might object that a judge who rules out imprisonment cannot then order a conditional sentence. It is also submitted that a conditional sentence can only be ordered when the offender is sentenced to a term of imprisonment of less than two years.

Contrary to what Binnie J. seems to suggest, the trial judge did not really ever contemplate imposing the minimum fine of $9,600 along with a time for payment and a period of imprisonment in the event of default. In my view, he would have preferred to impose a suspended sentence: "I am satisfied that, but for the minimum fine provisions, this would be a case for a suspended sentence." The law, however, did not authorize him to pass such a sentence. Moreover, he was authorized to impose a term of imprisonment in default of payment of the fine. In the context of his judgment, I believe that the distinction between imprisonment and incarceration made by Lamer C.J. in *Proulx*, *supra*, at paras. 21 and 40, must apply:

Digitized by Google

The conditional sentence . . . is a meaningful alternative to incarceration for less serious and non-dangerous offenders.

. . .

Although a conditional sentence is by statutory definition a sentence of imprisonment, this Court, in *R. v. Shropshire*, [1995] 4 S.C.R. 227, at para. 21, recognized that there "is a very significant difference between being behind bars and functioning within society while on conditional release". See also *Cunningham v. Canada*, [1993] 2 S.C.R. 143, at p. 150, *per* McLachlin J. These comments are equally applicable to the conditional sentence. Indeed, offenders serving a conditional sentence in the community are only partially deprived of their freedom. Even if their liberty is restricted by the conditions attached to their sentence, they are not confined to an institution and they can continue to attend to their normal employment or educational endeavours. They are not deprived of their private life to the same extent. Nor are they subject to a regimented schedule or an institutional diet.

When the trial judge states that the offender is not a candidate for imprisonment, I believe that he means that he does not think it necessary to incarcerate him. The trial judge is the one on the front lines. Even if some of his reasons could be perceived as interfering with the domain of prison authorities, and as such debatable as a strict matter of law, they denote a keen awareness of reality and a pragmatism that often eludes the appellate courts. In giving reasons for the conditional sentence, the judge expresses himself clearly:

Here, I have to impose much more than that [the judge is referring here to a case where he imposed a lesser fine for a more serious crime] and that is Parliament's wish and I have to give effect to that wish. On the other hand, I cannot blind myself to two circumstances. Firstly, if there was a regime in this province permitting offenders to work off the fines, this entire discussion would be obviated. Secondly, there is a very difficult tendency where sentences do not end up being translated within the system in the appropriate fashion. . . . It is one thing to impose an eight-year sentence. It's another thing to understand that the person is within the community on day parole within a fraction of that period. If I impose a 90-day sentence, for example, it may well be that Mr. Wu will be released within a matter of days through a work program. If I impose a 90-day sentence, it may well be that Mr. Wuwill be released within a matter of days with a bracelet. It may be that Mr. Wu will be released simply because they only have so many rooms at the inn, so to speak, and he is not a dangerous individual and it's a revolving door situation. I have to be mindful of the fact that if I incarcerate someone for a non-violent offence, that it is also a great tax and concern to the community.

At the end of the day, I don't see that this individual needs to be detained or confined in a correctional facility. I am satisfied that a conditional sentence is appropriate in light of the instructions of the Supreme Court that a conditional sentence with appropriate, severe conditions is a significant deterrent and denunciatory penalty. There is an element of public education. But this is for a first offender having been involved in very minimal behaviour and, of course, nothing that occurred during the defence is at all relevant.

The factual circumstances in this case do not lead to the conclusion that the judge did not want to impose imprisonment in default of payment. The judge wanted to impose a realistic and suitable punishment. He was aware that a warrant of committal would perhaps, in practice, not be executed and, above all, did not believe that incarceration was necessary. I would not, therefore, regard the reasons given by the judge as a justification for concluding that the judge could not order imprisonment

Digitized by Google

in default of payment of the fine. In practice, a judge who does not give time for payment orders imprisonment. In this case, the trial judge was entirely aware of this when he made his decision.

The important issue, rather, is whether, knowing that the offender did not have any money, the judge could order imprisonment in default of payment of the fine. There is nothing in the text against it, but such an order, at first glance, seems to punish the poor more severely and appears contrary to Parliament's intent. In his opinion, Binnie J. explains this aspect of the matter very well, and I will not dwell on it. I do not dispute that incarceration for civil debts does not befit a civilized society.

Having recognized the principle, I believe it necessary to bring its limits to light. First, poverty is a complex situation. It has consequences on every aspect of the lives of those it afflicts. In the sphere of sentencing, the adjustment required to take into account the poverty of an offender cannot be reduced to a concern for ensuring that absence of means does not become a reason for imprisonment. Numerous authors emphasize the necessity of considering all of the effects of a sentence. B. Hudson states her point of view as follows ("Punishing the Poor: Dilemmas of Justice and Difference", in W. C. Heffernan and J. Kleinig, eds., *From Social Justice to Criminal Justice: Poverty and the Administration of Criminal Law* (2000), 189, at pp. 205 and 209):

. . .

"[E]quality"of penal treatment is not a simplified sameness of treatment, but punishment of equivalent severity for offences of *equal culpability with regard to all relevant circumstances*.

Equality can be approached only if a system of sanctions for crimes most strongly correlated with poverty is instituted and which has as key principles not only commensurability of penalty and offense seriousness, but also appropriateness and feasibility of penalty to offender. [Emphasis in original.]

See also P. Pettit, "Indigence and Sentencing in Republican Theory", in Heffernan and Kleinig, *supra*, 230; A. Ashworth, *Sentencing and Criminal Justice*(3rd ed. 2000), at pp. 82-83.

Admittedly, not all types of offences lend themselves to conditional sentencing. I do not, however, see any policy grounds that would rule it out in this case. The conditional sentence could and should remain an option open to the sentencing judge so that he or she has the broadest possible range of options for tailoring the sentence.

It is possible that certain offenders with the means to pay their fine might opt to stay in prison rather than pay a fine. It is also conceivable that individuals might choose, for show or on principle, to be put in jail rather than pay the fine. While we are faced with a different situation in the present case, it is not all that different.

The respondent, through his counsel, has supported the judge's decision as far as this Court. Some would argue that this was not by choice, but I believe that the adoption of a paternalistic attitude must be avoided for a number of reasons.

Firstly, a prison term, once served, extinguishes the debt (s. 734.7(4) *Cr. C.*). An offender, even an impoverished one, should not be deprived of an avenue that is available to those who are more well-to-do. The greater the debt is, the more an offender will be tempted to choose this avenue. Even if, in principle, imprisonment in default of payment is supposed to encourage the payment of fines, in reality, certain offenders use it as a way to pay their debt. I cannot imagine that the most indigent offenders would be excluded simply because they are poor.

Digitized by Google

Secondly, a judge can adjust the conditions of a conditional sentence to take the particular circumstances and essential needs of an impecunious person into account, exercising a flexibility that he or she does not have where the law prescribes a minimum fine. In this case, the terms of the curfew are flexible and are minimal restrictions on the liberty of the respondent (i.e., daily curfew from 6:00 p.m. to 6:00 a.m. for 75 days, except for employment, health or worship reasons and two additional hours of freedom on the weekend).

Thirdly, in order to have a deterrent effect on the general public and on offenders who might not care about their rehabilitation, the fine must be accompanied by an incentive measure, or at least a sanction serving as an alternative measure. The sentence must contribute to respect for the law and to the maintenance of a just and safe society (s. 718 *Cr. C.*) and cannot therefore be perceived as an order with no real teeth.

Fourthly, the potential end result of a warrant of committal cannot be left to the discretion of the Crown prosecutor.

Fifthly, I believe that the contemporary philosophy of criminal law, which seeks the rehabilitation of offenders, is better served by measures that enable the offender to pay his or her debt to society within a reasonable period after sentencing. Counting on a windfall making it possible to pay the fine does not seem to be the solution. To compensate for the more significant effect of a fine on an impoverished person, the law must be flexible and accept that the less fortunate find themselves in special circumstances.

Conclusion

It is sometimes more prudent for the courts to defer to Parliament in cases of doubt. In this case, however, Parliament cannot, unless it abandons minimum fines, show more flexibility towards the poor. It therefore serves no purpose to disregard the latitude clearly given by the *Code*.

In my view, the imposition of a fine along with an assurance that the prosecution will not be able to ask for the issuance of an arrest warrant does not constitute a just sanction. This sanction either does not allow an impoverished offender to see the end of his or her sentence in a reasonable time or, for those offenders for whom indebtedness is not a source of constraint, allows the offence to go unpunished. The sentence proposed by my colleague would be, in his opinion, more respectful of the respondent's liberty and of Canadian penological principles. The proposed sentence does not seem to be tailored to the circumstances of the case or respectful of the fundamental principles of the 1996 reforms. The concept of liberty must not be interpreted in an abstract manner. It must be the object of a personalized evaluation that takes the particular circumstances of each case into account and that does not disregard the different impact that certain sentences could have on different individuals.

The sentence handed down by the trial judge is not a panacea. Admittedly, it would have been preferable that the respondent benefit from a fine option program. Unfortunately, no such program was available. The trial judge had to work with the tools at his disposal. In my opinion, his decision was enlightened and sensitive to the particular circumstances of the case. It respected the principles of gradation of sentences and properly balanced the relevant penological goals.

For these reasons, I would dismiss the appeal.

Digitized by Google

Appeal allowed with costs to the respondent, DESCHAMPS J. *dissenting. Solicitor for the appellant: Attorney General of Canada, Toronto.*

Solicitors for the respondent: Karam, Greenspon, Ottawa. Solicitor for the intervener: Nova Scotia Legal Aid, Halifax.

Her Majesty The Queen v. Pierre Bourque, Court Of Appeal For Ontario, Docket: C40814, Date: 2005 02 18, Application of C.C. Sentencing Retroactively

On appeal from the judgment of Justice W. Dan Chilcott of the Superior Court of Justice dated October 9, 2003.
MACPHERSON J.A.:

INTRODUCTION

[1] Section 734.7 of the *Criminal Code*, R.S.C. 1985, c. C-46, as amended by S.C. 1995, c. 22, permits the imprisonment of a person for default in payment of a fine in certain circumstances.

[2] Section 734.7 came into force on September 3, 1996. The issue in this appeal is whether s. 734.7 applies to fines imposed after September 3, 1996, but in relation to offences committed before that date. The question of potential retrospective operation turns on whether s. 734.7 is characterized as a procedural or substantive provision. If it is procedural, retrospective operation is permitted; if it is substantive, such operation is forbidden.

FACTS

[3] The appellant, Pierre Bourque, did not declare $332,000 in income for the taxation years 1989 to 1993, thereby evading federal taxes of $95,212.70. On January 10, 2000, in a summary conviction proceeding, the appellant pleaded guilty before Justice B. T. Ryan of the Ontario Court of Justice to one count of tax evasion contrary to s. 239(1)(d) of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.).

[4] On January 31, 2000, Ryan J. imposed a fine of $100,000, to be paid within one year. Ryan J. stated that if the appellant had difficulty paying the fine, he could apply for an extension of time. He cautioned, however, that he would not entertain such an application unless half the fine was paid.

[5] The appellant did not pay the fine. Nor did he apply for an extension of time to pay.

[6] The Crown applied for a warrant of committal to have the appellant incarcerated in default of payment. The application was based on s. 734.7 of the *Criminal Code*, which provides:

734.7(1) Where time has been allowed for payment of a fine, the court shall not issue a warrant of committal in default of payment of the fine

until the expiration of the time allowed for payment of the fine in full; and
unless the court is satisfied
that the mechanisms provided by sections 734.5 and 734.6 are not appropriate in the circumstances, or
that the offender has, without reasonable excuse, refused to pay the fine or discharge it under section 736.

[7] The matter returned before Ryan J. on June 13, 2003. The appellant argued that Ryan J. had no jurisdiction to entertain the committal proceedings because s. 734.7 could not apply to an offence committed before it came into force. Ryan J.

Digitized by Google

ruled in favour of the Crown, but agreed to adjourn the committal proceedings to permit the appellant to take the matter to a higher court.

[8] The appellant applied to the Superior Court of Justice for an order enjoining Ryan J. from hearing the committal application. In a decision dated October 9, 2003, Chilcott J. dismissed the appellant's application. He concluded:

In my view, s. 734.7 deals with procedure upon default of payment of a fine and, therefore, applies to such proceedings on and after the date of the enactment of the section, regardless of when the offences took place that spawned the default proceedings.

[9] The appellant appeals Chilcott J.'s judgment.

ISSUE

[10] The only issue on the appeal is whether Chilcott J. erred in holding that a warrant of committal issued under s. 734.7 of the *Criminal Code* can apply to offences committed before s. 734.7 came into force.

ANALYSIS

[11] Statutes that affect substantive rights and liabilities presumptively apply only prospectively. Statutes that change procedure, and do not affect substantive rights and liabilities, apply retrospectively: see *Gustavson Drilling (1964) Ltd. v. M.N.R.*, [1977] 1 S.C.R. 271; *Brosseau v. Alberta Securities Commission*, [1989] 1 S.C.R. 301; and *Re Application Under s. 83.28 of the Criminal Code*, [2004] 2 S.C.R. 248.

[12] The appellant contends that s. 734.7 of the *Criminal Code* is a substantive provision. It creates a regime in which a punishment of imprisonment can replace a punishment of fine. This change, the appellant submits, imposes a different substantive liability on him. Such a result would be inappropriate in the appellant's case because the offence for which he received the fine (tax evasion) was committed several years before s. 734.7 came into force.

[13] I do not accept this submission. In my view, it is inconsistent with the interpretation of s. 734.7 enunciated in *R. v. Wu*, [2003] 3 S.C.R. 530.

[14] In *Wu*, a sentencing judge imposed a fine and, in default of payment, a conditional sentence. The Supreme Court of Canada struck down the conditional sentence component of the punishment. In doing so, the court stated clearly that s. 734.7 did not impose an automatic term of imprisonment for default in payment of a fine. Rather, the proper interpretation of s. 734.7, taking into account its own explicit wording and the important contextual fact of the other changes to the sentencing regime made in the 1995 amendments to the *Criminal Code*, was that it was designed as a mechanism to encourage an offender to pay a fine. In other words, s. 734.7 serves *to enforce a fine*, not to impose imprisonment.

[15] In his reasons, Binnie J. examined the history of s. 734.7 and related provisions enacted at the same time and concluded that the purpose of the amendments was to separate inability to pay a fine and a punishment of imprisonment. He also emphasized the words "without reasonable excuse, refused to pay the fine" in s. 734.7(1)(b)(ii). These components of his analysis, taken together, led him to a conclusion which he had presaged early in his reasons, at para. 3:

As will be seen, the purpose of imposing imprisonment in default of payment is to give serious encouragement to offenders with the means to pay a fine to make payment. Genuine inability to pay a fine is not a proper basis for imprisonment. A conditional sentence is a form of imprisonment. Therefore, a conditional sentence is not an appropriate sentence to impose on an offender simply because he or she has

Digitized by Google

no means to pay a fine.

[16] This reasoning is applicable in the present case. The appellant will not automatically go to jail for non- payment of his fine. He will have the opportunity to contend that he is unable to pay the fine. If he establishes this, it will constitute a "reasonable excuse" and a warrant of committal will not be issued. On the other hand, if the appellant has the ability to pay the fine, the possibility of imprisonment will provide an incentive to him to pay the fine. In other words, in this second scenario, the possibility of imprisonment is a mechanism − a legitimate one − for enforcing the fine penalty that has already been imposed on him. As an enforcement mechanism, s. 734.7 is a procedural provision that can be applied retrospectively, by virtue of both the canons of statutory interpretation and s. 44(d)(i) of the *Interpretation Act*, R.S.C. 1985, c. I-21.

[17] The appellant advances a second argument on the appeal, which his previous counsel appears not to have raised before Ryan and Chilcott JJ. He submits that s. 734.7 of the *Criminal Code* applies only to indictable offences and that s. 787 is the only provision relating to imprisonment in default of payment of a fine for summary conviction offences.

[18] A complete answer to this submission is that *Wu* was a summary conviction case.

[19] Finally, the appellant makes an alternative argument based on s. 787(2) of the *Criminal Code*, which authorizes that "the court may order that in default of payment of the fine … the defendant shall be imprisoned for a period not exceeding six months". The appellant submits that since a term of imprisonment in default of payment of a fine under s. 734.7 can be up to two years, he should be entitled to the benefit of the "lesser" punishment in s. 787 because of s. 11(i) of the *Charter* and s. 44(e) of the *Interpretation Act*.

[20] In my view, this argument is misconceived. Although a period of imprisonment for default in payment of a fine imposed as part of an initial sentence under s. 787 is a true punishment, *Wu* makes it clear that a subsequent imprisonment imposed for a default in payment of a fine imposed under s. 734.7 is not a punishment; rather it is an enforcement mechanism designed "to give serious encouragement to offenders with the means to pay a fine to make payment". In short, the provisions for imprisonment in default of payment of fines in ss. 734.7 and 787 of the *Criminal Code* are not of the same *genus*.

DISPOSITION

[21] I would dismiss the appeal.

RELEASED: February 18, 2005 ("JCM")

"J. C. MacPherson J.A."

"I agree Robert J. Sharpe J.A." "I agree E. A. Cronk J.A."

Prosecution on indictment – 239(2)

Every person who is charged with an offence described in subsection 239(1) or 239(1.1) may, at the election of the Attorney General of Canada, be prosecuted on indictment and, if convicted, is, in addition to any penalty otherwise provided, liable to

a fine of not less than 100% and not more than 200% of

where the offence is described in subsection 239(1), the amount of the tax that was sought to be evaded, and

where the offence is described in subsection 239(1.1), the amount by which the amount of the refund or credit obtained or claimed exceeds the amount, if any, of the refund or credit

Digitized by Google

to which the person or other person, as the case may be, is entitled; and

imprisonment for a term not exceeding 5 years.

Digitized by Google

Indictment or Summary Proceedings

Smythe, reproduced following, illustrates that the Crown is in no way limited to one or the other in ways to proceed against an instance of s. 239(1) tax evasion. While it applied only in respect of the Bill of Rights it is also applicable in case of the Charter.

> Conn Stafford Smythe *Appellant;*
> and
> Her Majesty The Queen *Respondent.*
> 1971: June 14; 1971: June 28.
> Present: Fauteux C.J. and Abbott, Martland, Judson, Ritchie, Hall and Spence JJ. ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO
> *Taxation—Civil rights—Equality before the law—False and deceptive income tax return—Attorney General electing to proceed by indictment instead of summary conviction—More severe penalties—Canadian Bill of Rights, 1960 (Can.), c. 44, ss. 1, 2—Income Tax Act, R.S.C. 1952, c. 148, s. 132.*
> The appellant was charged with evading income tax payments and with having made false and deceptive statements in his income tax returns, contarary to ss. 132(1) (*d*) and 132(1) (*a*) of the *Income Tax Act,* R.S.C. 1952, c. 148. Pursuant to s. 132(2), the Attorney General elected that these charges be prosecuted upon indictment, thereby rendering the appellant liable to more severe penalties than if prosecuted by way of summary convicition pursuant to s. 132(1). A judge of the County Court held that he had no jurisdiction to try the charges because s. 132(2) was inoperative by reason of the provisions of ss. 1 and 2 of the *Canadian Bill of Rights, 1*960 (Can.), c. 44. An application by the Attorney General for an Order of *mandamus* was granted by the High Court of Ontario. This judgment was affirmed by the Court of Appeal. The appellant appealed to this Court where his fundamental submission is that s. 132(2) is made inoperative because it violates the principle established under s. 1(*b*) of the *Canadian Bill of Rights* of the right of the individual to equality before the law and the protection of the law.
> *Held:* The appeal should be dismissed.
> The provisions of s. 132(2) of the Act are not discriminatory and do not offend the principle of equality before the law. They do not, by themselves, place any particular person or class of persons in a condition of being distinguished from any other member of the community. They are applicable without distinction to everyone. The manner in which a Minister of the Crown exercises a statutory discretionary power conferred upon him for the proper administration of a statute is irrelevant in the consideration of the question whether the statute, in itself, offends the principle of equality before the law. **Enforcement of the law and especially of the criminal law would be impossible unless someone in authority be vested with some measure of discretionary power. If an authority such as the Attorney General can have the right to decide whether or not a person shall be prosecuted, surely he may, if authorized by statute, have the right to decide what form the prosecution shall take. The situation is not altered because s. 132(2) provides for a minimum term of imprisonment. Before the enactment of the *Canadian Bill of Rights,* the discretion of the Attorney General to elect the mode of prosecution as he saw fit was part of the British and Canadian conception of**

Digitized by Google

equality before the law. It is not possible to infer from the provisions of the *Canadian Bill of Rights* any suggestion that Parliament diferred from that view or had any intention to depart so radically from that state of law. The appellant's submission is tantamount to a recognition that Parliament has used an oblique method to paralyse the administration of the law.

APPEAL from a judgment of the Court of Appeal for Ontario[133], affirming a judgment of the High Court which had granted an Order of *mandamus.* Appeal dismissed.
John J. Robinette, Q.C., for the appellant.
Joseph Sedgwick, Q.C., and N.A. Chalmers, Q.C., for the respondent.

The judgment of the Court was delivered by
THE CHIEF JUSTICE—This is an appeal from a unanimous judgment of the Court of Appeal for Ontario[1] refusing to set aside an Order of Mandamus issued by Chief Justice Wells of the High Court, whereby he directed His Honour Judge Joseph P. Kelly, a judge of the County Court Judge's Criminal Court for the County of York or some other judge of that court, to proceed with the trial of the appellant on an indictment presented in that court.
The circumstances leading to this appeal may be stated briefly. By information, sworn to on July 9, 1969, the appellant was charged to have, between April 28, 1965 and March 2, 1968, evaded income tax payments in the amount of $289,372.33 and also to have made false and deceptive statements in his income tax returns for taxation years 1964, 1965, 1966 and 1967, committing thereby infractions respectively described in s. 132(1) (d) and in s. 132(1) (a) of the *Income Tax Act,* R.S.C. 1952, c. 148, as amended.
Pursuant to s. 132(2) of the Act, the Attorney General of Canada elected that these charges be prosecuted upon indictment. The accused elected trial by a county court judge alone and, after a preliminary inquiry, was committed for trial on February 18, 1970. An indictment was then preferred with respect to these charges by the agent of the Attorney General of Canada. On October 5, 1970, the accused appeared before His Honour Judge Kelly and after being arraigned on the indictment, without any plea having been taken, his counsel moved to quash the indictment on the ground that s. 132(2) of the *Income Tax Act* was inoperative by reason of the provisions of ss. 1 and 2 of the *Canadian Bill of Rights,* 1960 (Can.), c. 44, and that the presiding judge had therefore no jurisdiction to try the charges for the alleged infractions of s. 132(1) of the *Income Tax Act.* The learned judge allowed this motion to quash. He held that the provisions of s. 132(2) permitting the Attorney General of Canada to proceed by indictment at his election,—in which event the accused is liable to more severe penalties than if prosecuted by way of summary conviction pursuant to s. 132(1),—were repugnant to the requirement of s. 1(b) of the *Canadian Bill of Rights* that every law of Canada be construed and applied so as not to abrogate the right to equality before the law. The learned judge relied on the decision of the Supreme Court of Oregon in *State of Oregon v. Pirkey*[134] which was subsequently applied by the Supreme Court of the State of Washington in *Olsen v. Delmore*[135] and he declined to follow the unanimous judgment rendered in *Regina v. Court of the*

[133] [1971] 2 O.R. 209, 13 C.R.N.S. 33, [1971] 3 C.C.C. (2d) 97, 17 D.L.R. (3d) 389
[134] (1955), 281 P. (2d) 698
[135] (1956), 295 P. (2d) 324

Digitized by Google

Sessions of the Peace et al., ex parte Lafleur[136]

where the Court of Appeal for the province of Quebec had rejected as ill founded a similar argument made in a case similar to the present.

The Attorney General of Canada then applied to the High Court for an Order of Mandamus. The application was heard and ultimately granted by Chief Justice Wells. In lengthy reasons for judgment, the Chief Justice of the High Court reviewed the history of the Office of the Attorney General, found that the discretion of the latter to conduct criminal proceedings as he saw fit was, at the time of the coming into force of the *Canadian Bill of Rights,* part of the British and Canadian conception of equality before the law, held that in view of the existing difference in the system of Government in Canada and that of the United States of America, the cases decided in the American State Courts had no application in Canada notwithstanding any similarity of wording between the 14th Amendment of the Constitution of the United States of America and the relevant provisions of the *Canadian Bill of Rights* and, finally, he held that the refusal of the Supreme Court of Canada to grant leave to appeal from the judgment in the *Lafleur* case, *supra,* made that judgment binding upon him. The appeal of Smythe from this judgment of the High Court was dismissed at the conclusion of the argument. Delivering orally the judgent for the Court of Appeal, Chief Justice Gale referred to the decision in *Lafleur, supra,* and the refusal of this Court to grant leave to appeal from the same; and the learned Chief

Justice also pointed out that in *Regina v. Drybones*[137] there was no suggestion in any of the reasons for judgment that the correctness of the decision in the *Lafleur* case was in doubt. Hence the present appeal to

this Court.

It is convenient, at the outset, to reproduce the provisions of s. 132(2) of the *Income Tax Act* and state the substance of appellant's submissions expressed in the concluding paragraphs of his factum.

132. (2) Every person who is charged with an offence described by subsection (1) may, at the election of the Attorney General of Canada, be prosecuted upon indictment and, if convicted, is, in addition to any penalty otherwise provided, liable to imprisonment for a term not exceeding 5 years and not less than 2 months.

In appellant's views, s. 132(2) is made inoperative by the *Canadian Bill of Rights* because:

the section violates the principle established under s. 1(b) of the *Canadian Bill of Rights.,* that is "the right of the individual to equality before the law and the protection of the law";

in the alternative, the section violates s. 2(a) of the *Canadian Bill of Rights* in that it authorizes the Attorney General to decide in advance, when at the highest he can only have *prima facie* evidence before him, that the sentence must be at least two months should the accused be convicted;

in the further alternative, the section violates s. 2(e) of the *Canadian Bill of Rights* in that the Attorney General can decide in advance without any hearing at all, much less a fair hearing, that the sentence must be at least two months if the accused is convicted and this at a time when the Minister of Justice can at the highest only have *prima facie* evidence before him.

In essence, appellant's basic submission is that the unfettered discretionary power, conferred by **s. 132(2) upon the Attorney General of Canada, to decide whether**

---

[136] [1967] 3 C.C.C. 244, [1967] Que. Q.B. 405, 49 C.R. 333, 66 D.T.C. 5441

[137] [1970] S.C.R. 282, 10 C.R.N.S. 334, [1970] 3 C.C.C. 355, 9 D.L.R. (3d) 473

Digitized by Google

a person charged of an offence under s. 132(1) should be prosecuted by way of summary conviction or by way of indictment,—and thus be subjected, if convicted, to more severe mandatory penalties in the latter than in the former case,—constitutes a disparity or discrimination completely destructive of the concept of equality before the law. It is argued that there being no standard whatsoever set out or even indicated in s. 132(2) to guide or control this unfettered discretionary power, the Attorney General of the day is empowered to treat differently persons charged under s. 132(1) or to treat differently cases which are similar, or to require less serious cases to proceed by indictment or to adopt a policy which differs from that of another Attorney General and which may even vary, in its application, from province to province and from city to city.

In my opinion, appellant's views fail to recognize that the provisions of s. 132(2) do not, by themselves, place any particular person or class of persons in a condition of being distinguished from any other member of the community and that, applicable without distinction to everyone, as indeed they are, these provisions simply confer upon the Attorney General of Canada the power of deciding, according to his own judgment and in all cases, the mode of prosecution for offences described in s. 132(1). Appellant's arguments also fail to recognize that the manner in which a Minister of the Crown exercises a statutory discretionary power conferred upon him for the proper administration of a Statute is irrelevant in the consideration of the question whether the Statute, in itself, offends the principle of equality before the law. Obviously, the manner in which the Attorney General of the day exercises his statutory discretion may be questioned or censured by the legislative body to which he is answerable, but that again is foreign to the determination of the question now under consideration. Enforcement of the law and especially of the criminal law would be impossible unless someone in authority be vested with some measure of discretionary power. The following statements made in the *Lafleur* case, *supra,* at page 248, by Montgomery J., with the concurrence of Chief Justice Tremblay and Pratte J., are to the point and I adopt them.

I cannot conceive of a system of enforcing the law where some one in authority is not called upon to decide whether or not a person should be prosecuted for an alleged offence. Inevitably there will be cases where one man is prosecuted while another man, perhaps equally guilty, goes free. A single act, or series of acts, may render a person liable to prosecution in more than one charge, and someone must decide what charges are to be laid. If an authority such as the Attorney-General can have the right to decide whether or not a person shall be prosecuted, surely he may, if authorized by statute, have the right to decide what form the prosecution shall take. I cannot see that the situation is altered because s. 132(2) provides for a minimum term of imprisonment.

I am also in complete agreement with the view expressed in the present case by Chief Justice Wells who concluded that before the enactment of the *Canadian Bill of Rights,* the discretion of the Attorney General to elect the mode of prosecution as he saw fit was part of the British and Canadian conception of equality before the law. And I am unable to infer from the provisions of the *Canadian Bill of Rights* any suggestion that Parliament differed from that view or had any intention to depart so radically from that state of the law. Indeed, if appellant's fundamental submission was acceded to, some thirty sections of the *Criminal Code* and others in some forty Canadian statutes where, as in s. 132(2), the power to elect to proceed by way of summary conviction or by way of indictment is conferred, would be rendered

Digitized by Google

inoperative. In brief, appellant's submission is potentially destructive of statutory ministerial discretion conferred upon a Minister of the Crown for the administration of the law in Canada and tantamount to a recognition that Parliament has used an oblique method to paralyze the administration of the law.

With respect to the decision of the Supreme Court of Oregon in the *Pirkey* case, *supra,* as well as that of the Supreme Court of the State of Washington in *Olsen v. Delmore, supra,* I agree that these decisions are of no assistance in view of the differences existing between the systems of Government obtaining in Canada and in the United States of America. And I may, incidentally, point out that, as appears by the following extract of the reasons for judgment delivered by Brand J., in the *Pirkey* case, this decision rests mainly on the fact that, contrary to what is the case in Canada, the distinction between a felony and a misdemeanor still obtains in the United States of America. The extract can be found at p. 703 of the report:

Since the provision for punishment constitutes one element in the definition of a crime, it would appear that this statute, in effect, defines two crimes as a matter of substantive law; one a felony, and the other a misdemeanor. And since the statute itself furnishes no criterion by which to determine when an accused is to be charged with felony, and when with a misdemeanor, the statute, at least insofar as it provides for alternative charges, must be void by reason of constitutional mandate, unless a criterion not set forth in the statute can be implied therefrom, and unless the power to apply it can be delegated to the grand jury or magistrate.

In my opinion, the provisions of s. 132(2) of the *Income Tax Act* are not discriminatory and do not offend the principle of equality before the law. It follows that appellant's basic submission must be rejected as ill founded.

In these views, I find it unnecessary to say more with respect to the appellant's two alternative submissions, than that I am unable to find any substance in either. Suffice it to say that *prima facie* evidence tendered in an *ex parte* application before a justice of the peace is sufficient to permit him to compel, either by summons or warrant, the appearance before the court of the person charged and that *prima facie* evidence may also permit a justice of the peace to commit the person charged for trial at the end of the preliminary inquiry. To invite a person to be charged to make representations to the Attorney General before an information is laid before a justice of the peace would, in many cases and surely in most of the important ones, be tantamount to an invitation to that person to abscond. The following comments made by Kerwin J., as he then was, in

Dallman v. The King[138], at the bottom of page 344, is here relevant:

However, the gist of this ground of appeal is that the appelant is the. only one entitled to exercise the option as to the mode of trial. It would be strange if that were so as it would mean that a person against whom it was decided to prefer charges would first have to be found in order to ascertain his wishes in that regard; and we are clearly of opinion that this contention cannot prevail.

I would dismiss the appeal.

Appeal dismissed.

In R. v. Century 21 Ramos Realty Inc.[139] on the issue of equality of pretence of proceedings the Ontario Appeal Court held:

Whether Subsection 239(1) of the Income Tax Act Conferring on the Attorney

[138] [1942] S.C.R. 339, 77 C.C.C. 289, [1942] 3 D.L.R. 145.
[139] 1987 CanLII 171 (ON CA)

Digitized by Google

General of Canada the Right to Elect to Proceed by Indictment or by Summary Conviction Contravenes Section 15 of the Charter The appellant challenges the constitutional validity of sections 613(4), 748, 755 and 771 of the *Criminal Code* on the ground that these provisions violate sections 7, 11(h), 11(h) and 15 of the *Canadian Charter of Rights and Freedoms*. **In fact, his challenge must be taken to be to section 239 of the *Income Tax Act*, under which he was charged and convicted, because it is a hybrid offence provision.**

His submissions that section 15 of the Charter is violated by the *Criminal Code* sections mentioned are not based, *per se*, on the procedures therein set out, but rather on those procedures as compared to procedures that would have applied if the election provided for in section 239 for prosecuting upon indictment had been taken. Subsection (1) of section 239 provides:

Every person who has

. . . . .

...

d) wilfully, in any manner, evaded or attempted to evade, compliance with this Act or payment of taxes imposed by this Act,

is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

a fine of not less than 25% and not more than double the amount of the tax that was sought to be evaded, or

both the fine described in paragraph (f) and imprisonment for a term not exceeding 2 years.

However, subsection (2) permits the Attorney General of Canada to choose an alternate proceeding:

Every person who is charged with an offence described by subsection (1) may, at the election of the Attorney General of Canada, be prosecuted upon indictment and, if convicted, is, in addition to any penalty otherwise provided, liable to imprisonment for a term not exceeding 5 years and not less than 2 months.

In the present case the Attorney General did *not* elect to prosecute upon indictment, thereby proceeding under subsection (1) and the relevant provisions in Part XXIV of the *Criminal Code*. Thus the appeal provisions in sections 613(4), 748, 755 and 771 of the *Criminal Code* came into operation and it is these provisions to which the appellant objects as compared to the procedures that would have been applicable if the prosecution had proceeded upon indictment. The question to be addressed, therefore, is whether the distinctions between the rights of appeal in summary conviction offences, which applied to the appellant, and those in indictable offences, which did not, violate sections 7, 11(h) and 15 of the Charter.

Section 15 of the Charter provides:

"Every individual is equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination, and in particular without discrimination based on race, national or ethnic origin, colour, religion, sex, age or mental or physical disability."

Perhaps the best way to discuss the possible meaning of the equality rights in section 15 of the Charter is to start with the first opinion expressed on the issue by this Court in *Re McDonald and The Queen* (1985), 21

C.C.C. (3d) 330. At 349 Morden, J.A. put forth the basic proposition that:

"... [T]he purpose of s. 15 is to require "that those who are similarly situated be treated similarly": Tussman and tenBroek, "The Equal Protection of the Laws", 37 *Cal. L. Rev.* 341 (1948), at p. 344."

Digitized by Google

In the subsequent case of *R. v. R.L.* (1986), 26 C.C.C. (3d) 417, Morden, J.A. added a second observation as to the "essentially relational nature of equality". His two propositions were stated thus at 424-25:

"... The essentially relational nature of equality has been described as follows. "The concept of equality is, by definition, relational or comparative. A person can only be found to be equal *in relation to* or *in comparison with* some other person who serves as a standard or criterion." Monroe H. Freedman, "Equality in the Administration of Criminal Justice", Nomos IX (1967) 250 at pp. 253-4. The concern for equality is that those who are similarly situated with respect to the purpose of the law be treated similarly: see Tussman and tenBroek ... and *Re McDonald and The Queen* ... referring to the Tussman and tenBroek article."

The views of Morden, J.A. in *Re McDonald* were subsequently referred to with approval by Howland, C.J.O. and Robins, J.A. in their dissenting opinion in *Reference re an Act to Amend the Education Act (1986),* 53 O.R. (2d) 513 at 554-55, and by Dubin, J.A. in *Re Blainey and Ontario Hockey Association* (1986), 54 O.R. (2d) 513 at 524-25. It was applied by this court in *Bregman and Bregman v. Attorney General for Canada* (unreported, released 29, November 1986) to hold that someone who was a member of an allied force at a time when he had no connection with Canada, even though he subsequently became a citizen, is not "similarly situated" to someone who was domiciled in Canada when he joined an allied force for the purpose of the war.

Applying this approach, the determination of whether two or more particular classes of persons are in fact similarly situated becomes the analytical point of departure in any section 15 analysis. It would seem that if persons are held not to be similarly situated, then no further analysis is required. However, it is not always clear whether persons *are* or *are not* similarly situated, and whether, even if they are not, this is relevant to a section 15 inquiry. It is necessary to be cautious in this classification. It is usually possible to find differences between classes of persons and, on the basis of these differences, conclude that the persons are not similarly situated. However, what are perceived to be significant "differences" between persons or classes of persons could be the result of stereotypes based on existing inequalities which the equality provisions of the Charter are designed to eliminate, not perpetuate. The effects of past discrimination between classes of persons can result in these classes in fact not being similarly situated. Certain differences, such as the biological ones between the sexes, result in there being no actual comparable class, as with respect to reproductive issues. While some of these situations may well require differential treatment in the interests of equality, it is important that some differences between the classes of persons not operate to prevent a valid section 15 equality analysis by concluding that classes are not similarly situated. Rather, the determination of whether persons are similarly situated must also consider the relevance of the differences and, thus, the question ought to be whether the differences among those being treated differently by the legislation in question are relevant for the purposes of that legislation.

In the present case, the two relevant classes of persons are those persons whose acquittals for indictable offences are being appealed and those persons whose acquittals for summary conviction offences are being appealed. It is not clear, however, that these are the types of classifications contemplated by section 15 of the Charter. In considering whether the Crown's discretion to proceed either by way of summary conviction or by way of indictment violated the equality provision of the *Canadian Bill of Rights*, Fauteux, C.J.C. in *R. v. Smythe*, [1971] S.C.R. 680; 3 C.C.C

Digitized by Google

(2d) 366, stated at 685 (C.C.C. 370):
"In my opinion, appellant's views fail to recognize that the provisions of s. 132(2) [present s. 239] do not, by themselves place any particular person or class of persons in a condition of being distinguished from any other member of the community and that, applicable without distinction to everyone, as indeed they are, these provisions simply confer upon the Attorney-General of Canada the power of deciding, according to his own judgment and in all cases, the mode of prosecution for offences described in s. 132(1)."
A similar issue was addressed by the Oregon Supreme Court in *State v. Clark*, 630 P. 2d 810 (1981), in considering whether the distinction between those persons accorded a preliminary hearing because charged by information, and those persons denied such a hearing because indicted, violated the equal protection guarantees of the Fourteenth Amendment. With regard to the term "class", the court held, at p. 816:
"The terms "class" and "classification" are invoked sometimes to mean whatever distinction is created by the challenged law itself and sometimes to refer to a law's disparate treatment of persons or groups by virtue of characteristics which they have apart from the law in question. Familiar examples of the latter kind of "class" are personal characteristics such as sex, ethnic background, legitimacy, past or present residency or military service. On the other hand, every law itself can be said to "classify" what it covers from what it excludes. For instance, the rule of this court that limits the time for filing a petition for review ... "classifies" persons by offering the "privilege" of review to those who file within 30 days and denying it to those who file later. Similarly, a law that licenses opticians and optometrists to perform different functions. See *Williamson v. Lee Optical,* 348 U.S. 483 *...* (1955), does not grant or deny privileges to classes of persons whose characteristics are those of "opticians" and "optometrists"; rather, the law creates these classes by the licensing scheme itself. Attacks on such laws as "class legislation" therefore tend to be circular and, as the above quotations from early decisions show, have generally been rejected whenever the law leaves it open to anyone to bring himself or herself within the favoured class on equal terms ..." With respect to the classification suggested by the defendant, that is, those persons who are indicted, and those persons who are charged by information, the court held, at 817-18:
"... [W]e think this is an example of the "circular" use of the concept of "class" mentioned above. The distinction to be tested is the use or nonuse of preliminary hearings. The "classes" said to fail the test of equal protection are the "class" of those defendants who receive preliminary hearings (because charged by information) and the "class" of those who do not (because indicted). But these defendants do not exist as categories or as classes with distinguishing characteristics before and apart from a prosecutor's decision who to charge — one, or some, or all defendants. Aside from the manner in which the decision is made, see *City of Klamath Falls*, ... 619 P. 2d 217..., defendants charged under either procedure are "classes" only as an effect of the dual procedural scheme itself ..."
Similarly, the intervenant submits, it is not so much the provisions of the *Criminal Code* that distinguish any particular person or class of persons from any other member of the community, as that all members of the community are equally subject to the dual procedure. He argues that there are no personal characteristics or attributes of an individual person or class of persons upon which the distinction is drawn. Rather, the distinction is based on the Attorney General's judgment with regard to the act allegedly committed by the accused. As in *Clark*, the categories of

Digitized by Google

accused persons do not exist as categories or classes with distinguishing characteristics before and apart from the Attorney General's decision of how to charge them.

We would not be prepared to accept the proposition that it is necessary, if the persons alleging a section 15 infringement are to succeed, that these persons constitute categories or classes with distinguishing characteristics before and apart from the prosecutor's decision. It is true that there are no personal characteristics or attributes of an individual person or class of persons upon which the distinction in this case is drawn. However, in a section 15 case the question is not whether those alleging a violation of their equality rights have differences which exist independently of the law, but rather, whether the law treats those persons differently. Nonetheless we would be wise to heed the caution of the Court in *Clark* about avoiding the circular use of the term "class" in an analysis of equality.

However, assuming that persons charged with indictable offences and persons charged with summary conviction offences can be considered classes for the purpose of a section 15 analysis, it must then be determined whether these classes are similarly situated.

In the context of offences which are classified exclusively as indictable offences, such as murder, on the one hand, and those classified exclusively as summary conviction offences, such as fraudulently obtaining food or lodging, on the other hand, it is not difficult to conclude that persons charged with these indictable offences are not in the same class as persons charged with these summary conviction offences. The differences between these classes of persons, namely, the seriousness of the offence committed, can be seen to be relevant to the general purpose of the criminal procedure provisions of the *Criminal Code*, that is, providing the accused with a fair trial and appeal. Since the indictable offences carry with them harsher penalties, that is, greater threats to the liberty of the accused, the legislation demands that greater safeguards be provided.

However, this distinction becomes somewhat less clear in the context of hybrid offences. The choice of procedure in hybrid offences could also be seen to be based on the degree of seriousness of the offence. **This choice is not made on an a priori basis, but rather, is left to the discretion of the Attorney General to determine according to the particular circumstances of the case. However, where a hybrid offence is involved two virtually identical cases may nevertheless be treated differently if the Attorney General elects to proceed by indictment in one, and by summary conviction in the other. While the differential treatment thereby accorded these persons may well be justifiable in some cases, it may be difficult to conclude that two persons who have committed the same offence are not in fact similarly situated for the purpose of a section 15 analysis. It would appear that the appellant is attempting to compare either the general class of the persons charged with indictable offences with the general class of persons charged with summary conviction offences, or the somewhat narrower class of persons involved in an appeal concerning summary conviction offences with persons involved in an appeal concerning indictable offences. Nevertheless, it is necessary to proceed to the next step of a section 15 analysis, namely, whether differential treatment within the context of hybrid offences constitutes "discrimination" within the meaning of section 15. There are at least two approaches to the meaning of the term "without discrimination" in section 15, whether it prohibits any distinction or only such distinctions as are invidious, unreasonable or**

Digitized by Google

unjustifiable. These two approaches were set out by Morden, J.A. in the *McDonald* case, *supra*, at 348-49:

"... On the one hand, the section can be read as providing that there is no infringement unless there is unequal treatment *resulting from discrimination*, that is, discrimination in the sense of invidiousness — unjustifiability, unreasonableness or irrelevance. On this approach, putting it in its simplest terms, there would be no infringement unless the person alleging infringement could show an inequality that was unreasonably imposed: see Gold, "A Principled Approach to Equality Rights", 4 Supreme Court L.R. 131 (1982), at pp. 151-3, where this approach discussed on the basis that "the equality rights ... in the *Charter* contain within them a non-absolutist conception" without reference in this part of the article to the words "without discrimination". On the other hand, it has been argued that discrimination should be read in a neutral sense, as meaning merely distinction or classification, with the result that "s. 15 should be interpreted as providing for the universal application of every law. Where a law draws a distinction between individuals, on any ground, that distinction is sufficient to constitute a breach of s. 15, and to move the constitutional issue to s. 1 [to consider whether the law is justified]": Hogg, *Constitutional Law of Canada*, 2nd ed. (1985), pp. 799- 801."

Chief Justice Howland and Robins, J.A., in their dissenting opinion in the *Education Act Reference, supra*, at 554-55, although also not needing to choose between the two approaches, clearly recognized that more than just the making of distinctions is necessary before finding that section 15 is infringed;

"... There is no infringement of the section unless the unequal treatment is discriminatory. Most laws provide for distinctions and prescribe different results based on those distinctions. Indeed, a State could not function without classifying its citizens for various purposes and treating some differently from others. As Mr. Justice Stewart pointed out in his discussion of the equal protection clause of the U.S. Fourteenth Amendment in *San Antonio School District v. Rodriguez* (1973), 411 U.S. 1 at p. 60: "There is hardly a law on the books that does not affect some people differently from others." Similarly, although spoken in a different context, Chief Justice Dickson said at p. 347 S.C.R., p. 362 D.L.R. of *Big M Drug Mart Ltd., supra*, "... the interests of true equality may well require differentiation in treatment" ..."

We agree. The reasons for rejecting the neutral approach, which would hold *any* distinction to be in violation of section 15, were persuasively summarized by McLachlin, J.A. for the British Columbia Court of Appeal in *Andrews v. Law Society of British Columbia,* [1986] 4 W.W.R. 242 at 249-50:

"It cannot have been the intention of Parliament to guarantee a general right against unequal treatment. Almost all statutes draw distinctions between individuals. It cannot be supposed that in all such cases the individual's constitutional rights are infringed. To call every legislative distinction between people an infringement of s. 15 is to trivialize the fundamental rights guaranteed by the *Charter*.

Second, such an approach deprives the phrase "without discrimination" of content:

provided the treatment is unequal, one passes immediately to s. 1 of the *Charter*. That would run counter to accepted canons of statutory interpretation. Hogg, p. 800 acknowledges this problem, but says, because "discrimination" is ambiguous and can be read in a "neutral sense", it should be taken to remit the entire question of justification to s. 1. I cannot accept that view. "Discrimination" must be taken to have meaning within s. 15 itself.

Digitized by Google

Third, it cannot have been the intention of Parliament that the government be put to the requirement of establishing under s. 1 that all laws which draw distinction between people are "demonstrably justified in a free and democratic society". If weighing of the justifiability of unequal treatment is neither required nor permitted under s. 15, the result will be that such universally accepted and manifestly desirable legal distinctions as those prohibiting children or drunk persons from driving motor vehicles will be viewed as violations of fundamental rights and be required to run the gauntlet of s. 1."

Although we find her fourth reason for rejecting a neutral interpretation of section 15 less persuasive than the three quoted above, it adds a caution worth contemplating (at 250-1):

"Finally, it may further be contended that to define "discrimination" under s. 15 as synonymous with unequal treatment on the basis of personal classification will be to elevate

s. 15 to the position of subsuming the other rights and freedoms defined by the *Charter* ... That, however, may be what will become of s. 15 if it is interpreted as being violated by any distinction or unequal treatment. Section 15, like the 14th Amendment in the United States Constitution will dwarf the other provisions of the *Charter* and be the central issue in virtually all *Charter* litigation. Laws which do not violate any other fundamental right or freedom will almost always (if the United States experience is any guide) be *alleged* to violate s. 15 because the legislature classified or failed to classify. Even though legislation does not violate any other sections, it will always be required to run the gauntlet of ss. 15 and 1. In my view, this cannot have been the intention of the enactors of the *Charter*. To interpret s. 15 as other than a section guaranteeing equal protection and benefit without discrimination in the sense of unequal treatment that is unfair or unjustified is to quote Dickson J. [now C.J.C.] "to overshoot [its] actual purpose": Big *M Drug Mart, supra*, at p. 344."

Without a detailed and definitive analysis of what would be a proper test for the pejorative view of the words "without discrimination" in section 15, we are content for the purposes of this case to adopt that of Madam Justice McLachlin in the *Andrews* case, *supra*, at 253:

"... The ultimate question is whether a fair-minded person, weighing the purposes of legislation against its effects on the individuals adversely affected and giving due weight to the right of the legislature to pass laws for the good of all, would conclude that the legislative means adopted are unreasonable or unfair."

In the more recent case of *R. v. LeGallant* (1987), 54 C.R. (3d) 46 at 55, Hinkson, J.A., also for the British Columbia Court of Appeal, expressed it in these terms:

"... [D]iscrimination involves the drawing of an unreasonable or unjustifiable distinction. The question to be answered in determining whether or not law is discriminatory is whether the law is reasonable or fair, having regard to its purpose and effect. Involved in this approach there is the consideration that a law may be discriminatory if it treats some persons unduly prejudicially."

On this point it is interesting to note that although the French version of the equality rights provision in the European Convention on Human Rights (art. 14) uses the words "sans distinction aucune", the European Court of Human Rights, in the

Digitized by Google

Belgian Linguistic case (1968), 1 E.H.R.R. 252 at 284, decided that the pejorative implication of the English words "without discrimination" was more appropriate:

"... [T]he principle of equality of treatment is violated if the distinction has no objective and reasonable justification. The existence of such a justification must be assessed in relation to the aim and effects of the measure under consideration, regard being had to the principles which normally prevail in democratic societies. A difference of treatment in the exercise of a right laid down in the convention must not only pursue a legitimate aim:

Article 14 is likewise violated when it is clearly established that there is no reasonable relationship of proportionality between the means employed and the aim sought to be realised."

To apply the pejorative or adverse test to this case, we have to ask whether the different rights of appeal in a summary conviction offence, as against those in an indictable offence, do pose an inherent disadvantage. The appellant submits that he is disadvantaged because in summary conviction procedures the Crown has a right of appeal from an acquittal on questions of fact, which it does not have on appeals in proceedings by indictment. In determining this issue it is useful to consider the decision of the Supreme Court of Oregon in *City of Klamath Falls v. Winters*, 619 P. 2d 217 (1980).The court, at 225, considered whether the differences in appeal rights available to defendants prosecuted in district court as compared with those available to defendants prosecuted in municipal court or the discretion to prosecute defendants in municipal court rather than district court, violated the constitutional guarantees to the equal protection of the law:

"To convicted defendants seeking appeal, there are advantages inherent in each of these systems. Persons convicted in municipal court have the advantage of a complete new trial, including the right to a new jury. Thus, they have the opportunity to seek review not only of legal questions, but they may also seek new factual determinations as well. They also have an advantage resulting from possible use of the trial in municipal court for the purpose of "discovery" and prior to trial *de novo* in the circuit court. Further appeal to the Court of Appeals, however, is limited to questions of the constitutionality of Charter provisions or ordinances. Persons convicted in district court have the advantage of appellate review before a multi-judge court. That review, however, is limited to errors of law appearing on the record ..., and such persons do not have the advantages resulting from a review by trial *de novo* in the circuit court. It would be difficult to state categorically which system offers greater advantages to defendants. Whether one or the other system is to the advantage of a particular defendant depends on whether his defence rests only on factual contentions or also on legal contentions."

As in *Klamath Falls*, in the present case there are advantages inherent in each of the two procedures, and whether one or the other is to the advantage of a particular individual may depend at least partly on whether his or her defence rests on factual contentions or legal ones. In the present case, the appellant simply asserts that the distinctions between indictable and summary conviction procedures should end once a trial is concluded, and that there is no justification for the distinction in the rights of appeal. He submits, further, that there is no justification to permit an appellate court on an appeal by the Crown in summary conviction cases to review findings of fact. Since the burden of proof is on the appellant to demonstrate that the distinction is unreasonable and thus contrary to section 15 we consider that the appellant has failed to meet this burden.

The intervenant, the Attorney General of Ontario, directly addresses the question of

Digitized by Google

the reasonableness of the distinction in the rights of appeal. He submits in his factum that:

"... [T]he provisions of the *Code* relating to summary conviction procedure are aimed at providing what is generally a simpler, more expeditious mode of criminal procedure for those matters which do not call for the significant punishments available upon conviction by way of indictment. The provision of an intermediary appeal, in such cases, to a local court broad in scope, is a rational method of ensuring that the summary nature of the procedure set out in part XXIV does not give rise to miscarriages of justice, whether they arise out of questions of law or fact."

In addressing this question, useful reference can be made to another decision of the Supreme Court of Oregon — *State v. Jones*, 569 P. 2d 19 (1977).The defendant challenged, *inter alia*, the constitutionality of the procedure requiring a preliminary hearing or a grand jury indictment when a felony charge was laid, but not when it was a misdemeanour, on the ground that it denied him equal protection of the law. However, the court held, at 24, that there is a rational basis for the difference in treatment because of the distinction between felonies and misdemeanours:

"The greater penalties and more onerous consequences of a felony conviction form a rational basis for requiring a probable cause determination via preliminary hearing or grand jury indictment in order to try an accused for a felony. It is not a denial of equal protection to not accord a misdemeanant the same treatment. A misdemeanant charged in circuit court by information is subjected to the same statutory penalty provisions and is accorded the same procedural safeguards associated with arraignment and trial as any other misdemeanant charged in a court of limited jurisdiction. See *State v. Belt*, 16 O.R. App. 213, 517 P. 2d. 1219, Sup. Ct. review denied (1974). In other words a misdemeanant charged in circuit court is treated no differently than any other misdemeanant with the exception that the forum is different."

The court thus concluded that there was no violation of the equality guarantees of the Fourteenth Amendment.

One of the main purposes of the summary conviction procedure is to provide, as submitted by the intervenant, for a simpler, more expeditious mode of criminal procedure for those less serious offences which carry less significant punishments than for indictable offences. Indictable offences, on the other hand, in carrying greater penalties and more onerous consequences for the liberty of the accused, are thus provided with more complex procedural requirements to safeguard the liberty of the accused. The different purposes provide a rational basis for the difference in the right of appeal. As noted by the intervenant, the provision of an intermediate appeal in summary conviction offences by the Crown on questions of fact, as set out in the case law, provides what appears to be a rational method of ensuring that the summary nature of the procedure does not give rise to miscarriages of justice. The limitation of the Crown's right to appeal in indictable offences to grounds of law alone, on the other hand, appears to be a rational method of protecting the liberty of the accused.

The very purpose of a hybrid offence provision is to allow for a variation in the differing circumstances that are to be found from one case to another. An offence like tax evasion is such that in one case it will be appropriate, due to the greater seriousness of the act committed, to proceed by indictment, whereas in another less serious case, it will be appropriate to proceed by way of summary conviction. The hybrid offence provision in the *Income Tax Act* is thus a means by which the criminal law provides the Attorney General with sufficient flexibility to take the specific circumstances of each case into

Digitized by Google

account and ensure that, in each case, the interests of justice are served. In fact, lack of such choice could lead to a contravention of section 15 in that persons who are *not* similarly situated would get the same treatment and, thereby be treated unfairly.

It should be emphasized that we do not come to our conclusion because of any doubts that may have arisen, concerning judicial review of the Attorney General's discretion, in such older cases as *Florence Mining Co. v. Cobalt Lake Mining Co.* (1909), 18 O.L.R. 275 (Ont. C.A.), affd. 43 O.L.R. 474 and *Cripen v. Attorney General for Ontario* (1925), 56 O.L.R. 327, affd. 56 O.L.R. 530, or such Canadian Bill of Rights cases as *R. v. Court of Sessions of the Peace et al., ex parte Lafleur*, [1967] 3 C.C.C. 244, (Que.C.A.), *R. v. Smythe*, supra, (S.C.C.), *Morgentaler v. The Queen*, [1975] S.C.R. 616, 20 C.C.C. (2d) 449 and *Re Saikaly and The Queen* (1979), 48 C.C.C. (2d) 192 (O.C.A.). These are all pre-Charter cases and any doubts as to judicial review of ministerial discretion in such early Charter cases as *Stolar v. The Queen* (1983), 4 C.R.R. 252 (B.C.C.A.), and *R. v. Taylor* (1983), 8 C.R.R. 29 (B.C.S.C.) were laid to rest in the Supreme Court of Canada decision in *Operation Dismantle v. The Queen*, [1985] 1 S.C.R. 441. It is now clear that a decision of the Attorney General, like a decision of Cabinet, is reviewable, not on the ground of whether it was sound, but rather on the ground of whether or not it violates the accused's rights under the Charter. See *Re Regina and Arviv* (1985), 19 C.C.C. (3d) 395, a decision of this court which preceded *Operation Dismantle*, and *R. v. Kworak*, *Balian and Ghara Khanian* (1986), 20 C.R.R. 325, a decision of Smith, J. of the Ontario High Court which followed the Supreme Court decision. If the Attorney General's election were otherwise discriminatory, it could be found violative of section 15, but not merely on the ground of exercise of ministerial discretion. Thus, we conclude that section 239 of the *Income Tax Act* and the choice made in this case of proceeding by way of summary conviction do not contravene section 15 of the Charter.

Because of that conclusion, we do not need to consider the application of section 1 of the Charter.

It follows from these reasons that the Attorney General's right of election, pursuant to section 239 of the *Income Tax Act*, does not contravene paragraph 11(f) of the Charter providing for a right to a jury in the circumstances specified in that subsection.

Providing incorrect tax shelter identification number – 239(2.1)

(2.1) Every person who wilfully provides another person with an incorrect identification number for a tax shelter is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

a fine of not less than 100%, and not more than 200%, of the cost to the other person of that person's interest in the shelter;

imprisonment for a term not exceeding 2 years; or

both the fine described in paragraph 239(2.1)(a) and the imprisonment described in paragraph 239(2.1)(b).

Offence with respect to confidential information – 239(2.2) (2.2) Every person who

contravenes subsection 241(1), or

knowingly contravenes an order made under subsection 241(4.1)

is guilty of an offence and liable on summary conviction to a fine not exceeding $5,000 or to imprisonment for a term not exceeding 12 months, or to both.

Idem – 239(2.21)

Digitized by Google

(2.21) Every person

to whom taxpayer information has been provided for a particular purpose under paragraph 241(4)(b), (c), (e), (h), (k), (n), (o) or (p).

who is an official to whom taxpayer information has been provided for a particular purpose under paragraph 241(4)(a), (d), (f), (f.1), (i) or (j.1)

Digitized by Google

and who for any other purpose knowingly uses, provides to any person, allows the provision to any person of, or allows any person access to, that information is guilty of an offence and liable on summary conviction to a fine not exceeding $5,000 or to imprisonment for a term not exceeding 12 months, or to both.

Definitions – 239(2.22)

(2.22) In subsection 239(2.21), "official" and "taxpayer information" have the meanings assigned by subsection 241(10).

Offence with respect to an identification number – 239(2.3)

(2.3) Every person to whom the Social Insurance Number of an individual or to whom the business number of a taxpayer or partnership has been provided under this Act or a regulation, and every officer, employee and agent of such a person, who without written consent of the individual, taxpayer or partnership, as the case may be, knowingly uses, communicates or allows to be communicated the number (otherwise than as required or authorized by law, in the course of duties in connection with the administration or enforcement of this Act or for a purpose for which it was provided by the individual, taxpayer or partnership, as the case may be) is guilty of an offence and liable on summary conviction to a fine not exceeding $5,000 or to imprisonment for a term not exceeding 12 months, or to both.

Penalty on conviction – 239(3)

) Where a person is convicted under this section, the person is not liable to pay a penalty imposed under section 162, 163 or 163.2 for the same contravention unless the penalty is assessed before the information or complaint giving rise to the conviction was laid or made.

Stay of appeal – 239(4)

) Where, in any appeal under this Act, substantially the same facts are at issue as those that are at issue in a prosecution under this section, the Minister may file a stay of proceedings with the Tax Court of Canada and thereupon the proceedings before that Court are stayed pending final determination of the outcome of the prosecution.

Offence and punishment without reference to subsection 120(2.2) – 239(5)

) In determining whether an offence under this Act, for which a person may on summary conviction or indictment be liable for a fine or imprisonment, has been committed, and in determining the punishment for such an offence, this Act is to be read without reference to subsection 120(2.2).

Information for general warrant – CC Sec. 487.01

(1) A provincial court judge, a judge of a superior court of criminal jurisdiction or a judge as defined in section 552 may issue a warrant in writing authorizing a peace officer to, subject to this section, use any device or investigative technique or procedure or do any thing described in the warrant that would, if not authorized, constitute an unreasonable search or seizure in respect of a person or a person's property if

the judge is satisfied by information on oath in writing that there are reasonable grounds to believe that an offence against this or any other Act of Parliament has been or will be committed and that information concerning the offence will be obtained through the use of the technique, procedure or device or the doing of the thing;

the judge is satisfied that it is in the best interests of the administration of justice to issue the warrant; and

there is no other provision in this or any other Act of Parliament that would provide for a warrant, authorization or order permitting the technique, procedure or device to be used or the thing to be done.

Digitized by Google

Marginal note: Limitation

Digitized by Google

Nothing in subsection (1) shall be construed as to permit interference with the bodily integrity of any person.

Marginal note: Search or seizure to be reasonable
A warrant issued under subsection (1) shall contain such terms and conditions as the judge considers advisable to ensure that any search or seizure authorized by the warrant is reasonable in the circumstances.

Marginal note: Video surveillance
A warrant issued under subsection (1) that authorizes a peace officer to observe, by means of a television camera or other similar electronic device, any person who is engaged in activity in circumstances in which the person has a reasonable expectation of privacy shall contain such terms and conditions as the judge considers advisable to ensure that the privacy of the person or of any other person is respected as much as possible.

Marginal note: Other provisions to apply
The definition "offence" in section 183 and sections 183.1, 184.2, 184.3 and 185 to 188.2, subsection 189(5), and sections 190, 193 and 194 to 196 apply, with such modifications as the circumstances require, to a warrant referred to in subsection (4) as though references in those provisions to interceptions of private communications were read as references to observations by peace officers by means of television cameras or similar electronic devices of activities in circumstances in which persons had reasonable expectations of privacy.

Marginal note: Notice after covert entry
(5.1) A warrant issued under subsection (1) that authorizes a peace officer to enter and search a place covertly shall require, as part of the terms and conditions referred to in subsection (3), that notice of the entry and search be given within any time after the execution of the warrant that the judge considers reasonable in the circumstances.

Marginal note: Extension of period for giving notice
(5.2) Where the judge who issues a warrant under subsection (1) or any other judge having jurisdiction to issue such a warrant is, on the basis of an affidavit submitted in support of an application to vary the period within which the notice referred to in subsection (5.1) is to be given, is satisfied that the interests of justice warrant the granting of the application, the judge may grant an extension, or a subsequent extension, of the period, but no extension may exceed three years.

Marginal note: Provisions to apply
Subsections 487(2) and (4) apply, with such modifications as the circumstances require, to a warrant issued under subsection (1).

Marginal note: Telewarrant provisions to apply
Where a peace officer believes that it would be impracticable to appear personally before a judge to make an application for a warrant under this section, a warrant may be issued under this section on an information submitted by telephone or other means of telecommunication and, for that purpose, section 487.1 applies, with such modifications as the circumstances require, to the warrant.

Digitized by Google

There was a time whereby our Justice Dept. had advised CRA to use the ITA s. 231.2 warrant to obtain evidence of tax evasion.

Digitized by Google

Digitized by Google

Provision of information - S. 241
241. (1) Except as authorized by this section, no official or other representative of a government entity shall

(*a*) knowingly provide, or knowingly allow to be provided, to any person any taxpayer information;

(*b*) knowingly allow any person to have access to any taxpayer information; or

(*c*) knowingly use any taxpayer information otherwise than in the course of the administration or enforcement of this Act, the *Canada Pension Plan*, the *Unemployment Insurance Act* or the *Employment Insurance Act* or for the purpose for which it was provided under this section.

Evidence relating to taxpayer information
(2) Notwithstanding any other Act of Parliament or other law, no official or other representative of a government entity shall be required, in connection with any legal proceedings, to give or produce evidence relating to any taxpayer information.

Communication where proceedings have been commenced
(3) Subsections 241(1) and 241(2) do not apply in respect of

(*a*) criminal proceedings, either by indictment or on summary conviction, that have been commenced by the laying of an information or the preferring of an indictment, under an Act of Parliament; or

(*b*) any legal proceedings relating to the administration or enforcement of this Act, the *Canada Pension Plan*, the *Unemployment Insurance Act* or the *Employment Insurance Act* or any other Act of Parliament or law of a

Digitized by Google

province that provides for the imposition or collection of a tax or duty.

Circumstances involving danger

(3.1) The Minister may provide to appropriate persons any taxpayer information relating to imminent danger of death or physical injury to any individual.

Where taxpayer information may be disclosed

(4) An official may

(*a*) provide to any person taxpayer information that can reasonably be regarded as necessary for the purposes of the administration or enforcement of this Act, the *Canada Pension Plan*, the *Unemployment Insurance Act* or the *Employment Insurance Act*, solely for that purpose;

(*b*) provide to any person taxpayer information that can reasonably be regarded as necessary for the purposes of determining any tax, interest, penalty or other amount that is or may become payable by the person, or any refund or tax credit to which the person is or may become entitled, under this Act or any other amount that is relevant for the purposes of that determination;

(*c*) provide to the person who seeks a certification referred to in paragraph 147.1(10)(*a*) the certification or a refusal to make the certification, solely for the purposes of administering a registered pension plan;

(*d*) provide taxpayer information

(i) to an official of the Department of Finance solely for the purposes of the formulation or evaluation of fiscal policy,

(ii) to an official solely for the purposes of the initial implementation of a fiscal policy or for the purposes of the administration or enforcement of an Act of Parliament that provides for the imposition and collection of a tax or duty,

(iii) to an official solely for the purposes of the administration or enforcement of a law of a province that provides for the imposition or collection of a tax or duty,

(iv) to an official of the government of a province solely for the purposes of the formulation or evaluation of fiscal policy,

(v) to an official of the Department of Natural Resources or of the government of a province solely for the purposes of the administration or enforcement of a program of the Government of Canada or of the province relating to the exploration for or exploitation of Canadian petroleum and gas resources,

(vi) to an official of the government of a province that has received or is entitled to receive a payment referred to in this subparagraph, or to an official of the Department of Natural Resources, solely for the purposes of the provisions relating to payments to a province in respect of the taxable income of corporations earned in the offshore area with respect to the province under the *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act*, chapter 28 of the Statutes of Canada, 1988, the *Canada-Newfoundland Atlantic Accord Implementation Act*, chapter 3 of the Statutes of Canada, 1987, or similar Acts relating to the exploration for or exploitation of offshore Canadian petroleum and gas resources,

(vi.1) to an official of the Department of Natural Resources solely for

Digitized by Google

the purpose of determining whether property is prescribed energy conservation property or whether an outlay or expense is a Canadian renewable and conservation expense,

(vii) to an official solely for the purposes of the administration or enforcement of the *Pension Benefits Standards Act, 1985*, the *Pooled Registered Pension Plans Act* or a similar law of a province,

(vii.1) to an official solely for the purpose of the administration or enforcement of the *Canada Education Savings Act* or a designated provincial program as defined in subsection 146.1(1),

(vii.2) to an official solely for the purposes of the administration and enforcement of Part 1 of the *Energy Costs Assistance Measures Act*,

(vii.3) to an official solely for the purposes of the administration and enforcement of the *Children's Special Allowances Act* or the evaluation or formation of policy for that Act,

(vii.4) to an official solely for the purposes of the administration and enforcement of the *Universal Child Care Benefit Act* or the evaluation or formation of policy for that Act,

(vii.5) to an official solely for the purposes of the administration or enforcement of the *Canada Disability Savings Act* or a designated provincial program as defined in subsection 146.4(1),

(viii) to an official of the Department of Veterans Affairs solely for the purposes of the administration of the *War Veterans Allowance Act*, the *Canadian Forces Members and Veterans Re-establishment and Compensation Act* or Part XI of the *Civilian War-related Benefits Act*,

(ix) to an official of a department or agency of the Government of Canada or of a province as to the name, address, occupation, size or type of business of a taxpayer, solely for the purposes of enabling that department or agency to obtain statistical data for research and analysis,

(x) to an official of the Canada Employment Insurance Commission or the Department of Human Resources and Skills Development, solely for the purpose of the administration or enforcement of the *Employment Insurance Act*, an employment program of the Government of Canada or the evaluation or formation of policy for that Act or program,

(x.1) to an official of the Department of Human Resources and Skills Development solely for the purpose of the administration or enforcement of a program established under the authority of the *Department of Human Resources and Skills Development Act* in respect of children who are deceased or missing as a result of an offence, or a probable offence, under the *Criminal Code*,

(xi) to an official of the Department of Agriculture and Agri-Food or of the government of a province solely for the purposes of the administration or enforcement of a program of the Government of Canada or of the province established under an agreement entered into under the *Farm Income Protection Act*,

(xii) to an official of the Department of Canadian Heritage or a member of the Canadian Cultural Property Export Review Board solely for the purposes of administering sections 32 to 33.2 of the *Cultural Property Export and Import Act*.

Digitized by Google

(xiii) to an official solely for the purposes of setting off against any sum of money that may be due or payable by Her Majesty in right of Canada a debt due to

(A) Her Majesty in right of Canada, or

(B) Her Majesty in right of a province, or

(xiv) to an official solely for the purposes of section 7.1 of the *Federal-Provincial Fiscal Arrangements and Federal Post- Secondary Education and Health Contributions Act*;

(*e*) provide taxpayer information, or allow the inspection of or access to taxpayer information, as the case may be, under, and solely for the purposes of,

(i) subsection 36(2) or section 46 of the *Access to Information Act*,

(ii) section 13 of the *Auditor General Act*,

(iii) section 92 of the *Canada Pension Plan*,

(iv) a warrant issued under subsection 21(3) of the *Canadian Security Intelligence Service Act*,

(v) an order made under subsection 462.48(3) of the *Criminal Code*,

(vi) section 26 of the *Cultural Property Export and Import Act*,

(vii) section 79 of the *Family Orders and Agreements Enforcement Assistance Act*,

(viii) paragraph 33.1(*a*) of the *Old Age Security Act*,

(ix) subsection 34(2) or section 45 of the *Privacy Act*,

(x) section 24 of the *Statistics Act*,

(xi) section 9 of the *Tax Rebate Discounting Act*, or

(xii) a provision contained in a tax treaty with another country or in a listed international agreement;

(*f*) provide taxpayer information solely for the purposes of sections 23 to 25 of the *Financial Administration Act*;

(*f.1*) provide taxpayer information to an official for the purposes of the administration and enforcement of the *Charities Registration (Security Information) Act*, and where an official has so received taxpayer information, the official may provide that information to another official as permitted by subsection (9.1);

(*g*) use taxpayer information to compile information in a form that does not directly or indirectly reveal the identity of the taxpayer to whom the information relates;

(*h*) use, or provide to any person, taxpayer information solely for a purpose relating to the supervision, evaluation or discipline of an authorized person by Her Majesty in right of Canada in respect of a period during which the authorized person was employed by or engaged by or on behalf of Her Majesty in right of Canada to assist in the administration or enforcement of this Act, the *Canada Pension Plan*, the *Unemployment Insurance Act* or the *Employment Insurance Act*, to the extent that the information is relevant for the purpose;

(*i*) provide access to records of taxpayer information to the Librarian and Archivist of Canada or a person acting on behalf of or under the direction of the Librarian and Archivist, solely for the purposes of section 12 of the *Library and Archives of Canada Act*, and transfer such records to the care and control of such persons solely for the purposes of section 13 of that

Digitized by Google

Act;

(*j*) use taxpayer information relating to a taxpayer to provide information to the taxpayer;

(*j.1*) provide taxpayer information to an official or a designated person solely for the purpose of permitting the making of an adjustment to

(i) a social assistance payment made on the basis of a means, needs or income test, or

(ii) a payment pursuant to a prescribed law of a province in respect of a child within the meaning of the prescribed law, where the purpose of the adjustment is to take into account the amount determined for C in subsection 122.61(1) in respect of a person for a taxation year;

(*k*) provide, or allow inspection of or access to, taxpayer information to or by any person otherwise legally entitled to it under an Act of Parliament solely for the purposes for which that person is entitled to the information;

(*l*) subject to subsection (9.2), provide to a representative of a government entity the business number of, the name of (including any trade name or other name used by), and any contact information, corporate information and registration information in respect of, the holder of a business number (other than an excluded individual), if the information is provided solely for the purposes of the administration or enforcement of

(i) an Act of Parliament or of a legislature of a province, or

(ii) a by-law of a municipality in Canada or a law of an aboriginal government;

(*m*) provide taxpayer information to an official of the government of a province solely for use in the management or administration by that government of a program relating to payments under subsection 164(1.8);

(*n*) provide taxpayer information to any person, solely for the purposes of the administration or enforcement of a law of a province that provides for workers' compensation benefits;

(*o*) provide taxpayer information to any person solely for the purpose of enabling the Chief Statistician, within the meaning assigned by section 2 of the *Statistics Act*, to provide to a statistical agency of a province data concerning business activities carried on in the province, where the information is used by the agency solely for research and analysis and the agency is authorized under the law of the province to collect the same or similar information on its own behalf in respect of such activities;

(*p*) provide taxpayer information to a police officer (within the meaning assigned by subsection 462.48(17) of the *Criminal Code*) solely for the purpose of investigating whether an offence has been committed under the *Criminal Code*, or the laying of an information or the preferring of an indictment, where

(i) such information can reasonably be regarded as being necessary for the purpose of ascertaining the circumstances in which an offence under the *Criminal Code* may have been committed, or the identity of the person or persons who may have committed an offence, with respect to an official, or with respect to any person related to that official,

(ii) the official was or is engaged in the administration or enforcement of this Act, and

(iii) the offence can reasonably be considered to be related to that

Digitized by Google

administration or enforcement; or

(*q*) provide taxpayer information to an official of the government of a province solely for the use in the management or administration by that government of a program relating to earning supplementation or income support.[140]

The Queen v. Snider, [1954] S.C.R. 479, The Historic Decision on Society's Privilege to A Criminally Accused Tax Returns

In The Matter of A Reference Under The Constitutional Questions Determination Act, R.S.B.C. 1948, c. 66.
and
In The Matter of Regina v. Snider.
1953: December 3, 4, 7; 1954: June 21.
Present: Rinfret C.J. and Kerwin, Taschereau, Rand, Kellock, Estey, Locke, Cartwright and Fauteux JJ.
ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA
Privileged documents—Evidence—Production of income tax returns sought in a criminal prosecution—Objection by Minister—Whether contrary to public policy—Income War Tax Act, R.S.C. 1927, c. 97, s. 81.—Income Tax Act, 1948, S. of C. 1948, c. 52, s. 121.—Excess Profits Tax Act, 1940, S. of C. 1940.

At a trial under the *Criminal Code,* the Crown in the right of the Province subpoenaed the Director of Taxation of the District of Vancouver requiring him to give evidence and to produce the income tax returns of the accused. The Minister of National Revenue, in an affidavit, objected to the production of the documents and to the giving of oral evidence, basing his claim that it would be prejudicial to the public interest on s. 81 of the *Income War Tax Act* and on s. 121 of the *Income Tax Act,* which prohibit such communications to any person other than a person "legally entitled thereto".

Consequent to the ruling of the trial judge that the returns must be produced and, if relevant, given in evidence, the following questions were submitted for the opinion of the Court of Appeal for British Columbia pursuant to the *Constitutional Questions Determination Act,* R.S.B.C. 1948, c. 66:

1. On the trial of a person charged with an indictable offence, where a subpoena *duces tecum* has been served on the appropriate Income Tax official to produce before the Court on such trial returns, reports, papers and documents filed pursuant to the provisions of the *Income Tax Act,* and the *Income War Tax Act* or the *Excess Profits Tax Act, 1940,* and to give evidence relating thereto, and where the Minister of National Revenue has stated on oath that in his opinion such evidence and the production of such returns, reports, papers and documents would be prejudicial to the public interest; ought such Court to order the production of such returns, reports, papers and documents and the giving or oral evidence relating thereto: (*a*) when such subpoena is served at the instance or on behalf of the Attorney General of the Province; (*b*) when such subpoena is served at the instance or on behalf of the accused?

2. Are the documents hereinbefore mentioned in Question 1, for the

[140] See The Requirement of Confidentiality Under the Income Tax Act and Its Effect on the Conduct of Appeals Before the Tax Court of Canada by Patrick Bendin, in the Canadian Tax Journal, (1996), Vol. 44, No. 3 / no 3, Pg 680. for an elaboration of the issues and how they are handled by Crowns.

Digitized by Google

purposes of a subpoena *duces tecum* directed to an Income Tax Official of the Income Tax Department, in the possession of the said official to the extent that the Court may order them produced in Court pursuant to the said subpoena, or are the said documents in the possession of the Crown?

3. Do Sections 81 and 121 of the *Income War Tax Act* and the *Income Tax Act, 1948,* respectively affect the right of the Minister of National Revenue to object on the ground of prejudice to the public interest to the production of the documents hereinbefore mentioned in Question 1 and to the giving of oral evidence by an Income Tax official relating to returns made under the said Acts?

On appeal to this Court, it was held:

1. (Per Rinfret C.J., Kerwin, Taschereau, Rand, Kellock, Estey and Fauteux JJ.) That the Court may order the production of the documents in question and the giving of oral evidence relating thereto, unless special facts or circumstances appearing in the Minister's affidavit make it clear to the Court that there might be prejudice to the public interest in the disclosure, but only to the extent of the document or documents within the special facts or circumstances.

2. (Per Locke J.) That the Court may order the production of the documents in question and the giving of oral evidence relating thereto to enable the Court to determine whether the facts discoverable by the production of the documents would be admissible, relevant or prejudicial or detrimental to the public welfare in any justifiable sense.

3. (Per Cartwright J.) That the Court may order the production of the documents in question and the giving of oral evidence relating thereto, limited however to a case in which the objection of the Minister is to the production of any documents belonging to the class consisting of returns, reports, papers and documents filed pursuant to the provisions of the *Income Tax Act,* the *Income War Tax Act* or the *Excess Profits Tax Act, 1940,* on the ground that they belong to that class.

4. (Per Curiam) That for the purposes of a subpoena *duces tecum* directed to an Income Tax Official of the Income Tax Department, the documents in question are in the possession of such official to the extent that the Court may order them produced in Court pursuant to a subpoena.

5. (Per Rinfret C.J., Kerwin, Taschereau, Rand, Kellock, Estey, Cartwright and Fauteux JJ.) That the Minister has no right to object to the production of the documents in question.

6. (Per Locke J.) That neither s. 81 of the *Income War Tax Act* or s. 121 of the *Income Tax Act, 1948,* affect the right of the Minister to object on the ground of public interest to the production of such documents in criminal proceedings and the giving of evidence relating thereto, but the effect of the sections is to render the objections subject to the discretionary jurisdiction and consequent order of the trial judge as set forth in the answer to Question 1.

APPEAL from the judgment of the Court of Appeal for British Columbia[1] in the matter of a reference under the *Constitutional Questions Determination Act,* R.S.B.C. 1948, c. 66, in respect of the production in Court of Dominion Income Tax returns in a criminal prosecution.

F. P. Varcoe, Q.C. and *D. H. W. Henry* for the Attorney General of Canada.

L. Kelley, Q.C. and *J.J. Urie* for the Attorney General of British Columbia.

The judgment of Rinfret C.J. and of Rand J. was delivered by:—

RAND J.:—This reference raises an important question of the right of the Minister of National Revenue to object to the production before a court of the income

Digitized by Google

returns of a person charged in criminal proceedings; and since there are many aspects to the general question of privilege claimed by the Crown in relation to which different considerations must be taken into account, I think it desirable to keep within the boundaries which the facts in this case have set for us. As the matter relates to evidence sought by either the Crown or the accused in a criminal prosecution, it is to be distinguished formally from a similar step in civil proceedings.

As Mr. Varcoe seemed to put it, any document coming into the hands of persons engaged in the work of any branch of the Executive, is ipso facto, on the ground of public policy, exempt from production on the objection of the departmental minister and for that proposition he cited many authorities concluding with that of *Duncan* v. *Cammell Laird & Company*[2]. When these authorities are closely examined, however, it will be found that they cannot be taken to proceed on any principle so broadly stated, and it becomes necessary, then, to enquire into the nature of testimonial privilege against disclosure and the grounds on which it is made effective in legal proceedings.

What is in debate are confidential communications and, for a better understanding of the question, the distinction is to be kept in mind between them and the matter which they deal with or express, that is, there may be confidential or secret matter apart from that of the communications themselves but to which they relate, or the secrecy may exist as to the matters which the communications themselves create or indeed to the fact of the communication alone. It requires as its essential condition that there be a public interest recognized as overriding the general principle that in a court of justice every person and every fact must be available to the execution of its supreme functions. As Lord Chancellor Hardwicke, in speaking against the Bill For Indemnifying Evidence, Cobbett's Parliamentary History 12, 675, 693, 1742, declared:—

> It has, my lords, I own, been asserted by the noble duke that the public has a right to every man's evidence—a maxim which in its proper sense cannot be denied. For it is undoubtedly true that the public has a right to all the assistance of every individual.

And this applies as fully to the private suitor or an accused as to the public. The privilege is one to be asserted by or on behalf of a person or persons including the Crown to whose benefit it enures, and it may be waived only by the beneficiary; if the disclosure is proposed in a proceeding between third parties, the court itself must interpose to safeguard the privilege.

It springs, then, from a confidential communication coupled with a paramount public interest in permitting the secrecy surrounding the communication or its contents to be maintained. This is perhaps best illustrated by the privilege relating to communications between husband and wife or between solicitor and client. The public interest in the latter relationship lies in securing to every citizen the skill and ability of a professional class to enable him to protect his own interest in life, liberty and property within the law and before its tribunals. If that means were not, in the widest sense, made available to him he would be denied that justice which it is a fundamental object of our political organization to secure to him. The client may, therefore, in absolute freedom, disclose to his solicitor the details of his business or personal matters on which he seeks legal advice or action, and upon that communication the law places the seal of confidence which only the client himself can remove. Of a similar nature are communications by an informer to public enforcement officers and those between officers of state on national or

Digitized by Google

international matters expressing views or making proposals on governmental policy which may affect the peace or safety of the country and which the ministers of the Crown may even be sworn not to disclose. There may also be external matters such as of defence which equally, for the same reasons, must be held to be within that safeguard, the facts of which may, in the discretion of ministers or government, be disclosed as considered desirable. Is there, then, a privilege of that nature here? If so, to whom does it run and what is the public policy supporting it?

It is claimed that the circumstances give rise to such a privilege in the Crown and that the public interest emanates from an undertaking on its part, implied by the *Income Tax Act,* toward all income taxpayers that the contents of the returns of none of them will be revealed beyond the circle of officials concerned in administering the statute. Sec. 121 of that *Act* forbids the disclosure of and information obtained under it to any person "not legally entitled thereto". For the purposes of his argument, however, Mr. Varcoe puts that aside as being irrelevant to the proposition urged.

I am unable to agree with either of these contentions. I can find nothing in the statute indicating such an undertaking. The disclosure of a person's return of income for taxation purposes is no more a matter of confidence or secrecy than that, say, of his real property which for generations has been publicly disclosed in assessment rolls. It is in the same category as any other fact in his life and the production in court of its details obtained from his books or any other source is an everyday occurrence. The ban against departmental disclosure is merely a concession to the inbred tendency to keep one's private affairs to one's self. Now that, in this competitive society, is a natural and unobjectionable tendency but it has never before been elevated to such a plane of paramount concern. The most confidential and sensitive private matters are daily made the subject of revelation before judicial tribunals and it scarcely seems necessary to remark on the relative insignificance to any legal or social policy of such a fact as the income a man has been able to produce. I should say, therefore, that the only privilege furnished is that given by the statute and that it is a privilege for the benefit of the individual and not the Crown.

The prohibition of the statute is against disclosure to others than the departmental staff charged with the assessment but since the public interest in the administration of justice transcends that of any individual in the details of his ledger account, the ban is to be taken to be directed against a voluntary disclosure only and has no application to judicial proceedings. The intervention of the minister, as would be that of the person himself, is therefore ineffectual.

The second question of the reference suggests a distinction between possession of the Crown and by departmental officials administering the Act. The "Crown" as used in this sense is assumed to carry with it some mystical character which removes the case from the level on which taxation takes place. Where in constitutional or high governmental functions the prerogative or even statutory power is exercised in relation to the possession of a document whether personally by the Sovereign or by means of secretaries, ministers, or other high officers of state acting themselves or through subordinate officers, there are or may be undoubtedly elements that give the possession a special character. But here is a statute providing for the assessment and collection of taxes by an administrative department which the statute itself sets up. The subject is placed in communication with the officials of that department in immediate relation to a

Digitized by Google

function that directly and individually affects his private financial affairs. Neither the prerogative nor any constitutional or political function is involved. To suggest that either in the case of protecting or attacking the private interest of the taxpayer the custody of tax returns rendered to the department can be refused production on the ground of the nature of the possession is to attract some vague magic sensed or associated with the prerogative to the routine of administrative government. All governmental and administrative activity may be said to be carried out by the Executive but it is not in these levels of administration, which might extend to every clerk, say, of a government railway, that any degree or shade of possession in the course of executive action is, by a reference to the Crown, to be placed beyond the reach of the courts.

Once the nature, general or specific as the case may be, of documents or the reasons against its disclosure, are shown, the question for the court is whether they might, on any rational view, either as to their contents or the fact of their existence, be such that the public interest requires that they should not be revealed; if they are capable of sustaining such an interest, and a minister of the Crown avers its existence, then the courts must accept his decision. On the other hand, if the facts, as in the example before us, show that, in the ordinary case, no such interest can exist, then such a declaration of the minister must be taken to have been made under a misapprehension and be disregarded. To eliminate the courts in a function with which the tradition of the common law has invested them and to hold them subject to any opinion formed, rational or irrational, by a member of the executive to the prejudice, it might be, of the lives of private individuals, is not in harmony with the basic conceptions of our polity. But I should add that the consequences of the exclusion of a document for reasons of public interest as it may affect the interest of an accused person are not in question here and no implication is intended as to what they may be.

What is secured by attributing to the courts this preliminary determination of possible prejudice is protection against executive encroachments upon the administration of justice; and in the present trend of government little can be more essential to the maintenance of individual security. In this important matter, to relegate the courts to such a subserviency as is suggested would be to withdraw from them the confidence of independence and judicial appraisal that so far appear to have served well the organization of which we are the heirs. These are considerations which appear to me to follow from the reasoning of the Judicial Committee in *Robinson v. South Australia* ***[3]***.

I would therefore answer the questions as follows:—

Question I: (a) and (b) Yes, unless special facts or circumstances appearing on the minister's affidavit make it clear to the court that there might be prejudice to the public interest in the disclosure, but only to the extent of the document or documents within the special facts or circumstances.

Question II: The documents are in the custody of officials to the extent that the court may order them produced in court pursuant to subpoena.

Question III: The minister has no right to object to the production of the documents.

Subject to the variation indicated, the appeal must be dismissed.

The judgment of Kerwin,Taschereau, Kellock and Fauteux JJ. delivered by:—

Digitized by Google

KELLOCK J.:—In support of the appeal Mr. Varcoe relied heavily upon the decision of the House of Lords in *Duncan* v. *Cammell Laird**[4]***: The present questions, however, relate exclusively to criminal proceedings, and it is stated by Viscount Simon L.C., in the above case at p. 591 that

> The judgment of the House in the present case is limited to civil actions and the practice, as applied in criminal trials where an individual's life or liberty may be at stake, is not necessarily the same.

Even in criminal proceedings it has been held, for example, that the usual rule that the channel of information giving rise to a prosecution is not to be disclosed upon the ground of public interest, is not an absolute rule. In *Hardy's* case[5], Eyre C.J. said:

> …there is a rule which has universally obtained on account of its importance to the public for the detection of crimes, that those persons who are the channel by means of which that detection is made, should not be unnecessarily disclosed: if it can be made to appear that really and truly it is necessary to the investigation of the truth of the case that the name of the person should be disclosed, I should be very unwilling to stop it.

In referring to the above statement and to others of the same character, Viscount Simon said at the above page:

> Indeed, Eyre, C. J., in the passage referred to appears only to be restricting needless cross-examination.

There is, accordingly, not only a public interest in maintaining the secrecy of documents where the public interest would otherwise be damnified, as, for example, where disclosure would be injurious to national defence or to good diplomatic relations, or where the practice of keeping a class of document is necessary for the proper functioning of the public service, but there is also a public interest which says that "an innocent man is not to be condemned when his innocence can be proved"; per Lord Esher M.R., in *Marks v. Beyfus**[6]***. It cannot be said, however, that either the one or the other must invariably be dominant.

In considering the applicability of the rule as to secrecy of documents in the public interest, it is to be remembered that where it does apply, not even a copy of a document, no matter from what source it may be forthcoming, nor any oral evidence as to its contents are admissible.

In *Chatterton v. Secretary of State for India**[7]***, A. L. Smith, L.J., laid down the rule at p. 195 as follows:

> The cases have gone the length of holding that, even if no objection were taken to the production of such a document by the person in whose custody it was, it would be the duty of the judge at the trial to intervene, and to refuse to allow it to be produced: and it has further been held that, if an attempt were made to get round that difficulty by giving secondary evidence of its contents, the judge ought also to prevent that from being done.

Viscount Simon, L.C., referred to the above with approval in the *Cammell Laird case* at p. 595, where he said:

> The present opinion is concerned only with the production of documents, but it seems to me that the same principle must also apply to the exclusion of verbal evidence which, if given, would jeopardize the interests of the community.

In 1888, in *Hennessy v. Wright**[8]***, Wills J. had said:

> I think the above cases abundantly show that no sound distinction can be

Digitized by Google

> drawn between the duty of the judge when objection is taken by the responsible officer of the Crown, or by the party, or when, no objection being taken by anyone, it becomes apparent to him that a rule of public policy prevents the disclosure of the documents or information sought.

