LEGAL BUSINESS REPORT
ALPERT LAW FIRM
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# SEARCH WARRANTS, DISCLOSURE & CLIENT PRIVILEGE

**This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on Search Warrants, Disclosure and Client Privilege under the Income Tax Act (Canada) and the possible challenges to and ramifications of statutorily compelled production of information and disclosure. Alpert Law Firm is experienced in providing legal services to its clients in tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions and estate administration.**

## A. SECTION 231.3 SEARCH WARRANTS

The Minister may make an *ex parte* application to a judge for a warrant covering any building, receptacle or place to be searched. The powers conferred under section 231.1 and section 231.2 of the Income Tax Act ("the Act") to audit, examine or require information are separate from the power to seize the documents, which requires a warrant.

Before issuing the warrant, the judge must be satisfied pursuant to subsection 231.3(3) of the Act that there are reasonable grounds to believe that:

(i) an offence under the Act has been committed;

(ii) a document or thing that may afford evidence to the commission of the offence is likely to be found; and

(iii) the building, receptacle or place specified in the application is likely to contain such a document or thing.

Subsection 231.3(5) of the Act permits the person executing the warrant to seize documents in addition to those listed on the warrant, if the person reasonably believes that the documents afford evidence of an offence under the Act.

Documents seized must be brought before the judge, who may order the document or thing seized to be returned if it was not seize in accordance with the warrant or section 231.3 of the Act. Subsection 231.3(8) of the Act allows the person from whom the documents or things were seized to inspect them at reasonable times and to obtain one copy of the document at the Minister's expense. Subsection 490(15) of the Criminal Code allows a judge to grant permission for an interested person to examine detained or seized material. Failure to comply will result in the penalties pursuant to subsection 238(1) of the Act.

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## 1. *R. v. Jarvis*, [2002] 3 SCR 757

In this Supreme Court of Canada case, the taxpayer's appeal raised the issue of whether the Court of Appeal of Alberta erred in admitting evidence collected by CRA auditors during an audit that became an investigation. The taxpayer was charged with tax evasion and making false or deceptive statements in his 1990 and 1991 tax returns. The taxpayer's wife was an artist who was deceased. The taxpayer was able to continue selling her art after her death. The auditor attempted to contact the taxpayer but when she was unsuccessful she contacted third-party sources such as art galleries in order to obtain records pertaining to art sales. When the taxpayer's accountant contacted the CRA auditor, he notified her that the file was in disarray because of the taxpayer's poor record-keeping skills, and his general apathetic attitude towards financial and taxation matters since his wife's death.

After meeting with the taxpayer and obtaining many of his records in April 1994, the CRA auditor determined there was a discrepancy of approximately $700,000 between what was reported on the taxpayer's 1990 and 1991 tax returns and his actual income over the two years. The auditor referred the file to CRA Investigations in May 1994, but did not notify the taxpayer of the change in status, even after inquiries by the taxpayer's accountant. The CRA investigator was able to obtain a search warrant in November 1994 based on the information from the April 1994 meeting, and a search was conducted. Documents found in the search were seized and tendered as evidence during the taxpayer's first criminal trial in 1997.

This evidence was challenged by the taxpayer during his 1997 criminal trial in the Provincial Court of Alberta on the grounds that it had been unlawfully obtained. The trial judge excluded all the evidence from the time the audit had become an investigation forward and acquitted the taxpayer. The Crown appealed to the Court of Queen's Bench of Alberta and a new trial was ordered. The taxpayer appealed the order for a new trial to the Court of Appeal of Alberta. His appeal was dismissed but he was granted leave to appeal to the Supreme Court of Canada.

The Supreme Court of Canada dismissed the appeal and upheld the Alberta Court of Appeal's judgment order for a new trial. The Supreme Court of Canada held that the warrant had been validly issued since an investigation had not yet been started in April 1994. The evidence obtained from the search under this warrant was admissible at the new trial. The Supreme Court held that any evidence obtained pursuant to subsection 231.2(1) requirement letters once the investigation had started was to be excluded from the new trial, as the audit powers of this subsection were not to be used to further a criminal investigation. The Supreme Court concluded that when the

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predominant purpose of the inquiry is penal liability, the Minister must relinquish the powers under subsections 231.1(1) and 231.2(1).

At the taxpayer's new, second trial (*R. v. Jarvis*, 2006 DTC 6477) he was acquitted of tax evasion as he did not have the intent to willfully evade the payment of taxes and make false or deceptive statements on his 1990 and 1991 tax returns.