It follows that if, in any case, the nature of the information sought to be placed before the court is not of such a nature that by no person or by no means may evidence be given of it, there is no public interest attaching to its nondisclosure. Moreover, as observed by Lord Blanesburgh in Robinson's case[9]

> ...the privilege, the reason for it being what it is, can hardly be asserted in relation to documents the contents of which have already been published.

The documents which are involved in the questions presently before the court are all documents which have been "filed" pursuant to the provisions of one or other of the designated statutes, that is, they are all documents emanating from a taxpayer or a person required by the lgislation to furnish information. As pointed out by Viscount Simon in the Cammell Laird case at p. 592, the question as to what documents are non-producible on the ground of public interest, may arise with respect to the contents of a particular document or with respect to a *class* of document. The questions presently before the court relate exclusively to a class of document and not to the contents of any particular document within that class.

In considering the proper answers to be given to the questions asked, it is pertinent to consider whether in the legislation itself, Parliament has indicated whether or not any secrecy, from the standpoint of the state, is to attach to documents of this class. The situation will sufficiently appear if I refer only to the provisions of the *Income Tax Act* (1948) 11-12 Geo. VI, c. 52.

By s. 82(2), which deals with appeals by a taxpayer to the Income Tax Appeal Board from the decision of the Minister, it is not the Crown but the appellant who is given the right to require a hearing in camera. The present form of the section emphasizes the intention of Parliament in that the right formerly given by the previous s. 68 to the Crown to require the hearing to be in camera, no longer exists. It would seem difficult to contend in the light of this legislation that any state secrecy was intended by Parliament to surround the class of document here in question. S. 93, which deals with appeals to the Exchequer Court, is similar to s. 82(2). These provisions, in my view, indicate that any secrecy which is in contemplation of the statute is for the benefit of the taxpayer only.

Nor do the sections just referred to stand alone. By s. 120(1) it is made an offence to make, participate in or assent to the making of a false or deceptive statement in a return. Proceedings to enforce the penalty provided for such an offence necessarily involve the production of the offending return in evidence. In fact, by s. 124(8) provision is made for the admission of a sworn copy of any document made by or on behalf of a taxpayer as prima facie evidence of the nature and contents of the document. In *Snell v. Haywood* (No. 2)[10], it was held by the Appellate Division of the Supreme Court of Alberta that proceedings of this character by way of summary conviction must be in public.

I respectfully agree with the decision in *Ship* v. *The King**[11]*, where it was held by the Court of King's Bench, Appeal Side, that s. 121, which deals with the subject-matter of secrecy as to "any information obtained under this Act", or "any written statement furnished under this Act", and which prohibits communication by employees of Her Majesty to anyone except a person "legally entitled thereto", applies in the administrative field only. The statute itself has nothing to say as to the identity of the persons so entitled but leaves that to be determined by the

Digitized by Google

general law. In my opinion, a court of competent jurisdiction issuing its subpoena would, in any event, be within the language of the exception and entitled to enforce the production of any returns or statements filed. It may be observed that in *Ship's case* the Crown did not, on that occasion, even object to the production of such documents.

The decision reached by a divided court in British Columbia in the case of *Weber v. Pawlik**[12]***, is one with which, with respect, I cannot agree. That was a partnership action in which the plaintiff alleged that the defendant, by concealing and mis-stating to him the firm's earnings, had deprived him of his proper share of the profits and eventually induced him to sell his interest at an undervalue. The plaintiff had left the management of the partnership business to the defendant, the latter making the income tax returns on its behalf, while furnishing the plaintiff with statements as to profits.

After the plaintiff had sold out his interest to the defendant, he was assessed for taxes in respect of periods during which the partnership was in existence, on profits substantially in excess of those which had been reported to him by the defendant. On application to the Income Tax authorities, the plantiff was given full particulars of the returns the defendant had filed, which were, of course, fully as much those of the plaintiff as of the defendant, but at the trial, on objection of the Minister, the returns were excluded. The objection appears to have involved the contention that the returns were not producible in the public interest because "confidential".

This decision, with respect, involves a misconception not only of the effect of the statute itself but also of the scope of the rule purported to be invoked, as, if applicable, no evidence of the contents of the returns could have been given either by production of a copy or by oral evidence. This could scarcely have been contended in such a case as the defendant would be obligated to make full disclosure of the income of the partnership.

Mr. Varcoe refused to take any such position in the case at bar but based the appeal upon the ground of an undertaking on the part of the Crown that tax returns will be kept confidential by the department. Neither in criminal nor in civil proceedings are documents which are merely "official" or "confidential" within the rule as to nondisclosure on the ground of public interest. In *Asiatic Petroleum Company* v. *Anglo-Persian Oil Company Limited**[13]***, Swinfen Eady, L.J., (with the subsequent approval of the Privy Council in *Robinson* v. *South Australia**[14]***, said p. 830 that the foundation of the rule

> is that the information cannot be disclosed without injury to the public interests, and not that the documents are confidential or official, which alone is no reason for their non-production: *Smith v. East India Co.,* 1 Ph. 60; *Hennessy v. Wright,* 21 Q.B.D., 509.

In my view of the statute, there is no provision as to the confidential character of returns filed except that provided for by ss, 82(2), 93 and 121, with which I have already dealt.

It only remains, in this aspect of the matter, to refer to the decision in re *Hargreaves**[15]***. That case arose under s. 115 of the *Imperial Companies Act,* 1862, which gives the court a discretion as to making an order for production of documents. The liquidator of the company there in question, in order to obtain evidence in support of a misfeasance summons against the directors, applied for an order that the surveyor of taxes should attend for examination and produce certain balance-sheets of the company which had been delivered to him for the

Digitized by Google

purpose of assessment for income tax. The surveyor, who objected to produce on the ground that it would be contrary to the oath he had taken, was supported in his objection to production of the documents by the Board of Inland Revenue on the ground that to do so would be "prejudicial and injurious to the public interests and service".

Wright J., the judge of first instance, referred to the discretionary nature of the jurisdiction conferred by s. 115 and said that if he had sufficient evidence that in the opinion of the Board of Inland Revenue the Public service would suffer by the production of the documents, very strong ground ought to be shown before he would be justified in going behind the certificate of the Board and he refused to do so. His order was upheld on appeal, the court refusing to reverse the exercise of discretion below.

There is no such discretionary statutory provision applicable to the case at bar, but apart from that consideration, there are two matters to be noted. The first is the observation of Romer L.J., at p. 353:

> The question now before us is not necessarily the same as that which may possibly arise upon the hearing of the misfeasance summons if the judge has then to consider the question of a subpoena for the production of these documents.

The other is that the provisions of the statute there in question, namely, the *Income Tax Act* of 1842, 5-6 Victoria, c. 35, are not the same as those of the Canadian statute. Sections 38 and 189, unlike s. 121 of the Canadian statute, contain no exception with respect to communication.

Apart from the statutory provisions to which I have referred, our attention was not called to any others, federal or provincial, having any relevancy.

For these reasons therefore, I would answer question 1(a) and (b) in the affirmative, unless special facts or circumstances appearing on the minister's affidavit make it clear that there might be prejudice to the public interest in the disclosure, but only to the extent of the document or documents within the special facts or circumstances.

As to question 2, it was held by Wills J. in *Hennessy* v. *Wright, ubi cit,* at p. 523, that whether documents with respect to which the privilege on the ground of public policy exists are the property of the Crown rather than the property of the witness is immaterial. The question remains the same. This is indicated also by Viscount Simon in the *Cammell Laird case* at p. 591, where he said:

> The question which we have to decide can only arise as a matter of law in England in cases where a subpoena is issued to a minister or department to produce a document (usually, but not necessarily, in a suit where the Crown is not a party), or where it intervenes in a suit between private individuals (as is the present case) to secure, on the ground of public interest, that documents in the hands of one of the litigants should not be produced. A similar situation might conceivably arise in litigation between the Crown and a subject where it was considered necessary to prevent the subject from producing a document in his possession on the ground that this would be injurious to public interests.

I would therefore answer that the documents are in the possession of the official to the extent that the court may order them produced in court pursuant to subpoena.

As to question 3, the minister has no right to object to the production of the documents.

Digitized by Google

Subject to the variations involved in these answers, the appeal should be dismissed.

ESTEY, J.:—The questions are restricted to a trial of an indictable offence, where a subpoena *duces tecum* has been served on the appropriate income tax official to produce before the court returns, reports, papers and documents filed pursuant to the provisions of the *Income Tax Act,* the *Income War Tax Act* or the *Excess Profits Tax Act, 1940,* and to give evidence relating thereto as to which the Minister of National Revenue has stated on oath that in his opinion such evidence and the production of such returns, reports, papers and documents would be prejudicial to the public interest (a) when such subpoena is served at the instance or on behalf of the Attorney-General of a province and (b) when such subpoena is served at the instance or on behalf of the accused.

That considerations of public safety and security require that the utmost secrecy be maintained with respect to certain documents and information in relation thereto in the possession of the Crown has long been recognized. The courts, in the administration of justice, have accepted, as part of their duty, the maintenance of that secrecy and have not required either be adduced in evidence. The basis of the rule is stated by Lord Blanesburgh in *Robinson* v. *State of South Australia**[16]*:

> As the protection is claimed on the broad principle of State policy and public convenience, the papers protected, as might have been expected, have usually been public official documents of a political or administrative character. Yet the rule is not limited to these documents. Its foundation is that the information cannot be disclosed without injury to the public interests and not that the documents are confidential or official, which alone is no reason for their non-production.

and by Viscount Simon in *Duncan v. Cammell, Laird & Co.**[17]*:

> The principle to be applied in every case is that documents otherwise relevant and liable to production must not be produced if the public interest requires that they should be withheld.

We are here concerned only with documents and information associated therewith filed pursuant to the requirements of the above-named statutes. Issues are constantly being tried before our courts relative to the liability of the taxpayer as well as prosecutions for the failure to perform duties imposed by these statutes. Accordingly, such documents and information in relation thereto have been repeatedly before the courts without any suggestion that the public safety or security has been at all imperilled; nor does there appear to be any reason in principle why these documents and information in relation thereto should, under ordinary circumstances, not be disclosed. It must follow that as a class these documents, in the ordinary course, do not involve questions of safety or security and as such their production would not be prevented upon the basis of public interest.

There may, however, with respect to one or more of these documents and information in relation thereto, be special circumstances which the minister may consider such as to require his taking the objection in respect of these particular documents. It is, therefore, pertinent to consider, in that event, the procedure to be followed.

We were referred to a great many authorities under which the rule has long been recognized but in which there has been much difference of judicial opinion as to the manner in which the objection to produce such documents ought to be made and the respective functions of the minister and the judge. More recent authorities

Digitized by Google

appear to have established that the objection must be made by the minister presiding over the department, commission, board or other body in whose custody the documents, the production of which is requested, are held. Before making the objection the minister should acquaint himself with the facts and, as a responsible minister of the Crown, decide whether the production of these documents, or evidence in relation thereto, would or would not be detrimental to the public interest. If he comes to the conclusion that their disclosure would be detrimental, it would appear that the more convenient procedure would be that he embody in an affidavit sufficient of the facts to indicate the nature of his objection and that he, as a responsible minister of the Crown, has concluded that their production, or information in relation thereto, in a court of law would be detrimental to the public interest.

The presiding judge, who, upon the affidavit, is satisfied that the production of these documents and information in relation thereto might be detrimental to the public interest, would give effect to the minister's objection.

The different opinions expressed by the authorities as to the right of a presiding judge to examine the documents appear to have been resolved by the observations of Viscount Simon in the *Cammell, Laird case, supra.* There the House of Lords expressly disapproved of the practice followed in *Robinson v. State of South Australia, supra,* where the Judicial Committee "remitted the case to the Supreme Court with the direction that it was one proper for the exercise of the court's power of inspecting documents to determine whether their production would be prejudicial to the public welfare". This view but emphasizes the fact that the documents and information in relation thereto to which the rule applies are such that neither should, by order of a court, be required to pass out of the possession of those officials of Her Majesty who are charged with their custody.

The *Cammel, Laird* was a civil case, but it would appear that the foregoing quotations and observations taken from or founded upon this case are relevant to the trial of an indictable offence.

Sections 81 of the *Income War Tax Act* and 121 of the *Income Tax Act, 1948* would appear to have been placed in the statutes to assure that those charged with the administration of the foregoing statutes would treat as confidential the information contained in or filed in relation to these documents. The reason and basis therefor is quite different and has no bearing on or relation to the above-discussed rule founded upon the necessity of public safety and security.

In my opinion the questions submitted should be answered as phrased by the majority of the Court and set forth in the reasons of my brothers Rand and Kellock.

LOCKE J.:—I respectfully agree with the opinion of the learned Chief Justice of British Columbia and with the answers made by him to the questions referred to the Court of Appeal and would accordingly dismiss this appeal.

CARTWRIGHT J.:Question No. 1 may, at a first reading, appear to be ambiguous; but when it is considered in the light of the arguments addressed to us by both counsel it becomes clear that it is directed to a case in which the objection to the production of the documents called for in the subpoena *duces tecum* is based not upon any apprehended danger to the public interest from disclosure of the matter contained in the particular returns and other documents of which production is sought but upon the view entertained by the Minister that as a matter of public or departmental policy he ought to object to the production from the custody of the department of any income tax returns or correspondence relating thereto. The

Digitized by Google

reason assigned in support of this view is that, while the returns are made under statutory compulsion, the taxpayers rely in making them upon an implied undertaking that the department will treat them as confidential communications and that it would be prejudicial to the public interest that this implied undertaking should be dishonoured.

In my view there is nothing in the acts referred to in the question which affirms the existence of any representation or undertaking on the part of the department that its officials will not produce the returns if called upon to do so by regular process issued from a court in which the trial of an indictable offence is pending. Sections 81 and 121 of the *Income War Tax Act* do not assist the appellant on this point. I agree with the view expressed by Barclay J. in *Ship* v.*The King****[18]*** that the judicial officer presiding at the trial of a person charged with an indictable offence is a person legally entitled to the information referred to in those sections if the production of such information is duly called for by subpoena and is relevant to the pending charge. For the purposes of the question before us, such relevance is assumed.

It is said for the appellant, however, that once the Minister has stated on oath that in his opinion the production of such returns would be prejudicial to the public interest while it is still the function of the court out of which the subpoena issued to decide whether or not production shall be ordered that court must decide the question by accepting the objection of the Minister as conclusive and giving effect to it. It is argued that this conclusion flows irresistibly from the judgment of the House of Lords in *Duncan* v*. Cammell Laird and Company****[19]***. In approaching this argument it is necessary to bear in mind the often quoted words of Lord Halsbury in *Quinn* v.*Leathem****[20]***:

> …Now, before discussing the case of *Allen v. Flood* and what was decided therein, there are two observations of a general character which I wish to make, and one is to repeat what I have very often said before, that every judgment must be read as applicable to the particular facts proved, or assumed to be proved, since the generality of the expressions which may be found there are not intended to be expositions of the whole law, but governed and qualified by the particular facts of the case in which such expressions are to be found. The other is that a case is only an authority for what it actually decides. I entirely deny that it can be quoted for a proposition that may seem to follow logically from it Such a mode of reasoning assumes that the law is necessarily a logical code, whereas every lawyer must acknowledge that the law is not always logical at all.

It is at once apparent that the facts with which the Law Lords were dealing in *Duncan* v*. Cammell Laird and Company* were altogether different from the assumed facts upon which the questions before us are based. Moreover, as is pointed out by my brother Kellock, Viscount Simon L.C. was careful to state (at page 633) that the judgment of the House was limited to civil actions.

In the case at bar, in the supposed state of facts, the Minister has not only asserted his objection but has fully informed the Court as to the grounds upon which it is founded and these appear to me to be grounds of the sort which Viscount Simon indicated (at page 642) "would not afford to the Minister adequate justification for objecting to production".

Perhaps unnecessarily, I wish to emphasize that any opinion which I have expressed in the course of these reasons is strictly limited to the supposed state of facts upon which the first question, as I have interpreted it above, is based.

Digitized by Google

Particularly, I do not think we are called upon to express any opinion as to what would have been the result if the objection of the Minister had been based on any other grounds than those indicated above or as to whether, as the answer to Question 1 given by the majority of the Court of Appeal in British Columbia might be thought to suggest, there may be circumstances in which the judge presiding at the trial of a person charged with an indictable offence may privately examine a document sought to be introduced in evidence.

I would answer Question 1 (a) and (b) as follows: Yes. This answer is however limited, as I have interpreted the question to be limited, to a case in which the objection of the Minister is to the production of any documents belonging to the class consisting of returns, reports, papers and documents filed pursuant to the provisions of the *Income Tax Act, the Income War Tax Act* or the *Excess Profits Tax Act, 1940* on the ground that they belong to that class.

I would answer Questions 2 and 3 as proposed by my brother Kellock.

Appeal dismissed.

Solicitor for the Attorney General of Canada: F. P. Varcoe.

Solicitor for the Attorney General of British Columbia: E. Pepler.

---

[1] [1953] 2 D.L.R. 9; 8 W.W.R. (N.S) 1; C.T.C. 136.
[2] [1942] A.C. 624.
[3] [1931] A.C. 704.
[4] [1942] 1 A.E. 587; [1942] A.C. 624.
[5] (1794) 24 State Trials 199 at 808.
[6] (1890) 25 Q.B.D. 494 at 498.
[7] [1895] 2 Q.B. 189.
[8] (1888) 21 Q.B.D. 509 at 521.
[9] [1931] A.C. 704 at 718.
[10] [1947] 3 D.L.R. 586.
[11] (1949) 95 C.C.C. 143.
[12] [1952] 5 W.W.R. (N.S) 49.
[13] [1916] 1 K.B. 822.
[14] [1931] A.C. 704 at 714.
[15] [1900] 1 Ch. 347.
[16] [1931] A.C. 704 at 714.
[17] [1942] A.C. 624 at 636.
[18] (1949) 95 C.C.C. 143 at 155.
[19] [1942] A.C. 495 at 506.
[20] [1901] A.C. 495 at 506.

R v. Wilder, 2000 BCCA 29 (CanLII), 2000-01-14, 142 CCC (3d) 418; 70 CRR (2d) 259, Confidentiality Provision not Bar to Admissibility of Evidence on Alternative Criminal Code Charge in face of Charter Self- Incrimination

Written Reasons by:
The Honourable Mr. Justice Esson
Concurred in by:
The Honourable Madam Justice Ryan The Honourable Mr. Justice Mackenzie

Digitized by Google

Reasons for Judgment of the Honourable Mr. Justice Esson:

[1] **The Crown appeals against the acquittal of Mr. Wilder on 7 counts of fraud and one of possession of money and property obtained by crime. The charges were laid under what are now *Code* ss.380(2)(a) and 354. The acquittal was entered after the trial judge ruled that a large body of evidence introduced by the Crown, which had previously been ruled admissible, was inadmissible as being in breach of the privilege against self-incrimination embodied in s.7 of the *Charter*.**

FACTUAL BACKGROUND

[2] The charges arose out of Mr. Wilder's participation in the Scientific Research Tax Credit ("SRTC") program in 1984-85. The essence of the alleged fraud is that Mr. Wilder and others claimed to have incurred expenses for research far in excess of the amount of research actually done and that the inflated research claims led to the fraudulent creation of tax credits which deprived the Crown of tax revenue in many millions of dollars.

[3] Mr. Wilder was president of Canadian Biomass Research Inc. and Coastal Natural Resources Research Inc. Those companies filed a number of "designations" on behalf of investors pursuant to s.194(4) of the *Income Tax Act* ("the Act"). The Crown alleges that, as a result, investors in the two companies received tax credits of about $38 million which triggered a tax liability of the same amount under the Act.

[4] The two companies deposited funds to meet their tax obligations in escrow accounts with a bank. That money was not to be released without certificates from Mr. Wilder as president of the two companies, Michael Richards, an accountant, and Gerald Byerlay, an engineer. The certificates were intended to confirm that sufficient qualified scientific research expenditures had been incurred by the companies to extinguish the tax liability. In late 1984 and early 1985, a number of certificates were filed with the bank which then released the escrow monies to the companies.

[5] The Crown alleges that the certificates were fraudulent in that the research expenditures were in one case inflated, that in a second no expenditures were incurred and, in a third, that there actually was no research project and that the escrow funds ought therefore have been used to satisfy the tax liability.

HISTORY OF PROCEEDINGS AGAINST CO-ACCUSED

[6] An audit review was launched in 1985, in the course of which Revenue Canada personnel obtained information under s.231(1) of the Act. In October, 1985, Revenue Canada's special investigation unit began an investigation to determine whether there was a basis for charges under the Act or the ***Criminal Code***. In 1985, bank records were obtained from various financial institutions pursuant to powers under the Act. In 1986 potential witnesses were interviewed. In May, 1987 search warrants issued under the Act were executed, as a result of which records and documents were seized from the business premises of various corporations and private residences, including a house owned by Mr. Wilder's wife. **Some of the grounds for the searches were based on information obtained during the audit review.**

[7] The investigation culminated in November, 1990 with Mr. Wilder, seven other

Digitized by Google

individuals and a company owned by one of the seven (Lawrence) being charged in a direct indictment with eight counts of fraud and two of possession of money and property obtained by crime. One count of each charge was stayed against Mr. Wilder before his trial began.

[8] In February, 1993 a trial before Mr. Justice Wong and a jury of the charges against four of the accused (Lawrence, Richards, Johnson and Byerlay) began. Mr. Wilder had been severed from them a few days before that. That trial ended on September 30, 1993 with all four being convicted on five counts of fraud and some other charges. Lawrence and Johnson were sentenced to seven years imprisonment, Richards to six years imprisonment and Byerlay to one year. The convictions and sentences of Lawrence, Richards and Johnson were upheld by this court in January, 1996. A new trial was ordered for Byerlay: ***R. v. Richards (M.B.) et al*** (1996), 70 B.C.A.C. 161. Lawrence's application to the Supreme Court of Canada for leave to appeal that decision was refused on October 1, 1998. For various reasons, the charges were never proceeded with against the accused Attrill, Vaz and Seona Wilder.

HISTORY OF PROCEEDINGS AGAINST MR. WILDER

[9] Mr. Wilder elected trial before judge alone. The hearing of pretrial motions began in September, 1995 and continued with some interruptions until March, 1997. **On October 27, 1995, the trial judge ruled that the transmission of taxpayer information from Revenue Canada investigators to Crown counsel, and the use of that information to lay *Criminal Code* fraud charges, did not contravene the confidentiality** provisions in s. 241(1) of the Act and therefore did not breach Mr. Wilder's s. 7 *Charter* rights.

[10] **In a ruling delivered on January 30, 1996, the trial judge decided an issue which arose out of amendments made to the confidentiality provisions of the Act during the time this proceeding was on foot. It will be convenient here to reproduce a chart prepared by Crown counsel which sets out the language of s.241 during the three relevant periods.**

Pre-February 18, 1987	February 18, 1987 - June 10, 1993	Post-June 10, 1993

Digitized by Google

241(1) Except as authorized by this section, no official or authorized person shall (a) knowingly communicate or knowingly allow to be communicated to any person any information obtained by or on behalf of the Minister for the purposes of this Act or the Petroleum and Gas Revenue	241(1) Except as authorized by this section, no official or authorized person shall (a) knowingly communicate or knowingly allow to be communicated to any person any information obtained by or on behalf of the Minister for the purposes of this Act or the Petroleum and Gas Revenue	241 (1) Except as authorized by this section, no official shall knowingly provide, or knowingly allow to be provided, to any person any taxpayer information; knowingly allow any person to have access to any taxpayer information; or knowingly use any taxpayer
Tax Act; knowingly allow any person to inspect or to have access to any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act or the Petroleum and Gas Revenue Tax Act; or knowingly use, other than in the course of the duties of the official or authorized person in connection with the administration or enforcement of this Act or the Petroleum and Gas Revenue Tax Act any	Tax Act; knowingly allow any person to inspect or to have access to any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act or the Petroleum and Gas Revenue Tax Act; or knowingly use, other than in the course of the duties of the official or authorized person in connection with the administration or enforcement of this Act or the Petroleum and Gas Revenue Tax Act any	information otherwise than in the course of the administration or enforcement of this Act, the Canada Pension Plan or the Unemployment Insurance Act or for the purpose for which it was provided under this section.

Digitized by Google

Notwithstanding any other Act or law, no official or authorized person shall be required, in connection with any legal proceedings. to give evidence relating to any information obtained by or behalf of the Minister for the purposes of this Act or the ***Petroleum, and Gas Revenue Tax Act***; or to produce any book, record, writing, return or other document obtained by or on behalf of the Minister for the	Notwithstanding any other Act or law, no official or authorized person shall be required, in connection with any legal proceedings. to give evidence relating to any information obtained by or behalf of the Minister for the purposes of this Act or the ***Petroleum, and Gas Revenue Tax Act***; or to produce any book, record, writing, return or other document obtained by or on behalf of the Minister for the	(2) Notwithstanding any other Act of Parliament or other law, no official shall be required, in connection with any legal proceedings, to give or produce evidence relating to any taxpayer information.
(3) Subsections (1) and (2) do not apply in respect of criminal proceedings, either by indictment or on summary conviction, under an Act of the Parliament of Canada, or in respect of proceedings relating to the administration or enforcement of this Act or the ***Petroleum and Gas Revenue Tax Act***.	(3) Subsections (1) and (2) do not apply in respect of criminal proceedings, either by indictment or on summary conviction, that have been commenced by the laying of an information, under an Act of the Parliament of Canada, or in respect of proceedings relating to the administration or enforcement of this Act or the ***Petroleum and Gas Revenue Tax Act***.	Subsection (1) and (2) do not apply in respect of criminal proceedings, either by indictment or on summary conviction, that have been commenced by the laying of an information or the preferring of an indictment, under an Act of the Parliament; or any legal proceedings relating to the administration or enforcement of this Act, the Canada Pension Plan or the Unemployment
		241(4) An official may

Digitized by Google

provide to any person taxpayer information that can reasonably be regarded as necessary for the purposes of the administration or enforcement of this Act, the ***Canada Pension Plan*** or the ***Unemployment Insurance Act***, solely for that purpose;

The scheme of the section is that the confidentiality rights created by s-ss. (1) and (2) do not apply in those court proceedings described in s-s.(3). That subsection was amended twice during the period starting in 1985 when the audit investigation began and up to the time of the trial. The first amendment resulted in the words "that have been commenced by the laying of an information" being added. Undoubtedly, that change was made to overcome the decision of the Quebec Court of Appeal in ***A.G. (Canada) v. Thibault***, reflex, [1987] 1 C.T.C. 156 (Que. C.A.) which held that a search warrant issued before any charges were laid was part of a criminal proceeding for the purpose of that section. The words "that have been commenced by the laying of an information "did not, of course, cover the circumstances of this case which was commenced by direct indictment. That difficulty, which presumably resulted from an oversight in drafting the amendment, was removed by the 1993 amendment which added the words "or the preferring of an indictment". At the same time, the subsection was amended by dividing the reference to criminal proceedings and to administration or enforcement of the Act into separate sub-subsections.

[11] The word "suspended" has been used throughout this proceeding to describe the effect of s.241(3) in rendering the confidentiality provisions inapplicable to certain proceedings.

[12] The ruling delivered on January 30, 1996 provided that the confidentiality provisions were, by reason of the wording in effect from 1987 to June 10, 1993, not suspended prior to the latter date. By a further ruling delivered a few days later the trial judge "clarified" that ruling to hold that the confidentiality provisions were suspended prior to February 18, 1987.

[13] I will mention here that the Crown's position throughout has been that the confidentiality provisions have been suspended at all relevant times because they are "proceedings relating to the administration or enforcement of this Act", which language which has been in s.241(3) at all relevant times. That view, as I understand it, was accepted by Wong J. in the first trial but the trial judge on the trial of Mr. Wilder appears to have acted on the view that the confidentiality provisions could be suspended only if they were criminal proceedings of the kind described in s.241(3).

[14] **On March 21, 1997 the trial judge held that information obtained from the accused under the provisions of the Act prior to the beginning of a criminal investigation could be used in prosecuting the accused for fraud under the *Code* without offending his s. 7 *Charter* rights. In giving that ruling, he said:**

With respect, I agree with the Crown's submission that the *Income Tax Act* is a regulatory statute backed by penal sanctions found either in that *Act* or the *Criminal Code*. Those sanctions, the Crown says, can be found in the *Income Tax Act* or the *Criminal Code*. "The existence of the sanctions does not affect the constitutional legitimacy of the provisions of the *Income Tax Act* which compel the production of information and documents, and the use of such information in subsequent criminal proceedings is not constitutionally barred by section 7 of the *Charter*. In this case the obtaining of the information for the purposes of the administration or enforcement of the *Income Tax Act* was unrelated to the subsequent criminal investigation, and use of that information in the prosecution of the accused for offences under the *Criminal Code* for the purpose of the administration or enforcement of the *Income Tax Act* is proper."

The conclusion I have reached is that the use of the information in this prosecution does not violate s.7 of the *Charter*.

Digitized by Google

After that ruling was given, the accused was arraigned and the trial began.

[15] On January 20, 1998 this court delivered its decision in ***R. v. White*** 1998 CanLII 5519 (BC CA), (1998), 122 C.C.C. (3d) 167 holding that accident reports given by the accused under the statutory compulsion of the provincial ***Motor Vehicle Act*** could not be used against her in a prosecution for "hit and run" under the ***Code***. Shortly thereafter, Mr. Wilder applied for a reversal of the judge's decision of March 21, 1997 on the ground that the law had been changed by ***R. v. White***. On August 25, 1998 the trial judge granted that application. He delivered lengthy reasons for concluding that:

[60] ... [T]he information obtained by Revenue Canada auditors from the accused by Mr. Wilder under the compulsion provisions of the ***Income Tax Act*** prior to the commencement of the criminal investigation is, on the authority of ***R. v. White***, inadmissible as evidence in the prosecution of Mr. Wilder for the ***Criminal Code*** offences set out in the indictment.

[16] The trial judge did not decide at that point whether that ruling applied to information obtained from persons or institutions other than Mr. Wilder. After further hearings, he gave rulings on October 13 and November 4 which resulted in all of the "taxpayer information" relied upon by the Crown being ruled inadmissible. The Crown then closed its case and the "no evidence" application of the accused was granted. It is common ground that the evidence derived from taxpayer information is essential to proving the Crown's case although it cannot, by itself, prove the whole of that case.

[17] I will note here that the decision excluding taxpayer information from sources other than the accused depends in part upon the trial judge's view as to the scope of the decision in *R. v. White* but also upon his interpretation of s. 241 of the Act and certain factual conclusions made by him.

[18] The evidence excluded by the trial judge was all "taxpayer information" within the statutory definition in s.241(1) of the Act.

"taxpayer information" means information of any kind and in any form relating to one or more taxpayers that is

obtained by or on behalf of the Minister for the purposes of this Act, or

prepared from information referred to in paragraph (a),

but does not include information that does not directly or indirectly reveal, the identity of the taxpayer to whom it relates.

The trial judge described the evidence thus:

[35] In the case at bar the taxpayer information (documents and statements) in issue was obtained by Revenue Canada auditors prior to the commencement of a criminal investigation and thus was not produced in response to or in furtherance of a criminal investigation.

...

[46] The information demanded by the Revenue Canada auditors of Mr. Wilder consisted at least in part of the 'ordinary' records kept by him and others in the usual course of their businesses. Some of the documents were, however, created in response to the auditors' requests. But essentially the information obtained by Revenue Canada took the form of pre-existing records or documents which merely had to be 'located' by the accused or were created prior to any criminal investigation taking place.

[19] **Much of the excluded taxpayer information did not come directly from Mr. Wilder. It also came from the other indicted individuals, from the three corporations, and from other persons not charged.**

[20] The trial judge's reasons, as I have said, are lengthy but the essence of the decision is in these paragraphs:

[1] The distinction between the nature of the documents and statements in this case and *White* is not of significance, in my view, in deciding whether the information compelled by the auditors here can be used in a prosecution of *Criminal Code* offences. The critical

Digitized by Google

question in whether the information obtained under the compulsion provisions of the regulatory statute is being used as an integral part of the regulatory scheme.

[2] In my judgment *White* stands for the proposition that information obtained under the compulsion provisions of a regulatory statute for the purposes of carrying out the regulatory scheme of that statute can be used in a prosecution for a breach of a provision of that statute and not in proof of a charge under the *Criminal Code*. That principle, in my view, is supported by the reasoning in *Fitzpatrick* and *Ling*.

The reference to ***Fitzpatrick*** is of course to ***R. v. Fitzpatrick***, 1995 CanLII 44 (SCC), [1995] 4 S.C.R. 154, a leading decision on the issue of what evidence may be excluded as self-incriminatory. The reference to ***Ling*** is to ***R. v. Ling***, an unreported decision of Millward J. to which, without disrespect, I will make no further reference.

THE EFFECT OF *R. v. WHITE*

[21] Subsequent to the decision now under appeal, the majority decision of this court in ***R. v. White*** was upheld by the Supreme Court of Canada 1999 CanLII 689 (SCC), (1999), 174 D.L.R. (4th) 111. As the issues are dealt with much more completely and authoritatively in the reasons of Iacobucci J. for the majority, I need not try to explain whatever language in my reasons for the majority in this court led the trial judge into error. **I will say now that nothing in the reasons of Iacobbuci J. supports the broad proposition that no information obtained by statutory compulsion for the purposes of the statute's regulatory scheme can be used in proof of a charge under the *Criminal Code*.**

[22] In para. 44 of his reasons, Iacobucci J. described the rule against self-incrimination as "an overarching principle within our criminal justice system". He then went on under the heading "The Importance of Context" to say:

[45] That the principle against self-incrimination does have the status as an overarching principle does not imply that the principle provides absolute protection for an accused against all uses of information that has been compelled by statute or otherwise. The residual protections provided by the principle against self- incrimination as contained in s.7 are specific, and contextually sensitive. ... The principle against self-incrimination demands different things at different times, with the task in every case being to determine exactly what the principle demands, if anything, within the particular context at issue.

[46] In *Fitzpatrick*, *supra*, at paras. 21-25, La Forest J., speaking on behalf of the full Court, confirmed that this Court has always expressly limited the application of the principle against self-incrimination to cover only the specific circumstances raised by a given case. He stressed, at para. 25, that a court must begin "on the ground", with a concrete and contextual analysis of the circumstances, in order to determine whether the principle against self-incrimination is actually engaged on the facts.

And, in para. 48:

[48] It is the balancing of principles that occurs under s. 7 of the *Charter* that lends significance to a given factual context in determining whether the principle against self-incrimination has been violated. In some contexts, the factors that favour the importance of the search for truth will outweigh the factors that favour protecting the individual against undue compulsion by the state. ... In every case, the facts must be closely examined to determine whether the principle against self-incrimination has truly been brought into play by the production or use of the declarant's statement.

[23] Those statements are consistent with what was said in ***Thomson Newspapers Ltd. v. Canada (Director of Investigation & Research, Restrictive Trade Practices Commission)***, 1990 CanLII 135 (SCC), [1990] 1 S.C.R. 425, 54 C.C.C. (3rd) 417, in a

Digitized by Google

passage quoted by La Forest J. in ***R. v. Fitzpatrick***, *supra*, at pp.166-167:

[O]ne should not automatically accept that s.7 comprises a broad right against self-incrimination on an abstract level or, for that matter, on the American model, complete with all its residual doctrines. If that had been intended, it would have been very easy to say so. That is not what the *Charter* does, and the *Charter* must be read in its own terms. Accordingly, while I am prepared to accept that s.7 can protect the individual from fundamental unfairness arising out of self-incriminatory statements in circumstances not covered by ss.11(*c*) and 13, an assessment of what this means must be made in accordance with the spirit of those provisions.

[24] In my view, the trial judge erred in failing to have sufficient regard to the factual context of the case before him and, more specifically, in failing to weigh in the balance, in the words of Iacobucci J., *supra*, "the factors that favour the importance of the search for truth". **I do not say that the judge overlooked those factors in the sense of making no reference to them. Indeed, at one point or another in his reasons, he mentioned most of the relevant factors but in the end dismissed them from consideration on the basis of an overly broad interpretation of what was held in *White*.**

[25] It may be, as Mr. Harper for the Crown suggests, that that interpretation was based upon a comment in para. 21 of my reasons in ***White*** to the effect that the reasoning in ***Fitzpatrick*** did not support the Crown's position in ***White***. In that case, the Crown's submissions in this Court and in the Supreme Court of Canada were primarily based on ***Fitzpatrick***. In ***White***,***Fitzpatrick*** was accepted as authoritative but was distinguished because of the wholly different circumstances in which the statutory compulsion arose. ***White*** cannot be confined entirely to its own facts, but it does not support the broad proposition which the trial judge took from it. The facts and circumstances on which it depends are so different from those in the case at bar as to render it of no direct application. The facts and circumstances of ***Fitzpatrick***, on the other hand, have important points of similarity with those in the case at bar.

[26] A number of the factors upon which the decision in *Fitzpatrick* was based are summarized by Iacobucci in *R. v. White* at pp. 134-139 (D.L.R.).

Absence of Coercion

... [T]he obligations created by the provincial fisheries regulations at issue in [*Fitzpatrick*] ... were imposed upon the accused with his free and informed consent. The accused had a free choice whether or not to participate in the commercial fishery. (para. 53)

Nature of the Records

The hail reports and fishing logs could not properly be characterized as "confessions". Even if they were, their use as evidence in regulatory proceedings for over-fishing did not increase the likelihood of their being falsified. (para. 61)

The hail reports and fishing logs were comparable to business records in that they were impersonal lists in which the declarant had little expectation of privacy. (para. 66)

Use of the Records in Context of the Regulatory Scheme

The reports were "essential to the integrity of the entire regulatory regime - a regime that was beneficial to both the state and the accused...". (para. 60)

[27] A comparison of the factors identified in ***Fitzpatrick*** to the facts of the case at bar supports the Crown's position. **In terms of the nature of the records, the records in this case were not merely "like" business records, but appear, for the most part, to be business records in the ordinary sense. As to** the Crown's purpose in using the records, s. 241 expressly provides for the use of taxpayer information in litigation including criminal proceedings. This accords with *Fitzpatrick* where it was held that the intended use

Digitized by Google

of the records in the prosecution of over-fishing was contemplated by, and indeed essential to, the regulatory scheme. This is, however, in sharp contrast to the language of s. 61 of the *Motor Vehicle Act* (at issue in *White*) which extended use immunity to the contents of an

accident report and thus revealed a legislative intent to use such reports only for "non-litigious purposes".

[28] Two other factors should be noted. First, the records in question here are not remotely like "confessions". That is one of the more obvious distinguishing features from ***White*** where the statement was made after the events which gave rise to the charge. A related consideration is that a true confession (as was the accident report in ***White***) is generally tendered to prove the truth of what is said therein. **These business records may not serve that purpose but any falsity in them may constitute the essence of the offence. Secondly, in *Fitzpatrick* there was emphasis on the consideration that the obligation to file the reports was one voluntarily assumed by the persons engaged in fishing because that was an activity they voluntarily entered into. That applies *a fortiori* to those who engaged in the SRTC scheme. They were necessarily persons of some sophistication in matters of business who had the constant assistance of lawyers, accountants and other advisors. They knew that they had to keep records. They knew that they had to produce them to the tax authorities and they knew, or should have known, that s.241, while creating a right of confidentiality had a clear exception in s.241(3) for proceedings such as these.**

[29] There is a significant distinction between this case and ***Fitzpatrick*** in that the latter was not a case where the Crown sought to use the statutorily compelled information in proof of a criminal charge. In this regard, ***Fitzpatrick*** does not directly support the Crown's position. On the other hand, I see nothing in the Supreme Court's decisions in either ***Fitzpatrick*** or ***White*** which would preclude the use of such information in criminal cases. The fact that the accident report in ***White*** was sought to be used in a criminal prosecution was of course significant in the particular circumstances of that case. As Iacobucci J. said in para. 60:

The fact that the statements in this case are sought to be introduced in criminal rather than regulatory proceedings simply serves to accentuate the fact that the Crown seeks to use the statement for a purpose that was never contemplated as being a component of the regulatory regime.

In this case, however, the compelled information is sought to be used in proof of a charge of fraud against the regulatory scheme. The evidence sought to be introduced is, in large part, the records maintained by the accused in availing themselves of the statutory scheme and, the Crown alleges, in obtaining fraudulent benefits from that scheme. That circumstance, combined with the fact that Parliament expressly sanctions the use of the records in proof of such charges, makes it clear that this case is well outside any protection which could be provided by s. 7.

[30] The most recent decision of the Supreme Court of Canada dealing with enforcement of the Act is ***Del Zotto v. Canada***, 1999 CanLII 701 (SCC), [1999] 1 S.C.R. 3. While not directly on point, that case is entirely consistent with the view that s. 7 has no application to this case. ***Del Zotto*** dealt with the question whether s.

of the Act is in conflict with ss. 7 and 8 of the ***Charter***. That section provides for the appointment by the Tax Court of a hearing officer to "make such inquiry as the officer may deem necessary with reference to anything relating to the administration or enforcement of this Act." Mr. Del Zotto, having been suspected of tax evasion following an audit, was made the subject of such an inquiry. He challenged the constitutional validity of the section on the basis of ss. 7 and 8 of the ***Charter***. The Supreme Court, in upholding the validity of

Digitized by Google

s.231.4, adopted the dissenting reasons of Mr. Justice Strayer in the Federal Court of Appeal: 147 D.L.R. (4th) 457.

[31] In the course of his reasons, Strayer J.A. commented tartly on the somewhat overblown rhetoric indulged in by Mr. Del Zotto's counsel in expounding his view of the necessity for a broad application of ***Charter*** rights. Strayer J.A. said at p. 475:

Briefly put I am unwilling to accept that because some might characterize this as a criminal process the preconditions for a search as proclaimed by the Supreme Court in ***Hunter v. Southam Inc.,*** 1984 CanLII 33 (SCC), [1984] 2 S.C.R. 145, 11 D.L.R. (4th) 641, 14 C.C.C. (3d) 97, must automatically be met before an inquiry under section 231.4 of the ***Income Tax Act***, R.S.C. 1952, c. 148, can be commenced. If particular uses of the subpoena power by such an inquiry, or particular subsequent uses of evidence obtained through such subpoenas threaten to endanger section 7 or section 8 rights, it is only then that those rights should be invoked.

The appellants' case suffers from verbal excess: the inflation of language which detracts from precise consideration of what is involved here. The factum tells us that

Such Inquiries are a hallmark of the worst of the police states that the world has seen. [Appellants' factum paragraph 150.]

Much was heard of the Star Chamber, now dead some 350 years but still the stuff of legal rhetoric. Revenue Canada was said to have "passed"(sic) the Rubicon (Appellants' factum, paragraph 50). Counsel argued that this whole process would destroy the "Golden Thread" of the common law, a familiar but unhelpful metaphor in the application of finely balanced Charter guarantees.

[32] In this case, as in many others in which *Charter* issues are raised, we were treated by the respondent to similar verbal excess. That approach gives no weight to what Iacobucci J. in *White* called "the factors that favour the importance of the search for truth".

[33] **For these reasons, I conclude that the trial judge erred in holding that taxpayer information given by Mr. Wilder is not admissible against him in proof of the charges laid in this case. That being so, it almost goes without saying that the trial judge erred in holding that taxpayer information provided by others could not be used against Mr. Wilder. However, as the broader exclusion did not depend entirely on the self-incrimination principle, I find it necessary to explain why that aspect of the decision should also be reversed.**

[34] This issue turns in part on the interpretation which should be given to s. 241(3) of the Act which, as it now stands, reads as follows:

241(3) Subsections (1) and (2) do not apply in respect of

criminal proceedings, either by indictment or on summary conviction, that have been commenced by the laying of an information or the preferring of an indictment, under an Act of the Parliament; or

any legal proceedings relating to the administration or enforcement of this Act, the ***Canada Pension Plan*** or the ***Unemployment Insurance Act*** or any other Act of Parliament or law of a province that provides for the imposition or collection of a tax or duty.

[35] Subsections (1) and (2) are of course the confidentiality provisions. The Crown submits that s. 241(3)(b) applies both to civil and criminal proceedings which relate to the administration or enforcement of the Act. This prosecution, the Crown submits, is a proceeding "relating to the administration or enforcement of this Act" and is therefore not one to which s. 241(3)(a) applies. The submission is that that subsection applies to all criminal proceedings other than those relating to the administration or enforcement of the Act. If that is so, it follows that there is no need to refer to s. 241(3)(a) to determine whether the confidentiality provisions are suspended. The significance of that is that, if the confidentiality provisions are suspended in this case under s. 241(3)(b), the suspension

Digitized by Google

continued during the period from 1987 to 1993 when prosecutions brought by direct indictment were not included in s. 241(3). That, as I understand it, is the position which was taken by Wong J. on the trial of the co-accused. It does not appear that that was an issue on appeal.

[36] The trial judge in this case, perhaps in an effort to reconcile the language of the section with his view of the scope of ***R. v. White***, held that subsection (a) applies only to criminal proceedings which relate to the administration or enforcement of the Act and that subsection (b) applies only to civil proceedings relating to the administration or enforcement of the Act.

[37] That view of the matter would result in the confidentiality provisions not being suspended for any criminal proceedings other than those which relate to the administration or enforcement of the Act. That conclusion, in my view, is entirely at odds with the plain language of s-s. (a) and, for the reasons I have already given, is not supported by the decision in *R. v. White.*

[38] Nor is it supported by the legislative history. I referred earlier to the decision of the Quebec Court of Appeal in ***R. v. Thibault*** which had extended the words "criminal proceedings" in the pre-1987 version of s. 241(3) to applications for search warrants brought before any charge was laid. Parliament moved with some alacrity to bring in the amendment of 1987 to exclude pre-charge proceedings. ***R. v. Thibault*** was a drug prosecution entirely unrelated to the administration or enforcement of any of the statutes referred to in s. 241(3). Had it been the intention of Parliament that the words "criminal proceedings" be applicable only to proceedings for the administration or enforcement of the statutes referred to in s. 241(3), it surely would have amended the section at the same time to make clear that restriction.

[39] The trial judge's conclusion that s-s. (a) does not suspend the confidentiality provisions with respect to criminal proceedings in general was presumably based on his view that ***R. v. White*** precluded any information obtained through regulatory legislation from being introduced in proof of a criminal charge. From that he moved to the conclusion that, as he put it in his reasons of October 13:

In my judgment the legal effect of the decision of the Court of Appeal in ***White*** is to restrict the meaning of "criminal proceedings" in s. 241(3)(a) to criminal proceedings related to carrying out the regulatory scheme under the ***Income Tax Act.***

I have already explained why in my view *R. v. White* has no effect on the meaning of "criminal proceedings" in s. 241(3)(a). It therefore follows that I disagree with the conclusion that it restricts that phrase in the manner suggested by the trial judge. His conclusion seems to imply that s.241(3)(a) is constitutionally invalid insofar as it suspends the confidentiality provisions for criminal proceedings other than those arising under the enumerated statutes. That approach ignores the fact that the constitutionality of the section has not been challenged in whole or in part.

[40] **I agree with the Crown's submission that s. 241(3)(b) applies to a criminal proceeding relating to the administration or enforcement of the Act, and I also agree that this is such a proceeding.**

[41] The leading decision on s. 241 of the Act is that of the Supreme Court of Canada in ***Slatterly v. Doane Raymond Ltd.*** (1993), D.T.C. 5443 (S.C.C.). The majority judgment is that of Iacobucci J. (McLachlin J. dissenting). In that case Slatterly was petitioned into bankruptcy by Revenue Canada; Doane Raymond was the trustee in bankruptcy. The issue was whether the trustee's action under the ***Bankruptcy Act*** for a declaration that certain property was that of the bankrupt's estate was, in the language of s. 241(3), a proceeding "relating to the administration or enforcement" of the Act. If it was, s. 241(3) would permit the use of taxpayer information as evidence against the bankrupt. If it was

Digitized by Google

not, the use of the information was precluded.
[42] The issue which divided the Court was summarized thus by McLachlin J. at p. 5451:
Focusing in part on the fact that the trial would ultimately result in the collection of unpaid taxes, [Iacobucci J.] finds that the trial was a proceeding "relating to" the administration or enforcement of the Act.
In my view, the s. 241(3) exemption applies only in the case of proceedings specifically provided for in the ***Income Tax Act***.
[43] Iacobucci J., after stating that neither the text nor the context ofs. 241 supported the narrow interpretation accepted by McLachlin J., went on to say at p. 5447:
The connecting phrases used by Parliament in s. 241(3) are very broad. The confidentiality provisions are stated not to apply *in respect of* proceedings *relating to* the administration or enforcement of the *Income Tax Act*.
The phrase "in respect of" was considered by this Court in ***Nowegijick v. The Queen***, 1983 CanLII 18 (SCC), [1983] 1 S.C.R. 29, at p. 39.
The words "in respect of" are, in my opinion, words of the widest possible scope. They *import such meanings as "in relation to"*, "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters.
[Emphasis added]
In my view, these comments are equally applicable to the phrase "relating to". *The Pocket Oxford Dictionary*(1984) defines the word "relation" as follows:
... what one person or thing has to do with another, way in which one stands or is related to another, kind of connection or correspondence or contrast or feeling that prevails between persons or things;...
So, both the connecting phrases of s. 241(3)suggest that a wide rather than narrow view should be taken when considering whether a proposed disclosure is in respect of proceedings relating to the administration or enforcement of the ***Income Tax Act***.
[44] This proceeding, unlike the proceeding in question in ***Slatterly v. Doane Raymond***, is not one for the collection of tax. But, in view of the broad interpretation given to the words "in respect of" and "relating to", **I find this proceeding to be one relating to the enforcement of the Act. It is unnecessary to consider whether it is also a proceeding for the administration of the Act.**
[45] It is also unnecessary to decide whether the confidentiality provisions are also suspended by s. 241(3)(a) which, on its plain language, applies to all criminal proceedings. I am, however, inclined to the view that criminal proceedings relating to the administration or enforcement of the Act are impliedly excluded from subsection (a), which comes into effect only upon the laying of an information or the preferring of an indictment. **Subsection (b) has no specific provision triggering the application of the suspension. As subsection (b), in relation to criminal proceedings relating to the administration or enforcement of the Act, covers all of the ground covered by subsection (a), but with the added flexibility that it covers proceedings before information or indictment, it seems a reasonable inference that subsection (a) was not intended to apply to criminal proceedings relating to the administration or enforcement of the Act. However, I need decide only that subsection (b) is effective to suspend the confidentiality provisions in respect of this prosecution.**
[46] The trial judge did not find that, in general, a proceeding of this kind would not be one for the administration and enforcement of the Act. Rather, he reached that conclusion on the basis of an affidavit sworn by Crown counsel shortly after the indictment was preferred which included this paragraph:
THAT the prosecution of the accused named in the said indictment is not being undertaken

Digitized by Google

and will not be used for the direct or indirect enforcement of any revenue law of Canada or directly or indirectly for the establishment or collection of tax, but is a prosecution for alleged crimes of fraud and possession of property obtained by crime.

[47] That affidavit was sworn by the late P.W. Halprin, Q.C. in support of an application to the Supreme Court of British Columbia for the appointment of a commissioner to take evidence in Hong Kong pursuant to what was then s. 709(b). Mr. Halprin exhibited to his affidavit a letter from a Mr. Gunasekera, a senior Crown counsel in Hong Kong, setting out the matters which would be taken into consideration in that jurisdiction in deciding whether to honour a request for judicial assistance in the taking of evidence for proceedings in foreign jurisdictions. One of those considerations was that Hong Kong would not, as a matter of public policy, assist in the enforcement of a foreign revenue law. For that reason, it was, he said, necessary "... to ascertain that this application is not in any manner related, either directly or indirectly, to the establishment or collection of tax."

[48] It appears that the order appointing a commissioner was duly made and that the Hong Kong authorities provided the requisite assistance in the obtaining of evidence. The matter of para. 7 of Mr. Halprin's affidavit first became an issue at an early stage of the trial of the co-accused before Wong J. The issue then, as I understand it, was whether the commission evidence should be ruled inadmissible on the ground that Mr. Halprin in his capacity as Crown counsel had deliberately misled the Hong Kong authorities. Wong J. rejected the application to exclude. The position of the Crown on this point is now, as it was before Wong J., that Mr. Halprin was simply tracking the language of the letter from Mr. Gunasekera and that para. 7, read as a whole, merely put forward an assurance that the proceeding was not one "for the establishment or collection of tax".

[49] In this case, the trial judge concluded:

... that Mr. Halprin's carefully chosen words-- "the prosecution of the accused named in the said Indictment is not being undertaken and will not be used for the direct or indirect enforcement of any revenue law of Canada" -- mean the prosecution of the accused, including Mr. Wilder, is not for the purpose of the administration or enforcement of the *Income Tax Act*.

The question whether the proceeding is one relating to the administration or enforcement of the Act cannot be answered by reference to the view held by an employee or agent of the Crown. It must be answered by reference to the known facts as to the charges laid and the case which the Crown seeks to make. Having regard to those matters, it is clear for the reasons expressed earlier that this proceeding is one relating to the enforcement of the Act.

[50] There was some logical basis for the defence in the first trial relying on para. 7 of Halprin's affidavit as a basis for ruling inadmissible the commission evidence. Wong J. considered that submission and, accepting the Crown's submission that the paragraph read as a whole was not misleading, ruled against it. In this case, the contention is not that the paragraph was misleading but rather that Mr. Halprin's statement conclusively establishes that the prosecution was not brought for the enforcement of any revenue law of Canada. The affidavit, as I have said, has no relevance to that question.

[51] It follows that I would not uphold any of the grounds upon which the trial judge in his rulings of August 25, October 13 and November 4, 1998 held taxpayer information to be inadmissible. It follows that the evidence, saving any just exceptions based on other grounds, should have been admitted.

[52] In addition to his submissions with respect to the issues raised by the Crown on this appeal, Mr. Wilder filed a document headed "The Indictment and Previous Trial" which raises various allegations of fraudulent conduct and abuse of process on the part of the Crown in pursuing this case. If there is a proper basis for such contentions, and that is not at all clear from the record before us, such matters must first be pursued in the trial court.

Digitized by Google

There is no basis upon which this court can deal with them on this appeal.
[53] I would allow the appeal, set aside the verdict of acquittal and order a new trial.

"THE HONOURABLE MR. JUSTICE ESSON"
I AGREE:
"THE HONOURABLE MADAM JUSTICE RYAN"
I AGREE:
"THE HONOURABLE MR. JUSTICE MACKENZIE"
Corrigendum - April 18, 2000
The reference in para. [1] to Code s.254 should be to s.354.
In para. [17], the word "from" should be inserted between "information" and "sources".

Slattery (Trustee of) v. Slattery, [1993] 3 S.C.R. 430, Realizing Information for Bankruptcy Proceedings and the Extent of "the Act"

Slattery (Trustee of) *v.* Slattery, [1993] 3 S.C.R. 430
Marguerite Slattery *Appellant*
v.
Doane Raymond Limited, Trustee of the Estate of Raymond P. Slattery, a Bankrupt *Respondent*
Indexed as: Slattery (Trustee of) *v.* Slattery
File No.: 22618.
1993: March 29; 1993: September 30.

Present: Lamer C.J. and La Forest, L'Heureux-Dubé, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.
on appeal from the new brunswick court of appeal

Income tax -- Enforcement -- Confidentiality -- Evidence gained from Income Tax Act investigations protected unless required in proceedings relating to administration or enforcement of the Act -- Taxpayer petitioned into bankruptcy by Revenue Canada -- Trustee in bankruptcy seeking declaration that assets held by taxpayer's wife rightfully assets of bankrupt's estate -- Testimony of Revenue Canada officials from income tax investigation admitted into evidence -- Whether a civil action commenced by the trustee for a declaration that certain property belongs to the bankrupt's estate is a proceeding relating to the enforcement of the Income Tax Act -- Income Tax Act, S.C. 1970-71-72, c. 63, s. 241(1)(a), (b), (c), (2)(a), (b), (3), (4)(c).

A taxpayer unable to pay his taxes owing was petitioned into bankruptcy by Revenue Canada. The respondent trustee in bankruptcy commenced an action against the appellant (the bankrupt's wife) seeking a declaration that certain assets registered in her name were the property of the bankrupt's estate or were held in trust for that estate.

At trial, the trustee sought to introduce testimony from two Revenue Canada officials who had participated in the investigation into the bankrupt's affairs. Appellant argued that that testimony was barred because s. 241 of the *Income Tax Act* prohibits Revenue Canada officials from disclosing information obtained from a taxpayer for the purposes of that Act. The trial judge ruled that this testimony fell within the exception in s. 241(3) which provides that the prohibition does not apply in respect of proceedings relating to the administration or

Digitized by Google

enforcement of the Act. Both officials testified, and the court granted the declaration in part. The New Brunswick Court of Appeal agreed with the trial judge's interpretation of s. 241 and dismissed the appeal. At issue here was whether a civil action commenced by the trustee for a declaration that certain property is property of the bankrupt's estate is a proceeding "relating to the . . . enforcement of" the *Income Tax Act* within the meaning of s. 241(3) of the Act.

Held (L'Heureux-Dubé, Sopinka and McLachlin JJ. dissenting): The appeal should be dismissed.

Per Lamer C.J. and La Forest, Gonthier, Cory, Iacobucci and Major JJ.: Section 241 involves a balancing of competing interests: the privacy interest of the taxpayer with respect to his or her financial information, and the interest of the Minister in being allowed to disclose taxpayer information to the extent necessary for the effective administration and enforcement of the *Income Tax Act* and other federal statutes referred to in s. 241(4). Only in exceptional or prescribed situations does the privacy interest give way to the interest of the state. By instilling confidence in taxpayers that the personal information they disclose will not be communicated in other contexts, Parliament encourages voluntary disclosure of this information. Parliament, however, has also recognized that the possession of personal information is useless if it cannot be used to assist in tax collection, when required, including tax collection by way of judicial enforcement.

Section 241(3) contemplates not only administrative and enforcement proceedings brought under the *Income Tax Act* itself but also other proceedings. Both the text and the context of s. 241 buttress this conclusion. The connecting phrases used by Parliament in s. 241(3) ("in respect of" and "relating to") are of the widest possible scope and suggest that a wide rather than narrow view should be taken when considering whether a proposed disclosure is in respect of proceedings relating to the administration or enforcement of the *Income Tax Act*. This breadth of meaning is confirmed by the French version of the section.

Section 222 clearly states that the Minister may resort generally to the courts to institute civil proceedings to collect taxes as debts in addition to the procedures specified in the *Income Tax Act*. In order to take full advantage of this power, the Minister must be able to disclose in court otherwise confidential information in order to prove the cause of action in debt. Absent the ability to disclose as required to prove a debt, s. 222 would be deprived of part of its meaning.

Glover v. Glover (No. 1) must be read to mean that the confidentiality provisions apply to any legal proceeding of a civil character which is not covered by the exception provided in s. 241(3). Sections 241(1) and (2) apply to civil proceedings not related to the administration or enforcement of the *Income Tax Act*. *Glover* does not inform the issue already set out: the essential question is whether or not the bankruptcy proceedings taken herein are related to the administration or enforcement of the *Income Tax Act*.

The proceedings taken here were related to the administration or enforcement of the *Income Tax Act* even though they were taken by the trustee in bankruptcy. A contrary interpretation is not supported by the wording of s. 241(3) and is somewhat inconsistent with the power given to creditors in s. 38(1) of the *Bankruptcy Act*. At the policy level, the Minister should not be inhibited from recourse to the bankruptcy process in light of the advantages and protection that this process can entail. If the Minister cannot disclose confidential information in bankruptcy to prove a claim asserted, the bankruptcy procedure will in many cases not be available for income tax enforcement.

The difference in nature between bankruptcy proceedings and proceedings under s. 160, where disclosure was admitted to be available by appellant, was not relevant. The important point was that disclosure made during bankruptcy proceedings was made in respect of proceedings relating to the administration or enforcement of the Act within the meaning of s. 241(3). The fact that the Minister chose to collect taxes by petitioning the taxpayer into

Digitized by Google

bankruptcy did not disentitle Revenue Canada from disclosing the confidential information.

Arguments raising the possibility of difficult questions as to competence and compellability were not persuasive.

Per L'Heureux-Dubé, Sopinka and McLachlin JJ. (dissenting): The s. 241(3) exemption applies only in the case of proceedings specifically provided for in the *Income Tax Act*. These proceedings are, for the most part, set out in Part XV of the Act which establishes "Administration and Enforcement" provisions. A trial to determine title between an individual and a trustee in bankruptcy is not a proceeding provided for in Part XV, or elsewhere in the Act. Accordingly, Revenue Canada officials should have been barred from disclosing information obtained in the course of their investigation of the bankrupt's affairs.

This Court gave the phrase "in respect of" a wide interpretation in the circumstances of the *Indian Act* as it related to taxation of personal property. The wide interpretation given the phrase in that context is not determinative of its application in s. 241(3). The context of s. 241(3), and jurisprudence of this Court treating the section, suggest that the phrase should be construed narrowly, not broadly.

The proceedings at issue on this appeal are not proceedings so connected to the administration of the Act that they fall within the contemplation of the exemption in s. 241(3). Part XV of the Act provides the Minister of Revenue with a system of debt collection proceedings that mirrors ordinary creditors' remedies. It does not, however, deal with bankruptcy, except to the extent of providing the Minister with the power to collect money owed to a secured creditor by a trustee in bankruptcy, notwithstanding the *Bankruptcy Act.* This legislative silence is significant. Bankruptcy is a particular process which has specific and salutary aims and which involves all of the creditors of a particular debtor. Concern for the confidentiality of information that is not public is very much at issue.

The proceeding at issue here is not an action under s. 222. The action is brought by a trustee in bankruptcy and not by the Crown as the section appears to contemplate. Under s. 69 of the *Bankruptcy Act,* all collection proceedings are stayed when the debtor is declared bankrupt. Until that point the Minister arguably may prove its debt by disclosure of information obtained for the purposes of the Act. But once a debtor is declared bankrupt, and a trustee in bankruptcy has been put in place to pursue the bankruptcy, the proceeding is no longer capable of being accurately characterized as a proceeding relating to the administration of the Act. The stay operates until the trustee in bankruptcy is discharged. The practical effect of the proceedings permitting the Minister to realize upon an outstanding debt does not operate to make the proceeding one relating to the administration of the Act.

Part XV of the Act makes no specific provision for disclosure in the context of bankruptcy. When the Minister has recourse to this procedure, its actions are governed by the *Bankruptcy Act* and no longer by the *Income Tax Act*. In so proceeding the Minister loses the capacity to deploy the special information gathering techniques, which accrue only by virtue of the *Income Tax Act*, either to its own advantage, or to those of its fellow creditors.

The Minister was not permitted to disclose confidential information in the case at bar even though a superior court judge is a person, as provided in s. 241(4)(*c*), "legally entitled" to the information. A party should not be able to avail itself of the s. 241(4)(*c*) exemption if it cannot bring the proceeding within the terms of s. 241(3).

Cases Cited

By Iacobucci J.

Considered: *Glover v. Minister of National Revenue*, 1981 CanLII 64 (SCC), [1981] 2 S.C.R. 561, aff'g (1980), 29 O.R. (2d) 392; **referred to**: *Canadian Pacific Tobacco Co. v. Stapleton* (1952), 86 C.L.R. 1; *Nowegijick v. The Queen*, 1983 CanLII 18 (SCC), [1983] 1 S.C.R. 29; *Diversified Holdings Ltd. v. Canada*, reflex, [1991] 1 F.C. 595.

Digitized by Google

By McLachlin J. (dissenting)

Nowegijick v. The Queen, 1983 CanLII 18 (SCC), [1983] 1 S.C.R. 29; *R. v. McKinlay Transport Ltd.*, 1990 CanLII 137 (SCC), [1990] 1 S.C.R. 627; *Glover v. Minister of National Revenue*, 1981 CanLII 64 (SCC), [1981] 2 S.C.R. 561, aff'g (1980), 29 O.R. (2d) 392.

Statutes and Regulations Cited

Bankruptcy Act, R.S.C., 1985, c. B-3, ss. 16(3), (4), 17(1), 19(1), (2), 38(1), 69(1), 136, 163 to 167.

Income Tax Act, R.S.C. 1952, c. 148, s. 133.

Income Tax Act, S.C. 1948, c. 52, s. 121.

Income Tax Act, S.C. 1966-67, c. 47, s. 17.

Income Tax Act, S.C. 1966-67, c. 91, s. 22.

Income Tax Act, S.C. 1970-71-72, c. 63, ss. 160(1)(*a*) [rep. & sub. S.C. 1980-81-82-83, c. 140, s. 107], (*e*) [rep. & sub. *idem*], 222, 223(3), (5) [rep. & sub. S.C. 1988, c. 55, s. 168], 224(1), 224(1.2) [ad. S.C. 1987, c. 46, s. 66], 224.1 [rep. & sub. S.C. 1980-81-82-83, c. 48, s. 104], 225(1), 238, 239, 241(1)(*a*), (*b*) [am. S.C. 1987, c. 46, s. 68(1)], (*c*) [ad. *idem*], (2)(*a*), (*b*), (3) [rep. & sub. *ibid.*, s. 68(2)], (4)(*c*) [am. S.C. 1978-79, c. 5, s. 9].

Income War Tax Act, R.S.C. 1927, c. 97, s. 81(1), (2).

Income War Tax Act, 1917, S.C. 1917, c. 28, s. 11.

Indian Act, R.S.C. 1970, c. I-6, s. 87.

Authors Cited

Bohémier, Albert. *Faillite et Insolvabilité*, t. 1. Montréal: Thémis, 1992.

Brown, D. Scott. "Bankruptcy and Income Tax: A Revenue Canada Perspective" in *1990 Conference Report: Report of Proceedings of the Forty-Second Tax Conference.* Canadian Tax Foundation, 1991.

Chabot, Marc. *Faillite et Insolvabilité*. Sillery, Québec: Presses de l'Université du Québec, 1987.

Dictionnaire de la langue française. Paris: Larousse, 1989, "traits".

Harris, Edwin C. *Canadian Income Taxation*, 4th ed. Toronto: Butterworths, 1986.

Houlden, L. W. *Bankruptcy and Insolvency Law of Canada*, 3rd ed. By L. W. Houlden and C. H. Morawetz. Toronto: Carswell, 1993 (loose-leaf).

Le Robert Méthodique. Paris: Le Robert, 1988, "avoir trait à".

The Pocket Oxford Dictionary, 7th ed. Edited by R. E. Allen. Oxford: Clarendon Press, 1984, "relation".

Toope, Stephen J., and Alison L. Young. "The Confidentiality of Tax Returns Under Canadian Law" (1982), 27 *McGill L.J.* 479.

APPEAL from a judgment of the New Brunswick Court of Appeal 1991 CanLII 4083 (NB CA), (1991), 120 N.B.R. (2d) 4, 84 D.L.R. (4th) 360, 7 C.B.R. (3d) 157, dismissing an appeal from a judgment of Jones J. Appeal dismissed, L'Heureux-Dubé, Sopinka and McLachlin JJ. dissenting.

B. A. Crane, *Q.C.*, and *Randall J. Hofley*, for the appellant.

John R. Power, *Q.C.*, and *Michael Donovan*, for the respondent.

The judgment of Lamer C.J. and La Forest, Gonthier, Cory and Major JJ. was delivered by

IACOBUCCI J. -- This appeal concerns the interpretation to be given to s. 241(3) of the *Income Tax Act*, S.C. 1970-71-72, c. 63 (the *Income Tax Act*), which permits in certain circumstances the disclosure of otherwise confidential information obtained from a taxpayer by officials of the Department of National Revenue. More specifically, the appeal concerns an action by a trustee in bankruptcy under the *Bankruptcy Act*, R.S.C., 1985, c. B-3, for a declaration that certain property is the property of a taxpayer bankrupt's estate. The issue is whether such an action is a proceeding "relating to the administration or enforcement of" the

Digitized by Google

Income Tax Act.

I.Facts

Raymond Slattery, who is not a party to this action, fell into arrears in paying income tax, resulting in a lengthy investigation by Revenue Canada. Unable to collect the taxes owing, Revenue Canada petitioned Slattery into bankruptcy. The respondent, Doane Raymond Limited (the Trustee), was appointed as trustee in bankruptcy of the Raymond Slattery estate. In the bankruptcy, Revenue Canada proved a claim of just over $1 million and other creditors proved claims of over $3 million; however, since Revenue Canada is the only preferred creditor, it appears that the assets of the estate will not be sufficient to satisfy the claims of any other creditors.

The trustee commenced an action against the appellant, Marguerite Slattery, who is the wife of the bankrupt Slattery. The action sought a declaration that certain assets registered in Marguerite Slattery's name were, in fact, the property of the bankrupt's estate or were held in trust for that estate.

At trial, the trustee sought to introduce testimony from two Revenue Canada officials who had participated in the investigation into Raymond Slattery's affairs. Counsel for Marguerite Slattery objected on the ground that such testimony was barred by s. 241 of the *Income Tax Act*, which prohibits Revenue Canada officials from disclosing information which has been obtained from a taxpayer for the purposes of the *Income Tax Act*. The trial judge ruled that the testimony was not barred by s. 241 because it fell within the exception contained in s. 241(3), which exception provides that the prohibition does not apply "in respect of proceedings relating to the administration or enforcement of" the *Income Tax Act*. Both officials testified, and the New Brunswick Court of Queen's Bench granted the declaration sought in part.

Marguerite Slattery appealed. She argued that the trial judge had erred in permitting the Revenue Canada officials to testify. The New Brunswick Court of Appeal agreed with the trial judge's interpretation of s. 241 of the *Income Tax Act*, and dismissed the appeal.

II.Relevant Statutory Provisions

Income Tax Act, S.C. 1970-71-72, c. 63, s. 241:

241. (1) Except as authorized by this section, no official or authorized person shall

(*a*) knowingly communicate or knowingly allow to be communicated to any person any information obtained by or on behalf of the Minister for the purposes of this Act or the *Petroleum and Gas Revenue Tax Act*,

(*b*) knowingly allow any person to inspect or to have access to any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act or the *Petroleum and Gas Revenue Tax Act*, or

(*c*) knowingly use, other than in the course of his duties in connection with the administration or enforcement of this Act or the *Petroleum and Gas Revenue Tax Act*, any information obtained by or on behalf of the Minister for the purposes of this Act or the *Petroleum and Gas Revenue Tax Act*.

(2) Notwithstanding any other Act or law, no official or authorized person shall be required, in connection with any legal proceedings,

(*a*) to give evidence relating to any information obtained by or on behalf of the Minister for the purposes of this Act or the *Petroleum and Gas Revenue Tax Act*, or

(*b*) to produce any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act or the *Petroleum and Gas Revenue Tax Act*.

(3) Subsections (1) and (2) do not apply in respect of criminal proceedings, either by indictment or on summary conviction, that have been commenced by the laying of an information, under an Act of the Parliament of Canada, or in respect of

Digitized by Google

proceedings relating to the administration or enforcement of this Act or the *Petroleum and Gas Revenue Tax Act.*

(4) An official or authorized person may ...

(*c*) communicate or allow to be communicated information obtained under this Act or the *Petroleum and Gas Revenue Tax Act*, or allow inspection of or access to any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act or the *Petroleum and Gas Revenue Tax Act*, to or by any person otherwise legally entitled thereto.

III. Judgments Below

1. *New Brunswick Court of Queen's Bench* (Jones J.)

The judgment of the New Brunswick Court of Queen's Bench consists of an oral ruling during the trial on the admissibility of testimony from the Revenue Canada officials. Jones J. held that the proceedings in the case at bar fell within the exception in s. 241(3) of the *Income Tax Act*. In interpreting the phrase "in respect of proceedings relating to the... enforcement of this Act", the trial judge commented upon two possible approaches, namely, the one set out in *Glover v. Minister of National Revenue*, 1981 CanLII 64 (SCC), [1981] 2 S.C.R. 561, in which the exception in s. 241(3) was held not to apply in any legal proceedings of a civil character, and a second approach taken in *Canadian Pacific Tobacco Co. v. Stapleton* (1952), 86 C.L.R. 1 (Aust. H.C.), which was more supportive of the trustee's position.

The trial judge held that "relating to" in s. 241(3) has a broad meaning. He suggested that, although s. 241(3) does not apply to civil proceedings unrelated to the *Income Tax Act*, some civil proceedings nonetheless fall within the exemption. He concluded that the action by the Trustee was of this latter kind, stating:

Now I know there can be civil legal proceedings strictly under the Income Tax Act, nevertheless, it is my finding that on the interpretation that I make of the words "relating to the enforcement of the Act" that -- and bearing in mind the circumstances in this case, the fact that it is -- this is a civil action by trustee in bankruptcy, major -- while the primary creditor is Revenue Canada, and the purpose for which -- came out in evidence before me yesterday morning, this action is pursued, I would find that it comes within the meaning of s. 241.3 and I would, therefore allow the plaintiff to continue with questions along that -- along the line which he was pursuing, or at least I would say that Sections 241.1 and 241.2 would not apply in this proceeding.

Accordingly, the trial judge permitted the Revenue Canada officials to testify.

2. *New Brunswick Court of Appeal* 1991 CanLII 4083 (NB CA), (1991), 120 N.B.R. (2d) 4 (Hoyt, Ayles and Ryan JJ.A.)

The reasons of the court were delivered by Hoyt J.A. (as he then was). During a brief review of the facts, Hoyt J.A. noted the importance of the testimony given by the Revenue Canada officials to the decision reached by the trial judge. He also noted that the purpose of the trustee's action was to ensure that the assets of the estate were collected, so that the bankrupt's creditors, including Revenue Canada, could be paid. In determining whether such proceedings were "proceedings relating to the administration or enforcement of this Act", Hoyt J.A. held at pp. 11-12:

A taxpayer who, like Mr. Slattery, circumvents tax collection procedures found in the *Act* is not thereby immune from other proceedings that the Minister may take to collect unpaid taxes and thus enforce the *Act*. Although Mr. Slattery is not a defendant in this proceeding, the trial judge has found, correctly in my view, that this situation arose because Mr. Slattery attempted to avoid paying outstanding taxes owed to Revenue Canada by implicating Mrs. Slattery with, it must be noted, her acquiescence.

Digitized by Google

Hoyt J.A. held at p. 12 that to "accept the appellant's submission could prevent the Minister from enforcing the *Income Tax Act* in proceedings other than those brought specifically under that *Act*". He distinguished *Glover*, *supra*, by stating that the present action could not be characterized as a non-*Income Tax Act* legal proceeding. Although this proceeding was not instituted under the *Income Tax Act*, he found it to be related to the enforcement of that Act.

As a result, the Court of Appeal held that the Revenue Canada officials had properly been permitted to testify and the appeal was dismissed.

IV. Issue

The question raised by this appeal is whether a civil action commenced by the trustee for a declaration that certain property is property of the bankrupt's estate is a proceeding "relating to the ... enforcement of" the *Income Tax Act* within the meaning of s. 241(3) of that Act. If it is, the prohibitions contained in s. 241 of the *Income Tax Act* against Revenue Canada officials' communicating or giving evidence of information obtained from the taxpayer do not apply. The respondent trustee in its factum also argues that the disclosure could be permitted by the exception contained in s. 241(4)(*c*), by suggesting that a bankruptcy judge is a "person otherwise legally entitled" to such information. As a result of my conclusion, I need not discuss this argument further.

An analysis of the history of s. 241, its underlying purposes and policy, its text and context, applicable judicial authority, and the nature of the proceedings involved herein, leads me to conclude that the courts below were correct in their holdings and that this appeal should be dismissed.

V. Analysis

1. *History of s. 241*

At the outset, it is worth noting that the taxation of income in Canada has been and is based on a self assessment and self reporting system. Confidentiality of taxpayer information has been an important part of our income tax collection system.

Legislated confidentiality of information obtained from taxpayers has moved through two distinct stages in Canada. The first stage began with s. 11 of the *Income War Tax Act, 1917*, S.C. 1917, c. 28. That section was a simple prohibition against disclosure by a person employed in the service of the Crown to a person, not legally entitled thereto, of any information obtained under the Act. Section 11 read as follows:

> **11.** No person employed in the service of His Majesty shall communicate or allow to be communicated to any person not legally entitled thereto, any information obtained under the provisions of this Act, or allow such person to inspect or have access to any written statement furnished under the provisions of this Act. Any person violating any of the provisions of this section shall be liable on summary conviction to a penalty not exceeding two hundred dollars.

Section 11 was re-enacted as s. 81 of the 1927 *Income War Tax Act*, R.S.C. 1927, c. 97, with the only modification being that the section was divided into two subsections, with the penalty portion becoming s. 81(2). In 1948, s. 81 became s. 121 of *The Income Tax Act*, slight changes in wording took place, and the subsections reverted to a consolidated form once more (S.C. 1948, c. 52). In 1952, the last change of the first stage occurred, and s. 121 became s. 133 in the *Income Tax Act*, R.S.C. 1952, c. 148. Viewed as a whole, this stage of legislative history is distinguishable because the extent of confidentiality protection afforded to taxpayers by the plain language of the statute had two features. First, the prohibition against disclosure was directed only at persons in the service of the Crown. Second, the success of that prohibition depended almost entirely upon the meaning ascribed to the statutory phrase "a person, not legally entitled thereto", which phrase offered the only exception to the otherwise blanket statutory prohibition.

The second legislative stage began in 1966 when the confidentiality section was

Digitized by Google

entirely modified by two amendments (S.C. 1966-67, c. 47, s. 17, and S.C. 1966-67, c. 91, s. 22). These amendments extended the general rule of non-disclosure to everyone, and at the same time spelled out specific exceptions for prescribed situations. (See Stephen J. Toope and Alison L. Young, "The Confidentiality of Tax Returns Under Canadian Law" (1982), 27 *McGill L.J.* 479.) The following is a succint summary of the 1966 amendments at p. 489:

> The general effect of these provisions is to make the section easier to apply. There is now a general prohibition against release of tax information to anyone. The subsections which follow the general prohibition set up exceptions to the rule, and the circumstances in which ministerial discretion may operate seem to be clear. The organization of the section is, in this respect, more amenable to application by common law courts as it resembles a set of rules rather than an abstract principle.

As will be noted again below, the 1966 amendments were described by the Ontario Court of Appeal as "a comprehensive code designed to protect the confidentiality of all information given to the Minister for the purposes of the *Income Tax Act*" -- *Glover v. Glover (No. 1)* (1980), 29 O.R. (2d) 392, at p. 396. The amendments were initially embodied in s. 133, but in 1970, s. 133 became s. 241 of the *Income Tax Act*, as it remains today. Since then, the section has been only slightly modified.

2. *Purposes and Policy Underlying s. 241*

In my view, s. 241 involves a balancing of competing interests: the privacy interest of the taxpayer with respect to his or her financial information, and the interest of the Minister in being allowed to disclose taxpayer information to the extent necessary for the effective administration and enforcement of the *Income Tax Act* and other federal statutes referred to in s. 241(4).

Section 241 reflects the importance of ensuring respect for a taxpayer's privacy interests, particularly as that interest relates to a taxpayer's finances. Therefore, access to financial and related information about taxpayers is to be taken seriously, and such information can only be disclosed in prescribed situations. Only in those exceptional situations does the privacy interest give way to the interest of the state.

As alluded to already, Parliament recognized that to maintain the confidentiality of income tax returns and other obtained information is to encourage the voluntary tax reporting upon which our tax system is based. Taxpayers are responsible for reporting their incomes and expenses and for calculating the tax owed to Revenue Canada. By instilling confidence in taxpayers that the personal information they disclose will not be communicated in other contexts, Parliament encourages voluntary disclosure of this information. The opposite is also true: if taxpayers lack this confidence, they may be reluctant to disclose voluntarily all of the required information (Edwin C. Harris, *Canadian Income Taxation* (4th ed. 1986), at pp. 26-27).

Parliament has also recognized, however, that if personal information obtained cannot be used to assist in tax collection when required, including tax collection by way of judicial enforcement, the possession of such information will be useless. Disclosure of information obtained through tax returns or collected in the course of tax investigations may be necessary during litigation in order to ensure that all relevant information is before the court, and thereby to assist in the correct disposition of litigation. But this necessity is sanctioned by Parliament in a very limited number of situations. Disclosure is authorized in criminal proceedings and other proceedings as set out in s. 241(3). Certain other situations are specified in s. 241(4), which have been described by the Ontario Court of Appeal as being "largely of an administrative nature" (*Glover v. Glover (No. 1)*, *supra*, at p. 397).

3. *The Text and Context of s. 241(3)*

As already noted, s. 241(3) provides, *inter alia*, that the confidentiality provisions in s. 241(1) and (2) do not apply "in respect of proceedings relating to the administration or

Digitized by Google

enforcement of" the *Income Tax Act*. The appellant argues that the only proceedings covered by this exception are those which are expressly provided for in Part XV of the Act, entitled "Administration and Enforcement". The appellant's argument would require the words in s. 241(3) to be read as meaning that the confidentiality provisions do not apply "in respect of proceedings taken pursuant to the administration or enforcement provisions" of the *Income Tax Act*. Neither the text nor context of s. 241 supports this argument.

The connecting phrases used by Parliament in s. 241(3) are very broad. The confidentiality provisions are stated not to apply in respect of proceedings relating to the administration or enforcement of the *Income Tax Act*.

The phrase "in respect of" was considered by this Court in *Nowegijick v. The Queen*, 1983 CanLII 18 (SCC), [1983] 1 S.C.R. 29, at p. 39:

> The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters. [Emphasis added.]

In my view, these comments are equally applicable to the phrase "relating to". *The Pocket Oxford Dictionary* (1984) defines the word "relation" as follows:

> ... what one person or thing has to do with another, way in which one stands or is related to another, kind of connection or correspondence or contrast or feeling that prevails between persons or things;...

So, both the connecting phrases of s. 241(3) suggest that a wide rather than narrow view should be taken when considering whether a proposed disclosure is in respect of proceedings relating to the administration or enforcement of the *Income Tax Act*.

This breadth of meaning is confirmed when one examines the French version of the section. The French version of s. 241(3) reads as follows:

> **241.** ...
>
> (3) Les paragraphes (1) et (2) ne s'appliquent ni aux poursuites au criminel, sur acte d'accusation ou sur déclaration sommaire de culpabilité, engagées par le dépot d'une dénonciation, en vertu d'une loi fédérale, ni aux poursuites ayant trait à l'application ou à l'exécution de la présente loi... [Emphasis added.]

The phrase "ayant trait à" is defined in the Larousse dictionary *Dictionnaire de la langue française* (1989) as: "Avoir trait à : avoir un rapport avec". The dictionary *Le Robert Méthodique* (1988) defines the phrase as: "Avoir trait à: Se rapporter à... V. Rapport". And the same dictionary defines the word "rapport" as meaning "Lien, relation". Consequently, the French version of s. 241(3) is as broad as the English version.

The next question to ask considers what type of administration or enforcement proceedings are contemplated by s. 241(3): only proceedings brought under the *Income Tax Act* itself, or both such proceedings and others? To answer this question, one must look first to the wording of s. 241(3). That provision contains no language which confines the concept of proceedings relating to administration or enforcement to the boundaries of the *Income Tax Act*. This conclusion is buttressed when one considers the context of s. 241.

Section 241 is found in Part XV of the *Income Tax Act*, which deals with administration and enforcement as previously noted. It is obvious, but the fact must nonetheless be highlighted, that the collection of money owing to Revenue Canada is an important part of the Act's enforcement. This proposition is confirmed by s. 222 of the Act which reads as follow:

> **222.** All taxes, interest, penalties, costs and other amounts payable under this Act are debts due to Her Majesty and recoverable as such in the Federal Court of Canada or any other court of competent jurisdiction or in any other manner

Digitized by Google

provided by this Act. [Emphasis added.]

Section 222 is a clear statement that, in addition to the procedures specified in the *Income Tax Act*, the Minister may resort generally to the courts to institute civil proceedings to collect taxes as debts. But, in order to take full advantage of this power, the Minister must be able to disclose in court otherwise confidential information in order to prove the cause of action in debt. It must therefore be possible to disclose such information to establish the amount owed and to prove related matters. Absent the ability to disclose as required to prove a debt, s. 222 would be deprived of part of its meaning. The absurdity of such a result strongly suggests that the collection proceedings specified in s. 222 are proceedings "relating to the... enforcement" of the *Income Tax Act* within the meaning of s. 241(3).

This legislative interpretation accords with the necessary balancing of privacy and state interests which takes place in s. 241. Confidentiality of tax information is necessary in order to promote the privacy interests of taxpayers and the success of voluntary tax reporting. But the success of the voluntary tax reporting system will be of no import if Revenue Canada cannot effectively collect taxes owed by taxpayers. In order to collect taxes owed, Revenue Canada should be able to resort to various procedures and proceedings to pursue the amounts owed and in doing so should also be able to disclose in court the information necessary to prove a cause of action in debt. As Décary J.A. said in *Diversified Holdings Ltd v. Canada*, reflex, [1991] 1 F.C. 595 (C.A.), at p. 599:

> In the instant case, the documents are part of a process, the collection proceedings, which is in itself in the public domain and which involves by its very nature the publication of information that would otherwise have remained confidential. One cannot seize a property pursuant to a certificate which has the force and effect of a judgment (see subsection 223(2) of the Act) without revealing to some extent information given to the Minister.

4. *Judicial Interpretation of s. 241*

I do not find it necessary to discuss all the cases which were decided under s. 241's predecessor sections or which deal with actions related to those predecessor sections. However, both the appellant and respondent cited, in support of their respective positions, the decision of the Ontario Court of Appeal in *Glover v. Glover (No. 1)*, *supra*, which was affirmed by this Court in a short judgment (*Glover v. Minister of National Revenue*, *supra*). Accordingly, some comment on this case is required.

In *Glover*, a trial judge ordered Revenue Canada to disclose the address of a taxpayer who had abducted his children in violation of a court order which granted custody to the children's mother. The question was whether the judge who ordered disclosure of the information was a person "legally entitled thereto". That phrase had been carried over from s. 241's predecessor provision and was restated in s. 241(4)(*c*) as an enumerated exception. The Ontario Court of Appeal set aside the trial judge's order, holding that the judge did not come within the s. 241(4)(*c*) exception.

In the course of his reasons, MacKinnon A.C.J.O. on behalf of a unanimous court made some general comments on the interpretation of s. 241. He stated at p. 396 that "[s]ection 241, in my view, is a comprehensive code designed to protect the confidentiality of all information given to the Minister for the purposes of the *Income Tax Act*". In his opinion, at p. 397, s. 241(3) was:

> ... a clear statement of parliamentary policy that no information obtained for the purpose of the Act shall be communicated and no official or authorized person shall be required to give evidence relating to such information in any non-*Income Tax Act* civil legal proceedings.

The mother appealed the decision of the Ontario Court of Appeal to this Court, which dismissed the appeal with brief reasons in which Laskin C.J. said at p. 562:

Digitized by Google

Sympathetic though one is inclined to be to the appellant's plight, the statutory provisions above-mentioned for non-disclosure, in connection with any legal proceedings of a civil character, do not give any power to a court to qualify them, nor do the exceptions set out in s. 241(4)(*c*) assist the appellant.

I agree with the respondent that, in *Glover*, the proceedings in question had no connection whatsoever with the administration or enforcement of the *Income Tax Act*. As a result, this Court's decision must be read to mean that the confidentiality provisions apply to any legal proceeding of a civil character which is not covered by the exception provided in s. 241(3). In other words, ss. 241(1) and (2) apply to civil proceedings which are not related to the administration or enforcement of the *Income Tax Act*. In my view, *Glover* does not inform the issue already set out: the essential question is whether or not the bankruptcy proceedings taken herein are related to the administration or enforcement of the *Income Tax Act*. As I will now discuss, I think they are.

V. *Are the Present Proceedings Covered by s. 241(3)*?

In determining whether the present bankruptcy proceedings are covered by the exception in s. 241(3) of the *Income Tax Act*, I think it worthwhile to note briefly some of the features of the bankruptcy process.

It has been stated that among the purposes of the *Bankruptcy Act* are a desire to permit an effective and fair distribution of the assets of a bankrupt person, and a desire to protect creditors of insolvent persons. See Houlden and Morawetz, *Bankruptcy and Insolvency Law of Canada* (3rd ed. 1993), at pp. 1-3, 1-4; see also Marc Chabot, *Faillite et Insolvabilité* (1987), at p. 8. Indeed, it has been asserted that not only are the interests of debtors and creditors protected under the *Bankruptcy Act*, but so is the public interest. See Professor Albert Bohémier, *Faillite et Insolvabilité*, vol. 1, (1992), at pp. 48-56. Thus, there are many who would advocate resort to bankruptcy proceedings as an effective and fair means of debt collection. I need not join the debate as to whether or to what extent these assertions are true. I will simply note that the bankruptcy process is aimed at the proper protection of debtor, creditor and public interests.

In the case on appeal, the Minister of National Revenue petitioned Raymond Slattery into bankruptcy. Mr. Slattery filed a statement of affairs stating that he had virtually no assets. The trustee then commenced the present action in the Court of Queen's Bench of New Brunswick seeking a declaration that certain assets held in the name of the appellant, Marguerite Slattery, were in reality property of the bankrupt's estate.

The appellant admits that, if the Minister through Revenue Canada had instituted proceedings under the *Income Tax Act*, such proceedings would be enforcement proceedings covered by the exception in s. 241(3). However, the appellant argues that because the proceedings herein were taken by the trustee, they cannot qualify as such. In my view, this argument fails for several reasons.

First, the appellant's argument is not supported by the wording of s. 241(3). As mentioned earlier, in my opinion the exception authorizing Revenue Canada to disclose tax related information in proceedings is very broad; that is, it operates in respect of proceedings relating to the enforcement of the *Income Tax Act*. The practical purpose and result of the present proceedings will be to increase the estate of the bankrupt taxpayer, Raymond Slattery. The ultimate purpose and result of these same proceedings will be the payment of taxes owed, inasmuch as Revenue Canada is a preferred beneficiary under the scheme of distribution established by s. 136 of the *Bankruptcy Act*. I find it quite clear that, under the terms of s. 241(3), such a proceeding has a "relation" or "connection" with the enforcement of the *Income Tax Act*. Neither the fact that the bankruptcy proceedings involve other creditors of the bankrupt, nor the fact that the proceedings were commenced by the trustee, detracts from the "relation" or "connection" between the proceedings and the enforcement of the *Income Tax Act*.

Digitized by Google

Second, the appellant's argument is also somewhat inconsistent with the power given to creditors in s. 38(1) of the *Bankruptcy Act*. Section 38(1) provides for the following:

> **38.** (1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk....

If we accept the appellant's proposition, a potential contradiction obviously results. That is, if a trustee initiated proceedings, confidential information obtained by Revenue Canada could not be disclosed in order to prove the fraudulent scheme, whereas if the trustee refused to act and Revenue Canada took the same proceedings, the information could arguably be disclosed. This result makes no sense since, in either case, the proceedings would be under the *Bankruptcy Act* and would be taken in furtherance of enforcing the *Income Tax Act*. The intervention of the trustee does not change the character of the bankruptcy proceedings, in so far as that character relates to the enforcement of the *Income Tax Act*.

Third, at the level of policy, I see no valid reason why the Minister should be inhibited from recourse to the bankruptcy process in light of the advantages and protection that this process can entail. If the Minister cannot disclose confidential information in bankruptcy to prove a claim asserted, the bankruptcy procedure will in many cases not be available for income tax enforcement. Again, the sense of this result is not apparent.

Without wishing to rule in any way on the matter, it is alleged that Revenue Canada had and still has at its disposal some *Income Tax Act* remedies against the appellant, which are unaffected by the stay of proceedings provided for by s. 69 of the *Bankruptcy Act*, which reads as follows:

> **69.** (1) On the filing of a proposal made by an insolvent person or on the bankruptcy of any debtor, no creditor with a claim provable in bankruptcy shall have any remedy against the debtor or his property or shall commence or continue any action, execution or other proceedings for the recovery of a claim provable in bankruptcy until the trustee has been discharged or until the proposal has been refused, unless with the leave of the court and on such terms as the court may impose.

(See D. Scott Brown, "Bankruptcy and Income Tax: A Revenue Canada Perspective" in *1990 Conference Report: Report of Proceedings of the Forty-Second Tax Conference*, at p. 18:11).

One of these allegedly unaffected remedies is found in s. 160 of the *Income Tax Act* which provides:

> **160.** (1) Where a person has, on or after the 1st day of May, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to
>
> (*a*) his spouse or a person who has since become his spouse,
>
> ...
>
> the following rules apply:
>
> ...
>
> (*e*) the transferee and transferor are jointly and severally liable to pay under this Act an amount equal to the lesser of
>
> (i) the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and
>
> (ii) the aggregate of all amounts each of which is an amount that the transferor is liable to pay under this Act in or in respect of the taxation year in which the property was transferred or any preceding taxation year.

Digitized by Google

D. Scott Brown, in the article cited above, comments on the scope of s. 160 as follows (at p. 18:13):

> The provisions of section 160 enable the minister to assess a transferee in respect of a transfer of property that, but for that provision, would require recourse under the settlement provisions of sections 91, 92, or 93 of the Bankruptcy Act, or alternatively under a provincial fraudulent conveyance statute. Generally, section 160 provides a very effective remedy against this type of transfer. In fact, the result of any direct or indirect transfer to a spouse... will be that the transferee and the transferor will be held jointly and severally liable under section 160 to pay the lesser of (1) the difference between the fair market value of the property and the amount paid for the property, and (2) the amount of the tax due by the transferor in the year of the transfer or any prior year.

It was apparently acknowledged by the appellant that the Minister could have used s. 160 in an attempt to recover some of the taxes owed by Raymond Slattery, but did not do so. The appellant agrees that, in the context of s. 160, the Minister could have disclosed the confidential tax information, but the appellant argues that the bankruptcy proceedings are different in nature. However, whether or not they are different in nature is beside the point. The important point is whether or not the disclosure within the bankruptcy proceedings occurred "in respect of proceedings relating to the administration or enforcement of" the *Income Tax Act*. The possible existence of an alternative enforcement procedure which would clearly permit disclosure is further support for the respondent's position. Although the Minister chose to collect taxes by petitioning the taxpayer into bankruptcy, in my view, this did not disentitle Revenue Canada from disclosing the confidential information. The disclosure occurred in respect of proceedings which can be clearly characterized as relating to the enforcement of the *Income Tax Act* within the meaning of s. 241(3) of that Act.

Finally, counsel for the appellant argued that to characterize the bankruptcy proceedings as "proceedings relating to the... enforcement of" the *Income Tax Act* would open up difficult questions relating to competence and compellability as those issues might affect Revenue Canada in a variety of possible actions. I find this argument unpersuasive, particularly in light of the circumstances of this case. Those circumstances include Revenue Canada's act of petitioning the taxpayer into bankruptcy, the active involvement of Revenue Canada in the bankruptcy proceedings, the collaboration between officials and the trustee, and the reality that Revenue Canada was entitled to volunteer and did, in fact, volunteer to disclose the otherwise confidential information in order to enforce the *Income Tax Act*.

VI.Conclusion

For the foregoing reasons, I conclude that the proceedings taken by the trustee are "proceedings relating to the administration or enforcement" of the *Income Tax Act* as set out in s. 241(3). Accordingly, I would dismiss the appeal with costs.

The reasons of L'Heureux-Dubé, Sopinka and McLachlin JJ. were delivered by

MCLACHLIN J. (dissenting) -- I have had the benefit of reading the reasons of my colleague, Justice Iacobucci. I respectfully disagree with his conclusion regarding the scope of the s. 241(3) exemption from non-disclosure of information obtained by the Minister of Revenue for the purposes of the *Income Tax Act*, S.C. 1970-71-72, c. 63.

Section 241(3) provides that the general prohibition on disclosure of such information, as set out in ss. 241(1) and (2), does not apply, *inter alia*, "in respect of proceedings relating to the administration or enforcement of this Act ...." The sole question on this appeal is whether the proceedings at issue are of this type.

These proceedings should be carefully described. Raymond Slattery fell into arrears paying income taxes. Revenue Canada conducted a lengthy investigation into his affairs. They petitioned Mr. Slattery into bankruptcy. In bankruptcy proceedings Revenue Canada proved a

Digitized by Google

claim against Mr. Slattery of over $1,000,000. At a subsequent trial to determine title between the appellant and the bankrupt's estate, the trustee in bankruptcy sought to introduce testimony from two Revenue Canada officials who had participated in the earlier investigation of Mr. Slattery's affairs. This testimony was admitted on the ground that the trial was a proceeding relating to the administration or enforcement of the *Income Tax Act*. The ruling was upheld on appeal.

My colleague Iacobucci J. would uphold these decisions. Focusing in part on the fact that the trial would ultimately result in the collection of unpaid taxes, he finds that the trial was a proceeding "relating to" the administration or enforcement of the Act.

In my view, the s. 241(3) exemption applies only in the case of proceedings specifically provided for in the *Income Tax Act*. These proceedings are, for the most part, set out in Part XV of the Act which, as the title of the Part indicates, establishes "Administration and Enforcement" provisions. A trial to determine title between an individual and a trustee in bankruptcy is not a proceeding provided for in Part XV, or elsewhere in the Act. Accordingly, in my view, Revenue Canada officials should have been barred from disclosing information obtained in the course of their investigation of the bankrupt's affairs.

The Scope of s. 241

Iacobucci J. has discussed the character of the provisions which govern the disclosure of information obtained for the purposes of the Act. He notes, at p. 444, that "[o]nly in those exceptional situations does the privacy interest [of citizens] give way to the interest of the state." These words, as my colleague notes, reflect the balance which Parliament has established between the competing interests at play: the interest in ensuring voluntary disclosure to the Minister of Revenue, which is served by the general rule of confidentiality, and the state's interest the collection of tax debts.

But having noted the primacy of privacy concerns under the *Income Tax Act*, Iacobucci J. goes on to interpret the disclosure clause of s. 241 broadly. He finds that the connecting phrases used in s. 241(3) are "very broad". Relying on *Nowegijick v. The Queen*, 1983 CanLII 18 (SCC), [1983] 1 S.C.R. 29, he interprets these connecting phrases to encompass proceedings which have any connection with the administration of the Act.

I do not share the view that *Nowegijick* informs the issue. That case does not concern s. 241 or any of its predecessor sections. Rather, *Nowegijick* discusses the phrase "in respect of" as it is employed in s. 87 of the *Indian Act,* R.S.C. 1970, c. I-6, in relation to taxation of personal property. Giving the phrase the "widest possible scope" in that context is not determinative of its application in s. 241(3). Instead, the context of s. 241(3), and jurisprudence of this Court treating the section, suggests that the phrase should be construed narrowly, not broadly. As Wilson J. noted in *R. v. McKinlay Transport Ltd.*, 1990 CanLII 137 (SCC), [1990] 1 S.C.R. 627, at p. 650:

> ... the taxpayer's privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies. [Emphasis added.]

See also *Glover v. Minister of National Revenue*, 1981 CanLII 64 (SCC), [1981] 2 S.C.R. 561, at p. 562, *per* Laskin C.J.

The structure of s. 241 subsequent to its 1966 amendment (S.C. 1966-67, c. 47, s. 17 and S.C. 1966-67, c. 91, s. 22) bears out the interpretation given the section by Wilson J. Prior to 1966, the Minister of Revenue was barred from disclosing information obtained under the Act to persons "not legally entitled thereto ...." This phrase did not constitute a serious hurdle to disclosure. As noted by Stephen J. Toope and Alison L. Young, in "The Confidentiality of Tax Returns Under Canadian Law" (1982), 27 *McGill L.J.* 479, at p. 487, "the [former] section created a *carte blanche* for the Minister to consider almost anyone to be `legally entitled' to the information as long as they could show some vague need." After 1966,

Digitized by Google

the prohibition was extended to "any person", unless a specific exemption had been provided. The exemptions are few, and are set out in ss. 241(3) and (4). Disclosure is permitted in specific criminal proceedings, in proceedings relating to the administration or enforcement of the Act, and, by virtue of s. 241(4), as might be required to facilitate specific government programs and the internal working of the Ministry of specific features of the Act. In s. 241(4)(*c*), disclosure to persons "otherwise legally entitled thereto" is again permitted, but the phrase is no longer the animating concern of the section. Rather, it must be understood as one element in a group of narrow and particular exemptions largely administrative in nature: see *Glover v. Glover (No. 1)* (1980), 29 O.R. (2d) 392, at p. 398.

The appellant submits that the proceedings at issue on this appeal are not proceedings relating to the administration of the Act in which the Minister can disclose information obtained for the purposes of the Act since they are not specifically provided for in Part XV of the Act. I agree with the substance of this submission. We are not here concerned with the capacity of the Ministry to undertake, or to involve itself in, proceedings which may bear some connection to the enforcement of the Act. The concern is whether these are the sort of proceedings which are so connected to the administration of the Act that they fall within the contemplation of the exemption in s. 241(3) and thereby allow the Ministry to disclose information which it has only by virtue of special investigative powers provided for in the Act (see ss. 231.1 to 231.5).

Part XV of the Act provides the Minister of Revenue with a system of debt collection proceedings that mirrors ordinary creditors' remedies. Taxes owing may be recovered by registering the amount in court and enforcing it as a judgment (s. 223(3)), registering the amount as a charge on land (s. 223(5)), garnishing sums destined to the tax debtor from third parties (s. 224(1)), deducting the amount from or setting it off against other sums payable by the Crown to the tax debtor (s. 224.1), seizing and selling the debtor's chattels (s. 225(1)) and prosecuting the tax debtor for offences under the Act and obtaining compliance orders (ss. 238 and 239). But Part XV does not deal with bankruptcy, except to the extent of providing the Minister the power to collect money owed to a secured creditor by a trustee in bankruptcy, notwithstanding the *Bankruptcy Act*, R.S.C., 1985, c. B-3: see *Income Tax Act*, s. 224 (1.2) (added by S.C. 1987, c. 46, s. 66).

In the context of Part XV this legislative silence is significant. Bankruptcy is a particular process with specific and salutary aims. Above all, however, bankruptcy is a process that involves all of the creditors of a particular debtor. Concern for the confidentiality of information that is not public is very much at issue.

My colleague is of the view that the bankruptcy process is available to the Minister by virtue of s. 222 of the Act, which provides that the Minister may resort to a court of competent jurisdiction to collect tax debts. I concur in this interpretation of the plain wording of s. 222, but I am not persuaded that the proceeding that is at issue here is an action under s. 222.

In the first place, the action is not brought by Her Majesty, as the section appears to contemplate. It is brought by a trustee in bankruptcy. Iacobucci J. is of the view that this does not take the proceedings out the s. 241(3) exemption. I disagree. Under s. 69 of the *Bankruptcy Act,* all collection proceedings are stayed once the debtor is declared bankrupt. Until that point the Minister arguably may prove its debt by disclosure of information obtained for the purposes of the Act. But once a debtor is declared bankrupt, and a trustee in bankruptcy has been put in place to pursue the bankruptcy, the proceeding is no longer capable of being accurately characterized as a proceeding relating to the administration of the Act. The stay operates until the trustee in bankruptcy is discharged. The trustee has a statutory duty to take possession of the bankrupt's property. It has a statutory power to institute legal proceedings. Persons in possession of a bankrupt's property have a statutory duty to deliver it to the trustee.

Digitized by Google

(See *Bankruptcy Act*, ss. 16(3), (4), 19(1), (2), and 17(1).) The trustee is a fiduciary of the estate of the bankrupt and institutes an action to the benefit of the state as a whole. The trustee does not act a mere agent of the creditors, or as an agent of particular creditors. In such a legal context, I do not think that it can be said that the fact that the practical effect of the proceedings will permit the Minister to realize on an outstanding debt suffices to make the proceeding one that relates to the administration of the Act.

The fact that Part XV of the Act makes no specific provision for disclosure in the context of bankruptcy suggests that when the Minister has recourse to this procedure, its actions are governed by the *Bankruptcy Act* and no longer by the *Income Tax Act*. In so proceeding the Minister loses the capacity to deploy the special information gathering techniques, which accrue only by virtue of the *Income Tax Act*, either to its own advantage, or to those of its fellow creditors. The broad powers to compel appearance and disclosure which are exercisable by the trustee in bankruptcy under the *Bankruptcy Act* (see ss. 163 through 167) should be interpreted in light of this fact. Information available from public sources is not unavailable in such proceedings simply because it has passed through the hands of Revenue Canada. But information that issues from the Minister, by virtue of any special investigative powers, must remain confidential.

Section 241(4)(*c*)

The respondent also argues that the Minister was permitted to disclose confidential information in the case at bar since a superior court judge is a person, as provided in s. 241(4)(*c*), "legally entitled" to the information. In my view the decisions of this Court and of the Ontario Court of Appeal in *Glover*, *supra*, dispense with this argument. The issue in those cases was whether the judge in child custody proceedings was a "person ... legally entitled" to the information. The Ontario Court of Appeal, in a decision that was affirmed in this Court, held (at p. 397) that the s. 241(4) exemptions were administrative in nature, and that if a court could at any time by its own order entitle itself to receive otherwise confidential taxpayer information "it would emasculate the effect of s. 241(2) and render s. 241(3) unnecessary". The point of these judgments is that a party should not be able to avail itself of the s. 241(4)(*c*) exemption if it cannot bring the proceeding within the terms of s. 241(3). I have found above that this respondent cannot.

Disposition

The Court of Appeal found that the trial judge's findings in declaring some of the property of the appellant to be the property of the bankrupt's estate depended largely upon the testimony and evidence of the Revenue Canada officials. This information was gathered in the course of an investigation undertaken according to special investigatory powers available to Revenue Canada under the Act. Section 241 forbad its disclosure in the bankruptcy proceedings. I would allow the appeal and set aside the judgments below. I would grant costs to the appellant.

Digitized by Google

Appeal dismissed, L'HEUREUX-DUBÉ, SOPINKA *and* MCLACHLIN JJ. *dissenting.*
Solicitors for the appellant: Mockler, Allen & Dixon, Fredericton.
Solicitors for the respondent: Palmer, O'Connell, Leger, Roderick & Glennie, Saint John.

Glover v. Minister of National Revenue[1], Ontario Court of Appeal, CANLII.org, Piercing s. 241 for Civil Purposes Not Allowed

MACKINNON, A.C.J.O., WILSON AND THORSON, JJ.A. 18TH JUNE 1980.
Ian S. MacGregor, for appellant, Attorney-General of Canada on behalf of Minister of National Revenue. William D. Dunlop, for respondent.
[1] The judgment of the Court was delivered by
[2] MACKINNON, A.C.J.O.:—The issue in this appeal is: does the Supreme Court of Ontario have the power, in order to assist in the implementation of one of its orders, to require the Minister of National Revenue to reveal confidential information secured under the provisions of the *Income Tax Act,*1970-71-72 (Can.), c. 63, against which requirement and revelation there appears to be a direct prohibition in the *Income Tax Act?*
[3] Mrs. Glover instituted a petition for divorce in 1977 and also sought, by way of corollary relief, custody of her two young children. Her husband cross-petitioned for divorce and custody. Judge Blair at Milton made an interim custody order on March 10, 1977, in favour of Mrs. Glover and granted limited access to Mr. Glover. On August 16, 1977, Mr. Glover absconded with the children and, despite all her efforts, Mrs. Glover had not seen or heard of them since.
[4] Mr. Justice Garrett made an order on October 11, 1977, directing that Mr. Glover return the children to Mrs. Glover. He also ordered that she was to have interim custody until a final order for custody was made. He authorized the law enforcement agencies to take all necessary steps to carry out the provisions of his order.
[5] The petition for divorce was heard on March 2, 1979, and Mr. Justice Lerner granted a decree *nisi* and custody of the children to Mrs. Glover. Mr. Glover did not, of course, appear at the trial. At the time of the trial Mr. Justice Lerner made an order directing, *inter alia,* Revenue Canada, Taxation, to provide "this Court with particulars of the addresses of the respondents Paule Wenenn and James Glover pursuant to *The Family Law Reform Act".*
[6] The Attorney-General of Canada, on behalf of the Minister of National Revenue, moved before Mr. Justice Lerner on March 10, 1980, for an order that the reference to Revenue Canada, Taxation be deleted from the order of March 2, 1979. The learned Judge stated that the order of March 2, 1979, while purporting to be made pursuant to s. 26(2) of the *Family Law Reform Act,* 1978 (Ont.), c. 2, was so titled in error, and he held that the order had been made under a federal statute, the *Divorce Act,* R.S.C. 1970, c. D-8. He amended the wording of his order to this limited extent and dismissed the application.
[7] The Minister of National Revenue now appeals the order. Counsel submits that the prohibition in s. 241 [am. 1978-79, c. 5, s. 9] of the *Income Tax Act* against requiring the communication of any information obtained by the Minister for the purposes of the *Income Tax Act* is an absolute one and that the Court, in the circumstances of this case, does not come within any of the listed exceptions to that prohibition. [See 26 O.R. (2d) 477, 102 D.L.R. (3d) 707, 12 R.F.L. (2d) 193.]
[8] Section 241 reads as follows:
241(1) Except as authorized by this section, no official or authorized person shall knowingly communicate or knowingly allow to be communicated to any person any

Digitized by Google

information obtained by or on behalf of the Minister for the purposes of this Act, or

knowingly allow any person to inspect or to have access to any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act.

Notwithstanding any other Act or law, no official or authorized person shall be required, in connection with any legal proceedings,

to give evidence relating to any information obtained by or on behalf of the Minister for the purposes of this Act, or

to produce any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act.

Subsections (1) and (2) do not apply in respect of criminal proceedings, either by indictment or on summary conviction, under an Act of the Parliament of Canada, or in respect of proceedings relating to the administration or enforcement of this Act.

An official or authorized person may,

in the course of his duties in connection with the administration or enforcement of this Act,

communicate or allow to be communicated to an official or authorized person information obtained by or on behalf of the Minister for the purposes of this Act, and

allow an official or authorized person to inspect or to have access to any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act;

under prescribed conditions, communicate or allow to be communicated information obtained under this Act, or allow inspection of or access to any written statement furnished under this Act to the government of any province in respect of which information and written statements obtained by the government of the province, for the purpose of a law of the province that imposes a tax similar to the tax imposed under this Act, is communicated or furnished on a reciprocal basis to the Minister; or

communicate or allow to be communicated information obtained under this Act, or allow inspection of or access to any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act, to or by any person otherwise legally entitled thereto; or

communicate or allow to be communicated to a taxpayer, such information obtained under this Act regarding the amount of income of his spouse or of any other person as is necessary for the purposes of an assessment or reassessment of tax, interest, penalty or other amount payable by the taxpayer or of the determination of any refund to which he is entitled for the year.

Notwithstanding anything in this section, the Minister may permit a copy of any book, record, writing, return or other document obtained by him or on his behalf for the purposes of this Act to be given to the person from whom such book, record, writing, return or other document was obtained or

the legal representative of such person, or to the agent of such person or of such legal representative authorized in writing in that behalf.

An order or direction made in the course of or in connection with any legal proceedings requiring an official or authorized person to give evidence relating to any information or produce any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act, may, by notice served upon all interested parties, be appealed forthwith by the Minister or by the person against whom the order or direction is made to

the court of appeal of the province in which the order or direction is made, in the case of an order or direction made by a court or other tribunal established by or pursuant to the laws of the province, whether or not such court or tribunal is exercising a jurisdiction conferred by the laws of Canada; or

Digitized by Google

the Federal Court of Appeal, in the case of an order or direction made by a court or other tribunal established by or pursuant to the laws of Canada.
The court to which an appeal is taken pursuant to subsection (6) may allow the appeal and quash the order or direction appealed from or dismiss the appeal, and the rules of practice and procedure from time to time governing appeals to the courts shall apply, *mutatis mutandis,* to an appeal instituted pursuant to subsection (6).
An appeal instituted pursuant to subsection (6) shall stay the operation of the order or direction appealed from until judgment is pronounced.
Every one who, being an official or authorized person, contravenes subsection (1) is guilty of an offence and liable on summary conviction to a fine not exceeding $1,000 or to imprisonment for a term not exceeding 2 months, or to both such fine and imprisonment.
In this section,
"official" means any person employed in or occupying a position of responsibility in the service of Her Majesty, or any person formerly so employed or formerly occupying a position therein;
"authorized person" means any person engaged or employed, or formerly engaged or employed, by or on behalf of Her Majesty to assist in carrying out the purposes and provisions of this Act; and
"court of appeal" has the meaning assigned by paragraphs (*a*) to (*j*) of the definition "court of appeal" in section 2 of the *Criminal Code.*
[9] Subsection (4)(*d*) was added in 1979 after the original order was made. It does not assist in the resolution of the problem which faced the trial Judge.
[10] It appears to be common ground that, as a result of the judgment in *R. v. Snider,* 1954 CanLII 40 (SCC), [1954] S.C.R. 479, [1954] 4 D.L.R. 483, 109 C.C.C. 193, the extended s. 241 was first enacted in its present
form by 1966-67 (Can.), c. 47, s. 17, and 1966-67, c. 91, s. 22. Section 241, in my view, is a comprehensive code designed to protect the confidentiality of all information given to the Minister for the purposes of the *Income Tax Act.* The only exception to s. 241 found elsewhere in the *Income Tax Act* is contained in s. 149.1(15) [enacted 1976-77, c. 4, s. 60; am. 1979-80, c. 5, s. 52] which explicitly states that, "notwithstanding section 241", the Minister shall communicate to the public the information contained in the annual public information return required to be made by every registered charity by virtue of s. 149.1(14) [enacted *ibid*]. Accordingly, unless the "Court" or Mrs. Glover can come within one of the exceptions found in s. 241 itself, the order herein was made without jurisdiction.
[11] Section 241(1) makes it clear that: "Except as authorized by this section", no official shall communicate to *"any person any information* obtained by or on behalf of the Minister *for the purposes of this Act"* (emphasis added). To make the matter clear, so far as legal proceedings are concerned, s-s. (2) is added which states that:"Notwithstanding any other Act or law, no official or authorized person [as defined] *shall be required, in connection with any legal proceedings*" to give evidence or produce *any* writing relating to *any* information obtained for the purposes of the Act (emphasis added). This is an all-embracing section which, apart from the exceptions listed in s-s. (3), applies to "any legal proceedings" and to the Court.
[12] Section 241(3) limits the effect of s. 241(1) and (2) by stating that those subsections do not apply in respect of criminal proceedings or in respect of proceedings relating to the administration or enforcement of the *Income Tax Act.* If one views s. 241(3) conversely along with the two previous subsections, it is a clear statement of parliamentary policy that no information obtained for the purpose of the Act shall be communicated and no official or authorized person shall be required to give evidence relating to such information in any non-*Income Tax Act* civil legal proceedings.

Digitized by Google

[13] The absolute prohibition as defined and limited in the first three subsections of s. 241, leads directly into s-s. (4). This permissive subsection and its components allow, for the purposes of the effective working of the entire statute, the communication of confidential information obtained for the purpose of the legislation to other persons as therein defined and limited. These persons are, equally, on receipt of the confidential information, under the ukase of s. 241(1). Section 241(4), as has been recently pointed out by this Court, sets out certain exceptions, largely of an administrative nature, to the restrictions imposed by the section: *Re Herman et al. and Deputy A.-G. Can.* reflex, (1979), 26 O.R. (2d) 520 at p. 529, 103 D.L.R. (3d) 491 at p. 500, 13 C.P.C. 363.

[14] Section 241(4)(*c*) states that an official or authorized person may communicate information obtained under the Act for the purposes of the Act to "any person otherwise legally entitled thereto". Counsel for Mrs. Glover argues that a Judge of the Supreme Court would be "a person otherwise legally entitled". His submission is that a Judge could "designate" himself to be a person to receive the confidential information or he could direct that it be given to Mrs. Glover. In either case, the Judge or Mrs. Glover would thereby become "a person otherwise legally entitled". This argument overlooks the effect and purpose of s. 241(2) and (3). If the Court, at any time, has the power to make such orders, it would emasculate the effect of s. 241(2) and render s. 241(3) unnecessary.

[15] The accepted rule of statutory interpretation which has application here was stated by Lord Davey in *Canada Sugar Refining Co. Ltd. v. The Queen,* [1898] A.C. 735 at p. 741:

[16] Every clause of a statute should be construed with reference to the context and the other clauses of the Act, so as, so far as possible, to make a consistent enactment of the whole statute or series of statutes relating to the subject-matter.

[17] Further, as the editor of *Maxwell on the Interpretation of Statutes,* 12th ed. (1969), p. 36, points out: "A construction which would leave without effect any part of the language of a statute will normally be rejected." The interpretation urged by counsel for Mrs. Glover, if accepted, would be to ignore the other clauses of the same section and indeed, as I have stated, render them either meaningless or ineffectual.

[18] It was suggested that, by virtue of the original order for custody, Mrs. Glover became a "person otherwise legally entitled" to any information as to the address of her husband, within the meaning of the words quoted as found in s. 241(4)(*c*). In other words, the mere fact that she had been given an order for custody carried with it, by implication, the authority to secure information as to the location of her children from any individual or agency which might have such information. Such an approach, when applied to the *Income Tax Act,* would, in my view, give far too wide a meaning to the words "otherwise legally entitled" and once again the result would be to ignore or subvert the limitations imposed by the section in its attempt to ensure the confidentiality of the information secured and received by the Revenue Department under the Act. [19] In considering the interpretation to be given to s. 241(4)(*c*) and the words "any person otherwise legally entitled", the whole of that subsection must be looked at. Section 241(4)(*a*) allows an official or authorized person (as defined by s-s. (10), in the course of his duties, to communicate to other officials or authorized persons (as defined) certain information. Section 241(4)(*b*) allows for the communication to provincial officials, on a reciprocal basis, information when a similar tax has been imposed by the Province. The latest amendment, s. 241(4)(*d*), allows for the communication to a taxpayer of certain information relating to other taxpayers' incomes for the purpose of determining the first taxpayer's assessment or reassessment of tax, interest, penalty or other amount payable. This is a carefully circumscribed permissive subsection to ensure that the taxpayer who is being assessed or reassessed, has knowledge of the basis of such assessment, etc. Section 241(4)(*c*), for its part, has an administrative purpose similar to the other subsections of s. 241(4). It permits the

Digitized by Google

administration of various Departments of Government to proceed within the limits of the confidentiality imposed by s. 241(1) and of the governing statutes of those Departments. Sections of various statutes indicate who could fall within the words "persons otherwise legally entitled", for example: *Canada Pension Plan,*
[20] R.S.C. 1970, c. C-5, s. 94(2)(*b*); *Corporations and Labour Unions Returns Act,* R.S.C. 1970, c. C-31, s. 16; *Old Age Security Act,* R.S.C. 1970, c. 0-6, s. 19(3)(*a*); *Statistics Act,* 1970-71-72 (Can.), c. 15, s. 23(1) [am. 1976-77, c. 28, s. 41(5)].
[21] Section 241(5) contains an obvious and necessary exception to the blanket prohibition. It allows the Minister to communicate to the taxpayer or his legal representatives or agent information from the taxpayer's own returns or material. This case does not fall within that exception.
[22] The trial Judge did not rely on any exception to be found within s. 241 but rather appeared to base his order on the "inherent jurisdiction" of the Court to control its own process and see that its orders are obeyed. There is no evidence, of course, that Mr. Glover was aware ofthe orders of Mr. Justice Garrett and of Mr. Justice Lerner but he certainly was aware of the interim order made by Judge Blair on March 10, 1977. Although the record does not disclose it, I assume that Judge Blair's order was made as a Local Judge of the Supreme Court in the course of the divorce proceedings brought in the Supreme Court of Ontario.
[23] The question of the inherent jurisdiction of the Court was not directly canvassed by the trial Judge. However, it was fully argued before us. In his helpful article entitled "Inherent Jurisdiction of the Court" (1970), 23 Curr. L. Prob. 23, Master Jacob points out that inherent jurisdiction is the reserve or fund of powers which the Court may draw upon as necessary whenever it is just or equitable to do so. He goes on to emphasize that this is not an unlimited jurisdiction and that it cannot be exercised in contravention of any statutory provision. In dealing with the general jurisdiction of the Court, a term which includes inherent jurisdiction, Brooke, J.A., in *80 Wellesley St. East Ltd. v. Fundy Bay Builders Ltd. et al.,* [1972] 2 O.R. 280 at p. 282, 25 D.L.R. (3d) 386 at p. 388, said:
As a superior Court of general jurisdiction the Supreme Court of Ontario has all of the powers that are necessary to do justice between the parties. Except where provided specifically to the contrary, the Court's jurisdiction is unlimited and unrestricted in substantive law in civil matters.
[24] The limiting words in that passage, and with respect in my view correctly so, are "except where provided specifically to the contrary". In the instant case there is a specific statutory limitation on the jurisdiction of the Court, which prohibits the divulging by the Minister or his officials of the information sought in this type of proceeding. The address of the taxpayer is a necessary and integral part of the information sought and received for the purposes of the *Income Tax Act.* To deliberately misstate the address is an offence under the Act. The section does not allow the Court to weigh the quality of relative value of the information. It prohibits the communication of "any" information received for the purposes of the *Income Tax Act.* In my opinion, the address received by the Minister of taxpayers on the income tax returns is information obtained by or on behalf of the Minister for the purposes of the *Income Tax Act.* Such information can only be communicated to persons authorized to receive it by virtue of the exceptions or qualifications contained in s.
241. As I have already stated, I do not believe that the Court of Mrs. Glover, either under s. 241 or by virtue of the invocation of the inherent jurisdiction of the Court, is such a person.
[25] An affidavit was filed in the Court below on behalf of the Minister by an employee of the Department of National Revenue stating that in his (the employee's) opinion, the disclosure of any information received in connection with the administration or enforcement of the *Income Tax Act* would be prejudicial to the public interest. I do not think such an affidavit is

Digitized by Google

required in connection with the interpretation and application of s. 241 which is clear in its terms. Accordingly, I have not considered the affidavit.

[26] While one may have considerable sympathy with Mrs. Glover and her difficulties, if the Court can make the order that was here made, I can see no limitation on the power of the Court to make an order requiring any information received as a result of the requirements of the *Income Tax Act,* to be divulged or communicated to the Court or any other person as the Court directs. This would confer on the Court an unlimited discretion which would ignore the combined effect of s. 241(1), (2) and (3). I do not think this is a possible interpretation of s. 241 or of the applicable legal principles.

[27] The appeal is allowed and the order of the Court below is varied by striking out the words "Revenue Canada—Taxation" from para. 1 of the order of March 2, 1979. There will be, under the circumstances, no order as to costs on the appeal or of the order of Mr. Justice Lerner of March 10, 1980.

Appeal allowed.

Glover v. Minister of National Revenue, [1981] 2 S.C.R. 561, The Ontario Case Appealed

Present: Laskin C.J. and Martland, Ritchie, Dickson, Beetz, Estey, McIntyre, Chouinard and Lamer JJ. ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO.

Courts—Powers of courts—Income tax—Confidentiality—Whether Revenue Canada is obliged or can be compelled to disclose information contained in tax return—Statutory provisions precluding disclosure of information—Case did not fall within exception—Inherent jurisdiction of the court could not be exercised in contravention of statutory provisions—Income Tax Act, 1970-71-72 (Can.), c. 63 as amended, s. 241.

APPEAL from a judgment of the Court of Appeal for Ontario[141], setting aside an order of Lerner

J[142] directing Revenue Canada to provide the Court with certain information secured under the provisions of the *Income Tax Act.* Appeal dismissed.

William D. Dunlop and Susan J. Serena, for the appellant.

L.R. Olsson, Q.C., and Ian S. MacGregor, for the respondent.

The judgment of the Court was delivered by

THE CHIEF JUSTICE—The issue in this appeal is whether the revenue authorities of the Government of Canada are obliged or can be compelled to disclose the address of a taxpayer to the appellant who was awarded custody of her children as against the taxpayer, her former husband, he having abducted the two children and his whereabouts being unknown. Lerner J. made an order for disclosure, notwithstanding the provisions of s. 241(1) and (2) of *the Income Tax Act*, 1970-71-72 (Can.), c. 63 as amended. His order was set aside by the Ontario Court of Appeal in unanimous reasons given for the Court by MacKinnon A.C.J.

Sympathetic though one is inclined to be to the appellant's plight, the statutory provisions above-mentioned for non-disclosure, in connection with any legal proceedings of a civil character, do not give any power to a court to qualify them, nor do the exceptions set out in s. 241(4)(c) assist the appellant. MacKinnon A.C.J. has dealt fully with the issues that arise in the appeal and no ground has been shown to depart from his reasons and conclusion.

I would, accordingly, dismiss the appeal. There will be no order as to costs.

Appeal dismissed.

Solicitors for the appellant: Martin, Dunlop, Hillyer & Associates, Burlington. Solicitor for the

[141] (1980), 29 O.R. (2d) 392, 80 D.T.C. 6262.

[142] (1979), 26 O.R. (2d) 477, 79 D.T.C. 5391

Digitized by Google

respondent: L.R. Olsson, Toronto.

Her Majesty The Queen and The Minister of National Revenue v. George William Harris (et al), A-25-99, Mister Harris and his Purportedly Favoured Trusts

REASONS FOR JUDGMENT
Sexton J.A.
INTRODUCTION

[1] Mr. Harris issued a statement of claim, alleging that the Ministry of National Revenue acted illegally or improperly or for ulterior motives by providing preferential treatment to a taxpayer when the Ministry of National Revenue issued an advance tax ruling in 1991. The Ministry of National Revenue moved to strike the statement of claim on the basis that it disclosed no cause of action because one person is not permitted to challenge another's income tax treatment, and because Mr. Harris lacked public interest standing.

[2] The following issues are raised by this appeal:

ISSUES

1. Does the statement of claim describe a reasonable cause of action, arising out of Mr. Harris' allegations that the Minister of National Revenue acted illegally or improperly or for ulterior motives, namely favouritism and preferential treatment by way of a covert deal when he interpreted the provisions of the *Income Tax Act* in favour of a specific trust?
2. Does Mr. Harris have public interest standing to seek declaratory relief relating to the alleged maladministration of the *Income Tax Act* by the Minister of National Revenue?

BACKGROUND

The nature of Revenue Canada's advance income tax rulings

[3] Revenue Canada permits taxpayers to request advance income tax rulings ("rulings"), where taxpayers ask Revenue Canada to explain how it will apply specific provisions of the *Income Tax Act*[1] (the "Act") to proposed transactions.[2] Revenue Canada generally regards the rulings as binding, so as to permit taxpayers to obtain certain tax consequences when the proposed transactions are eventually carried out in accordance with the ruling.[3] In so doing, a taxpayer may choose to not carry out a proposed transaction if Revenue Canada proposes to issue an unfavourable ruling.[4]

The 1985 ruling

[4] In 1984, an accounting firm's client asked it to obtain a ruling from Revenue Canada.[5] In its request for a ruling, the firm explained that a Canadian-resident trust proposed to exchange private corporation shares for public corporation shares. In the ruling, Revenue Canada was required to determine whether, if the trust's residence changed, the trust would be deemed to have disposed of the shares within the meaning of ss. 48(1) of the Act (as it then read) so as to cause the trust to incur an immediate tax liability on the trust's properties' accrued capital gains, or whether such a deemed disposition would not occur because the property constituted a type of property known as "taxable Canadian property."

[5] In January 1985, the Non-Corporate Rulings Division of Revenue Canada issued a favourable ruling to the trust. The ruling was not made public.[6]

The 1985 opinion

[6] One week after the ruling was issued, Revenue Canada received a request for an opinion from a different taxpayer, essentially asking the same question that the trust had earlier asked. When the opinion was issued some five months later, the same Revenue Canada division that had issued the earlier ruling "directly contradicted"[7] that earlier ruling. The opinion was made public.

The 1991 ruling

Digitized by Google

[7] In 1991, a law firm that represented a trust that was related to the parties who had obtained the favourable 1985 ruling requested a similar ruling from Revenue Canada. Even though the 1985 ruling had not been made public, the law firm had a copy of that ruling.[8]

[8] The law firm explained that a trust known as the "Family Trust" had obtained public company shares in exchange for private company shares. The law firm proposed changing the residence of a newly-established so-called "Protective Trust" from Canada to the U.S., and to transfer the public company shares held by the Family Trust to the Protective Trust.

[9] The taxpayer's transaction posed the following problem to Revenue Canada. If Revenue Canada concluded that the public company shares held by the resident Family Trust were taxable Canadian property, the Family Trust would be permitted to dispose of the public company shares to the non-resident Protective Trust without triggering a deemed disposition at fair market value pursuant to ss. 107(5) of the Act.[9] In other words, the Family Trust would not incur an immediate tax liability merely by distributing the shares to the Protective Trust.

[10] In its ruling, Revenue Canada concluded that the Family Trust would not trigger a deemed disposition pursuant to s. 107(5) of the Act when it distributed the shares to the Protective Trust. Therefore, the ruling would have permitted the non-resident Protective Trust to immediately dispose of the public company shares, while sheltering the proceeds from Canadian income tax.

[11] The ruling was made subject to a ten-year waiver that would permit Revenue Canada to reassess the Family Trust "with respect to subsection 107(5)," a waiver that presumably would permit Revenue Canada to reverse its conclusion that Canadian residents could hold taxable Canadian property. The waiver would permit Revenue Canada to conclude that a deemed disposition and corresponding tax liability occurred when the Family Trust transferred the public company shares to the Protective Trust.

[12] Therefore, to summarize, the implicit assumption made in the 1985 and the 1991 non-public rulings was that Canadian residents could hold taxable Canadian property, and that a deemed disposition and corresponding tax liability would not occur when such taxable Canadian property was transferred out of Canada. By contrast, the public opinion released by Revenue Canada in 1985 directly contradicted those conclusions.

The Auditor General's report

[13] In response to the 1991 ruling, the Auditor General issued a strongly-worded report criticizing the ruling itself, the seeming covertness in which the ruling was made, and the lack of documentation associated with the way in which the rulings were made. The Auditor General also suggested that because the taxpayers who obtained the 1991 ruling were bolstered by the 1985 ruling that was not available to the public at large, the taxpayer who received the 1991 ruling might have enjoyed advantages not available to other taxpayers.

George Harris' statement of claim

[14] George Harris is a taxpayer. He is a member of an unincorporated organization known as "CHO!CES - A Coalition for Social Justice," an organization that Mr. Harris describes in his statement of claim as one that "deals with a wide variety of public issues,"[10] including "fiscal and budgetary matters at all levels of government."[11]

[15] After the Auditor General released its report, CHO!CES requested the Attorney General of Canada to refer the rulings "to a court of competent jurisdiction for a determinative decision concerning the correctness and propriety of the Minister's rulings."[12] The Attorney General did not respond to the letter.

[16] Mr. Harris sought to obtain relief on his own. He issued a statement of claim, essentially relying on many of the criticisms the Auditor General had made of the 1991 ruling. As relief for those criticisms, Mr. Harris sought, *inter alia*, "a declaration that the Minister is obliged to utilize all available measures under the Act to collect any tax properly due and

Digitized by Google

owing as a result of the transaction referenced in the 1991 Ruling, including resort to the waiver given by Family Trust [...]."[13]

The Attorney General of Canada's motion to strike

[17] The Attorney General brought a motion to strike the entire statement of claim, pursuant to the former Rule 419 of the *Federal Court Rules*. The central grounds upon which the Attorney General based its motion to strike were that the Statement of Claim disclosed no reasonable cause of action, and that Mr. Harris lacked the requisite standing to bring his action.

DECISIONS BELOW

The Prothonotary's decision

[18] Giles A.S.P. granted the Attorney General's motion to strike the entire claim. He held that "a third-party challenge to an assessment has never been permitted in our tax system."[14] Accordingly, he concluded that Mr. Harris' statement of claim should be struck as disclosing no reasonable cause of action. Alternatively, Giles A.S.P. concluded that Mr. Harris did not have standing to bring his claim.

Appeal to the Federal Court - Trial Division

[19] Mr. Harris appealed the decision of Giles A.S.P. to the Federal Court - Trial Division, which allowed the appeal. Again, at this stage of the proceedings, the Attorney General adopted the position that the statement of claim should be struck in its entirety.

[20] In his reasons, Muldoon J. applied the three-stage test stated by the Supreme Court of Canada in *Canadian Council of Churches* v. *The Queen et al.*[15] so as to conclude that Mr. Harris had standing to bring his claim. Muldoon J. concluded that the three-stage test was satisfied in the following ways:

1. Mr. Harris had raised "a serious issue [...] as to the invalidity of the favouring acts complained of in question."[16] Muldoon J. held that "what is at stake, to be determined if possible in the action, are: (1) alleged favouritism or blundering in the administration of tax collection; and (2) a huge erosion of the national tax base."[17] He added that "either one of the foregoing, it is evident, is of towering seriousness [...]."[18]
2. Mr. Harris had demonstrated "a genuine interest."[19] Muldoon J. noted that Mr. Harris was a concerned taxpayer and a member of CHO!CES, a group he found to be concerned with "fair taxation."[20] Accordingly, Muldoon J. wondered "what more can be expected of the plaintiff in order to satisfy the second criterion?"[21]
3. There was no other reasonable and effective way to bring the issue before the Court. Muldoon J. held that "the only directly affected individuals were accorded a mighty benefit by the departmental administrative acts which the plaintiff challenges,"[22] while the "Attorney General, a member of the government"[23] could not be expected to impugn the 1991 ruling.

[21] The Attorney General appeals Muldoon J.'s decision to this Court.

ANALYSIS

1. Does the statement of claim describe a reasonable cause of action?

Test on a motion to strike

[22] The test to determine whether a motion to strike should be granted was stated by the Supreme Court in *Hunt* v. *Carey Canada Inc.*:[24]

> Assuming that the facts as stated in the statement of claim can be proved, is it "plain and obvious" that the plaintiff's statement of claim discloses no reasonable cause of action? As in England, if there is a chance that the plaintiff might succeed, then the plaintiff should not be "driven from the judgment seat." Neither the length and complexity of the issues, the novelty of the cause of action, nor the potential for the defendant to present a strong defence should prevent the plaintiff from proceeding with his or her case. Only if the action is certain to fail because it contains a radical defect [...] should the relevant portions of

Digitized by Google

a plaintiff's statement of claim be struck out under Rule 19(24)(a).[25]

[23] Similarly, in *Operation Dismantle Inc.* v. *The Queen*,[26]the majority held:

> The law then would appear to be clear. The facts pleaded are to be taken as proved. When so taken, the question is do they disclose a reasonable cause of action, *i.e.* a cause of action "with some chance of success" (*Drummond-Jackson* v. *British Medical Association*, [1970] 1 All E.R. 1094) or, as Le Dain J. put it in *Dowson* v. *Government of Canada* (1981), 37 N.R. 127 (F.C.A.), at p. 138, is it "plain and obvious that the action cannot succeed?"[27]

Pertinent allegations relating to cause of action

[24] As previously mentioned, Mr. Harris' statement of claim largely relies on the facts and conclusions contained in the Auditor General's May 1996 report. In that report, the Auditor General concluded that the impugned 1991 ruling raised the following issues that are pleaded by Mr. Harris in his statement of claim:

(a) The Auditor General concluded that the transaction for which the 1991 ruling was issued "may have circumvented the intent of the law,"[28]in that there is a "convincing argument that the general scheme of the Act contemplates the ownership of 'taxable Canadian property' only by non-residents":[29]a "convincing argument" based on the reasons offered in the 1985 opinion.

(b) For over two months after the 1991 ruling request was received, "officials concluded repeatedly that the Department should not rule favourably."[30] Indeed, on December 3, 1991, Revenue Canada advised the Department of Finance that it intended to bring the matter before the general anti-avoidance rule committee to recommend that s. 245(2) of the Act be applied to the transaction. Similarly, on December 19, 1993, a draft legal opinion was provided by counsel at the Department of Justice, which concluded that "the Act is ambiguous with respect to the subject issue," but that "given the general scheme of the Act, I share your view that an argument is available that only a non-resident can dispose of 'taxable Canadian property' for purposes of the deeming provisions of paragraph 85(1)(i) of the Act."

Despite those concerns, the Auditor General found that the ruling was issued after a series of meetings were held between senior officials from Revenue Canada and officials from the Department of Finance on December 23, 1991. According to the Auditor General, no minutes or details were kept of the meetings, even though the transactions represented a potential "legitimate future claim to hundreds of millions of dollars in tax revenue."[31] Only after the ruling was made did the Department of Justice provide an opinion that concluded that "a resident can dispose of 'taxable Canadian property' for the purposes of the deeming provisions of paragraph 85(1)(i) of the Act."

(c) Other taxpayers might have been denied the benefit afforded to the taxpayer who received the 1991 rulings, since the ruling was not made public until March, 1996, while the 1985 opinion that concluded that resident Canadians could not hold taxable Canadian property was made public earlier.

Claim for relief

[25] The substantive relief claimed by Mr. Harris is located at paragraph 43 of his Statement of Claim. There, he seeks the following relief:

> A declaration that the Minister is obliged to utilize all available measures under the Act to collect any tax properly due and owing as a result of the transaction referenced in the 1991 Ruling, including resort to the waiver given by the Family Trust pursuant to section 152(4)(a)(ii) of the Act with respect to the application of section 107(5) of the Act in the taxation year of Family Trust in which the distribution was made.

The Attorney General's submissions

[26] On appeal, the Attorney General submits that a plaintiff cannot ask a court for a

Digitized by Google

declaration on a mere issue of the proper interpretation of the Act, in the absence of a specific fact situation. In particular, the Attorney General challenges the relief sought at paragraph 36(c) of Mr. Harris' Statement of Claim, where he seeks "a declaration that prior to October 1, 1996, on a proper construction of the *Income Tax Act*, as a matter of law, 'taxable Canadian property' could not be held by a resident of Canada."

[27] More broadly, the Attorney General submits that one person is not permitted to challenge another's income tax treatment. The Attorney General relies on Strayer J.'s (as he then was) decision in *Nova Ban-Corp Ltd.* v. *Tottrup*,[32]where he held:

> Nor does the *Income Tax Act* authorize anyone but the taxpayer to challenge a tax assessment. The plain words of the *Act* do not so provide. By section 165, 169 and formerly 172 (authorizing appeals to the Federal Court) it is the "taxpayer" who is authorized to file an objection to an assessment or to bring an appeal [...] Apart from the absence of any express authority for such a proceeding, I agree respectfully with my colleague Walsh J. in *Hart and Gunther's Building Centre Ltd.* v. *M.N.R.* where he held that a creditor of a taxpayer had no standing to challenge the assessment and the enforcement action taken pursuant to it. I believe that the House of Lords decision in *Inland Revenue Commission* v. *National Federation of Self-Employed and Small Businesses Limited* quoted by him, provides a clear rationale for denying any implication that a person other than the taxpayer can challenge his assessment. The House of Lords there emphasized the confidentiality of taxation information which militates against third parties coming in to attack an assessment. In Canada that confidentiality is required, in circumstances such as the present, by section 241(2) of the *Income Tax Act* which states that no official shall be required in connection with any legal proceedings to testify as to information obtained on behalf of the Minister for the purposes of the Act. This would clearly provide a major obstacle to any third party challenging an assessment in Court and it cannot be implied that such a challenge is authorized [...] The action is intrinsically defective. That is, there is no Court which will entertain a challenge to federal income tax assessment other than one brought by the taxpayer nor entertain such a challenge except in the form of an appeal [...].[33]

[28] To the same effect, the Attorney General cites the following extract from Lord Wilberforce's decision in *I.R.C.* v. *Federation of Self-Employed*[34]for the proposition that the only person who may complain of the tax treatment afforded by a taxing authority is the taxpayer subject to that treatment:

> [...] The commissioner's duties are to the Crown, and that matters relating to income tax are between the commissioners and the taxpayer concerned. No other person is given any right to make proposals about the tax payable by any individual; he cannot even inquire as to such tax. The total confidentiality of assessments and of negotiations between individuals and the Revenue is a vital element in the working of the system. As a matter of general principle I would hold that one taxpayer has no sufficient interest in asking the court to investigate the tax affairs of another taxpayer or to complain that the latter has been under-assessed or over-assessed; indeed there is a strong public interest that he should not. And this principle applies equally to groups of taxpayers: an aggregate of individuals each of whom has no interest cannot of itself have an interest.[35]

[29] Finally, the Attorney General submits that Mr. Harris' action is barred by the confidentiality afforded to taxpayers by s. 241 of the Act.

Analysis of the cause of action

[30] I agree with the Attorney General's submission that one cannot bring in isolation an action for a declaration on a mere interpretation of the Act, and that this conclusion is supported by Strayer J.'s decision in *Nova Ban*.[36] However, in his statement of claim, Mr. Harris does not seek such a mere declaration: much more is alleged and much more is claimed.

Digitized by Google

[31] Mr. Harris' statement of claim alleges that the 1985 and the 1991 rulings, which provided favourable tax benefits to certain taxpayers, were not made public until much later on. By contrast, the 1985 opinion, in which Revenue Canada expressed the opinion that taxpayers could not obtain the sort of benefits permitted by the 1985 ruling and the 1991 ruling, was made public earlier. In so doing, Mr. Harris claims that "the Crown bestowed an undue preference and special benefit on Protective Trust and Family Trust, whereas other trusts, and the class of Plaintiffs herein in general, were unaware of the favourable interpretation of the Act being applied by the Minister in such circumstances."[37] Mr. Harris also claims that there was a "lack of documentation and analysis of key decisions made by Crown officials in this regard."[38] He alleges that Revenue Canada and the Department of Finance held meetings on December 23, 1991, during which no minutes of the meetings were taken or made by either department, after which Revenue Canada suddenly concluded that a favourable ruling should be issued to the taxpayer.[39] All this, Mr. Harris pleads, has caused him to have a "reasonable apprehension of bad faith administration" and to conclude that there was an ulterior motive on the part of the Crown in the circumstances of this case.[40]

[32] Therefore, in the context of those allegations, supported in large measure by the Auditor General's report, Mr. Harris seeks "a declaration that the Minister is obliged to use all available measures under the Act to collect any tax properly due and owing [...]."[41] In essence, he seeks to "overcome the inaction or misconduct of persons charged with the performance of duties of a public nature."[42]

[33] Mr. Harris' allegation of maladministration and ulterior motives is akin to the obligation that public officials act in "good faith" when carrying out statutory duties. In *Roncarelli* v. *Duplessis*,[43]Rand J. recognized that public officials must act "with a rational appreciation" of statutory intent, and must not act "arbitrarily":

> In public regulation of this sort there is no such thing as absolute and untrammelled "discretion," that is that action can be taken on any ground or for any reason that can be suggested to the mind of the administrator; no legislative Act can, without express language, be taken to contemplate an unlimited arbitrary power, exercisable for any purpose, however capricious or irrelevant, regardless of the nature or purpose of the statute. [...] "Discretion" necessarily implies good faith in discharging public duty; [...]
>
> "Good faith" in this context, [...] means carrying out the statute according to its intent and purpose; it means good faith in acting with a rational appreciation of that intent and purpose and not with an improper intent and alien purpose; it does not mean for the purposes of punishing a person for exercising an unchallengeable right; it does not mean arbitrarily and illegally attempting to divest a citizen of an incident of his civil status.[44]

[34] I do not think that the House of Lords' decision in *I.R.C.* v. *Federation of Self-Employed* demonstrates that Mr. Harris' claim must fail. As previously mentioned, the Attorney General has cited the decision in support of the proposition that no person other than the person subject to a tax assessment may complain of tax treatment afforded by Revenue Canada. In my view, the case can be distinguished on the basis that certain broad powers are afforded to Britain's Inland Revenue Commissioners, which Revenue Canada does not have. In that case, Lord Wilberforce indicated the very wide discretion afforded to the Inland Revenue Commissioners to conclude compromise agreements with taxpayers:

> The 1970 Act provides (s. 1) that "Income tax [...] shall be under the care and management of the Commissioners." This Act contains the very wide powers of the Board and of inspectors of taxes to make assessments on persons designated by Parliament as liable to pay income tax. With regard to casual employment, there is a procedure laid down by statutory instrument, the *Income Tax (Employment) Regulations 1973*, SI 1973 No. 334, Reg. 50, by which inspectors of taxes may proceed by way of special assessment or in

Digitized by Google

accordance with any special arrangements which the Commissioners of Inland Revenue may make for the collection of tax. As I shall show later it was a "special arrangement" that the commissioners set out to make in the present case.[45]

[35] Lord Diplock confirmed Lord Wilberforce's opinion by holding that income tax officials in Britain are vested with a "wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge the highest net return that is practicable having regard to the staff available to them and the cost of collection."[46] In concurring reasons, Lord Scarman held that "the Taxes Management Act 1970 places income tax under [the Commissioners'] care and management and for that purpose confers on them and inspectors of tax very considerable discretion in the exercise of their powers."[47]

[36] Revenue Canada is vested with no such powers. In *Ludmer et al.* v. *The Queen*,[48]this Court held that the powers provided to the Commissioners which were at issue in the *Federation of Self-Employed* case are "fundamentally different"[49]from the powers of the Minister in Canada:

> Neither the Minister of National Revenue nor his employees have any discretion whatever in the way in which they must apply the *Income Tax Act*. They are required to follow it absolutely, just as taxpayers are also required to obey it as it stands. The institution of Commissioners equipped with broad powers and an extensive discretion to deal with particular cases does not exist here. Accordingly, it is not possible to judge their actions by varying and flexible criteria such as those required by the rules of natural justice. In determining whether their decisions are valid the question is not whether they exercised their powers properly or wrongfully, but whether they acted as the law governing them required them to act.[50]

[37] Similarly, this Court has held that the Minister of National Revenue is limited to making decisions based solely on considerations arising from the Act itself. As previously mentioned, in *Galway*, while this Court concluded that the Minister has a statutory duty to assess tax "in accordance with the law as he understands it," it also held that the Minister "cannot assess for some amount designed to implement a compromise settlement."[51] Indeed, in *Cohen* v. *The Queen*,[52]this Court concluded that any "agreement whereby the Minister would agree to assess income tax otherwise [than] in accordance with the law would [...] be an illegal agreement."[53] Likewise, the Minister cannot award preferential treatment to some taxpayers for ulterior motives or make covert deals. The allegations made in the statement of claim, supported in large measure by the Auditor General's report, take Mr. Harris' claim outside the ambit of a mere question of administrative interpretation.

[38] In *Longley* v. *Canada (Minister of National Revenue)*, the British Columbia Court of Appeal confirmed the proposition that the Minister is bound to follow the Act absolutely. Hutcheon J.A. held that the "Minister is bound to administer the *Income Tax Act* according to law,"[54]and added that he knew "of no legal grounds on which the Minister could be directed by the court to act contrary to the law."[55]

[39] Nor do I agree with the proposition that Strayer J.'s decision in *Nova Ban* demonstrates that it is plain and obvious that Mr. Harris' claim discloses no reasonable cause of action. In *Nova Ban*, Nova Ban was the creditor of a company called Container Port. Nova Ban sought to challenge the Minister's assessment of Container Port on the basis that it "acceded to an excessive assessment of income tax which should have been payable"[56]by the individual president of Container Port. In other words, the dispute was a private commercial dispute over money. Strayer J. did not consider principles of public interest standing, nor did he conclude that no cause of action could exist where a plaintiff sought to challenge a person's tax assessment for public interest purposes in circumstances where a public interest plaintiff alleges illegality, improper actions, ulterior motives,

Digitized by Google

favouritism, preferential treatment, and covert deals.

[40] Accordingly, I conclude that the cases relied upon by the Attorney General do not demonstrate that it is plain and obvious that Mr. Harris' statement of claim discloses no cause of action. Mr. Harris alleges that the Minister of National Revenue acted illegally or improperly or for ulterior motives, namely favouritism and preferential treatment by way of a covert deal when he interpreted the provisions of the Act in favour of a specific trust. Assuming those facts to be true (as must be done on a motion to strike), and considering that the material facts in Mr. Harris' statement of claim are not "allegations based on assumptions and speculations,"[57]but are supported by the Auditor General's report, it is not plain and obvious that Mr. Harris' action cannot succeed.

[41] I wish to emphasize that the Attorney General's motion to strike was made and argued before Giles A.S.P, Muldoon J. and this Court on the basis that the Attorney General sought to strike the entire statement of claim. The original notice of motion and the notice of appeal reflect this,[58]as do the decisions of Giles A.S.P. and Muldoon J. This was not a motion to sever parts of the pleading. Therefore, because I have concluded that it is not plain and obvious that Mr. Harris' action overall cannot succeed, there is no need to consider individual aspects of the statement of claim, such as whether the Minister owes a fiduciary duty or acts in a capacity akin to a fiduciary toward taxpayers in general. Mr. Harris' action is not necessarily dependent on this allegation.

[42] In any event, I have concluded that it is not plain and obvious that the Minister owes no fiduciary obligations to taxpayers. On the one hand, I recognize that there is law to suggest that the Minister owes no such obligation to taxpayers. For example, in *Guerin* v. *The Queen*,[59]Dickson J. (as he then was) held:

> It should be noted that fiduciary duties generally arise only with regard to obligations originating in a private law context. Public law duties, the performance of which requires the exercise of discretion, do not typically give rise to a fiduciary relationship. As the "political trust" cases indicate, the Crown is not normally viewed as a fiduciary in the exercise of its legislative or administrative function.[60]

[43] Similarly, in *Rothmans of Pall Mall*, Le Dain J.A. held that "the duty of the [Minister of National Revenue] under section 202 of the *Excise Act* is one owing to the Crown rather than [to Rothmans.]"[61]

[44] On the other hand, there is law to suggest that the Minister does owe fiduciary obligations to taxpayers. In *Bromley London Borough Council* v. *Greater London Council and another*,[62]Lord Diplock held that "a local authority owes a general fiduciary duty to the taxpayers from whom it obtains moneys needed to carry out its statutory functions [...]."[63] In *Roberts* v. *Hopwood*,[64]Lord Atkinson held:

> A body charged with the administration for definite purposes of funds contributed in whole or in part by persons other than the members of that body, owes, in my view, a duty to those latter persons to conduct that administration in a fairly businesslike manner with reasonable care, skill and caution, and with a due and alert regard to the interest of those contributors who are not members of the body. Towards these latter persons the body stands somewhat in the position of trustees or managers of the property of others.[65]

[45] In *Federation of Self-Employed*, despite holding that "the commissioners' duties are to the Crown," Lord Wilberforce recognized that a taxpayer could challenge other taxpayers' tax treatment where a court examined evidence to demonstrate the "breach of duty" alleged.[66] In so doing, Lord Wilberforce must have implicitly recognized that the commissioners' duties are not exclusively owed to the Crown.

[46] Similarly, in *Federation of Self-Employed*, Lord Scarman held:

> [...] Nor do I accept that the duty to collect "every part of inland revenue" is a duty owed exclusively to the Crown. Notwithstanding the *Treasury* case in 1872, I am persuaded

Digitized by Google

that the modern case law recognises a legal duty owed by the Revenue to the general body of the taxpayers to treat taxpayers fairly [...][67]

[47] These last few cases, I think, demonstrate that it is not plain and obvious that the Minister owes no fiduciary obligations to taxpayers. Even though the Attorney General could present strong arguments to the contrary, I do not think that Mr. Harris should be "driven from the judgment seat," language used by the Supreme Court of Canada in *Hunt* v. *Carey Canada Inc*.

2. Does Mr. Harris have public interest standing to seek declaratory relief relating to the alleged maladministration of the Income Tax Act by the Minister of National Revenue?

[48] The Attorney General submits that public interest standing may be granted to permit a citizen to litigate a non-constitutional issue only where the issue raised concerns the limits of statutory authority for administrative action. The Attorney General relies heavily on Le Dain J.A.'s (as he then was) decision in *Rothmans* v. *Pall Mall Canada Ltd.* v. *M.N.R. et al.* [No. 1].[68]

[49] To evaluate the Minister's argument, a brief reference to the Supreme Court of Canada's decisions in *Thorson* v. *Canada (A.G.)*,[69]*Nova Scotia Board of Censors* v. *McNeil*,[70]*Minister of Justice (Canada)* v. *Borowski*,[71]*Finlay* v. *Canada (Minister of Finance)*,[72]and *Canadian Council of Churches* v. *Canada (Minister of Employment and Immigration)*[73]must be made. In the *Thorson, McNeil* and *Borowski* cases, the Supreme Court established the conditions under which a public interest plaintiff could challenge legislation on constitutional grounds. In *Borowski*, Martland J. for the majority held that to obtain public interest standing, a plaintiff must (1) demonstrate that there is a serious issue as to the invalidity of legislation, (2) that the plaintiff has a genuine interest, and (3) there is no other reasonable and effective manner to bring the issue before the court.[74] In *Canadian Council of Churches*, the Supreme Court of Canada adopted the same three-part test to determine when public interest litigants should be granted standing to challenge legislation on *Charter* grounds.[75]

[50] In *Finlay* v. *Canada (Minister of Finance)*, Le Dain J. considered whether the principles of public interest standing that applied to litigants who seek to challenge legislation on constitutional grounds ought to be extended to a "non-constitutional challenge [...] for a declaration to the statutory authority for public expenditure or other administrative action."[76] Le Dain J. confirmed that public interest standing should be so extended to ensure "the maintenance of respect for the limits of administrative authority":

> The issue, then, as I see it, is whether the principle reflected in *Thorson, McNeil* and *Borowski* should be extended by this Court to such cases. This question raises again the policy considerations and underlying judicial attitudes to public interest standing, and in particular, whether the same value is to be assigned to the public interest in the maintenance of respect for the limits of administrative authority as was assigned by this Court in *Thorson, McNeil* and *Borowski* to the public interest in the maintenance of respect for the limits of legislative authority. In my view an affirmative answer should be given to this question.[77]

[51] By contrast, in *Rothmans*, Le Dain J.A. declined to grant Rothmans standing to challenge the Minister's calculations. He held:

> The decisions of the Supreme Court of Canada in *Thorson* v. *Attorney General of Canada* [1975] 1 S.C.R. 138, and *McNeil* v. *Nova Scotia Board of Censors* (1975) 5 N.R. 43, were urged upon us as indicating a relaxation of the requirement of *locus standi*. A careful reading of these decisions shows, in my respectful opinion, that the principal consideration governing them is the importance in a federal state of opportunity to challenge the constitutional validity of statutes. No such consideration is applicable here. It was suggested

Digitized by Google

that there is a comparable consideration of public policy in broad access to challenge the validity of administrative action, and this view finds some support in the recognition of a judicial discretion to permit a stranger to bring *certiorari* or prohibition in certain cases. The present case is not one that raises any question of the limits of statutory authority. The most that is raised is a question of administrative interpretation that the authorities are obliged to make in their application of the governing statute.[78]

[52] The essential difference between *Rothmans* and the instant appeal is that in *Rothmans*, the court concluded that the issues raised did not involve a question of the respect of the limits of administrative authority. By contrast, Mr. Harris' statement of claim does. He complains that certain taxpayers have been afforded tax advantages by Revenue Canada that were not afforded to other taxpayers. In other words, he alleges that Revenue Canada has afforded preferential treatment to certain taxpayers, something that raises a question of the limits of statutory authority.

[53] This Court has recognized that where strong public interest issues arise, a Court may exercise its discretion to recognize public interest standing. In *Distribution Canada Inc.* v. *M.N.R.*,[79]a case in which a plaintiff sought to require the Minister to comply with certain provisions of the *Customs Tariff*, Desjardins J.A. held that public interest standing may exist where "the matter raised [...] is one of strong public interest and there may be no other way such an issue could be brought to the attention of the Court, were it not for the efforts of the [public interest litigant]."[80]

[54] Similarly, in *Federation of Self-Employed*, despite holding that "as a matter of general principle I would hold that one taxpayer has no sufficient interest in asking the court to investigate the tax affairs of another taxpayer or to complain that the latter has been underassessed or overassessed,"[81]Lord Wilberforce held:

> That a case can never arise in which the acts or abstentions of the Revenue can be brought before the court I am certainly not prepared to assert, nor that, in a case of sufficient gravity, the court might not be able to hold that another taxpayer or other taxpayers could challenge them. Whether this situation has been reached or not must depend on an examination, on evidence, of what breach of duty or illegality is alleged. On this, and relating it to the position of the complainant, the court has to make its decision.[82]

[55] In the same vein, Lord Diplock held:

> I do not doubt, however, and I do not understand any of your Lordships to doubt, that if it were established that the Board were proposing to exercise or to refrain from exercising their powers not for reasons of 'good management' but for some extraneous or ulterior reason that inaction or inaction of the Board would be *ultra vires* and would be a proper matter for judicial review if it were brought to the attention of the court by an applicant with "a sufficient interest" in having the Board compelled to observe the law.[83]

[56] Lord Diplock added that it would "be a grave lacuna in our system of public law if a pressure group, like the federation, or even a single public spirited taxpayer, were prevented by outdated technical rules of *locus standi* from bringing the matter to the attention of the court to vindicate the rule of law and get the unlawful conduct stopped."[84]

[57] Similarly, Lord Scarman recognized that public interest standing could be granted to a litigant to challenge the tax treatment that the Inland Revenue Commissioners had afforded to other taxpayers. Lord Scarman did not permit the public interest litigant's leave application to proceed further because he concluded that the Inland Revenue Commissioners had ample statutory authority to conclude compromise agreements with taxpayers. However, he added that if the Federation had presented "reasonable grounds for believing that the failure to collect tax [...] was an abuse of the Revenue's managerial discretion or that there was a case to that effect which merited investigation and examination by the court," the Federation would have "shown a sufficient interest for the grant of leave to

Digitized by Google

proceed further with its application."[85]

[58] Again, as I have explained earlier in these reasons, Revenue Canada would not have the power to conclude the compromise agreement that was at issue in *Federation of Self-Employed*. Accordingly, I do not think that the reason for which the House of Lords denied public interest standing to the Federation of Self-Employed constitutes good law in Canada. Therefore, I do not think that the House of Lords' decision demonstrates that Mr. Harris is precluded from obtaining public interest standing to challenge the tax treatment afforded to other taxpayers by Revenue Canada. Indeed, I think that the *obiter* statements of Lord Wilberforce, Lord Diplock and Lord Scarman reproduced above demonstrate the opposite: namely, that if Revenue Canada concludes compromise agreements or covert deals or provides preferential treatment to certain taxpayers without statutory authority, public interest standing may be granted to challenge the tax treatment that Revenue Canada affords to taxpayers who benefit from those actions.

[59] I now turn to the four criteria established in *Finlay* to determine whether this Court should exercise its discretion to recognize Mr. Harris' public interest standing. In *Finlay*, Le Dain J. held that courts should be concerned about their proper role and their constitutional relationship to other branches of governments. He held that where an issue may be appropriately decided by a court, a court "should not decline to determine it on the ground that because of its policy context or implications it is better left for review and determination by the legislative or executive branches of government."[86]

[60] In my view, Mr. Harris' statement of claim raises a justiciable issue. His claim that the Minister of National Revenue acted illegally or improperly or for ulterior motives, namely favouritism and preferential treatment by way of a covert deal when he interpreted the provisions of the Act in favour of a specific trust, raises a question of a potential violation of the Act that a Court may assess by reference to the Minister's duty to follow the Act "absolutely," as this Court held in *Ludmer*.[87]

[61] The second criterion established by Le Dain J. in *Finlay* was that a public interest litigant must raise a serious issue. As Le Dain J. concluded in *Finlay*, the issues raised by Mr. Harris are "far from frivolous."[88] Mr. Harris does not merely bring an action to obtain a declaration for an interpretation of particular sections of the Act. Rather, as stated above, he alleges that the Minister of National Revenue acted for ulterior motives with a view to favouring particular taxpayers, in circumstances where there was a "lack of documentation and analysis of key decisions made by Crown officials in this regard."[89] The issues are serious.

[62] The third criterion is that the public interest litigant must have a genuine interest in the issue. On appeal, the Attorney General did not seriously contest that Mr. Harris did have a genuine interest in the issues he raises. Mr. Harris is a taxpayer. He is a member of an organization that seeks to ensure the fair administration of the taxation system. Accordingly, I conclude that Mr. Harris has a genuine interest in the issues he raises.

[63] Finally, in exercising its discretion to recognize public interest standing, a court must be satisfied that there is no other reasonable and effective manner in which the issue may be brought before a court. Here too, the Attorney General did not seriously contend that there was another reasonable or effective manner in which the issue could be brought before a court. Mr. Harris requested the Attorney General to do so twice, but to this date, the Attorney General has not yet complied. It cannot be seriously contended that the taxpayers who were provided with the 1991 ruling favourable to them would raise the issues brought by Mr. Harris. Therefore, I conclude that there is no other reasonable and effective manner in which the issue could be brought before a court.

Conclusion on standing

[64] Public interest standing has been granted in analogous cases. For example, in

Digitized by Google

Greater Victoria Concerned Citizens Assoc. v. *Provincial Capital Commission*,[90]a citizens group successfully obtained standing to seek to obtain a declaration that an agreement to lease certain heritage property as a tourist attraction was beyond the Provincial Capital Commission's jurisdiction. In *Union of Northern Workers* v. *Jewell*,[91]a union was granted public interest standing to seek to compel a government Minister to hold occupational health and safety board meetings. In *Sierra Club of Canada* v. *Canada (Minister of Finance)*,[92]an organization promoting protection of the environment was granted standing to seek to compel several government Ministers to subject the sale of nuclear reactors to a full environmental assessment under the *Canadian Environmental Assessment Act*,[93]the absence of which was said to be unlawful.

[65] I do not think that there is a principled basis for concluding that the Minister of National Revenue is somehow protected from a similar action by a public interest litigant to compel the Minister to perform his or her statutory duties. Accordingly, I conclude that Muldoon J. properly ruled that Mr. Harris could be granted public interest standing and therefore correctly set aside the Prothonotary's granting of the Crown's motion to strike.

[66] I wish to emphasize the narrow cause of action for which public interest standing has been granted. Mr. Harris does not merely seek to obtain the interpretation of a particular provision of the Act, akin to requesting a court to provide a legal opinion. A mere *bona fide* change of position on interpretation of a statute, without more, would be insufficient to constitute a cause of action and would have been insufficient to persuade this Court to exercise its discretion to recognize public interest standing. Nevertheless, in considering Mr. Harris' cause of action for which public interest standing has been granted, the trial judge may incidentally find it necessary to consider whether, on a proper construction of the Act, "taxable Canadian property" may be held by a resident of Canada.

Taxpayer confidentiality

[67] I will briefly address the concerns about taxpayer confidentiality raised by the Attorney General. The Attorney General submitted that to permit Mr. Harris' proceeding to go forward would inevitably tend to breach the confidentiality that is required to be protected by section 241 of the Act. Subsections 241(1) and (2) of the Act state that no official shall, *inter alia*, "knowingly provide [...]_to any person any taxpayer information," and that "no official shall be required, in connection with any legal proceedings, to give or produce evidence relating to any taxpayer information."

[68] By contrast, subsection 241(3) states that ss. 241(1) and (2) do not apply in respect of "any legal proceedings relating to the administration or enforcement of the Act," something that Mr. Harris submits his public interest action seeks to achieve.

[69] As Lord Scarman decided in *Federation of Self-Employed*,[94]I think that concerns about taxpayer confidentiality should be left to a case management or trial judge to decide. I note that there is ample provision in the *Federal Court Rules, 1998*, that would adequately address confidentiality concerns. Rule 29(2) permits a Court to "direct that all or part of a proceeding be heard *in camera* if it is satisfied that the hearing should not be open to the public." Rule 151 permits a Court to "order that material to be filed shall be treated as confidential." Rule 152(2)(b) requires a solicitor of record to be given confidential material, *inter alia*, "only if the solicitor gives a written undertaking to the Court that he or she will not disclose its content except to solicitors assisting in the proceeding or to the Court in the course of argument."

[70] I would therefore dismiss the appeal, with costs.

"J. Edgar Sexton"

J.A.

"I agree

Gilles Létourneau J.A.:

Digitized by Google

"I agree
J. T. Robertson J.A."

---

[1]R.S.C. 1985, c. 1 (5th Supp.).

[2]Information Circular 70-6R2.

[3] *Ibid.*, para. 4 & 5.

[4] *Ibid.*, para. 3.

[5] On this appeal, I have made reference to the Auditor General of Canada's report, dated May 7, 1996, as well as the Standing Committee on Finance's report, dated September 17, 1996, which are referred to in Mr. Harris' statement of claim (see Rule 177 and *Web Offset Publications* v. *Vickery et al.* (1999), 43 O.R. (3d) 802 (C.A.), application for leave to appeal filed September 24, 1999, [1999]_S.C.C.A. No. 460).

[6] *Ibid.*, p. 1-22. See also Statement of Claim, paras. 26 & 29(3).

[7] *Third Report of the Standing Committee on Finance, "Taxable Canadian Property"* (September 1996) **online: < http://www.parl.gc.ca/committees352/fine/reports/03_1996-09/fine-03-appb-e.html** > (last modified: September 23, 1996). See also Statement of Claim, para. 25.

[8]Statement of Claim, para. 29(e).

[9]Subsection 107(5) of the Act generally triggers a deemed disposition of property where a trust distributes property to a non-resident taxpayer, except where the property is taxable Canadian property.

[10]Statement of Claim, para. 7.

[11] *Ibid.*

[12] *Ibid.*, para. 16.

[13] *Ibid.*, para. 43(c).

[14][1997] F.C.J. No. 1826 (Prothon.) at para. 31.

[15][1992] 1 S.C.R. 236.

[16][1992] 2 F.C. 392 (T.D.) at 410.

[17] *Ibid.*

[18] *Ibid.*

[19] *Ibid.*, p. 411.

[20] *Ibid.*, p. 413.

[21] *Ibid.*, p. 414.

[22] *Ibid.*, p. 410.

[23] *Ibid.*, p. 414.

[24][1990] 2 S.C.R. 959.

[25] *Ibid.*, p. 980.

[26][1985] 1 S.C.R. 441.

[27] *Ibid.*, p. 486-487.

[28] *Report of the Auditor General of Canada to the House of Commons* (May 1996), *supra* at 1-15. See Statement of Claim, para. 11.

[29] *Ibid.*, p. 1-16.

[30] *Ibid.* See Statement of Claim, para. 29.

[31] *Ibid.*, p. 1-21.

[32][1990] 1 F.C. 288 (T.D.).

[33] *Ibid.*, pp. 294-296 (emphasis added).

[34][1981] 2 All E.R. 93 (H.L.).

[35] *Ibid.*, pp. 98-99.

Digitized by Google

[36]However, I note that in *Longley* v. *Canada (Minister of National Revenue)* (1992), 66 B.C.L.R. (2d) 238 (C.A.), counsel for the Attorney General submitted that "a declaration related to the interpretation and application of s. 127 [of the *Income Tax Act*] is within the jurisdiction of the Federal Court under s. 18 of the *Federal Court Act*" (at p. 243).

[37]Statement of Claim, para. 33.

[38] *Ibid.*, para. 13.

[39] *Ibid.*, para. 29.

[40] *Ibid.*, para. 33.

[41] *Ibid.*, para. 43(c).

[42] *Karavos* v. *The City of Toronto et al.*, [1948] O.W.N. 17 (C.A.) at p. 18.

[43][1959] S.C.R. 121.

[44] *Ibid.*, pp. 140-141, cited approvingly in *Longley* v. *Canada (Minister of National Revenue)*, [1999]_B.C.J. No. 1705 (B.C.S.C.) at paras. 82-83.

[45] *Federation of Self-Employed, supra* at 98.

[46] *Ibid.*, p. 101.

[47] *Ibid.*, p. 111.

[48] *Ludmer et al.* v. *The Queen*, 95 DTC 5311 (F.C.A.).

[49] *Ibid.*, p. 5317.

[50] *Ibid.*

[51] *Galway, supra* at 602.

[52][1980] CTC 318 (F.C.A).

[53] *Ibid.*, p. 319.

[54] *Longley, supra* at p. 243.

[55] *Ibid.*

[56] *Nova Ban, supra* at 291.

[57] *Operation Dismantle, supra* at 455.

[58] The original notice of motion stated that "the Statement of Claim discloses no reasonable cause of action" and that the "Statement of Claim is prejudicial and embarrassing and is an abuse of the process of the Court." The notice of appeal states that "the appellant asks that [...]_the Statement of Claim be struck out pursuant to Rule 221 of the *Federal Court Rules, 1998*, with costs to the Appellants."

[59][1984] 2 S.C.R. 335.

[60] *Ibid.*, p. 385. See also *Lac Minerals* v. *International Corona Resources*, [1989] 2 S.C.R. 574, *per* La Forest J. (dissenting).

[61] *Rothmans of Pall Mall, supra* at 510.

[62][1982]_1 All E.R. 128 (H.L.).

[63] *Ibid.*, p. 165.

[64] [1925] A.C. 578 (H.L.).

[65] *Ibid.*, pp. 595-596.

[66] *Federation of Self-Employed, supra* at 99.

[67] *Ibid.*, p. 112.

[68][1976] 2 F.C. 500 (C.A.).

[69][1975] 1 S.C.R. 138.

[70][1976] 2 S.C.R. 265.

[71][1981] 2 S.C.R. 575.

[72][1986] 2 S.C.R. 607.

[73][1992] 1 S.C.R. 236.

[74] *Borowski, supra* at 598.

[75] *Canadian Council of Churches, supra* at p. 252 ("The principles for granting public standing set forth by this Court need not and should not be expanded").

Digitized by Google

[76] *Finlay, supra* at 630.
[77] *Ibid.*, pp. 630-631.
[78] *Ibid.*, p. 510 (emphasis added).
[79][1993] 2 F.C. 26 (C.A.).
[80] *Ibid.*, p. 39.
[81] *Federation of Self-Employed, supra* at 99.
[82] *Ibid.*
[83] *Ibid.*, p. 101.
[84] *Ibid.*, p. 107.
[85] *Federation of Self-Employed, supra* at 114.
[86] *Finlay, supra* at 632.
[87] *Ludmer, supra* at 5317.
[88] *Finlay, supra* at 633.
[89]Statement of Claim, para. 13.
[90][1990] 46 Admin. L.R. 74 (B.C.S.C.).
[91][1991] N.W.T.J. No. 40 (N.W.T.S.C.).
[92][1999] 2 F.C. 211 (T.D.).
[93]S.C. 1992, c. 37.
[94] *Ibid.*, p. 114 ("[...] discovery can safely be left to the discretion of the court guided by the law as I believe it to be.")

Her Majesty The Queen and The Minister Of National Revenue v. George William Harris, 2001 FCA 74, The Final Resolution

REASONS FOR JUDGMENT

SHARLOW J.A.

The Crown is appealing the order of a Case Management Judge that requires it to make limited disclosure of the identity of a taxpayer who obtained a certain advance income tax ruling in 1991.

The question arises in the context of an action commenced by the respondent George William Harris in 1996. Mr. Harris seeks a number of declarations based on allegations that the ruling is incorrect in law and that the Minister, in giving the ruling, bestowed an undue preference and special benefit on the taxpayer who received it. The statement of claim also alleges "a reasonable apprehension of bad faith administration and an ulterior motive on the part of the Crown in the circumstances of this case".

The Crown argues in its defence that the 1991 ruling is correct in law and that there was nothing improper or unlawful about the issuance of the ruling.

There is no allegation of wrongdoing on the part of the taxpayer.

The affidavit of documents filed on behalf of the Crown lists a number of documents in Schedule "2" as documents for which privilege was claimed on the basis of section 241 of the *Income Tax Act*, R.S.C. 1985, C. 1 (5th supp), and section 37 of the *Canada Evidence Act*, R.S.C. 1985, c. C-5.

The Crown sought directions from the Case Management Judge under Rule 54 as to the validity of its claims of privilege with respect to these documents.

The Case Management Judge directed that the Crown's privilege claims could not stand and ordered the disclosure of the documents listed in Schedule "2" of its affidavit of documents, including any information that would disclose the identity of the taxpayer, subject to editing to

Digitized by Google

remove irrelevant details. However, she directed that the disclosure be limited under Rules 151 and 152 to taxpayer's counsel and any other lawyers working on the case.
The Crown appeals these directions.

At the hearing of the appeal, counsel for the Crown conceded its obligation to disclose the documents in Schedule "2" of its affidavit of document. However, the Crown maintains that the documents should first be edited so that they do not reveal the identity of the taxpayer. The Crown's proposal is to edit the documents by blanking out names and other information that could lead a knowledgeable reader to discern the identity of the taxpayer, and replacing the blanked out words with generic descriptions that will be explicit enough to permit counsel for Mr. Harris to conduct a meaningful examination for discovery.
It is not clear whether the documents as so edited are intended to continue to be treated as confidential under Rule 151 and Rule 152. This is a matter to be determined by the case management judge who made the original order.
As a result of this concession on the part of the Crown, this appeal now relates only to the question of the disclosure of the identity of the taxpayer.
Counsel for the Crown also indicated at the hearing of this appeal that the taxpayer involved had consented, under subsection 241(5) of the *Income Tax Act*, to the disclosure of the documents in unedited form to the Case Management Judge or the Trial Judge. That consent is intended to permit a review of the editing process to ensure that it is done appropriately, and to facilitate the Crown's application under section 37 of the *Canada Evidence Act*.

The issues to be addressed may be summarized as follows:
1. Was the Case Management Judge correct in concluding that the action of Mr. Harris is a legal proceeding within the scope of paragraph 241(3)(b) of the *Income Tax Act*, so that subsections 241(1) and (2) do not preclude the Minister from disclosing the identity of the taxpayer?
2. Was the Case Management Judge correct in concluding that section 37 of the *Evidence Act* does not apply?
3. Was the Case Management Judge correct to order disclosure of the taxpayer's identity?

Section 241 of the *Income Tax Act*
Section 241 of the *Income Tax Act* provides as follows:

241(1) Except as authorized by this section, no official shall	241(1) Sauf autorisation prévue au présent article, il est interdit à un fonctionnaire:
(a) knowingly provide, or knowingly allow to be provided, to any person any taxpayer information;	a) de fournir sciemment à quiconque unb) de permettre sciemment à quiconque renseignement confidentiel ou d'end'avoir accès à un renseignement permettre ciemmen la prestation;(b) confidentiel;
knowingly allow any person to have access to any taxpayer information; or	
(c) knowingly use any taxpayer information otherwise than in the course of the administration or enforcement of this Act, the Canada Pension Plan,	c) d'utiliser sciemment un renseignement confidentiel en dehors du cadre de l'application ou de l'exécution de la présente loi, du Régime de pensions du

Digitized by Google

Unemployment Insurance Act or the Employment Insurance Act or for purpose for which it was provided under this section.

(2) Notwithstanding any other Act of Parliament or other law, no official shall be required, in connection with any legal proceedings, to give or produce evidence relating to any taxpayer information.

(3) Subsections 241(1) and 241(2) do not apply in respect of

(a) criminal proceedings, either by indictment or on summary conviction, that have been commenced by the laying of an information or the preferring of an indictment, under an Act of Parliament; or

(b) any legal proceedings relating to the administration or enforcement of this Act, the Canada Pension Plan, the Unemployment Insurance Act or the Employment Insurance Act or any other Act of Parliament or law of a province that provides for the imposition or collection of a tax or duty.

Canada, de la Loi sur l'assurance-chômage ou de la Loi sur l'assurance-emploi, ou à une autre fin que celle pour laquelle il a été fourni en application du présent article.

(2) Malgré toute autre loi ou règle de droit, nul fonctionnaire ne peut être requis, dans le cadre d'une procédure judiciaire, de témoigner, ou de produire quoi que ce soit, relativement à un renseignement confidentiel.

(3) Les paragraphes (1) et (2) ne s'appliquent:

a) ni aux poursuites criminelles, sur déclaration de culpabilité par procédure sommaire ou sur acte d'accusation, engagées par le dépôt d'une dénonciation ou d'un acte d'accusation, en vertu d'une loi fédérale;

b) ni aux procédures judiciaires ayant trait à l'application ou à l'exécution de la présente loi, du Régime de pensions du Canada, de la Loi sur l'assurance-chômage ou de la Loi sur l'assurance-emploi ou de toute autre loi fédérale ou provinciale qui prévoit l'imposition ou la perception d'un impôt, d'une taxe ou d'un droit.

The identity of the taxpayer that obtained the 1991 ruling is clearly "taxpayer information" within the meaning of section 241 of the *Income Tax Act*. The question is whether the action commenced by Mr. Harris is a legal proceeding "relating to the administration or enforcement" of the *Income Tax Act*.

As explained above, the subject matter of the action is an advance income tax ruling. The Minister issued that ruling as part of the administration of the *Income Tax Act*. Mr. Harris commenced this proceeding to establish that the issuance of that ruling was not a proper administrative act. In that sense this proceeding "relates to" the administration of the *Income Tax Act*. Therefore, the words of paragraph 241(3)(b) are broad enough to cover this proceeding.

However, counsel for the Crown argues for a narrower interpretation of paragraph 241(3)(b). He argues that because the Minister is the only person who is authorized to administer and enforce the *Income Tax Act*, only a legal proceeding undertaken by or on behalf of the Minister for the purpose of the administration or enforcement of the *Income Tax Act* can be within the scope of paragraph 241(3)(b). The Minister is arguing, in essence, that a legal proceeding that seeks to uncover improper administration of the *Income Tax Act* cannot be said to be related to its administration. This argument seems to me illogical and I am unable to accept it.

I conclude that this proceeding is within the scope of paragraph 241(3)(b) of the *Income Tax Act*. It follows that the Case Management Judge was correct in determining that subsections

Digitized by Google

241(1) and (2) of the *Income Tax Act* do not preclude the Minister from disclosing the identity of the taxpayer.

Section 37 of the *Evidence Act*

Section 37 of the *Evidence Act* permits the Crown to resist disclosure of information in a legal proceeding on the basis of a judicial determination that there is a specified public interest that outweighs the public interest in the disclosure of the information. Subsections 37(1) and (2) read as follows:

37(1) A minister of the Crown in right of Canada or other person interested may object to the disclosure of information before a court, person or body with jurisdiction to compel the production of information by certifying orally or in writing to the court, person or body that the information should not be disclosed on the grounds of a specified public interest.

37 (1) Un ministre fédéral ou toute autre personne intéressée peut s'opposer à la divulgation de renseignements devant un tribunal, un organisme ou une personne ayant le pouvoir de contraindre à la production de renseignements, en attestant verbalement ou par écrit devant eux que ces renseignements ne devraient pas être divulgués pour des raisons d'intérêt public déterminées.

(2) Subject to sections 38 and 39, where an objection to the disclosure of information is made under subsection (1) before a superior court, that court may examine or hear the information and order its disclosure, subject to such restrictions or conditions as it deems appropriate, if it concludes that, in the circumstances of the case, the public interest in disclosure outweighs in importance the specified public interest.

(2) Sous réserve des articles 38 et 39, dans les cas où l'opposition visée au paragraphe (1) est portée devant une cour supérieure, celle-ci peut prendre connaissance des renseignements et ordonner leur divulgation, sous réserve des restrictions ou conditions qu'elle estime indiquées, si elle conclut qu'en l'espèce, les raisons d'intérêt public qui justifient la divulgation l'emportent sur les raisons d'intérêt public invoquées lors de l'attestation.

In this case the Crown invoked subsection 37(1) of the *Evidence Act* on the basis of the certificate of the current Director General of the Income Tax Rulings Directorate in the Policy and Legislation Branch of the Canada Customs and Revenue Agency, the entity that is now responsible for income tax administration. That certificate describes the harm that the Director General believes would result from disclosure of the documents referred to in Schedule "2" of the Crown's affidavit of documents. The certificate does not specifically address the question of whether there is a specified public interest in preventing the disclosure of the identity of taxpayer, which is the only information the Crown still seeks to protect.

It appears that the Case Management Judge did not embark on the enquiry mandated by subsection 37(2) of the *Evidence Act*. Rather, she seems to have considered section 37 to

Digitized by Google

be inoperative because of her conclusion that disclosure was not precluded by subsections 241(1) or (2) of the *Income Tax Act*. She said, at paragraph 38 of the reasons:

The exception provided in section 241(3)(b) [of the *Income Tax Act*], to the general bar against disclosure of taxpayer information, overrides the public interest immunity which is claimed here. In my opinion, the public interest lies in determining whether the Minister discharged his statutory duty in applying the [*Income Tax*] Act.

In this case, the disclosure of the information sought by Mr. Harris is required by the *Federal Court Rules, 1998*, subject only to any applicable claim of privilege. In my view, the Crown must be permitted to assert a claim of public interest immunity with respect to taxpayer information independently of its nondisclosure obligations in section 241 of the *Income Tax Act*.

I conclude that the Case Management Judge erred in relying on section 241 of the *Income Tax Act* as a basis for determining the scope of the public interest immunity claim made by the Crown in this case. She ought to have considered specifically whether the public interest in disclosure outweighed the specified public interest asserted by the Crown in the certificate. Having failed to do so, she was in no position to conclude that the documents were not protected from disclosure on the basis of public interest immunity.

The appropriate remedy is to refer the Crown's section 37 application back to the Case Management Judge for reconsideration. In light of the Crown's concessions as described above, the claim of privilege must now be considered to relate only to the taxpayer's identity. It may be appropriate for the Crown to submit a new certificate, and it should be at liberty to do so.

Order for disclosure of taxpayer identity

It cannot be determined from the pleadings whether the identity of the taxpayer who obtained the 1991 ruling is relevant to any of the allegations in the statement of claim. Nor does the record disclose any evidence on that point. The absence of such evidence may be explained by the unusual procedure followed in this case. It appears that the directions sought by the Crown preceded the commencement of examinations for discovery, so there are no unanswered questions that could give rise to a motion under Rule 242. Nor has Mr. Harris moved for disclosure under Rule 229.

The result in any event is that the Case Management Judge had before her no evidence from which it could be determined whether the identity of the taxpayer is relevant to the allegations in the statement of claim. In the absence of such evidence, the Case Management Judge erred in ordering the disclosure of the identity of the taxpayer.

Conclusion

On the basis of the foregoing reasons, I would allow this appeal in part.

The direction for disclosure of the taxpayer's identity should be vacated, without prejudice to the right of Mr. Harris to make an application for disclosure under Rule 229 or 242 as appropriate.

The direction that the documents are not immune from disclosure under section 37 of the *Canada Evidence Act* should be vacated and the Crown's section 37 application should be referred back to the Case Management Judge for a redetermination that is independent of section 241 of the *Income Tax Act*. Given the Crown's new position on the disclosure of edited documents, the Crown should be entitled to present a new certificate dealing with the issue of the disclosure of the taxpayer's identity.

Karen R. Sharlow

J.A.

Digitized by Google

"I agree
J. Richard C.J."
"I agree
B.L. Strayer J.A."

Maxine Collins v. Her Majesty The Queen, 2011 FCA 140, A CRA Employee with a s. 241 Breach, on Her Own Information

REASONS FOR JUDGMENT
DAWSON J.A.

[1] The appellant, R. Maxine Collins, appeals from a decision of a Judge of the Federal Court striking out, with costs, the amended statement of claim filed by Ms Collins. The Judge's order was silent as to whether the pleading was struck out with or without leave to amend. The reasons in support of the Judge's order are cited as 2010 FC 254, 366 F.T.R. 40.

[2] Paragraph 1(a) of the amended statement of claim set out Ms Collins' claim for general damages against the Crown on account of:

i. misfeasance in public office;
ii. negligence in deliberately failing to enforce statutory provisions; and
iii. violation of the *Canadian Charter of Rights and Freedoms* (Charter).

[3] The main issue to be determined on this appeal is whether the Judge erred in striking out the amended statement of claim.

The Nature of Ms Collins' Claim

[4] Ms Collins' claim arises from her assertion that while she was employed by the Canada Revenue Agency (CRA), her co-workers violated subsection 241(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (Act) by improperly looking at her personal income tax information. Although subsection 239(2.2) of the Act makes contravention of subsection 241(1) an offence, Ms Collins asserts that, aside from firing one employee, the CRA failed to provide any effective redress to her. The two subsections of the Act referred to by Ms Collins state as follows:

239. (2.2) Every person who (a) contravenes subsection 241(1), or (b) knowingly contravenes an order made under subsection 241(4.1) is guilty of an offence and liable on summary conviction to a fine not exceeding $5,000 or to imprisonment for a term not exceeding 12 months, or to both.	239. (2.2) Commet une infraction et encourt, sur déclaration de culpabilité par procédure sommaire, une amende maximale de 5 000 $ et un emprisonnement maximal de 12 mois, ou l'une de ces peines, toute personne : a) soit qui contrevient au paragraphe 241(1); b) soit qui, sciemment, contrevient à une ordonnance rendue en application du paragraphe 241(4.1).
[...]	. . .

Digitized by Google

241. (1) Except as authorized by this section, no official or other representative of a government entity shall	241. (1) Sauf autorisation prévue au présent article, il est interdit à un fonctionnaire ou autre représentant d'une entité gouvernementale :
(a) knowingly provide, or knowingly allow to be provided, to any person any taxpayer information;	a) de fournir sciemment à quiconque un renseignement confidentiel ou d'en permettre sciemment la prestation;
(b) knowingly allow any person to have access to any taxpayer information; or	b) de permettre sciemment à quiconque d'avoir accès à un renseignement confidentiel;
(c) knowingly use any taxpayer information otherwise than in the course of the administration or enforcement of this Act, the *Canada Pension Plan*, the *Unemployment Insurance Act* or the *Employment Insurance Act* or for the purpose for which it was provided under this section.	c) d'utiliser sciemment un renseignement confidentiel en dehors du cadre de l'application ou de l'exécution de la présente loi, du *Régime de pensions du Canada*, de la *Loi sur l'assurance-chômage* ou de la *Loi sur l'assurance-emploi*, ou à une autre fin que celle pour laquelle il a été fourni en application du présent article.

[5] Ms Collins alleges that the CRA has made a planned and deliberate policy decision not to enforce subsection 239(2.2) of the Act. Ms Collins further asserts that she wanted the CRA to tell its employees "that what they were doing was not only morally and ethically wrong, but also a criminal offence for which they could be prosecuted" (emphasis deleted). However, it did not, and after she requested that the CRA investigate the unauthorized access to her personal tax records CRA employees retaliated against her in a manner that created a toxic work environment. Subsequent requests for assistance from the Public Service Human Resources Management Agency of Canada, the Public Service Integrity Commissioner and the RCMP, an attempted complaint under the *Canada Labour Code*, and requests for access under the *Privacy Act* and the *Access to Information Act* did not result in any assistance being provided to Ms Collins.

The Issues

[6] On this appeal Ms Collins raises a number of arguments, including her assertions that the Judge ignored misconduct by counsel for the respondent, restricted oral argument and showed "a blatant bias" against her in her reasons. In my view, the issues to be decided on this appeal are:

i. Has the appellant made out her allegations of bias against the Judge?
ii. If not, what is the standard of review to be applied by this Court to the Judge's decision to strike out the amended statement of claim?
iii. Did the Judge err by striking out the amended statement of claim?
iv. Should the appellant be given leave to re-amend the amended statement of claim?

Consideration of the Issues

i. Have the allegations of bias been made out?

Digitized by Google

[7] As we explained in our reasons dismissing Ms Collins' three motions that asked the members of the panel hearing this appeal to recuse themselves on account of real or apprehended bias, there is a strong presumption that judges will administer justice impartially. This presumption is not easily rebutted and "convincing evidence" is required to prove an allegation of reasonable apprehension of bias (*R. v. R.D.S.*, [1997] 3 S.C.R. 484 at paragraph 32).

[8] Ms Collins acknowledges that she cannot substantiate any allegation of bias arising from the conduct of the hearing before the Judge. This is because she alleges a conspiracy involving the court reporter and others that resulted in a falsified and fabricated transcript.

[9] Turning to her other allegations of bias, there is no merit in Ms Collins' submission that the Judge acted improperly in accepting the Crown's re-amended motion to strike the claim. Justice Campbell allowed Ms Collins to amend her claim so as to withdraw those portions of the claim that related to a proposed class action and he stated that this amendment was without prejudice to the Crown's right to pursue its pending motion to strike the claim in its entirety. The Crown's motion to strike had been filed, but not served (see page 94 of the appeal book). Nothing in Justice Campbell's comments could, or did, prohibit the Crown from amending its motion record in order to advance further grounds for striking the pleading.

[10] Finally, many of Ms Collins' imputations of bias stem from the Judge's interpretation of the amended statement of claim. Ms Collins says that the Judge did not construe the claim as Ms Collins intended. From this, Ms Collins infers that the Judge was biased. However, during the hearing of this appeal we advised Ms Collins that it was not clear to us that the amended statement of claim can fairly be construed as Ms Collins submits. Ms Collins acknowledged both that she was "not an artful pleader" and that the statement of claim "was not perfect". The fact that the Judge interpreted the allegations in the amended claim in a different manner from Ms Collins' intended interpretation is not evidence of bias.

[11] In my view, the Judge's reasons demonstrate a careful and thorough review of a long (123 paragraphs) and difficult pleading. Nothing in the Judge's reasons supports any reasonable apprehension of bias on the part of the Judge. No convincing evidence of real or apprehended bias has been provided by Ms Collins.

ii. The Standard of Review to be Applied to the Judge's Decision

[12] In *Apotex Inc. v. Canada (Governor in Council)*, 2007 FCA 374, 370 N.R. 336 this Court considered the test to be applied when reviewing a decision of a judge on a motion to strike a pleading. At paragraph 15 the test was described as follows:

> The respondents correctly point out that the decision to grant or refuse a motion to strike is a discretionary one. When the lower court judge has made a discretionary decision, it will usually be afforded deference by the appellate court. However, the latter will be entitled to substitute the lower court judge's discretion for its own if the appellate court clearly determines that the lower court judge has given insufficient weight to relevant factors or proceeded on a wrong principle of law: *Elders Grain Co. v. Ralph Misener (The)*, [2005] F.C.J. No. 612, 2005 FCA 139 at paragraph 13. This Court may also overturn a discretionary decision of a lower court where it is satisfied that the judge has seriously misapprehended the facts, or where an obvious injustice would otherwise result: *Mayne Pharma (Canada) Inc. v. Aventis Pharma Inc.*, [2005] F.C.J. No. 215, 2005 FCA 50, 38 C.P.R. (4th) 1 at paragraph 9. [emphasis added]

Digitized by Google

[13] The burden is on Ms Collins to demonstrate an error that justifies this Court's interference with the order under appeal (*j2 Global Communications, Inc. v. Protus IP Solutions Inc.*, 2009 FCA 41, 387 N.R. 135 at paragraphs 4-5).

iii. Did the Judge err in striking out the amended statement of claim?

[14] As set out above, the amended statement of claim sought damages on account of:

a. misfeasance in public office;
b. negligence in deliberately failing to enforce statutory provisions; and
c. Charter violations.

Each cause of action will be considered in turn.

a. Misfeasance in public office

[15] The Judge understood the amended statement of claim to base the claim of misfeasance upon the failure of the CRA and the RCMP to lay charges and prosecute offences under subsection 239(2.2) of the Act. The Judge correctly found that law enforcement officers and prosecutors possess discretion as to the laying of charges and their prosecution, so that a failure to lay charges cannot be an unlawful act as required in order to establish the tort of misfeasance in public office.

[16] Ms Collins does not take issue with that analysis. Rather, she states that the amended statement of claim does not base the claim of misfeasance in public office upon any failure to enforce the statutory provision.

[17] However, paragraphs 4, 29, 36, 37, 42 and 43 of the amended statement of claim allege that:

> 4. In written policy consistent with statements on the Canada Revenue Agency [CRA] website, the CRA has made a planned and deliberate decision not to enforce subsection 239(2.2) of the ITA by characterizing unauthorized access as unlawful, i.e., not authorized by law, rather than illegal, i.e., expressly forbidden by statute, or an offence liable to a fine or imprisonment.
>
> [...]
>
> 29. The Plaintiff's experience in laying information and making a complaint pursuant to subsection 244(1) of the ITA is that the RCMP acts in concurrence with the CRA with respect to the non-enforcement of subsection 239(2.2) of the ITA.
>
> [...]
>
> 36. The failure on the part of the CRA to call a spade a spade with respect to offences committed by CRA employees, indicates the clear priority of protecting the employees of the CRA in order to protect the reputation of the CRA even at the expense of failing to adequately protect the confidentiality of taxpayer information.
>
> 37. The Plaintiff states that the CRA owes Canadian taxpayers a

Digitized by Google

statutory duty to ensure the protection of personal information from unauthorized disclosure to CRA employees, and through these individuals to the general public; and, the CRA is deliberately negligent in performing this duty through failing to enforce provisions enacted for the purpose.

[…]

42. The Plaintiff has in her possession documents supporting the involvement of many federal government entities, including documents which confirm the agreement of the RCMP with the policy of the CRA with respect to the plan not to enforce subsection 239(2.2) of the ITA.

43. The Plaintiff asserts that the aforesaid deliberate conduct of the CRA and the federal government in denying taxpayers, and the Plaintiff in particular, the protection of statutory law, case law, and the Charter of Rights and Freedoms constitutes misfeasance in public office, negligent statutory administration, abuse of power, and disregard for the principles of fundamental justice under the rule of law which has resulted in loss and damage to the Plaintiff.

[18] In my view, the Judge's interpretation of the claim as framed by Ms Collins was reasonable, and her analysis of that claim was appropriate. Ms Collins has not demonstrated that in striking the pleading relating to misfeasance in public office the Judge seriously misapprehended the pleadings, proceeded on a wrong principle of law or otherwise erred so as to warrant intervention by this Court.

b. Negligence in the enforcement of a statutory provision

[19] Ms. Collins argues that:

46. It is under the negligence cause of action that the claim reaches out beyond the CRA to those other federal government entities who were made aware of violations of section 241 of the *Income Tax Act* and did nothing to protect taxpayer information choosing instead to act to protect the CRA.

47. This cause of action is not based on a statutory duty to enforce subsection 239(2.2) of the *Income Tax Act*, but rather on the necessity of enforcing this provision in order to meet the requirements of a statutory private law duty of care to protect taxpayer information. This is clearly established in paragraphs [5] and [6] of the Amended Statement of Claim.

[…]

52. The Appellant specifically established the statutory law duty of care in paragraphs [10] and [12] of the Amended Statement of Claim.

53. Throughout the Amended Statement of Claim, the Appellant pleaded that subsection 239(2.2) of the *Income Tax Act*, being a criminal offence provision, was enacted for the purpose of deterring unauthorized

Digitized by Google

access to taxpayer information.

[20] Paragraphs 5, 6, 10 and 12 of the amended statement of claim referred to in argument by Ms Collins allege the following:

> 5. In the Plaintiff's experience, employees of the CRA are not advised by the CRA, either verbally or through written policy, that violations of subsection 241(1) of the ITA constitute an offence pursuant to subsection 239(2.2) of the ITA.
>
> 6. This policy deprives Canadian taxpayers of the protection of section 241 which has been interpreted by the Federal Court of Appeal [*Diversified Holdings Ltd. v. Canada, [1991] 1 C.T.C. 118*] as being for the protection of taxpayers.
>
> [...]
>
> 10. The CRA is required, under the provisions of the *Privacy Act*, to keep a record of all authorized and unauthorized uses of a taxpayer's personal information.
>
> [...]
>
> 12. The Federal Court of Appeal found the legislative intent of section 241 to be for the protection of the confidentiality of information given to the Minister for the purposes of the ITA. The Federal Court of Appeal further found privilege to be established in favour of the taxpayer who gives information to Revenue Canada on the understanding such information will remain confidential.

[21] Relying upon the decision of the Supreme Court of Canada in *Canada v. Saskatchewan Wheat Pool*, [1983] 1 S.C.R. 205, the Judge found the failure to follow a statutory provision does not by itself constitute negligence. The Judge also found that no positive common law duty lies upon the Crown to bring forth charges and prosecute under subsection 239(2.2) of the Act.

[22] Ms Collins has not demonstrated any error in the Judge's analysis. No common law or private duty of care arises from the facts as pleaded in the amended statement of claim. It follows from this failure that the amended statement of claim does not plead any proper cause of action in negligence. That portion of the pleading relating to alleged negligence was properly struck.

c. Charter violations

[23] As the Judge correctly noted, the amended statement of claim neither identified which rights were said to be violated nor pled material facts that might support such a claim. On this appeal, Ms Collins argues as follows with respect to this aspect of the claim:

> 59. Do civil servants, or Ministers of the federal government, have the authority to create and implement a policy which enforces section 239 of the *Income Tax Act* against taxpayers but does not enforce section 239 against federal government employees?

Digitized by Google

60. The Amended Statement of Claim pleads “they” do not possess the requisite authority due to the operation of the rule of law enshrined in the Constitution.

61. Is the undisputed policy of never enforcing subsection 239(2.2) of the *Income Tax Act*, an issue which comes within the tests established in Anns as referenced in paragraph [20] of the Amended Amended Written Representations of the Responding Party?

[…]

66. The Respondent has a statutory private law duty of care to protect taxpayer information. The Respondent was negligent in exercising this duty of care in that a powerful tool provided by Parliament went unused and ignored.

67. The failure to use this powerful tool against government employees while regularly filing criminal offence charges against taxpayers, violates the rule of law. A policy that violates the rule of law is a policy made in bad faith and under the influence of extraneous considerations.

[…]

71. The Appellant is not claiming damages pursuant to subsection 24(1) of the *Charter*.

[…]

73. The Appellant established a prima facie private law duty of care under section 241 of the *Income Tax Act* and also through reference to the statutory duty to keep records of all access to taxpayer information as provided under the relevant provisions of the *Privacy Act*.

[24] In my view, these paragraphs fail for the same reasons the claim in negligence failed. The submission that any failure to follow the law is actionable is contrary to the jurisprudence of the Supreme Court of Canada in cases such as *Saskatchewan Wheat Pool*, cited above, and *Holland v. Saskatchewan*, 2008 SCC 42, [2008] 2 S.C.R. 551.

iv. Should Ms Collins be given leave to re-amend the amended statement of claim?

[25] As noted above, the Judge’s order did not specify whether the claim was struck out with or without leave to amend. Rule 221 of the *Federal Courts Rules* requires consideration of this issue.

[26] In order to strike a pleading without leave to amend, any defect in the pleading must be one that cannot be cured by amendment. See *Simon v. Canada*, 2011 FCA 6, 410 N.R. 374 at paragraph 8. In my view, the claim in negligence and the claim based upon violation of the Charter cannot be cured by amendment. However, I believe the claim based upon misfeasance in public office can be cured.

[27] The elements of the cause of action of misfeasance in public office are:

Digitized by Google

1. A public officer must engage in deliberate and unlawful conduct in his or her capacity as a public officer.
2. The public officer must have been aware that his or her conduct was both unlawful and likely to harm the plaintiff. This requirement establishes a required nexus between the parties. There must be a conscious disregard for the interests of those who will be affected by the misconduct in question.

[28] Insofar as the nature of the misconduct is concerned, the essential question is whether the alleged misconduct is deliberate and unlawful. A plaintiff must also show damage which was caused by the alleged misconduct and that the damage was of sufficient magnitude to warrant compensation. See *Odhavji Estate v. Woodhouse*, 2003 SCC 69, [2003] 3 S.C.R. 263 at paragraph 22 and following.

[29] Turning to the current pleading, the amended statement of claim alleges the following:

a. Paragraph 241(1)(*c*) of the Act prohibits an official from knowingly using any taxpayer's information otherwise than in the course of the administration or enforcement of the Act.
b. The plaintiff worked at the CRA from November 2005 to November 2007.
c. Two employees of the CRA accessed the plaintiff's personal income tax account and this access was unauthorized.
d. Following an investigation by the CRA that found unauthorized access, co-workers made remarks to the plaintiff based on personal knowledge of her personal income tax returns.
e. The plaintiff suffered retaliation and public embarrassment.
f. As a result of the breach of privacy, the plaintiff sought professional help and suffered from depression, thoughts of suicide and anxiety attacks. As well, she had to resign from what was a toxic workplace, thus suffering financial hardship.

[30] I conclude that with appropriate amendments a cause of action could properly be pleaded alleging the Crown to be vicariously liable for the misfeasance of officials who improperly accessed and disseminated confidential information concerning Ms Collins. It follows that I would clarify the Judge's order by specifying that Ms Collins is given leave to re-amend her pleading so as to allege the tort of misfeasance in public office. No leave would be given to amend any other cause of action.

[31] It may well be helpful to remind Ms Collins that any further pleading must comply with all of the rules of the Federal Court governing pleadings. Any failure to comply with those rules could result in the re-amended pleading being struck out.

[32] To illustrate, the amended statement of claim pleads evidence extensively and does not contain a concise statement of the material facts as is required by Rule 174. Further, while a party may raise any point of law in a pleading (Rule 175), a statement of claim cannot consist of legal argument.

[33] The requirement that a pleading contain a concise statement of the material facts relied upon is a technical requirement with a precise meaning at law. Each constituent element of the cause of action must be pled with sufficient particularity. What is required

Digitized by Google

when pleading the tort of misfeasance in public office was discussed by this Court in *Merchant Law Group v. Canada (Revenue Agency)*, 2010 FCA 184, 405 N.R. 160 at paragraph 29 and following. A narrative of what happened is unlikely to meet the requirements of the *Federal Courts Rules*. Ms Collins would be well advised to seek legal advice with respect to the elements that must be contained in any re-amended pleading she may wish to file.

Conclusion

[34] For these reasons I would dismiss the appeal, but I would clarify the order appealed from to specify that Ms Collins is given leave to re-amend the amended statement of claim to allege the tort of misfeasance in public office.

[35] I would award the costs of this appeal in the cause.

"Eleanor R. Dawson"

J.A.

"I agree
John M. Evans J.A."

"I agree
Johanne Trudel J.A."

Circumstances involving danger – 241(3.1)

(3.1) The Minister may provide to appropriate persons any taxpayer information relating to imminent danger of death or physical injury to any individual.

Registered charities – 241(3.2)

Digitized by Google

(3.2) An official may provide to any person the following taxpayer information relating to another person that was at any time a registered charity (in this subsection referred to as the "charity"):

a copy of the charity's governing documents, including its statement of purpose;

any information provided in prescribed form to the Minister by the charity on applying for registration under this Act;

the names of the persons who at any time were the charity's directors and the periods during which they were its directors;

a copy of the notification of the charity's registration, including any conditions and warnings;

if the registration of the charity has been revoked or annulled, a copy of the entirety of or any part of any letter sent by or on behalf of the Minister to the charity relating to the grounds for the revocation or annulment;

financial statements required to be filed with an information return referred to in subsection 149.1(14);

a copy of the entirety of or any part of any letter or notice by the Minister to the charity relating to a suspension under section 188.2 or an assessment of tax or penalty under this Act (other than the amount of a liability under subsection 188(1.1)); and

an application by the charity, and information filed in support of the application, for a designation, determination or decision by the Minister under subsection 149.1(6.3), (7), (8) or (13).

Where taxpayer information may be disclosed – 241(4)

An official may

provide to any person taxpayer information that can reasonably be regarded as necessary for the purposes of the administration or enforcement of this Act, the *Canada Pension Plan*, the *Unemployment Insurance Act* or the *Employment Insurance Act*, solely for that purpose;

provide to any person taxpayer information that can reasonably be regarded as necessary for the purposes of determining any tax, interest, penalty or other amount that is or may become payable by the person, or any refund or tax credit to which the person is or may become entitled, under this Act or any other amount that is relevant for the purposes of that determination;

provide to the person who seeks a certification referred to in paragraph 147.1(10)(a) the certification or a refusal to make the certification, solely for the purposes of administering a registered pension plan;

provide taxpayer information

to an official of the Department of Finance solely for the purposes of the formulation or evaluation of fiscal policy,

) to an official solely for the purposes of the initial implementation of a fiscal policy or for the purposes of the administration or enforcement of an Act of Parliament that provides for the imposition and collection of a tax or duty,

to an official solely for the purposes of the administration or enforcement of a law of a province that provides for the imposition or collection of a tax or duty,

to an official of the government of a province solely for the purposes of the formulation or evaluation of fiscal policy,

Digitized by Google

to an official of the Department of Natural Resources or of the government of a province solely for the purposes of the administration or enforcement of a program of the Government of Canada or of the province relating to the exploration for or exploitation of Canadian petroleum and gas resources,

to an official of the government of a province that has received or is entitled to receive a payment referred to in this subparagraph, or to an official of the Department of Natural Resources, solely for the purposes of the provisions relating to payments to a province in respect of the taxable income of corporations earned in the offshore area with respect to the province under the *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act*, chapter 28 of the Statutes of Canada, 1988, the*Canada-Newfoundland Atlantic Accord Implementation Act*, chapter 3 of the Statutes of Canada, 1987, or similar Acts relating to the exploration for or exploitation of offshore Canadian petroleum and gas resources,

(vi.1) to an official of the Department of Natural Resources solely for the purpose of determining whether property is prescribed energy conservation property or whether an outlay or expense is a Canadian renewable and conservation expense,

) to an official solely for the purposes of the administration or enforcement of the *Pension Benefits Standards Act, 1985* or a similar law of a province,

(vii.1) to an official solely for the purpose of the administration or enforcement of the *Canada Education Savings Act* or a designated provincial program as defined in subsection 146.1(1),

(vii.2) to an official solely for the purposes of the administration and enforcement of Part 1 of the *Energy Costs Assistance Measures Act*,

(vii.3) to an official solely for the purposes of the administration and enforcement of the *Children's Special Allowances Act* or the evaluation or formation of policy for that Act,

(vii.4) to an official solely for the purposes of the administration and enforcement of the *Universal Child Care Benefit Act* or the evaluation or formation of policy for that Act,

(vii.5) to an official solely for the purposes of the administration or enforcement of the *Canada Disability Savings Act* or a designated provincial program as defined in subsection 146.4(1),

an official of the Department of Veterans Affairs solely for the purposes of the administration of the *War Veterans Allowance Act*, the*Canadian Forces Members and Veterans Re-establishment and Compensation Act* or Part XI of the *Civilian War-related Benefits Act*,

to an official of a department or agency of the Government of Canada or of a province as to the name, address, occupation, size or type of business of a taxpayer, solely for the purposes of enabling that department or agency to obtain statistical data for research and analysis,

to an official of the Canada Employment Insurance Commission, the Department of Human Resources and Skills Development or the Department of Social Development, solely for the purpose of the administration or enforcement of the *Employment Insurance Act*, an employment program of the Government of Canada or the evaluation or formation of policy for that Act or program,

) to an official of the Department of Agriculture and Agri-Food or of the government of a province solely for the purposes of the administration or enforcement of a

Digitized by Google

program of the Government of Canada or of the province established under an agreement entered into under the *Farm Income Protection Act*,
an official of the Department of Canadian Heritage or a member of the Canadian Cultural Property Export Review Board solely for the purposes of administering sections 32 to 33.2 of the *Cultural Property Export and Import Act*.
an official solely for the purposes of setting off against any sum of money that may be due or payable by Her Majesty in right of Canada a debt due to
Her Majesty in right of Canada, or
Her Majesty in right of a province, or
an official solely for the purposes of section 7.1 of the *Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act*;
provide taxpayer information, or allow the inspection of or access to taxpayer information, as the case may be, under, and solely for the purposes of,
subsection 36(2) or section 46 of the *Access to Information Act*,
section 13 of the *Auditor General Act*,
section 92 of the *Canada Pension Plan*,
a warrant issued under subsection 21(3) of the *Canadian Security Intelligence Service Act*,
an order made under subsection 462.48(3) of the *Criminal Code*,
section 26 of the *Cultural Property Export and Import Act*,
section 79 of the *Family Orders and Agreements Enforcement Assistance Act*,
paragraph 33.11(a) of the *Old Age Security Act*,
subsection 34(2) or section 45 of the *Privacy Act*,
section 24 of the *Statistics Act*,
section 9 of the *Tax Rebate Discounting Act*, or
provision contained in a tax treaty with another country or in a comprehensive tax information exchange agreement between Canada and another country or jurisdiction that is in force and has effect;
provide taxpayer information solely for the purposes of sections 23 to 25 of the *Financial Administration Act*;
(f.1) provide taxpayer information to an official for the purposes of the administration and enforcement of the *Charities Registration (Security Information) Act*, and where an official has so received taxpayer information, the official may provide that information to another official as permitted by subsection (9.1);
use taxpayer information to compile information in a form that does not directly or indirectly reveal the identity of the taxpayer to whom the information relates;
use, or provide to any person, taxpayer information solely for a purpose relating to the supervision, evaluation or discipline of an authorized person by Her Majesty in right of Canada in respect of a period during which the authorized person was employed by or engaged by or on behalf of Her Majesty in right of Canada to assist in the administration or enforcement of this Act, the *Canada Pension Plan*, the *Unemployment Insurance Act* or

Digitized by Google

the *Employment Insurance Act*, to the extent that the information is relevant for the purpose;

provide access to records of taxpayer information to the Librarian and Archivist of Canada or a person acting on behalf of or under the direction of the Librarian and Archivist, solely for the purposes of section 12 of the *Library and Archives of Canada Act*, and transfer such records to the care and control of such persons solely for the purposes of section 13 of that Act;

use taxpayer information relating to a taxpayer to provide information to the taxpayer;

(j.1) provide taxpayer information to an official or a designated person solely for the purpose of permitting the making of an adjustment to

a social assistance payment made on the basis of a means, needs or income test, or

) a payment pursuant to a prescribed law of a province in respect of a child within the meaning of the prescribed law,

where the purpose of the adjustment is to take into account the amount determined for C in subsection 122.61(1) in respect of a person for a taxation year;

provide, or allow inspection of or access to, taxpayer information to or by any person otherwise legally entitled to it under an Act of Parliament solely for the purposes for which that person is entitled to the information;

subject to subsection (9.2), provide to a representative of a government entity the business number of, the name of (including any trade name or other name used by), and any contact information, corporate information and registration information in respect of, the holder of a business number (other than an excluded individual), if the information is provided solely for the purposes of the administration or enforcement of

an Act of Parliament or of a legislature of a province, or

) a by-law of a municipality in Canada or a law of an aboriginal government;

provide taxpayer information to an official of the government of a province solely for use in the management or administration by that government of a program relating to payments under subsection 164(1.8);

provide taxpayer information to any person, solely for the purposes of the administration or enforcement of a law of a province that provides for workers' compensation benefits;

provide taxpayer information to any person solely for the purpose of enabling the Chief Statistician, within the meaning assigned by section 2 of the *Statistics Act*, to provide to a statistical agency of a province data concerning business activities carried on in the province, where the information is used by the agency solely for research and analysis and the agency is authorized under the law of the province to collect the same or similar information on its own behalf in respect of such activities;

provide taxpayer information to a police officer (within the meaning assigned by subsection 462.48(17) of the *Criminal Code*) solely for the purpose of investigating whether an offence has been committed under the *Criminal Code*, or the laying of an information or the preferring of an indictment, where

such information can reasonably be regarded as being necessary for the purpose of ascertaining the circumstances in which an offence under the*Criminal Code* may have been committed, or the identity of the person or persons who may have committed an offence, with respect to an official, or with respect to any person related to that official,

Digitized by Google

) the official was or is engaged in the administration or enforcement of this Act, and
the offence can reasonably be considered to be related to that administration or enforcement; or
provide taxpayer information to an official of the government of a province solely for the use in the management or administration by that government of a program relating to earning supplementation or income support.
Measures to prevent unauthorized use or disclosure – 241(4.1)
(4.1) The person who presides at a legal proceeding relating to the supervision, evaluation or discipline of an authorized person may order such measures as are necessary to ensure that taxpayer information is not used or provided to any person for any purpose not relating to that proceeding, including
holding a hearing *in camera*;
banning the publication of the information;
concealing the identity of the taxpayer to whom the information relates; and
sealing the records of the proceeding. Disclosure to taxpayer or on consent – 241(5)
An official or other representative of a government entity may provide taxpayer information relating to a taxpayer
to the taxpayer; and
with the consent of the taxpayer, to any other person. Appeal from order or direction – 241(6)
An order or direction that is made in the course of or in connection with any legal proceedings and that requires an official, other representative of a government entity or authorized person to give or produce evidence relating to any taxpayer information may, by notice served on all interested parties, be appealed forthwith by the Minister or by the person against whom the order or direction is made to
the court of appeal of the province in which the order or direction is made, in the case of an order or direction made by a court or other tribunal established by or pursuant to the laws of the province, whether or not that court or tribunal is exercising a jurisdiction conferred by the laws of Canada; or
the Federal Court of Appeal, in the case of an order or direction made by a court or other tribunal established by or pursuant to the laws of Canada.
Disposition of appeal – 241(7)
The court to which an appeal is taken pursuant to subsection 241(6) may allow the appeal and quash the order or direction appealed from or dismiss the appeal, and the rules of practice and procedure from time to time governing appeals to the courts shall apply, with such modifications as the circumstances require, to an appeal instituted pursuant to that subsection.
Stay of order or direction – 241(8)
An appeal instituted pursuant to subsection 241(6) shall stay the operation of the order or direction appealed from until judgment is pronounced.
Threats to security – 241(9)
An official may provide, to an official of the Canadian Security Intelligence Service, of the Royal Canadian Mounted Police or of the Financial Transactions and Reports Analysis Centre of Canada,

Digitized by Google

publicly accessible charity information;
designated taxpayer information, if there are reasonable grounds to suspect that the information would be relevant to
an investigation by the Canadian Security Intelligence Service of whether the activity of any person may constitute threats to the security of Canada, as defined in section 2 of the *Canadian Security Intelligence Service Act*,
an investigation of whether an offence may have been committed under
Part II.1 of the *Criminal Code*, or
section 462.31 of the *Criminal Code*, if that investigation is related to an offence under Part II.1 of that Act, or
the prosecution of an offence referred to in subparagraph (ii); and
information setting out the reasonable grounds referred to in paragraph (b), to the extent that any such grounds rely on information referred to in paragraph (a) or (b).
Threats to security – 241(9.1)
(9.1) Information — other than designated donor information — provided to an official of the Canadian Security Intelligence Service or the Royal Canadian Mounted Police, as permitted by paragraph (4)(f.1), may be used by such an official, or communicated by such an official to another official of the Canadian Security Intelligence Service or the Royal Canadian Mounted Police for use by that other official, for the purpose of
investigating whether an offence may have been committed, ascertaining the identity of a person or persons who may have committed an offence, or prosecuting an offence, which offence is
described in Part II.1 of the *Criminal Code*, or
) described in section 462.31 of the *Criminal Code*, if that investigation, ascertainment or prosecution is related to an investigation, ascertainment or prosecution in respect of an offence described in Part II.1 of that Act; or
investigating whether the activities of any person may constitute threats to the security of Canada, as defined in section 2 of the *Canadian Security Intelligence Service Act*.
Restrictions on information sharing – 241(9.2)
(9.2) No information may be provided to a representative of a government entity under paragraph (4)(l) in connection with a program, activity or service provided or undertaken by the government entity unless the government entity uses the business number as an identifier in connection with the program, activity or service.
Public disclosure – 241(9.3)
(9.3) The Minister may, in connection with a program, activity or service provided or undertaken by the Minister, make available to the public the business number of, and the name of (including any trade name or other name used by), the holder of a business number (other than an excluded individual).
Public disclosure by representative of government entity – 241(9.4)
(9.4) A representative of a government entity may, in connection with a program, activity or service provided or undertaken by the government entity, make available to the public the business number of, and the name of (including any trade name or other name used by), the holder of a business number (other than an excluded individual), if

Digitized by Google

a representative of the government entity was provided with that information pursuant to paragraph (4)(l); and
the government entity uses the business number as an identifier in connection with the program, activity or service.
Definitions – 241(10)
) In this section "aboriginal government"
« gouvernement autochtone »
"aboriginal government" means an aboriginal government as defined in subsection 2(1) of the *Federal-Provincial Fiscal Arrangements Act*;

"authorized person"
« personne autorisée »
"authorized person" means a person who is engaged or employed, or who was formerly engaged or employed, by or on behalf of Her Majesty in right of Canada to assist in carrying out the provisions of this Act, the *Canada Pension Plan*, the *Unemployment Insurance Act* or the *Employment Insurance Act*;
"business number"[Repealed, 1998, c. 19, s. 236(9)] "contact information"
« coordonnées »
"contact information", in respect of a holder of a business number, means the name, address, telephone number, facsimile number and preferred language of communication of the holder, or similar information as specified by the Minister in respect of the holder, and includes such information in respect of one or more
trustees of the holder, if the holder is a trust,
members of the holder, if the holder is a partnership,
officers of the holder, if the holder is a corporation, or
officers or members of the holder, if the holder is not described by any of paragraphs (a) to (c);

"corporate information"
« renseignements d'entreprise »
"corporate information", in respect of a holder of a business number that is a corporation, means the name (including the number assigned by the incorporating authority), date of incorporation, jurisdiction of incorporation and any information on the dissolution, reorganization, amalgamation, winding-up or revival of the corporation;

"court of appeal"
« cour d'appel »
"court of appeal" has the meaning assigned by the definition "court of appeal" in section 2 of the *Criminal Code*;

"designated donor information"
« renseignements désignés sur les donateurs »
"designated donor information" means information of a charity, or of a person who has at any time made an application for registration as a registered charity, that is directly attributable to a gift that has been made or proposed to be made to the charity or applicant and that is presented in any form that directly or indirectly reveals the identity of the donor or prospective donor, other than a donor or prospective donor who is not resident in Canada and is neither a citizen of Canada nor a person described in subsection 2(3);

Digitized by Google

"designated person"
« personne déterminée »
"designated person" means any person who is employed in the service of, who occupies a position of responsibility in the service of, or who is engaged by or on behalf of,
a municipality in Canada, or
a public body performing a function of government in Canada,
or any person who was formerly so employed, who formerly occupied such a position or who was formerly so engaged;

"designated taxpayer information"
« renseignement confidentiel désigné »
"designated taxpayer information" means taxpayer information — other than designated donor information — of a registered charity, or of a person who has at any time made an application for registration as a registered charity, that is
in respect of a financial transaction
relating to the importation or exportation of currency or monetary instruments by the charity or applicant, or
) in which the charity or applicant has engaged a person to whom section 5 of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* applies,
information provided to the Minister by the Canadian Security Intelligence Service, the Royal Canadian Mounted Police or the Financial Transactions and Reports Analysis Centre of Canada,
the name, address, date of birth and citizenship of any current or former director, trustee or like official, or of any agent, mandatary or employee, of the charity or applicant,
information submitted by the charity or applicant in support of an application for registration as a registered charity that is not publicly accessible charity information,
publicly available, including commercially available databases, or
information prepared from publicly accessible charity information and information referred to in paragraphs (a) to (e);

"excluded individual"
« particulier exclu »
"excluded individual" means an individual who is a holder of a business number solely because the individual is required under this Act to deduct or withhold an amount from an amount paid or credited or deemed to be paid or credited;

"government entity"
« entité gouvernementale »
"government entity" means
a department or agency of the government of Canada or of a province,
a municipality in Canada,
an aboriginal government,
a corporation all of the shares (except directors' qualifying shares) of the capital stock of which are owned by one or more persons each of which is
Her Majesty in right of Canada,
Her Majesty in right of a province,
a municipality in Canada, or
a corporation described in this paragraph, or
a board or commission, established by Her Majesty in right of Canada or Her Majesty in

Digitized by Google

right of a province, that performs an administrative or regulatory function of government, or by one or more municipalities in Canada, that performs an administrative or regulatory function of a municipality;

Digitized by Google

"official"
« fonctionnaire »
"official" means any person who is employed in the service of, who occupies a position of responsibility in the service of, or who is engaged by or on behalf of,
Her Majesty in right of Canada or a province, or
an authority engaged in administering a law of a province similar to the *Pension Benefits Standards Act*, 1985,
or any person who was formerly so employed, who formerly occupied such a position or who was formerly so engaged and, for the purposes of subsection 239(2.21), subsections 241(1) and 241(2), the portion of subsection 241(4) before paragraph (a), and subsections 241(5) and 241(6), includes a designated person;

"publicly accessible charity information"
« renseignement d'organismes de bienfaisance accessible au public »
"publicly accessible charity information" means taxpayer information that is
described in subsection (3.2), or that would be described in that subsection if the words "that was at any time a registered charity" were read as "that has at any time made an application for registration as a registered charity",
information — other than designated donor information — submitted to the Minister with, or required to be contained in, any public information return filed or required to be filed under subsection 149.1(14), or
information prepared from information referred to in paragraph (a) or (b);

"registration information"
« renseignements relatifs à l'inscription »
"registration information", in respect of a holder of a business number, means
any information pertaining to the legal form of the holder,
the type of activities carried on or proposed to be carried on by the holder,
each date on which
the business number was issued to the holder,
) the holder began activities,
the holder ceased or resumed activities, or
the business number assigned to the holder was changed, and
the reasons for the cessation, resumption or change referred to in subparagraph (c)(iii) or (iv);

"representative"
« représentant »
"representative" of a government entity means a person who is employed in the service of, who occupies a position of responsibility in the service of, or who is engaged by or on behalf of, a government entity, and includes, for the purposes of subsections (1), (2), (5) and (6), a person who was formerly so employed, who formerly occupied such a position or who formerly was so engaged;

"taxpayer information"
« renseignement confidentiel »
"taxpayer information" means information of any kind and in any form relating to one or more taxpayers that is

Digitized by Google

obtained by or on behalf of the Minister for the purposes of this Act, or
prepared from information referred to in paragraph (a),
but does not include information that does not directly or indirectly reveal the identity of the taxpayer to whom it relates and, for the purposes of applying subsections (2), (5) and (6) to

Digitized by Google

a representative of a government entity that is not an official, taxpayer information includes only the information referred to in paragraph (4)(l).

References to *Petroleum and Gas Revenue Tax Act* – 241(11)
The references in subsections 241(1), 241(3), 241(4) and 241(10) to "this Act" shall be read as references to "this Act or the *Petroleum and Gas Revenue Tax Act*".

Digitized by Google

[143]

Non Arm's Length Transfers to Shield Assets from Tax Payment

Tax liability re property transferred not at arm's length - S. 160
160. (1) Where a person has, on or after May 1, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to

(*a*) the person's spouse or common-law partner or a person who has since become the person's spouse or common- law partner,
(*b*) a person who was under 18 years of age, or
(*c*) a person with whom the person was not dealing at arm's length, the following rules apply:
(*d*) the transferee and transferor are jointly and severally, or solidarily, liable to pay a part of the transferor's tax under this Part for each taxation year equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of sections 74.1 to 75.1 of this Act and section 74 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, in respect of any income from, or gain from the disposition of, the property so transferred or property substituted for it, and
(*e*) the transferee and transferor are jointly and severally, or solidarily, liable to pay under this Act an amount equal to the lesser of

(i) the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and
(ii) the total of all amounts each of which is an amount that the transferor is liable to pay under this Act (including, for greater certainty, an amount that the transferor is liable to pay under this

[143] "Tree of Life/Wind of Change", 2012, Patricia Vertes, Howick, Quebec

Digitized by Google

section, regardless of whether the Minister has made an assessment under subsection (2) for that amount) in or in respect of the taxation year in which the property was transferred or any preceding taxation year, but nothing in this subsection limits the liability of the transferor under any other provision of this Act or of the transferee for the interest that the transferee is liable to pay under this Act on an assessment in respect of the amount that the transferee is liable to pay because of this subsection.

Joint and several, or solidary, liability — subsection 69(11)

(1.1) If a particular person or partnership is deemed by subsection 69(11) to have disposed of a property at any time, the person referred to in that subsection to whom a benefit described in that subsection was available in respect of a subsequent disposition of the property or property substituted for the property is jointly and severally, or solidarily, liable with each other taxpayer to pay a part of the other taxpayer's liabilities under this Act in respect of each taxation year equal to the amount determined by the formula A - B where A is the total of amounts payable under this Act by the other taxpayer in respect of the year, and B is the amount that would, if the particular person or partnership were not deemed by subsection 69(11) to have disposed of the property, be determined for A in respect of the other taxpayer in respect of the year, but nothing in this subsection limits the liability of the other taxpayer under any other provision of this Act or of any person for the interest that the person is liable to pay under this Act on an assessment in respect of the amount that the person is liable to pay because of this subsection.

Joint and several, or solidary, liability — tax on split income

(1.2) A parent of a specified individual is jointly and severally, or solidarily, liable with the individual for the amount required to be added because of subsection 120.4(2) in computing the specified individual's tax payable under this Part for a taxation year if, during the year, the parent

(*a*) carried on a business that was provided property or services by a partnership or trust all or a portion of the income of which partnership or trust is directly or indirectly included in computing the individual's split income for the year,

(*b*) was a specified shareholder of a corporation that was provided property or services by a partnership or trust all or a portion of the income of which partnership or trust is directly or indirectly included in computing the individual's split income for the year,

(*c*) was a specified shareholder of a corporation, dividends on the shares of the capital stock of which were directly or indirectly included in computing the individual's split income for the year;

(*d*) was a shareholder of a professional corporation that was provided property or services by a partnership or trust all or a portion of the income of which partnership or trust is directly or indirectly included in computing the individual's split income for the year, or

(*e*) was a shareholder of a professional corporation, dividends on the shares of the capital stock of which were directly or indirectly included in computing the individual's split income for the year, but nothing in

Digitized by Google

this subsection limits the liability of the specified individual under any other provision of this Act or of the parent for the interest that the parent is liable to pay under this Act on an assessment in respect of the amount that the parent is liable to pay because of this subsection.

Joint liability — tax on splitpension income
(1.3) Where a pensioner and a pension transferee
(as those terms are defined in section 60.03) make a joint election under section 60.03 in respect of a split-pension amount (as defined in that section) for a taxation year, they are jointly and severally, or solidarily, liable for the tax payable by the pension transferee under this Part for the taxation year to the extent that that tax payable is greater than it would have been if no amount were required to be added because of paragraph 56(1)(*a.2*) in computing the income of the pension transferee under this Part for the taxation year.

Assessment
(2) The Minister may at any time assess a taxpayer in respect of any amount payable because of this section, and the provisions of this Division (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, in respect of an assessment made under this section as though it had been made under section 152 in respect of taxes payable under this Part.

Assessment
(2.1) The Minister may at any time assess a taxpayer in respect of any amount payable because of paragraph 94(3)(*d*) or (*e*) or subsection 94(17) and the provisions of this Division (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, in respect of an assessment made under this section as though it had been made under section 152 in respect of taxes payable under this Part.

Discharge of liability
(3) If a particular taxpayer has become jointly and severally, or solidarily, liable with another taxpayer under this section or because of paragraph 94(3)(*d*) or (*e*) or subsection 94(17) in respect of part or all of a liability under this Act of the other taxpayer,

(*a*) a payment by the particular taxpayer on account of that taxpayer's liability shall to the extent of the payment discharge their liability; but
(*b*) a payment by the other taxpayer on account of that taxpayer's liability discharges the particular taxpayer's liability only to the extent that the payment operates to reduce that other taxpayer's liability to an amount less than the amount in respect of which the particular taxpayer is, by this section, made jointly and severally, or solidarily, liable.

Fair market value of undivided interest or right
(3.1) For the purposes of this section and section 160.4, the fair market value at any time of an undivided interest, or for civil law an undivided right, in a property, expressed as a proportionate interest or right in that property, is, subject to subsection (4), deemed to be equal to the same proportion of the

Digitized by Google

fair market value of that property at that time.

Special rules re transfer of property to spouse or common-law partner
(4) Notwithstanding subsection 160(1), where at any time a taxpayer has transferred property to the taxpayer's spouse or commonlaw partner pursuant to a decree, order or judgment of a competent tribunal or pursuant to a written separation agreement and, at that time, the taxpayer and the spouse or common-law partner were separated and living apart as a result of the breakdown of their marriage or common- law partnership, the following rules apply:

(*a*) in respect of property so transferred after February 15, 1984,

(i) the spouse or common-law partner shall not be liable under subsection 160(1) to pay any amount with respect to any income from, or gain from the disposition of, the property so transferred or property substituted therefor, and

(ii) for the purposes of paragraph 160(1)(*e*), the fair market value of the property at the time it was transferred shall be deemed to be nil, and

(*b*) in respect of property so transferred before February 16, 1984, where the spouse common-law partner would, but for this paragraph, be liable to pay an amount under this Act by virtue of subsection 160(1), the spouse's or common-law partner's liability in respect of that amount shall be deemed to have been discharged on February 16, 1984, but nothing in this subsection shall operate to reduce the taxpayer's liability under any other provision of this Act.

Vicarious Liability for Another's Tax Debt on Non-FMV Transfer

Section 160 through 160.4 set out CRA's legal apparatus to collect on tax payment evaders who attempt to shield assets from realization by the Receiver General by transferring ownership of their property to specified parties (specified above in the provision) for less than fair market value consideration. When there is fair market value consideration provided back on any transfer that transfer is exempt. Likewise, when a loan is merely made or repaid, it is still not a transfer since a note receivable is either created or extinguished, that authentically reflects the subject taxpayer's landscape. It should be noted that the provisions do not automatically allow CRA to rank commercial loan repayment arrangements, but do allow it to rank in the face of any "gratuitous" transfers that take place such as mortgage payments on another's property, certain family maintenance payments, dividends on shares, and outright sales (it is suspected especially with extremely favourable payment terms ie; 99-yr payments[144]).

The Broadest of Nature of Transfer

With respect to how broad the transfer activity can be we have Roger Riverin v. The Queen[145] where the Appeal Court held:

[3] Noting the care taken by Parliament to employ more than once the broadest possible terms in its introductory words, no doubt for the purpose of giving its rule a full extension " "either directly or indirectly, by means of a trust or by any other

[144] The researcher was not able to find one case on this issue.
[145] A-48-96

Digitized by Google

means whatever" " **we have no difficulty in concluding that the provision ~~applies once the tax de~~btor does the act that gives rise to the process by which his property will ultimately end up in the patrimony of any of these persons with whom he has a non- arm's length relationship. In the particular case of a payment in kind or a payment given as security for the repayment of a loan, it makes no difference whether the payment takes full effect and** becomes definitive as a result of some additional intervention of the debtor, a court decision or the mere operation of the Act.

The Classic Case of Livingston

A classic instance where a taxpayer attempts to have someone shield their financial resources by having another non-arm's length party cash their cheques or function as a conduit through which their financial transactions can be performed. Such was exactly the case in the Appeal case of Livingston[146] where it was held:

> **REASONS FOR JUDGMENT**
> **SEXTON J.A.**
>
> [1] The power to tax means little without the power to collect. As a result, the *Income Tax Act* R.S.C. 1985, c. 1 (5th Supp.) (the "Act") provides for a myriad of powers to collect taxes owed that would otherwise not be obtainable when taxpayers attempt to evade their creditors. These powers must be interpreted in light of their intended purpose and within the contexts of the factual situations to which they are applied.
>
> [2] This is an appeal by Her Majesty the Queen (the "appellant") of the judgment of Tax Court Justice Beaubier (the "Tax Court Judge") who held that section 160 of the Act had not been engaged when Jean Livingston (the "respondent") accepted a taxpayer's funds in order to defeat the Crown as a creditor for unpaid taxes.
>
> [3] For the reasons that follow, I would allow the appeal.
>
> **FACTS**
>
> [4] The respondent and Michele Davies ("Ms. Davies") have been friends for 11 years. Ms. Davies personally owed around $80,000 in taxes, and was potentially liable for over $700,000 in taxes and various remittances and interest as director of various corporations. When the Canada Revenue Agency (the "CRA") began attempting to collect Ms. Davies' tax debt, no funds could be collected. Ms. Davies repeatedly transferred funds into new banking and brokerage accounts before the CRA could locate and collect the money owed. The respondent was well-aware of Ms. Davies' collection problems. After numerous discussions, the respondent opened a bank account in her name only at a branch of CIBC. The respondent was the sole account holder and signatory with respect to the account.
>
> [5] The account was used only by Ms. Davies, however. Ms. Davies would deposit cheques into the account, and also direct other parties to pay

[146] 2008 FCA 89

Digitized by Google

amounts owed to her into the respondent's account. The respondent provided Ms. Davies with the only debit card in order to allow Ms. Davies to make withdrawals from the account. The respondent had also signed blank cheques on the account which Ms. Davies could use. The respondent had the ability to take money from the account at any time; she also had the ability to close the account. All bank statements, however, were sent to Ms. Davies and not the respondent.

[6] During the period from October 16, 2001 to April 28, 2003, funds totalling $36,650.82 were deposited into the bank account. However, bank records seem to indicate that there was never more than $9,000 in the account at any one time. The funds included money withdrawn from Ms. Davies' RRSP, Canada Child Tax Benefit and GST Credit cheques, welfare cheques payable to Ms. Davies and spousal support seized from Ms. Davies' ex-spouse by the British Columbia Family Maintenance Enforcement Program.

[7] On April 30, 2003, Ms. Davies declared bankruptcy. When her estate was distributed, the CRA received $233 in satisfaction of the $80,000 tax debt. Ms. Davies did not disclose in her sworn statement in bankruptcy that she was the beneficiary of trust funds, despite the fact that on and around the date her statement was sworn, there was around $1,000.00 in the respondent's account.

[8] The respondent was assessed for the total amount of money that had been deposited into the account between October 16, 2001 to April 28, 2003, namely $36,650.82.

DECISION BELOW

[9] The Tax Court Judge determined that in order for subsection 160(1) of the Act to apply, the following four criteria must be met:

1) There must be a transfer of property;
2) The parties must not be dealing at arm's length;
3) There must be no consideration or inadequate consideration flowing from the transferee to the transferor (I would note that the trial judge considered the test to be "No consideration or inadequate consideration flowing from the **transferor** to the **transferee**" [emphasis added]: this is a mistaken quotation of the test as cited in *Raphael v. Canada* 2002 FCA 23.); and
4) The transferor must be liable to pay tax under the Act at that time.

[10] The Tax Court Judge found that the first, second and fourth criteria had been fulfilled. However, he found that there had been consideration flowing from the respondent to Ms. Davies. Specifically, he concluded the following (at paragraphs 3 & 5):

> The deposit by Ms. Davies of funds into Ms. Livingston's name and the delivery by Ms. Livingston to Ms. Davies of a bank debit card and signed blank cheques on the Account constitute an exchange of consideration. As a result, there was a form of

Digitized by Google

contractual agreement between the parties.

[…]

> At all the times that Ms. Davies made the transfers of each sum, Ms. Davies had the ability to take each sum in full by using a signed blank cheque from the Appellant or by using the bank debit card. Ms. Davies even got the bank account statements so she, and not Mrs. Livingston, was the person who knew what was in the Account, although Ms. Livingston also had the power to find that out and to take anything in the Account at any time. But, in any event, these findings establish that at all times Ms. Livingston provided adequate consideration to Ms. Davies for the deposit of these funds by Ms. Davies.

The Tax Court Judge also emphasized that the respondent did not obtain any benefit from the bank account.

[11] However, the Tax Court Judge rejected the respondent's contention that the respondent was a bare trustee of the funds in question. He found that the Court will not favour a transferor where property is transferred with the intention of prejudicing a creditor. Nevertheless, as the third criterion had not been fulfilled, subsection 160(1) did not apply to the respondent.

[12] The Tax Court Judge made a number of findings of fact that are crucial for the purposes of this appeal. He found that the respondent's purpose in opening the bank account was to enable Ms. Davies to place her funds beyond the reach of creditors, including the CRA. He even went so far as to conclude that both parties conspired to prejudice the CRA (at paragraph 6). He also found that Ms. Davies was the only person who used the account; that is, the respondent never deposited into, nor withdrew funds from the account.

ISSUES

[13] Broadly speaking, there is only one issue in this appeal: was subsection 160(1) engaged when Ms. Davies made numerous transfers to the respondent's bank account? More specifically there are three areas of analysis to explore in this appeal:

1) What is the test for the application of subsection 160(1) of the Act?
2) Was there a transfer of property?
3) Was there adequate consideration flowing from the transferee to the transferor?

Digitized by Google

STANDARD OF REVIEW

[14] In appellate review, the standard of review is governed by the nature of the question at issue. Questions of law are generally reviewed on a standard of correctness, while findings of fact or mixed fact and law will be set aside only if the trial judge has made an overriding and palpable error: see *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235.

ANALYSIS

Interpreting Subsection 160(1)

[15] The Supreme Court of Canada's preferred approach to statutory interpretation remains Dreidger's modern principle (Elmer A. Driedger, *The Construction of Statutes* (Toronto: Butterworths, 1974) at 67):

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

See *Re Rizzo and Rizzo Shoes Ltd.* [1998] 1 S.C.R. 27 at 41; *Bell ExpressVu Limited Partnership v. Rex*, 2002 SCC 42 at paragraph 26.

[16] Subsection 160(1) of the Act provides as follows:

Where a person has, on or after May 1, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to	Lorsqu'une personne a, depuis le 1er mai 1951, transféré des biens, directement ou indirectement, au moyen d'une fiducie ou de toute autre façon à l'une des personnes suivantes:
(*a*) the person's spouse or common-law partner or a person who has since become the person's spouse or common-law partner,	*a*) son époux ou conjoint de fait ou une personne devenue depuis son époux ou conjoint de fait;
(*b*) a person who was under 18 years of age, or	*b*) une personne qui était âgée de moins de 18 ans;
(*c*) a person with whom the person was not dealing at arm's length,	*c*) une personne avec laquelle elle avait un lien de dépendance,
the following rules apply:	les règles suivantes s'appliquent :
(*d*) the transferee and transferor are jointly and severally liable to pay a part of the transferor's tax under this Part for each taxation year equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of sections 74.1 to	*d*) le bénéficiaire et l'auteur du transfert sont solidairement responsables du paiement d'une partie de l'impôt de l'auteur du transfert en vertu de la présente partie pour chaque année d'imposition égale à l'excédent de l'impôt pour l'année sur ce que cet impôt aurait été sans l'application

Digitized by Google

75.1 of this Act and section 74 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, in respect of any income from, or gain from the disposition of, the property so transferred or property substituted therefore, and

(*e*) the transferee and transferor are jointly and severally liable to pay under this Act an amount equal to the lesser of

(i) the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and

(ii) the total of all amounts each of which is an amount that the transferor is liable to pay under this Act in or in respect of the taxation year in which the property was transferred or any preceding taxation year,

but nothing in this subsection shall be deemed to limit the liability of the transferor under any other provision of this Act.

des articles 74.1 à 75.1 de la présente loi et de l'article 74 de la *Loi de l'impôt sur le revenu*, chapitre 148 des Statuts revisés du Canada de 1952, à l'égard de tout revenu tiré des biens ainsi transférés ou des biens y substitués ou à l'égard de tout gain tiré de la disposition de tels biens;

e) le bénéficiaire et l'auteur du transfert sont solidairement responsables du paiement en vertu de la présente loi d'un montant égal au moins élevé des montants suivants :

(i) l'excédent éventuel de la juste valeur marchande des biens au moment du transfert sur la juste valeur marchande à ce moment de la contrepartie donnée pour le bien,

(ii) le total des montants dont chacun représente un montant que l'auteur du transfert doit payer en vertu de la présente loi au cours de l'année d'imposition dans laquelle les biens ont été transférés ou d'une année d'imposition antérieure ou pour une de ces années;

aucune disposition du présent paragraphe n'est toutefois réputée limiter la responsabilité de l'auteur du transfert en vertu de quelque autre disposition de la présente loi.

[17] In light of the clear meaning of the words of subsection 160(1), the criteria to apply when considering subsection 160(1) are self-evident:

1) The transferor must be liable to pay tax under the Act at the time of transfer;
2) There must be a transfer of property, either directly or indirectly, by means of a trust or by any other means whatever;
3) The transferee must either be:

Digitized by Google

i. The transferor's spouse or common-law partner at the time of transfer or a person who has since become the person's spouse or common-law partner;

ii. A person who was under 18 years of age at the time of transfer; or

iii. A person with whom the transferor was not dealing at arm's length.

4) The fair market value of the property transferred must exceed the fair market value of the consideration given by the transferee.

[18] The purpose of subsection 160(1) of the Act is especially crucial to inform the application of these criteria. In *Medland v. Canada* 98 DTC 6358 (F.C.A.) ("*Medland*") this Court concluded that "the object and spirit of subsection 160(1), is to prevent a taxpayer from transferring his property to his spouse [or to a minor or non-arm's length individual] in order to thwart the Minister's efforts to collect the money which is owned to him." See also *Heavyside v. Canada* [1996] F.C.J. No. 1608 (C.A.) (QL) ("*Heavyside*") at paragraph 10. More apposite to this case, the Tax Court of Canada has held that the purpose of subsection 160(1) would be defeated where a transferor allows a transferee to use the money to pay the debts of the transferor for the purpose of preferring certain creditors over the CRA (*Raphael v. Canada* 2000 D.T.C. 2434 (T.C.C.) at paragraph 19).

[19] As will be explained below, given the purpose of subsection 160(1), the intention of the parties to defraud the CRA as a creditor can be of relevance in gauging the adequacy of the consideration given. However, I do not wish to be taken as suggesting as there must be an intention to defraud the CRA in order for subsection 160(1) to apply. The provision can apply to a transferee of property who has no intention to assist the primary tax debtor to avoid the payment of tax: see *Wannan v. Canada* 2003 FCA 423 at paragraph 3.

Was There A Transfer of Property?

[20] The Tax Court Judge concluded that Ms. Davies' deposits to the respondent's bank account constituted a transfer of property. The respondent argues that depositing funds into a bank account is not, in and of itself, a transfer of property to the account holder. Rather, there must also be a divesting by the transferor of the funds deposited into the bank account, which, it is submitted, never occurred. As a result, claims the respondent, there was no transfer of property, and the beneficial title to the funds remained with Ms. Davies, and not the respondent. The respondent therefore asks the Court to find a resulting trust to Ms. Davies. I do not find this argument at all convincing.

[21] The deposit of funds into another person's account constitutes a transfer of property. To make the point more emphatically, the deposit of funds by Ms. Davies into the account of the respondent permitted the respondent to withdraw those funds herself anytime. The property transferred

Digitized by Google

was the right to require the bank to release all the funds to the respondent. The value of the right was the total value of the funds.

[22] In addition, there is a transfer of property for the purposes of section 160 even when beneficial ownership has not been transferred. Subsection 160(1) applies to any transfer of property – "by means of a trust or by any other means whatever". Thus, subsection 160(1) categorizes a transfer to a trust as a transfer of property. Certainly, even where the transferor is the beneficiary under the trust, nevertheless, legal title has been transferred to the trustee. Obviously, this constitutes a transfer of property for the purposes of subsection 160(1) which, after all, is designed, *inter alia*, to prevent the transferor from hiding his or her assets, including behind the veil of a trust, in order to prevent the CRA from attaching the asset. Therefore it is unnecessary to consider the respondent's argument that beneficial title to the funds remained with Ms. Davies.

[23] The respondent cites the Tax Court of Canada's decision in *Leblanc v. The Queen* 99 DTC 410 (T.C.C.). In that case, Tax Court Justice Hamlyn found that following a deposit into a jointly held bank account the property did not vest in or pass to the wife as the wife was acting as agent for her ill husband. That finding in and of itself is suspect: there was certainly a transfer of property. Because Justice Hamlyn concluded that there was no transfer of property, he did not consider whether the wife had provided consideration.

[24] The trial judge emphasized in his reasons that the respondent ultimately received no monetary benefit. The respondent argues that this is a critical factor in considering whether there has been a transfer of property. In my opinion it is irrelevant whether or not the respondent ultimately received a "benefit." It does not matter that the funds went back to Ms. Davies. The respondent certainly received property at the time of transfer which is the relevant time for the purposes of subsection 160(1). That the money happened to go back to Ms. Davies in the end is not sufficient to reverse the triggering of the provision. As was stated by this Court in *Heavyside*, *supra* at paragraph 9:

> Once the conditions of subsection 160(1) are met... the transferee becomes personally liable to pay the tax determined under that subsection ... That liability arises at the moment of the transfer ... and is joint and several with that of the transferor. The Minister may "at any time" thereafter assess the transferee (subsection 160(2)) and the transferee's joint liability will only disappear with a payment made by her or by the transferor in accordance with subsection 160(3)).
>
> [Emphasis added.]

[25] For the reasons above, I find there was a transfer of property.

Was There Adequate Consideration Flowing from the Transferee to the Transferor?

Digitized by Google

[26] As outlined above, the Tax Court Judge concluded that there was adequate consideration flowing from the respondent to Ms. Davies by way of the respondent giving Ms. Davies the ability to take each sum in full by using a signed blank cheque from the respondent or by using the bank debit card. The respondent, in the alternative, argues that the forbearance of the respondent from seizing the monies in the account constituted consideration. In my opinion, both the Tax Court Judge and the respondent are in error.

[27] Under subsection 160(1), a transferee of property will be liable to the CRA to the extent that the fair market value of the consideration given for the property falls short of the fair market value of that property. The very purpose of subsection 160(1) is to preserve the value of the existing assets in the taxpayer for collection by the CRA. Where those assets are entirely divested, subsection 160(1) provides that the CRA's rights to those assets can be exercised against the transferee of the property. However, subsection 160(1) will not apply where an amount equivalent in value to the original property transferred was given to the transferor at the time of transfer: that is, fair market value consideration. This is because after such a transaction, the CRA has not been prejudiced as a creditor. Applying such principles to the case at bar, it is clear that the transaction between Ms. Davies and the respondent left Ms. Davies without anything equivalent to the property transferred that could be collected by the CRA, and thus there couldn't possibly be consideration.

[28] The Tax Court Judge erred in law by failing to conduct <u>any</u> analysis of the fair market value of the consideration. He simply concluded that it was "adequate." I fail to see how the fair market value of the consideration, if any did exist, would be equivalent to the funds deposited. Why would Ms. Davies give an amount of money to the respondent in consideration for the ability to withdraw the money, when the respondent retains the power to take the money? No prudent, arm's length purchaser not motivated by the prospect of evading collection of their tax debt would pay the full value of funds in exchange for the right of access that Ms. Davies received. There was no evidence on which the Tax Court Judge could conclude that what was provided by the respondent was equal to the fair market value of the money put into the account.

[29] Nor am I convinced that the respondent's failure to seize the money constituted consideration for the moneys deposited. While forbearance – the act of refraining from enforcing a right, obligation, or debt – can act as consideration for a promise given in return (S.M. Waddams, *The Law of Contracts*, 5th ed., at paragraph 121), in my opinion there was no legal forbearance in this case. Indeed, contrary to the finding of the Tax Court Judge, there was no contract. Rather, it is my opinion that the respondent simply acted out of a sense of moral obligation to Ms. Davies. Such an action does not constitute a binding agreement: *Raphael v. Canada* 2002 FCA 23 at paragraph 10. This is supported by cross-examination of the respondent at trial:

> Q: And why did you agree?
> A: Why did I agree to do this bank account for Ms. Davies?

Digitized by Google

Q: You wanted to help her.
A: That's right and her four children.
Q: And you were her friend.
A: That's correct.

[30] For the reasons above, the Tax Court Judge erred in finding that there had been fair market value consideration.

CONCLUSION

[31] The Tax Court Judge made a palpable and overriding error by concluding that adequate consideration had been given. I would allow the appeal with costs and set aside the decision of the Tax Court. Proceeding to render the decision that should have been rendered, I would dismiss with costs the respondent's appeal to the Tax Court of Canada.

"J. Edgar Sexton"

J.A.

"I agree
Gilles Létourneau J.A."

"I agree
J.D. Denis Pelletier J.A."

A secondary argument that will not work is when the transferee feels they are under "a moral obligation" to not use the funds in their account thus preventing a transfer of property to them that would draw application of s. 160. Such was the case in Debra Raphael v. The Queen[184] where the Appeal Ct. opined:

REASONS FOR JUDGMENT OF THE COURT

(Delivered from the Bench at Toronto, Ontario
on Thursday, January 17, 2002)

SEXTON J.A.

[1] The Appellant's husband, through a company owned by him operated a large number of jewellery stores in Canada. During the recession in the early 90's, the jewellery business suffered greatly and the husband's company went bankrupt. The husband had guaranteed several hundred thousand dollars of leases and loans for which the company was liable. As a result, the husband's bank alerted him to the fact that a number of his creditors had served garnishees on his bank accounts and that any funds in his accounts with the bank would have to be given to those creditors.

[2] At the time, the husband had money in his RRSP plan and he desired to use those monies so that he could honour some of his debts and

Digitized by Google

thus have the possibility of continuing to carry on the jewellery business. However, he knew that if these monies were deposited into an account in his name they could be garnisheed by his creditors. In order to avoid this happening and still to accomplish his plan, the husband and the Appellant agreed that he would deposit the monies in her account and that she would pay out money from that account on instructions from her husband, as she wished to save him from personal bankruptcy. The monies were duly paid into her account and she in turn in fact paid out monies to a great many of the husband's creditors pursuant to his instructions but as well, paid money out on account of personal expenses for the two of them. Only approximately half of the husband's monies went to pay off existing debts of the husband. His monies in the account were blended along with hers making an accounting somewhat difficult, and the Tax Court Judge concluded that it was not possible to trace the husband's monies to payment of his creditors.

[3] In addition to his other creditors, the husband also owed income tax which was not paid. When the income tax authorities became aware of the transfer of the funds into the wife's account, the Appellant was assessed under section 160(1) of the *Income Tax Act*. It provided as follows:

(1) Where a person has, on or after May 1, 1951, **transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to**

(a) the person's spouse or common-law partner or a person who has since become the person's spouse or common- law partner,

(b) a person who was under 18 years of age, or

(c) a person with whom the person was not dealing at arm's length, the following rules apply:

(d) the transferee and transferor are jointly and severally liable to pay a part of the transferor's tax under this Part for each taxation year equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of sections 74.1 to 75.1 of this Act and section 74 of the Income Tax Act, chapter 148 of the Revised Statutes of Canada, 1952, in respect of any income from, or gain from the disposition of, the property so transferred or property substituted therefor, and

(e) the transferee and transferor are jointly and severally liable to pay under this Act an amount equal to the lesser of

(i) the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and

(ii) the total of all amounts each of which is an amount that the transferor is liable to pay under this Act in or in respect of the taxation year in which the property was transferred or any preceding taxation year,

but nothing in this subsection shall be deemed to limit the liability of the transferor under any other provision of this Act. [Emphasis added].

[4] The Tax Court Judge set out four conditions to be met in order for subsection 160(1) to apply and in so doing he was following a decision of the Tax Court, *Doreen Williams* v. *The Queen*, File No. 98-1604, July 4, 2000. Those conditions were:

1) There must be a transfer of property;

2) The transferor and transferee are not dealing at arm's length

Digitized by Google

3) There must be no consideration or inadequate consideration flowing from the transferee to the transferor; and
4) The transferor must be liable to pay an amount under the *Act* in or in respect of the year when the property was transferred or any preceding year.

[5] The Tax Court judge found that there had been a transfer of property by reason of the fact that the funds were transferred into the wife's bank account. He also held that the husband and wife were not dealing at arm's length. In dealing with the third condition, he held that the wife's stated moral obligation to pay out the monies according to his instructions did not amount to consideration. He said:

To put the transfer issue in plain language, a private arrangement between the Appellant and Ernest (the husband) may impose a moral obligation on the Appellant but that moral obligation does not avoid or prevent the application of section 160(1).

[6] The Tax Court Judge therefore dismissed the wife's appeal.

[7] Before us it was argued by the Appellant that there was no transfer of the monies within the meaning of section 160(1) of the *Act*. The Appellant argued that given the Appellant's evidence that she believed she had a moral obligation to use the funds as her husband directed, which evidence was accepted by the learned Tax Judge, coupled with the evidence that in fact she used the funds to pay amounts which he directed, there was not a transfer of funds within the meaning of subsection 160(1).

[8] The Appellant argued, as well, that a trust had been created for her husband so that there was no transfer of property. However, the intention of the husband and wife in the present case to put the husband's funds where they would be secure from his creditors in not consistent with the creation of a trust. If indeed a trust was established then the husband would be beneficially entitled to those funds and they would not be immune from garnishment proceedings at the instance of his creditors. Thus, clearly the intention of the parties was not to set up an arrangement whereby the funds remained beneficially owned by the husband. Thus no trust was created.

[9] The stronger argument put by the Appellant was that there had been valid consideration given by the wife in the form of her promise to pay out monies only on his direction. If there was valid consideration equal in value to the property transferred, then section 160(1) does not apply.

[10] If indeed the wife had made a legally enforceable promise to pay out monies only on the husband's direction to his creditors in amounts equal to the monies transferred, this might well have constituted sufficient consideration in order to avoid the application of section 160(1). However, this was not the evidence nor was it the finding of the Tax Court Judge. The Appellant when asked whether she had any legal obligation to pay bills as directed by the husband agreed that she had no such legal obligation and that it was only a moral obligation. She admitted further, that he could not force her to pay bills which he wanted paid. If of course there was a legal obligation based on a trust, he could have compelled such payment. This evidence confirms that the Appellant really only felt a moral obligation and we agree with the Tax Court Judge that that is not sufficient consideration.

Digitized by Google

[11] It is also noteworthy that all of the monies transferred did not go to payment of the husband's debts. The monies were used for other purposes as well. Thus, this evidence does not support the alleged promise to use the husband's funds only for the payment of the husband's creditors in amounts equal to the money transferred.

[12] We do not wish to be taken however, as agreeing with all of the comments of the Tax Court Judge relating to whether there can be a consideration given between husband and wife so as to preclude the application of section 160(1).

[13] We therefore are of the view that there was a transfer of property within the meaning of section 160(1) and that consideration was not proven.

[14] For all of these reasons, we would dismiss this appeal with costs.

"J. E. Sexton"

J.A .

For an instance where property was repossessed and subsequently involved a transfer to a parent see Roger St-Fort v. Her Majesty The Queen, 2009 FCA 188, for an instance where the transfer had the involvement of a Quebec bank seizure mixing in with the transfer:

LÉTOURNEAU J.A.

Issue

[1] The Court has before it two appeals that have been consolidated for procedural reasons and for hearing by an order of our colleague, Justice Trudel, on February 26, 2008.

[2] The issue that the appeals raise is the correctness of the decision by Justice Archambault of the Tax Court of Canada (judge), in which the judge found that, pursuant to section 160 of the *Income Tax Act*, 1985, c. 1 (5th Supp.) (Act), the appellants were jointly and severally liable to pay a part of their son's tax liability.

[3] This final conclusion by the judge is based on the fact that there was a non-arms' length transfer of property.

[4] In my view, the two appeals must be dismissed for the reasons that follow.

Relevant legislation

[5] In addition to sections 160 and 250 of the Act, article 476 of the Quebec *Code of Civil Procedure*, R.S.Q.,
c. C-25, and articles 1651, 1654, 2781, 2941 and 2944 of the *Civil Code of Québec*, S.Q. 1991, c. 64, must be taken into consideration to resolve the case at bar.

[6] These provisions read as follows:

***Income Tax Act,* R.S.C. 1985, c. 1 (5th Supp.)**

Tax liability re property transferred not at arm's length

160. (1) Where a person has, on or after May 1, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to

Digitized by Google

the person's spouse or common-law partner or a person who has since become the person's spouse or common- law partner,
a person who was under 18 years of age, or
a person with whom the person was not dealing at arm's length,
the following rules apply:
the transferee and transferor are jointly and severally liable to pay a part of the transferor's tax under this Part for each taxation year equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of sections 74.1 to 75.1 of this Act and section 74 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, in respect of any income from, or gain from the disposition of, the property so transferred or property substituted therefor, and
the transferee and transferor are jointly and severally liable to pay under this Act an amount equal to the lesser of
the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and

Transfert de biens entre personnes ayant un lien de dépendance

160. (1) Lorsqu'une personne a, depuis le 1er mai 1951, transféré des biens, directement ou indirectement, au moyen d'une fiducie ou de toute autre façon à l'une des personnes suivantes :
son époux ou conjoint de fait ou une personne devenue depuis son époux ou conjoint de fait;
une personne qui était âgée de moins de 18 ans;
une personne avec laquelle elle avait un lien de dépendance,
les règles suivantes s'appliquent :
le bénéficiaire et l'auteur du transfert sont solidairement responsables du paiement d'une partie de l'impôt de l'auteur du transfert en vertu de la présente partie pour chaque année d'imposition égale à l'excédent de l'impôt pour l'année sur ce que cet impôt aurait été sans l'application des articles 74.1 à 75.1 de la présente loi et de l'article 74 de la *Loi de l'impôt sur le revenu*, chapitre 148 des Statuts revisés du Canada de 1952, à l'égard de tout revenu tiré des biens ainsi transférés ou des biens y substitués ou à l'égard de tout gain tiré de la disposition de tels biens;
le bénéficiaire et l'auteur du transfert sont solidairement responsables du paiement en vertu de la présente loi d'un montant égal au moins élevé des montants suivants :
(i) l'excédent éventuel de la juste valeur marchande des biens au moment du transfert sur la juste valeur marchande à ce moment de la contrepartie donnée pour le bien,

Digitized by Google

Arm's length
251. (1) For the purposes of this Act,
(*a*) related persons shall be deemed not to deal with each other at arm's length; […]
Definition of "related persons"
For the purpose of this Act,
"related persons", or persons related to each other, are individuals connected by blood relationship, marriage or common-law partnership or adoption;
[Emphasis added.]

Lien de dépendance
251. (1) Pour l'application de la présente loi :
a) des personnes liées sont réputées avoir entre elles un lien de dépendance;
[…]
Définition de « personnes liées »
(2) Pour l'application de la présente loi, sont des « personnes liées » ou des personnes liées entre elles :
a) des particuliers unis par les liens du sang, du mariage, de l'union de fait ou de l'adoption;
[Nous soulignons.]

***Code of Civil Procedure*, R.S.Q., c. C-25**
476. A party may renounce rights arising from a judgment rendered in his favour, by filing in the office of the court a total or partial renunciation signed by him or by his special attorney. A total renunciation accepted by the opposite party places the case in the position it was in immediately before the judgment.

476. Une partie peut renoncer aux droits qui lui résultent d'un jugement rendu en sa faveur, en produisant au greffe un désistement total ou partiel, signé d'elle-même ou de son fondé de procuration spéciale. Le désistement total accepté par la partie adverse a pour effet de remettre la cause dans l'état où elle était immédiatement avant le jugement.

***Civil Code of Québec*, S.Q. 1991, c. 64**
1651. A person who pays in the place of a debtor may be subrogated to the rights of the creditor.
He does not have more rights than the subrogating creditor. 1654. Subrogation may be made by the creditor only at the same time as he receives payment. It takes effect without the consent of the debtor, notwithstanding any stipulation to the contrary.
2781. Where the default has not been remedied or the payment has not been made in the time allotted for surrender, the creditor takes the property in payment by the effect of the judgment of surrender, or of a deed voluntarily made by the person against whom the hypothecary right is exercised, and accepted by the creditor, if neither the subsequent creditors nor the debtor have required him to

Digitized by Google

proceed with the sale.
The judgment of surrender or the deed voluntarily made and accepted constitutes the
1651. La personne qui paie à la place du débiteur peut être subrogée dans les droits du créancier.
Elle n'a pas plus de droits que le subrogeant.
1654. La subrogation consentie par le créancier doit l'être en même temps qu'il reçoit le paiement. Elle s'opère sans le consentement du débiteur, malgré toute stipulation contraire. **2781.** Lorsqu'il n'a pas été remédié au défaut ou que le paiement n'a pas été fait dans le délai imparti pour délaisser, le créancier prend le bien en paiement par l'effet du jugement en délaissement, ou par un acte volontairement consenti par celui contre qui le droit hypothécaire est exercé, et accepté par le créancier, si les créanciers subséquents ou le débiteur n'ont pas exigé qu'il procède à la vente.
Le jugement en délaissement ou l'acte volontairement consenti et accepté constitue le titre de creditor's title of ownership. **2941.** Publication of rights allows them to be set up against third persons, establishes their rank and, where the law so provides, gives them effect.
Rights produce their effects between the parties even before publication, unless the law expressly provides otherwise.
2944. Registration of a right in the register of personal and movable real rights or the land register carries, in respect of all persons, simple presumption of the existence of that right.

propriété du créancier.
2941. La publicité des droits les rend opposables aux tiers, établit leur rang et, lorsque la loi le prévoit, leur donne effet.
Entre les parties, les droits produisent leurs effets, encore qu'ils ne soient pas publiés, sauf disposition expresse de la loi.
2944. L'inscription d'un droit sur le registre des droits personnels et réels mobiliers ou sur le
registre foncier emporte, à l'égard de tous, présomption simple de l'existence de ce droit.

Factual background to the transfer and these proceedings

[7] On June 2, 1992, the appellants' son, René St-Fort, and his spouse acquired a house in Chelsea, Quebec. The purchase price was $250,000. A $50,000 down payment was made to the seller. The balance of the purchase price was financed through two hypothecs. The first-ranking hypothec amounted to $150,000 and was granted by the National Bank of Canada (Bank). The second-ranking hypothec, held by the Bank of Hong Kong, was for $50,000. Since the second-ranking hypothec was settled, no further mention will be made of it in these reasons.

[8] In December of that same year, René St-Fort's spouse assigned him her share in the immovable by notarial act duly registered at the Gatineau registry office: see tab 10 of the Appellants' Record.

Digitized by Google

[9] Beginning in April 1996, René St-Fort ceased making the monthly principal and interest repayments to the Bank.
[10] On September 18, 1996, the Bank asserted its rights as creditor. The Bank served René St-Fort and his spouse with a prior notice of the exercise of a hypothecary right under article 2757 of the *Civil Code of Québec*: *ibid*. at tab 11.
[11] When the debtors did not respond to the notice, the Bank filed a motion for forced surrender and for taking in payment in the Superior Court: *ibid*. The motion, based on article 795 of the *Code of Civil Procedure*, was filed on December 13, 1996.
[12] By judgment dated January 10, 1997, the Superior Court, District of Hull, ordered the debtors to voluntarily surrender the immovable, failing which the Bank would be placed in possession of the immovable by means of a writ of possession: *ibid*. at tab 12.
[13] The judgement also declared the Bank the sole owner of the immovable as of the registration of the notice, mentioned above, given on September 27, 1996. This judgment in favour of the Bank is not registered in the land register: *ibid*. at tab 18, at index of immovables.
[14] On January 31, 1997, following discussions with the Bank and its counsel, the appellants registered a $130,000 hypothec on the immovable in favour of the Caisse Populaire St-Jean Bosco in Hull: *ibid*. at tab 13. [15] Subsequently, more specifically on February 13, 1997, the Bank renounced the judgment in its favour dated January 10, 1997: *ibid*. at tab 14.
[16] Following this renunciation, the Bank subrogated the appellants to all of its rights in relation to the hypothecary remedies available to it as a result of René St-Fort's failure to pay his hypothecary debt to the Bank. The subrogation was made by notarial act dated April 1, 1997, on payment of $142,016.52: *ibid*. at tab
The notarial act was published on April 7, 1997, in the Gatineau registration division: *ibid*.
[17] Still in the same Superior Court file, the Bank and the appellants, represented by the same counsel, filed an appearance for a continuance of suit on May 27, 1997. In the appearance, the Bank was identified as the original applicant and the appellants as applicants in the continuance of suit: *ibid*. at tab 16.
[18] The case having been given new life, the appearance for a continuance of suit was followed by a notice indicating that the motion for forced surrender and for taking in payment, which had resulted in the January 10, 1997, judgment that had been renounced, would be re-filed in the Superior Court for determination on June 23, 1997: *ibid*.
[19] On June 27, 1997, the Superior Court delivered a new judgment in the file, ordering that the immovable be surrendered and granting the possession thereof to the appellants. Furthermore, the Court declared that the appellants took the immovable in payment and are the sole owners thereof, retroactive to the registration of the notice of intent on September 27, 1996.
[20] René St-Fort never surrendered the immovable, which he has occupied since its purchase in June 1992. On April 7, 1997, the immovable's fair market

Digitized by Google

value was $220,000. René St-Fort's liability to the Minister of National Revenue amounted to $365,238.69.

[21] On November 15, 2001, the Minister of National Revenue issued the appellants an assessment of $77,983.48, representing the difference between the fair market value of the house, namely $220,000, and the amount they paid in consideration for the subrogation to the Bank's rights, namely $142,016.52. The assessment was based on subsection 160(1) of the Act.

[22] The appellants appealed this assessment to the Tax Court of Canada. The judgment and reasons were delivered orally from the bench on November 5, 2007, but the reasons for judgment delivered at that time were later "amended for greater clarity and precision" on January 21, 2008. The finding was that the appeals should be dismissed. This prompted the appellants' application for the Tax Court of Canada's decision to be overturned.

Analysis of the judge's decision and the parties' submissions

Existence of a non-arm's length relationship

[23] The bond of filiation between the tax debtor, René St-Fort, and the appellants meets the definition of "related persons", thus triggering the presumption of non-arm's length dealing at section 251 of the Act. The appellants raise no objection in that respect. Rather, they submit that they acquired the immovable from the Bank, not from their son, such that there was no transfer between related persons within the meaning of the Act.

[24] The appellants are self-represented. With respect, I believe they are mistaken as to the legal effect of the various transactions that led to their ownership of the immovable, or that they are guided by a misapprehension of the consequences of those transactions.

Validity of the Bank's renunciation

[25] The appellants are challenging the judge's conclusions that under article 476 of the *Code of Civil Procedure*, the Bank could renounce the rights conferred upon it by the January 10, 1997, judgment, that the renunciation of that judgment was valid and that this renunciation had the effect of placing the case in the position it was in before the January 10, 1997, judgment: see paragraph 11 of the judge's reasons for decision. According to the appellants, the renunciation is not valid because the Bank did not sign it. **Moreover, it cannot have the effect that the judge ruled it had because René St-Fort and his spouse never accepted the Bank's total renunciation.**

[26] In my opinion, there is no question that the Bank made a total and valid renunciation of the January 10, 1997, judgment. It is clear that the renunciation, signed by the attorneys representing the Bank, [TRANSLATION] "is, in fact and in law, a true renunciation of the judgment" since the Bank [TRANSLATION] "waived the benefit that would result therefrom": see paragraph 21 of Justice Dalphond's reasons for judgment in *Vernet v. Forage expert Québec Inc.*, J.E. 2007-1095 (C.A.Q.).

[27] The Bank's subsequent actions confirm beyond a shadow of a doubt the validity of the mandate it gave its attorneys to prepare a renunciation and file it

Digitized by Google

in the record. I agree with Justice Dalphond that [TRANSLATION] "there is no call for us to go any further and attempt to interfere in the relationship between lawyer and client": *ibid.*, see also *Assurance-vie Desjardins Inc v. Succession de Richard Proulx*, [1995] R.D.J. 479 (C.A.Q.).

[28] This brings me to the matter of determining whether the Bank's two debtors, René St-Fort and his spouse, accepted the renunciation.

Acceptance of the renunciation by the Bank's debtors

[29] The appellants submit that the renunciation cannot be set up against their son, René St-Fort, because he did not sign it. Under article 476 of the *Code of Civil Procedure*, the opposing party need not sign a renunciation; it need only accept it. A signature may be the best evidence of acceptance; however, it is not the only means by which that fact may be established. Acceptance may also be proven from the parties' conduct, including that of the opposing party.

[30] In *Vernet*, above, Justice Dalphond inferred acceptance of the judgment from the agreement as to the conduct of the proceedings signed by the parties to continue the suit: see paragraphs 10 and 21 of his reasons for decision, where he concludes that it is [TRANSLATION] "clear that the opposing parties accepted this total renunciation".

[31] In the case at hand, there is no evidence that the hypothecary debtors objected to the Bank's total renunciation of the January 10, 1997, judgment. To the contrary, in fact, the following evidence in the record leads to the conclusion that the hypothecary debtors accepted it.

[32] First of all, the two debtors were respondents in the renunciation document: see Appellants' Record at tab14. They were also respondents in the appearance filed in the Superior Court in connection with the continuance of suit: *ibid.* at tab 16. As well, they were respondents in the continuance of the motion for forced surrender and for taking in payment re-filed in the Superior Court owing to the renunciation of the January 10, 1997, judgment: *ibid.* Last, the two debtors had the status of respondents in the June 27, 1997, judgment delivered following the renunciation and the continuance of suit: *ibid.* at tab 17.

[33] In my understanding, it is significant that throughout this series of events beginning with the renunciation document, at no time did the debtors oppose, in any way whatsoever, any of the proceedings subsequent and giving effect to the renunciation. In the circumstances, it is certainly not unreasonable, let alone erroneous, to conclude that the two hypothecary debtors accepted the renunciation.

[34] Regardless, according to the Court of Appeal of Québec's interpretation of article 476 of the *Code of Civil Procedure*, [TRANSLATION] "renunciation is essentially a unilateral act". And the beneficiary of a judgment may renounce it unilaterally, without the other party's involvement, if the judgement does not, in and of itself, benefit that other party (*2632-8419 Québec Inc. v. 3170578 Canada Inc.*, J.E. 97-1817, paragraphs 6 to 10; *118372 Canada inc. v. Groupe Tecnum inc.*, 2007 QCCS 4283; *Caisse populaire Desjardins Saint-Jérôme (reprise d'instance) v. 3099-1947 Québec inc. (reprise d'instance de)*, [2002] J.Q. No. 5467).

[35] In this case, the January 10, 1997, judgment, which was the subject of the

Digitized by Google

renunciation, did not benefit the two hypothecary creditors in any way. It could therefore be renounced unilaterally.

Appellants' capacity to invoke the invalidity of the revocation

[36] Although it is not necessary to decide this question to resolve the dispute, it is certainly appropriate to seriously question the appellants' capacity to challenge the validity of a renunciation of a judgment in proceedings to which they were not parties when, furthermore, they benefitted from the renunciation and accepted it at all times.

[37] In retrospect, it would probably have been preferable for the appellants to proceed differently than in the manner in which they agreed to acquire the immovable.

Legal effect of the renunciation

[38] As provided by article 476 of the *Code of Civil Procedure*, total renunciation places the case in the position it was in immediately before the judgment. That explains the appearance filed in connection with the continuance of suit, the filing for a rehearing of the motion for forced surrender and for taking in payment and the judgment dated June 27, 1997, granting the appellants (who were the applicants in the continuance of suit) ownership of the immovable.

Legal effect of the subrogation of the appellants to the hypothecary creditor's rights

[39] As already mentioned, the appellants submit that they acquired the immovable from the Bank, not their son However, the evidence affords no legal basis for this submission..

[40] The appellants acquired the immovable by way of a taking in payment, as was made possible by the subrogation document dated April 1, 1997. Pursuant to that document, the appellants acquired the Bank's claims against the hypothecary debtors and, more specifically, its right to exercise [TRANSLATION] "the hypothecary remedies of taking in payment constituted on December 13, 1996, under file No. 550 05 004282961 of the Superior Court, District of Hull": see subrogation document, Appellants' Record at page 92. **They do not have more rights than the subrogating creditor: see art. 1651, *Civil Code of Québec*. In the case at bar, the subrogating creditors were entitled to take, in payment, the immovable in respect of which the hypothecary debtors were in default: *ibid*. art. 2781.**

[41] The appellants' taking in payment was confirmed by the June 27, 1997, judgment with effect as regards the appellants' ownership of the immovable retroactive to September 27, 1996, at which time the appellants' son had possession and ownership of the immovable. **Therefore, legally, the immovable was not transferred from the Bank to the appellants, as could have been the case had it been sold by the Bank, but by a taking in payment, authorized by the Superior Court, from René St-Fort, then-hypothecary debtor to the Bank and tax debtor to the Minister of National Revenue.**

Conclusion

[42] In conclusion, I believe that the judge made no error in finding that the

Digitized by Google

conditions for applying section 160 of the Act were met and, accordingly, in dismissing the appellants' appeals.

[43] For these reasons, I would dismiss the appeals, but with a single set of costs payable by the appellants in equal shares. A copy of these reasons and another original judgment to this effect will be placed in file A- 556-07.

"Gilles Létourneau" J.A.
"I agree.
M. Nadon J.A."
"I agree.
Pierre Blais J.A."

Applies to Cover Subsequent Interest and Penalties

In Gary Richard v. The Queen[147] the Tax Court had to address whether interest and penalties that arose after the transfer were also to be considered in the application of s. 160. It held:

> [12] More importantly, the appellant argued in court, although the argument was not raised in his Notice of Appeal, that he is not liable pursuant to section 160 of the ITA for interest assessed or accrued after the date of transfer. In support of that argument, he relied on the decision of this Court in *Currie v. MNR*, 2008 TCC 338, a case heard under the informal procedure by Rossiter J. (as he then was), and in which Rossiter J. interpreted the oral decision rendered by Judge Dussault in *Algoa Trust v. R.*, [1998] 4 C.T.C. 2001. In court, the appellant, who is himself a lawyer, did not have those decisions with him. As everyone was caught by surprise, I adjourned the hearing for a short period of time to find those decisions myself. As at first glance the decision in *Currie* seemed to support the appellant's argument, I asked counsel for the respondent to call an officer from the Canada Revenue Agency (CRA) to explain the appellant's assessment in order to determine the amount of interest accrued after the date of the transfer. Everyone being confused, I decided to adjourn the hearing to give the respondent a chance to explain in detail the assessment, particularly the amount of interest accrued after the year of the transfer. At that point, counsel for the respondent asked me for permission to make written submissions on that particular issue, which I granted. I also advised the appellant that he would have a chance to reply. Contrary to what is alleged by the appellant in a letter filed on December 16, 2010 in response to the respondent's written submissions, I never gave my decision from the bench. Although I told the appellant that he might be right, I reserved my decision until I received both parties' submissions on that particular issue. The Court received the respondent's on December 15, 2010 and the appellant's on December 29, 2010. The respondent replied on January 12, 2011.
>
> [13] Now that I have everything to hand, I am in a position to give my decision. It is true that Rossiter J. held in *Currie*, *supra*, that a transferee cannot be

[147] 2011 TCC 136

Digitized by Google

assessed interest accrued on the transferor's debt after the year of the transfer. McArthur J. seems to have followed that decision in a judgment amending his earlier oral judgment in *Provost v. The Queen*, 2009 TCC 585 (however, it is not clear in *Provost* whether the interest cancelled pertained to the section 160 assessment or whether it was interest accrued on the transferor's debt after the year of the transfer). It is also true, as alleged by the appellant, that there is a draft proposed amendment of July 16, 2010 to subparagraph 160(1)(*e*)(ii) of the ITA, which has not yet been enacted. I reproduce hereunder subparagraph 160(1)(*e*)(ii), as it now reads followed by the proposed amendment (as found in Carswell, TaxnetPro):

the total of all amounts each of which is an amount that the transferor is liable to pay under this Act in or in respect of the taxation year in which the property was transferred or any preceding taxation year, but nothing in this subsection shall be deemed to limit the liability of the transferor under any other provision of this Act.

Proposed Amendment – 160(1)(e)(ii) and 160(1) closing words

(e)

(ii) the total of all amounts each of which is an amount that the transferor is liable to pay under this Act (including, for greater certainty, an amount that the transferor is liable to pay under this section, regardless of whether the Minister has made an assessment under subsection (2) for that amount) in or in respect of the taxation year in which the property was transferred or any preceding taxation year, but nothing in this subsection limits the liability of the transferor under any other provision of this Act or of the transferee for the interest that the transferee is liable to pay under this Act on an assessment in respect of the amount that the transferee is liable to pay because of this subsection.

Application: The July 16, 2010 draft legislation (Part 1 -- technical), subsec. 114(1), will amend the portion of subsec. 160(1) after subpara. (e)(i) to read as above, applicable in respect of assessments made after December 20, 2002.

Technical Notes (July 2010): The amount that a taxpayer is liable to pay in respect of the transfer of property from a non-arm's length tax debtor is determined under subsection 160(1). The Minister may assess the taxpayer for such a liability under subsection 160(2). Paragraph 160(1)(e) is amended, in respect of assessments made after December 20, 2002, to clarify that the assessment of the taxpayer is subject to interest, without any limit on the amount of interest for which the taxpayer may be liable.

This overrules *Algoa Trust*, [1998] 4 C.T.C. 2001 (TCC), and *Currie*, [2009] 1 C.T.C. 2139 (TCC); but in *Zen*, [2010] 6 C.T.C. 28 (FCA) (leave to appeal to SCC denied 2011 CarswellNat 47 (SCC)), the FCA suggests that *Algoa Trust* is wrong due to "the provisions of this Division apply" in 160(2), and that interest runs anyway. The CRA charges interest from the assessment date, not from the date of transfer, according to VIEWS doc 2008-0287751E5 (but presumably the s. 160 assessment will itself be for an amount that includes the transferor's interest). ...

[14] Nevertheless, I fully agree with the recent decision by Archambault J. of this court in the general procedure case of *Christiane Gagnon v. The Queen*,

Digitized by Google

2010 TCC 482. Archambault J. did not follow *Currie*, and ruled that the Minister could legitimately assess the transferee for interest owed by the transferor for any period after the transfer, as long as it was interest in respect of an amount of tax owed for the taxation year in which the transfer took place or for a preceding taxation year. I also fully agree with Archambault J. that it cannot be said (as held by Rossiter J.) that Judge Dussault held in *Algoa Trust* that the transferee could not be held liable for interest accrued after the year of the transfer with respect to the transferor's tax debt.

[15] In *Gagnon*, Archambault J. stated the taxpayer's argument in that regard at paragraph 16 :

Whether the tax debt includes interest

16 Ms. Gagnon's counsel argued that the assessment could be only for the amount of $14,855, that is, only the tax amount, and that the $7,257 in interest had to be excluded because it was not part of the tax debt that existed during the year of the transfer. In fact, at December 31, 2001, no such obligation existed. Interest started to accrue only on April 30, 2002. In support of his claim, he cited *Currie v. Canada*, 2008 TCC 338, [2008] TCJ No. 266 (QL), where justice Rossiter (as he then was)

specifically stated at paragraphs 22 and 27:[148]

22 Subparagraph 160(1)(*e*)(i) is really not applicable. Under subparagraph 160(1)(*e*)(ii), the Appellant is liable for all amounts which the transferor, that is the Estate, is liable to pay under the *Act* in or in respect of the taxation year in which the property was transferred or in a preceding taxation year - this means any amount owing for the transfer of the Estate up to and including December 31st of the year of the transfer. The Appellant is only liable for that which the Estate was liable as per subparagraph 160(1)(*e*)(ii). The transfer most certainly took place before Assessment

#1. As a result, Assessment #1 must be sent back to the Minister for recalculation and reconsideration, on the basis that the Appellant is only liable for the amount owing by the transferor, that is the Estate, up to and including December 31st of the year of the transfer and nothing more. This is certainly consistent with *Algoa Trust, supra*. Also, the Appellant specifically wanted to be repaid the $75,000, paid by him as interest, post the Assessment #1. This amount will be deleted from the assessment, per my previous comment and most certainly should be deleted to be consistent with *Algoa Trust, supra,* in which Dussault T.C.J. set out the inability of the Minister of National Revenue to levy interest against the transferee, at pages 2002 and 2003:

---

[148] From what I understand of the facts of that case, the transfers of property took place in 1996 and 1999. The transferee was assessed under section 160 on February 3, 2004. The tax debt he was liable for was $544,146, $321,444 of which was interest. From July 2004 to March 2006, the transferee paid the Minister a total of $620,289 (paragraph 16 of the Reasons). The transfe ree acknowledged that he was jointly and severally liable with the transferor to pay the Estate's debt up to February 3, 2004, date of the assessment, but argued that he was not liable to pay the interest that had accrued on the debt between February 3, 2004 a nd the date of payment. Therefore, he was claiming the extra interest he had paid, namely, the amounts accumulated and paid after February 3, 2004. Thus, he acknowledged that he owed the interest incurred after the year in which the transfer had taken place. However, the Court cancelled the interest starting on December 31 of the year of the transfer.

Digitized by Google

. . .
The rule stated in s. 160 of the Act does not have the effect of creating a tax debt. The effect of the provision is not to create a second debt: there is only one tax debt. The wording of the Act is quite clear: the purpose of s. 160 is essentially to add another debtor who is jointly and severally liable with the transferor. This new debtor is called the transferee. There is thus no new debt created under the Act and the obligation arises not from the assessment but from the Act itself. Fundamentally, therefore, there is only one debt and only that debt can bear interest.
First, subsection (1) of s. 160 in fact states that the transferee is jointly and severally liable and that his or her liability is limited to the lesser of the two amounts mentioned in s. 160(*e*)(i) and (ii), namely (i) the value of the property transferred less the consideration, and (ii) the total of all amounts which the transferor is liable to pay in or in respect of the year of the transfer or any preceding year, that is to say, for the year of the transfer and for any preceding years.
Secondly, s. 160(2) provides that the Minister of National Revenue ("the Minister") may at any time make an assessment. This is also quite clear. However, the limit imposed in s. 160(1)(*e*) must be observed for each assessment. 6. Thirdly, I would say that there is no provision of the Act regarding interest that may be applicable to an assessment issued pursuant to s. 160 of the Act. This is logical, since there is no new tax debt and an assessment under s. 160 already incorporates the interest which the transferor owed in addition to the tax. The assessment may also incorporate penalties and interest thereon.
. . .
27 The Appeal is allowed and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant is not liable for interest on the Estate debt from December 31st of the year of the transfer. [Emphasis added.] [16] Thereafter, Archambault J. made a thorough analysis on this particular issue to which I wholeheartedly subscribe. I reproduce here his reasoning:
As always, it is important to cite the relevant provisions of the Act as a starting point for any analysis where there is a dispute as to interpretation:
160. (1) Where a person has, on or after May 1, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to
. . .
(*e*) the transferee and transferor are jointly and severally liable to pay under this Act an amount equal to the lesser of
the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and
the total of all amounts each of which is an amount that the transferor is liable to pay under this Act in or in respect of the taxation year in which the property was transferred or any preceding taxation year,
but nothing in this subsection shall be deemed to limit the liability of the

Digitized by Google

transferor under any other provision of this Act.
160. (1) Lorsqu'une personne a, depuis le 1er mai 1951, transféré des biens, directement ou indirectement, au moyen d'une fiducie ou de toute autre façon à l'une des personnes suivantes :
. . .

e) le bénéficiaire et l'auteur du transfert sont solidairement responsables du paiement en vertu de la présente loi d'un montant égal au moins élevé des montants suivants :
(ii) l'excédent éventuel de la juste valeur marchande des biens au moment du transfert sur la juste valeur marchande à ce moment de la contrepartie donnée pour le bien,
(ii) le total des montants dont chacun représente un montant que l'auteur du transfert doit payer en vertu de la présente loi au cours de l'année d'imposition dans laquelle les biens ont été transférés ou d'une année d'imposition antérieure ou pour une de ces années;
aucune disposition du présent paragraphe n'est toutefois réputée limiter la responsabilité de l'auteur du transfert en vertu de quelque autre disposition de la présente loi.
[Emphasis added.]
In response to *Currie*, counsel for the respondent cited *Montreuil v. R.*, 1994 CarswellNat 2034, [1994]
T.C.J. No 418 (QL), [1996] 1 C.T.C. 2182, a decision rendered in 1994 by the late Judge Dussault. In that decision, which is not mentioned in *Currie*, Judge Dussault adopted an interpretation of subparagraph 160(1)(*e*)(ii) that is the opposite of that adopted in *Currie*. Indeed, he held that that subparagraph covered "all interest compounded on an outstanding tax debt for a specified preceding taxation year at the time of the transfer or for the taxation year during which the transfer occurred, whether these are compounded before or after the year of the transfer." [Emphasis added.] Judge Dussault based that ruling on the following analysis, found at paragraphs 43 to 46 CarswellNat (39 to 42 QL):
43 On the second question, we need at the outset to recall that on the date of death, which in my view is also the date of the transfer as I explained above, paragraph 160(1)(*e*) of the Act prescribed that the transferee and transferor are jointly and severally liable to pay an amount equal to the lesser of the amounts specified in subparagraphs 160(1)(*e*)(i) and (ii), i.e.:
the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and
the aggregate of all amounts each of which is an amount that the transferor is liable to pay under this Act or in respect of the taxation year in which the property was transferred or any preceding taxation year.
In view of the facts admitted, the only problem here concerns the interpretation of subparagraph 160(1)(*e*)(ii) for the purpose of establishing the tax liability of the transferor pursuant to this provision because it is used as

Digitized by Google

one of the parameters to determine the quantum of the transferee's liability. [...] Subsection 161(1) of the Act prescribes that interest is payable on any excess unpaid tax for a taxation year and that it is "computed for the period during which that excess is outstanding". In fact interest is compounded daily, and since 1987, compounded daily pursuant to subsection 248(11) of the Act. The rate is prescribed by Part XLIII of the Income Tax Regulations. Interest is payable as provided in subsection 161(1) for as long as the tax payable for a "taxation year" remains outstanding. Hence the only relationship that exists between the interest on an outstanding tax liability and a "specified taxation year" is precisely the relationship established in subsection 161(1) of the Act based on the amount of tax unpaid for this taxation year and "for the period during which" the amount is outstanding. The tax is the principal and the interest is the accessory. In this sense, interest that compounds until full payment of an outstanding taxation amount for a specified "taxation year" prior to the transfer constitutes, whatever the year in which it is compounded, an amount that the transferor is required to pay under the Act "in respect of" this preceding taxation year according to the wording of subparagraph 160(1)(*e*)(ii) as it applied prior to December 17, 1987, or "in or in respect of" this preceding year according to the wording that has applied since that date. Indeed, the Bordas dictionary40 defines the expression "à l'égard de" in its usual and modern sense as meaning "envers" and "en ce qui concerne". Moreover, the Grand Robert de la langue française41 gives particularly to the word "pour" the meaning of "en ce qui concerne" and "par rapport à". The English expression used in subparagraph 160(1)(*e*)(ii) "in respect of" has the same meaning and in my view corroborates the interpretation to the effect that these expressions cover all interest compounded on an outstanding tax liability for a specified preceding taxation year at the time of the transfer or for the taxation year during which the transfer occurred, whether these are compounded before or after the year of the transfer. We also know that the words "in respect of" have a very wide meaning, as recognized by the Supreme Court of Canada in *Norwegijick*. In his judgment in this case, Dickson J., who was later to become Chief Justice, analyzed these words in the following terms:

The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters.

In my view, this is enough to dispose of the second point. The question of determining whether an amount assessed under section 160 bears interest by application of section 161

was not raised as such and is not directly in issue here, and I thus need not rule on this question.[149]

[Emphasis added.]

19 In my view, Judge Dussault's interpretation is entirely consistent with the

[149] He would rule on this issue in *Algoa Trust v. Canada,* [1998] TCJ No. 292 (QL), 98 DTC 1614. Judge Dussault's footnotes have been omitted.

Digitized by Google

wording of subsection 160(1) of the Act. Though it is true that, as Judge Dussault held, the meaning of the French expression "pour une de ces années" is broad enough to include the meanings of "en ce qui concerne" and "par rapport à", the English version of subparagraph 160(1)(*e*)(ii) dispels all doubt by defining tax debt, for the purposes of section 160, as "an amount that the transferor is liable to pay under this Act in or in respect of the taxation year in which the property was transferred or any preceding taxation year". If the words "in respect of" were not in the provision, it might be argued that the tax debt is that which existed at the end of the year during which the transfer was made. However, Parliament clearly intended, by adding the words "or in respect of", not to impose any such limit. 20 Not only is Judge Dussault's interpretation more consistent with the wording of the section, it is also more consistent with Parliament's intention. Indeed, when a taxpayer transfers property to a person with whom he or she is not dealing at arm's length for a consideration that is less than the fair market value of the property, the taxpayer is diminishing his or her assets by an amount that could be used to pay off his or her tax debt. A taxpayer's tax debt is not limited to the tax owed, but also includes interest and, if applicable, penalties. Why would Parliament want tax authorities to be unable to recover the interest owed by the tax debtor when the benefit received by the transferee is enough to allow him or her to assume such an obligation?

In addition, I do not accept that Judge Dussault had rejected that interpretation in his opinion for *Algoa Trust*, mentioned in *Currie*. On the one hand, he did not do so explicitly, since he did not cite *Montreuil*. On the other hand, there is nothing in his reasoning in *Algoa Trust* that would lead me to believe that he changed his interpretation of subparagraph 160(1)(*e*)(ii) of the Act.

Let us briefly review the facts of that case. Algoa Trust was a shareholder of the Jaans Leasing. That company had reported dividends totalling $78,000 in May and September 1982 in favour of Algoa Trust. At the time of the transfer, Jaans had a tax debt of $88,244.82, $21,952.37 of which was tax for 1980 and 1981 and $66,292.45 was interest (that is, an amount more than three times as high as the tax) in respect of the 1978 to 1982 taxation years. (See Judge Rip's reasons for *Algoa Trust v. Canada*, [1993] TCJ No. 15 (QL), 93 DTC 405 at page 406.) One of the important issues before Judge Rip was whether the dividends constituted a transfer of property within the meaning of section 160. Judge Rip held that that was the case and confirmed the assessment made by the Minister under section 160. However, payments had been made by Jaans, or by another party on behalf of Jaans, to reduce its tax debt, and those payments had been made during different taxation years from those indicated at the time of payment. Allowing the appeal, Judge Rip referred the notice of assessment back to the Minister in order that he redetermine the interest taking into account the payments made.

In the reassessment resulting from Judge Rip's decision, the Minister determined a tax debt balance of $25,278.60, but Algoa Trust challenged that reassessment. Judge Dussault heard that appeal. At paragraph 8 of his Reasons, Judge Dussault stated that Jaans' tax debt for 1982 and the preceding

Digitized by Google

years was $88,244.82, which was the same amount as that stated by Judge Rip. According to Judge Dussault, Algoa Trust made a payment of $57,387.14 on February 14, 1991. (See paragraph 13 of his decision.) That payment was not acknowledged until 1993 and was applied to reducing Jaans' debt retroactive to February 14, 1991. As the total benefit received by Algoa Trust, which was determined under subparagraph 160(1)(*e*)(i) of the Act, was $78,000, the amount of the tax debt in respect of which Algoa Trust could be held jointly and severally liable, could not exceed $78,000, even though the debt was $88,244.82 and interest continued to accrue. Since it had paid $57,387, Algoa Trust could not have been held liable to pay more than $20,612.86 ($78,000 - $57,387.14).

That being said, there is nothing in Judge Dussault's reasoning that would lead me to conclude that Algoa Trust could not be held liable for interest accrued in respect of the tax debt owed after the year of the transfer. Quite on the contrary, the assessment under section 160 was dated November 20, 1989. On that date, $66,292 in interest had been calculated in respect of the 1978 to 1982 taxation years. Since the transfers were made in May and September 1982, it is quite likely that the interest of $66,292 in respect of the 1979 to 1982 taxation years was for a period that went beyond 1982. In fact, it is quite likely that the interest was calculated up to the date of the assessment made under section 160 and dated February 20, 1989. Judge Dussault wrote at paragraph 14 that, between November 20, 1989 (date of assessment), and February 14, 1991 (date of payment), the debt increased because of interest, and that, subsequently, the debt, reduced by the payment of $57,387.14, continued to increase, reaching $26,810.36 by December 21, 1995, according to the collection officer's calculations. That was the date of the second assessment before Judge Dussault. He wrote the following at paragraph 14:

Between November 20, 1989 (the date of the assessment) and February 14, 1991 the total debt increased because of interest, and subsequently the debt reduced by the payment of

$57,387.14 continued to increase, reaching $26,810.36 by December 21, 1995 according to Mr. Gélinas's calculations. It is now perhaps $32,000 or $33,000, but again this is not significant. If Algoa Trust were assessed now for the first time and a payment of $57,387.14 were received the same day, clearly Algoa Trust could not be held liable for an amount greater than $20,612.86 pursuant to s. 160(1)(*e*) and (3)(*a*), namely the difference between the amount established under s. 160(1)(e), that is, $78,000, and the amount already paid, namely $57,387.14. Even if nothing were recovered from Algoa Trust for 50 years, in my opinion no more than $20,612.86 could ever be recovered.

[Emphasis added.]

To really understand the meaning of Judge Dussault's comments, it must be understood that he was making a distinction between the interest that could accrue on the amount established under section 160 and that which was being accrued on the transferor's tax debt. Judge Dussault only said that, in the first case, interest was not being accrued, while, in the second case, it was. He wrote the following at paragraph 6:

Digitized by Google

6. Thirdly, I would say that there is no provision of the Act regarding interest that may be applicable to an assessment issued pursuant to s. 160 of the Act. This is logical, since there is no new tax debt and an assessment under s. 160 already incorporates the interest which the transferor owed in addition to the tax. The assessment may also incorporate penalties and interest thereon.
[Emphasis added.]
His reasoning is clearly expressed at paragraph 3:
3. The rule stated in s. 160 of the Act does not have the effect of creating a tax debt. The effect of the provision is not to create a second debt: there is only one tax debt. The wording of the Act is quite clear: the purpose of s. 160 is essentially to add another debtor who is jointly and severally liable with the transferor. This new debtor is called the transferee. There is thus no new debt created under the Act and the obligation arises not from the assessment but from the Act itself. Fundamentally, therefore, there is only one debt and only that debt can bear interest.
[Emphasis added.]
Judge Dussault's reasoning seems to be cogent. If the Minister could charge interest in respect of the amount determined under section 160, he could, in some way, collect interest more than once on the same debt: once from the principal debtor and another time from the transferee (joint and several debtor). If there were several transferees, the Minister could have as many times the interest. In addition, if the interest could be calculated on the amount of the assessment determined under section 160, that could mean that the amount that the transferee may have to pay would exceed the amount of the benefit he or she received, which would be contrary to the intent of section 160. That would be unfair. 28 On the other hand, nothing prevents the Minister from holding the transferee liable for the interest owed by the transferor under section 160. Thus, he can assess the transferee to pay the interest owed by the transferor for any period after the year of the transfer, including, it would seem, a period following the assessment under section 160, as long as it is interest owed by the transferor. Obviously, as Judge Dussault held in *Algoa Trust*, that interest amount could not exceed the limit prescribed in subparagraph 160(1)(*e*)(i) of the Act, that is, the amount of the benefit received by the transferee.
29 Accordingly, it cannot be convincingly argued that Judge Dussault held that the transferee could not be held liable for the interest accrued after the year of the transfer with respect to the transferor's tax debt. For these reasons, I rule that Ms. Gagnon is liable to pay the interest indicated in the assessment made by the Minister, namely, $7,257.73.
[17] There is not much that I can add to Archambault J.'s reasoning. In *Montreuil*, *supra* (followed by this court in *Achtem v. M.N.R.*, 1995 CarswellNat 316), judge Dussault clearly interpreted subparagraph 160(1)(*e*)(ii) in such a way that the transferee is liable for the amount of tax owed by the transferor in respect of the taxation year in which the transfer took place or any preceding taxation year (including penalties assessed and interest accrued, after the year of the transfer, on the tax debt owed by the transferor) up to the amount of the benefit received by the transferee. In *Algoa*

Digitized by Google

Trust, *supra*, judge Dussault concluded that the tax assessed against the transferee pursuant to section 160 related to the transferor's tax liability, but the section 160 assessment itself did not attract interest, as interest was already included in the transferor's tax liability. My reading of the proposed amendment to subparagraph 160(1)(*e*)(ii) is that it is aimed at overruling that particular conclusion in *Algoa Trust*. The way in which the proposed amendment is drafted leads me to conclude that the purpose behind it is to have an assessment pursuant to section 160 considered as a distinct assessment with regard to which interest could accrue. Considering the recent decision in *Zen v. Canada*, 2010 FCA 180, it might not be necessary to amend subparagraph 160(1)(*e*)(ii) at all. However, it is my understanding that this proposed amendment is not directed at the interest accruing on a transferor's amount of tax owed even after the year of the transfer, as it is clear from the actual wording of the provision that the transferee is jointly and severally liable with the transferor to pay the amount owed by the transferor in respect of the taxation year in which the transfer occurred and any preceding year. That amount, according to the decision in *Montreuil*, *Achtem* and *Gagnon*, *supra*, includes penalties and all interest accrued on the transferor's debt to the date the transferee is assessed but may not exceed the limit prescribed in subparagraph 160(1)(*e*)(i) of the ITA. I will not follow the reasoning in *Currie* (a case heard under the informal procedure and which, pursuant to section 18.28 of the *Tax Court of Canada Act*, does not constitute a precedent), which, in my view, does not reflect what Judge Dussault said in *Algoa Trust*, *supra*. [18] In court, I also raised the point as to whether a section 160 assessment could cover the provincial tax owed by the transferor. Although the appellant did not dispute that it could, I just want to mention that such tax is covered by virtue of the definition of "amount payable" in subsection 223(1) of the ITA, which defines that expression as including an amount payable by a person under an Act of a province with which the Minister of Finance has entered into an agreement for the collection of taxes payable to that province under that Act, which is the case here.

[19] I therefore conclude that the appellant is liable pursuant to section 160 of the ITA for the lesser of 1) the total of all tax, penalties and interest accrued on the debt owed by his spouse in respect of the taxation year in which the transfer took place or any preceding taxation year ($9,011.78) and 2) the amount of the benefit received ($96,000, which is the fair market value of the property ($171,000) less the consideration paid for it ($75,000))**.** I will therefore confirm the assessment in the amount of $9,011.78.

[20] The appeal is dismissed.

Transferee Cannot Be Absolved with Due Diligence, but held to Strict Liability and Intent to Evade Irrelevant

A transferee cannot take steps to ascertain the tax liability of a transferor before receipt of a legal title so as to prevent being financially disenfranchised when CRA launches an action to collect from them. There is no defence of due diligence available here

Digitized by Google

and the provision is to applied as a strict liability as was noted in Nancy Jo Wannan v. Her Majesty the Queen[150] where the Appeal Court provided:

> [3] Section 160 of the *Income Tax Act* is an important tax collection tool, because it thwarts attempts to move money or other property beyond the tax collector's reach by placing it in presumably friendly hands. **It is, however, a draconian provision. While not every use of section 160 is unwarranted or unfair, there is always some potential for an unjust result. There is no due diligence defence to the application of section 160. It may apply to a transferee of property who has no intention to assist the primary tax debtor to avoid the payment of tax. Indeed, it may apply to a transferee who has no knowledge of the tax affairs of the primary tax debtor. However, section 160 has been validly enacted as part of the law of Canada. If the Crown seeks to rely on section 160 in a particular case, it must be permitted to do so if the statutory conditions are met.**

There is no requirement that the transferor and transferee act with some sort of mens rea via attempt to evade taxes by the transferor. This was provided in Suzanne Tétrault and Her Majesty the Queen[151] with:

[16] In *Medland v. Canada*, [1998] F.C.J. No. 708 (Q.L.), Madam Justice Desjardins of the Federal Court of Appeal wrote, at paragraph 14, that "the tax policy embodied in, or the object and spirit of subsection 160(1), is to prevent a taxpayer from transferring his property to his spouse in order to thwart the Minister's efforts to collect the money which is owned [*sic*] to him." Although this is the purpose of the provision, Ms. Tétrault's representative is wrong in claiming that an intention to evade the tax must exist for this section to apply. In the first place, it is obvious that section 160 does not contain such a requirement. Moreover, this interpretation, that no intentional element is required, was adopted by my colleague Dussault J.T.C.C. in *Montreuil et al. v. The Queen*, 94 DTC 1821, at page 1828. Furthermore, the same approach was taken recently by the Federal Court of Appeal in *Wannan v. Canada*, [2003] F.C.J. No. 1693 (Q.L.), at paragraph 3. Here is what it says:

Section 160 of the *Income Tax Act* is an important tax collection tool, because it thwarts attempts to move money or other property beyond the tax collector's reach by placing it in presumably friendly hands. It is, however, a draconian provision.... It may apply to a transferee of property who has no intention to assist the primary tax debtor to avoid the payment of tax. Indeed, it may apply to a transferee who has no knowledge of the tax affairs of the primary tax debtor....

The fact that the taxpayer transferee can be assessed at practically any time with respect to the transferor's tax liability is a serious problem since it may prevent them from recourse to the transferor on property they thought they had obtained clearly title to. This issue has been discussed in Canada *v.* Addison & Leyen Ltd.[152]where the Supreme Court held:

---

[150] 2003 FCA 423
[151] 2004TCC332
[152] [2007] 2 S.C.R.

Digitized by Google

Her Majesty The Queen in Right of Canada and Canada Customs and Revenue Agency *Appellants v.*

Addison & Leyen Ltd., Concrest Corporation Ltd.,

John Joseph Dietrich, Jeannette Marie Dietrich, Rofamco Investments Ltd., Wilfrid Daniel Roach and Helen Ann Roach *Respondents*

Indexed as: Canada *v.* Addison & Leyen Ltd. Neutral citation: 2007 SCC 33.

File No.: 31451.

2007: May 24; 2007: July 12.

Present: McLachlin C.J. and Bastarache, Binnie, LeBel, Deschamps, Abella and Charron JJ. on appeal from the federal court of appeal

Taxation — Income tax — Tax liability — Property transferred not at arm's length — Taxpayers assessed pursuant to s. 160 of Income Tax Act in respect of non-arm's length transfers of property at less than fair market value — Provision expressly authorizing Minister of National Revenue to assess "at any time" — Assessment made after long delay — Taxpayers filing notices of objection but no appeal raised in Tax Court Judicial review sought in Federal Court of discretionary assessment — Whether length of delay before decision to assess taxpayers enough to ground judicial review — Whether regular appeal process could have dealt with tax liability issues — Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 160 — Federal Courts Act, R.S.C. 1985, c. F-7, s. 18.5.

Administrative law — Judicial review — Availability — Jurisdiction of Federal Court — Taxpayers assessed pursuant to s. 160 of Income Tax Act in respect of non-arm's length transfers of property at less than fair market value — Provision expressly authorizing Minister of National Revenue to assess "at any time" — Assessment made after long delay — Taxpayers filing notices of objection but no appeal raised in Tax Court Judicial review sought in Federal Court of discretionary assessment — Whether judicial review available

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 160 — Federal Courts Act, R.S.C. 1985, c. F-7, s. 18.5. In February 2001, the Minister of National Revenue sent notices of assessment to the respondent taxpayers pursuant to s. 160 of the *Income Tax Act* for taxes owing by a company to the limit of the payments received by them as direct or indirect shareholders of that company. The Minister had concluded the company's taxes, which arose from a 1992 assessment of its 1989 taxation year, were not recoverable. The taxpayers filed notices of objection in May 2001, to which Revenue Canada did not respond, but never appealed to the Tax Court. In 2005, the taxpayers applied for judicial review, under s. 18.5 of the *Federal Courts Act*, of the Crown's decision to use its discretionary assessment powers under s. 160, arguing that the long delay before the assessment was abusive, prevented their mounting a proper challenge to the assessment's validity in the Tax Court and deprived them of any possibility of indemnification by the primary taxpayer. The Federal Court granted the Crown's motion to strike the

Digitized by Google

claim, but a majority of the Federal Court of Appeal reversed that decision and allowed the application for judicial review to proceed. *Held*: The appeal should be allowed.

On the facts of this case, judicial review was not available because the Minister can assess at any time as s. 160 of the *Income Tax Act* contains no limitation period. This does not mean that the exercise of this discretion is never reviewable, but the length of the delay before a decision whether or not to assess is not enough to ground judicial review. The length of delay might, however, ground a remedy like mandamus to prod the Minister to act with due diligence. Furthermore, the allegations of fact here did not show that the regular appeal process could not have dealt with the tax liability issues. [9-10]

Statutes and Regulations Cited

Federal Courts Act, R.S.C. 1985, c. F-7, s. 18.5.

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 152, 160.

APPEAL from a judgment of the Federal Court of Appeal (Rothstein, Sharlow and

Malone JJ.A.), [2006] 4 F.C.R. 532, 265 D.L.R. (4th) 253, 346 N.R. 238, [2006] 3 C.T.C. 95, 2006 2007 SCC 33 (CanLII) D.T.C. 6248, [2006] F.C.J. No. 489 (QL), 2006 FCA 107, reversing a judgment of Kelen J., [2005] 2 C.T.C. 201, 2005 D.T.C. 5212, [2005] F.C.J. No. 516 (QL), 2005 FC 411. Appeal allowed.

Graham R. Garton, *Q.C.*, and *Wendy Burnham*, for the appellants.

Roderick A. McLennan, *Q.C.*, *H. M. Kay*, *Q.C.*, *Curtis R. Stewart* and *L. A. Goldbach*, for the respondents. The following is the judgment delivered by

THE COURT — The respondents applied for judicial review of a tax assessment issued by the Minister of National Revenue under s. 160 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"). On a motion by the Crown, the Federal Court struck the application. A majority of the Federal Court of Appeal reversed this judgment and allowed the application for judicial review to proceed. For the reasons that follow, we are of the view that the Crown's motion to strike was well founded, that its appeal should be allowed and that the application for judicial review should be struck.

The present litigation arises out of the tax planning decisions that were made several years ago and the business dealings that were subsequently transacted. In 1989, the respondents, who held shares, directly or indirectly, in a company, York Beverages (1968) Ltd. ("York"), which had sold its bottling business the year before, sold their York shares to another company, Synergy Inc. ("Synergy"). Synergy planned to use York's cash in hand to purchase seismic data and reduce York's tax liability to zero. Between the time of the sales of the bottling business and of the York shares, the respondents received various payments from York in the form of dividends, directors' fees, loan repayments, etc.

In 1992, the Minister of National Revenue reassessed York for the 1989 taxation year under s. 152 *ITA* after determining that the seismic data

Digitized by Google

had been overvalued. The reassessment was for $3,247,074.05, including a penalty and interest. York filed a notice of objection. The Minister never responded and York never appealed to the Tax Court of Canada.

At some point, the Minister concluded that nothing would ever be recovered from York. In February 2001, the Minister sent notices of assessment to the respondents under s. 160 *ITA*. In the notices of assessment, the Minister claimed York's entire tax liability from the respondents, jointly and severally, and the amount assessed in respect of each of the respondents was limited to the amount of the payments that person had received from York in 1988 and 1989. Including interest, the claim now exceeds $6,000,000.

The respondents filed notices of objection in May 2001. Revenue Canada never dealt with the objections and the respondents never appealed to the Tax Court of Canada. In 2005, they applied for judicial review of the Crown's decision to use its discretion to assess them under s. 160 *ITA*. They submitted that the long delay in issuing the assessment was abusive, prevented them from mounting a proper challenge to the validity of the assessment in the Tax Court and deprived them of any possibility of indemnification by the primary taxpayer.

The Crown moved to strike the application for judicial review. In the Federal Court, Kelen J. granted the motion and struck the application: [2005] 2 C.T.C. 201, 2005 FC 411. He found that judicial review was not available to the respondents and that they could and ought to have pursued alternative remedies. The majority of the Federal Court of Appeal reversed the trial judgment: [2006] 4 F.C.R. 532, 2006 FCA 107. Sharlow J.A. held that the Federal Court had jurisdiction over the matter and that the test for granting a motion to strike had not been met. She stated that judicial review might be available on the issue of the exercise of the discretion to assess a taxpayer under s. 160 *ITA*. Rothstein J.A. (as he then was), in dissent, would have upheld Kelen J.'s judgment. He was of the view that a delay in issuing an assessment under s. 160 is not reviewable by the Federal Court under its judicial review jurisdiction.

The issue in this appeal is whether judicial review under s. 18.5 of the *Federal Courts Act*, R.S.C. 1985, c. F-7, is available to challenge the exercise of the Minister's discretion to assess a taxpayer under s. 160 *ITA*. What the case actually turns on, however, is the interpretation of s. 160.

We need not engage in a lengthy theoretical discussion on whether s. 18.5 can be used to review the exercise of ministerial discretion. It is not disputed that the Minister belongs to the class of persons and entities that fall within the Federal Court's jurisdiction under s. 18.5. Judicial review is available, provided the matter is not otherwise appealable. It is also available to control abuses of power, including abusive delay. Fact-specific remedies may be crafted to address the wrongs or problems raised by a particular case.

Digitized by Google

> Nevertheless, we find that judicial review was not available on the facts of this case. As Rothstein J.A. pointed out, the interpretation of s. 160 *ITA* by the majority of the Federal Court of Appeal amounted to reading into that provision a limitation period that was simply not there. The Minister can assess a taxpayer at any time. In the words of Rothstein J.A.:
>
> While in the sense identified by the majority, subsection 160(1) may be considered a harsh collection remedy, it is also narrowly targeted. It only affects transfers of property to persons in specified relationships or capacities and only when the transfer is for less than fair market value. Having regard to the application of subsection 160(1) in specific and limited circumstances, Parliament's intent is not obscure. Parliament intended that the Minister be able to recover amounts transferred in these limited circumstances for the purpose of satisfying the tax liability of the primary taxpayer transferor. The circumstances of such transactions mak[e] it clear that Parliament intended that there be no applicable limitation period and no other condition on when the Minister might assess. [para. 92]
>
> The Minister is granted the discretion to assess a taxpayer at any time. This does not mean that the exercise of this discretion is never reviewable. However, in light of the words "at any time" used by Parliament in s. 160 *ITA*, the length of the delay before a decision on assessing a taxpayer is made does not suffice as a ground for judicial review, except, perhaps, inasmuch as it allows for a remedy like mandamus to prod the Minister to act with due diligence once a notice of objection has been filed. Moreover, in the case at bar, the allegations of fact in the statement of claim do not disclose any reason why it would have been impossible to deal with the tax liability issues relating to either the underlying tax assessment against York or the assessments against the respondents through the regular appeal process.
>
> Reviewing courts should be very cautious in authorizing judicial review in such circumstances. The integrity and efficacy of the system of tax assessments and appeals should be preserved. Parliament has set up a complex structure to deal with a multitude of tax-related claims and this structure relies on an independent and specialized court, the Tax Court of Canada. Judicial review should not be used to develop a new form of incidental litigation designed to circumvent the system of tax appeals established by Parliament and the jurisdiction of the Tax Court. Judicial review should remain a remedy of last resort in this context.
>
> For these reasons, the appeal is allowed, the judgment of the Federal Court of Appeal is set aside and the judgment of the motions judge is restored, with costs.

Possible to Contest Transferor's Tax Liability as a Latent Party

They're called derivative actions: where a 3rd party who is not one of the initial two parties to a contest, have an interest and should seek independent "natural justice"

Digitized by Google

from a decision that has been provided. In the context of a s. 160 assessment the transferee has an interest in any proceedings that give effect to the transferor's liability upon which the s. 160 assessment has been based. At least, this was the opinion of the Appeal Court in Joanne M. Gaucher v. The Queen[153] where the transferee attempted to argue such, given that the defence of statute-barred assessment had not been raised by the primary taxpayer- transferor at the TCC, when it held:

> [1] The issue in this appeal is whether a taxpayer assessed under a derivative assessment pursuant to subsection 160(1) of the *Income Tax Act* may object to that assessment by challenging the primary assessment on which the derivative assessment is based.
>
> [2] The appellant's former husband was assessed for approximately $350,000 of tax. **The assessment was confirmed by the Tax Court of Canada.** Shortly before the Tax Court confirmed the assessment, the appellant's former husband transferred a residence to her. A few months later, the former husband declared bankruptcy.
>
> …
>
> [4] The appellant now says that the Minister reassessed her former husband after the three year limitation period provided in subsection 152(3.1) had expired and wishes to raise the limitation period as a defence to her assessment under subsection 160(1). The Minister says that she may not raise this defence because, once the former husband's assessment was confirmed by the Tax Court, it cannot be challenged. By assessing after the expiry of the limitation period, the Minister says that the Minister must be presumed to have alleged misrepresentation, that the limitation defence was not raised by the appellant's former husband in his appeal and that the appellant is precluded from now raising it in her appeal.
>
> [5] The learned Tax Court Judge agreed with the Minister. He stated at paragraph 10 of his reasons:
>
> In the end, I conclude that the Appellant is precluded from claiming the defense that the reassessment of her former husband was statute-barred on the basis that the Tax Court of Canada confirmed the Minister's reassessment and it is not open to the Appellant to interfere with that decision. Given the facts of the case, Margeson J. confirmed the Minister's assessment [of the former husband], not to mention that Haynes conceded at the beginning of trial that part of the amounts in dispute were properly assessed.
>
> …
>
> [6] I am of the respectful view that the Tax Court Judge was in error in coming to this conclusion. It is a basic rule of natural justice that, barring a statutory provision to the contrary, a person who is not a party to litigation cannot be bound by a judgment between other parties. The appellant was not a party to the reassessment proceedings between the Minister and her former husband. Those proceedings did not purport to impose any liability on her. While she may have been a witness in those proceedings, she was not a party, and hence could not in those proceedings raise defences to her former husband's assessment.

---

[153] A-275-00

Digitized by Google

[7] When the Minister issues a derivative assessment under subsection 160(1), a special statutory provision is invoked entitling the Minister to seek payment from a second person for the tax assessed against the primary tax payer. That second person must have a full right of defence to challenge the assessment made against her, including an attack on the primary assessment on which the second person's assessment is based.

[8] This view has been expressed by Judges of the Tax Court. See, for example, *Acton v. The Queen* (1994), 95 D.T.C. 107, at 108 *per* Bowman T.C.C.J.; *Ramey v. The Queen* (1993), 93 D.T.C. 791, at 792 *per* Bowman T.C.C.J.; *Thorsteinson v. M.N.R.* (1980), 80 D.T.C. 1369, at 1372 *per* Taylor T.C.C.J. While the contrary view was expressed in *Schafer (A.) v. Canada*, [1998] G.S.T.C. 7-1, at 7-9 (appeal dismissed for delay (August 30, 1999), A-258-98 (F.C.A.)), I am of the respectful opinion that such view is in error**. It seems to me that this approach fails to appreciate that what is at issue are two separate assessments between the Minister and two different taxpayers. Once the assessment against the primary taxpayer is finalized, either because the primary taxpayer does not appeal the assessment, or the assessment is confirmed by the Tax Court (or a higher court if further appealed), that assessment is final and binding between the primary taxpayer and the Minister. An assessment issued under subsection 160(1) against a secondary taxpayer cannot affect the assessment between the Minister and the primary taxpayer.**

[9] By the same token, since the secondary taxpayer was not a party in the proceedings between the Minister and the primary taxpayer, she is not bound by the assessment against the primary taxpayer. The secondary taxpayer is entitled to raise any defence that the primary taxpayer could have raised against the primary assessment. The result may be that the assessment against the secondary taxpayer is quashed or is found to be for a lesser amount than the assessment against the primary taxpayer. That, of course, will have no effect on the assessment against the primary tax payer against whom the primary assessment was final and binding.

…

[11] There is no reason why the appellant cannot raise the limitation period as a defence to the assessment made against her under subsection 160(1).

[12] As indicated in paragraph 4, there is some suggestion in the material that there may have been misrepresentation by the primary taxpayer that entitled the Minister to invoke subsection 152(4) and assess after the normal assessment period. Subsection 152(4) provides:

152. (4) The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if

(a) the taxpayer or person filing the return

Digitized by Google

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

It will be open to the parties to address the question of misrepresentation, if it arises, by calling evidence in the Tax Court appeal.
[13] This appeal will be allowed with costs in this Court and in the Tax Court. The decision of the Tax Court will be set aside. In the appeal of her subsection 160(1) assessment, the appellant may raise before the Tax Court any defence that her former husband could have raised in respect of his assessment.

Prescription on Tax Debt and When Minister May Make Assessment

A tax debt "falls off the table" and is not actionable for collection past a certain point in time as a consequence of Markevich v. Canada[154] but when does that period of time start in relation to debts that previously existed and taxpayer actions that were latently executed in respect of them. This was the issue in Huguette Bleau v. The Queen[155]:

Position of the parties
[8] Counsel for Ms. Bleau maintained that at the time the assessment pursuant to section 160 of the Act was arrived at, on June 28, 2001, the tax debt of 6421 was barred by limitation under section 32 of the Crown Liability Act, which stipulates that proceedings shall be taken within six years. Pursuant to section 225.1 of the Act, the date for calculating the time limit for the recovery of this tax debt is, **according to Counsel for Ms. Bleau, June 10, 1995,[194] or 90 days after March 13, 1995, the date on which the assessment in respect of 6421 was established. As was recognized by the Supreme Court of Canada in *Markevich* (*supra*), the recovery of a tax debt is subject to a limitation of six years from the cause of action. Consequently, since no recovery action was taken during the period from March 13, 1995 to June 28, 2001, the tax debt of 6421 was extinguished on June 10, 2001, or became, at the very least, not payable.**
[9] Counsel added that one must refer to the provisions of the *Civil Code of Quebec* (**Civil Code)** because of the use of the concept of joint and several liability stipulated by section 160 and because of the application of section 8.1 of the *Interpretation Act.* Since section 160 creates joint and several liability and we are dealing here with joint and several liability in respect of the same debt and not two separate debts, articles 1531 and 1671 of the Civil Code apply.[195]
[10] Subsidiarily, he maintains, rightly, that repayment of an advance is not a transfer within the meaning of section 160 of the Act. However, the only repayment of an advance that has been demonstrated before me is the repayment of the $46,693 which 6421 owed to Projets and this amount does not form part of the amount of the assessment. This argument is accordingly

[154] [2003] 1 S.C.R. 94
[155] 2006TCC36

Digitized by Google

unfounded, in light of the facts.

[11] The final argument of Counsel for Ms. Bleau is that the Minister had informed her that the settlement offer was comprehensive; Ms. Bleau could not, consequently, suspect that an assessment would be established under section 160 of the Act.

[12] As far as the Respondent is concerned, Counsel maintains that the tax debt of 6421 in respect of its 1990 taxation year was not extinguished, since Ms. Bleau's liability was created at the time of the transfer in 1992 (less than two years after the creation of the tax debt), and not at the time of the assessment of June 28, 2001, as Counsel for Ms. Bleau stated. Counsel based her argument on the decision by the Federal Court of Appeal in *Heavyside v. Canada*, [1996] F.C.J. No. 1608 (QL), in particular paragraphs 9 and 10 of the reasons given by Décary J.A., which I will reproduce:

Once the conditions of subsection 160(1) are met, as they are in the present case, the transferee becomes personally liable to pay the tax determined under that subsection (here, $2,759.50). That liability arises at the moment of the transfer (here, June 6, 1989) and is joint and several with that of the transferor. The Minister may "at any time" thereafter assess the transferee (subsection 160(2) and the transferee's joint liability will only disappear with a payment made by her or by the transferor in accordance with subsection 160(3)).

The moment chosen by the Minister to assess the transferee is of no consequence. It is trite law that liability for tax results from the act and not from the assessment and that in the instant case it is the transfer that triggers the liability. The respondent, therefore, was personally liable, in her 1989 taxation year, for income tax in respect of the gains from the disposition of the property transferred and her liability being joint and several with that of her husband, it had a life of its own and survived the eventual extinguishment through bankruptcy, in 1994, of her husband's own tax liability. The fact that she was assessed only in 1994 and only after her husband's discharge is irrelevant as far as her own liability is concerned.

[My emphasis.]

[13] Counsel for the Respondent also cites paragraph 16 of the decision of the Supreme Court of Canada in *Markevich* (*supra*), where the said Court emphasises that an assessment under section 160 of the Act may be made at any time by virtue of subsection 160(2):

16 This conclusion is supported by the explicit manner in which the *ITA* addresses limitation periods in its assessment provisions. The Court held in Friesen, *supra* at para. 27, that [r]eading extra words into a statutory definition is even less acceptable when the phrases which must be read in appear in several other definitions in the same statute". **Numerous provisions in the *ITA* expressly stipulate that that the Minister may make an assessment "at any time": see ss. 152(4), 152(4.2), 159(3), 160(2), 160.1(3), 160.2(3), 160.3(2), 160.4(3) and 227(10.1). Parliament has demonstrated a clear willingness to address the issue of limitation periods in the *ITA* where it sees fit to do so. As Rothstein J.A. noted at para. 22, "Parliament has put its mind to the limitation question in the *Income Tax Act* and when it intends there to**

Digitized by Google

be no limitation period, it has so stated."
Accordingly, the unescapable conclusion is that the plain language used in the collection provisions does not support the inference that Parliament intended to exclude the application of limitation provisions to the Minister's collection powers.
[My emphasis.]
[14] Consequently, since the Minister was able to issue an assessment under section 160 at any time, that at the relevant moment, namely on the date of the transfer by 6421 to Ms. Bleau, the tax debt of that corporation was not extinguished because of the application of a limitation period and the other conditions for the application of section 160 are met, the assessment of the Minister is well founded.
[15] Subsidiarily, the Respondent maintains that the changes made to section 222 of the Act, in particular the addition of the new subsection 222(10), have the effect that, even if the Court were to conclude that the tax debt of 6421 is extinguished, this tax debt was re-established with effect from March 4, 2004, and, as a result, the assessment pursuant to section 160 is well founded. The Respondent cited, in support of her position, the decision of the Federal Court in *Gibson v. Canada*, [2005] F.C.J. No. 817(QL), 2005 FCA 180.
expressly stipulate that that the Minister may make an assessment "at any time": see ss. 152(4), 152(4.2), 159(3), 160(2), 160.1(3), 160.2(3), 160.3(2), 160.4(3) and 227(10.1). Parliament has
demonstrated a clear willingness to address the issue of limitation periods in the *ITA* where it sees fit to do so. As Rothstein J.A. noted at para. 22, "Parliament has put its mind to the limitation question in the *Income Tax Act* and when it intends there to be no limitation period, it has so stated." Accordingly, the unescapable conclusion is that the plain language used in the collection provisions does not support the inference that Parliament intended to exclude the application of limitation provisions to the Minister's collection powers.
[My emphasis.]
[14] Consequently, since the Minister was able to issue an assessment under section 160 at any time, that at the relevant moment, namely on the date of the transfer by 6421 to Ms. Bleau, the tax debt of that corporation was not extinguished because of the application of a limitation period and the other conditions for the application of section 160 are met, the assessment of the Minister is well founded.
[15] Subsidiarily, the Respondent maintains that the changes made to section 222 of the Act, in particular the addition of the new subsection 222(10), have the effect that, even if the Court were to conclude that the tax debt of 6421 is extinguished, this tax debt was re-established with effect from March 4, 2004, and, as a result, the assessment pursuant to section 160 is well founded. The Respondent cited, in support of her position, the decision of the Federal Court in *Gibson v. Canada*, [2005] F.C.J. No. 817(QL), 2005 FCA 180.

Analysis
[16] The relevant provisions of section 160 of the Act are as follows:

Digitized by Google

…
[17] For the reasons cited by Counsel for the Respondent and analyzed at paragraphs 12 to 14 above, I believe that the tax debt of 6421 was not extinguished at the relevant moment. In fact, the assessment under section 160 may be made at any time and is thus not subject to a time limit. With regard to the conditions under which section 160 is applicable, the only condition that applies here was the existence of a debt owed by the transferor to the Crown and, since the relevant moment for determining whether such a tax debt existed is the date of transfer – here less than two years after the creation of the tax debt, - this date is not
extinguished as a result of a time limit. Consequently, the Minister's assessment is well founded and it is not necessary to comment on the subsidiary argument of Counsel for the Respondent.
[18] With regard to the subsidiary argument of Ms. Bleau, based on the concept of joint and several liability and on the modes of extinction set out in the Civil Code, also seems to me ill founded. In fact, in order to apply the provisions of the Civil Code, such application must be in accordance with the requirements of section 8.1 of the *Interpretation Act.* Its rules must be used in applying the Act and there must be no rule of law that militates against it. This section stipulates the following:
8.1 Both the common law and the civil law are equally authoritative and recognized sources of the law of property and civil rights in Canada and, unless otherwise provided by law, if in interpreting an enactment it is necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights, reference must be made to the rules, principles and concepts in force in the province at the time the enactment is being applied.
[My emphasis.]
[19] I see nothing here that might indicate the need to revert to the concept of solidarity found in the Civil Code or to the causes of extinction provided for under articles 1531 and 1671 of the Civil Code. On the contrary, section 160 of the Act, in my view, provides a complete code of rules regarding the liability of a transferee of a good in respect of the tax debt of the transferor. The amount in respect of which a transferee may be held liable is calculated on the basis of paragraph 160(1)(*e*) of the Act. Subsection 160(3) of the Act describes the circumstances under which the obligation of the transferee to pay the tax debt of the transferor may be extinguished. Use of the provisions of the Civil Code would constitute an unjustified interference in the exercise of the powers conferred by the Act on the Minister to collect federal taxes.
[Footnotes omitted.]
[20] In support of this interpretation, there are these comments by Décary J.A. in *Heavyside*, at paragraphs 12 and 14:
12 There is no doubt that the husband's discharge from bankruptcy relieves him from paying the Minister the amount due by him under section 160 of the *Income Tax Act*; this is made clear by subsection 178(2) of the Bankruptcy Act. But the order of discharge does not extinguish the debt; it is personal to the husband and does not affect the liability of the respondent who is jointly bound.

Digitized by Google

As noted by Sarchuk T.C.J., in *Garland,* when referring to Section 179 of the Bankruptcy Act, it is clear that the Bankruptcy Act did not intend a person who was "jointly bound" with the bankrupt to be released by the discharge of the bankrupt. Unless a payment be made under the terms of subsection 160(3) of the Act, the transferee's liability remains, and a discharge under the Bankruptcy Act is simply not a payment under the terms of subsection 160(3).

...

14 To allow the Respondent to escape her tax liability in the present case because of her husband's discharge from bankruptcy would be to allow what Parliament precisely sought to prevent by the adoption of section 160.

[My emphasis.]

or Regulation or any portion of an Act or regulation" and the word "Act" has the meaning of an "Act of Parliament". Thus, the first condition is met.

[28] The second condition is that it must be necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights. For the purposes of defining "property and civil rights", it is important to remember that this phrase is found in subsection 92(13) of the *Constitution Act, 1867*, which specifies the classes of subjects in respect of which the legislature of each province may exclusively make laws. Professors Brun and Tremblay clarify the scope of subsection 92(13):

[TRANSLATION]

Subsection 92(13) legitimizes the greater part of what is considered civil law in Quebec and is traditionally included in the Civil Code. In the other provinces, the corresponding matters within the common law system also come under provincial jurisdiction.

...

[30] The third condition requires that there should be no "law" precluding reference to the rules, principles and concepts forming part of the law of property and civil rights. The expression used is "unless otherwise provided by law". Molot elucidates the scope of this condition:

... In the case of cl. 8.1, there appear to be two point [*sic*] in the interpretive process where a federal enactment could "otherwise provide". Federal legislation may make it "unnecessary to refer" to provincial private law principles, or may express an intention that reference not be made to rules, etc. of the province concerned. For example, such legislation could so comprehensively define its terms as to implicitly exclude any reference to provincial private law as the external source of interpretation and application. Federal legislation could also expressly refer to some other external source of interpretation thereby demonstrating a contrary intent as regards it being "necessary to refer to a province's rules … " [Emphasis added.]

Mortgage Payments – A Classic Transfer

When a tax debtor makes a payment towards another's mortgage it has been held as a transfer for purposes of s. 160. This was the case in the appeal case of Medland

Digitized by Google

v. The Queen[156] where it was held, on appeal from the TCC that:

> [3] The applicant and her husband, Mr. John Medland, purchased a house in 1985 as joint tenants. The purchase was financed in part by way of a mortgage loan from the Toronto Dominion Bank. They were joint mortgagors. The mortgage, which was renewed a number of times, was secured by the property. On April 8, 1987, the applicant and her husband, as joint tenants, transferred the property to the applicant alone without any consideration being given. The husband then, alone, made all payments on the mortgage for a total sum of $39,979.74. The mortgage payments were made by Mr. Medland issuing cheques to the Toronto Dominion Bank from his personal and business accounts and directing that the funds from those cheques be used to make the mortgage payments. On June 10, 1994, the Minister assessed the applicant $38,857.48 pursuant to section 160 of the *Income Tax Act* representing the lesser of (a) Mr. Medland's unpaid liability under the *Income Tax Act* of British Columbia and section 36 of the *Canada Pension Plan*, and (b) the value of property allegedly transferred by Mr. Medland to the applicant. The applicant objected to the assessment. The Minister later reassessed the applicant thereby reducing the amount assessed to $15,219.56 on the basis that the value of the property allegedly transferred to the applicant was not more than the sum of the mortgage payments attributable to the principal, namely $13,321.69 plus $1,897.87 in interest. Mr. Medland is indebted to the Minister in excess of $49,000 as of June 10, 1994, in respect of his 1990, 1991, 1992 and 1993 taxation years, of which $24,288.83 was in respect of federal taxes.
>
> The decision under review
>
> [4] Before the Tax Court judge, the applicant submitted that her husband never transferred property to her, either directly or indirectly, pursuant to subsection 160(1) of the *Income Tax Act*. The mortgage payments were made directly to the Bank. Mr. Medland, she said, paid his own liability to the Bank. Following the transfer by the applicant and her husband of the property to the applicant alone on April 8, 1987, Mr. Medland remained fully liable to the Bank. His liability under the mortgage in question was joint and several with that of the applicant. Thus, she argued, there was no indirect transfer of property. If a benefit was conferred on the applicant, it was not covered by subsection 160(1) of the *Income Tax Act*.
>
> [5] The Tax Court judge made the following observations:
>
> It is apparent that section 160 of the *Income Tax Act* is directed only at transfers of property. This section is not aimed at the conferral of benefits, as correctly pointed out by Counsel for the Appellant. In this regard, section 160 is unlike subsection 15(1) of the Act which requires the inclusion in a shareholder's income of any benefit he may receive from the corporation of which he is a shareholder. Section 160 deals with transfers of property like the present sections 74.1 and 74.2 which set out the attribution rules. The wording relating to the circumstances which trigger the application of section 160 is similar to some extent to the language used in sections 74.1 and 74.2 of the *Income Tax Act*.

---

[156] A-18-97

Digitized by Google

Having regard to the foregoing observations respecting the Appellant's rights in the subject property and the ambit of section 160 of the *Income Tax Act*, I do not agree with the proposition advanced by the Appellant that a reduction in the Appellant's liability under the mortgage to the extent of $13,321.69 as a direct result of the payments made to the mortgagee by Mr. Medland does not constitute property. The examination of two hypothetical situations leads me to the conclusion that such reduction in the Appellant's liability amounts to an indirect transfer of property made by Mr. Medland to the Appellant.

[6] He proceeded to examine two hypothetical situations:

In the first situation, termed Example "A", I am assuming that Mr. Medland, instead of paying a little over $13,000 to the mortgage towards the principal of the mortgage, had made, with the agreement of the mortgagee, a balloon payment when he was indebted to the Government of Canada in respect of federal taxes and paid the full amount owing under the mortgage. In such an eventuality, there is no doubt that this payment would have constituted a transfer of property because the Appellant would have acquired the right to redeem the property because a "right of whatever kind" is property, according to the definition of the term "property" in section 248 of the *Income Tax Act*.

One can imagine another case, which I describe as Example "B", where a person in Mr. Medland's situation would have made just a few regular payments to the mortgagee, which payments happen to represent the last payments to be made under the mortgage. On this assumption, an individual like the Appellant would be entitled to redeem the property and would be left with an unhampered fee simple if, of course, there was no other encumbrance on the property. Again the right to redeem the mortgage would constitute property within the meaning of section 248 of the *Income Tax Act*, as I have just explained.

I don't see between Examples "A" and "B" on the one hand and the present case on the other hand any substantial difference. In each of these two examples, the situation is simply more apparent, more conspicuous because the right to redeem property and to secure full title is undoubtedly property having regard to the wide import of the term "property" in section 248 of the Act. It would be highly artificial, if not absurd, to conclude on the one hand that in Examples "A" and "B" the payments in question involve the transfer of property and on the other hand assert that the making of regular payments do not happen to include the last payment which gives rise to the right to redeem the property. Such a result would be clearly unintended.

[7] He then concluded:

The matter can be looked at in a very simple fashion. If Mr. Medland had made the regular payments directly to his wife out of his own moneys and if his wife had each time immediately thereafter, used these moneys to make payments directly to the mortgagee it could not be challenged that these payments would constitute a direct transfer of property to his wife. Mr. Medland, instead of making the regular payments owing under the mortgage to his wife, made them to the mortgagee at a time where his wife was the sole owner of equity of redemption. This in my view, constitutes an indirect transfer of

Digitized by Google

property.
Looking at the overall situation, I am persuaded that the regular payments made by Mr. Medland to the mortgagee when the Appellant was the sole owner of the equity of redemption had a dual effect from the standpoint of Mr. Medland and the Appellant: a) Mr. Medland paid his own liability under the mortgage and b) Mr. Medland transferred property indirectly to his wife with respect to the portion of the payments that related to the principal of the mortgage. These two results are inextricably linked. In my view, the Appellant in submitting that Mr. Medland simply satisfied his own liability by making these payments is ignoring an important aspect of the situation, the other side of the coin, so to speak. There was a transfer of economic interest involving the equity of redemption in favour of his wife, as in the *Kieboom* decision.
I am therefore of the view that Mr. Medland had transferred property during the relevant period to the Appellant in an indirect way within the purview of section 160 of the *Income Tax Act*. Consequently, the assessment made by the Minister of National Revenue in respect of this transfer of property is confirmed.
The applicant's submission
[8] In essence, the applicant submits that, given that she provided no consideration to Mr. Medland in exchange for his making the payments under the mortgage, subsection 160(1) of the *Income Tax Act* could only apply if Mr. Medland "transferred property either directly or indirectly "to her" by means of a trust or by any other means whatever". This, she says, did not happen.
[9] The applicant accepts the proposition that the more Mr. Medland made payments on the mortgage, the less indebted she found herself towards the mortgagee. She argues, however, that a reduction in the applicant's liability under the mortgage does not constitute "property" being transferred, even if the word "property" is of wide import.[3] A reduction in the applicant's liability is a result, or an event, but is not a property being transferred. She submits that in order for a "transfer" to occur, Mr. Medland must have had divested himself of a particular property and that same property, under the decision of *Fasken Estate v. M.N.R.*,[4] must have become vested in the applicant.
Mr. Medland divested himself of money (something included in the word "property") but he made his payments directly to the mortgagee and not to the applicant.
[10] She submits that at all material times after April 8, 1987, the date upon which Mr. Medland transferred his interest in the property to her, she was the sole owner of the equity of redemption.[5] The Tax Court judge erred, she says, when he stated, in both of his hypothetical situations, that the equity of redemption would have passed to her had a balloon payment or the last payment of the mortgage been
made by the husband. The Tax Court judge was also in error, she claims, when he calculated that, by making the principal payments, "[t]here was a transfer of economic interest involving the equity of redemption in favour of his wife, as in the *Kieboom*[6] decision". In that decision, she says, the transferor

Digitized by Google

therein owned a
specific portion or percentage of the "equity" of a corporation which he transferred to his spouse and children by compelling the corporation to issue some common shares to them, thereby diluting his interest in the corporation.

[11] In the present case, she says, when Mr. Medland divested himself of money by making the payments, the net value of the equity of redemption of the applicant in the house increased by the amount of the principal payments. That net value is expressed in money but is not money in itself. Had Parliament intended subsection 160(1) of the *Income Tax Act* to apply to the facts in issue, the word "amount" defined in subsection 248(1) of the *Income Tax Act* which includes "the value in

terms of money of the right or thing",[7] would have been used in subsection 160(1) instead of the word "property".

[12] In any event, she says, even if Mr. Medland made the payments on her behalf, that situation is not caught by subsection 160(1) of the *Income Tax Act*. The words "on behalf of" his spouse are not found in that section as they are found in paragraph 224(1.1)(b) of the Act. While it is clear that the applicant benefitted from Mr. Medland making the principal payments, she claims that conferring a benefit does not come within the purview of subsection 160(1) of the Act. Such language is to be found in subsections 15(1) and 74.1(1), but not in subsection 160(1).

Analysis

[13] As a preliminary comment, the respondent does not dispute the applicant's proposition that no "right to redeem the property" was transferred to the applicant as a direct consequence of the mortgage payments made by her spouse on the debt owing under the mortgage. That right existed earlier when she became the sole owner of the property. Perhaps, the first judge confused the "equity of redemption" and the "right to redeem" with the concept of "equity" itself. This should not deter us, however, from recognizing the correct direction he gave to this case.

[14] It is not disputed that the tax policy embodied in, or the object and spirit of subsection 160(1), is to prevent a taxpayer from transferring his property to his spouse in order to thwart the Minister's efforts to collect the money which is owned to him.[8] The issue turns, however, on the proper

meaning to be given to the terms used in subsection 160(1) of the Act, namely whether Mr. Medland "transferred property... indirectly by any other means" to his wife.

[15] In my view, the Tax Court judge was correct when he concluded that the applicant's spouse transferred property indirectly to the applicant to the extent of the portion of the mortgage payments that related to the principal of the mortgage.

[16] The word "property" in subsection 160(1) of the Act, which is defined as meaning "property of any kind", including "money", has been described by Lord Langdale[9] as "the most comprehensive of all the terms which can be used inasmuch as it is indicative and descriptive of every possible

Digitized by Google

interest which the party can have".

[17] The word "transfer" is not defined in the Act. It was commented upon in the *Estate of David Fasken v. M.N.R.*[10] by President Thorson of the Exchequer Court of Canada in the following terms:

The word "transfer" is not a term of art and has not a technical meaning. It is not necessary to a transfer of property from a husband to his wife that it should be made in any particular form or that it should be made directly. All that is required is that the husband should so deal with the property as to divest himself of it and vest it in his wife, that is to say, pass the property from himself to her. The means by which he accomplishes this result, whether direct or circuitous, may properly be called a transfer. The plain fact in the present case is that the property to which Mrs. Fasken became entitled under the declaration of trust, namely, the right to receive a portion of the interest on the indebtedness, passed to her from her husband who had previously owned the whole of the indebtedness out of which the right to receive a specified portion of the interest on it was carved. If David Fasken had conveyed this piece of property directly to his wife by a deed such conveyance would clearly have been a transfer. The fact that he brought about the same result by indirect or circuitous means, such as the novation referred to by counsel involving the intervention of trustees, cannot change the essential character of the fact that he caused property which had previously belonged to him to pass to his wife. In my opinion, there was a transfer of property from David Fasken to his wife within the meaning of the Act.

[18] The circumstances of that case ought not to be forgotten. The taxpayer had bought a farm in Texas by means of a corporation of which he originally owned nearly all the shares. The title to the farm was vested in the company subject to a lien indebtedness in his favour for the unpaid purchase price. In 1920, he transferred his shares to his son and was never, thereafter, a shareholder, director or officer of the company. He did, however, retain his rights against the company in respect of the unpaid purchase price of the farm and other advances. In 1924, the company executed an acknowledgement of indebtedness in favour of three trustees, one of them representing the wife of the taxpayer. What Mrs. Fasken became entitled to, under the declaration of trust, was the right to receive a portion of the interest on the indebtedness passed on to her from her husband who had previously owned the whole of the indebtedness out of which her right to receive a portion of the interest had been carved.

[19] By applying the phrases "transfer... of property..." of subsection 41(4) of the *Income Tax Act* of 1917 to that situation, Thorson P. indicated, in effect, that, contrary to the submission of the applicant in the case at bar, it is not necessary that, when a husband divest himself of a particular property, that same property must have become vested in his spouse.

[20] The words "indirectly... by... any other means" in subsection 160(1) of the Act refer to any circuitous way in which property of any kind passes from one person to another. In the case at bar, when Mr. Medland made the payments to

Digitized by Google

the mortgagee, he specified that such money was to be attributed in diminution of the mortgage on the property on which he had no more interest. While it is true that subsection 160(1) of the Act does not contain the words "for the benefit of" or "on behalf of" as found in subsections 15(1) or 74.1(1) or paragraph 224(1.1)(b) of the Act, the applicant does not deny that she became less indebted by the payments and her equity in the property increased. The means by which this result occurred were monies paid to the Bank which was then transferred by the Bank on the account of the mortgage of a house owned solely by the applicant. The payment to the Bank was simply a conduit through which the funds passed indirectly from her husband to her.

[21] The applicant's submission, that no transfer of property occurred because what Mr. Medland divested himself was money which monies were never transferred [physically] to the applicant, is without merit. The present scheme, although different from that in *Her Majesty the Queen v. Kieboom* and *White (D.P.) v. Canada* amounts to the same thing.

[22] I would dismiss this application for judicial review.

"Alice Desjardins"

J.A.

"I agree

Barry L. Strayer, J.A."

"I agree

F. Joseph McDonald, J.A." [See case for numerous footnotes]

Consideration for Shared Living Expenses

Can an argument be made for transfers of consideration to reimburse for shared living expenses towards the household, and thus, for fair market value, thus exempting it from collection focus?

REASONS FOR JUDGMENT

DESJARDINS J.A.

[1] It is my view that the appeal should be dismissed. My reasons for this conclusion are the following.

[2] The facts are not in dispute. In brief, Mr. Yates had an outstanding tax liability, at all relevant times, in excess of $485,000. On December 23, 2002, he released his joint interest in two bank accounts for amounts of $4,972.30 and $2,406.45 in favour of his wife, the appellant. Also, as of December 23, 2002, and throughout 2003, Mr. Yates deposited his paycheques for a total amount of $54,406.20 in a bank account owned by his wife. This account had been used by both to pay their household expenses for many years prior to December 23, 2002. The appellant customarily took care of these expenditures. Between December 23, 2002, and October 31, 2003, the total household expenses set out by the appellant amounted to a total of $151,248.08. Mr. Yates filed for bankruptcy on February 16, 2004.

[3] The Minister issued three reassessments against Ms. Yates under subsection 160(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act) on September 12, 2004, for a total of $61,784.95.

[4] The Tax Court Judge whose judgment is reported as *Yates and Her*

Digitized by Google

Majesty the Queen, 2007 TCC 498, [2007] T.C.J. No. 328 (QL), found at paragraph 12 of his reasons that, of the four requirements which must be satisfied under subsection 160(1) of the Act, only the following two were in question, namely that:

a. there must be a transfer of property; and
b. there must be no or inadequate consideration flowing from the transfer to the transferor.

[5] The Tax Court Judge had no difficulty in concluding on the first point that there had been a transfer of property since Mr. Yates had divested himself of property, firstly by the removal of his name from the two joint accounts and, secondly, by the deposits of his paycheques into his wife's account. In doing so, he applied *Fasken Estate v. MNR*, [1948] Ex.C.R. 580, endorsed by this Court in *Medland v. Canada*, [1998] F.C.J. No. 708, at paragraph 14. His approach was consistent with the decision of this Court in *Livingston v. Canada*, 2008 FCA 89, at paragraph 21, where it was held that "The deposit of funds into another person's account constitutes a transfer of property".

[6] The more difficult issue was whether Ms. Yates had given consideration for these transfers.

[7] The Tax Court Judge explained at paragraph 16 of his reasons:

> The more difficult issue is whether there was consideration rendered by the Appellant for these transfers from Mr. Yates. This boils down to whether these transfers were merely his satisfying his legal obligation to support his wife and family. If so, then the payments in certain restricted circumstances are not subject to section 160 liability. To find in the Appellant's favour, I must find there was adequate consideration flowing from her to Mr. Yates. I agree with the Appellant that there is a legal obligation for support under the *Family Law Act* of Ontario. The greatest disparity between the submission of counsel for the Appellant and the present case law is latitude given to the legal obligation.

[8] He further explained at paragraph 19 of his reasons.

> I accept the second approach to the effect that certain limited payments made for some household expenses by a spouse, who is obligated to support his or her family, are not subject to subsection 160(1). I believe these expenditures should be for daily living necessities as opposed to permitting an accustomed lavish standard of living. The Appellant cited the following cases which support this: Michaud v. Canada, Ferracuti v. Canada, Laframboise v. Canada and Ducharme v. Canada.

[9] He reviewed the line of cases cited by the appellant and stated at paragraph 29 of his reasons:

> I agree that the function of this Court under section 160 is not to parse a taxpayer's grocery bills in order to determine which food items are reasonable and which are not. Each case must be considered on its own merits. The Court must examine the evidence of the taxpayer with respect to household expenditures to

Digitized by Google

> determine which expenses, if any, are the vital household expenses that may be excluded from the reach of section 160. I say this because section 160 is a far-reaching collection tool in the Act. It has been described as draconian and Parliament drafted it as such. Accordingly, the exceptions to the reach of this section are narrow. In Ferracuti, I attempted to determine which expenditures were made in satisfaction of the person's legal obligation to support his family.

[10] The Tax Court Judge concluded that the expenditures made in the case at bar were not the vital household expenses envisaged in the above line of cases. They went beyond the expenditures permitted in satisfaction of a person's legal obligation to support his family. He consequently dismissed the appeals of Ms. Yates against the Minister's reassessments.

[11] The appellant claims that the Tax Court Judge, although recognizing that at least some payments made by a spouse towards supporting his or her family were beyond the reach of subsection 160(1) of the Act, erred by failing to consider or articulate an appropriate framework for determining the appropriate quantum of such payments. He should, submits the appellant, have adopted an approach consistent with the jurisprudence developed in connection with family law for the determination of support. Indeed, subsection 160(4) of the Act expressly exempts from capture any payments made on account of support pursuant to a separation agreement or judgment of the court. Couples who remained married should be no worse off than those who have separated. Hence, says the appellant, the calculation of support payments should be guided by principles articulated in the family legislation in each province and in the *Divorce Act*, R.S.C. 1985, c. 3 (2nd Supp.).

[12] Section 160 of the Act is unquestionably a draconian measure. But the issue is whether a court of law is permitted to read in a taxation statute provisions that are inexistent in the legislation.

[13] The Court in *Medland* at paragraph 14 has explained the policy behind this provision in the following manner:

> It is not disputed that the tax policy embodied in, or the object and spirit of subsection 160(1), is to prevent a taxpayer from transferring his property to his spouse in order to thwart the Minister's efforts to collect the money which is owned [*sic*] to him.
> …

[14] Again, in *Wannan v. Canada* (2003 FCA 423) at paragraph 3, this Court recognized that "[s]ection 160 of the *Income Tax Act* is an important collection tool, because it thwarts attempts to move money or other property beyond the tax collector's reach by placing it in presumably friendly hands".

[15] In *Livingston*, this Court explained at paragraph 27 that "a transferee of property will be liable to the CRA to the extent that the fair market value of the consideration given for the property falls short of the fair market value of that property". The Court stated in the same paragraph that the "very purpose of subsection 160(1) is to preserve the value of the existing assets in the taxpayer for collection by the CRA".

Digitized by Google

[16] A reading of section 160 makes it clear that the only exception provided under the Act is that of subsection 160(4) of the Act.

[17] The line of cases illustrated by *Michaud v. Canada*. [1998] T.C.J. 908 (QL); *Ferracuti v. Canada*. [1998] T.C.J. No. 883 (QL); and *Laframboise v. Canada*, [2002] T.C.J. No. 628, which takes the position that payments made by one spouse to another in satisfaction of a legal obligation to support his or her family are beyond the reach of section 160, is not supported by the legislation.

[18] The respondent cited the decision of the Supreme Court of Canada in *Canada v. Addison & Leyen Ltd.*, 2007 SCC 33, [2007] S.C.J. No. 33 (QL) in support of a strict interpretation of section 160 of the Act. That case arose out of a dispute as to whether the Minister was barred from acting under section 160 of the Act, due to some limitation period.

[19] The Supreme Court of Canada held in that case that judicial review was not available because the Minister, under section 160 of the Act, could assess at any time since there was no limitation period provided. The Supreme Court of Canada indicated its preference for the minority view expressed in the court below, the Federal Court of Appeal, by Rothstein J.A. as he then was. At paragraph 9, the Supreme Court of Canada stated the following:

> Nevertheless, we find that judicial review was not available on the facts of this case. As Rothstein J.A. pointed out, the interpretation of s. 160 by the majority of the Federal Court of Appeal amounted to reading into that provision a limitation period that was simply not there. The Minister can reassess a taxpayer at any time. In the words of Rothstein J.A.:
>
> > While in the sense identified by the majority, subsection 160(1) may be considered a harsh collection remedy, it is also narrowly targeted. It only affects transfers of property to persons in specified relationships or capacities and only when the transfer is for less than fair market value. Having regard to the application of subsection 160(1) in specific and limited circumstances, Parliament's intent is not obscure. Parliament intended that the Minister be able to recover amounts transferred in these limited circumstances for the purpose of satisfying the tax liability of the primary taxpayer transferor. The circumstances of such transactions mak[e] it clear that Parliament intended that there be no applicable limitation period and no other condition on when the Minister might assess. [para. 92]
>
> [Emphasis added.]

Digitized by Google

[20] The words “no other condition” followed by the words “on when the Minister might assess” make it clear that the *Leyen* case is directed to the concept of a limitation period only. We are not dealing, in the case at bar, with a limitation period but with whether family obligations should be read in subsection 160(1) of the Act. The case does not assist the respondent in his demonstration that Parliament’s intent is to exclude family obligations from the purview of the legislation. The *Leyen* case cannot be read in such a manner.

[21] The appellant claims in his favour the decision of this Court in *Ducharme v. Canada* (2005 FCA 137), Rothstein J.A., as he then was, writing for the Court, relied essentially on a finding of fact of the Tax Court Judge. At the time, Mr. Vienneau, the common-law partner of Ms. Ducharme, paid the mortgage payments. As found by the Tax Court Judge, the rent for an equivalent (and apparently average) house in the area the couple was living in ranged two times the amount of money transferred by Mr. Vienneau to Ms. Ducharme. Rothstein J.A. felt a reasonable inference could be drawn from these facts, namely that Ms. Ducharme gave to Mr. Vienneau the availability and use of the house she owned in consideration for his payments on the mortgage. The amounts paid by Mr. Vienneau were considered tantamount to rent. Rothstein J.A. was careful to add that identifying the amounts paid by Mr. Vienneau as rent was not a re-characterization of the legal effects of transactions. It was simply a way of explaining that Mr. Vienneau received consideration equivalent to or greater than the amounts he transferred to Ms. Ducharme.

[22] Rothstein J.A. made it clear that in view of the conclusion he had arrived at, it was unnecessary to address Ms. Ducharme’s other arguments based on valuing domestic services or “domestic obligations” of spouses.

[23] The *Ducharme* case rests therefore on its own facts.

[24] For the same reason, I cannot agree with the respondent that Rothstein J.A. implicitly found that there was a legally enforceable agreement between Ms. Ducharme and Mr. Vienneau according to which each had promised to give the other something they did not already have under the British Columbia legislation which did not give common law spouses the right to use and enjoy the matrimonial home (*Family Relations Act* [R.S.B.C. 1996] c. 128).

[25] I find on the whole that it is for Parliament to articulate an appropriate framework that would give married couples the equal treatment the appellant wishes they should enjoy by comparison to those who come under the purview of subsection 160(4) of the Act.

[26] I would dismiss this appeal with costs.

“Alice Desjardins”

J.A.

NADON J.A (Concurring Reasons)

[27] I am entirely in agreement with the reasons which Desjardins J.A. gives in support of her view that the appeal cannot succeed. I wish only to elaborate on the following points.

[28] Mr. Yates transferred to his wife's account the sum of $61,784.95. The appellant says that in releasing his joint interest in two bank accounts in favour of his wife and in depositing his paycheques in a bank account owned by his wife,

Digitized by Google

Mr. Yates did not transfer property which falls within the purview of subsection 160(1) of the *Income Tax Act,* 1985, c.1 (5th supplement) (the "Act") and that, in any event, if there is a transfer within the purview of the subsection, adequate consideration was given for the transfer.

[29] In support of her argument that there was no transfer within the meaning of subsection 160(1), the appellant says that by reason of her husband's obligation pursuant to sections 30, 31 and 33 of the *Ontario Family Law Act*, R.S.O. 1990, c. F.3, to support his family, the deposits made to her account were for the purpose of paying household expenses and that she did pay such expenses, pointing out that the total household expenses during the period at issue exceeded the sum transferred to her by her husband.

[30] With respect to consideration, the appellant again says that her husband transferred money to her by reason of his legal obligation to support his family. She further says that Mr. Yates was allowed to use the matrimonial home during the time that he was making the payments. Thus, she submits that her husband received consideration equal to the funds transferred by him into her bank account.

[31] In my view, these submissions are without merit. As Desjardins J.A. makes clear in her Reasons (paragraph 5), only two of the four requirements to be met under subsection 160(1) are at issue in this appeal:

1. whether there is a transfer of property to a spouse and if so,
2. whether the spouse gave consideration amounting to fair market value.

[32] On the facts of the case before us, the answer can only be that there was a transfer and that no consideration at fair market value was given.

[33] At paragraph 47 of her memorandum of fact and law, the appellant summarizes her position as to why subsection 160(1) does not find application in the present matter:

a. the deposit of John Yates pay cheque net of deductions for tax does not constitute a transfer;
b. the payments made were made pursuant to Mr. Yates' obligation to support his family;
c. the Yates' family had significant living expenses during the relevant time that the payments were made that exceed the amount deposited;
d. thus, there was no "unjust enrichment" as contemplated by section 160 of the Act;
e. in the alternative and, in any event, the amounts paid were for living expenses that John Yates was duty bound to provide for his family;
f. in the further alternative, John Yates received consideration for the transfer in light of the fact that he enjoyed the use of the matrimonial home in exchange for the payments made; and
g. in the further alternative and, in any event, no tax was payable by John Yates at the time that the deposits were made.

Digitized by Google

[34] What the appellant is clearly asking us is, in my respectful view, to read subsection 160(1) as if the exception provided at subsection 160(4) applied to spouses who were not separated and living together. At paragraph 50 of the appellant's memorandum of fact and law the appellant clearly invokes the benefit of subsection 160(4):

> The appellant contends that the Court should adopt an approach consistent with the jurisprudence developed in connection with family law for the determination of support. Indeed, subsection 160(4) of the *Income Tax Act* expressly exempts from capture any payments made on account of support pursuant to a separation agreement or judgment of the court. Couples who remain married should be no worse off than couples that have separated when considering the effect of section 160.

[35] Subsection 160(1) is clear and unambiguous and the Act does not provide for any exception, other than the one found at subsection 160(4), i.e. that transfers made between spouses "separated and living apart" shall not render them liable under subsection 160(1) to "pay any amount with respect to any income from, or gain from the disposition of, the property so transferred or property substituted therefore, …". The provision also provides that for the purposes of paragraph 160(1)*(e)*, the fair market value of property transferred after February 15, 1984, shall be deemed to be nil.

[36] The question raised by the appellant is clearly a question of law which calls for review on a standard of correctness. In effect, what we have to decide in this appeal is whether a family law exception can be read into subsection 160(1).

[37] As my colleague Desjardins J.A. says at paragraph 13 of her Reasons, "section 160 of the Act is unquestionably a draconian measure. But the issue is whether a court of law is permitted to read in a taxation statute provisions that are inexistent in the legislation". The answer to that question is clearly a no.

[38] Whether Mrs. Yates spent the $61,784.95 transferred to her by her husband on holidays, personal items, groceries or other household expenditures is, in my respectful view, of no relevance to the determination of whether there was a transfer. Let us assume, for example, that Mr. Yates had given Mrs. Yates an automobile valued at $61,784.95. Let us also assume that on the day following the gift, Mrs. Yates sells the automobile for its full value and proceeds to defray household expenses with that money. Would we seriously entertain an argument that the gift of the automobile does not constitute a transfer because the monies resulting from its sale served to defray the family's living expenses? I suspect that we would have no difficulty in dismissing such an argument.

[39] Consequently, I see absolutely no basis for the appellant's argument that the nature of the expenses incurred with the money transferred to her by her husband is a relevant factor in determining whether she is subject to subsection 160(1) of the Act.

[40] The Judge correctly concluded that there had been a transfer by Mr. Yates to the appellant in the sum of $61,784.95. He then turned his attention to the issue of consideration, which he considered to be the more troublesome issue. He stated the issue as follows at paragraph 16:

Digitized by Google

> [16] … This boils down to whether these transfers were merely his satisfying his legal obligation to support his wife and family. If so, then the payments in certain restricted circumstances are not subject to section 160 liability. To find in the Appellant's favour, I must find there was adequate consideration flowing from her to Mr. Yates. I agree with the Appellant that there is a legal obligation for support under the Family Law Act of Ontario. The greatest disparity between the submission of counsel for the Appellant and the present case law is latitude given to the legal obligation.

[41] In my view, the Judge's approach is clearly in error. As I have already indicated, subsection 160(1) does not contain any ambiguity. If there is a transfer within the purview of the provision, then the transferee must satisfy the Court that he or she provided consideration at fair market value. In view of the wording of subsection 160(1), there is simply no basis for the position taken by the Judge.

[42] The Judge had to determine whether Mrs. Yates had provided consideration at fair market value and, in my view, on the record before him, it is clear that the appellant did not provide such consideration. The Judge reached this conclusion based upon the view that only those household expenses which could be considered as "vital household expenses" were beyond the reach of subsection 160(1). In my respectful view, that approach is clearly erroneous.

[43] To conclude, the appellant submits that she gave consideration at fair market value for the sums received from her husband. I see no evidence in the record to support that view. To make things perfectly clear, let me say that in allowing her husband to live in the family residence, the appellant did not provide consideration at fair market value. This is simply another attempt by Mrs. Yates to benefit from the exception found at subsection 160(4).

[44] I therefore agree that the appeal should be dismissed with costs.

"Marc Nadon"

J.A.

BLAIS J.A. (Concurring Reasons)

[45] I am in agreement with the disposition of this matter proposed by my colleague Desjardins J.A.; I am of the view that this appeal should be dismissed.

[46] This is an appeal from a decision of the Tax Court of Canada dated August 27, 2007 dismissing the appeals from reassessments made under section 160 of the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1 (the Act).

Relevant Facts

[47] John Yates, the appellant's husband was a tax debtor who owed the Minister of National Revenue (the Minister) more than $485,000. As of December 2002 and throughout 2003, while he was indebted to the Minister, he transferred money to his wife. The Minister assessed his wife, the appellant, under subsection 160(1) of the Act. The assessment concluded that the appellant should be jointly and severally liable for her husband's tax debt in an amount equivalent to the value of the transferred property. According to the Minister, the appellant is liable to pay $61,784 of her husband's income tax liability because there was a transfer from Mr. Yates to her without adequate consideration, pursuant to subsection 160(1). Mr. Yates filed a personal assignment in

Digitized by Google

bankruptcy in February 2004.

Decision Below

[48] The trial judge applied a correct test and reached the correct result in holding that John Yates' removal of his name from the joint bank accounts and deposits of his pay cheques into Debra Yates' account constituted transfers within meaning of subsection 160(1).

[49] The trial judge also decided that certain limited payments made for household expenses by John Yates to Debra Yates are not subject to section 160; specifically, at paragraph 29 of his judgment, he wrote:

> [29] …the Court must examine the evidence of the taxpayer with respect to household expenditures to determine which expenses, if any, are the vital household expenses that may be excluded from the reach of section 160. I say this because section 160 is a far-reaching collection tool in the Act. It has been described as draconian and Parliament drafted it as such. Accordingly, the exceptions to the reach of this section are narrow. In *Ferracuti*, I attempted to determine which expenditures were made in satisfaction of the person's legal obligation to support his family.

Applicable Legislation

[50] Subsections 160(1) and 160(4) read:

***Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1**	***Loi de l'impôt sur le revenu*, L.R.C. 1985 (5e supp.), c. 1**
160. (1) Where a person has, on or after May 1, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to	**160.** (1) Lorsqu'une personne a, depuis le 1er mai 1951, transféré des biens, directement ou indirectement, au moyen d'une fiducie ou de toute autre façon à l'une des personnes suivantes :
(*a*) the person's spouse or common-law partner or a person who has since become the person's spouse or common- law partner,	*a*) son époux ou conjoint de fait ou une personne devenue depuis son époux ou conjoint de fait;
(*b*) a person who was under 18 years of age, or	*b*) une personne qui était âgée de moins de 18 ans;
(*c*) a person with whom the person was not dealing at arm's length,	*c*) une personne avec laquelle elle avait un lien de dépendance,
the following rules apply:	les règles suivantes s'appliquent :
(*d*) the transferee and transferor are jointly and severally liable to pay a part of the transferor's tax under this Part for	*d*) le bénéficiaire et l'auteur du transfert sont

Digitized by Google

each taxation year equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of sections 74.1 to 75.1 of this Act and section 74 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, in respect of any income from, or gain from the disposition of, the property so transferred or property substituted therefor, and

(*e*) the transferee and transferor are jointly and severally liable to pay under this Act an amount equal to the lesser of

(i) the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property, and

(ii) the total of all amounts each of which is an amount that the transferor is liable to pay under this Act in or in respect of the taxation year in which the property was transferred or any preceding taxation year,

but nothing in this subsection shall be deemed

solidairement responsables du paiement d'une partie de l'impôt de l'auteur du transfert en vertu de la présente partie pour chaque année d'imposition égale à l'excédent de l'impôt pour l'année sur ce que cet impôt aurait été sans l'application des articles 74.1 à 75.1 de la présente loi et de l'article 74 de la *Loi de l'impôt sur le revenu*, chapitre 148 des Statuts révisés du Canada de 1952, à l'égard de tout revenu tiré des biens ainsi transférés ou des biens y substitués ou à l'égard de tout gain tiré de la disposition de tels biens;

e) le bénéficiaire et l'auteur du transfert sont solidairement responsables du paiement en vertu de la présente loi d'un montant égal au moins élevé des montants suivants :

(i) l'excédent éventuel de la juste valeur marchande des biens au moment du transfert sur la juste valeur marchande à ce moment de la contrepartie donnée pour le bien,

(ii) le total des montants dont chacun représente

Digitized by Google

to limit the liability of the transferor under any other provision of this Act.

un montant que l'auteur du transfert doit payer en vertu de la présente loi au cours de l'année d'imposition dans laquelle les biens ont été transférés ou d'une année d'imposition antérieure ou pour une de ces années;

aucune disposition du présent paragraphe n'est toutefois réputée limiter la responsabilité de l'auteur du transfert en vertu de quelque autre disposition de la présente loi.

(4) Notwithstanding subsection 160(1), where at any time a taxpayer has transferred property to the taxpayer's spouse or common-law partner pursuant to a decree, order or judgment of a competent tribunal or pursuant to a written separation agreement and, at that time, the taxpayer and the spouse or common-law partner were separated and living apart as a result of the breakdown of their marriage or common-law partnership, the following rules apply:

(*a*) in respect of property so transferred after February 15, 1984,

(i) the spouse or common-law partner shall not be liable under subsection 160(1) to pay any

(4) Malgré le paragraphe (1), lorsqu'un contribuable a transféré un bien à son époux ou conjoint de fait en vertu d'une ordonnance ou d'un jugement d'un tribunal compétent ou en vertu d'un accord écrit de séparation et que, au moment du transfert, le contribuable et son époux ou conjoint de fait vivaient séparément par suite de la rupture de leur mariage ou union de fait, les règles suivantes s'appliquent :

a) relativement à un bien ainsi transféré après le 15 février 1984:

(i) l'époux ou conjoint de fait ne peut être tenu, en vertu du paragraphe (1), de payer un montant relatif au revenu provenant du bien

Digitized by Google

amount with respect to any income from, or gain from the disposition of, the property so transferred or property substituted therefor, and

(ii) for the purposes of paragraph 160(1)(*e*), the fair market value of the property at the time it was transferred shall be deemed to be nil, and

(*b*) in respect of property so transferred before February 16, 1984, where the spouse common-law partner would, but for this paragraph, be liable to pay an amount under this Act by virtue of subsection 160(1), the spouse's or common-law partner's liability in respect of that amount shall be deemed to have been discharged on February 16, 1984,

but nothing in this subsection shall operate to reduce the taxpayer's liability under any other provision of this Act.

transféré ou du bien qui y est substitué ou un montant relatif au gain provenant de la disposition du bien transféré ou du bien qui y est substitué,

(ii) pour l'application de l'alinéa (1)*e*), la juste valeur marchande du bien au moment du transfert est réputée être nulle;

b) relativement à un bien ainsi transféré avant le 16 février 1984, lorsque l'époux ou conjoint de fait serait, sans le présent alinéa, tenu de payer un montant en application de la présente loi en vertu du paragraphe (1), il est réputé s'être acquitté de son obligation relativement à ce montant le 16 février 1984;

aucune disposition du présent paragraphe n'a toutefois pour effet de réduire les obligations du contribuable en vertu d'une autre disposition de la présente loi.

Issue

[51] In conducting the analysis as to whether a fair market value consideration for the property transferred was given, is the judge entitled to exclude some household expenses from the reach of subsection 160(1)?

Standard of Review

[52] The standard of review applicable depends on the nature of the question. *Housen v. Nikolaisen*, 2002 SCC 33, 2002 S.C.J. No. 31, [2002] 2 S.C.R. 235 (QL), teaches us that questions of law are generally reviewed on a

Digitized by Google

standard of correctness, while finding of fact or mixed fact and law will be set aside only if the trial judge has made an overriding and palpable error.

Analysis

[53] Pursuant to subsection 160(1), when a tax debtor transfers property to a non arm's length person, that person becomes jointly and severally liable with the tax debtor for the tax debt in an amount equal to the difference between the fair market value of the transferred property and the consideration given for the transferred property.

[54] There is nothing in subsection 160(1) that permits a court to excuse a spouse from liability where the conditions of the provision are met; in fact, there is no mention of a family law exception in this provision.

[55] Subsection 160(4) deals specifically with a transfer of property between spouses who are separated and living apart, which shows Parliament's intention to exempt specific transfers in a matrimonial context from the application of subsection 160(1). In my view, our case does not fall under this particular exemption.

[56] The trial judge erred in law by following the line of jurisprudence which concludes that certain limited payments made for household expenses by a spouse are not subject to section 160 (see Reasons for Judgment, paragraphs 19 and 29).

[57] The trial judge failed in this case to conduct the proper analysis as to whether John Yates was given fair market value consideration for the property that was transferred. In fact, he made a palpable and overriding error by concluding that the Court must examine the evidence of the taxpayer with respect to household expenditures to determine which expenses, if any, are the vital household expenses that may be excluded from the reach of section 160.

[58] In my view, there is no ambiguity in the reading of subsection 160(1); nevertheless, several decisions of the Tax Court of Canada have read a "family law exception" into it.

[59] In *Livingston v. Canada*, 2008 FCA 89, [2008] F.C.J. No. 360 (QL) (*Livingston*), Sexton J.A. held at paragraphs 27 and 28:

> 27. Under subsection 160(1), a transferee of property will be liable to the CRA to the extent that the fair market value of the consideration given for the property falls short of the fair market value of that property. The very purpose of subsection 160(1) is to preserve the value of the existing assets in the taxpayer for collection by the CRA. [...] However, subsection 160(1) will not apply where an amount equivalent in value to the original property transferred was given to the transferor at the time of transfer: that is, fair market value consideration. This is because after such a transaction, the CRA has not been prejudiced as a creditor. [...]
>
> 28. The Tax Court Judge erred in law by failing to conduct <u>any</u> analysis of the fair market value of the consideration. He simply concluded that it was "adequate." I fail to see how the fair market value of the consideration, if any did exist, would be equivalent to the funds deposited. [...] There was no evidence on which the Tax

Digitized by Google

> Court Judge could conclude that what was provided by the respondent was equal to the fair market value of the money put into the account.

In that case, my colleague Sexton J.A. made clear that the trial judge must conduct a proper analysis of the fair market value of the consideration.

[60] In *Medland v. Canada*, [1998] F.C.J. No. 708 (QL) (*Medland*), Desjardins J.A. held at paragraph 14:

> 14. It is not disputed that the tax policy embodied in, or the object and spirit of subsection 160(1), is to prevent a taxpayer from transferring his property to his spouse in order to thwart the Minister's efforts to collect the money which is owned to him. […]

[61] In *Wannan v. Canada*, 2003 FCA 423, [2003] F.C.J. No. 1693 (QL) (*Wannan*), Sharlow J.A. held at paragraph 3:

> 3. Section 160 of the Income Tax Act is an important tax collection tool, because it thwarts attempts to move money or other property beyond the tax collector's reach by placing it in presumably friendly hands. […]

[62] I have no hesitation in concluding that the narrow interpretation provided by the decisions in *Livingston*, *Medland* and *Wannan*, should be followed.

[63] A recent decision of the Supreme Court of Canada, *Canada v. Addison & Leyen Ltd.*, 2007 SCC 33, [2007] S.C.J. No. 33 (QL), favoured the dissenting reasons of Justice Rothstein of the Court of Appeal, (as he then was), with respect to subsection 160(1). The Supreme Court's decision reflects the narrow approach regarding Parliament's intent. At paragraph 9, the Supreme Court of Canada quoted Justice Rothstein:

> […] As Rothstein J.A. pointed out, the interpretation of s. 160 by the majority of the Federal Court of Appeal amounted to reading into that provision a limitation period that was simply not there. The Minister can reassess a taxpayer at any time. In the words of Rothstein J.A.:
>
> > While in the sense identified by the majority, subsection 160(1) may be considered a harsh collection remedy, it is also narrowly targeted. It only affects transfers of property to persons in specified relationships or capacities and only when the transfer is for less than fair market value.
> >
> > Having regard to the application of subsection 160(1) in specific and limited circumstances, Parliament's intent is not obscure. Parliament intended that the Minister be able to recover amounts transferred in these limited circumstances for the purpose of

Digitized by Google

> satisfying the tax liability of the primary taxpayer transferor. The circumstances of such transactions mak[e] it clear that Parliament intended that there be no applicable limitation period and no other condition on when the Minister might assess. [para. 92]
> [My emphasis]

[64] Even if Justice Rothstein's comment on section 160 refers to whether a limitation period should apply, he nevertheless mentioned that section 160 provides: "no other condition on when the Minister might assess". This again reflects the narrow approach followed so far by our Court, and I see no reason to depart from it.

[65] I believe that the approach taken by our Court in *Ducharme v. Canada*, 2005 FCA 137, [2005] F.C.J. No. 713 (QL), should be distinguished on the basis that the trial judge's conclusion was motivated by a very fact-specific situation with which Court of Appeal decided not to interfere.

[66] There is some confusion in jurisprudence since provincial legislation on family law regarding property, family definition, common law partners and matrimonial homes varies from one province to another. Nevertheless, subsection 160(1) should apply equally everywhere in Canada without exception apart from those specifically described in subsection 160(4).

Conclusion

[67] In my view, the trial judge arrived at the correct conclusion in dismissing the appeal but based his decision on some questionable reasoning. A plain language interpretation of subsection 160(1) does not allow for a family law exception, nor does it allow for an exception for household expenses. If Parliament had wanted to provide for such exemptions, it would have done so expressly. It is not for our Court to read these exemptions into the Act.

[68] Therefore, I would dismiss the appeal with costs.

"Pierre Blais"

J.A.

See also the TCC of Lynda Bernier v. The Queen 2010 TCC 85,where the court held with respect to Quebec mandatories:

> [1] By notice of assessment dated October 4, 2006, the Minister of National Revenue ("the Minister") claimed a payment of $29,298.99 from the Appellant under section 160 of the *Income Tax Act* ("the Act") in connection with a transfer of funds to the Appellant from her spouse on May 10, 2004. On that date, the Appellant deposited $81,869.42 into her account at the Caisse populaire Desjardins du Rivage et des Monts. This amount is equal to the amount of a cheque dated May 3, 2004, issued by the Commission de la santé et de la sécurité du travail (the Quebec workers' compensation board, hereinafter referred to as the CSST) to Richard Ouellet, the Appellant's spouse.
>
> [2] Earlier, on March 21, 2002, the Minister had issued reassessments against

Digitized by Google

the Appellant's spouse for his 1998 and 1999 taxation years such that, when the Appellant deposited the $81,869.42, her spouse owed money to the Minister. It was this debt that gave rise to the assessment against the Appellant. It should be noted that Richard Ouellet and the Appellant were married at the relevant time.

[3] At the outset of the hearing, the parties told the Court that there were in fact only two points at issue. The Appellant acknowledges that she and her spouse are related persons within the meaning of the Act, and that property was transferred at a time when the transferor owed money to the Minister. However, and this constitutes the first point at issue, she submits that there was consideration for the transfer. The second point raised by the Appellant is that the transferred amount is an income replacement benefit representing the capitalization of benefits, and that, since it is from the CSST, it is exempt from seizure regardless of whether it happens to be in Mr. Ouellet's hands or in the Appellant's.

[4] I must also determine whether certain evidence adduced by the Appellant is inadmissible by reason of irrelevance. The evidence in question includes Exhibit A-2, a statement of the household income and expenses of the Appellant, her spouse and their 28-year-old son who, for health reasons, is their dependant. The evidence in question also includes the testimonial evidence regarding the same subject. In fact, the matter of the relevance of this evidence was raised because of the recent decision of the Federal Court of Appeal in *Yates v. Canada*, 2009 FCA 50, in which it was held that subsection 160(1) of the Act contemplates no exceptions based on family law or domestic obligations. [5] It is true that evidence can be declared inadmissible by reason of irrelevance.

Such a declaration is all the more possible where the impugned evidence can easily be severed from the rest of the evidence. A decision that evidence is inadmissible is not always clear-cut, and, in most cases, it is more prudent to admit the evidence so that the judge who presides at the hearing can analyze it and determine its relevance in light of the issues that the judge will have to decide. In the case at bar, the evidence adduced by the Appellant is directly related to the basis of her argument. It is therefore important that the evidence be admitted so that the Appellant can substantiate her claims.

[6] In 1999, the Appellant's spouse sustained a serious injury while working as a lumberjack. He had also been a fisherman for a number of years, and his wife and son had worked with him in this activity. In fact, it was the tax on the sale of his fishing permit that gave rise to the tax liability that is the subject of the assessment in issue.

[7] The above-mentioned accident forced the Appellant's spouse to seek CSST benefits. Neither the Appellant nor the couple's son was working at the time. According to the Appellant's spouse, the $600 benefit paid every two weeks by the CSST was not enough to meet their needs. He and the Appellant therefore submitted to the CSST a benefit capitalization proposal with a view to investing the money in a restaurant. The CSST accepted the proposal and allowed the Appellant's spouse to capitalize six years' worth of benefit payments, from November 25, 2003, to November 24, 2009. The CSST thus paid him

Digitized by Google

$81,869.42.

[8] Owing to the effects of the work accident on her spouse, the Appellant handled and managed the family's finances. Therefore, she was the one who had to ensure — using the restaurant's revenues — that the home loan and auto loan were repaid and that all other family expenses were defrayed. The Appellant's spouse says that he gave the Appellant the money in question so that she could meet the family's financial obligations. She assumed responsibility for the family expenses.

[9] In her answers upon written examination for discovery, the Appellant explained, with great clarity, that the $81,869.42 was given to her by her spouse, that she invested the amount in a restaurant that constitutes their sole source of income, and that she had to use the restaurant revenues to cover all the family expenses and meet all the needs of her spouse related to his condition resulting from the work accident.

[10] The officer from the Canada Revenue Agency (CRA) who dealt with the Appellant's objection related a conversation that he had with the Appellant's representative. According to the officer, at no point in the conversation was it claimed that the Appellant was her spouse's mandatary, or that she had assumed his debts.

[11] Thus, the question to be determined is whether the transfer of the sum of money in question to the Appellant by her spouse was made for consideration or not. If I find that the transfer was not made for consideration, the question will be whether the transferred amount's being exempt from seizure prevents section 160 of the Act from applying here.

[12] The position of counsel for the Appellant is that since the amount is exempt from seizure by virtue of its being intended to provide the necessaries of life and by virtue of the Quebec *Act respecting industrial accidents and occupational diseases*, there was valid consideration, and thus, the facts of this case are different from those in *Yates*, above. The Appellant's assumption of the family obligations constitutes valid consideration, the value of which is even higher than that of the amount transferred, since the evidence clearly shows that five years' worth of family expenses add up to an amount greater than the amount transferred. This position is supported by a table of monthly income and expenditures, produced as Exhibit A-2.

According to *Hewett v. Canada*, [1997] F.C.J. No. 1541 (QL), contends counsel for the Appellant, the purpose of section 160 of the Act is to prevent taxpayers from divesting themselves of money that would otherwise be seizable by the Minister. Counsel further contends that the fact that the amount was deposited into an account does not cause them to lose their exemption from seizure: *D.(J.) v. J.(T.) et al.*, REJB 1998-08139. Moreover, argues counsel, the transfer is similar to the ones in *Canada v. Ducharme*, 2005 FCA 137 and *Tétreault v. The Queen*, 2004 TCC 332, and since it is a gift with concomitant obligations, there is adequate consideration.

[13] For his part, counsel for the Respondent relies on *Yates*, above, and argues that the only exception to section 160 is the one found in subsection 160(4) of the Act, which does not apply to this case. The decision in *Wannan v. Canada*,

Digitized by Google

2003 FCA 423, establishes that it matters little whether there is intent to help the transferor avoid the payment of tax. If the four criteria of section 160 are satisfied, the assessment is valid. According to the decision in *Yates*, the payments made by the transferee to meet family obligations are subject to section 160 of the Act because there is no exception for such obligations. As for whether the exemption of the money at issue from seizure can prevent section 160 from applying, counsel contends that the transfer of the money to the Appellant puts and end to the exemption from seizure, thereby making the Appellant liable for the tax debt. Moreover, the purpose of this appeal is to determine the validity of the assessment, not whether the money at issue is seizable, and so the argument regarding exemption from seizure is premature. According to counsel for the Respondent, exemptions from seizure under provincial law cannot be relied upon where federal law applies: *Marcoux v. Canada (Attorney General)*, 2001 FCA 92. Lastly, counsel argues, the exception conferring an exemption from seizure disappears at the time of transfer: see *Cox v. Canada*, [1995] T.C.J. No. 242 (QL), 96 DTC 1690.

[14] With respect to the first question, namely, whether, in the present case, there was consideration when the Appellant's spouse transferred the funds to her, it should be pointed out that, in *Yates*, above, the Federal Court of Appeal clearly established that the only exception contemplated by the Act is in subsection 160(4). At paragraph 17 of the decision, Justice Desjardins provides the following explanation:

The line of cases illustrated by *Michaud v. Canada*. [1998] T.C.J. 908 (QL); *Ferracuti v. Canada*. [1998] T.C.J. No. 883 (QL); and *Laframboise v. Canada*, [2002] T.C.J. No. 628, which takes the position that payments made by one spouse to another in satisfaction of a legal obligation to support his or her family are beyond the reach of section 160, is not supported by the legislation.

Justice Nadon adds the following, at paragraphs 35, 37, 38 and 39:

Subsection 160(1) is clear and unambiguous and the Act does not provide for any exception, other than the one found at subsection 160(4), i.e. that transfers made between spouses "separated and living apart" shall not render them liable under subsection 160(1) to "pay any amount with respect to any income from, or gain from the disposition of, the property so transferred or property substituted therefore [*sic*],

...". The provision also provides that for the purposes of paragraph 160(1)*(e)*, the fair market value of property transferred after February 15, 1984, shall be deemed to be nil.

. . .

As my colleague Desjardins J.A. says at paragraph 13 of her Reasons, "section 160 of the Act is unquestionably a draconian measure. But the issue is whether a court of law is permitted to read in a taxation statute provisions that are inexistent in the legislation". The answer to that question is clearly a no.

Whether Mrs. Yates spent the $61,784.95 transferred to her by her husband on holidays, personal items, groceries or other household expenditures is, in my respectful view, of no relevance to the determination of whether there was a transfer.

Digitized by Google

Let us assume, for example, that Mr. Yates had given Mrs. Yates an automobile valued at $61,784.95. Let us also assume that on the day following the gift, Mrs. Yates sells the automobile for its full value and proceeds to defray household expenses with that money. Would we seriously entertain an argument that the gift of the automobile does not constitute a transfer because the monies resulting from its sale served to defray the family's living expenses? I suspect that we would have no difficulty in dismissing such an argument.

Consequently, I see absolutely no basis for the appellant's argument that the nature of the expenses incurred with the money transferred to her by her husband is a relevant factor in determining whether she is subject to subsection 160(1) of the Act.

[15] Since that decision, there seems to be a general consensus that once the four criteria in section 160 have been met, there is no choice but to conclude that the assessment is valid. This Court's decisions in *Provost v. The Queen*, 2009 TCC 585, *Woodland v. The Queen*, 2009 TCC 434, *Allen v. The Queen*, 2009 TCC 426 and *Campbell v. The Queen*, 2009 TCC 431, acknowledge this principle, notwithstanding the *Ducharme* decision, above, in which Justice Rothstein, who was then on the Federal Court of Appeal, held that, given the facts of the case, it was reasonable to infer that there was consideration because the payment was tantamount to a payment of rent. However, Justice Rothstein did not consider the question of whether domestic service obligations can constitute consideration.

[16] The Court of Appeal in *Yates* could not have stated more clearly that purpose is of no importance in determining whether a transfer has taken place. Here, the transfer was done to enable the Appellant to invest the funds in a restaurant that would generate income to meet the family's needs. Thus, it was the Appellant who alone took on the management of the funds. To support the argument that there was no transfer there would have to have been a mandate in contemplation of incapacity or a similar document. Consequently, all the criteria of section 160 have been met and the assessment is valid.

[17] The question now is whether the money in issue is exempt from seizure such that section 160 does not apply. Assuming that the amount transferred by the Appellant's spouse is exempt from seizure, can section 160 apply nonetheless, thereby making the Appellant liable for the transferor's tax debt? This question arises because of the object of section 160 of the Act, which, as described by Justice Strayer in *Hewett*, above, is to prevent taxpayers from avoiding payment of their taxes by transferring their assets to relatives.

[18] In *Yates*, Justice Desjardins provided an overview of the decisions that deal with the object of section 160 and with Parliament's intent. I shall reproduce paragraphs 13-15 of her reasons for judgment:

The Court in *Medland* at paragraph 14 has explained the policy behind this provision in the following manner:

It is not disputed that the tax policy embodied in, or the object and spirit of subsection 160(1), is to prevent a taxpayer from transferring his property to his spouse in order to thwart the Minister's efforts to collect the money which is owned [*sic*] to him. ...

Digitized by Google

Again, in *Wannan v. Canada* (2003 FCA 423) at paragraph 3, this Court recognized that "[s]ection 160 of the *Income Tax Act* is an important collection tool, because it thwarts attempts to move money or other property beyond the tax collector's reach by placing it in presumably friendly hands".

In *Livingston*, this Court explained at paragraph 27 that "a transferee of property will be liable to the CRA to the extent that the fair market value of the consideration given for the property falls short of the fair market value of that property". The Court stated in the same paragraph that the "very purpose of subsection 160(1) is to preserve the value of the existing assets in the taxpayer for collection by the CRA".

[19] In my opinion, once the transferee's tax liability is triggered by section 160, the CRA is not limited to recovering the property transferred by the transferor. All the transferee's assets are within the CRA's reach and their availability for seizure, should the case arise, has nothing to do with the transferee's tax liability under section 160 of the Act.

[20] That said, I now return to the question of whether the transfer of property exempt from seizure can render section 160 inapplicable because the Respondent cannot claim that the transferor avoided his tax obligations by transferring the property when that property was beyond the CRA's grasp in any event.

[21] Assuming that the answer to that question is affirmative, we must determine what money the CRA cannot seize. In *Bourgoin c. Bouchard*, 2008 QCCQ 7141, the Court of Québec (Civil Division) made the following statement regarding disability benefits:

[TRANSLATION]

This exemption from seizure results from the fact that the benefits will be used to cover Mr. Bouchard's essential needs resulting from an illness that prevents him from working and that the benefits must accordingly be regarded as being in the nature of support.

[22] However, exemption from seizure is not always assured. In *Les sûretés réelles au Québec*, Jacques Deslauriers writes:

[TRANSLATION]

In order to avail oneself of this exemption from seizure, the amounts in question cannot have been commingled with other, seizable, money. An example of such commingling would be a deposit into the debtor's general or consolidated bank account. Normally, unless an exception provided for by statute or in the case law applies, these amounts must remain identifiable. . . . It should be noted that, in certain cases — involving CSST, employment insurance and Quebec Pension Plan benefits, for example — the courts have allowed the amounts to remain exempt from seizure even though they had been deposited into the debtor's general account. In such instances, the nature of the funds in the accounts suggested that all the deposits therein were for the purpose of meeting living expenses.

[23] Justice Béliveau of the Quebec Superior Court, in *D.(J.) c. J.(T.)*, above, confirmed that even if unseizable money is commingled with seizable money, the unseizable money does not necessarily lose its unseizable status. At

Digitized by Google

paragraph 47 of his decision, he stated that amounts paid by the CSST retain their unseizable nature, even when the amounts are in the hands of the person who receives the money.

[24] However, this exemption from seizure is not ironclad. In *Canada c. Bruyère*, 2009 QCCA 2246, the Quebec Court of Appeal allowed the Department of Human Resources to recover overpayments of employment insurance benefits on the basis of subsection 126(4) of the *Employment Insurance Act*, which provides that where a person owes money to a debtor of the Department, that person can be required to pay directly to the Department any amounts payable by the person to the person's creditor. Accordingly, the Department seized money that the CSST was to pay the respondent, Mr. Bruyère. It did so despite section 144 of the *Act respecting industrial accidents and occupational diseases*. Paragraph 7 of the decision states:

[TRANSLATION]

Where, in exercising its legislative jurisdiction, the Parliament of Canada wishes to subject an enforcement measure to a provincially-enacted exemption from seizure, it may do so. This is what Parliament did, for example, in subsection 225(5) of the *Income Tax Act* (ITA), whose counterpart is subsection 126(2) of the EIA. In this case, however, the enforcement measure set out in subsection 126(4) of the EIA, like the one set out in section 224 of the ITA, is not subject to any such restriction. The inference that must therefore be drawn is that there is a conflict of intent between subsection 126(4) of the EIA and section 144 of the *Act respecting industrial accidents and occupational diseases* (LATMP), since the latter provision effectively neutralizes a rapid procedure for recovery that the EIA authorizes the Employment Insurance Commission to use. To this extent, section 144 of the LATMP frustrates Parliament's intent and is inapplicable where the Employment Insurance Commission sends the CSST the notice referred to in subsection 126(4) of the EIA.

[25] This principle was also endorsed by the Federal Court of Appeal in *Marcoux v. Canada*, 2001 FCA 92.

[26] Some writers have expressed their opinion regarding the CRA's powers in cases involving exemptions from seizure. In an article entitled "La protection des revenus de retraite : où en sommes nous?" (in the *Cours de perfectionnement du notariat*, a continuing education program for Quebec notaries), Lucie Quesnel writes that unseizability clauses in provincial legislation are not binding on the federal government when it comes to recovering tax debts. At paragraphs 21, 22 and 23, she states the following:

[TRANSLATION]

By enacting subsection 224(1.2) of the *Income Tax Act*, Parliament has given itself an important tool to ensure that tax debts are collected.

. . .

As we can see, Parliament's intention is for tax debts to have priority over all others. In this regard, Louis Rabeau wrote:

[TRANSLATION]

Revenue Canada maintains that non-seizability, in its broad sense, cannot be

Digitized by Google

invoked against it: since section 224 of the *Income Tax Act* does not state that the rules regarding exemption from seizure can be set up against the federal Crown, non-seizability cannot be invoked against Revenue Canada. It should be specified that this principle applies to all proceeds that are exempt from seizure: RRSPs, pension funds, benefits from the Société de l'assurance automobile du Québec, Quebec Pension Plan payments, etc.

Roger P. Simard states the following: [TRANSLATION]

It must be noted that, apart from contexts governed by the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended ("the BIA"), the federal Crown is not bound by provincial grounds of exemption from seizure. Thus is may, through an administrative garnishment mechanism, intercept monthly pension payments and other amounts that might become payable under the contract, though such garnishment does not appear to allow it to exercise the right of withdrawal that the taxpayer might have under the contract.

[27] It would seem that, in view of the decision in *Bruyère* and the foregoing excerpts from scholarly writings, one can conclude that amounts paid by the CSST can be seized by the Minister of National Revenue, and thus, the application of section 160 of the Act would not be jeopardized by a transfer of unseizable property.

[28] It should be remembered, moreover, that, in *Yates*, the Federal Court of Appeal clearly held that nothing in subsection 160(1) of the Act enables a court to release a spouse from the tax liability imposed by section 160 if all the requisite conditions are met, since there is no ambiguity in subsection 160(1) of the Act. The exemption of the transferred property from seizure has no effect on the application of subsection 160(1).

[29] Since the Appellant's liability with respect to her spouse's tax debt has now been established, the question whether the amounts paid to him are exempt from seizure is not within this Court's jurisdiction to decide. [30] The appeal is dismissed, with costs.

Signed at Ottawa, Canada, this 12th day of February 2010. "François Angers"

Angers J.

See also Diana De Sanctis-Pedro, and Adamo De Sanctis, v. The Queen, 2010 TCC 118, where it was opined:

[1] The Appellants appeal from assessments under section 160 of the *Income Tax Act (*the *"Act")*.

[2] The Appellants are, respectively, the daughter and son of Anthony De Sanctis. The three are therefore 'related persons' within the meaning of subsection 251(2) of the *Act* and are deemed by paragraph 251(1)(*a*) of the *Act* not to deal with each other at arm's length.

[3] On May 31, 2001, a house which was owned by Anthony De Sanctis and in which he had lived with his son and daughter, was sold. The cash payable by the purchaser on closing was $27,824.10.

[4] On the same day, a condominium residence was purchased using the $27,824.10 cash proceeds from the sale of the house. Title to the condominium was conveyed not to Anthony De Sanctis but rather to the Appellants. It was

Digitized by Google

used by Anthony De Sanctis and his children as a residence.

[5] At the time of the transactions, Anthony De Sanctis was liable to pay more than $69,000.00 under the *Act*.

[6] On February 14, 2008, the Minister of National Revenue assessed the Appellants under section 160 of the *Act* in respect of the transfer of the cash. Each assessment was for $27,824.10. It is those assessments which are under appeal. The appeals were heard together on common evidence.

[7] Counsel for the Respondent conceded at the commencement of the hearing that the liability of the Appellants under section 160 could not exceed $13,912.05 each, and that judgment should issue accordingly.

[8] Section 160 of the *Act* provides in part:

[9] The Appellants did not lead any evidence to prove that Anthony De Sanctis did not transfer the net proceeds from the sale of his house to them as had been found by the Minister on assessment. The essence of the position taken by the Appellants at the hearing was that they gave consideration to their father for the transfer of the money. Paragraphs 2 and 3 of the Notices of Appeal read:

The family income was low throughout the living arrangements in the house and the condominium. To keep the family afloat, the father and the children made a contractual arrangement such that the children would pay for their living expenses including mortgage payment contributions, hence providing consideration for their vital living arrangement.

The enforceable legal agreement enabling the father in part to pay the mortgage and vital expenses from the child's contribution and own expense, amounts to an arm's length relationship disengaging the potential for applying s. 160(1). That section applies only in relationships where there is a tax benefit intended to be obtained by passing the benefit on to a relative with no consideration for such transfer of benefit.

[10] The Appellants both testified that, during the years leading up to the transaction, the income of the family was low, the family was struggling financially and there was an oral arrangement made under which the Appellants contributed as much as possible to the cost of food, shelter and other living expenses of the household. Each stated that the contributions were made by reason of a moral obligation. The amount of the contribution was left to be determined from time to time by the contributor. The contributions were made by payments of cash to the father. No record was kept of the amounts paid. The arrangements could not, in my view, be characterized as enforceable, legal agreements as alleged in the Notices of Appeal. It is obvious that there was no intent to create a binding contractual agreement.

[11] It is not possible to estimate with any reasonable degree of accuracy the amounts paid to Anthony De Sanctis by his children pursuant to the arrangements. Some evidence was led with respect to the earnings of the children during the five years prior to the sale of the house in 2001. This was done in order to demonstrate the ability of the children to make payments to their father. Diana De Sanctis- Pedros' annual earnings were modest. During 1997, 1998 and 1999, they did not exceed $6,697. During 2000 and 2001, the annual figures did not exceed $28,500. Adamo's annual income did not exceed $8,000

Digitized by Google

during any of those years. There was no basis in the evidence for making a leap from what was earned by either Appellant to what he or she decided to pay to their father.

[12] Section 160 was enacted to assist in the collection of taxes owing by counteracting the attempts of reluctant taxpayers to put their assets beyond the reach of the Minister by means of a transfer of such assets into friendlier hands for nothing or for consideration less than the market value of the assets transferred.

[13] It is not necessary to consider whether the transfer of the cash from the sale of Anthony De Sanctis' house was a deliberate attempt to prevent the Minister from seizing the money. In *Wannan v. Canada*, [2003] F.C.J. No. 1693. Sharlow J. noted that: 3 Section 160 of the *Income Tax Act* is an important tax collection tool, because it thwarts attempts to move money or other property beyond the tax collector's reach by placing it in presumably friendly hands. It is, however, a draconian provision. While not every use of section 160 is unwarranted or unfair, there is always some potential for an unjust result. There is no due diligence defence to the application of section 160. It may apply to a transferee of property who has no intention to assist the primary tax debtor to avoid the payment of tax. Indeed, it may apply to a transferee who has no knowledge of the tax affairs of the primary tax debtor. …

[14] **The arrangements between the Appellants and Anthony De Sanctis whereby they made voluntary payments from time to time to assist with the living expenses of the household can have no bearing upon the application of section 160 to the transfer now in question.** Subparagraph 160(1)(*e*)(i) limits the liability of the transferee to the excess of the fair market value of the property transferred over the consideration given for that property. **The evidence given by the Appellants makes it quite clear that the payments which they made were not "… consideration given for the property …" within the meaning of the subparagraph. The payments made by the Appellants to their father were quite unrelated to the transfer of that property. They were, as described by the witnesses, contributions to the shared cost of running the family household, nothing more.**

[15] As already noted, the evidence fails to establish how much money was paid by either of the Appellants to their father. It was not suggested that any attempt was made to keep a record. No doubt this is due to the fact that the Appellants and their father did not intend to form an enforceable agreement requiring either of the Appellants to pay any particular amount at any particular time as consideration for a transfer of property.

[16] In my view, no consideration was given by the Appellants for the transfer by Anthony De Sanctis to them of the proceeds from the sale of his house. Section 160 therefore applies.

[17] The appeals will be dismissed. Success was divided. The parties shall bear their own costs.

Digitized by Google

Resulting and Constructive Trust Extinguishment

When legal title of property is held in the name of one party but a constructive trust has arisen in it in respect of another, does the transfer of that legal title constitute a transfer without adequate consideration for purposes of s. 160? This was the issue in the TCC of Gillian N. Darte v. The Queen[157] where the ct. held:

> [1] The issue in these appeals is whether the Appellant had any interest in or any right to any interest in the property located at 317 - 319 Fitzroy Street in Charlottetown, Prince Edward Island (the "Property") at the time that it was transferred to her by Danny MacAdam, her common-law partner, and therefore whether the assessments issued against her under section 160 of the *Income Tax Act* and section 325 of the *Excise Tax Act* should be reduced.
>
> [2] Danny MacAdam has been the common-law partner of the Appellant for the past 20 years. The Appellant moved in with him approximately two months before she gave birth to their first child. At that time she was 19 years of age and in grade 10. She later received her GED from Holland College. Danny MacAdam's highest level of education was possibly grade 10. The Appellant and Danny MacAdam now have two children.
>
> [3] In 1989, Danny MacAdam had an agreement to acquire the Property. The deed to the Property however was not executed until November 3, 1992. The deed conveyed the title to the property to Danny MacAdam as the sole grantee. The Property was acquired without either Danny MacAdam or the Appellant making any down payment toward the purchase price of the Property. The consideration for the purchase of the Property consisted entirely of an assumption of an existing mortgage on the Property in favor of Royal Trust Corporation of Canada in the amount of $74,906.87 and a second mortgage granted to the vendor of the Property in the amount of $26,433.25. The mortgages that were on the Property were paid in full before the Property was transferred to the Appellant. The Appellant stated that she paid the mortgages. Based on the evidence presented at the hearing, I conclude that the mortgage payments were made from the rents that were collected.
>
> [4] The Property had five units and required substantial renovations. The original plan, which was followed after the Property was renovated, was that the Appellant and Danny MacAdam would occupy one of the units and would rent the other four units. The Appellant and Danny MacAdam initially moved into one of the one-bedroom units until the unit that they would be occupying was renovated.
>
> [5] The renovations that were completed were substantial, including ripping up the flooring and replacing it with new carpet or tile, painting, renovating the bathrooms, tearing down plaster walls and replacing the plaster with gyproc, adding new walls, installing a new backdoor and adding a parking lot. The Appellant performed many of the tasks herself including building walls and a partition, crack filling the gyproc and then sanding and painting, and cutting and installing all of the trim and mouldings around the windows, baseboards and along the ceiling.
>
> [6] Only the Appellant testified during the hearing. It was clear from her

[157] 2008TCC66

Digitized by Google

testimony that the renovations were completed as a result of her efforts and not as a result of the efforts of Danny MacAdam. Danny MacAdam also did not provide any assistance in looking after the children while the Appellant worked on the Property. During this period of time Danny MacAdam was working outside the home and had very little, if any, involvement with the renovations that were being done to the Property. The Appellant also testified that Danny MacAdam was an alcoholic and was violent, although no specific acts of violence were mentioned. There was no evidence that the Appellant received any compensation for her work that she did in relation to the Property, other than the transfer of the Property to her in 2001.

[7] There were items that were donated by the Appellant's mother and father, and the Appellant's father and his friend helped with the labour required to complete the renovations. The Appellant also contributed some of her money to the materials acquired for the renovations although no actual amount was established. The only sources of funds for the renovations were the Appellant's paycheques from her work, family allowance payments, and the rental income generated by the renting of the units in the Property.

[8] Danny MacAdam was involved in a car business and he encountered some problems with his business. He was assessed for unremitted GST and unpaid income taxes. As well, Danny MacAdam was incarcerated for a period of time in relation to certain offences related to provincial sales tax and, as part of his probation, he was prohibited from being involved in the car business. The total amount of Danny MacAdam's outstanding liabilities under the *Excise Tax Act* and the *Income Tax Act*, including penalties and interest, at the time that the Property was transferred to the Appellant was $59,143.92 under the *Excise Tax Act* and $78,791.76 under the *Income Tax Act* for a total of $137,935.68. The fair market value of the Property, as agreed upon by counsel for the Appellant and counsel for the Respondent, was $140,000. The Appellant was assessed $78,791.76 pursuant to section 160 of the *Income Tax Act* and $59,143.92 pursuant to section 325 of the *Excise Tax Act.*

[9] In the written submissions of counsel for the Respondent the issue is described as follows:

The sole issue in these cases is whether the Appellant is liable to pay the amounts of $78,791.76 and $59,143.92 with respect to the transfer of the Property from Danny MacAdam pursuant to section 160 of the *ITA* and section 325 of the *ETA*, respectively.

A determination of whether the Appellant had any right, title or interest in the Property, at the time it was transferred, aids in resolving this issue.

[10] The Appellant claims that she had an interest in the Property based on her claim that there was a constructive trust. In *Peter v. Beblow*, [1993] 1 S.C.R. 980, McLachlin J. (as she then was), stated the following on behalf of the majority of the Supreme Court of Canada:

3 The basic notions are simple enough. **An action for unjust enrichment arises when three elements are satisfied: (1) an enrichment; (2) a corresponding deprivation; and (3) the absence of a juristic reason for the enrichment.** These proven, the action is established and the right to claim

Digitized by Google

relief made out. At this point, a second doctrinal concern arises: the nature of the remedy. "Unjust enrichment" in equity permitted a number of remedies, depending on the circumstances. One was a payment for services rendered on the basis of quantum meruit or quantum valebat. **Another equitable remedy, available traditionally where one person was possessed of legal title to property in which another had an interest, was the constructive trust. While the first remedy to be considered was a monetary award, the Canadian jurisprudence recognized that in some cases it might be insufficient.** This may occur, to quote La Forest J. in Lac Minerals Ltd. v. International Corona Resources Ltd., [1989] 2 S.C.R. 574, at p. 678, "if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property". Or **to quote Dickson J., as he then was, in Pettkus v. Becker, [1980] 2 S.C.R. 834, at p. 852, where there is a "contribution [to the property] sufficiently substantial and direct as to entitle [the plaintiff] to a portion of the profits realized upon sale of [the property]." In other words, the remedy of constructive trust arises, where monetary damages are inadequate and where there is a link between the contribution that founds the action and the property in which the constructive trust is claimed.**
(emphasis added)

[11] In this case, it seems clear that Danny MacAdam was enriched as a result of the labour provided by the Appellant as well as the materials purchased by her and the labour and materials supplied by the Appellant's parents and the labour provided by the Appellant's father and his friend. There was also a corresponding deprivation to the Appellant and the absence of any juristic reason for the enrichment.

[12] In *Peter v. Beblow*, *supra* McLachlin J. (as she then was), also stated the following on behalf of the majority of the Supreme Court of Canada:

6 I share the view of Cory J. that the three elements necessary to establish a claim for unjust enrichment -- an enrichment, a corresponding deprivation, and the absence of any juristic reason for the enrichment -- are made out in this case. The appellant's housekeeping and child-care services constituted a benefit to the respondent (1st element), in that he received household services without compensation, which in turn enhanced his ability to pay off his mortgage and other assets. These services also constituted a corresponding detriment to the appellant (2nd element), in that she provided services without compensation. Finally, since there was no obligation existing between the parties which would justify the unjust enrichment and no other arguments under this broad heading were met, there is no juristic reason for the enrichment (3rd element). Having met the three criteria, the plaintiff has established an unjust enrichment giving rise to restitution.

…

12 **This Court has held that a common law spouse generally owes no duty at common law, in equity or by statute to perform work or services for her partner**. As Dickson C.J., speaking for the Court put it in Sorochan v. Sorochan, supra, at p. 46, the common law wife "was under no obligation,

Digitized by Google

contractual or otherwise, to perform the work and services in the home or on the land". So there is no general duty presumed by the law on a common law spouse to perform work and services for her partner.

…

24 I doubt the wisdom of dividing unjust enrichment cases into two categories -- commercial and family -- for the purpose of determining whether a constructive trust lies. A special rule for family cases finds no support in the jurisprudence. Neither Pettkus, nor Rathwell, nor Sorochan suggest such a departure. Moreover, the notion that one can dispense with a link between the services rendered and the property which is claimed to be subject to the trust is inconsistent with the proprietary nature of the notion of constructive trust.

(emphasis added)

[13] Counsel for the Respondent argued that no constructive trust could arise in the circumstances of this case because the Appellant and Danny MacAdam were still living together at the time that the Property was transferred to her. In support of this proposition, counsel for the Respondent relied on the case of *Blackman*

Davison, [1987] B.C.J. No. 200, 12 B.C.L.R. (2d) 24 (BCCA) and *Nova Scotia (Attorney General) v. Walsh*, [2002] 4 S.C.R. 325. The decision of the British Columbia Court of Appeal in *Blackman v. Davison* was based on the *Family Relations Act* of British Columbia (which is not applicable in this case) and it was rendered before the decision of the Supreme Court of Canada in *Rawluk v. Rawluk*, [1990] 1 S.C.R. 70.

[14] In the *Walsh* case, the issue before the Supreme Court of Canada was whether the matrimonial property legislation of the province of Nova Scotia contravened the *Canadian Charter of Rights and Freedoms* because it did not provide common-law partners with the same rights that were available to married couples. Counsel for the Respondent argued that the following excerpts from the *Walsh* case supported her position that no constructive trust could arise until there was a breakdown of the common-law relationship:

49 …The general principle is that, without taking some unequivocal consensual action, these cohabiting persons maintain the right to deal with any and all of their property as they see fit.

…

59 …In these cases, the law has evolved to protect those persons who may be unfairly disadvantaged as a result of the termination of their relationship.

…

61 For those couples who have not made arrangements regarding their property at the outset of their relationship, the law of constructive trust remains available to address inequities that may arise at the time of the dissolution.

[15] The issue before the Supreme Court of Canada in *Walsh* was not whether a constructive trust can only arise if there has been a breakdown in the common-law relationship and none of these statements indicate that this is the only time that a constructive trust could arise. These statements simply provide that the law of constructive trust is available to address inequities that may arise at the time of the dissolution.

Digitized by Google

[16] In *Rawluk v. Rawluk, supra*, the Supreme Court of Canada specifically addressed the issue of when the property interest arises under a constructive trust. The issue in that case, as summarized by Cory J., was:

At issue in this appeal is whether the doctrine of constructive trust can be applied to determine the ownership of assets of married spouses under the provisions of the Family Law Act, 1986, S.O. 1986, c. 4.

[17] Cory J. stated as follows on behalf of the majority of the Supreme Court of Canada in relation to the question of when a property interest arises under a constructive trust:

It is important in this respect to keep in mind that a property interest arising under a constructive trust can be recognized as having come into existence not when the trust is judicially declared but from the time when the unjust enrichment first arose. As Professors Oosterhoff and Gillese state, "the date at which a constructive trust arises ... is now generally accepted to be the date upon which a duty to make restitution occurs" (Oosterhoff and Gillese, A. H. Oosterhoff: Text, Commentary and Cases on Trusts (3rd ed. 1987), at p. 579). Professor Scott has stated in Law of Trusts, op. cit., at pp. 323-24, that:

The beneficial interest in the property is from the beginning in the person who has been wronged. The constructive trust arises from the situation in which he is entitled to the remedy of restitution, and it arises as soon as that situation is created. ... It would seem that there is no foundation whatever for the notion that a constructive trust does not arise until it is decreed by a court. It arises when the duty to make restitution arises, not when that duty is subsequently enforced.

I agree completely with the position taken on this issue by the authors of these helpful texts.

As well in Hussey v. Palmer, supra, at p. 1290 (quoted by Dickson J. in Rathwell v. Rathwell, supra, at p. 455), Lord Denning M.R. noted that a constructive trust "may arise at the outset when the property is acquired, or later on, as the circumstances may require". As a result, even if it is declared by a court after the parties have already separated, a constructive trust can be deemed to have arisen when the duty to make restitution arose. It should therefore be considered as part of the property owned by the beneficiary at valuation date.

It must be emphasized that the constructive trust is remedial in nature. If the Court is asked to grant such a remedy and determines that a declaration of constructive trust is warranted, then the proprietary interest awarded pursuant to that remedy will be deemed to have arisen at the time when the unjust enrichment first occurred. But, as Professor Scott makes clear, the fact that the proprietary interest is deemed to have arisen before the remedy was granted is not inconsistent with the remedial characteristics of the doctrine.

[18] It is clear, based on the comments of the Supreme Court of Canada in *Peter v. Beblow*, *supra* and *Rawluk v. Rawluk*, *supra,* that no distinction is to be made between commercial situations and family situations in determining whether a constructive trust exists and the constructive trust, when granted, comes into existence when the unjust enrichment first arose. The constructive

Digitized by Google

trust does not arise because of a breakdown in the relationship between common law partners but because one party has been unjustly enriched. As noted by the Supreme Court of Canada, in paragraph 12 of the decision in *Peter v. Beblow*, "a common-law spouse generally owes no duty at common law, in equity or by statute to perform work or services for her partner". Since the Appellant did not owe any duty to perform work for or provide services to Danny MacAdam, she had no duty to perform any work on the Property (that was only registered in his name) and therefore she had a right to be compensated for her efforts. Since she was not compensated by Danny MacAdam for her efforts, the unjust enrichment (and the Appellant's interest in the Property) would arise when she worked on the Property for no consideration.

[19] There has been no finding by a court of equity that there is a constructive trust in this case. The British Columbia Court of Appeal in *LeClair v. LeClair Estate*, 159 DLR (4th) 638 discussed the requirement that a constructive trust must be judicially declared. Ryan J.A., on behalf of the BCCA stated as follows, after quoting the above paragraphs from *Rawluk*:

[45] The appellant says that because of the unjust enrichment, the property in question (one-half of the proceeds of the sale of Clair Manor) was automatically subject to a constructive trust before the death of John LeClair. He submitted that it followed from this that the property was not John LeClair's to devise under his Will.

[46] The flaw in the appellant's argument lies in its failure to take into account the remedial nature of the remedy of constructive trust and the requirement that the trust must be judicially declared. In my view, in the passage I have just quoted Cory J. addressed the question whether, once a court declares constructive trust, the interest arises at the time of judicial declaration, or, as of the time of the unjust enrichment. His answer was that it arises at the time of the unjust enrichment. However, contrary to the appellant's argument in this case, this passage does not negate the need for a court to first determine whether an unjust enrichment occurred and whether the appropriate remedy would be a constructive trust. The appellant's argument that a constructive trust arose automatically prior to John LeClair's death is not supported by Rawluk v. Rawluk.

[47] The Rawluk case has not displaced the well-entrenched rule that the remedy of constructive trust does not follow automatically from a finding of unjust enrichment. In Sorochan v. Sorochan, [1986] 2 S.C.R. 38, 29 D.L.R. (4th) 1, Dickson C.J. said this, at p. 47:

The constructive trust constitutes one important judicial means of remedying unjust enrichment. Other remedies, such as monetary damages, may also be available to rectify situations of unjust enrichment. We must, therefore, ask when and under what circumstances it is appropriate for a court to impose a constructive trust.

[20] Therefore a declaration by a court of equity would be required to find that there was a constructive trust in the Property. Once so declared, the constructive trust would have come into existence when the unjust enrichment arose. Sobier J. made the following comments on whether this Court is a court of equity in *Sunil Lighting Products v. Minister of National Revenue*, [1993] T.C.J.

Digitized by Google

No. 666:

18 The jurisprudence clearly affirms that the Tax Court of Canada is not a court of equity and its jurisdiction is based within its enabling statute6. In addition, the Court cannot grant declaratory relief given that such relief is beyond the jurisdiction of the Court7. In an income tax appeal, the Court's powers are spelled out in subsection 171(1) of the Income Tax Act. Consequently, these powers essentially entail the determination of whether the assessment was made in accordance with the provisions of the Income Tax Act8.

[21] As this Court is not a court of equity, the equitable remedy of constructive trust cannot be granted by this Court.

[22] The issue of whether the application of the equitable doctrine of constructive trust can affect an assessment under section 160 of the *Income Tax Act* has been discussed in earlier decisions of this Court. There appear to be differing views of the Judges of this Court in relation to this matter. In *Savoie v. The Queen*, [1993] 2 C.T.C. 2330, 93 DTC 552, Bowman J. (as he then was) clearly stated that the doctrine of constructive trust could be invoked in determining, for the purposes of the application of section 160 of the *Income Tax Act,* the fair market value of a property transferred by a tax debtor. In the subsequent cases of *Raphael v. The Queen*, 2000 DTC 2434, [2000] 4 C.T.C. 2620 and *Burns v. Her Majesty the Queen* 2006 DTC 3383, [2006] 5 C.T.C. 2392, the principle of unjust enrichment was held to not be applicable in dealing with assessments issued under section 160 of the *Income Tax Act.* In neither *Burns* nor *Raphael* was there any reference to the decision of Bowman J. (as he then was) in *Savoie* nor were there any references to the Supreme Court of Canada decisions in *Peter v. Beblow* and *Rawluk v. Rawluk.*

[23] The issue before me is whether the existence of an interest of the Appellant in the Property or any right that the Appellant had to have an interest in the Property granted to her by a court of equity, can affect the assessments issued under section 160 of the *Income Tax Act* and section 325 of the *Excise Tax Act.* In my opinion, as a result of the decisions of the Supreme Court of Canada in *Peter v. Beblow* and *Rawluk v. Rawluk,* since the beneficial interest of the Appellant in the Property, if the equitable remedy of constructive trust would have been granted by a court of equity, would have come into existence when the unjust enrichment occurred (which was when the Appellant improved the Property for no consideration) the right of the Appellant to have a declaration by a court of equity of her beneficial interest in the Property as of the time of the unjust enrichment, is a right that the Appellant surrendered when the Property was conveyed to her in 2001 and hence would be consideration that she gave for the Property.

[24] Both sections 160 of the *Income Tax Act* and 325 of the *Excise Tax Act* are intended to prevent taxpayers from escaping their liability for taxes by transferring their assets to persons with whom they do not deal at arm's length for inadequate consideration. Each section imposes a liability on a transferee who receives property from a non-arm's length tax debtor for inadequate consideration. From the Appellant's perspective, the issue, in relation to the

Digitized by Google

application of these sections to the transfer of the Property to her, is to what extent should she be held liable for the tax debts of Danny MacAdam? The Appellant earned her right to an interest in the Property as a result of the substantial amount of work that she performed to improve the Property and her contributions of her own resources to the improvements. It would be unfair to not recognize her rights to an interest in the Property when dealing with an assessment under section 160 of the *Income Tax Act* and section 325 of the *Excise Tax Act*.

[25] Counsel for the Respondent also submitted that the law of constructive trusts could not be applied when the rights of creditors are affected. However in *Re Roberts Estate*, [1998] O.J. No. 1109, the Ontario Court of Justice (General Division) applied the law of constructive trust in a bankruptcy situation and found that the wife of the bankrupt held a constructive trust in part of the proceeds from the sale of shares and she was only required to return to the trustee in bankruptcy the portion of the proceeds that was not affected by the trust in her favour. This case was followed by Registrar Herauf of the Saskatchewan Court of Queen's Bench (in Bankruptcy and Insolvency) in the *Estate of John Allen Patrick*, [1999] S.J. No. 82. As well a constructive trust was found in a bankruptcy situation in *Ellingsen (Trustee of) v. Hallmark Ford Sales Ltd.*, 2000 BCCA 458.

[26] In my opinion, a determination that the Appellant had a right to apply to a court of equity for a declaration that she had a beneficial interest in the property under a constructive trust in this case does not prejudice the Respondent because the Respondent did not become a creditor of Danny MacAdam based on any assumption or reliance on the fact that Danny MacAdam was the owner of the Property.

[27] As a result, I find that for the purposes of section 160 of the *Income Tax Act* and section 325 of the *Excise Tax Act,* the Appellant had a right to apply to a court of equity for a declaration that she had an interest in the Property at the time that the Property was transferred to her in 2001 and this right was surrendered when the Property was transferred to her and hence the surrender of this right was consideration that the Appellant gave for the transfer of this Property to her. The Appellant has established, on a balance of probabilities, that the elements of unjust enrichment, as set out above, are present in this case and that there is a direct link to the Property as the Property was the one on which the Appellant worked for no consideration. Therefore the Appellant had a right to apply to a court of equity for a declaration that she had an interest in the Property. The only evidence was that the Appellant, and not Danny MacAdam, was the person who did the work needed to improve the Property and who looked after renting the Property, collecting rents and, when necessary, evicting a tenant. There was no evidence of any work performed on the Property by Danny MacAdam or of any of his money (other than his share of the rental income) being used to pay for the Property.

[28] Counsel for the Appellant submitted that the fair market value of the Appellant's interest in the Property, at the time that the Property was transferred to her, was equal to one-half of the fair market value of the

Digitized by Google

Property. Counsel for the Appellant did not call Danny MacAdam as a witness. Although the evidence that was presented was clear that Danny MacAdam did not make any contribution of labour or capital to the Property and hence the Appellant may have a right to more than a 50% interest in the Property, without hearing from Danny MacAdam and with counsel for the Appellant only seeking a ruling that she had a 50% interest in the Property, I am not prepared to find that the Appellant had a right to any more than a 50% interest in the Property. The possibility that the Appellant may have a right to more than a 50% interest would, in my opinion, negate any discount that should be applied in determining the fair market value of her right to apply for a declaration that she had a 50% interest in the property. Since there has been no declaration by a court of equity that the Appellant had a 50% interest in the Property and, since this is an equitable remedy, there is no guarantee that such remedy would have been granted by a court of equity. However, this possibility that a court of equity may not have granted this remedy is, for the purposes of determining the fair market value of her right to apply for this declaration, offset by the possibility that she had a right to a declaration that her interest was greater than 50%, and therefore I find that the fair market value of her right to apply to a court of equity for a declaration of a constructive trust is equal to $70,000, which is one-half of the fair market value of the Property, for the purposes of sections 160 of the *Income Tax Act* and 325 of the *Excise Tax Act.*

[29] Counsel for the Respondent had also raised the issue that the Appellant had not reported any of the rental income on her tax returns. In the Reply filed by the Respondent it is stated that the Respondent "denies that until April 12, 2001, Danny MacAdam reported all rental income and expenses relating to the 317 - 319 Fitzroy Street Property and states that for taxation years 1999 and 2000, he failed to file [*sic*] in his income tax returns as required by the *Income Tax Act,* hence, he failed to report his income". Therefore it would appear that Danny MacAdam did not report the rental income either. The reporting of the rental income is not the issue in this case. The only issue in this case is the validity of the assessments issued under section 160 of the *Income Tax Act* and section 325 of the *Excise Tax Act.*

[30] As a result, the appeal under the *Income Tax Act* is allowed and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the Appellant gave consideration of $70,000 for the transfer of the Property to her as she surrendered her right to have a declaration by a court of equity that she had a beneficial interest in the Property at the time it was transferred from Danny MacAdam to the Appellant, for the purposes of the assessment issued under section 160 of the *Income Tax Act.*

Eleanor Martin v. Her Majesty The Queen, 2013 TCC 38, An Argument for Constructive Trust on S. 160 Transfer

REASONS FOR JUDGMENT

Boyle J.

Digitized by Google

[1] This is an appeal by the Appellant, Eleanor Martin, of a section 160 transferee liability assessment in respect of transfers allegedly made to her without consideration by her late husband at a time when he was in arrears in his taxes. Two appeals, that of the Appellant and that of her late husband's estate, were to be heard together over two days. The parties filed a Partial Joint Statement of Facts which is appended hereto. Early on the first day the parties communicated that the estate's appeal had been settled and consented to judgment in accordance with that settlement. The hearing of the Appellant's appeal did not require a full day.

[2] Mrs. Martin is an elderly woman at this stage. She holds a university degree. In spite of her age and the long period of time to which her testimony related, I accept generally that all of her evidence is correct to the best of her recollection of the events and conversations she participated in, and what she was told. Her credibility was not challenged, her version of the events is largely consistent with the written evidence presented (especially on the significant issue of having been told very clearly different things by the Canada Revenue Agency ("CRA") auditor in writing than orally on the material issue of the salary paid to her as described below). I accept fully her version of the events.

[3] It is the Appellant's position that the section 160 reassessment ignores the consideration she provided for the amounts transferred in the form of services provided in his medical practice, and of premises made available to his medical practice.

[4] It is her position that (i) she was owed for accrued unpaid work prior to the years of her husband's tax arrears and the transfers, and (ii) that she had been unpaid for certain work, and underpaid for other years, during the years of her husband's transfers to her while he had unpaid tax debts. The CRA has recognized the latter unpaid years at the Objections level for years during which her husband made transfers to her. However, CRA has not made any comparable recognition for her accrued unpaid work for prior years nor for the alleged underpaid work in the latter years.

[5] The unpaid and underpaid employment work provided by Mrs. Martin to her husband's medical practice was argued as an accrued debt, as current consideration, as unjust enrichment and on a constructive trust basis relying upon the decisions of Webb J., as he then was, in *Darte v. The Queen*, 2008 TCC 66, and of Bowman J., as he then was, in *Savoie v. The Queen*, 93 DTC 552. I do not need to deal with the constructive trust arguments in the circumstances but have concerns that, unlike unjust enrichment, constructive trust is an equitable in rem claim for an interest in a property subject to the alleged trust and I fail to see how that fits the facts before me relating to unpaid services.

[6] The second consideration for the transfers put forward by the Appellant is in respect of unpaid rent for the Fenwick property of which she was the sole registered owner, had made significant financial contributions for its purchase, and which she claimed was beneficially owned only by her prior to the year in which her husband's accrued unpaid tax debts arose. She claims her husband gifted his interest in the property long prior to any tax arrears and that her husband's share of the mortgage repayments in his pre-tax debt period reflected his use of the property in those years for his professional practice.

Digitized by Google

[7] The only consideration for the transfers put forward by the Appellant are these two distinct items for services genuinely rendered to, and premises genuinely made available and used by, her husband's medical practice.

Mrs. Martin's Professional Services:

[8] Mrs. Martin was able to describe in her testimony and in her written summary her daily work duties in the years in question in considerable detail. I accept that to be entirely factual and without question. The only issue is what would have been a reasonable salary for her to have been paid for that work.

[9] This is made easier by the facts that (i) prior to the years in question, her husband had paid her a salary, some of those payments were challenged by CRA on audit, and CRA set out in a letter following its audit what it felt the reasonable arm's length value for the services rendered was, and (ii) in two of the six years in question Dr. Martin paid his wife a salary.

[10] CRA's written audit letter sets the arm's length value of Mrs. Martin's services at $30,000 for the year 1989 rising by $2,000 per year to $36,000 for 1992. The salary set by Dr. Martin, deducted by him and included in Mrs. Martin's income in 2001 and 2002 was $25,000 and $24,700.

[11] I do not accept that the more recent $25,000 or $24,700 number should govern. It is not at all unusual within family businesses for salaries to be lowered to below market to reflect the then current capital needs, cash flows, or other financial performance or realities of the business. Also, it undoubtedly reflected a balancing of CRA wrongly telling them nothing was deductible and their accountant then telling them that CRA was wrong.

[12] Judicial determination after the fact based on evidence available and presented can not be expected to fix an entirely accurate and correct amount. After considering the evidence before me, including the possible explanations for both sets of numbers, the services rendered, Mrs. Martin's accrued experience before 1995 in managing her husband's practice, the effects of inflation on salaries, et cetera, I find that for each year in the period 1995 to 2004 the reasonable amount of salary which would have been paid in an arm's length relationship would have been $38,000 annually.

[13] Dr. Martin made transfers to his wife while he had an unpaid tax liability during the six years 1999 to 2004. For the years 1999, 2000, 2003 and 2004, the Respondent only recognized consideration of $100,000 ($25,000 annually). I therefore find additional unrecognized consideration from her to him of $52,000 during this period.

[14] For the 2001 and 2002 years in which she was paid $25,000 and $24,700 annually during this period I similarly find additional consideration of $26,300.

[15] With respect to the prior unpaid years I find that, in the four years (1995 to 1998) prior to the husband's transfers to her while he had tax arrears, that she had provided services to him worth $38,000 annually and that she was therefore owed $152,000 by him at the time of the transfer. The Respondent's position was that the accrued amount for unpaid services for the prior period was not relevant since it pre-dated the years the husband had tax arrears and made transfers. For this reason it did not give any credit or assign any recognizable value to this. There is no apparent reason for this inconsistency. Had Mrs. Martin loaned Dr. Martin

Digitized by Google

money in the period, that was settled by the later transfers, that would be valuable consideration for section 160 purposes. I see no reason to treat her unpaid services during the years immediately preceding the transfers any differently than her unpaid services in the years that the transfers occurred. Nor when pressed, could counsel for the Respondent articulate one to the Court. CRA had correctly reassessed her following her Objection to allow this for the later years; this was done on a principled basis and not as a settlement. At the time Dr. Martin transferred money to her, she had a claim for unpaid services she had performed for his business. That amount was four years at $38,000 or $152,000 which should also be recognized.

Fenwick Property Rentals:

[16] I find on the evidence presented that Mrs. Martin paid at least 25% of the Fenwick property acquisition cost. The proceeds of the sale of the Australian home which they owned jointly and for which she paid at least one-half of the mortgage was used to finance the Fenwick property down payment. Mrs. Martin had also gone back to work in the years 1986 through 1988 while they were still living in the Fenwick property so that the family could save money to repay the mortgage on the Fenwick property on an accelerated basis. Mrs. Martin was the sole registered owner of the house and I therefore find that she had at least a 25% ownership of the house. Rent paid in years prior to 1995 had also been the subject of the earlier CRA audits of Dr. and Mrs. Martin. It can be noted that in the CRA audit previously discussed, the CRA's final position was described as her having a 25% ownership in the property and not the 100% ownership previously claimed. I do not need to decide if she was the 100% beneficial owner in order to vacate this assessment.

[17] The house was used entirely by her husband as a medical office in all of the relevant years.

[18] There is little evidence available to me regarding the fair market value rent which should have been paid in the years in question. The amount of rent previously paid to a commercial landlord for her husband's medical practice was approximately $2,500 a month. This is the amount that was paid and deducted in those prior years.

[19] Being conservative to account for possible differences between the commercially rented premises and the converted home as to size, services included, utilities included and the like, I can conservatively estimate that the fair market rental value of the Fenwick property in the years in question was at least half of the approximately $30,000 annually that had until then been paid to the commercial landlord for nearby premises for a similar use. Her share of the unpaid rent assuming only a 25% ownership would be $3,750 per year over the ten unpaid rental years in question (being 1995 through 2004). This amounts to a further $37,500 of consideration from her for the transfers by her husband. This would be the total unpaid rents owing to her for the years 1995 through 1998 before he fell into tax arrears and for the years 1999 through 2004 during the period he made transfers to her.

[20] In total I have found at least an additional $267,800 of consideration from Mrs. Martin to Dr. Martin for the transfers. That is sufficient to allow the appeal and to vacate the assessment.

Digitized by Google

[21] As mentioned above there is some considerable concern raised by the CRA correspondence with Dr. Martin and the Appellant in relation to the 1994 resolution of the prior audit of 1990 to 1992. There is a shocking difference between what CRA communicated in writing regarding the acceptable reasonable arm's length salary to be paid to Mrs. Martin for her work at her husband's dermatology practice, and what has now been confirmed by CRA to have been told to the Martins by that CRA auditor. This is not a case of a CRA auditor writing something incorrect or stating something incorrectly. It appears that it can only be considered to have been intentionally deceitful. Such actions by public servants are entirely inexcusable. The Court is very surprised that the CRA would in these circumstances have pursued its section 160 case against Mrs. Martin with such vigour given that the deceit related precisely to the most significant issue in this case being the worth of Mrs. Martin's services to her husband's practice. The Court has accepted Mrs. Martin's version that in 1994 the auditor told them in relation to the resolution of both her and her husband's audits that he could no longer deduct any portion of any salary he chose to pay her. The CRA has since acknowledged in writing that in fact that was what they were told, notwithstanding what the same auditor wrote. According to the Appellant this is what led her to continuing to work for her husband but to not be paid for the years prior to the years of her husband's tax arrears and transfers to her, and to be paid a much lesser amount in some of the later years after her husband's business accountant advised them that a reasonable salary was in fact properly deductible and always had been. I accept this explanation fully and believe this reinforces overall Mrs. Martin's credibility.

[22] The appeal is allowed and the assessment is vacated.

[23] I will allow 30 days to receive written submissions from the parties on costs. I would ask to be told by the Appellant what the total amount of Mrs. Martin's legal costs have been in this appeal. I would ask to be told by the Respondent what the date was of CRA's confirmation (referred to in the Report on Objection dated June 20, 2008) that the Martins were clearly misled at the conclusion of the 1994 audit.

Signed at Montréal, Québec this 4th day of February 2013.

"Patrick Boyle"

Boyle J.

See also Elizabeth Anne Warren v. The Queen[158] concerning a resulting trust situation at the TCC level.

[1] Elizabeth Warren appeals an assessment pursuant to section 160 of the *Income Tax Act*, whereby the Government assessed her as jointly and severally liable with her husband, Dr. Frederick Warren, for his tax liability of $261,921.56. The Minister of National Revenue invoked section 160 based on a transfer of the matrimonial home from Dr. Warren to his wife in 1998. **Mrs. Warren claims that notwithstanding that Dr. Warren was the sole registered owner of the property, she had a 50% equity interest pursuant to a resulting trust, and that she paid Dr. Warren consideration equal to**

158

Digitized by Google

the fair market value of his 50% interest; consequently, section 160 of the *Income Tax Act* should not apply. The following are the issues:

Facts

What property interest did Dr. Warren transfer to his wife? In this regard I must consider:

Does this Court have jurisdiction to consider whether a resulting trust existed for purposes of a section 160 assessment? Yes it does.

If so, was there such a resulting trust in the circumstances before me? Yes, there was a resulting trust.

What were the Warrens' respective interests in the matrimonial property? I conclude Mrs. Warren and Dr. Warren had a one-third and two-thirds interest, respectively, in the property.

Did Mrs. Warren pay to Dr. Warren consideration equal to the fair market value of such interest in the property? No, Mrs. Warren paid to Dr. Warren less than the fair market value of the property transferred ($55,333).[2] In November 1982, Dr. Warren entered an agreement to acquire a lot in Manotick for $74,500 (the "Manotick property"). The Warrens' intention was to construct their matrimonial home on this property. Prior to their move to Manotick, the Warrens lived in Ottawa (the "Elvaston property"). **They were registered as joint tenants on the Elvaston property, though when initially acquired in 1974, it was in Mrs. Warren's name, in trust. It was later transferred into both their names. I find their joint ownership of the Elvaston property reflected an equal interest in that property.**

[3] In April 1983, the Warrens took out a mortgage on the Elvaston property for $74,200. Also in April 1983, the Transfer of Land of the Manotick property was registered in Dr. Warren's name alone, indicating a consideration of $74,500. He also granted a mortgage back of $37,250 to the Vendor of the Manotick property. Mrs. Warren testified that she believed her husband would look after her interest in the matrimonial property, for, as she put it, they were married so they would share the home together.

[4] In June 1984, the Warrens sold the Elvaston property for $133,000. The construction of their home on the Manotick property was completed in 1984 and they moved into that property, where they continue to reside to this day.

[5] Mrs. Warren did not know what the home in Manotick cost to build, other than it was more than anticipated. Dr. Warren estimated the total cost of construction was approximately $280,000. He suggested that funds were borrowed to pay for the construction. He suggested the borrowed funds were paid off with income from his chiropractic business. A mortgage was registered against this property to the Royal Bank of Canada in 1989 for $280,000, several years after construction had been completed.

[6] There is a third property that also comes into play in the Warrens' story; a property on Woodroffe Avenue in Ottawa from which Dr. Warren carried on his chiropractic clinic. Mrs. Warren testified this property was held in a company, though the only documents presented at trial indicated this property was, in 1976, in Mrs. Warren's name (in trust), and in 1986 was transferred into her name alone. The transfer indicated consideration was "$2.00 - Transfer by Transferee

Digitized by Google

to the beneficiary of the trust". There was a mortgage of
$30,000 registered against this property in 1976 to the Royal Bank of Canada.
[7] Mrs. Warren testified that her husband paid the mortgage on the clinic property and on the Elvaston property, and also on the Manotick property up until the time that she took over ownership of the Manotick property in December 1997. She was unclear on that latter point in cross-examination. Dr. Warren testified that both he and his wife made payments on the Elvaston property. Mrs. Warren also testified that she received income from the company that owned the clinic and that she was a director of that company. I did not receive any documentary evidence indicating a company owned the clinic, received rent or paid Mrs. Warren any salary. She could not recall what rent the clinic paid, nor initially how much salary she received though she later reflected it may have been around $37,000 a year. She also made no mention of receiving salary for managing the clinic; indeed she admitted she was not a businesswoman. Dr. Warren testified that Mrs. Warren was the manager of the clinic and received a salary for that job, although he acknowledged that she did not actually have to go to the clinic to manage it. **I describe this testimony as it has led me to the conclusion that Mrs. Warren had little, if any, involvement in arranging the couple's financial situation. It is clear that it was Dr. Warren, with the assistance of an accountant, a Mr. Savarin, who made the arrangements. Mrs. Warren simply believed her husband would protect her.** I am satisfied she received income, though I am not sure exactly what she did to earn it.
[8] With that background, I turn now to what occurred in December 1997. Dr. Warren was in some financial straits. He needed to consolidate his debts and he turned to Healthgroup Financial, a division of Newcourt Credit Group Inc. to do so. As he testified, his accountant set up everything. He was not aware of any tax obligations at this stage. His current accountant, Mr. Patterson, testified that the former accountant had led Dr. Warren to believe he owed no taxes. Dr. Warren in fact owed $261,921.56.
[9] In December 1997, Dr. Warren transferred the Manotick property to his wife. The transfer documents show a transfer from Dr. Warren to his wife for $90,000 (the $90,000 being the assumption of the mortgage against the property). The property had a fair market value of $425,000. Coincidentally, with the registration of the transfer, a new mortgage was placed on the property (now in Mrs. Warren's name) in the amount of
$168,000 showing Healthgroup as the lender, Mrs. Warren as borrower, and Dr. Warren as guarantor. Also at the same time, a mortgage in the amount of $206,000 was registered by Healthgroup against the clinic property, again showing Dr. Warren as guarantor. This was all, according to Dr. Warren, in connection with the consolidation of debts.
[10] Clearly, Mrs. Warren entered these arrangements on the advice of her husband. At one point in testimony, she indicated she made the mortgage payments on the $168,000 mortgage, though in cross- examination she was less sure: she had no idea how much the payments were. She also assumed that her husband made the mortgage payments on the clinic property.

Digitized by Google

Appellant's Position

[11] The Appellant argues that at the time Dr. Warren transferred the Manotick property to her in December 1997, she already had a 50% interest in the property, arising from a resulting trust. She was therefore only acquiring Dr. Warren's 50% interest, valued at $212,500, for which she assumed her share of the $90,000 mortgage ($45,000) and borrowed a further $168,000, which she argues formed part of the consideration, as it went to Dr. Warren's consolidation of debts arrangement. There is therefore no inadequate consideration which would bring section 160 of the *Income Tax Act* into play.

Respondent's Position

[12] The Respondent argues firstly that the Court has no jurisdiction to consider the resulting trust, as the Tax Court of Canada is not a Court of equity. Further, Mrs. Warren only paid $90,000 for a property valued at $425,000, as the subsequent $168,000 mortgage did not constitute part of the consideration paid to Dr. Warren. Section 160 of the *Income Tax Act* is therefore engaged, and Mrs. Warren has been correctly assessed for her husband's tax liability of $261,921.56.

Analysis

[13] Subsection 160(1) reads as follows:

…

[14] There are four elements to the application of this provision in this case:

There must be a transfer of property from Dr. Warren to Mrs. Warren;

Dr. Warren and Mrs. Warren must be spouses;

There must be no consideration (or inadequate consideration) flowing from Mrs. Warren to Dr. Warren for the property transferred; and

Dr. Warren must be liable to pay an amount under the *Act* in or in respect of the year when the property was transferred or in any preceding year.

[15] Only the first and third elements are at play before me. With respect to the requirement of the transfer of property, there is no question Dr. Warren transferred property to his wife in December 1997. **The question, however, is what was the extent of his interest in the property transferred? He was the sole registered owner of the Manotick property, but the Appellant argues Dr. Warren only had a 50% interest in that property to transfer to her, as she had a 50% interest arising from her resulting trust.**

[16] **The Respondent argues that a finding of a resulting trust, as an equitable remedy, cannot be determined by this Court as the Tax Court is not a Court of equity. Certainly, Justice Webb concluded**

in the recent decision of *Darte v. R.*[159] that a constructive trust must be judicially declared, which had not happened in that case. He neatly sidestepped this obstacle by finding that the Appellant had a right to apply to a Court of equity for a declaration of constructive trust, and that that right could be valued at the same amount as the actual beneficial interest itself. The parties before me did not argue the constructive trust: they focused on the resulting trust.

[17] As pointed out by Professor Waters in the *Waters' Law of Trusts in*

[159] 2008 TCC 66

Digitized by Google

Canada:[160]

The terms "implied", "resulting" and "constructive" trusts have caused a good deal of confusion in the law of trusts, ... (page 454)

What is clear is that the resulting trust is recognized as something separate from the constructive trust. The Respondent argues that it is not open to the Tax Court to find Dr. Warren's interests in the Manotick property as anything other than a 100% interest, for purposes of the application of section 160 of the *Income Tax Act*.

The Crown seeks support for this proposition in the judgment of Justice Webb in *Darte*, and also the judgment of Justice Angers in *Burns v. R.*[161] where Justice Angers, in dealing also with a section 160 issue, stated:

25 In my opinion, the appellant cannot invoke these equitable remedies to argue that the transfers amounted to a conveyance to her of the interest she had in the properties at the time, when in fact she and **McCarthy were still living together and no apparent cause or need to remedy an economic injustice existed between McCarthy and the appellant. See *Blackman v. Davison* (1986), 2 B.C.L.R. (2d) 8 (B.C.S.C.). The transfer of the properties was not done pursuant to a finding that the appellant had an equitable interest in them.**

[18] In the recent decision of *Livingston v. R.*[162], the Federal Court of Appeal addressed the possibility of a resulting trust in the context of a section 160 issue, and found that it was unnecessary to

consider that argument, however, the Court did not raise any concerns about jurisdiction to consider such an equitable remedy. Further, in the case of *Savoie v. R.*,[163] Former Chief Justice Bowman stated that the doctrine of constructive trust could be invoked in determining the fair market value of

a property transfer by a tax debtor for purpose of the application of section 160 of the *Income Tax Act*.

[19] One purpose of section 160 is to prevent taxpayers from thwarting the Government's ability to collect tax by transferring property to a spouse**. It is not intended to widen the Government's collection powers to seize property that never was beneficially owned by the debtor taxpayer. To effectively turn a blind eye to the legal and equitable realities, under the guise of some purported lack of authority, could lead to not just a harsh result, but a result contrary to the very object and spirit of the legislation in issue. Given Former Chief Justice Bowman's view in *Savoie*, given I have been referred to no definitive statement from the Federal Court of Appeal or the Supreme Court of Canada as to the application of a resulting trust in a section 160 assessment situation, and given my colleague Justice Webb's end-around to accomplish the same objective**

---

[160] Donovan W.M. Waters, Q.C., Mark R. Gillen & Lionel D. Smith, *Waters' Law of Trusts in Canada,* 3rd ed. (Toronto: Thomson Carswell, 2005) at p. 454

[161] [2006] 5 C.T.C. 2392

[162] 2008 FCA 89

[163] 207 93 DTC 552

Digitized by Google

as a finding of constructive trust, I am prepared to consider whether the circumstances of the Warrens' property holdings justify a conclusion of a resulting trust for the purposes of determining exactly what property was transferred by Dr. Warren to his wife.

[20] In April 1983, at the time Dr. Warren took title to the Manotick property (at that stage bare land) in his name alone the following was the situation:

Dr. Warren provided a $37,250 mortgage back on the Manotick property to the Vendor.

Dr. Warren and Mrs. Warren borrowed $74,200 from the Royal Bank secured by a mortgage registered against the Elvaston property (held jointly).

Mrs. Warren's intention was that Dr. Warren would look after her interests. [21] For the several months after the transfer, the following transpired:

Costs were incurred of approximately $280,000 for construction of the home on the Manotick property.

In 1984, the Elvaston property sold for $133,000 (equity of approximately $60,000) and, according to Mrs. Warren, the proceeds went into construction of the house.

According to Dr. Warren, the house was constructed with borrowed funds, though a review of the documents provided show no further borrowing against the Manotick property until 1989.

[22] The concept of resulting trust is not complicated. As Professor Waters asks in *Waters Law of Trusts in Canada*, in his chapter on resulting trusts:

What is the position if two persons advance the money for the purchase of certain property, which is taken in the name of one of them? If the amount subscribed by each is determinable, it is clear that the transferee holds on a proportionate resulting trust. … (page 370)

[23] I believe that is the situation before me. Two people contributed to the Manotick property notwithstanding title was put in Dr. Warren's name alone. I have been convinced it was intended that some part of the Manotick property was held for Mrs. Warren. So, for purposes of the section 160 appeal, the property which the Government can trace, now in Mrs. Warren's name, is only that part of the property to which she was not previously beneficially entitled.

[24] What then is the extent of the interest in the property held by Dr. Warren for his wife.[?] The Warrens claim he held half the property for his wife. I am not convinced that reflects Mrs. Warren's real contribution. According to Dr. Warren, the Manotick property cost $74,500 for the lot and approximately $280,000 for the construction of the house for a total cost of $354,500. Of that, $133,000 came from the Elvaston property, the former matrimonial home, held jointly by Dr. Warren and his wife**. In reviewing the history of that property, the Elvaston property, I have been satisfied that joint ownership reflects an equal ownership.** A further $37,000 came from a mortgage Dr. Warren gave back to the Vendor of the Manotick property, and for which Dr. Warren made the mortgage payments. There remains approximately $184,500 to account for, to cover the costs towards the construction of the Manotick property. Dr. Warren testified this came from borrowing. Mrs. Warren did not have a clear handle on the financial and business affairs to offer any insight on this issue. I conclude

Digitized by Google

that the source of the $184,500 could only have come from the one source of revenue for the Warrens and that was the clinic. The clinic was registered in Mrs. Warren's name and she claims to have received some rental income from it. Again, her testimony was somewhat confusing on this point, as she suggested a company owned the property and she got salary from the company. Dr. Warren testified that Mrs. Warren received a salary as manager of the clinic and rent as owner of the clinic. I accept that Mrs. Warren received some income from the clinic in 1983 and 1984 when funds were needed to put into the Manotick property. The only evidence as to amount is the $37,000 per year Mrs. Warren suggested. I find that such income was likely considerably less than what Dr. Warren was taking from the clinic. Unfortunately, I heard little evidence on this critical aspect of the source of funds for the Manotick property. Though Dr. Warren suggested funds were borrowed for the construction costs, I have no evidence of that. The only mortgage was long after the construction.

[25] To find a resulting trust, the amount contributed by the beneficiary must be readily determinable. Dr. Warren and Mrs. Warren have made it difficult to make such a ready determination. I am left to surmise from Mrs. Warren's annual income, Dr. Warren's control of financial affairs and, granted, a presumption that he drew the lion's share from the clinic that of the $184,500 contributed to the construction of the house, $50,000 at most may have been contributed by Mrs. Warren. This is, I would suggest, closer to the truth than a finding that Mrs. Warren contributed none of it, half of it or all of it.

[26] In summary, of the $354,500 for the purchase of the lot and construction of the home, Mrs. Warren contributed half of $133,000 plus $50,000 or a total of $116,500, compared to Dr. Warren's contribution of $238,000. I conclude that the interest held by Dr. Warren for Mrs. Warren in the Manotick property was approximately a one-third interest. Dr. Warren had a two-thirds interest. It was this two-thirds interest in the property that he transferred to Mrs. Warren in January 1998. I wish to emphasize that this analysis is not one of a constructive trust on the breakdown of marriage. It is an analysis to determine the extent of Mrs. Warren's interest as a beneficiary of a resulting trust for purposes of the application of section 160 of the *Income Tax Act*. I conclude Dr. Warren did indeed transfer property to his wife, but the property transferred was a two-thirds interest in the Manotick property, not the 50% interest as suggested by the Appellant nor the 100% interest as suggested by the Respondent.

[27] I now turn to the second element of the section 160 analysis, and that is the adequacy of the consideration Mrs. Warren provided to her husband for the two-thirds interest. There is no dispute that at the time of transfer the Manotick property was valued at $425,000, with a $90,000 mortgage against it, leaving an equity of $335,000. So what did Mrs. Warren pay to Dr. Warren for his two-thirds interest?

[28] In the transfer document the consideration is shown only as the $90,000 remaining balance of the mortgage, and the purpose for the conveyance is stated as "conveyance from husband to wife for natural love and affection". Coincidentally with the transfer a mortgage is registered against the

Digitized by Google

property for $168,000 showing Mrs. Warren as the chargor, Healthgroup Financial as the chargee and Dr. Warren as the guarantor. The Respondent argues that the $168,000 was not part of the consideration, firstly, as it was not registered against the property at the time of the transfer, and secondly that there was no documentary evidence indicating the funds went to Dr. Warren.

[29] With respect to the Respondent's first position that the mortgage was subsequent to the transfer, and therefore not part of the consideration, I refer to the Transfer/Deed of Land which shows a registration date of January 6, 1998 at 11:40 a.m. and the mortgage for $168,000 showing a registration date of January 6, 1998 at 11:41 a.m. While the transfer does not refer to the $168,000 mortgage as part of the consideration, the timing is such that these events did take place coincidentally. The Respondent appears to be suggesting that Mrs. Warren only paid $90,000 for the property, then borrowed against the property to raise $168,000 for whatever other purpose she may have intended. But that purpose was to accommodate her husband's consolidation of debt agenda. It is not the timing of the registration of the mortgage that is conclusive, nor the statements in the Transfer/Deed of Land itself, but whether in fact the $168,000 went from Mrs. Warren to Dr. Warren to buy the property. This leads to the consideration of the Respondent's second point. [30] What evidence is there that the $168,000 mortgage went to Dr. Warren as consideration for the Manotick property. As already indicated, the Transfer does not recognize the $168,000 as part of the consideration. The Charge/Mortgage of Land document registered with the Land Registry Office does though show Dr. Warren as a guarantor. I have already commented on Mrs. Warren's limited knowledge of the financial affairs: it was not her but Dr. Warren who, with the assistance of an accountant, devised this plan to consolidate debts. As he testified, he asked his wife to take out the $168,000 mortgage as he was consolidating debts and needed the money for his business, presumably the clinic. When questioned in cross-examination about how much the mortgage payments were and who made them, it was clear Mrs. Warren had no idea. This is not intended in any way to be a criticism of Mrs. Warren: the financial arrangements were just not her area of expertise. She was simply helping her husband.

[31] Although there is no documentary trace of exactly where the $168,000 went, I have been satisfied that it did not go into Mrs. Warren's pocket, but went directly or indirectly to the benefit of her husband. There is no evidence to suggest otherwise. It really comes down to whether Mrs. Warren gave her husband the money, or paid him the money to buy his interest out. She never addressed her mind to how this was structured legally. Dr. Warren needed money. If he simply borrowed the $168,000 against the Manotick property, and the property remained in his name, he would have reduced his wife's equity in the property (whether she had a 50% resulting trust interest, or as I have determined, a one-third interest). So, he protected his wife's interest by shifting the property into her name (presuming he, in turn, retains no resulting trust interest in the property now in his wife's name - this is not an avenue of analysis explored by either side, for good reason - the image of a dog chasing its tail comes to mind). Tax impact aside, this objective was met whether the $168,000

Digitized by Google

was consideration for the transfer or simply a subsequent loan, the proceeds of which were for Dr. Warren's benefit. While Mrs. Warren and Dr. Warren may not have addressed their minds as to how the $168,000 was to be categorized, it is clear that it went hand in hand with the transfer. It was clearly prearranged so that it would be registered coincidentally with the transfer. There is no doubt, as far as Dr. Warren was concerned, there would be no transfer unless there was the Healthgroup mortgage. I conclude it was all part of the same deal, and therefore, did constitute part of the consideration from Mrs. Warren to her husband.

[32] I have a concern with respect to the value of the $168,000 mortgage Mrs. Warren took out to pay her husband. Firstly, she was unsure whether she made the mortgage payments. Secondly, I am satisfied she had no involvement in arranging the financing. Thirdly, Dr. Warren was guarantor and may have been making the mortgage payments himself. No banking documents were presented to indicate who made the payments. The Respondent did not raise these matters to suggest that the $168,000 had a value of anything other than $168,000. While I have concerns whether in these circumstances the $168,000 is properly valued as $168,000 of consideration for the property, I do not intend to engage in an exercise of actuarial and appraisal speculation, when the Respondent has not led me there. I take the $168,000 at its face value.

[33] What really occurred between Dr. Warren and Mrs. Warren was that by assuming the existing mortgage and adding a further $168,000 mortgage, proceeds of which went to Dr. Warren's benefit, Mrs. Warren was effectively acquiring Dr. Warren's equity in the property for $168,000. She argues that Dr. Warren's equity was $168,000 so she paid adequate consideration for purposes of section 160. In that regard, she is mistaken. Dr. Warren's equity interest in the property was twothirds of $335,000, or $223,333. She therefore did not pay him fair market value. She fell short by $55,333, and it is that amount for which she is exposed pursuant to section 160.

[34] The appeal is allowed and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that Mrs. Warren's tax liability pursuant to section 160 is to be limited to $55,333. Given the limited success, I am making no award of costs in this matter.

See also the Queen v. Valerie Gail Rose, 2009 FCA 93, where the Appeal ct. held:

[1] This is an appeal by Her Majesty the Queen from a decision by Justice Sheridan of the Tax Court of Canada in which she allowed an appeal by Valerie Gail Rose against an assessment of the Minister of National Revenue under subsection 160(1) of the *Income Tax Act,* R.S.C. 1985, c. 1 (5th Supp.). The Tax Court's decision is reported as *Rose v. The Queen*, 2007 TCC 657.

…

[4] The Judge concluded on the basis of the evidence that Mr Rose had established that he had intended to transfer to Ms Rose only the bare legal title, and that their relationship with respect to the house was to be unchanged. **Accordingly, the Judge found that Ms Rose held the legal title on a**

Digitized by Google

resulting trust for Mr Rose as the beneficial owner of half of the equitable interest in the house. Hence, she held, there had been no transfer of property for the purpose of subsection 160(1), and set aside the assessment.

[5] In my respectful view, the Tax Court Judge erred in reaching this conclusion. I fully accept the Judge's finding that the Roses were credible witnesses. Nonetheless, when considered against the relevant legal background, the evidence unmistakably indicates that Mr Rose transferred the entirety of his interest in the property. I would allow the Crown's appeal.

...

[19] Counsel **for the Crown argues that the Tax Court Judge erred in her conclusion that Mr Rose had retained his beneficial interest and that Ms Rose was a resulting trustee for her husband.** It was common ground that this is a question of mixed fact and law and that the Judge's decision may be set aside only if she made a palpable and overriding error in her application of the law to the facts, or decided a readily extricable question of law incorrectly. [20] Before both the Tax Court and this Court, the parties agreed that Ms Rose has the burden of proving that her husband retained his beneficial interest in the house and that, if she discharged this burden, she would hold the title on a resulting trust for him.

[21] A determination of whether Mr Rose transferred the entirety of his interest to Ms Rose must start with his reason for making the transfer. On this, the evidence is unequivocal: Mr Rose thought that Mr Holyoak might succeed in his claim against him, and wanted to prevent him from placing a lien on the family home. He had taken his name off the title of his daughter's house for a similar reason.

[22] Mr Rose's reason for the transfer is almost conclusive evidence of an intention to transfer his beneficial interest to his wife. Only by divesting himself entirely of his interest in the property could Mr Rose put it beyond the reach of Mr Holyoak, subject to the right of the latter, if a defeated, hindered or delayed creditor, to seek to have the transfer set aside as a fraudulent conveyance. It is also clear from the evidence that Ms Rose understood the reason for the transfer of title to her.

[23] The question before us is whether it was open to the Tax Court Judge on the evidence before her to conclude that, despite Mr Rose's stated intention to avoid Mr Holyoak's claim, he had established that he did not transfer his beneficial interest when he removed his name from the title and put it into his wife's. I note that Mr Rose did not allege, and the Tax Court Judge did not find, that Mr Rose intended to cheat Mr Holyoak by hiding the fact that, despite the transfer of legal title to his wife, he retained a beneficial interest in the house.

[24] The Tax Court Judge relied principally on three items of evidence to establish that Mr Rose retained his beneficial interest in the house. **First, the Roses asserted that they intended only to change the ownership of the legal title and had no discussions about the terms on which Ms Rose was to hold the title. The inference to be drawn from this evidence does not depend on the Roses' credibility. However, this evidence is inconsistent**

Digitized by Google

with Mr Rose's undisputed intention to transfer title in order to defeat Mr Holyoak's claim.

[25] Second, the Judge relied on the fact that the Roses continued their previous arrangements for paying household bills from their separate bank accounts. **Mr Rose made the mortgage payments**. However, the maintenance of their previous household financial arrangements is likely to have had more to do with the fact that they intended to remain married, and to occupy the house as their home, than with the question of ownership. **In short, this evidence is compatible with either view of the ownership of the beneficial interest.**

[26] **The same is true of the fact that Mr Rose continued to reside in the house. Counsel for Ms Rose argued that this is evidence that he retained his beneficial interest; if he had divested himself of his entire interest, he would have had no right to remain in the house. Again, his continued residence likely had much more to do with the fact that they were a married couple, who intended to continue to live together, than with any legal niceties about ownership of the home.**

---

[27] Third, the Roses testified that although Ms Rose could have sold, leased or mortgaged the house after the legal title was put into her name, she would never have done so without Mr Rose's agreement. Indeed, Ms Rose testified, such a thing had never occurred to her. However, whether or not Ms Rose had the entire beneficial interest, she was highly unlikely to sell the house without regard to Mr Rose's wishes. A spouse who has had a long marriage, like Ms Rose, would not normally dispose unilaterally of the matrimonial home, however title is held. Consequently, their testimony has little bearing on the question in dispute; it is equivocal on the question of whether Mr Rose retained his beneficial interest in the house.

[28] Counsel made two other arguments. First, he relied on the Tax Court Judge's finding that, because Mr Rose did not expect the CRA to place a lien on the house, he had no intention of hindering its ability to collect his tax debt. The short answer to this argument is that subsection 160(1) does not require an intention to avoid the payment of tax owing (*Addison & Leyen Ltd. v. Canada*, [2006] 4 F.C.R. 532, 2006 FCA 107, at para. 65(6) *per* Sharlow J.A.). In addition, Mr Rose did intend to defeat Mr Holyoak; the transfer of property with the intention of avoiding one creditor may equally prejudice another.

[29] Second, counsel submitted that Mr Rose's interest, valued at $15,000, was exempt from execution by *The Exemptions Act* because it was worth less than the $32,000. Hence, even if Mr and Ms Rose had remained joint tenants, neither Mr Holyoak nor the CRA could have executed a lien on Mr Rose's half interest. Counsel pointed to the statement in *Logiudice v. The Queen*, 97 DTC 1462 (TCC) at para. 16, that subsection 160(1) is aimed at preventing tax debtors from placing their *exigible* assets beyond the reach of the Crown.

[30] I do not agree. To limit the application of subsection 160(1) in this way would require words to be read into the text which are not there. **I see no warrant for so doing. Further, no judicial determination of the availability of**

Digitized by Google

an exemption has been made on the particular facts of this case. A lien could become enforceable if the value of Mr Rose's equity increased significantly as a result of paying down the mortgage and an increase in the market value of the property.

[31] In my respectful view, the Tax Court Judge committed a palpable and overriding error when she inferred from the facts that Mr Rose had discharged his burden of establishing that he had retained his beneficial interest in the house. **It an almost inescapable inference from Mr Rose's statement that he transferred title in order to prevent Mr Holyoak from pursuing his claim by placing a lien on the house that he intended to do this in the most effective, and lawful, manner: that is, by transferring his entire interest in the house. The evidence on which the Judge relied as proving that he did not do this is, in my opinion, largely equivocal on the nature of the interest transferred to Ms Rose.**

[32] The Crown also argued that, by virtue of the broad wording of subsection 160(1), Ms Rose was liable for her husband's tax debt, up to the value of his half interest in the house (that is, $15,000), even if he had transferred only legal title and retained his beneficial interest. Counsel said that this result flows from the decision of this Court in *Livingston v. Canada*, 2007 FCA 89. Because of my conclusion that Mr Rose transferred his beneficial interest in the house to his wife, it is not necessary to decide this question. The implications of *Livingston* are best left for another day.

[33] For these reasons, I would allow the appeal with costs, both here and below, set aside the judgment of the Tax Court, and restore the Minister's assessment of Ms Rose under subsection 160(1) in the amount of $15,000.

Matrimonial Property Transfers

Is a transfer of the matrimonial home pursuant to satisfying a provincial matrimonial Act obligation for without consideration that can be captured by s. 160? There have been differing cases on this as below in Bernice A. Campbell v. Her Majesty The Queen[164]:

[1] The Appellant was assessed the amount of $24,341.00 pursuant to section 160 of the *Income Tax Act* (the "*Act*") and section 20 of the *Nova Scotia Income Tax Act* (the "*NS Act*") in respect to a transfer of property from her husband, Gerald Campbell, on October 8, 2002.

[2] Initially, the Appellant took the position that the conveyance of the property was not a transfer within the meaning of section 160 of the *Act* because the disposition did not result in a change of beneficial ownership. However, the Appellant has conceded that there was in fact a transfer in light of the decision in *The Queen* v. *Livingston,* 2008 DTC 6233, but argues that Gerald Campbell had only a legal title to transfer which had a value of nil. Therefore, in deciding the issue of whether the Appellant is liable to pay $24,341.00 in respect to this property transfer, it is necessary to address the sub-issue of whether the Appellant's spouse had a beneficial interest in the property when he transferred

[164] 2009 TCC 431

Digitized by Google

it to the Appellant in 2002.

[3] After the Appellant and Gerald Campbell were married in 1979, they moved to Alberta. In 1989 they returned to Nova Scotia and eventually on January 25, 1993 they purchased a condominium property (the "condo") in Halifax. Title to the condo was registered in both names as joint tenants. The Appellant testified that she initiated this purchase and received the down payment of $10,000.00 as a gift from her mother. The Appellant's mother confirmed that she gifted not only the down payment of $10,000.00 but also an additional amount of $1,000.00 to cover legal fees. A mortgage with Scotia Mortgage Corporation was placed on the property on January 25, 1993. This mortgage was renegotiated on December 27, 2000 and both parties remained as co-mortgagors until October 8, 2002.

[4] The Appellant testified that she has made all the mortgage payments on the condo initially from a joint bank account held with Gerald Campbell. Mr. Campbell has had no signing authority on this account since 2001. According to the Appellant, she paid not only the mortgage payments but all of the other expenses associated with this property. Mr. Campbell's work is sporadic within the construction industry while the Appellant has full time employment as an executive secretary with the Nova Scotia Department of Community Services. The Appellant did state that her husband contributed varying amounts between $100.00 and $600.00 once or twice monthly and that he assisted with child care (although the Appellant's mother, Pearl Engram, did most of the babysitting for the Appellant), some household chores and paid for some groceries and the power bill. Mr. Campbell acknowledged that, although he was aware that he was named on the mortgage, he did not make mortgage payments and was not fully aware of how the payments were made. However, he confirmed that the Appellant paid for a joint life insurance policy with respect to this mortgage until 2002 while the Appellant in her testimony claimed that she was not aware of this insurance until her memory was refreshed by documentation (Exhibit R-1, Tab 10).

[5] From the time of purchase in January 1993 until the present time the condo has been occupied by the Appellant, Mr. Campbell and their daughter as a family residence except for periods of marital problems when the Appellant's husband would leave the residence. According to the evidence, Mr. Campbell left the residence in early January 1993 for approximately five or six months. He returned to the residence because he could no longer pay rent and continues to reside in the condo because "… it's better than sleeping on the street." (Transcript, page 110).

[6] On October 8, 2002, Mr. Campbell executed a Warranty Deed (Exhibit A-1, Tab 2) conveying his interest in the property to the Appellant in consideration of one dollar "Because we were going to separate, and she put all the money into it in the first place …" (Transcript, page 110).

[7] As of October 8, 2002 the fair market value ("FMV") of the property was no less than $106,000.00, subject to a mortgage balance of $57,316.83 with Scotia Mortgage Corporation. At the time of the transfer the FMV of 50% of the equity in this property totalled $24,341.58.

Digitized by Google

[8] Until 2000, the Appellant completed Mr. Campbell's income tax returns. On cross-examination, he agreed that he was probably first assessed for taxes around February 2001. The aggregate of all amounts that he was liable to pay under the *Act* in respect to the 1999, 2000, 2001 and 2002 taxation years was not less than
$45,287.51.
The Appellant's Position:
[9] The Appellant claims that since the purchase of the property her husband's only interest in the condo was that of legal title but that he never had a beneficial interest or equity of redemption. The Appellant testified that she has always assumed full financial responsibility for the property including the initial down payment and the subsequent mortgage payments. An assessment should not be made pursuant to section 160 because it was only a legal title to the property that Gerald Campbell released and conveyed to the Appellant by Warranty Deed in 2002. Since nothing of value was conveyed to the Appellant and because the Appellant always held the full beneficial interest in the property, the FMV of Gerald's interest did not exceed the FMV of the one dollar consideration given by the Appellant.
The Respondent's Position:
[10] The Respondent's argument is that the Appellant's husband had both a legal and beneficial interest in the condo at all material times. Because they are spouses of each other, they were not dealing at arm's length. When the property was transferred to the Appellant in 2002, Gerald Campbell owed taxes under the *Act* with the FMV of the property at transfer exceeding the consideration given by the Appellant. Therefore the Appellant is liable to pay $24,341.00 pursuant to section 160.
Provisions Relied Upon:
[11] The parties relied upon sections 160, 251 and subsection 248(1) of the *Act* together with section 20 of the *NS Act* and sections 3, 6 and 8 of the *Matrimonial Property Act*. The relevant portions of section 160 provide:
[12] Section 251 states:
…
[13] Subsection 248(1) provides the following definition of "property":
…
[14] Subsections 3(1) and 6(1) and section 8 of the *Matrimonial Property Act* read as follows:
"matrimonial home" defined
3(1) In this Act, "matrimonial home" means the dwelling and real property occupied by a person and that person's spouse as their family residence and in which either or both of them have a property interest other than a leasehold interest.
…
Equal right of possession of matrimonial home
6(1) A spouse is equally entitled to any right of possession of the other spouse in a matrimonial home.
…

Digitized by Google

Disposition of matrimonial home

8(1) Neither spouse shall dispose of or encumber any interest in a matrimonial home unless

the other spouse consents by signing the instrument of disposition or encumbrance, which consent shall not be unreasonably withheld;

the other spouse has released all rights to the matrimonial home by a separation agreement or marriage contract;

the proposed disposition or encumbrance is authorized by court order or an order has been made releasing the property as a matrimonial home; or

the property is not designated as a matrimonial home and an instrument designating another property as a matrimonial home of the spouses is registered and not cancelled.

Disposition contrary to subsection (1)

Where a spouse disposes of or encumbers an interest in a matrimonial home contrary to subsection (1), the transaction may be set aside by the other spouse upon an application to the court unless the person holding the interest or encumbrance acquired it for valuable consideration, in good faith and without notice that the property was a matrimonial home.

[15] Section 20 of the *NS Act* provides:

… Analysis:

[16] Although often described as a draconian provision, section 160 is an important tax collection tool under the *Act*. The purpose of the section is to prevent a taxpayer from avoiding a tax liability by transferring property to certain individuals or non-arm's length persons, thereby avoiding the tax debt, while still possibly benefiting from the assets. In this appeal the Minister seeks to invoke section 160 to prevent the tax debtor, Gerald Campbell, from transferring assets to his spouse, the Appellant, in an attempt to shield the property from tax collection. If successful, it makes the Appellant liable for the tax liability owed in the year of transfer or any preceding year to the extent that the FMV of the property transferred to the Appellant exceeds the consideration received. It should be noted however that there is no requirement that the transferor have an intention to avoid tax liability at the time of the transfer [*Montreuil et al.* v. *The Queen*, 95 DTC 138].

[17] In *Wannan* v. *The Queen*, 2003 DTC 5715, the Federal Court of Appeal at paragraph 3 stated the following:

[3] … There is no due diligence defence to the application of section 160. It may apply to a transferee of property who has no intention to assist the primary tax debtor to avoid the payment of tax. Indeed, it may apply to a transferee who has no knowledge of the tax affairs of the primary tax debtor. However, section 160 has been validly enacted as part of the law of Canada. If the Crown seeks to rely on section 160 in a particular case, it must be permitted to do so if the statutory conditions are met.

[18] There are four conditions that must be satisfied before section 160 can be applied. According to the decision in *Livingston* at paragraphs 17 to 19, the following criteria will trigger the application of section 160:

[17] In light of the clear meaning of the words of subsection 160(1), the

Digitized by Google

criteria to apply when considering subsection 160(1) are self-evident:
The transferor must be liable to pay tax under the Act at the time of transfer;
There must be a transfer of property, either directly or indirectly, by means of a trust or by any other means whatever;
The transferee must either be:
The transferor's spouse or common-law partner at the time of transfer or a person who has since become the person's spouse or common-law partner;
A person who was under 18 years of age at the time of transfer; or
A person with whom the transferor was not dealing at arm's length.
The fair market value of the property transferred must exceed the fair market value of the consideration given by the transferee.
[18] The purpose of subsection 160(1) of the Act is especially crucial to inform the application of these criteria. In *Medland* v. *Canada* 98 DTC 6358 (F.C.A.) ("*Medland*") this Court concluded that "the object and spirit of subsection 160(1), is to prevent a taxpayer from transferring his property to his spouse [or to a minor or non-arm's length individual] in order to thwart the Minister's efforts to collect the money which is owned to him." See also *Heavyside* v. *Canada* [97 DTC 5026] [1996]
F.C.J. No. 1608 (C.A.) (QL) ("*Heavyside*") at paragraph 10. More apposite to this case, the Tax Court of Canada has held that the purpose of subsection 160(1) would be defeated where a transferor allows a transferee to use the money to pay the debts of the transferor for the purpose of preferring certain creditors over the CRA (*Raphael* v. *Canada* 2000 DTC 2434 (T.C.C.) at paragraph 19).
[19] … [G]iven the purpose of subsection 160(1), the intention of the parties to defraud the CRA as a creditor can be of relevance in gauging the adequacy of the consideration given. However, I do not wish to be taken as suggesting as there must be an intention to defraud the CRA in order for subsection 160(1) to apply. The provision can apply to a transferee of property who has no intention to assist the primary tax debtor to avoid the payment of tax: see *Wannan* v. *Canada* [2003 DTC 5715] 2003 FCA 423 at paragraph 3.
[19] Three of these four conditions are not in dispute in this appeal.
Tax Liability – subparagraph 160(1)(e)(ii)
[20] One of the Minister of National Revenue's (the "Minister") assumptions was that the Appellant's spouse had a tax liability of $45,287.00 at the time of the transfer on October 8, 2002. Although the Appellant testified that she was unaware of her husband's tax liability because she had ceased filing his tax returns in the early 2000s, according to the decision in *Wannan,* the transferee need not have knowledge of the tax affairs of the primary debtor in order to trigger the application of section 160. Mr. Campbell's tax liability was not in dispute.
Relationship between Transferor and Transferee – paragraph 160(1)(a)
[21] The definition of "related persons" contained in subsection 251(2) includes individuals connected by marriage or common-law partnership. Since related persons are deemed not to be dealing with each other at arm's length and the evidence supports that the parties have been married since 1979, this

Digitized by Google

requirement is also met.

Consideration and FMV – subparagraph 160(1)(e)(i)

[22] Pursuant to subparagraph 160(1)(e)(i), a transferee will be liable for the transferor's tax liability to the extent that the value of the property exceeds the value of the consideration received for the property. The Minister assumed that Gerald Campbell's equity in the condo was $24,341.00 and that he transferred both his legal and beneficial interest in the condo to the Appellant for the consideration of one dollar. The Appellant did not dispute that the FMV of the condo on October 8, 2002 was $106,000.00 or that the mortgage balance was $57,316.00. However she maintained that the FMV of her husband's interest in the condo was nil and not $24,341.00 as the Respondent contends. Therefore, she submits that her liability is nil pursuant to section 160 because the FMV of her husband's interest did not exceed the consideration of one dollar.

[23] A determination of the FMV of Gerald Campbell's interest in the condo is dependent upon whether he had only a legal title where the FMV of that interest will be nil or whether he had both a legal and beneficial interest in the condo where the FMV of his interest would then equal $24,341.00.

Transfer of Property

[24] The term "property" is defined in subsection 248(1) of the *Act*. The condo which was conveyed to the Appellant falls within the ambit of this definition as it includes real property.

[25] The term "transfer" is not defined in the *Act* but numerous decisions have discussed this term. Thorson

J. in the oft cited case of *Fasken* v. *Minister of National Revenue*, 49 DTC 491 at page 497, provided the following definition:

The word "transfer" is not a term of art and has not a technical meaning. It is not necessary to a transfer of property from a husband to his wife that it should be made in any particular form or that it should be made directly. All that is required is that the husband should so deal with the property as to divest himself of it and vest it in his wife, that is to say, pass the property from himself to her. The means by which he accomplishes this result, whether direct or circuitous, may properly be called a transfer. …

[26] The recent decision of *Livingston* established that the mere transfer of a legal title constitutes a transfer under section 160. At paragraph 22, Sexton J. made the following comment:

[22] In addition, there is a transfer of property for the purposes of section 160 even when beneficial ownership has not been transferred. Subsection 160(1) applies to any transfer of property – "by means of a trust or by any other means whatever".

Thus, subsection 160(1) categorizes a transfer to a trust as a transfer of property. Certainly, even where the transferor is the beneficiary under the trust, nevertheless, legal title has been transferred to the trustee. Obviously, this constitutes a transfer of property for the purposes of subsection 160(1) which, after all, is designed, *inter alia*, to prevent the transferor from hiding his or her assets, including behind the veil of a trust, in order to prevent the CRA from

Digitized by Google

attaching the asset. Therefore it is unnecessary to consider the respondent's argument that beneficial title to the funds remained with Ms. Davies.

....

[27] In light of the *Livingston* decision, the Appellant conceded that there was a transfer pursuant to section 160 but contends that the decision did not address the value of a legal title. The Appellant argues that since Gerald Campbell did not have a beneficial interest in the property, nothing of value passed to the Appellant in the transfer of the property because the value of the legal title was nil. The Appellant submits that the authorities seem to state that the value of a legal interest is nil but does not cite those authorities. It is likely that the Appellant is referring to Justice Brulé's decision in *Gardner* v. *M.N.R.*, 88 DTC 1649, where at page 1651 he concluded that the taxpayer's interest in the property was nil because he held only a legal title in the property.

Beneficial Interest v. Legal Title:

[28] In response to the Appellant's argument that Gerald Campbell transferred only legal title which had a value of nil, the Respondent contends that as a pre-condition of concluding that Gerald Campbell had no beneficial interest to convey, this Court must find that he was acting as a prête-nom or holding his interest in the condo in trust for the Appellant. The Respondent submits that there is no evidence that would allow such a conclusion.

[29] In the case of *Gardner*, Brulé J. concluded that the Appellant's spouse became a joint tenant to facilitate the acquisition of financing and therefore the Appellant's husband held legal title only as trustee. In *Hurd* v. *The Queen*, [2001] 2 C.T.C. 2489, McArthur J. concluded that there was no transfer of beneficial interest to an uncle because he was merely a trustee for the taxpayer, having executed a valid declaration of trust.

[30] In both *Gardner* and *Hurd* as well as the decision in *Linke* v. *The Queen*, 94 DTC 1549, individuals were added to the title of the property as joint tenants so that the appellants in those cases could acquire mortgage financing. However, in the present appeal the Appellant did not register her husband as a joint tenant of the condo to obtain financing because she testified that she chose the property based solely on her salary. In addition, she stated that there was no formal discussion respecting the addition of his name to the deed at the time of the purchase or at least no discussions that she could recall with her husband or with their lawyer who completed the purchase. The Appellant claims that the evidence supports that she was simply content to have title registered as it was generally done – that is, by way of joint tenancy. The Appellant understood this to mean that her husband was on title as a precautionary measure to avoid estate problems in the event of her death so that her daughter would be assured a home.

[31] While it is true that the Appellant is a layperson with no legal background, she has worked her way into the position of Executive Secretary and in addition had the benefit of legal counsel at the time of purchase. The evidence showed that the Appellant's husband had both a drinking and gambling problem. If, at the time of purchase, she was concerned about the welfare of her daughter as she testified, I have difficulty accepting her evidence that she would not discuss this

Digitized by Google

with the solicitor at the time of purchase rather than proceed on what her own views were of a "joint tenancy" proposition. I am reinforced in my perception of this evidence by the fact that she refused to waive solicitor-client privilege and did not call the lawyer to validate her testimony. This lends support to my suspicion that if this lawyer had been called as a witness, he may have contradicted her testimony.

[32] The Respondent relied on the cases of *Miller* v. *M.N.R.*, 88 DTC 1488, *Splinter* v. *The Queen*, [2001] 3 C.T.C. 2553 and *Isaac* v. *The Queen*, [2006] G.S.T.C. 6, to demonstrate that the Appellant's husband was not a prête-nom holding the interest in the condo in trust for the Appellant. In the decisions of both *Miller* and *Splinter*, title was not held as joint tenants. In *Miller*, Taylor J. concluded that in light of a trust agreement indicating that the transferor received only legal title to the property, he could therefore not transfer what he did not own, namely a beneficial interest.

[33] In *Splinter*, while there was no declaration of trust document that had been executed, there was a finding that other documentary evidence supported that a trust relationship existed so that the transferor held the property in trust only.

[34] In *Isaac*, the transferor was not a resident in the property at the time of transfer and, in addition, documentation, including an executed power of attorney and a separation agreement, indicated that the transferor did not have a beneficial ownership.

[35] Based on this jurisprudence, the Respondent contends that there was no evidence, including documentary evidence such as a declaration of trust, that the Appellant's husband was holding the property in trust for her. Although the Appellant did not specifically address the prête-nom argument and did not argue that Gerald Campbell was holding any interest in the property in trust for the Appellant, in the oral submissions, Appellant's counsel relied on the Saskatchewan Court of Appeal decision in *Anderson* v. *Hervieux*, [1985] S.J. No. 29 (S.K.C.A.). In *Anderson*, the Court held that the Plaintiff, who was residing in a common-law relationship, was entitled to full ownership of the house upon separation based on a resulting trust because the Defendant made no financial contribution and the Plaintiff had registered the property in joint names to ensure that the equity would pass to her on his death. The Appellant argued that these two factors of *Anderson* are similar to the facts in the present appeal and lend support to the Appellant's position that only legal title was transferred but not the beneficial ownership.

[36] The *Anderson* decision does not involve a section 160 assessment. It involves family law and estate trust principles. The parties in *Anderson* were separating while the parties in the present appeal are still married and in fact continue to reside in the condo. There was no evidence in *Anderson* of monetary contribution to the household while Gerald Campbell made financial contributions in amounts between
$100.00 and $600.00 once or twice monthly. Further, in *Anderson* there was no evidence of joint bank accounts or joint VISA statements as in the present appeal. Although the Appellant testified that title to the condo was registered in both names to protect their daughter, she affirmed that she never had any

Digitized by Google

formal discussions with her husband or the lawyer respecting title and the consequences of registering the condo in both names.

[37] In summary, there is insufficient evidence to allow me to conclude that the Appellant's husband was a prête-nom, holding the interest in the condo in trust for the Appellant. There is no documentary evidence to support such a proposition and the oral testimony contains some inconsistencies.

Joint Tenancy

[38] Joint tenancy is a form of ownership in which the joint tenants have concurrent ownership and possession of the same property. The Respondent argued that the most significant factor favouring beneficial ownership is that the Appellant and her husband acquired the condo and held title as joint tenants as opposed to tenants in common. The Respondent also submits that a presumption exists, in the absence of credible documentary evidence, that when parties own property as joint tenants each will have both a legal and beneficial interest in the property. Because the interest of each joint tenant is identical and the property cannot be sold or mortgaged without the consent of both joint tenants, whatever the Appellant had in law so did her husband.

[39] The Appellant contends that it was always her intention that her husband would hold legal title only. However, there is no documentary or circumstantial evidence to support this claim. The evidence supports that the Appellant's husband was involved to some extent with the purchase. He met with the realtor and viewed the condo before purchasing it; he met with the lawyer and reviewed the documents and executed all of the mortgage documentation (although few of these documents are before me). In fact, he remained on the mortgage when it was renegotiated in 2000 until he came off in 2002. In the event of the Appellant's death, her husband had a right of survivorship in respect of the property and he would then have become sole owner of the property. I am perplexed by the Appellant's testimony that she wanted to protect her daughter's future by putting the property in joint names in light of her testimony that her husband had a drinking and gambling problem and that it was primarily her mother that provided child care when her daughter was younger. The designation of the Appellant and her husband as joint tenants and co- mortgagors clearly contradict the Appellant's assertion that she always intended that her husband would have only a legal title to the property.

[40] Respondent has also asked that I draw an adverse inference in respect to the fact that the lawyer that represented the parties in the purchase in 1993 was not called as a witness to confirm the Appellant's intentions at the time of the purchase. The Appellant submitted that this lawyer was on holidays and therefore not available to appear at the hearing. In addition, the Appellant suggested that the Respondent could have subpoenaed this lawyer.

[41] Both the Appellant and her husband met with the lawyer but the evidence was vague in respect to exactly what was discussed at the time of the purchase. Consequently, the testimony of this lawyer could have clarified the questions, concerns and explanations that were discussed with the Appellant and her husband. His testimony had the potential of validating the Appellant's testimony respecting her intentions at the time of purchase. The fact that the

Digitized by Google

Appellant refused to waive solicitor-client privilege leaves me wondering whether the lawyer might have contradicted her testimony respecting the ramifications of joint tenancy if he had been called as a witness. In respect to the Appellant's suggestion that the Respondent could have subpoenaed the lawyer, this becomes largely irrelevant because the solicitor-client privilege was not waived. This lawyer would not have been able to provide any relevant information without the Appellant's consent to revoke this privilege.

[42] The Respondent contends that even if the Appellant's husband was not a joint tenant, he still had a beneficial interest in the condo at the time of transfer. The Minister interprets "beneficial ownership" to mean the entitlement to use or benefit from a property, whether or not one has legal title (Respondent's Submissions, paragraph 40). The Respondent submitted several technical and interpretation bulletins to show how Canada Revenue Agency ("CRA") has come to interpret joint ownership and beneficial ownership [Technical Interpretation 2000-0048195 – Joint Tenancy – Beneficial Ownership; Interpretation – external 2007-025699IE5 - Beneficial Ownership; Interpretation Bulletin IT-437R – Ownership of Property (Principal Residence)].

The *Income Tax Act* (Act) does not define the term "owned". In the common law jurisdictions, two forms of property ownership are recognized -- legal and beneficial. Normally "legal ownership" exists when title is transferred to, recorded in, registered in or otherwise carried in the name of a person. Legal owners are generally entitled to enforce their ownership rights against all other persons. By contrast, the term "beneficial ownership" is used to describe the type of ownership of a person who is entitled to the use and benefit of the property whether or not that person has concurrent legal ownership. The determination of whether a person beneficially owns a property is a question of fact that can only be determined after a review of all the documents and the circumstances applicable to a particular situation. The primary attributes of beneficial ownership include possession, use and risk. Therefore, in determining whether a person has beneficial ownership in a property, one should consider such factors as the right to possession, the right to collect rents, the right to call for the mortgaging of the property, the right to transfer title by sale or by will, the obligation to repair, the obligation to pay property taxes and other relevant rights and obligations. [...] (CRA Views – external 2007-025699IE5 – Beneficial ownership, December 6, 2007). (Emphasis added)

[43] I agree with the Respondent's submissions that Gerald Campbell held a beneficial interest in the condo because he exercised continued use and possession and bore the usual financial risks associated with home ownership (Respondent's Submissions, paragraph 42). Because the Appellant's husband was named as a joint tenant in the deed and as a co-mortgagor on the financing documents, he was liable on an equal footing with the Appellant for payment of property taxes, repairs, condo fees and any outstanding mortgage balance. The property could not be sold or encumbered by further mortgages without his consent. Although the evidence supports that the Appellant made all of the mortgage payments, this alone will not be a defence to an assessment pursuant to section 160 nor does it support an argument that her husband did not have

Digitized by Google

a beneficial interest. Bowman J. (as he was then) at paragraph 25 of *MacDougall* v. *The Queen*, 98 DTC 2180, stated the following in this respect:

[25] Even if this case arose in a common law province I would have reached the same conclusion. The mere fact that a husband makes all the payments under a mortgage on a house that he and his wife own jointly does not mean that she is not a beneficial owner of her one-half. One needs very cogent evidence that a spouse who is shown as the legal owner of an interest in property is not also the beneficial owner. …

(Emphasis added)

[44] The Appellant stated that the bank included her husband's name on the mortgage to allow her to look better in respect to the bottom line picture (Transcript, page 78). According to her evidence, the bank took a "guesstimate" of her husband's earnings without proof and instead relied on her statement of earnings. I have difficulty believing that a lending institution would rely on a "guestimate" and if, as the Appellant contends, the condo was purchased and financed based on her salary alone then there would be no need for her husband to remain on the mortgage documents until October 8, 2002.

[45] In the present appeal, there is little evidence respecting the actual financial contribution of the husband. His contribution varied between $100.00 and $600.00 either once or twice monthly. There was no specific evidence as to how household expenses and duties were divided. The account from which the mortgage payments were made was a joint account. The Appellant claimed that her husband's signing authority was removed in 1994 but I was not provided with any record to support this. The bank records could only confirm that it was removed in 2001. In addition, these records do not cover the entire period for which the parties owned the condo.

[46] The Appellant stated that her mother gifted her $11,000.00 to cover the down payment plus legal fees for the purchase and submitted that the testimony of the Appellant's mother was consistent with that of the Appellant in respect to how the funds were transferred - that is, by way of a joint account. However, while the Appellant's mother did testify that she gifted $11,000.00 to the Appellant, she did not corroborate the Appellant's testimony respecting the transfer of the funds. She initially did not recall how it was transferred and, when questioned further, Pearl Engram recalled that she left the money in a TD account from which her daughter, the Appellant, withdrew the funds even though it did not appear that the Appellant was named on that account. In addition, there were no bank statements, receipts or other financial records to support the Appellant's contention that this $11,000.00 amount was used as a down payment on the condo. The Appellant's testimony therefore has not been fully corroborated here.

[47] On a balance of probabilities the Appellant's financial contribution to the condo was greater than that of her husband. However, as stated by Angers J. in *Burns* v. *The Queen*, 2006 DTC 3383, this Court cannot invoke equitable remedies to conclude that a transfer amounted to a conveyance of the interest he/she had in the home at the time, when in fact the Appellant and her husband were living together in the property and there is no apparent cause or need to

Digitized by Google

remedy an economic injustice.

[48] The Respondent submits that it is difficult to accept the Appellant's contention that she did not realize for numerous years that she and her husband shared a joint bank account. While the evidence suggests that Gerald Campbell was removed from the account by 1999, there is nothing in the evidence to support that he was removed from the account before that date (Transcript, page 168-169). The banking records are incomplete and do not cover the entire period that the Appellant and her husband owned the condo. The Appellant's testimony respecting the origin of transactions of less than $500.00 was vague and few records of any transactions were submitted.

[49] Neither Appellant's counsel nor Respondent's counsel questioned Gerald Campbell about his income or where he was depositing his money if not into the joint Scotiabank account. This certainly would have been beneficial in light of the fact that he incurred a substantial tax debt throughout 1999 to 2002. This leads me to believe that he had income although the Appellant has claimed that his work was sporadic and that he could not be counted on for financial help. If he was not depositing his money into a separate account and was drinking and gambling then I am left to wonder why the Appellant allowed him on title to the condo as a joint tenant, registered him as a co-mortgagor, maintained a joint account, joint life insurance and joint credit cards. The Appellant's evidence did not address these issues. In fact, it is interesting to note that while the Appellant removed her husband's name from the title to the condo, the mortgage and the joint bank account, she did not remove his name from the joint credit cards even though she had to refinance the mortgage to pay them off. Her reason for this was that she needed his signature to do so and did not want to confront him about the credit cards. I am left wondering again why the Appellant felt comfortable in approaching her husband about removal of his name in respect to larger transactions that required his signature but did not want to deal with him on the credit card debt. Also Mr. Campbell contradicted this evidence as he did not believe that he shared joint credit cards with the Appellant. It is also strange that Mr. Campbell testified that the Appellant paid for joint life insurance while the Appellant claimed that she did not know about this – why then would her husband know about the insurance if, as the Appellant claimed, he was never involved in the mortgage because the Appellant attended to all of the affairs of the condo? How could the Appellant be unaware that she was paying for a joint life insurance while her husband had such knowledge?

[50] The Appellant submits that the inconsistencies in the testimony were "quibbling differences" only and of minimal significance. However, I do believe that the evidence before me is sufficient to conclude that Gerald did not have a beneficial interest. There were a number of inconsistencies in the testimony and unanswered questions concerning why Gerald was on the title to the condo and the mortgage, the origin of various deposits to the account, how Gerald was involved in the purchase, the lawyer's absence and the Appellant's refusal to waive solicitor-client privilege. In addition, supporting documentation was either lacking or incomplete.

Digitized by Google

Nova Scotia Matrimonial Property Act ("MPA")

[51] The Respondent argued that as a spouse under the *MPA*, that even if the Appellant's husband had not been a legal owner of the property, he would nevertheless be equally entitled to any right of possession of the condo pursuant to his rights in law as a spouse under the relevant provincial family law legislation. The Respondent asserted that, pursuant to subsection 8(1) of the *MPA*, the Appellant could not dispose of the condo or encumber it unless her husband consented to or otherwise released his rights, for example by separation agreement or court order. At all material times, he lived in the condo after the transfer with the Appellant and their daughter.

[52] The Appellant referred to the decision in *Yates* v. *The Queen*, 2009 DTC 5062 where the Federal Court of Appeal stated that family obligations under provincial legislation do not provide any exceptions to the operation of section 160. The Court stated the following at paragraphs 41, 43, 54 and 70:

[41] […] As I have already indicated, subsection 160(1) does not contain any ambiguity. If there is a transfer within the purview of the provision, then the transferee must satisfy the Court that he or she provided consideration at fair market value. In view of the wording of subsection 160(1), there is simply no basis for the position taken by the Judge.

…

[43] To conclude, the appellant submits that she gave consideration at fair market value for the sums received from her husband. I see no evidence in the record to support that view. To make things perfectly clear, let me say that in allowing her husband to live in the family residence, the appellant did not provide consideration at fair market value. This is simply another attempt by Mrs. Yates to benefit from the exception found at subsection 160(4).

…

[54] There is nothing in subsection 160(1) that permits a court to excuse a spouse from liability where the conditions of the provision are met; in fact, there is no mention of a family law exception in this provision.

…

[70] There is some confusion in jurisprudence since provincial legislation on family law regarding property, family definition, common law partners and matrimonial homes varies from one province to another. Nevertheless, subsection 160(1) should apply equally everywhere in Canada without exception apart from those specifically described in subsection 160(4).

(Emphasis added)

[53] I agree with the Appellant's contention that family law concepts and principles should not play any part when section 160 is being considered and this is particularly so in light of the comments in the *Yates* decision. I note that the Appellant placed considerable reliance on the decision in *Anderson*, which involved family law and estate trust principles, to support the argument that her husband held only legal title to the condo. By the Appellant's own admission, *Anderson* should not therefore be considered given that merging provincial legislation and matrimonial property principles with section 160 is not encouraged according to the jurisprudence. Further, as noted in counsel's Reply

Digitized by Google

Submissions, the concept of matrimonial rights does not exist unless and until there is a separation. In *Anderson* the parties lived in a common-law relationship but had separated. In the present appeal the parties remain married and both continue to reside in the condo. Consequently, I do not believe that the decision in *Anderson* should be given any weight in this appeal.

Section 20 of *NS Act*

[54] Finally, the Reply referenced section 20 of the *NS Act*, which provides a formula for the calculation of income not earned within the Province of Nova Scotia. Neither the Appellant nor the Respondent addressed this provision in their Submissions and I am unsure of how this provision is relevant to the issues in this appeal. Since I received no submissions from either counsel and because it is unclear why the Minister would have resorted to this provision in assessing the Appellant, I do not believe that it is necessary for me to comment on it.

[55] The appeal is therefore dismissed, with costs.

"Family Support Obligations" – Statutorily Recognized?

When a parent makes a contribution towards the up-keep of the estranged family needs is there a transfer for consideration, being his/her obligation to provide in light of a provincial Family Relations Act? This was the case in Harish Kadola v. The Queen[165] where the TCC held:

> [21] Counsel also contended that the amounts transferred by Jagir to Slrender were made partly to meet Jagir's statutory obligation to support his spouse and children. He referred to sections 88 and 89 of the *Family Relations Act* R.S.B.C. 1996 c. 128, which read as follows:
>
> Obligation to support child
>
> (1) Each parent of a child is responsible and liable for the reasonable and necessary support and maintenance of the child.
>
> (2) The making of an order against one parent for the maintenance and support of a child does not affect the liability of another parent for the maintenance and support of the child or bar the making of an order against the other parent.
>
> Obligation to support spouse
>
> (1) A spouse is responsible and liable for the support and maintenance of the other spouse having regard to the following:
>
> the role of each spouse in their family;
>
> an express or implied agreement between the spouses that one has the responsibility to support and maintain the other;
>
> custodial obligations respecting a child;
>
> the ability and capacity of, and the reasonable efforts made by, either or both spouses to support themselves;
>
> economic circumstances.

[165] 2008 TCC 474

Digitized by Google

(2) Except as provided in subsection (1), a spouse or former spouse is required to be self sufficient in relation to the other spouse or former spouse.

[22] Counsel said that Slrender was unaware of Jagir's tax problems when he made the payments to her and there was no complicity in trying to defeat the Crown's claims to Jagir's property. He said that the payments were no more than what was necessary to support Jagir's family and that they were made for good consideration according to the provisions of the *Family Relations Act*.

[23] Counsel relied on the decisions of this Court in *Michaud v. R.* 99 DTC 43, *Dupuis* v. *The Queen* 93 DTC 723 and *Ferracuti v. R.* 99 DTC 194 in which it was held that payments made by one spouse to the other or for the other's benefit in order to fulfill a legal obligation to provide spousal or family support were made for valuable consideration.

[24] Counsel also brought to my attention the decision of this Court in *Raphael* v. *The Queen* 2000 DTC 2434. There, Mogan, J. held that no consideration was given by a spouse to whom property was transferred by the other spouse pursuant to an obligation to support his spouse. Although the case was appealed to the Federal Court of Appeal, this point was not argued and the appeal was decided on other grounds. Counsel said, however, that the Court distanced itself from the comments of the trial judge relating to the issue of whether fulfillment of a family support obligation constituted consideration and referred to the following comments at paragraph 12 of the Reasons:

We do not wish to be taken however, as agreeing with all of the comments of the Tax Court Judge relating to whether there can be a consideration given between husband and wife so as to preclude the application of section 160(1).

Analysis

[25] With respect to the Appellants' first argument, I find that it has not been shown that part of the amounts Slrender received from Jagir between 2002 and 2004 were repayments of a loan. The Appellant admitted that she had not loaned any money to Vertex, and there was no evidence produced to show that Jagir had personally borrowed money from Slrender. While counsel maintained that the promissory note and demand letter were written before Jagir became indebted for taxes, Jagir was first assessed for director's liability in 1998. In this light, a promise to repay a loan that was admittedly never made in the first place is hightly suspect and is by all appearances a sham.

[26] Even if I were inclined to accept Slrender's explanation for the creation of the promissory note, her explanation does not satisfy me that she gave any consideration for the note, and any payments made pursuant to the note would therefore not have been made for any consideration.

[27] I am of the view that the Appellant's second argument cannot succeed either. I am aware of the conflicting decisions in this Court on the point of whether payments of amounts by one spouse to the other spouse or for the other spouse's benefit as family support are made for consideration. The relevant jurisprudence was fully reviewed by Archambault, J. in *Tétrault v. R.* 2004 TCC 332, and I agree with his conclusions at paragraphs 47 to 50 which read as follows:

[47] The contribution to the expenses of the marriage is, in my opinion, in the

Digitized by Google

nature of a donation by which a property is given without any consideration.27 This analysis of the domestic obligation concurs with that made by Judge Mogan in the *Raphael* decision, where he says "[t]hose same domestic obligations, however, cannot be 'consideration' within the meaning of section 160...." (paragraph 27 of the decision). It also concurs with that in *Logiudice*, where it is explained that "The word consideration, as it is used in the context of section 160 of the Act, in its ordinary sense refers to the consideration given by one party to a contract to the other party, in return for the property transferred" and that "The limiting provision in subparagraph 160(1)(*e*)(i) of the Act is to protect genuine business transactions from the operation of the section" (paragraph 16 of the decision). It is also consistent with the analysis made by Judge Sobier in *Sinnott v. The Queen*, *supra*, at paragraph 19 (Q.L.), page 598 DTC: The Appellant's counsel put a good deal of emphasis on the argument that consideration was given for the transfer. But what was that consideration? Can it be said that the paying of household expenses is consideration for the transfers? Subparagraph 160(1)(e)(i) states that the joint liability of the transferor and transferee is an amount equal to the lesser of the amount by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property. At the time the transfers were made, no consideration was given.

[Emphasis added.]

[48] The absence of any consideration given in return for the performance of the domestic obligation readily explains why it highly problematic, if not impossible, to determine what the FMV would be of the transferee's right to receive the property transferred by the transferor pursuant to the latter's domestic obligation. Furthermore, as Judge Mogan said, even if a FMV could be determined, this right would not constitute "consideration given for the property".28

[49] Not only does this interpretation seem to me to be in greater harmony with the language of section 160 of the Act, but it is unavoidable in light of the interpretative presumption that the law is coherent and systematic.29 Section 160 must be considered as a whole if we are to determine its scope. Subsection 160(4)30 of the Act provides that the paragraph 160(1)(*e*) rule is of no effect when a spouse transfers property to the other spouse as a result of the breakdown of the marriage. For the purposes of this rule, the FMV of the transferred property is deemed to be nil. If the reasoning adopted in the *Ferracuti*, *Michaud* and *Dupuis* decisions were adopted, one would have to conclude that subsection 160(4) is of no use, for upon separation,31 the spouse's right to receive a portion of the other spouse's domestic estate is recognized by law, in this case the *Civil Code*, in particular in the rules governing the partition of the family patrimony set out in articles 414 et seq. of the Code. It then involves "a transfer of property ... in performing [a] legal obligation".32 Furthermore, if the right to receive this property under the *Civil Code* constituted consideration, the FMV of which is equal to the FMV of the transferred property, it would not have been necessary to enact that the FMV of

Digitized by Google

the transferred property is nil. On the contrary, I think Parliament assumed that such a transfer upon a separation constitutes a transfer without consideration and, were it not for subsection 160(4) of the Act, the transferee could have been jointly and severally liable for any tax debt of the transferor.

[50] Consequently, the conclusion is unavoidable: the transfer of property under a legal obligation (as in the partition of the family patrimony) constitutes a "transfer" for the purposes of section 160 of the Act and is subject to that section. The mere right to be the beneficiary of this obligation does not constitute a particular consideration. Likewise, the transfer of property to the other spouse in performance of a domestic obligation constitutes a transfer for which no consideration has been given, and there is nothing in section 160 that would allow this Court to exempt this transfer from its operation.33

Strictly speaking, it can be argued that the liberality that is necessary for the existence of a donation is missing here. However, most people who live together would contribute quite voluntarily to the expenses of the marriage, even in the absence of such a domestic obligation; it is generally during a separation or a divorce that the situation becomes conflictual and the existence of this obligation becomes significant.

Paragraph 27 of Raphael and subparagraph 160(1)(*e*)(i) of the Act.

See in particular Pierre-André Côté, *The Interpretation of Legislation in Canada*, 3rd ed. (Toronto: Carswell, 2000), at pages 308 *et seq.*

This subsection reads as follows:

Special rules re transfer of property to spouse -

Notwithstanding subsection 160(1), where at any time a taxpayer has transferred property to the taxpayer's spouse pursuant to a decree, order or judgment of a competent tribunal or pursuant to a written separation agreement and, at that time, the taxpayer and the spouse were separated and living apart as a result of the breakdown of their marriage, the following rules apply:

in respect of property so transferred after February 15, 1984,

the spouse shall not be liable under subsection 160(1) to

pay any amount with respect to any income from, or gain from the disposition of, the property so transferred or property substituted therefor, and

for the purposes of paragraph 160(1)(*e*), the fair market value of the property at the time it was transferred shall be deemed to be nil,

...

but nothing in this subsection shall operate to reduce the taxpayer's liability under any other provision of this Act.

The transfer after divorce is generally not subject to section 160 since the transferee is no longer the spouse of the transferor.

To use the words of the *Michaud* decision, paragraphs 19 and 20.

In my opinion, an amendment to the Act, like the one enacted by S.C. 1984. c. 45, subsection 65(1), applicable after February 15, 1984, for subsection 160(4), would be needed to exempt from the operation of section 160 the property transferred in performance of a domestic obligation. Parliament could draw on provisions such as articles 552 et seq. of the Quebec *Code of Civil Procedure*,

Digitized by Google

which list the exemptions from seizure, such as "The food, fuel, linens and clothing necessary for the life of the household".

[28] Even if I had accepted that payments made by a spouse pursuant to a legal obligation to pay his or her share of family expenses were transfers made for consideration, it would still not have been possible on the evidence before me to determine what portion of the funds transferred to Slrender by Jagir were used by her for expenses that Jagir was required to share under the *Family Relations Act* provisions.

[29] I note firstly that many of the expenses that she paid would appear to have benefited all members of the household equally, including Slrender and Jagir's adult children, Jagir's mother and Jagir himself. The Appellants' counsel did not produce any authority to show that Jagir's support obligations extended to these individuals.

For the purposes of section 88 of the B.C. *Family Relations Act* the term "child" is defined in section 87 as including "a person who is 19 years of age or older and, in relation to the parents of the person, is unable, because of illness, disability or other cause, to withdraw from their charge or to obtain the necessaries of life." Subsection 90(2) of that *Act* provides that a child is liable to maintain and support a parent where the parent is dependent on an adult child because of age, illness or infirmity. In this case, however, there was no evidence led to show that the adult children were unable to withdraw from their parents' charge or that Jagir's mother was dependent on him because of age, illness or infirmity.

[30] Furthermore, only a few of the household and family expenses paid by Slrender with the transferred funds were quantified to any extent by her or corroborated by any other evidence. Slrender estimated that she spent $2,000 a month on groceries, $4,000 a year on Harish's private school fees, and $25,000 on Shawna's wedding. As well, some credit card statements that were put into evidence showed that her monthly payments on the Mercedes-Benz car were about $800 a month. She did not quantify any other expenses that she incurred or paid in 2002, 2003 or 2004 such as cable, hydro or gasoline. In cross- examination, Slrender was shown a withdrawal slip for the bank account in issue that indicated $2,000 was used to purchase U.S. dollar travellers cheques. She said she had no recollection of the transaction or what the funds were used for.

[31] I am therefore left without any means of determining what Jagir's support obligations were or what portion of the funds transferred by Jagir to Slrender would have related to those support obligations.

Corporate Distributions – Dividends, Taxable and Otherwise

When a corporation, which has an outstanding tax liability, pays a dividend to its shareholders it is possible to use s. 160 to pursue that dividend amount for collection. This was the case in Christian Larouche v. The Queen[166] where the

[166] 2010 FCA 32

Digitized by Google

Appeal Ct. held:

[1] This is an appeal of a decision of Justice Angers of the Tax Court of Canada (judge) by which he ruled that there had been a transfer of property between persons who were not dealing at arm's length within the meaning of section 160 of the *Income Tax Act*, R.S.C. 1985, 5th Supp., c. 1 (Act) and that this transfer was made without consideration.

[2] Accordingly, he dismissed the appellants' appeals regarding the notices of assessment established for the 1993, 1994, 1995 and 1996 taxation years.

[3] The appeal before this Court raises only one issue: **Is the payment of dividends to the appellant a transfer of property without consideration within the meaning of section 160 of the Act?** This section reads as follows:

…

Appellants' submissions

[4] The company 9039-0618 Québec Inc. (the assignor) transferred $141,250 in dividends to appellant Christian Larouche and $41,980 in dividends to appellant 2753-1359 Québec Inc. At the time of the transfer, the assignor owed income tax, interest and penalties to the federal Minister of Revenue.

[5] The fact that a transfer was made between persons who were not dealing at arm's length is not contested. **However, the appellants submit that the payment of a dividend should not be considered to be a transfer without consideration as described in section 160. This submission is based on the following two lines of reasoning.**

[6] First, legal ownership of a dividend must be determined on the basis of the principles of Quebec corporate and civil law. Corporate law determines the rules that apply when a dividend is illegal. Under article 910 of the *Civil Code of Québec*, a paid dividend is revenue yielded by capital invested in a company.

[7] Second, although the payment of a dividend is a transfer within the meaning of section 160, it is not made without consideration. The declaration of a dividend either creates a debt to the shareholder — in which case the payment of the debt and the release given by the shareholder are consideration, or the dividend is paid in consideration of a corresponding reduction in the value of the shares held by the shareholder — or it represents an income paid in consideration of the capital supplied by the shareholder for use by the corporation.

Analysis of the decision and of the appellants' submissions

[8] The appeal basically challenges well-established case law of the Supreme Court of Canada (*Newman v. M.N.R..*, [1998] 1 S.C.R. 770, *McClurg v. Canada* [1990] 3 S.C.R. 1020), of our Court (*Addison & Leyen Ltd. Canada*, [2006] F.C.J. No. 489, *The Queen v. Gilbert*, 2007 FCA 136, *Algoa Trust v. The Queen*, A-201-93, 1998, *Fasken Estate v. Canada (Minister of National Revenue – M.N.R.)*, [1948] Ex.C.R. 580, *Riverin v. Canada*, [1999] F.C.J. No. 913, 99 D.T.C. 5356, *Delage v. Her Majesty the Queen*, A-14-01, 2002) and of the Tax Court of Canada (*Algoa Trust v. The Queen*, [1993] 1 C.T.C. 2294, *Ruffolo v. Canada*, [1998] T.C.J. No. 714, affirmed by this Court in [2000] F.C.J. No. 700, *Gosselin v. Canada*, [1996] T.C.J. No. 206, *Côté v. Canada*, [2002] T.C.J. No. 76).

Digitized by Google

[9] Dividends are property within the meaning of the Act: see subsection 248(1). According to case law, there is no doubt that the payment of dividends is a transfer of property within the meaning of section 160.

[10] In addition, it is difficult to see how the legal treatment of a dividend under corporate and civil law would prevent Parliament from regarding that dividend, for tax purposes, as a transfer of property without consideration when made by persons who are not dealing at arm's length.

[11] The purpose of section 160 is to protect the integrity of a tax debtor's assets against a transfer of that person's property to non-arm's length persons where that transfer thwarts, or could thwart, collection of a tax debt: see *Medland v. Canada*, 98 D.T.C. 6358 (F.C.A.), *Canada v. Livingston*, 2008 FCA 89. Hence, such a transfer must be made for consideration corresponding to the fair market value of the transferred property.

Conclusion

[12] For these reasons, the appeal will be dismissed with costs. However, costs will be limited to one set, given the joint hearing of these two appeals.

In Her Majesty the Queen v. Adela Gilbert[167] the Appeal Ct. also held:

[1] This is an appeal of a decision by Madam Justice Lamarre Proulx of the Tax Court of Canada dated October 17, 2005, in dockets 2002-3402(IT)G and 2002-3401(IT)G, allowing the appeal of Adela and Pierre Gilbert (the respondents) against an assessment made in their regard by the Minister of National Revenue (the Minister or the appellant) pursuant to section 160 of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) (the Act).

[2] The appellant asked the Court to vary the Tax Court of Canada's decision by ordering that the fair market value of the dividends correspond to the actual amount of the dividend received by each of the respondents. The appellant also asked that the respondents' cross-appeal be dismissed with costs.

[3] For their part, the respondents asked the Court to vary the Tax Court of Canada's decision and to decide that the payment of dividends does not amount to a transfer without consideration within the meaning of paragraph 160(1)(*a*) of the Act.

Statement of facts

[4] The respondents were the sole shareholders of the corporation Sécovac Inc. (the corporation) and responsible for the administration and control of the corporation. Incorporated in 1996, the corporation was in the field of design and sales of lumber drying kilns.

[5] For tax years 1999 and 2000, the corporation paid dividends to each of the respondents totalling $55,000. At the time the dividends were paid, the corporation had a tax debt of $36,338.04 owing to the Minister of National Revenue.

[6] On June 6, 2002, the Minister assessed each of the respondents under section 160 of the Act, in the amount of $55,000.

[7] The respondents appealed the Minister's decision to the Tax Court of Canada and on October 17, 2005, Lamarre Proulx J. allowed the appeal in part

[167] 2007 FCA 136

Digitized by Google

(*Gilbert v. Canada* [2005] T.C.J. No. 570). First, she determined that paying a divided to a shareholder was a transfer without consideration within the meaning of subsection 160(1) of the Act. Second, she determined that the fair market value of the dividends paid to the respondents was the amount transferred less the tax payable by the transferee for the dividend received.

[8] On November 15, 2007, the appellant filed a notice of appeal before this Court challenging the second finding by the Tax Court of Canada. The respondents challenged the judge's first finding by way of a notice of cross-appeal.

Issues

[9] Two issues are therefore raised by the appeal and by the cross-appeal. The first is whether the payment of dividends to the respondents was a transfer of property without consideration within the meaning of paragraph 160(1)(*a*) of the Act. If we answer the first question in the affirmative, the second question arises regarding the fair market value of the dividends paid to the respondents.

Analysis

[10] Prior to reviewing the judge's decision, I immediately refer to subsection 160(1) of the Act:

…

[11] With regard to the first issue, Lamarre Proulx J. determined that the dividends paid to the respondents amounted to a transfer without consideration within the meaning of paragraph 160(1)(*a*) of the Act. At paragraphs 30 to 32 of her reasons, she stated the following:

[30] From my understanding of corporate law, it is when a corporation is wound up that the shareholders share the remaining property of the corporation. The issuing of a dividend is different in nature. I cannot accept the argument that receipt of a dividend causes the correlative impoverishment of the shareholder transferee. I do not believe that is the case in corporate law and it is decidedly not the case in tax law. In tax law, a person who receives a dividend must include it in computing his income because it is an increase in his income. For the corporation that issues it, it constitutes a reduction of its retained earnings and a reduction of its assets.

[31] There is therefore impoverishment of the issuing corporation and enrichment of the transferee, as is the case in any transfer of property subject to section 160 of the Act.

[32] As to the possibility of consideration to be given for the issuing of a dividend, I believe that the Supreme Court of Canada clearly stated in *Neuman* (*supra*) there was no such possibility. The right to a dividend stems from ownership of the shares. The consideration given to acquire the shares must not be confused with the consideration for dividends. The consideration given to acquire shares is considered for the acquisition and disposition of shares. It is not a consideration given for a dividend.

[12] In my opinion, Lamarre-Proulx J. did not err in dismissing the respondents' argument to the effect that a dividend was paid to them as shareholders of the corporation for consideration, since she was simply following the

Digitized by Google

precedents of our Court and the Supreme Court.

[13] Specifically, Lamarre Proulx J. referred to *Newman v. M.N.R.*, [1998] 1 S.C.R. 770, at page 791, where the Supreme Court of Canada, referring with approval to the dissenting reasons of LaForest J. in *McClurg v. Canada,* (1990) 3 S.C.R. 1020), clearly confirmed that no consideration can be given for the payment of a dividend:

. . . a dividend is received by virtue of ownership of the capital stock of a corporation. It is a fundamental principle of corporate law that a dividend is a return on capital which attaches to a share, and is in no way dependent on the conduct of a particular shareholder.

[14] This finding ratified the determination of Rip J. of the Tax Court of Canada in *Algoa Trust v. Canada*, [1993] 1 C.T.C. 2294, page 2303, a decision which our Court dismissed on appeal, on February 4, 1998 (Court docket A-201-93):

When a person subscribes for shares of a corporation he or she is paying theoretically for the acquisition of a share of the ownership of the corporation and receives shares of a class in the capital stock of the corporation. The shareholder gives consideration for the shares and not for what the shares may bring. Ownership of shares gives the shareholder certain rights: right to vote as a shareholder, right to a distribution of capital on the winding-up of the corporation, right to receive dividends. (This list is not meant to be exhaustive.) **When the shareholder receives a dividend it is not as a result of any consideration he or she gave the corporation and which the corporation is obliged to pay for investing. When a shareholder purchases shares he is not purchasing an income right**. A shareholder receives a dividend solely because the right to a dividend is an attribute of owning shares.

[Emphasis added.]

[15] With regard to the issue of whether the payment of a dividend is a transfer of property within the meaning of section 160 of the Act, Sharlow J.A. in *Addison & Leyen Ltd. v. Canada* [2006] F.C.J. No. 489, at paragraphs 57 to 60, stated that dividends could be subject to section 160:

[57] . . . One of the questions raised but not answered by the 1981 amendment to section 160 was whether the payment of a dividend could be a "transfer of property" within the meaning of section 160. It is possible to imagine a corporation, especially a closely held one, using the payment of a dividend to divest itself of assets in order to avoid paying a tax liability, but in most cases the payment of a dividend is an ordinary commercial transaction. A dividend is also taxable income to the recipient (except for certain corporate recipients) . . .

[60] . . . **Thus, the 1993 decision of the Tax Court in *Algoa Trust* is the leading authority for the proposition that section 160 may apply to a dividend.** [Emphasis added.]

[16] Despite his very clever arguments, Mr. Ryan, the respondents' counsel, did not persuade me that the respondents had given consideration for the dividend they were paid by the corporation. Moreover, he did not persuade me that there was a basis for reconsidering Rip J.'s determination that a shareholder receiving a dividend does not give any consideration.

[17] I now turn to the second issue. According to subparagraph 160(1)(*e*)(i) of the

Digitized by Google

Act, the transferee and the transferor are jointly and severally liable to pay a tax debt in an amount equal to "the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property".

[18] In *Nash v. Canada*, 2005 FCA 386, our Court agreed with the definition of "fair market value" set out by Cattanach J. of the Federal Court in *Henderson Estate and Bank of New York v. M.R.N* (1973), 73 D.T.C. 5471, at page 5476 (affirmed by this Court in [1975] F.C.J. No. 613), namely:

. . . the highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm's length and under no compulsion to buy or sell. I would add that the foregoing understanding as I have expressed it in a general way includes what I conceive to be the essential element which is an open and unrestricted market in which the price is hammered out between willing and informed buyers and sellers on the anvil of supply and demand.

[19] Moreover, in *Hewett v. Canada*, [1997] F.C.J. No. 1541 (QL), our Court determined that the fair market value of property had to be assessed in the hands of the transferor and that the value of transferred property had to be the same in the patrimony of the transferor as it was in that of the transferee.

[20] In this case, the transferred property is a dividend in the amount of $55,000 received by each of the respondents. Applying the definition of fair market value accepted by our Court in *Nash*, *supra*, I find that the fair market value paid to the transferor for the purposes of section 160 is $55,000 for each of the respondents.

[21] It is therefore this amount which must be assessed, i.e. the amount that the Minister could have seized in the hands of the corporation had the transfer not been effected. It appears to me that this determination is the only one possible considering the fact that the fair market value must be assessed by considering that the property is still in the hands of the transferor, namely the respondents. This finding is consistent with section 160 of the Act, the purpose of which is to prevent taxpayers from transferring their property in order to circumvent the Minister's assessment for unpaid taxes.

[22] Moreover, I am satisfied that the fiscal consequences for the respondents resulting from the transfer are not at all relevant in regard to determining fair market value.

[23] Accordingly, in my opinion, Lamarre Proulx J. erred in deciding that the fair market value of a dividend is the amount of the dividend less the income tax payable on that dividend.

Conclusion

[24] I would allow the appeal with costs, I would dismiss the cross-appeal and I would set aside the decision of the Tax Court of Canada. Deciding as the Tax Court of Canada should have decided, I would dismiss the appeal filed by the respondent against the Minister's assessment with costs.

Digitized by Google

In the case of capital dividends (s. 83(2)) similar argument has been made with John Neumann, Monica Neumann v.The Queen[168] when the TCC held:

> [1] The Appellants are challenging assessments made under subsection 160(1) of the *Income Tax Act* (the "*Act*"). The Minister of National Revenue (the "Minister") assessed the Appellants on the basis that they had each received a dividend of $173,500 from 782047 Alberta Ltd. ("782"), a corporation with which they were not dealing at arm's-length, at a time when 782 had a debt of $39,152.51 under the *Act*.
>
> [2] The Appellants are contesting the assessments on two grounds. Firstly, they say that subsection 160(1) does not apply to the dividends paid by 782 because the dividends were capital dividends as described in subsection 83(2) of the *Act*. Secondly, they say that if section 160 does apply to a capital dividend, they provided consideration for the dividends that exceeded the amount of the dividends.
>
> Facts
>
> [3] The following summary of facts is taken from the statement of agreed facts filed by the parties at the hearing.
>
> [4] The Appellants are married. They incorporated 782 in 1998 and each held 50% of the shares. They were the only directors and officers of 782.
>
> [5] The principal asset of the corporation was an industrial building which it rented to another corporation, Apex Group Inc., which was also owned by the Appellants.
>
> [6] The Appellants worked approximately 10 hours per week for 782 managing its affairs but did not receive any payment for this work.
>
> [7] On December 28, 2002, 782 sold the building to an unrelated purchaser. This gave rise to a large capital gain to 782, and an increase of $347,337 in its capital dividend account for tax purposes.
>
> [8] On July 1, 2003, 782 filed an election under subsection 83(2) of the *Act* to pay its shareholders a capital dividend of $347,000. On August 20, 2003, 782 declared and paid a dividend of $347,000 to the Appellants. The directors' resolution of the same date read, in part, as follows:
>
> A dividend in the amount of $3,470 per Class A share (for a total dividend of $347,000) is hereby declared to be payable on the 20th day of August 2003 to all Class A common shareholders of record of the Corporation as of the 20th day of August 2003.
>
> The Corporation shall make an election under subsection 83(2) of the Income Tax Act (Canada) in respect of the full amount of the dividend.
>
> The said dividend shall not become payable unless and until the Corporation has duly filed an election, in prescribed manner and in prescribed form, under subsection 83(2) of the Income Tax Act (Canada) in respect of the full amount of the said dividend.
>
> …
>
> [9] The dividend was paid to the Appellants by way of a credit of $173,500 to each of their shareholder loan accounts with 782 on August 20, 2003. The amount owing by 782 to the Appellants as a result of the credit to their

[168] 2009 TCC 81

Digitized by Google

shareholder loan accounts was secured by a general security agreement registered in their favour in the Alberta Personal Property Registry.

[10] On December 2, 2004, 782 made a voluntary assignment in bankruptcy. The bankruptcy filing showed that 782 had assets of $319,729 against liabilities of $498,489. The Appellants, the only secured creditors and 782, filed proofs of claim in the amount of $160,000 each. The Minister was an unsecured creditor in the bankruptcy and did not receive any funds from the distribution of the assets of 782.

[11] On January 25, 2005 the Minister assessed each of the Appellants pursuant to subsection 160(1) for the outstanding liability of 782 under the *Act* for its taxation years ending January 31, 2003 and January 31, 2004 in the amount of $39,152.51.

Arguments

[12] The Appellants first argument is that section 160 does not apply to the dividend paid to the Appellants' by 782 because the dividend was a capital dividend.

[13] Counsel for the Appellants acknowledged that the payment of an ordinary dividend by corporation to its shareholder is a transfer of property within the meaning of section 160 of the *Act* but submitted that the capital dividend paid to the Appellants in this case was not an ordinary dividend and did not constitute a transfer property under section 160.

[14] According to counsel, a capital dividend is "a notional creature under the *Income Tax Act* and is not a corporate law concept." He said that a capital dividend is created by the *Act*, and is triggered by the filing of an election under subsection 83(2) of the *Act*, and that the filing of the election could not be equated to a transfer property by the Corporation.

[15] He also likened a capital dividend to a stock dividend, saying that a capital dividend was not the property of the corporation prior to the capital dividend being declared.

[16] If the payment of the dividend in this case is found to be a transfer of property by the corporation to the Appellants, counsel argued that the assessments should still be vacated because the Appellants provided consideration for the payment of the dividend. That consideration consisted of the Appellants filing the election, the unpaid work they had done for 782 over the years, and their loan of the dividend back to 782. [17] Finally counsel stated that the Appellants were not attempting to obtain the benefit of the dividend to the detriment of the other creditors of 782.

[18] Respondent's counsel submitted that the payment of the dividend to the Appellants was a transfer property within the meaning of subsection 160(1) and that the fact that the dividend was a capital dividend did not matter. The dividend was paid from the proceeds of the sale of the building owned by 782, and was therefore paid out of property of the Corporation. The Corporation was impoverished by the payment of the dividends and the Appellants were correspondingly enriched by the receipt of them. The transfer of the property out of the Corporation led ultimately to its inability to pay its taxes owing under the *Act*.

Digitized by Google

[19] Counsel for the Respondent referred to the case of *Neuman v. The Queen*, 1 S.C.R. 770, in which the Supreme Court held that the payment of a dividend relates to the entitlement of the shareholder to a capital or share interest in the corporation and not to any other consideration received from the shareholder. This decision was followed in *Ruffolo v. The Queen*, [1998] 4 C.T.C. 2114, [1998] T.C.J. No. 714, and *Cote v. The Queen*, [2002] T.C.J. No. 76, [2003].4 C.T.C. 2064, 2002 D.T.C. 1348.

[20] Lastly, counsel for the Respondent submitted that an intention to avoid payment of taxes by the transferor of the property is not required in order to apply section 160 of the *Act*.

… Analysis

[23] The Appellants' first argument, that a capital dividend is not a transfer of property under subsection 160(1) of the *Act*, cannot succeed. While I am not aware of any jurisprudence on point, and no cases were referred to me by counsel, it appears self-evident that a capital dividend is no less a transfer of property by a corporation to its shareholder than an ordinary dividend.

[24] In *Algoa Trust v. The Queen*, [1993] 1 C.T.C. 2294, 93 D.T.C. 405, Rip, J., as he then was, found that a dividend was a transfer of property within the meaning of subsection 160(1). In doing so, he said:

When a corporation pays a dividend to its shareholders the corporation gives or hands over property to its shareholders. Property is taken from the patrimony of a corporation and placed in the patrimony of a shareholder. When the dividend is declared, the corporation becomes indebted to the shareholder. When the dividend is paid, the corporation divests itself of ownership of the money (or other property) used to pay the dividend. This description is equally applicable to the payment of the dividends in this case. Property of 782 was taken from the patrimony of the corporation and placed in the patrimony of the Appellants; there was an impoverishment of the corporation and an enrichment of the Appellants.

[25] The fact that 782 elected under subsection 83(2) to pay the dividend out of its capital dividend account did not affect the legal nature of the dividend or the means by which the dividend was paid. A capital dividend allows a private corporation to make a tax-free distribution of certain non-taxable gains it earns, such as the untaxed portion of capital gains. The election only affects the tax attributes of the dividend payment once it had been made. Subsection 83(2) is applicable only "where at any particular time after 1971 a dividend becomes payable by a private corporation to shareholders of any class of shares" and an election under that section has been made.

[26] Contrary to the submission of the Appellants' counsel, the capital dividend election did not create the dividend; it simply made the dividend tax-free to the recipient shareholders. Subsection 83(2) does not purport to authorize the payment of the dividend by a corporation or to create a fund out of which to pay it. The authority to declare a dividend lies with the directors subject to any restrictions that have been included in the articles of incorporation. The dividend here was created by the directors' resolution and paid pursuant to that resolution out of the property of the corporation.

[27] Since the dividend was paid out of the property of the corporation it is

Digitized by Google

distinguishable from a stock dividend. As noted by Rip, J. at paragraph 51 of the *Algoa* case, supra, the shares authorized in a corporation's articles of incorporation are not assets of the corporation, and the issuance of shares pursuant to the declaration of a stock dividend is not a transfer of property by the corporation because the corporation has not divested itself of any of its property.

[28] The Appellants' argument that they provided consideration for the dividend cannot succeed either. It has now been clearly established that the right of a shareholder to receive the payment of a dividend that has been declared flows from his or her status as a shareholder and not from any consideration given by him or her. In other words, dividends attach to the shares and not to the shareholder. In *Neuman v. The Queen*, supra, Iacobucci J., writing for the Court said at paragraph 57 that:

…a dividend is a payment which is related by way of entitlement to one's capital or share interest in the corporation and not to any other consideration. Thus, the quantum of one's contribution to a company, and any dividends received from that corporation, are mutually independent of one another. La Forest J made the same observation in his dissenting reasons in *McClurg* (at p. 1073):

With respect, this fact is irrelevant to the issue before us. To relate dividend receipts to the amount of effort expended by the recipient on behalf of the payor corporation is to misconstrue the nature of a dividend. As discussed earlier, a dividend is received by virtue of ownership of the capital stock of a corporation. It is a fundamental principle of corporate law that a dividend is a return on capital which attaches to a share, and is in no way dependent on the conduct of a particular shareholder.

[29] Thus, neither work done for a corporation nor a promise by a shareholder to lend money to the corporation can be a consideration for the payment of a dividend to the shareholder. As well, the Appellants' position that they gave consideration for the dividends by making the capital dividend election is ill-founded also because the election was made by 782 rather than by them.

[30] In summary, therefore, I find that the payment of the dividend by 782 to each of the Appellants was a transfer of property within the meaning of subsection 160(1) that was made for no consideration. As a result, the appeals shall be dismissed, with one set of costs to the Respondent.

See also Peter Kirkwood and Peter Kirkwood Holdings Limited v. The Queen[169] for similar pronouncement on capital dividend account distributions.

CRA Internal Operations Manual - Non-Arm's Length Transfers
(See image pages below)

[169] 2003TCC76

Digitized by Google

NON-ARM'S LENGTH TRANSFER ASSESSMENTS 1

Overview 1

Legislation 1
Federal Statutory Authorities to Impose Liability 1
Provincial Statutory Authorities to Impose Liability 2

Background Information 2
Extent of Transferee's Liability 160(1) *ITA* 2
Benefit Conferred or FMVD 3
Transferor's Tax Liability Captured by 160(1)*(e)*(ii) *ITA* 3
Tax Debt Exists Before the Assessment Recognizing It is Made 4
Extent of Transferee's Liability 325(1) *ETA* 4
Transferor's Tax Liability Captured by 325(1) *ETA* 5
Limitation Periods 5
Limitation Period to Assess the Transferee 5
Limitation Period to Issue a Reassessment/Additional Assessment 6
Impact of the Memorandum Assessment on the Transferor's Own Debt Limitation Period 6
Interest on Assessments under Section 160 *ITA* or 325 *ETA* 6
Persons Not Dealing at Arm's Length 7
Related Persons 7
Blood Relationship 8
Marriage 8
Common-Law Partnership 8
Adoption 9
Extension of the Meaning of "Child" 9
Corporations and Other Persons 9
Related Group and Unrelated Group 10
Personal Trusts 11
When Dealing With Each Other at Non Arm's Length is a Question of Fact 12
What is a Fair Market Value? 13
Fair Market Value Concept 13
Fair Market Value of Undivided Interest 13
What is a transfer? 14
Methods of Transfer 15
Cascading Effect 15
Further Cascading 16
When Considering Cascading Assessments 17

Policy 17
When to Issue a Memorandum Assessment 17
When is a Memorandum Reassessment Issued 18
Resolving a Disputed Memorandum Assessment 18
Request for Adjustment to a Memorandum Assessment 19
Notice of Objection or Appeal Filed Subsequent to a Request for Adjustment 19
Notice of Objection or Appeal is Outstanding When Request for Adjustment is Made 19
Where Time to File Notice of Objection or Extension Order has not Expired 19
When Should Reassessment be Made or Adjustment Request be Declined? 20
Reassessment Approval Authority 20
Collection Restrictions on Reassessment 20
When is an Additional Assessment Issued? 20
Assessment Amount Limit 20
Transferee's Liability When the Transferor is Bankrupt 21

Digitized by Google

Transferee's Liability When the Transferor Files a Proposal 21
Transferee's Liability when Bankrupt or in a Proposal 22
Benefit Programs' Joint and Several Liability 22
Amalgamation Project Canada Child Tax Benefit 160.1(1) *ITA* 22
No 90-days Collection Restrictions Applicable to Refund Off-Set 23
RRSP or RRIF/Deceased Annuitant subsections 160.2(1) and 160.2(2) *ITA* 23
Combined Effect of ss. 84(2) of the *ITA* and s.160 of the *ITA* or s.325 of the *ETA* 24
Recourse When Corporation Struck from the Register 24
The Operation of Subsection 84(2) of the *ITA* 24
The Combined Effect of Ss. 84(2) and S.160 *ITA* or S. 325 *ETA* 25
The Subsection 84(2) Assessment 25
When Subsection 84(2) *ITA* is Statute-Barred 25
The Transfer of Property Assessment 25
Combined 84(2) and 160(2) Assessments Case Recounted by a Collection Officer 25
Attribution Rules Under the *Income Tax Act* 27
Amounts Which May be Subject to 160(1)*(d)* *ITA* 27
Joint Liability Where Anti Avoidance Rule Ss. 69(11) Applies 28
Criteria to Identify Non-Arm's Length Transactions 28
Defining Property 29
Definitions 29
Types of Properties 29
Reconveyance of Property Constitute a Transfer of Property 33
Situations Where Non-Arm's Length Transaction May Not Exist 33
Transfer as a Result of Marriage Breakdown 33
Transfer is a Valid Loan 35
Transfer as a Consequence of a Merger/Amalgamation 35
Other Situations Where Non-Arm's Length Transaction May Not Exist 35
Opinion from Department of Justice Required 35
Opinion from Department of Justice Not Required 36
Notice of Objection or Appeal 37
Collection Action on Memorandum Assessment 37

Procedures 38
Determining If Non-Arm's Length Transaction Occurred 38
The CRA does Not Have to Prove the Intention Behind the Transfer 38
A Dividend Payment is a Transfer of Property 39
When Transfer is Effected by Way of Mortgage Payments 39
Transfer by Means of Deposits Into a Related Person's Bank Account 40
Collecting Evidence of Transfer 40
Determining the Transferee's Ability to Pay 42
Pre-assessment Letter 42
Method of Service for Pre-Assessment Proposal Letters 42
Requesting an Opinion from the Department of Justice 43
Preparing a Non-Arm's Length Assessment 44
Third Party Assessment Approval 46
Recording the Details in the Control Register 46
Administrative Functions 47
Collection Measures 47
Law, Sheriff and Bailiff Costs 48
How to Create a Subsidiary Ledger Account 48
Allocating Payments 48
Accruing Interest 49
T779/GST259 Memorandum Assessment Verses 49
Joint and Several Liability Ss.160 (1) *ITA*, 325(1) *ETA* , 297 *ETA* 2001 or *CA*, 97.29(1) 49
Indirect Transfers 49
Joint and Several Liability of Cohabiting Spouse 160.1(1.1) *ITA* 50

Digitized by Google

Joint and Several Liability of Cohabiting Spouse 160.1(2.1) *ITA* 50
The Joint and Several Liability under Ss. 160.2(1) and 160.2(2) Deceased Annuitant under a RRSP or RRIF 50
The Joint and Several Liability under Ss. 160(1.1) Where Ss. 69(11) Applies 50
Retention of Primary Assessment Information 51
Obligation to Retain Information 51
How Collections Should Retain the Information 51

Resource Material **52**

Digitized by Google

Non-Arm's Length Transfer Assessments

Collections Manual Updates

Overview

This chapter is designed to be a resource document for Collections Officers who have received training on Non-Arm's Length Transfer Assessments and require a more extensive review of the applicable legislation and some of the relevant case law. It is intended to assist in addressing on-the-job situations that are often encountered. Collections Officers having little knowledge of Non-Arm's Length Transfer Assessments should first review the training product, TD8605-000, **Non-Arm's Length Transfer Assessments**.

Where a **transfer** of property has been made either directly or indirectly by means of a trust or by any other means to a spouse, to a minor, or to any other person with whom the transferor did not deal at arm's length, the **transferor** and the **transferee** are jointly and severally liable for the payment of certain taxes.

The purpose of sections 160 of the *Income Tax Act* and 325 of the *Excise Tax Act* is to prevent a taxpayer from avoiding his tax liability by simply transferring his assets to his or her spouse or to any other person described in these sections. Sections 160 and 325, in making the transferee jointly and personally liable for the debt owed by the transferor, allows the Minister to seek payment from a taxpayer who is not the original taxpayer. The purpose of these provisions is to ensure that a tax debtor may not transfer his assets or a part of them so as to reduce the value of his financial assets by receiving a consideration that is less than the value of the property transferred.

Legislation

This section identifies legislation related to a Non-Arm's Length Transaction.

- *Income Tax Act*, sections: 160, 251
- *Excise Tax Act*, sections: 325, 126
- *Excise Act 2001*, section: 297
- *Customs Act*, section: 97.29(1)

Related Topics:

- **Federal Statutory Authorities to Impose Liability**
- **Provincial Statutory Authorities to Impose Liability**

Federal Statutory Authorities to Impose Liability

The statutory authorities to impose liability under the Federal Acts are:

- Subsection 160(1), 160(1.1), 160.1(1.1), 160.1(2.1), 160.2(1), 160.2(2) *Income Tax Act*
- Subsection 325(1) *Excise Tax Act*
- Section 297 *Excise Act 2001*

Digitized by Google

- Section 97.29(1) *Customs Act*
- Subsection 23(2) *Canada Pension Plan* – Employer
- Section 36 *Canada Pension Plan* - Self-Employed
- Section 66 *Unemployment Insurance Act* – Employer
- Section 126 *Unemployment Insurance Act* - Benefit Repayment
- Section 99 *Employment Insurance Act* – Employer
- Section 149 *Employment Insurance Act* - Benefit Repayment

Provincial Statutory Authorities to Impose Liability

The statutory authorities to impose liability under the Provincial *Income Tax Acts* are identified in the "Memorandum Assessments" chapter section **Provincial Statutory Authorities to Impose Liability**.

Background Information

This section identifies background information related to Non-Arm's Length Transactions:

- **Extent of Transferee's Liability 160(1) *ITA***
- **Transferor's Tax Liability Captured by 160(1)(e)(ii) *ITA***
- **Extent of Transferee's Liability 325(1) *ETA***
- **Transferor's Tax Liability Captured by 325(1) *ETA***
- **Limitation Periods**
- **Interest on Assessments under section 160 *ITA* or 325 *ETA***
- **Persons Not Dealing at Arm's Length**
- **Related Persons**
- **Related Group and Unrelated Group**
- **Personal Trusts**
- **When Dealing With Each Other at Non-Arm's Length is a Question of Fact**
- **What is a Fair Market Value?**
- **What is a Transfer?**

Extent of Transferee's Liability 160(1) *ITA*

Related Topic:

Digitized by Google

Tax Debt Exists Before the Assessment Recognizing It Is Made

Collection Officers should be advised that arguments could be raised that at the time of the transfer no tax liability existed because the transferor had simply not yet been assessed. It is a recognized principle in tax law that liability for tax results from the Act and not from the assessment. This means that for example if the transferor's tax debt is from a reassessment of the year 2003, issued in 2005 and the transfer of property to a spouse occurred in 2003 prior to the 2005 reassessment, the transferor is deemed to have been liable to pay tax for the year 2003 at the time the transfer took place. See: The *Queen v. Simard-Beaudry Inc.*, [1971] F.C. 396; *D'Argys v. MNR* 93 DTC 1710 (TCC); The *Queen v. Westbrook Management Ltd.* 96 DTC 6590 (FCA) with leave to appeal refused by the SCC, *Canada v. Heavyside* 97 DTC 5026 (FCA) ***Jurak***:

- transfer occurs in 2003
- at the time of this transfer, the transferor did not have an outstanding tax debt
- in 2005, the transferor is reassessed for the 2003 taxation year
- in 2007, a 160(1) *ITA* assessment is raised against the transferee
- transferee argues that the transferor wasn't liable for any tax at the time of the 2003 transfer
- counter argument: tax debt exists before the assessment recognizing it is made, the assessment merely states the obligation to pay income tax because the tax liability itself is created by the Act

Extent of Transferee's Liability 325(1) *ETA*

In calculating the extent of the transferee's liability pursuant to ss. 325(1) of the *ETA* there is a further factor to consider, in addition to those found under the *ITA* and described in the section **Extent of Transferee's Liability 160(1) *ITA***. The Benefit Conferred will take into consideration any amount assessed pursuant to 160(1) of the *ITA* that relates to the same transfer. By taking the same example as the one found under Extent of Transferee's Liability *ITA* and adding to it, for the purpose of this *ETA* example, a previous 160(1) *ITA* memo assessment of $10,000, the result is as follows:

For example:	Fair market value of property:	$65,000
	Price paid (consideration given):	$30,000
	Benefit conferred *ITA*:	$35,000
	Less 160(1) *ITA* assessment:	-$10,000
	Benefit conferred *ETA* :	$25,000
	Registrant's debt:	$50,000

The lesser of the two amounts between the Benefit conferred pursuant to the *ETA* and the Registrant's debt would be $25,000. This amount represents the extent of transferee's liability pursuant to ss. 325(1) of the *ETA* .

If, for example, a payment of $3,000, is applied against the $10,000 s.160 assessment further to a payment received from the principal debtor (for instance from a Requirement to Pay for monies owing to the transferor), this would increase the unused portion of the benefit conferred by $3,000 for the purpose of ss. 325(1) of the *ETA* :

Digitized by Google

For example:	Fair market value of property:	$65,000
	Price paid (consideration given):	$30,000
	Benefit conferred *ITA*:	$35,000
	160(1) *ITA* assessment:	$10,000
	Less amount paid by transferor	$3,000
	Total 160(1) *ITA* liability	$7,000
	Benefit conferred *ETA*:	$28,000
	Registrant's debt:	$50,000

Although the 160 *ITA* and 325 *ETA* memorandum assessments total $38,000 and exceed the Benefit conferred, the CRA will not claim more than $35,000 from the transferee in light of the fact that $3,000 has been collected from the transferor himself.

For further details refer to Directive RCD-00-10, **Calculating the Transfer of Property Liability for GST under par. 325(1)*(d)* of the *ETA***.

Transferor's Tax Liability Captured by 325(1) *ETA*

All amounts for the reporting period at the time of the transfer—*or* any preceding reporting period of the transferor, including applicable penalty and interest at that time—are captured by 325(1) *ETA*.

Under section 325 of the *ETA* interest is charged from the date of assessment. Reference is made, in this regard, to subparagraph 325(1)*(e)*(ii) of the *ETA*: "*interest or penalty for which the transferor is liable as of that time*" (time of the transfer). It is likely that the transferee is not liable for interest accruing after the date of transfer and before the date of assessment.

Refer to RCD-96-13, **Application of Interest in respect of Memorandum Assessments** and RCD-99-05, **Interest on Assessments under section 160 of the *Income Tax Act (ITA)***.

Limitation Periods

Related Topics:

- **Limitation Period to Assess the Transferee**
- **Limitation Period to Issue a Reassessment/Additional Assessment**
- **Impact of the Memorandum Assessment on the Transferor's Own Debt Limitation Period**

Limitation Period to Assess the Transferee

Subsection 160(2) is the actual provision to issue such an assessment, and it allows the Agency the ability to raise an assessment against the transferee "at any time", providing that at such time the transferor's own limitation period doesn't prevent any collection action from being taken. The assessment issued against the transferee will be governed by a separate limitation period that will begin the 90th day after the day the Memorandum Assessment is mailed.

On appeal to the Supreme Court of Canada, (*Quasen and CRA v Addison & Leyen* et al, 2007 SCC 33), the "at any time" wording of section 160 was affirmed by the Court and noted

Digitized by Google

parliaments intent that there is no applicable limitation period on when the Minister might assess under Section 160.

Unlike the English version of subsection 325(2) *ETA* that provides for the "at any time" provision, the same provision found in the 160(2) *ITA*, this wording is absent in the French 325(2) *ETA* version. This discrepancy causes us to turn to the general limitation period found under 298(1) *ETA* . Since the 4 year limitation period outlined in ss.298(1) *ETA* to raise an initial assessment relates to audit restrictions starting the limitation period and that 325(2) *ETA* has no relation with filing obligations, it is likely that it does not preclude Collections from raising a Memorandum Assessment beyond the 4 year limitation. Subsection 298(1) *ETA* states "*more than four years after the later of the day on or before which the person was required under section 238 to file a return for the period and the day the return was filed...*".

A request will be made to have the French version of the 325(2) *ETA* amended to include the equivalent "at any time" provision.

Limitation Period to Issue a Reassessment/Additional Assessment

An additional assessment for instance, is possible when the value of the Benefit conferred has not been totally used with the issuance of the initial 160(1) assessment, and the transferor's liability for the year of the transfer or for prior years has increased since that issuance. Because subsection 160(2) brings into use section 152 of the *ITA*, we can only reassess or issue an additional assessment over the same transfer within 3 years of the initial 160(1) assessment.

In the case of a memorandum assessment issued under the *Excise Tax Act* and the Excise Act, 2001, a reassessment must be made within four (4) years of a third party becoming liable for an amount. For purposes of calculating the (4) year's limitation period, the third party becomes liable from the time the initial memorandum assessment was issued.

For further information refer to RCD-00-29, **Reassessing a Transferee under the *Income Tax Act***, and TSDMB-2004-014, **Reassessing Joint and Several Liabilities**.

Impact of the Memorandum Assessment on the Transferor's Own Debt Limitation Period

If a Collection Officer issues an assessment for a non-arm's length transfer of property, the limitation period for the main debtor will restart for a new 10-year period pursuant to paragraph 222(5)c) *ITA* and 313(2.3)e) *ETA* .

For further information refer to ARD-2005-024, **Limitation Periods Applicable to the Collection of Tax Debts**.

Interest on Assessments under Section 160 *ITA* or 325 *ETA*

Section 160 of the *ITA* and section 325 of the *ETA* allows the Agency to assess a transferee for an amount up to the amount of the benefit conferred. However there are differences for charging interest on assessment after it has been issued

S160 *ITA*

In Algoa Trust, [1998] 4 C.T.C. 2001(TCC) the Court ruled that accrued interest on a 160 assessment is limited by the value of the transfer. In other words, a transferee's liability cannot exceed the benefit conferred.

Digitized by Google

Accrued interest on a S160 assessment must be raised either by reassessment of the original S160 assessment or by an additional assessment. The total of the assessment including accrued interest cannot exceed the amount of the benefit conferred.

Not: Collection restrictions apply to reassessments and additional assesements

S325 *ETA*

Under section 325 of the *ETA*, the transferee is not liable for interest accruing after the date of transfer and before the date of assessment, pursuant to subparagraph 325(1)(*e*)(ii) of the *ETA*: "*interest or penalty for which the transferor is liable as of that time*" (time of the transfer). However, accrued interest can be charged to the transferee, from the date of assessment without limit or the need for additional (re)assessments. For further details, refer to RCD-96-13, **Application of Interest in respect of Memorandum Assessments** and RCD-99-05, **Interest on Assessments under section 160 of the *Income Tax Act (ITA)*** and Communication TSDMB-2008-066, **Interest on Assessments for Liability under Section 160(1).**

Note; A technical amendment to paragraph 160(1)(e) is pending. This amendment seeks to establish that the liability pursuant to subsection 160(2) of the Act is subject to interest, without limit as to the amount of interest for which the taxpayer may be liable. A similar amendment has not been sought in relation to the *Excise Tax Act*, as it is believed that the wording contained within section 325 of the *ETA* provides a reasonable legal basis for the charging of subsequent interest without limit from the date of assessment.

Persons Not Dealing at Arm's Length

The key element in determining whether or not there has been a non-arm's length transfer is the relationship between the transferor and transferee. In fact, it is essential that the parties be related in some way—for example, by blood, marriage, adoption or a question of fact—for the relationship to be deemed not at arm's length. Subsection 251(1) of the *ITA* sets out the essential framework through the definitions of related persons contained in ss. 251(2) for determining if a transaction was conducted between non arm's length parties.

Section 126 of the *ETA* refers to section 251 of the *ITA*. Therefore, non-arm's length applies for GST/HST purposes in the same way as for *ITA* purposes.

Related Persons

Pursuant to subsection 251(2) of the *ITA*, individuals related by blood, marriage, common-law partnership or adoption are always deemed to not be dealing at arm's length.

Related Topics:

- **Blood Relationship**
- **Marriage**
- **Common-Law Partnership**
- **Adoption**
- **Extension of the Meaning of "Child"**
- **Corporations and Other Persons**

Digitized by Google

Blood Relationship

Pursuant to paragraph 251(6)(a), individuals are related by blood if one is the child, grandchild or great grandchild of the other, or if one is the brother or sister of the other.

Section 252 extends the meaning of these terms to encompass other individuals who might otherwise not be considered to fit the normal use of the term "related by blood." For instance, a taxpayer's brother is related to him by blood pursuant to 251(6)(a) of the *ITA* while through the application of 252(2)*(b)*(i) *ITA* the term brother is extended to also capture the brother of the taxpayer's spouse.

The term "blood relation" does not include aunts, uncles, nieces, nephews or cousins even if listed under paragraph 252(2) of the *ITA* because they would first have to meet the criteria of blood relationship under 251(6)*(a)*. The criteria of blood relationship is restricted to a child or other descendant such as a grandchild and, to a brother or sister.

Marriage

Pursuant to paragraph 251(6)*(b) ITA*, two persons are connected by marriage if one is married to the other or to a person who is connected by blood relationship to the other. An example of the latter situation: John is married to June and he is deemed related to June's brother Paul because Paul is connected by blood to June.

However the relationship between John's own brother and June's brother would not be captured by 252(2) of the *ITA*.

Therefore, an individual will be connected by marriage to the parents and any siblings of the individual's spouse.

Where an individual's marriage is dissolved by either divorce or the death of the individual's spouse, the individual will cease to be "connected by marriage" or to be "connected by blood relationship" to the parents and any siblings of the individual's former spouse. The relation between persons is established at the time the transfer giving rise to a third party assessment occurs.

Common-Law Partnership

Paragraph 251(6)*(b.1) ITA* provides that two individuals are "*connected by common-law partnership*" if one individual is in a common-law partnership with the other or with a person who is connected by blood relationship to that other person. Subsection 248(1) defines a common-law partnership as the relationship between two persons who are common-law partners of each other. The expression "common-law partner" is also defined in subsection 248(1) and means a person of the opposite or same sex who, at that time, lives with and has a conjugal relationship with the individual. In addition, one of the following conditions must be satisfied:

- the person has been living in a conjugal relationship with the individual for a continuous period of at least one year; or
- the person is the natural or adoptive parent (whether legally or in fact) of the individual's child.

Paragraph 251(6)*(b.1)* was added by the 2000 same-sex partners bill, effective for 2001 and later taxation years, or earlier by election.

Digitized by Google

Adoption

Pursuant to paragraph 251(6)*(c,)* two persons are connected by adoption if one is the adopted child of the other.

The term "adoption" includes legal and de facto adoption. In addition, a person related by blood (except a brother or sister) to another person would be related by adoption to a child adopted by that person. Consequently, individuals are related by adoption to their adopted children, parents, and grandparents.

Extension of the Meaning of "Child"

Subsection 252(1) of the *ITA* states that the child of an individual includes any of the following individuals:

- a person of whom the taxpayer is the legal parent
- a person who is wholly dependent on the individual and of whom the individual has, in law or in fact, custody and control, or had custody and control just prior to the child turning 19
- a child of individual's spouse or common-law partner
- a spouse or common-law spouse of a child of the individual, e.g. a son-in-law or daughter-in-law, as well as the spouse or common-law spouse of a stepson or stepdaughter, adopted child or person deemed to be the individual's child under paragraph (a)

Corporations and Other Persons

Paragraphs 251(2)*(b)* and *(c)* set out the statutory rules for determining when a corporation and another person will be considered to be "related persons" (or persons related to each other) for purposes of the Act. Under paragraph 251(2)*(b)*, a corporation will be related to another person (including another corporation) where:

- that person (individual or corporation) controls the corporation;
- that person (individual or corporation) is a member of a related group that controls the corporation; or
- that person (individual or corporation) is a person who is related to a person described above.

In addition, paragraph 251(2)*(c)* provides that two corporations will be related if:

- the two corporations are controlled by the same person or group of persons;
- each of the corporations is controlled by one person and the person who controls one corporation is related to the person who controls the other corporation;
- one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation;
- one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation;

Digitized by Google

Example 1: A has two adult children, C and D. C has two children, X and Y, and D has one child, Z. A owns all of the issued and outstanding shares of Aco, consequently, A controls Aco. Each of Y and Z owns 50% of the common shares of Opco. Since Y and Z are cousins, they will, for purposes of the Act, be an unrelated group that controls Opco. As A is related to each of Y and Z (i.e. A is their grandparent), Aco and Opco will be related pursuant to subparagraph 251(2)*(c)*(iv).

- any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation;

  Example 2: Same facts as in Example 1, except that each of A, C and D own 33 1/3% of the common shares of Bco. A, C and D are a related group that controls Bco. Since A is related to each of Y and Z (i.e. A is their grandparent), Bco and Opco will be related pursuant to subparagraph 251(2)*(c)*(v).

- each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation.

  Example 3: Mr. X, Mr. Y and Mr. Z are an unrelated group that controls XYZ Co. Their spouses, Mrs. X, Mrs. Y and Mrs. Z are an unrelated group that controls ZYX Co. As Mr. X is related to Mrs. X, Mr. Y is related to Mrs. Y and Mr. Z is related to Mrs. Z, XYZ Co will be related to ZYX Co pursuant to subparagraph 251(2)*(c)*(vi).

For the purposes of subsection 251(2), control means *de jure* control, which generally means the right of control that rests in ownership of such number of shares as carries with it the right to a majority of the votes in the election of the board of directors of the corporation.

For detailed information on *de jure* control of a corporation, see the current version of IT-64R4, **Corporations: Association and Control**.

Related Group and Unrelated Group

The expression "related group" is defined in subsection 251(4) and means a group of persons each member of which is related to every other member of the group. For example, a group consisting of two common-law partners and their children would be a related group. An unrelated group refers to a group of persons that is not a related group. For a group of unrelated persons to constitute a group of persons which controls a corporation, there must be a common link or interest between the persons (which must involve more than their mere status as shareholders) or there must be evidence that those shareholders act together to exert control over the corporation. For further information on unrelated persons that control a corporation refer to the section **When Dealing With Each Other at Non Arm's Length is a Question of Fact**.

Subsection 251(3) of the *ITA* provides that where two corporations are each related to a third corporation, they will be considered to be related to each other for the purposes of subsections 251(1) and (2). For example, A and B are sisters and each has an adult child, being C and D, respectively. Each of A, B, C and D owns all of the issued shares of a corporation, Aco, Bco, Cco and Dco, respectively. In this situation, Aco and Bco are related to each other by virtue of subparagraph 251(2)*(c)*(ii). Also, Aco and Cco are related to each other and Bco and Dco are related to each other by virtue of subparagraph 251(2)*(c)*(ii). Therefore, Aco and Dco will be related to each other by virtue of subsection 251(3) because each of them is related to Bco. Similarly, Bco and Cco will be related under subsection 251(3) because each of them is related to Aco. However, since subsection 251(3) does not apply for the purposes of a subsequent application of subsection 251(3), Cco will not be related to Dco.

Digitized by Google

Personal Trusts

Paragraph 251(1)*(b)* provides that a taxpayer and a specified personal trust will be deemed not to deal with each other at arm's length if the taxpayer, or any person not dealing at arm's length with the taxpayer, is beneficially interested in the trust. Pursuant to subsection 248(25), a person who is beneficially interested in a trust includes:

- a person who has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to, the exercise of any discretion by any person or partnership) as a beneficiary to receive any of the income or capital of the trust either directly from the trust or indirectly through one or more trusts or partnerships;

- a particular person or partnership who is not otherwise beneficially interested in a trust at a particular time but may, by reason of the exercise of discretion by any person or partnership, subsequently become beneficially interested in the trust where any property has been acquired, directly or indirectly in any manner, by the trust from the particular person or partnership;

- a member of a partnership that is beneficially interested in the trust.

The following are examples of situations where an individual is beneficially interested in a trust:

- trust income is payable to the individual

- income is held in trust and will be paid upon the individual's attainment of a certain age

- the individual is one for whom a preferred beneficiary election may be made

- the individual is one of a class who has a remainder interest under the trust

- the individual has contributed property to the trust (e.g. the settlor of the trust) and may, by virtue of the existence of a power of appointment, be added as a beneficiary of the trust at a later date

Therefore, the Act provides that a 160(2) or 325(2) assessment may be raised in any of the above situations providing that other **governing criteria** are also met.

For example where a taxpayer, in this situation the settlor of the trust, appoints his/her spouse and/or children (or any other related person) as beneficiaries of a trust into which he has contributed property, two collection avenues arise. Collections may raise a 160 *ITA* or 325 *ITA* memo assessment against the trust itself and/or against the beneficiaries of the trust depending whether—at the time of contemplating the memo assessment—the property transferred into the trust rests within the trust and/or the beneficiaries' hands.

In the above example, the memorandum assessment against the trust is possible through the effect of 251(1)(b) of the *ITA*, which deems the taxpayer and the trust in such instance to not be dealing at arm's length. On the other hand, an assessment against the beneficiaries is also possible pursuant to the text of 160(1) *ITA* and 325(1) *ETA* which explicitly recognizes transfers made to a related person by means of a trust.

It is not necessary that the transfer of property to the beneficiary of the trust be the identical asset transferred as in the original transfer of property to the trust. This principle is further explained in the section **Cascading Effect**.

A personal trust, as defined in subsection 248(1), is either a testamentary trust or, an inter vivos trust where a beneficiary receives an interest from the trust without having paid any consideration

Digitized by Google

to the trust or to any person who contributed to the trust. The fact that the beneficiary is also the settlor of the trust will not deem his contribution as a settlor to be a consideration paid for an interest received from the trust.

When in doubt as to the ownership of a property transferred into a trust, the matter must be referred to DOJ for an opinion.

A specified personal trust will be deemed not to deal at arm's length with its beneficiaries or with any person who does not deal at arm's length with any such beneficiary. In any other case, it is a question of fact whether or not a trust and a particular person or group of persons are dealing at arm's length.

For further information on the relation between an individual and a personal trust refer to **Meaning of Arm's Length** IT-419R2.

When Dealing With Each Other at Non Arm's Length Is a Question of Fact

Shareholders holding more than 50% of a corporation's voting shares are related to the corporation, as defined in subsection 251(2) of the Act, and related persons are deemed to deal at non arm's length with each other. Paragraph 251(1)*(c)* provides that it may also be a question of fact whether persons not related to each other are, at a particular time, dealing at arm's length.

In order to determine whether there is non-arm's length relationship between two unrelated persons, the concept of "dealing at arm's length" must first be defined for the purposes of subsection 160(1).

Three criteria or tests are commonly used to determine whether the parties to a transaction are dealing at arm's length. They are:

a. the existence of a common mind which directs the bargaining for both parties to the transaction;

b. parties to a transaction acting in concert without separate interests; and

c. "de facto" control.

For instance, while investigating a possible 160 assessment through a transfer of dividend paid by a corporation to its shareholders, the investigation reveals there are only two shareholders, in equal proportions and they are unrelated between themselves. The relation between the shareholders and the corporation is not captured by the definition of related person pursuant to 251(1)(a) and 251(2)(b) because they are not part of a related group that control the corporation; however, an investigation could reveal a de facto relationship based on one of the above tests.

In *Gosselin* v. R., [1997] 2 C.T.C 2830 (TCC) a corporation, by declaring dividend, distributed all of its property and was wound up. The corporation only had two 50 per cent shareholders. *Gosselin* was one of them and was assessed under section 160 of the Act for the unpaid tax debt of the corporation. In this case, the court recognized that the shareholder was in fact in control of the corporation and not dealing at arm's length with the corporation.

In ***Gestion Yvan Drouin*** Inc v. HMTQ [2000] TCC 19991856., the Court rejected CRA's de facto relationship argument in a 50 per cent shareholders' scenario. This case however, offers a lengthy discussion on de facto non-arm's length relationships between two persons, starting at paragraph 72.

Additional jurisprudence;

Digitized by Google

- R. v. McLarty, 2008 SCC 26
- McNichol v. Canada, 97 DTC 111, at pages 117 and 118

Collection Officers must refer to DOJ for an opinion on the existence of a possible non arms length relationship between unrelated persons involved in a transaction.

What is a Fair Market Value?

The fair market value is the highest price in terms of money, which the subject property will bring to a willing seller if exposed for sale on the open market between parties acting at arm's length.

Related Topics:

- **Fair Market Value Concept**
- **Fair Market Value of Undivided Interest**

Fair Market Value Concept

The concept of fair market value assumes that:

- there is a willing buyer and a willing seller
- the buyer and the seller are fully informed
- the property was exposed for sale on the open market for a reasonable period of time
- neither party is compelled to act
- the buyer and seller are dealing at arm's length

Fair Market Value of Undivided Interest

For the purposes of sections 160 and 160.4 *ITA*, the fair market value at any time of an undivided interest in a property, expressed as a proportionate interest in that property, is deemed to be equal to the same proportion of the Fair Market Value of that property at that time.

Subsection 160(3.1) was enacted in 2000 and is applicable to transfers of property made after June 4, 1999. Its purpose is to further clarify the basis on which we calculate the value of an undivided interest in a property. It prevents any argument that a discount or reduction in the Fair Market Value is necessary to enable the sale of the undivided interest. For example:

> Mr. and Mrs. Jones share an undivided interest in their residential home. Mr. Jones transfers his 50% share of undivided interest in the home to Mrs. Jones. At the time of the transfer the value of their home is $200,000.
>
> Mrs Jones argues that if the CRA had tried to seize and sell her husband's undivided interest in the property before the transfer its value would have been discounted from $100,000 to a lesser value. In her view, any purchaser would have to take into account that he or she would obtain a 50 per cent interest as a joint tenant in a home in which the wife was still living.

Subsection 160(3.1) ensures that the valuation of the undivided interest Mr. Jones has transferred to his spouse is 50% of the property's value for purposes of subsection 160(1) *ITA*. In

Digitized by Google

the above example, Mrs Jones would not be able to assert that the FMV of her husband's undivided interest would be worth less than $100,000.

Further reference is made to *Hewett v. The Queen*, 97 DTC 561 (T.C.C.), affirmed 98 DTC 6003 (F.C.A.), which prompted the enactment of subsection 160 (3.1).

Subsection 160(3.1) is applicable to transfers of property made after June 4, 1999. Refer to Memorandum 00-10, **Bills C-24**.

What is a transfer?

A transfer is every method of disposing of, or parting with:

- property;
- an interest in property; or
- a charge against property.

A transfer can be:

- direct or indirect
- absolute or conditional
- voluntary or involuntary

On the meaning of the word "transfer", the most cited definition is from the Exchequer Court decision in *Fasken Estate v. Minister of National Revenue*, 49 DTC 491, in which Thorson, P. said at page 497:

"The word "transfer" is not a term of art and has not a technical meaning. It is not necessary to a transfer of property from a husband to his wife that it should be made in any particular form or that it should be made directly. All that is required is that the husband should so deal with the property as to divest himself of it and vest it in his wife, that is to say, pass the property from himself to her. The means by which he accomplishes this result, whether direct or circuitous, may properly be called a transfer."

Judge Marceau of the Federal Court of Appeal best summarized the scope of the meaning of a transfer, as defined in section 160 *ITA*, in the ***Riverin v. Canada*** decision:

"Noting the care taken by Parliament to employ more than once the broadest possible terms in its introductory words, no doubt for the purpose of giving its rule a full extension " "either directly or indirectly, by means of a trust or by any other means whatever" " we have no difficulty in concluding that the provision applies once the tax debtor does the act that gives rise to the process by which his property will ultimately end up in the patrimony of any of these persons with whom he has a non-arm's length relationship. In the particular case of a payment in kind or a payment given as security for the repayment of a loan, it makes no difference whether the payment takes full effect and becomes definitive as a result of some additional intervention of the debtor, a court decision or the mere operation of the Act."

Related Topics:

- **Methods of Transfer**
- **Cascading Effect**

Digitized by Google

Methods of Transfer

Transfers subject to section 160 of the *Income Tax Act* or 325 of the *Excise Tax Act* may include, but are not limited to:

- conveyance
- lien
- security
- sale
- encumbrance
- mortgage
- transfer of property and mortgage payments
- payment
- gift
- hypothecation
- pledge
- transfer from a settlor to a trust or trustee &/or trust beneficiary
- payment of cash dividend
- giving of a property under a will
- divestment of beneficial ownership without necessarily transferring possession
- release of an indebtedness
- repayment of a person's loans by another person

Cascading Effect

Related Topics:

- **Further Cascading**
- **When Considering Cascading Assessments**

The ***Jurak*** decision reversed the judgment in *Nanini v. Canada*, 94 DTC, 1839 (T.C.C.) and confirmed that cascading assessments are permissible within the scope of subsection 160(1) of the *ITA*. Of particular importance in that decision is the Court's comment that the decision in *Nanini* had not been accepted by the other judges of the Tax Court, and hence, ought not be followed. Affirming the reasoning of Lamarre Proulx T.C.J., the Federal Court of Appeal ruled as follows:

Digitized by Google

"The recipient of a transfer, therefore, can himself become a transferor for purposes of subsection 160(1) of the Act, if at the time of such transfer he is indebted for tax, either in his own right, or as the transferee of the original transfer (under subsection 160(1)) (TRANSLATION)."

In view of the decision in ***Jurak***, Collection Officers should proceed with assessments under subsection 160(1) of the *ITA*, subsection 325(1) of the *ETA* and subsection 97.29(1) of the *CA* where there has been a subsequent transfer of property. In this context, it is not necessary that the transfer of property be the identical asset transferred as in the original transfer of property. The significant element of a cascading assessment under these provisions is that the vicarious liability will be enforceable against the final recipient.

The following example provides an illustration of the cascading effect:

ABC Corporation, following an audit by the Agency in January 2003, was assessed the following amounts for unpaid corporate taxes:

Taxation year	
1999	$25,000
2000	35,000
2001	40,000

On referral to Collections, ABC claimed it was ceasing its business operations and was unable to make an arrangement for payment. However, a review by Collections, discovered that a cash dividend of $125,000 had been paid in October 2002. The dividend had been paid to DEF Corporation, a company that held 100% of the common voting shares of ABC Corporation.

Further investigation by Collections revealed a cash dividend totalling $100,000 had been paid by DEF Corporation in equal amounts of $33,333.33, to its three shareholders and directors in November 2002. A review of the corporate records showed the above individuals to be Allan and Cynthia Anderson, husband and wife and their eldest son, Robert Anderson.

Each of these three shareholders maintained one third of the common voting shares of DEF Corporation.

Assessments Raised: An initial assessment under subsection 160(1) was issued to DEF Corporation, in the amount of $100,000, the amount of ABC's corporate tax debt, being the lesser of ABC's tax liability and the October 2002 cash dividend of $125,000 represented the transfer of property without consideration.

On the presumption that DEF corporation had no ability to pay the above assessed amount, a further assessment under subsection 160(1) may be raised against each of the three shareholders in the amount of $33,333, this amount being the lesser of the fair market value of the dividend received without consideration and the liability of DEF corporation established via the initial 160(1) assessment. In this manner, it can be seen that the original tax liability has been cascaded down to a subsequent transferee.

Further Cascading

In the above example, if the individual shareholders subsequently made transfers of property to persons with whom they are deemed to deal at non-arm's length, those subsequent transferee's could potentially be subject to an assessment under subsection 160(1) of the *ITA*.

Should Collection Officers be presented with a similar fact situation, they are advised to seek guidance from their respective Legal Services Office before issuing the assessment.

Digitized by Google

When Considering Cascading Assessments

The rules for liability do not change. As stated at paragraph 10 in ***Williams D. v. The Queen*** [2000] DTC. 2340 (T.C.C.) affirmed 2002, F.C.A. 380, *"In order for subsection 160(1) of the Act to apply, four conditions need to be met. First, there has to be a non-arm's length dealing; second, a transfer of property must occur; third, there must be an absence of consideration from the person who receives the property and fourth, the transferor must be liable for tax the year in which the property was transferred or any preceding year."*

For further information refer to Directive RCD-03-02, **Transfers of Property: Cascading Assessments**.

Policy

This section provides policy related to Non-Arm's Length Transactions:

- **When to Issue a Memorandum Assessment**
- **Assessment Amount Limit**
- **Transferee's Liability When the Transferor is Bankrupt**
- **Transferee's Liability When the Transferor Files a Proposal**
- **Transferee's Liability When Bankrupt or In a Proposal**
- **Benefit Programs' Joint and Several Liability**
- **RRSP or RRIF/Deceased Annuitant Subsections 160.2(1) and 160.2(2) *ITA***
- **Combined effect of Ss. 84(2) of the *ITA* and S.160 of the *ITA* or S.325 of the *ETA***
- **Attribution Rules Under the *Income Tax Act***
- **Joint Liability Where Anti Avoidance Rule Ss .69(11) Applies**
- **Criteria to Identify Non-Arm's Length Transactions**
- **Defining Property**
- **Reconveyance of Property Constitute a Transfer of Property**
- **Situations Where Non-Arm's Length Transaction May Not Exist**
- **Opinion from Department of Justice Required**
- **Opinion from Department of Justice Not Required**
- **Notice of Objection or Appeal**
- **Collection Action on Memorandum Assessment**

When to Issue a Memorandum Assessment

A memorandum assessment is raised to establish the joint and several liability of a third party.

Digitized by Google

A memorandum assessment is issued:

- If the assessment is collectible and/or reasonable in view of the circumstances
- If applicable, where a Department of Justice opinion concurs with the action
- when the collection investigation of the situation is complete and all the required evidence has been secured

Related Topics:

- When is a Memorandum Reassessment Issued?
- When is an Additional Assessment Issued?

When is a Memorandum Reassessment Issued

In many circumstances, it is not unusual for additional relevant facts to come to light after an assessment has been issued. In some instances, had the additional information been available at the outset it may have impacted the amount included on the Notice of Assessment, or resulted in the assessment not having been made at all.

Accordingly, the following policies have been developed to provide Tax Services Offices with guidance and direction concerning the circumstances when Revenue Collections should consider downward reassessments of joint and several liabilities.

The policies outlined below can be found within Communication ARD-2004-014, entitled, Reassessing Joint and Several Liabilities.

Related Topics:

- Resolving a Disputed Memorandum Assessment
- Request for Adjustment to a Memorandum Assessment
- Notice of Objection or Appeal Filed Subsequent to a Request for Adjustment
- Notice of Objection or Appeal is Outstanding When Request for Adjustment is Made
- Where Time to File Notice of Objection or Extension Order has not Expired
- When Should Reassessment be Made or Adjustment Request be Declined?
- Reassessment Approval Authority
- Collection Restrictions on Reassessment

Resolving a Disputed Memorandum Assessment

It is not uncommon for disputes to arise after an assessment has been issued. When a dispute results in the amount of a debt being re-determined or recalculated, it does not constitute a compromised settlement, but rather is a re-consideration of the actual amount owed. When

Digitized by Google

amounts are re-determined or recalculated, the appropriate adjustments are made within the Agency's records and a Notice of Reassessment is issued to inform the taxpayer accordingly.

Issuing reassessments to resolve disputes cannot be done on an ad hoc basis; there must be a proper basis for doing so.

Request for Adjustment to a Memorandum Assessment

Occasionally, Revenue Collections is requested to reconsider a memorandum assessment that has been issued against a third party under one of the various joint and several liability provisions. Such requests may emanate from recipients who have been assessed, or their representatives. In some instances the third party who has been assessed, or the person's representative, is able to provide additional information to demonstrate that the amount assessed is in error.

Although rare, there have also been instances when counsel at the Department of Justice has requested Revenue Collections to consider an adjustment to a memorandum assessment. Although not always the case, usually counsel is representing the Agency in the dispute process when such a request has been made.

Revenue Collections Divisions will only reconsider the amount of a third party's liability and issue a reassessment to adjust the amount when there is a proper basis to do so and an objection or appeal is not outstanding. In the event an Objection or Appeal is outstanding, Revenue Collections should leave matters to the Appeals Division to handle the case and follow any instructions they may issue as a result of disposing of the Objection or Appeal.

Notice of Objection or Appeal Filed Subsequent to a Request for Adjustment

Occasionally, Revenue Collections may be requested to reconsider a memorandum assessment and subsequently, a Notice of Objection or Appeal is filed. Once a Revenue Collections Officer becomes aware that an Objection or Appeal is outstanding, he or she is encouraged to pass any additional information that they have gathered to the Appeals Division along with any observations, conclusions or recommendations they have made or wish to make. The Appeals Officer would benefit from this information and any additional work that has been done.

Notice of Objection or Appeal is Outstanding When Request for Adjustment is Made

Unless instructed to do so by Appeals, whenever an assessment is subject to a Notice of Objection or Appeal, Revenue Collections Division must not make an adjustment to a memorandum assessment under any circumstance. In the event that a request for an adjustment is received from a person who has been assessed pursuant to one of the memorandum assessment provisions, and a Notice of Objection or Appeal is outstanding, the person making the request should be referred to the Appeals Division. When disposing with the objection or appeal, the Appeals Division will issue instructions to Revenue Collections if and when appropriate.

Where Time to File Notice of Objection or Extension Order has not Expired

In the event a request is received for an adjustment and an Objection or Appeal has not been filed, the collection officer can reconsider the facts and can complete the necessary steps to have the assessment varied when the facts warrant it. However, the third party should be informed of their right to file an objection, or seek an order to extend the time to file an objection when time to do so has not lapsed, particularly when the request for adjustment is denied or there is a chance the time may expire before a decision can be made.

Digitized by Google

When Should Reassessment be Made or Adjustment Request be Declined?

When it is clear from the additional information that the amount of a memorandum assessment is in error, it would be appropriate for Revenue Collections to proceed with a reassessment provided a Notice of Objection or Notice of Appeal is not outstanding.

In the event a request for an adjustment is received and it is not clear from the additional information provided that the assessment is incorrect, the request for adjustment should be declined. It may be that the Tax Services Office staff will choose to obtain advice from the Department of Justice or the Field Support Section in advance of making such a decision.

Reassessment Approval Authority

A Collection Officer should not commit to an adjustment being made as a result of receiving a request. Instead, the matter should be referred to the person within the local office who has been delegated the authority to approve memorandum assessments to seek concurrence with the Collection Officer's recommendation. For further details refer to Memorandum 01-21, **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act***.

If the decision is made to make an adjustment, the Collection Officer will issue a reassessment accordingly.

Collection Restrictions on Reassessment

Since subsection 248(1) of the *Income Tax Act* (*ITA*), section 2 of the *Excise Act, 2001* (*EA 2001*) and subsection 58.1(1) of the *Excise Tax Act* (*ETA*) define an assessment to include a reassessment, collection restrictions, imposed by section 225.1 of the *ITA* and section 286 of the *EA 2001*, apply to the full amount of a reassessment. Therefore, once the Agency has issued a notice of reassessment, we will not continue or initiate collection actions, in respect of the amounts reassessed until the collection restrictions no longer apply on them.

For more information, please refer to Communication ARD-2005-022 entitled **Collection Restrictions following Reassessments Under the *Income Tax Act*, *Excise Act 2001* and *Excise Tax Act* – Non-GST**.

When is an Additional Assessment Issued?

An additional assessment is issued when the liability of the tax debtor is increased as a result of a further assessment(s) after the original memorandum assessment is issued. The additional assessment is separate and distinct, and does not replace the original assessment or previous reassessment.

Separate memorandum assessments are required in instances where there is more than one party to be assessed for a particular liability.

Assessment Amount Limit

It is recommended that the minimum assessment amount be set at $10,000. However, Tax Services Office (TSO) Management may use their discretion when considering an assessment below the recommended assessment balance limit.

In these circumstances, TSO Management will take into consideration:

- current TSO workloads
- cost effectiveness

Digitized by Google

- previous compliance history

Transferee's Liability When the Transferor is Bankrupt

The transferee remains liable despite the transferor's bankruptcy or discharge from bankruptcy.

In the matter *Canada v. Heavyside*, 97 DTC 5026 (F.C.A.) the Federal Court of Appeal upheld the Agency's position that:

- the transferee's liability under section 160 arises at the time of the transfer of the property, not at the time of the assessment, and
- the discharge in bankruptcy of the transferor does not discharge the liability of the transferee.

Transferee's Liability When the Transferor Files a Proposal

In respect of the transferee's liability where the transferor has filed a proposal, the transferee is not released by the acceptance of the proposal pursuant to subsection 62(3) of the *Bankruptcy and Insolvency Act* (BIA). In the matter of *Bergeron v. Her Majesty the Queen* 2003 DTC 1491, although seemingly not relying on subsection 62(3) BIA, the Court held: « *I conclude, therefore, that the acceptance of the proposal had no effect on the assessments [160(1) ITA] giving rise to these appeals. The respondent was therefore fully justified in making the notices of assessment [160(1) ITA] against the appellants [the transferee]*» In *Bergeron*, the Collection Officer insisted upon having a clause such as this one inserted in the proposal of the principal debtor «*The Canada Customs and Revenue Agency shall retain all its remedies under the Income Tax Act.*» In the end, when it was clear that the trustee would not consent to adding the clause, the Collection Officer sent out this written notice to the trustee «*We are informing you that not including, in the debtor's proposal, the clause we proposed last February 9 in no way limits the remedies available to the CCRA under the Income Tax Act.*»

When Collection Officers are made aware of transactions giving rise to Non-Arms' Length memorandum assessments, after the acceptance of a proposal made by the transferor, careful attention should be given to the proposal. Should the amended payment terms presented by the trustee not be satisfactory to the Agency, Collection Officers must give consideration to pursuing a third party assessment.

A third party's liability arises at the time of the transfer of the property not at the time of the assessment. The acceptance of a proposal, including the Agency's acceptance, does not release a third party's liability by the effect of subsection 62(3) and section 179 of the BIA.

Directive RCD-00-28, Terms for Proposals under the Bankruptcy and Insolvency Act, provides for terms that apply or could apply when a tax debtor files a proposal under the BIA. The following is an example of a term that would apply for a transfer of property:

> **transfer of property**
>
> The Agency reserves the right to issue assessments pursuant to section 160 of the *Income Tax Act*, or section 325 of the *Excise Tax Act* for any transfer of property which the proponent has made to his or her spouse or to a person who has since become that person's spouse, to a person who was under 18 years of age, or to a person with whom he or she was not dealing at arm's length.

Digitized by Google

Transferee's Liability when Bankrupt or in a Proposal

When the transferee has been assessed pursuant to 160(1) *ITA* prior to filing a bankruptcy or a proposal, we follow Collections policy and procedure as outlined in the **Bankruptcy** chapter, including filing a proof of claim.

If on the day of the bankruptcy or the filing of a proposal, the transfer giving rise to the 160(1) *ITA* assessment has occurred but the transferee has not yet been assessed, in order to take part in the dividend distribution the Agency will have to substantiate its claim by assessing and proving its claim before the declaration of the dividend.

Benefit Programs' Joint and Several Liability

Related Topics:

- **Amalgamation Project Canada Child Tax Benefit 160.1(1) *ITA***
- **No 90-days Collection Restrictions Applicable to Refund Off-Set**

Situations where a joint and several liability may exist for an excess credit refund include:

- a Goods and Services Tax Credit (GSTC) under the *Income Tax Act* (*ITA*) subsection 160.1(1.1)
- a Child Tax Benefit credit (CTB) under the *ITA*, subsection 160.1(2.1)

In both these situations the authority to raise a memorandum assessment will fall under subsection 160.1(1) *ITA*.

Subsection 160.1(2.1) *ITA*, applies to a spouse or a common-law partner who was cohabiting with the primary caregiver at the year-end of a base taxation year and during the months in which benefits were paid in the benefit year. The spouse and cohabiting spouse can be held jointly and severally liable for all benefits paid during the benefit year for the period they were cohabiting.

For example:

> Mary and Jim were cohabiting spouses on December 31, 1995. During the benefit year July 1, 1996 to June 30, 1997, Mary, as the primary care giver received monthly benefits. In April 1997, Mary and Jim separated with Jim moving to another location.
>
> Both Mary and Jim could be held jointly and severally liable for any CCTB overpayment incurred during the period July 1, 1996, up to the date in April 1997, when they ceased to be cohabitants.

The onus is on the individuals being assessed to prove they were not cohabiting spouses at the year-end of the base taxation year and during the months in which the benefits were initially paid.

Amalgamation Project Canada Child Tax Benefit 160.1(1) *ITA*

Under the CCTB legislation, only one cheque can be issued per family. Therefore, when two single parents marry or form a common-law partnership, an amalgamation of their CCTB accounts is processed combining all of the child benefit entitlements under the CCTB account of one parent. If the marriage or union took place in the past, the amalgamation can result in a debit on one client's CCTB account (usually the male's) and a corresponding credit on the other client's account.

Digitized by Google

CRA cannot arbitrarily use the credit the client will be receiving for the "underpayments" to offset the debit that will be created on their spouse's/partner's account, unless they give us permission. Requesting consent from the credit client is included in the procedures that the Child Tax Benefit Unit would be following, but sometimes consent is not given. The end result could be one party being assessed for several thousand dollars in overpayment of benefits, while their respective spouse is receiving a refund of underpayment of benefits for the same or greater amount.

In order to collect the refund of these underpayments, CRA must raise an assessment under subsection 160.1(2.1) of the *Income Tax Act* (*ITA*) to create a joint and several liability against a cohabiting spouse. Subsection 160.1(2.1) of the *ITA*, applies to a spouse who is cohabiting with the primary caregiver at the year end of a base taxation year, and the months in which benefits were paid during the benefit year. The spouse and cohabiting spouse can be held jointly and severally liable for all benefits paid during the benefit year for the period they were cohabitating.

For further information refer to Memorandum 03-04, **Amalgamation Project Canada Child Tax Benefit (CCTB)** and Communication ARD-2004-010 entitled **Hold Credit Overrides on Canada Child Tax Benefit Accounts**.

No 90-days Collection Restrictions Applicable to Refund Off-Set

The collection restrictions outlined in subsection 225.1(1) of the *ITA* are applicable to memorandum assessments raised. However, subsection 164(2) of the *ITA* permits the Minister where a person is, or is about to become, liable to make any payment to Her Majesty, to apply the amount of any refund or repayment to that other liability. There is no requirement for these funds to be held in abeyance until the collection restrictions as outlined in subsection 225.1(1) have expired. This section permits the CRA to apply the captured funds immediately to the debtor's account.

Therefore, Benefit Programs has been instructed to transfer the credit to the debtor's account as soon as Collections requests a Hold Credit Override (HCO) action.

For further information refer to Communication ARD-2004-010 entitled **Hold Credit Overrides on Canada Child Tax Benefit Accounts**.

RRSP or RRIF/Deceased Annuitant subsections 160.2(1) and 160.2(2) *ITA*

Under the *Income Tax Act* (*ITA*) subsections 160.2(1) and 160.2(2) respectively, a deceased taxpayer and the last annuitant under a registered retirement savings plan or a registered retirement income fund are jointly and severally liable to pay the amounts of additional tax which are created by the deemed disposition of the RRSP or RRIF. The legislation deems the disposition to have taken place "immediately before death."

Both obligations created by the deemed disposition of an RRSP or RRIF were enacted in two separate subsections 160.2(1) and 160.2(2); however, the treatment for purposes of a memorandum assessment is the same in both cases.

Situations where the Minister is permitted to raise an assessment under section 160.2 are those in which the third party beneficiary of the RRSP or RRIF funds is neither a spouse, a financially-dependant child, nor a grandchild.

In imposing these type of liabilities amongst Non Arm's Length beneficiaries, ss. 160.2(1) and 160.2(2) actually allow for memorandum assessments against beneficiaries dealing at Arm's Length such as a friend, where designated as beneficiary under the RRSP.

Digitized by Google

For further information refer to Communication TSDMB-2006-025, entitled **Subsection 160.(1) Non-arm's length Transfer of Property/ Subsections 160.2(1) and 160.2(2) Deceased Annuitant under a RRSP or RRIF** and Directive RCD-00-26, entitled **Assessments Under Section 160.2 of the *Income Tax Act* for Amounts received out of a RRSP or RRIF**.

Combined Effect of ss. 84(2) of the *ITA* and s.160 of the *ITA* or s.325 of the *ETA*

Related Topics:

- **Recourse When Corporation Struck from the Register**
- **The Operation of Subsection 84(2) of the *ITA***
- **The Combined Effect of S.84(2) and S.160 *ITA* or S. 325 *ETA***
- **The Subsection 84(2) Assessment**
- **When Subsection 84(2) *ITA* is Statute-Barred**
- **The Transfer of Property Assessment**
- **Combined 84(2) and 160(2) Assessments Case Recounted by a Collection Officer**

Recourse When Corporation Struck from the Register

Ordinarily, the Agency has two recourses for tax recovery when a corporation is involuntarily dissolved:

1. Reinstate the corporation and take action, provided that assets are available.
2. Issue directors' liability assessments.

Both recourses are time-sensitive. In (1), provincial and federal laws impose a time frame for reinstatement, while in (2) the *ITA* and the *ETA* stipulate that such an assessment must be raised within two years of the director ceasing to be a director. A director ceases to be a director when the corporate charter is revoked. Further, it is problematic in some provinces to reinstate a corporation, given the particularity of provincial law.

The Operation of Subsection 84(2) of the *ITA*

Under subsection 84(2) of the *ITA*, the shareholders of a corporation are deemed to have received a dividend on the:

- winding-up,
- discontinuance, or
- reorganization

of the business. The dividend is equal to the net worth of the corporation, on the happening of one of those events, and accrues to each shareholder in proportion to the shares that each holds.

Digitized by Google

The Combined Effect of Ss. 84(2) and S.160 *ITA* or S. 325 *ETA*

As long as the shareholders have the ability to pay, the combined effect of subsection 84(2) of the *ITA* and section 160 or 325 can result in increased tax recovery. The shareholders can be assessed a transfer of property assessment, following the subsection 84(2) assessment. This provides an alternative to recovery via an assessment for directors' liability, which is effective to collect payroll deductions and GST/HST, but not corporate (T2) income tax.

The Subsection 84(2) Assessment

The basis for calculating the deemed dividend is the net worth of the corporation at the date of the winding-up, discontinuance, or reorganization. To arrive at the net worth, Audit relies on the last return that the corporation filed, and allocates the net worth to each shareholder, in proportion to that person's interest in the corporation. Audit then assesses the shareholder under subsection 84(2), creating the liability for personal income tax on the dividend distribution.

Audit can raise the subsection 84(2) assessment on any shareholder, once that corporation's charter is revoked, or the company is otherwise struck from the register. It is not anticipated that Audit will calculate the net worth of all defunct corporations. Rather, Audit would do net worth assessments on those corporations with property at the date of the striking off. Revenue Collections could play a role as well, by advising Audit when a suitable situation exists for such an assessment.

When Subsection 84(2) *ITA* Is Statute-Barred

Time is of essence, when raising a subsection 84(2) assessment. To avoid the assessment being statute-barred, in keeping with subsection 152(4) of the *ITA* (the statute-barred provision), it must be raised within three years of the striking-off, provided that the shareholder has filed tax returns as required. If the shareholder has not filed a tax return, the statute-barred provision would not apply.

The Transfer of Property Assessment

Once Audit raises the subsection 84(2) assessment, and if the corporation at the time of the striking-off, is indebted for income tax or GST/HST, the shareholder can be assessed under subsection 160(2) of the *ITA*, or subsection 325(2) of the *ETA* .

The reason for the Agency's ability to raise a transfer of property assessment is that subsection 84(2) of the *ITA* creates a deemed dividend in the hands of the shareholder. This deemed dividend concept is no different from, and is legally as valid as, the **deemed trust** concept.

Moreover, such an assessment should not be construed as double taxation, keeping in mind the comments in *Algoa Trust v. The Queen*, [1998] 4 C.T.C. 2001 (TCC). In this respect, had the company liquidated the assets and paid its tax debt, no tax would be owing.

Combined 84(2) and 160(2) Assessments Case Recounted by a Collection Officer

"The corporation was struck from the corporate registry on April 1, 1991. The collection diary indicated that the business continued to operate as a proprietorship until the end of 1992. The principal of the business had confirmed that it operated as a proprietorship.

The corporation was audited in April 1994, and the shareholder received a Notice of Assessment for the deemed dividend, under subsection 84(2) of the Income Tax Act. The shareholder filed a Notice of Objection in October 1994. Appeals confirmed the assessment in May 1995, with minor adjustments to the amount.

Digitized by Google

The subsection 160(2) assessment stems from the striking-off of the corporate entity prior to the cessation of business operations. Pursuant to subsection 84(2) of the Income Tax Act, the shareholders of a corporation are deemed to have received a dividend at the date of the striking-off of the corporation. The dividend is approximately equal to the net worth of the corporation on that date, and accrues to each shareholder in proportion to his shares held. The shareholders are consequently liable for personal income tax on the dividend that they receive.

Audit had calculated and assessed a deemed dividend under subsection 84(2) of the Income Tax Act. This would therefore be the amount distributed to the shareholders. As the shareholder gave no consideration for this deemed dividend, the Department of Justice is of the opinion that the receipt by the shareholders of such a dividend constitutes a transfer of property, and the Agency may assess the shareholder, pursuant to section 160 of the Income Tax Act.

The dates in this case are also interesting, as the Assessment Committee approved the assessment in December 1998, on a deemed dividend that was assessed in 1994.

Audit has advised that the deemed dividend under subsection 84(2) can be assessed on any and all shareholders, once the company is struck. Audit does not require much documentation as to the actual disposition of the corporate assets. It is a simple matter that the ITA deems that the assets went to the shareholders in proportion to their shares held, and therefore that is where the assets were considered to have gone. Audit does not require entries to be recorded in the corporate Minute Book or cancelled cheques to show funds in the bank account being paid to a shareholder. It is a simple case of the ITA stating that this is what happened. Therefore, this is what happened, and the shareholders are assessed accordingly. Not all shareholders are actually assessed, but consideration will be given to corporations that have sufficient assets at dissolution, to make the expenditure of audit time worthwhile.

Particularly if there are large dollar amounts involved, we may be able to talk Audit into raising an assessment for us. Our chances of getting Audit to raise an assessment could possibly be improved if we already have some contact information, and evidence of the transfer, and if the people involved admit to carrying on as a partnership or proprietorship, or we have evidence of such (such as cancelled cheques with the corporate name on them, dated after the corporation was struck). However, the subsection 84(2) assessment must be raised within 3 years of when the corporation was struck, or when the return for that period was filed. If you are anywhere close to that critical date, it would be best to contact Audit for detailed information.

As we assessed the recipient of the dividends, and not the corporation, it is not necessary for the corporation to be revived before the assessment can be raised.

Assessments of this nature would likely be of most value on T2 accounts, where there is no recourse via Directors' Liability. However, this type of assessment could also be used on GST and payroll deductions accounts where the corporation was struck while still operating, but the two-year time limit for assessing a director was missed. Or, if the director has already been assessed under s.227.1 of the ITA or under s.323 of the ETA , but the director has insufficient assets to satisfy the debt, a section 160 or section 325 assessment on the deemed dividend could be used to recover, from the shareholder, the amount owing by the corporation.

We do not need evidence of a cheque written out to the shareholder, or entries in the corporate minute book declaring what is to become of the assets. We do not need to gather any further documentation of the date of transfer, to whom the assets were transferred, proof of the transfer, or the value of the transfer. This is all done for us.

Audit, of course, issues a Notice of Assessment when they assess the shareholders. The Notice of Assessment states the date of the transfer and the value of the transfer, information that we in Collections would need to have in order to raise a s. 160 or s. 325 assessment.

Digitized by Google

In my particular case, the opinion from Justice was that further documentary evidence of the transfer of assets, such as cancelled cheques, was not required. What was considered by Audit to be sufficient and appropriate documentary evidence for the subsection 84(2) assessment was considered by Justice to be sufficient and appropriate documentary evidence for Collections to raise a s.160 assessment.

Q: When does the clock start ticking for raising an assessment?

A: For raising a s.160 or s.325, we have no time limit; however, Audit has a time limit for raising the subsection 84(2).

When a corporation has been struck, any potential adjustments will be made to the respective shareholder's personal income tax return for the year the corporation was struck (e.g. corporation struck on June 1, 1995. Adjustments are to be made to the 1995 return of the shareholders). Audit has 3 years from the date of the initial T1 assessment.

Please bear in mind that these facts are specific to my particular case. We should be able to use deemed dividends on the striking of a corporation on a much broader range of accounts".

For further information refer to Directive ARD-03-05, **Collection Action on Involuntarily Dissolved Corporations**.

Attribution Rules Under the *Income Tax Act*

Related Topic:

- **Amounts Which May be Subject to 160(1)*(d) ITA***

The attribution rules are intended to prevent individuals from reducing their taxes by splitting their income with a spouse, certain minors, and persons with whom the transferor is not dealing at arm's length:

- Attribution may result when an individual loans or transfers property to certain family members.
- The taxpayer who transferred or loaned the property is deemed to be the recipient of any income generated from this property and is required to report this income on the return.

When reviewing a disposition, Audit will consider whether or not the attribution rules apply.

Related provisions of the *ITA*:

70(6), 70(9) & 70(9.2) 73(1) 73(3) & 73(4) 74.1(1) 74.2(1) 74.1(2) 75.1

Amounts Which May be Subject to 160(1)*(d) ITA*

Through the operation of attribution rules by Audit, the property transferred will remain in the name of the transferee but income or loss incurred from it will be taxed in the hands of the transferor. Consequently, this measure could prove problematic for Collections where the property transferred is the only asset available to satisfy the transferor's debt while the property is in the transferee's name.

Paragraph 160(1)*(d)* of the *ITA* establishes a joint and several liability in cases where Audit has applied the attribution rules. This provision enables Collections to assess the transferee for a part

Digitized by Google

of the transferor's tax equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of the attribution rules and this, for each taxation year.

Of special interest is that paragraph 160(1)*(d)* does not refer to a principal debt in terms of amounts payable by the transferor in the year of the transfer or previous years as found under 160(1)*(e)*. This is understandable in light that the attribution rules impacts the transferor's debt for the year of the transfer and/or subsequent years.

It is advisable to consult with Audit and validate that the underlying income is in fact attributable to the attribution rules before proceeding with a memorandum assessment. At the same time, Collections will confirm the amounts by which the tax debt of the transferor is greater for each year since only that portion represents the joint and several liability of the transferee under 160(1)*(d)* *ITA*.

Joint Liability Where Anti Avoidance Rule Ss. 69(11) Applies

Subsection 69(11) of the *ITA* is an anti-avoidance rule that is intended to prevent a vendor from disposing of property on a tax-deferred basis as part of a series of transactions where one of the main purposes is to obtain the benefit of tax deductions, or other entitlements available to a specified person, when a subsequent disposition of the property takes place within 3 years of the original disposition.

Subsection 160(1.1) of the *ITA* provides that where subsection 69(11) of the *ITA* applies to deem a disposition of property to have occurred at fair market value, both the person disposing of the property and the person acquiring the property are jointly and severally liable for the payment of each other's liabilities arising under the Act as a result of that disposition. Essentially, each person's liability for any taxation year affected by the disposition, is the excess of the amount payable under the *ITA* by that person for that year over the amount that would have been payable by that person for that year had subsection 69(11) not applied to the disposition. Subsection 160(1.1) of the Act applies to dispositions deemed by subsection 69(11) to have occurred after April 26, 1995.

Refer to Directives RCD-98-04, **Bill C-28 Impacts on Accounts Receivable Program** and RCD-98-06, **Lien and Charge Registration** for further details.

Criteria to Identify Non-Arm's Length Transactions

The criteria to identify non-arm's length transactions include:

- there has to be a non-arm's length dealing
- a transfer of property must occur
- there must be an absence of consideration from the person who receives the property meaning, insufficient or no consideration
- the transferor must be liable for tax the year in which the property was transferred or any preceding year

A failure to carry out a transaction at fair market value is not conclusive, and a transaction between unrelated persons at fair market value does not necessarily indicate an arm's length situation.

Digitized by Google

Defining Property
Related Topics:

- **Definitions**
- **Types of Properties**

Definitions
Pursuant to subsection 248(1) *ITA* "property" means property of any kind whatever whether real or personal or corporeal or incorporeal and, without restricting the generality of the foregoing, includes
(a) a right of any kind whatever, a share or a chose in action,
(b) unless a contrary intention is evident, money,
(c) a timber resource property, and
(d) the work in progress of a business that is a profession;

A similar definition of property is found under subsection 123(1) *ETA* and reads,

"property" means any property, whether real or personal, movable or immovable, tangible or intangible, corporeal or incorporeal, and includes a right or interest of any kind, a share and a chose in action, but does not include money;

The apparent exclusion of money as property in subsection 123(1) *ETA* is overcome by subsection 325(5) which specifically includes money as property for purposes of section 325 *ETA*

Types of Properties
Without being an exhaustive list, the following are properties that could be the object of a transfer:

1. Real Property/Real Estate
    - estate in fee simple
    - outright ownership of land
    - immovable property
    - land
    - business and or tenements
    - estates
    - interest in real property
    - mortgage payments
    - mobile homes
    - floating homes
    - leaseholds

Digitized by Google

- proprietary interest
- lessor rights or interest including:
  - leases
  - mortgages
  - agreements for sale
  - rights to purchase
  - options to purchase
  - mineral rights
  - rights of way
  - air space rights

2. **Tangible Property** Other Than Real Estate
   - personal use property
     - original works of art
     - jewellery
     - rare books
     - stamps
     - coins
     - household effects
     - furnishings
     - cars
     - boats
     - recreational vehicles
     - equipment
   - chattels used in business operations
     - equipment
     - computer hardware and software
     - telephone and communication systems

Digitized by Google

- copiers
- furnishings
- machinery
- inventory and work-in-progress
- livestock

3. Negotiable Financial Instruments and Interests

- cash
  - bank accounts
  - in safety deposit boxes
  - guaranteed investment certificates
  - term deposits
  - Canada Savings Bonds
- commercial paper
  - promissory notes and notes receivable
  - debentures
  - long-term bonds
  - chattel mortgages
  - bills of lading
  - warehouse receipts
- equity investments
  - stock and shares in distributing corporations
  - stock and shares in non distributing closely held corporations
  - dividends; when a corporation, while indebted for tax, pays a dividend to its shareholders, that payment constitutes a transfer of property

    For additional information regarding assessments for dividend payments refer to Directives RCD 00-23, **A Dividend Payment Is a Transfer of Property** and ARD 03-05, **Collection Action on Involuntarily Dissolved Corporations**.
- annuities
  - Income Averaging Annuity Contract
- pension investments

Digitized by Google

- RRSPs
- RRIFs

  For additional details on RRSPs and RRIFs, refer to Communication TSDMB-2006-025, entitled **Subsection 160.(1) Non-arm's length Transfer of Property/ Subsections 160.2(1) and 160.2(2)Deceased Annuitant under a RRSP or RRIF** and Directive RCD 00-26, **Assessment Under Section 160.2 of the *Income Tax Act* for Amounts Received out of a RRSP or RRIFs**.

- pension funds

4. **Intangible Property**

   - licenses and permits granted by government authorities
     - timber licenses
     - tree farm licenses
     - liquor vending licenses
     - fishing licenses
     - motor carrier permits
     - hospital operation permits
     - taxi licences
   - exclusive use rights
     - copyrights
     - patents
     - royalties
     - franchises
     - goodwill
     - right to explore for petroleum

5. Contingent Interest and Future Rights

   - Interests and rights that have a potential or accruing monetary benefit
   - Inheritances, for example, pending probate
   - income from trust

Digitized by Google

Reconveyance of Property Constitute a Transfer of Property

In *Riverin v. Canada*, 99 DTC 5356, a favourable Federal Court of Appeal decision for the Agency, with leave to appeal refused by the Supreme Court of Canada, the Court had to examine a transfer of property through the effect of a default on a loan where both parties were related persons.

The details are as follows, the borrower is the taxpayer and—for the purpose of s.160—he is the transferor. The transfer consisted of real estate property he transferred to his father-in-law in lieu of re-payment of a loan.

In February of 1989, the transferor borrowed $70,000 from his father-in-law and used real property to secure the loan. The loan agreement stipulated that in order to take possession of the property if the borrower failed to make payment, a 60-day notice must be issued to him. In February of 1990 he failed to make payment; he was served the 60-day notice and he continued in default after the 60-day period. In May of 1990 he transferred the property to his father-in-law retroactive to February 1989 as satisfaction of the debt.

The father-in-law was assessed pursuant to section 160 of the *ITA* for he was related to the transferor and did not provide sufficient consideration for the property received. The transferee argued that there was no transfer arguing that he became owner of the property under the provisions of article 1040a of the Civil Code of Lower Canada. In his view, the fact that the transferor transferred the property voluntarily in order to avoid court costs rather than act upon a Court order, should not affect his legal rights as a creditor.

The Court dismissed the appeal and held in favour of the CRA. Even if the *Income Tax Act* does not define what constitutes a transfer for the purposes of subsection 160(1) it has been extensively commented on in case law. The Court concluded that the meaning of the word transfer is broad enough to apply to every transaction in which an asset passes from one to another, whether the transfer was by an act between the parties or by operation of law, whether voluntary or involuntary and whether or not legal proceedings were instituted. For the purposes of subsection 160(1) a transfer occurred in May, 1990.

Situations Where Non-Arm's Length Transaction May Not Exist

Related Topics:

- Transfer as a Result of Marriage Breakdown
- Transfer is a Valid Loan
- Transfer as a Consequence of a Merger/Amalgamation
- Other Situations Where Non-Arm's Length Transaction May Not Exist

Transfer as a Result of Marriage Breakdown

A special rule exists to exempt a transferee from liability when the transfer arises as a result of a marriage breakdown. As stated in *Rose Fluxgold v. The Queen*, 90 DTC 6187:

"Section 160 has been specifically inserted into the [Income Tax] Act to obviate tax avoidance schemes by means of transfer of property between enumerated categories [as in (a), (b), and c) above]. The legislators were prepared to recognize certain exceptions to this strict rule, and enacted subsection (4) to provide relief in circumstances of marriage breakdown."

Digitized by Google

You will find the exception to a transfer of property assessment in subsection 160(4) of the *ITA* and subsection 325(4) of the *ETA* . But for these exceptions to prevail, some specific conditions must be met.

For the exemption to apply:

1. There must have been a breakdown in the marriage;
2. The spouses must have been separated and living apart; and
3. The transfer must have been made pursuant to
   a. *a written separation agreement; or
   b. a judicial order.

*In the case *Linda Carrière v. The Queen* 2006 CCI 289, the court held that in order to constitute a separation agreement the document should make reference to certain specifics such as child custody, support or division of matrimonial property. In other words a separation agreement is not just any document.

Ss. 248(1) *ITA* defines a separation agreement as follows:

"separation agreement" "includes an agreement by which a person agrees to make payments on a periodic basis for the maintenance of a former spouse or common-law partner, children of the marriage or common-law partnership or both the former spouse or common-law partner and children of the marriage or common-law partnership, after the marriage or common-law partnership has been dissolved, whether the agreement was made before or after the marriage or common-law partnership was dissolved;"

The exception provision does not apply if one of the circumstances mentioned below is present. Accordingly, you would raise an assessment if:

1. The transfer occurs before the judicial order or the separation agreement; for if the transfer instrument is executed without the benefit of the order or the agreement, the transfer will have already taken place, and there would be no connection then between the transfer and the separation of the spouses;
2. The judicial order or separation agreement does not contain any express provision that calls for the transfer of that particular property;
3. The spouses were not living separate and apart when the transfer took place; and
4. The transfer occurred as a result of a pre-nuptial contract, a marriage contract, or a change in the matrimonial regime.

Despite the exception provisions, it should be noted that if the value of the property transferred exceeds what the written separation agreement stipulates, or what the judicial order prescribes, the difference between what was transferred, and what should have been transferred, could be available for a transfer of property assessment.

Refer to Directive RCD-98-02 entitled **Exception to Transfer of Property Assessment**.

Digitized by Google

Transfer Is a Valid Loan

On occasion a taxpayer who has transferred moneys to a related party may invoke that the transfer is a loan rather than a gift. An all-inclusive statement that identifies when a loan is considered "valid" is not available; however, the following are some guidelines:

- a written contract to reimburse signed by the parties and specifying the amounts to pay over a given period of time
- evidence supports that regular payments were made with respect to principal and interest

The fact that no interest is required to be paid does not in itself mean that a valid loan was not made.

Transfer as a Consequence of a Merger/Amalgamation

A merger/amalgamation occurs when two or more corporations are combined to form one new corporation. Both Federal and Provincial Corporations' Acts provide that the amalgamated corporation remains responsible for all liabilities of the predecessor corporations. On this basis there is no application of the Non Arm's Length provisions. Reference is made to the *Canada Business Corporations Act* section 186 and the business corporation's acts of the provinces such as the *Ontario Business Corporations Act* section 179.

Other Situations Where Non-Arm's Length Transaction May Not Exist

Other situations where non-arm's length transaction may not exist include:

- situations where the value of consideration equals the fair market value of the property transferred
- the recipient of RRSP or RRIF funds upon the death of the annuitant provided the recipient is the surviving spouse or financially dependant children or grandchildren

  For additional details, refer to Communication TSDMB-2006-025, entitled **Subsection 160.(1) Non-arm's length Transfer of Property/Subsections 160.2(1) and 160.2(2) Deceased Annuitant under a RRSP or RRIF** and Directive RCD 00-26, **Assessments Under Section 160.2 of the *Income Tax Act* for Amounts Received out of a RRSP or RRIF**.

Opinion from Department of Justice Required

An opinion from the Department of Justice is required when there is a question as to:

- whether there was a transfer
- whether what was transferred was property
- whether there was adequate consideration
- whether there is any question concerning the validity of a **separation agreement** or judicial order
- whether the parties were related or otherwise dealing at non-arm's length

Digitized by Google

- in the case of dividend payments, where there is doubt whether the recipient (transferee), who was not related to the corporation, was at arm's length with the corporation with respect to the dividend payment
- where the transfer is stated to be, on the face of the documentation, "in trust"
- where the transfer is indirect for example: from the transferor to corporation A to the transferor's spouse or is effected by the dilution of shares in a corporation by the transferor
- where it is unclear if property was transferred

Collection Officers should consult with their Technical Advisor, Resource Officer/Complex Case Officer or a Headquarters Field Support Program Officer prior to referring a matter to the Department of Justice where a factual situation resulting from the examination of the matter does not fall into these guidelines.

Opinion from Department of Justice Not Required

An opinion from the Department of Justice is not required when all of the following criteria are met:

- investigation did not uncover any evidence of adequate consideration
- the value of the item transferred is clearly measurable
- the transfer took place subsequent to November 12, 1981
- the transferor became indebted in respect of, or prior to, the year the property was transferred
- the transferor, if an individual, is related to the transferee by
  - blood
  - adoption
  - marriage or common-law partnership
- the transferor, if a company, is either:
  - 100% owned by the transferee if the transferee is an individual
  - 100% owned by the same person who owns the transferee company
- there was a clear direct transfer with no conditions attached and no trust arrangement
- control of a corporation resides in the person or group of persons whether they are individuals or corporations which individually or collectively hold 50% plus 1 of the voting stock of the corporation
- the transfer occurred directly from the transferor to the transferee without any other party, except for the transferor, having held title to the property prior to the property being transferred to the transferee

Digitized by Google

Collection Officers should consult with their Technical Advisor, Resource Office/Complex Case Officer or a Headquarters Field Support Program Officer prior to referring a matter to the Department of Justice where a factual situation resulting from the examination of the matter does not fall into these guidelines.

Notice of Objection or Appeal

Persons assessed under section 160 have the same right to object and appeal as those who are assessed for their own primary tax liability. An objection or appeal of a section 160 assessment may raise any issue relating to the correctness of the assessment (for example, whether property was transferred for less than fair market value consideration, and whether the tax debtor and the transferee of its property deal with each other at arm's length), and may also raise any issue relating to the correctness of the underlying assessment (that is, the assessment of the primary tax liability of the tax debtor): *Gaucher v. R.*, 2000 D.T.C. 6678 (FCA).

For further information refer to the section **Obligation to Retain Information** and also Memorandum 01-09, entitled **Third Party Assessments - Retention of Primary Assessment Information**.

A protocol was agreed upon in 2002 that covers the roles and responsibilities of Appeals Officers and Revenue Collections Officers in the resolution of objections to assessments resulting from revenue collections activities (Income Tax and Goods and Services Tax/Harmonized Sales Tax). The Protocol is attached as Appendix A of Memorandum 02-06, entitled **National protocol agreement for memorandum assessments**.

Collection Action on Memorandum Assessment

The subsection 225.1(1) *ITA* restrictions will apply to all Memorandum Assessments. Although the *Excise Tax Act* permits immediate collection action on mailing of a Notice of Assessment, collection action on all Memorandum Assessments will be held in abeyance for 90 days.

Third party Memorandum Assessments are subject to the same legislative collection restrictions and rights to appeal as regular assessments.

Should Collection Officers identify a danger of loss on a memorandum issued under ss. 325(2) *ETA* they should inform Headquarters of the details surrounding the case and request approval to waive the 90-day period. In respect to a third party assessment issued pursuant to the *ITA*, a jeopardy action under subsection 225.2(2) *ITA* is required when facing a danger of loss situation.

The filing of a Notice of Objection and subsequent Appeal period on a primary tax debtor account does not preclude an officer from raising/issuing a memo assessment; however, the revenue type of the primary tax debtor account will determine how and when a memo assessment liability can be collected, for instance:

- When the primary tax debtor liability is either a PAYDAC or GST account and a memo assessment has been raised/issued, jeopardy must be invoked against the memo assessment before collection action can be initiated.

- When the primary tax debtor liability under appeal is either a T1 or T2 account and a memo assessment has been raised/issued, jeopardy provisions will generally be invoked against both the primary tax debtor and the memo assessment liability before collection actions can be initiated.

Digitized by Google

A Dividend Payment is a Transfer of Property

In *McClurg* [*The Queen v. McClurg*, 91 DTC 5001 S.C.C.] the Court held that *"had the dividend not been declared and paid to the third party, it would have been retained by the corporation; the taxpayer would not have received the funds."* In *Algoa Trust*, the transfer of property was a payment of dividend and the court added on to the *McClurg* reasoning in these words *"The corporation is impoverished and its shareholders are enriched."*

A transfer by means of Dividend payment will include a situation such as a shareholder taking compensation by way of an advance from the corporation, and converting such at year's end into a dividend to obtain a tax credit. When this is the case, and the corporation is indebted for income tax or GST, the Agency can raise an assessment pursuant to section 160 of the *Income Tax Act* or section 325 of the *Excise Tax Act* against the shareholders. This application is in addition to the usual assessment against shareholders, who function only as investors.

The same rule applies to surpluses distributed as capital dividends free of tax to the corporation's shareholders.

There are many decisions confirming that a Dividend payment is a transfer of property such as *Algoa Trust*, 93 DTC 405, *Delage*, [2002] 1 C.T.C. 2756 (TCC); also *Gazaille*, [2003] 2 C.T.C. 2732 (TCC).

For further information refer to Directive RCD-00-23 entitled **A Dividend Payment is a Transfer of Property**.

When Transfer Is Effected by Way of Mortgage Payments

Where a transfer of property concerns the payment of a mortgage obligation in the form of either a lump sum payment and or an accumulation of periodic payments, the Agency will not differentiate between the principal and interest portions of such payments. It is the Agency's position that the fair market value of the property transferred is the total value of the monetary payments made by the transferor in favour of the borrower.

For further information refer to Directive RCD-02-05, **Transfers of Property and Mortgage Payments**.

The following general guidelines are provided to assist collection officers when contemplating raising a non-arm's length assessment relating to mortgage payments.

Ability to Pay:

Collection officers must ensure an ability to pay on the part of the transferee before raising the assessment. The ability to pay may also include the ability to borrow against any equity available in the real property owned by the transferee or to provide consensual mortgage security in connection with an acceptable repayment arrangement or a non-consensual lien.

Legal Obligation:

Collection officers may expect arguments that the transferor is obligated by law to provide for the shelter and care of his family members and accordingly such payments are not transfers of property made without consideration. The Courts have accepted such arguments in some cases and may continue to do so where such payments do not appear to be unusual in nature or amount given the specific financial circumstances of the family unit.

Rental Benefit:

Digitized by Google

A ruling of the Federal Court of Appeal (*Ducharme*, [2005] FCA 137, April 29, 2005), has suggested that mortgage payments may be viewed as tantamount to rent with a net rental benefit being established on the basis of what a comparable home would rent for. Where such a benefit exceeds the amount of the mortgage payments a transferee will have been considered to have provided more than he/she received. Alternatively where the net rental benefit is less than the amount of the mortgage payments the excess amount would be considered a transfer of property subject to assessment.

Successful memo assessment based on mortgage payment transfers often require a thorough review of the transferor's lifestyle such as in the matter of ***Williams v Canada***, 2000 DTC, 2340 subsequently upheld by the Federal Court of Appeal. The final decision of whether to proceed with non-arm's length assessments based on mortgage payments rests with the delegated TSO authority in conjunction with the necessary Legal Services' opinion and input as required.

Transfer by Means of Deposits into a Related Person's Bank Account

It has been pretty much established that deposits made into a personal banking account of a related party are deemed to be transfers of property. The following cases stand for that proposition: *Thalheimer v. M.N.R.*, 83 DTC 498; *Sanger v. Canada*, 94 DTC 1955; *White v. Canada*, 96 DTC 1552 (TCC); *Simnott v. Canada*, 97 DTC 596 (TCC); *Moss v. Canada*, 2000 DTC 1729; and *Raphael v. Canada*, 2002 DTC 6798.

In *Caron v. R.* 2002 D.T.C. 1936 the husband would deposit cheques made to his name in his spouse's personal bank account but would also later withdraw these funds through a power of attorney provided to him by his wife. The Court held that even in this case the transfers were made without consideration from the beneficiary regardless of whether the amounts deposited were subsequently used for the transferor's own purposes. The deposits were deemed non-arm's length transactions within the meaning of s. 160 *ITA*.

Judge Dussault in *Caron v. R.* *"In my view, André Caron's deposits of cheques made out in his own name or of amounts belonging to him in the appellant's bank account constitute transfers of property within the meaning of section 160 of the Act since he legally divested himself of ownership of those amounts in favour of the appellant, the sole account holder. The power of attorney obtained from the appellant and dated May 7, 1992 (Exhibit A-2) did not transfer ownership of those amounts back to him, but simply gave him a mandate to administer them for and on behalf of the appellant as her agent. Such a power of attorney in no way implies that the appellant gave up her ownership of the amounts deposited in her account since, under the very terms of the power of attorney, all the powers set out therein must be exercised for her and on her behalf."*

In *Caron v. R.* the appellant argued that the power of attorney was the consideration given for the transfers of funds. Other often-raised arguments to counter third party assessment related to transfer of funds would be the legal obligation or domestic services provided as consideration. On this basis Collection Officers should be prepared to document and support the Agency's contention that the payment of legal obligations or household expenses are not valid consideration for the original transfers. For example, the investigation may reveal that these specific transfers are made in addition to the transferor's overall contribution to household expenses. Additional evidence may suggest that the transferor was providing for the support of his spouse while the investigation may reveal that each spouse has adequate independent means to meet their individual needs.

Collecting Evidence of Transfer

To determine if a non-arm's length transaction occurred:

Digitized by Google

1. Identify that property was transferred by examining and/or comparing:
   - details of changes to declared income
   - Audit/Appeals working papers
   - permanent document files
   - financial statements
   - notes to the financial statements
   - loan/credit application files
   - insurance policies
2. Request the appropriate searches:
   - land titles
   - registry office
   - personal property security
   - motor vehicle searches – Ownership history
   - credit bureau reports (Equifax)
3. Confirm:
   - date property acquired by transferor
   - consideration for which property was acquired
   - date transfer occurred
   - name and address of transferee
   - amount of consideration paid by transferee
   - particulars and amounts of all lien holders
4. Obtain copies of transfer documents, including:
   - deeds
   - conveyances
   - invoices
   - separation agreements
   - contracts

Digitized by Google

- titles
- sales/purchase documents
- copies of share register
- copies of transfer agent's records
- trust agreements
- statements of adjustment
- bank statements
- financial arrangements
- cancelled cheques
- instruments of payments
- lawyer's trust account ledger

Determining the Transferee's Ability to Pay

Determine if the proposed assessment is collectible from the transferee or if it can be secured.

For further information refer to the section **Ability to Pay** in the "Payment Arrangement" chapter.

Pre-assessment Letter

Related Topic:

- **Method of Service for Pre-Assessment Proposal Letters**

Transfer of property pre-assessment letter ELCS 80754 is meant to advise a third party of action being considered as a result of a transfer of property. It also provides the opportunity to the third party to inform the Agency of any information that would cause us to reconsider our actions.

In many instances this letter of intention will be brought to the attention of the principal debtor. The Agency's intention to hold a related third person liable for the principal debtor's taxes will, on occasion, prompt the tax debtor to resume discussions with Collections to resolve their tax liability.

Should circumstances dictate a jeopardy action in relation to a contemplated memo assessment, a pre-assessment letter would not be issued.

For further information refer to the Directive RCD 00-09, **Pre-assessment Letter for Transfer of Property Assessments**.

Method of Service for Pre-Assessment Proposal Letters

The information relating to the following topics is contained in the "Memorandum Assessment" chapter and can be viewed by choosing the corresponding topic:

- **Method of Service for Pre-Assessment Proposal Letters**

Digitized by Google

- No Response to the Pre-Assessment Proposal Letter
- Response Received to the Pre-Assessment Proposal Letter
- Verifying Documents Relating to Memo Assessments (Including Document Analysis by the Forensic Sciences Division)
- Follow-Up to the Third Party's Response

Related Topics:

- Requesting an Opinion from the Department of Justice
- Preparing a Non-Arm's Length Assessment

Requesting an Opinion from the Department of Justice

To request an opinion from the Department of Justice:

1. Prepare a memorandum requesting an opinion as to the legality of a proposed assessment.
2. Provide particulars of the transferor's liability including:
   - taxation year
   - date(s) of assessment or reassessment
   - summary of tax
   - penalty
   - interest
   - particulars of the basis of any objection or appeal filed by the transferor
3. Particulars of the asset transferred including:
   - description
   - ownership: title deeds, mortgage documents, agreements of purchase and sale
4. Particulars of the transfer and how the asset was transferred.
5. Provide particulars of the transferee, including:
   - the name of the transferee
   - relationship of the transferee
6. If the transferor and the transferee are not related, provide particulars setting out why the transferor and the transferee are believed not to have dealt with each other at arm's length.

Digitized by Google

7. Where the transfer was made directly to a trust or indirectly to a beneficiary of a trust provide all pertinent information to the Department of Justice.

8. Attach the following documents:

   - evaluation or appraisal of the fair market value of the property
   - evaluation or appraisal of the fair market value of the consideration at the time of transfer
   - documentation supporting the relationship of the transferee to the transferor

9. Obtain the authorization from the delegated authority. Refer to the Policy Authorities Matrix, Memorandum 01-21 entitled **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act***. While reference to the *EA 2001* is not made in Memorandum 01-21, delegation authorities to request a legal opinion are the same.

Preparing a Non-Arm's Length Assessment

To prepare a non-arm's length assessment, a specific Collection file will contain all documentation and evidence relating to the proposed assessment, this Collection file will also:

1. Demonstrate the **fair market value** of the property and,where applicable, this will be done through either:

   - a **Request for appraisal assistance** form (Form T104R)
   - a **Business equity valuation requisition** form (Form T104V)

   Refer to an example on how to complete Form T104R taken from training material TD8605-000-T, **Non-Arm's Length Transfer Assessments** (Tool 8605-3 and 8605-3a)

2. Determine the liability of the transferee by establishing which is the lesser of:

   - the difference between the fair market value of the property at the time of transfer and the consideration given for the property at that time
   - the liability of the transferor

   Refer to **Transferor's Tax Liability Captured by 160(1)(e)(ii) *ITA***.

   Note: Indicate that where property was previously held in joint tenancy, only 50% of the equity in the property is considered to have been transferred, less the fair market value of the consideration given for the property.

3. Establish the transferee's ability to pay through summaries of his income situation and net worth as well as a plan of action to collect the proposed assessment.

4. Where necessary, include an opinion from the Department of Justice. Refer to the policy when an **Opinion from the Department of Justice Required**.

Digitized by Google

5. Include an approved recommendation to assess by the appropriate level of authority. This is a summary of the following facts in the form of a memorandum recommending the assessment:

   a. Brief collection history

   b. Third party's ability to pay

   c. Facts related to the transfer

   d. Legal opinion where required

   e. Other relevant facts for e.g.:

      i. Outstanding Notices of Objections or Appeals

      ii. Danger of loss review

      iii. Bankruptcy information

   It is important that the information in the recommendation to assess be clear and concise. The clearer the facts are, the easier it will be for the person approving the recommendation. A complete and well organized file will also assist other interveners such as Appeal Officers in their decision making process.

   The recommendation to assess will be part of the non-arm's length memorandum assessment's Collection file that will contain copies of all documentation obtained by CRA that provide evidence relating to the third party assessment. A copy of this Collection file will be requested by the Appeals' Division should the third party file a notice of objection. Under normal circumstances, the original documents will remain in Collections and a copy of the entire Non-Arm's Length Collection file will be sent to Appeals.

6. The Collection file will also contain:

   a. A separate docket for the retention of all of the information relating to the original assessment, which should include: the Notice of Assessment; audit information and/or reports; returns (or copies) for the affected years; and, any other information which may have affected an assessment for the period(s) in question.

   b. A copy of the Particulars of Assessment. Refer to an example taken from TD8605-000-T Non-Arm's Length Transfer Assessments (Tool 8605-6); however, the transferor's debt should be broken down by years. A reassessment or additional assessment will also require the completion of a Particulars of Assessment or Particulars of Reassessment.

      The contents of amended Particulars of Assessment/Reassessment should include:

      - an accounting sufficient to detail the basis for the reassessment or additional assessment, and
      - the revised balance

      Note: The details of any amended Particulars of Assessment or Reassessment must provide a link between what is being assessed/reassessed with what was originally assessed.

Digitized by Google

A Particulars of Assessment must always accompany a Non-Arm's Length Assessment and be identified as being part of the Notice of Assessment. See example in **Tool 8605-6**.

c. A copy of the memorandum Notice of Assessment/Reassessment that has been issued.

The Notice of Assessment form can be completed upon receipt of written concurrence from the applicable delegated authority or submitted along with recommendation to assess depending on local divisional policy.

For detailed information on how to fill forms T779 and GST 259 refer to the Directors' Liability chapter, **Completion of the T779 Form** and/or **Completion of the GST259 Form** section.

Third Party Assessment Approval

The Approval authority for a third party assessment is delegated to the following:

- Director, Tax Services Office
- Assistant Director, Revenue Collections
- Manager, Revenue Collections

For further details please refer to Memorandum 01-21 entitled, **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act***. While reference to *EA 2001* is not presently included in Memorandum 01-21, delegated authorities for third party assessment are the same.

Recording the Details in the Control Register

Since memorandum assessments are not recorded in any computer system, the only way to monitor manually issued assessments is to keep a register. Before sending out the Notice of Assessment, you will have to ensure that the control register for all memorandum assessments is properly completed. In most offices, one person keeps the control register.

The following details will be entered in the control register by the designated person who will also keep a copy of the Memorandum Assessment form:

- the serial number of the Notice of Assessment/Reassessment
- the name of the person being assessed
- the date of the assessment
- an explanation of the type of assessment being issued
- the appropriate approval for the release

The status should be monitored and noted accordingly for changes (i.e. Collectible, Appealed, Reassessed/Amended, Paid, Uncollectible, Cancelled).

Digitized by Google

Administrative Functions

The following actions should be undertaken immediately upon the issuance of a memo assessment:

- If the third party is an individual, set a Keep Code 6 against the T1 account of the third party assessed. This will ensure that any T1 refunds or other credits, to which the third party is entitled, are intercepted and retained. For further details regarding Keep Code 6, refer to the chapter **Receiving and Managing Accounts**. Where funds have been intercepted and the taxpayer later requests these sums be reimbursed because he has filed a notice of objection, Collection Officers should refer to the section **Refund or Release of Security pursuant to Subsection 164(1.1) *ITA*** in the "Collection in Jeopardy" chapter. Set refund holds on the proprietorship payroll account. Set a disbursement inhibit on the proprietorship GST/HST account.

- If the third party is a corporation, set a disbursement inhibit on the GST/HST account and a refund hold on the CORTAX account.

  Note: Any disbursement inhibits that are set will require follow up every 120 days to re-input the inhibit until the memo assessment is resolved and the hold is no longer required.

- Reference to the issuance of a Memorandum Assessment should be captured in ACSES of the principal and third party's accounts. A Notepad entry (F21) is preferred to a Diary entry since Diary information is subject to deletion.

- Routine Collections letters available in the ELCS system can be issued during the 90-day collection restriction period. Officers must ensure that the taxpayer has received a legal warning within 120 days of any potential legal action. The following are the available ELCS letters (similar Collections letters are available for those accounts administered under the *Customs Act* and are maintained separately within the ELCS):

  1. "First Collection Letter", ELCS 19619.
  2. "Second Collection Letter", ELCS 19620.
  3. "Pre-Legal Letter", ELCS 19621.
  4. "Legal Action Letter", ELCS 19614

- Update the ACSES diary confirming the issuance of the Collection letters.

Collection Measures

Collection procedures for third party memorandum assessments are the same as for any other regular assessment.

If a Notice of Objection is not filed, or if the third party has not responded to any of the legal warning letters issued, proceed with legal action to resolve the account.

Any garnishments issued for a memo assessment must identify the original tax debtor account number in order for payments to be properly applied.

Certifying the memo assessment liability will require a request for Certificate and/or Writ of Seizure and Sale through the primary taxpayer's account. For more information, refer to the chapter entitled **Certificates, Writs and Other Legal Proceedings**.

Digitized by Google

Law, Sheriff and Bailiff Costs
Related Topic:

- How to Create a Subsidiary Ledger Account

Any law, Sheriff or Bailiff costs incurred in facilitating the collection of the transferee's debt cannot be charged to the memorandum assessment account. Any law costs applicable to the transferee alone cannot be included on the memorandum assessment because they are not considered to be joint and several liabilities shared with the transferor. Where applicable, charge law costs and Sheriff's costs to a separate ledger account in the name of the party being assessed.

How to Create a Subsidiary Ledger Account
To create the subsidiary ledger account:

1. Prepare a memorandum:
   a. Request the creation of a subsidiary ledger account, type 100, revenue type 0031, using the name and SIN of the individual assessed on the memorandum assessment where the law costs are being incurred.
   b. State that there is a valid transaction on a memorandum assessment account.
2. Send the memorandum to the Sub-Ledger Unit at the appropriate Tax Centre.
3. Indicate on the memorandum assessment account that a Subsidiary Ledger account has been created.

Allocating Payments
Related Topic:

- Accruing Interest

Because memorandum accounts are not controlled by the ACSES system, the docket specific to the Memorandum Assessment should contain a dummy card or posting sheet.

Where a transferor and transferee have become jointly and severally liable under s. 160 *ITA* and/or s. 325 *ETA* , the following rules apply:

- Payments made by the transferee are first applied to any Law, Sheriff or Bailiff costs and then applied to the portion of the debt that has the joint and several liability.
- Payments made by the transferor are first applied to any arrears that are not subject to the memorandum assessment. Once this is cleared any remaining amounts will be applied to the portion of the debt subject to the s. 160 and s. 325 liabilities.

Enter the amount of each payment received on the dummy card. This will enable you to keep track of the exact up to date amount owed by each party.

The maintenance of the dummy card or posting sheet is very important because there is no system equivalent to back it up. Refer to the example of a **posting sheet** found in the training manual TD8605-000-T (Tool 8605-11).

Digitized by Google

Accruing Interest

Another consequence of memorandum assessments not being on-line is that accrued interest charges must be calculated manually whenever a payment is received.

- Interest will be charged from the day after the date on which the memorandum assessment was issued to the date on which the payment was received. Collection Officers are reminded that the maximum amount collectable may never exceed the Fair Market Value Difference or benefit conferred. For further information refer to the section Interest on Assessments under section 160 *ITA* or 325 *ETA* .
- The payment will then be applied on the total amount owed.
- If either a reassessment is issued or another payment is received, the accruing interest will be calculated from the day after the last assessment was issued or the last payment was received to the date of the present reassessment or payment.

The amount of each payment received as well as accrued interest charges when applicable is recorded on the dummy card.

T779/GST259 Memorandum Assessment Verses

Related Topics :

- Joint and Several Liability Ss. 160(1) *ITA*, 325(1) *ETA* , 297 *ETA* 2001 or *CA*.97.29(1)
- Joint and Several Liability of Cohabiting Spouse 160.1(1.1) *ITA*
- Joint and Several Liability of Cohabiting Spouse 160.1(2.1) *ITA*
- The Joint and Several Liability under Ss. 160.2(1) and 160.2(2) Deceased Annuitant under a RRSP or RRIF
- The Joint and Several Liability under Ss. 160(1.1) Where Ss. 69(11) Applies

Joint and Several Liability Ss.160 (1) *ITA*, 325(1) *ETA* , 297 *ETA* 2001 or *CA*, 97.29(1)

Related Topic:

- Indirect Transfers

The joint and several liability of the transferee as a result of certain non-arm's length transfers, under the *ITA*, subsection 160(1), under the *Excise Tax Act*, subsection 325(1), the *Excise Act 2001*, section 297, or *Customs Act*, subsection 97.29(1):

> The liability under (insert the section of the Act for e. g. subsection 325(1) of the *Excise Tax Act*) and (insert the corresponding liability under the Provincial *Income Tax Act*, *Canada Pension*, *Unemployment Insurance Act* and *Employment Insurance Act*, where applicable) in the amount of $_____, in respect of a transfer that took place on or about (date) from (name of transferor) to (name of transferee) of property (describe). Please see the attached Particulars of Assessment for additional information.

Indirect Transfers

Digitized by Google

The liability under (insert the section of the Act for e. g. subsection 325(1) of the *Excise Tax Act*) and (insert the corresponding liability under the Provincial *Income Tax Act*, *Canada Pension*, *Unemployment Insurance Act* and *Employment Insurance Act*, where applicable) in the amount of $_____, in respect of an indirect transfer that took place on or about (date) from (name of transferor) to (name of transferee) of property (describe). Please see the attached Particulars of Assessment for additional information.

Joint and Several Liability of Cohabiting Spouse 160.1(1.1) *ITA*

Holding the cohabiting spouse or common-law partner jointly and severally liable with the individual to pay any excess GST credit:

The liability under subsection 160.1(1) of the *Income Tax Act* in the amount of $_____, in respect of Goods and Services Tax Credit refunded in excess of entitlement for which you are jointly and severally liable with (name of credit overpayment recipient) pursuant to subsection 160.1(1.1) of the *Income Tax Act*. Please see the attached Particulars of Benefits refunded in excess for additional information.

Joint and Several Liability of Cohabiting Spouse 160.1(2.1) *ITA*

Holding the cohabiting spouse or common-law partner jointly and severally liable with the individual to pay any overpayment of a CCTB credit:

The liability under subsection 160.1(1) of the *Income Tax Act* in the amount of $_____, in respect of Canada Child Tax Benefits refunded in excess of entitlement for which you are jointly and severally liable with (name of credit overpayment recipient) pursuant to subsection 160.1(2.1) of the *Income Tax Act*. Please see the attached Particulars of Benefits refunded in excess for additional information.

The Joint and Several Liability under Ss. 160.2(1) and 160.2(2) Deceased Annuitant under a RRSP or RRIF

The liability under subsection (select 160.2(1) or 160.2(2)) of the *Income Tax Act* and section (____) of the *Income Tax Act* - (name of province) in the amount of $_____, in respect of the amount of $_____ received on or about (date), out of a (select registered retirement income fund or a registered retirement savings plan), the annuitant being (name of annuitant) , deceased. This assessment is issued pursuant to the provisions of subsection 160.2(3) of the *Income Tax Act*. Please see the attached Particulars of Assessment for additional information.

The Joint and Several Liability under Ss. 160(1.1) Where Ss. 69(11) Applies

The liability under subsection 160(1.1) of the *Income Tax Act* and section _____ of the *Income Tax Act* (name of province) in the amount of $_____, in respect of a deemed disposition of property pursuant subsection 69(11) in respect of a transfer that took place in the taxation year (year) from (name of transferor) to (name to transferee) of property (describe). This assessment is issued pursuant to the provisions of subsection 160(2) of the *Income Tax Act*. Please see the attached Particulars of Assessment for additional information.

In addition, the information relating to the following topics is found in the "Memorandum Assessment" chapter and can be viewed by choosing the corresponding section:

- **Notice of Reassessment Verse for a Memorandum Assessment**

Digitized by Google

- Additional Assessment Verse
- Cancellation of a Memorandum Assessment Verse

Retention of Primary Assessment Information
Related Topics:

- Obligation to Retain Information
- How Collections Should Retain the Information

Obligation to Retain Information

Memorandum assessments, secondary, or derivative assessments, will often result in appeals or objections being filed.

The Courts have indicated that even though the primary debtor may not have appealed or objected to an original amount owing, the secondary debtor is entitled to object or appeal amounts owing on the primary debtor's assessment. Furthermore, in two decisions the courts required the Agency to produce the Notices of Assessment, and/or underlying information supporting those assessments.

In the Federal Court of Appeal decision, in *Gaucher v. M.N.R.*, it was indicated that:
"a person who is not a party to litigation cannot be bound by a judgment between other parties...and hence could not in those proceedings raise defences to her former husband's [primary debtor] assessment. Since the secondary taxpayer was not a party to the proceedings...she is not bound by the assessment against the primary taxpayer."

The Court went on to say:
"that second person must have the full right of defence to challenge the assessment made...including an attack on the primary assessment."

In *Drouin v. M.N.R.*, the Court concluded:
"the onus of providing prima facie evidence of the tax liability where an assessment has been made under subsection 160(1) of the Act generally falls on the Minister.."

More importantly, they concluded that as a result of not tendering a Notice of Assessment, or substantiating audit information:
"it has not been established with a reasonable degree of certainty that DPCI acknowledged that it owed the amounts determined by the Minister.."

The obvious result of these findings is that the onus has been placed on the Agency to retain information relating to the original, or primary assessment, in order to enable us to defend and advance our case, should it be appealed based on that assessment.

How Collections Should Retain the Information

Collection Officers should obtain, and retain, primary debt information until the file has been concluded, i.e. paid in full, resolved at all appeals stages, or deleted from active inventory. In order to achieve this, a separate docket must be established for the retention of all of the information relating to the original assessment and third party assessment and which should include, the Notice of Assessment, Audit information, returns for the affected years, Trust Examinations and any other information which may have affected an assessment for the period(s) in question.

Digitized by Google

For further information refer to Memorandum 01-09, entitled **Third Party Assessments - Retention of Primary Assessment Information**.

Resource Material

Non-Arm's Length Transfer Assessments, TD8605-000 (June 2005) issued by the Training and Learning Directorate.

IT-419R2, **Meaning of Arm's Length**

IT-64R4, **Corporations: Association and Control**

Memorandum 01-09, **Third Party Assessments – Retention of Primary Assessment Information**, issued July 6, 2001.

Memorandum 01-21, **Delegation of the Minister's Powers under the *Income Tax Act*, *Excise Tax Act* and *Customs Act***, issued December 18, 2001.

Memorandum 02-06, **National protocol agreement for memorandum assessments**, issued June 12, 2002.

Memorandum 03-04, **Amalgamation Project Canada Child Tax Benefit (CCTB)**, issued March 24, 2003.

Directive RCD-96-13, **Application of Interest in respect of Memorandum Assessments**.

Directive RCD-98-02, **Exception to Transfer of Property Assessment**, issued February 20, 1998.

Directive RCD-98-4, **Bill C-28 impacts on Accounts Receivable Program**, issued July 3, 1998.

Directive RCD-98-6, **Lien and Charge Registration**, August 28, 1998.

Directive RCD-99-05, **Interest on Assessments under section 160 of the *Income Tax Act* (*ITA*)**, issued May 27, 1999.

Directive RCD 00-09, **Preassessment Letter for Transfer of Property Assessments**, issued May 30, 2000.

Directive RCD-00-10, **Calculating the Transfer of Property Liability for GST under par. 326(1)(d) of the *ETA***, issued May 30, 2000.

Directive RCD 00-23, **A Dividend Payment is a Transfer of Property**, issued August 28, 2000.

Directive RCD-00-26, **Assessments Under Section 160.2 of the *Income Tax Act* for Amounts received out of a RRSP or RRIF**, issued September 20, 2000.

Directive RCD-00-28, **Terms for Proposals under the *Bankruptcy and Insolvency Act***, issued October 20, 2000.

Directive RCD-00-29, **Reassessing a Transferee under the *Income Tax Act***, issued November 1, 2000.

Directive RCD-02-05, **Transfers of Property and Mortgage Payments**, issued August 27, 2002.

Digitized by Google

Directive RCD-03-02, **Transfers of Property: Cascading Assessments**, issued June 1, 2003.

Directive ARD 03-05, **Collection Action on Involuntarily Dissolved Corporations**, issued July 25, 2003.

Communication ARD-2004-010, **Hold Credit Overrides on Canada Child Tax Benefit Accounts**, issued March 4, 2004.

Communication ARD-2004-014, **Reassessing Joint and Several Liabilities**, issued April 8, 2004.

Communication ARD-2005-022, **Collection Restrictions following Reassessments Under the *Income Tax Act*, *Excise Act 2001* and *Excise Tax Act* – Non-GST**, issued July 6, 2005.

Communication ARD-2005-024, **Limitation Periods Applicable to the Collection of Tax Debts**, issued August 10, 2005

Communication TSDMB-2006-025, **Subsection 160.(1) Non-arm's length Transfer of Property/ Subsections 160.2(1) and 160.2(2)Deceased Annuitant under a RRSP or RRIF**, March 16, 2006.

Glossary

Acting in Concert

Even when there are two distinct parties or minds to a transaction, these parties may act in a highly interdependent manner, and therefore it can be assumed that the parties are acting in concert and not at arm's length.

Arm's Length Transaction

A transaction negotiated by unrelated parties, each acting in their own self interest.

Common-Law Partner

Subsection 248(1) provides a detailed and current explanation of the term, for purposes of the *Income Tax Act*.

Common Mind

The Courts have held that where one person or group of persons is, in fact, the bargaining agent, or the mind by which the bargaining is directed, on behalf of all parties to a transaction, then the parties cannot be dealing at arm's length.

Control

Contemplates the right of control that rests in ownership of such a number of shares as to have a majority of the voting power in the corporation.

Conveyance

Digitized by Google

Document effecting the transfer of property.

Deed of Transfer

Written or printed instrument effecting the legal disposition and bearing the disposer's signature.

Fair Market Value

The price that would be agreed upon in an open and unrestricted market between fully-informed, knowledgeable and willing parties dealing at arm's length without constraint.

Intangible Property

Includes the value of partnerships, copyrights, royalties, patents, licenses, mortgages, notes and franchises etc.

Inter Vivos Trust

A trust other than a testamentary trust.

Non-Arm's Length Transaction

Occurs when related persons deal with each other.

Property

Property of any kind whether real or personal, tangible or intangible, a right of any kind, a share in an action, money, the work in progress of a business that is a profession or a timber resource property.

Real Estate

Includes land and improvements along with any interests, benefits and rights.

Real Estate Appraisal

Is requested for an appraisal of real property. The appraisal sets a price for the property.

Tangible Property

Includes chattels such as equipment, furniture, machinery, as well as works of art, jewellery, books, stamps and coins etc.

Testamentary Trust

Digitized by Google

Trust created within a will which does not take effect until the death of the settlor.

Transfer

The act that gives rise to the process by which property will ultimately end up in the patrimony of any other person either directly or indirectly.

Transferee

The recipient of the property transferred.

Transferor

The person who makes the transfer.

Valuation

Is requested for an evaluation of assets other than real property, for example, royalties, partnerships, copyright, goodwill, licenses, etc.

Digitized by Google