## 2. *R. v. Szalontai*, [1993] B.C.J. No. 2934

In this British Columbia Supreme Court case, the Minister made an application pursuant to subsection 490(15) of the Criminal Code for permission to examine documents that had been seized from the taxpayer by the RCMP as part of their own investigations. The Minister had already had some access to the documents from an invitation by the RCMP. The taxpayer argued that this: (i) infringed upon his rights; (ii) amounted to a warrantless search; and (iii) further access would infringe upon his right to be secure against unreasonable search or seizure pursuant to section 8 of the Charter.

The Court ruled that the Minister had not acted inappropriately, and granted the order giving the Minister permission to examine the documents seized by the RCMP. The Court noted that while a person would expect that their documents would not be made public, the taxpayer could not reasonably expect that documents seized would not be seen generally by another investigative governmental department. Further, the Court stated that a party applying under subsection 490(15) should have a general idea of what is contained within the documents and this could mean the party could have a general look at the materials without a warrant.

## 3. *R. v. Law*, 2002 DTC 6789

In this case before the Supreme Court of Canada, the taxpayers appealed the New Brunswick Court of Appeal decision that their section 8 Charter rights had not been infringed. The taxpayers had a safe from their restaurant stolen. It was later found abandoned and opened in a field. Inside the safe were financial documents. A police officer not involved in the investigation of the theft took the documents from forensics, photocopied them and then returned them into a box in the exhibit room at the police station as he suspected the restaurant owners of not submitting all of their taxes. No warrant or permission was obtained. This officer then contacted an investigator with the Canada Revenue Agency (the "CRA"), who examined the documents in the exhibit room. Based upon the documents, the CRA investigators then searched the taxpayers' restaurant and summary conviction proceedings were brought against the taxpayers for failing to file proper returns.

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At trial, the judge ruled that photocopying the documents was an unreasonable search under section 8 and excluded this evidence under subsection 24(2) of the Charter. The Crown won the appeal as the appellate court ruled that the expectation of privacy disappeared once the safe was stolen by thieves and was recovered by the police. The taxpayers appealed to the Supreme Court of Canada to have the trial judge's decision restored.

The Supreme Court of Canada allowed the taxpayers' appeal. The Court held that the taxpayers had not voluntarily discarded their private documents and so still had a reasonable expectation of privacy. Where the police could not reasonably conclude the property had been abandoned, they are limited in their investigation by the privacy interest of the owner under section 8 of the Charter. The police would have been permitted to conduct an investigation into the theft of the safe, but not into the tax liability of the taxpayers. The officer was not authorized by the Minister to conduct an audit. Additionally, there was no evidence to support the "plain view" doctrine, where evidence of illegal activity appears on the face of the documents to warrant further, legitimate investigations. The incriminating evidence in this case was only revealed after much work. The Court further held that the taxpayers did not waive their right to privacy by reporting the theft of the safe to the police and that one did not have to assert a claim of privacy in order for it to be respected.

The violation of section 8 was found to be sufficiently serious as the police officer had knowingly disregarded established procedures and assumed the role of a tax official, taking regulatory matters into his own hands when the role could have been left to the appropriate body. The Court also found that the admission of the evidence would risk bringing the administration of justice into disrepute, due to the summary proceedings and the quasi-criminal nature of the offence.

### 4. *R v. Borg*, 2007 CarswellOnt 8480

In this Ontario Court of Justice case, the taxpayer was charged with income tax evasion during the period between December 31, 1990 and June 19, 1995, pursuant to s. 239(1) (d) of the Act. These charges were a result of an audit of the taxpayer's carpet installation business initiated by the CRA. In April 1995 a CRA Auditor, was assigned and on March 16, 1996, she referred the taxpayer's file to CRA Investigations. Eventually, search warrants were obtained on July 9, 1997 and they were executed on July 10, 1997. The taxpayer was eventually charged on August 20, 1998. Before trial, the taxpayer brought an Application for exclusion of evidence on the basis that the auditor was engaged in a criminal investigation when using audit powers to demand information.

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The Ontario Court of Justice granted the taxpayer's Application. The Court found that from May 25, 1995 onwards, the CRA Auditor must have subjectively concluded that she had uncovered the necessary *mens rea* on the part of the taxpayer to commit tax fraud and tax evasion when she discovered the huge sums of business incomes that had been unreported in 1992 and 1993. The Court found that despite this evidence, the CRA Auditor failed to refer the taxpayer's file to CRA Investigations until almost 10 months later and was engaging in a criminal investigation under the guise of an audit during the interim period.

As a result, the Ontario Court of Justice excluded all evidence obtained by the CRA Auditor from May 25, 1995 onwards. The Court also excluded all of the evidence obtained or derived by the execution of search warrants since the Court found that the search warrants would not have been issued in the absence of the information obtained by the CRA Auditor subsequent to May 25, 1995.

## B. SOLICITOR-CLIENT PRIVILEGE

Section 232.(1) of the Act defines "solicitor-client privilege" as the right of a person to refuse to disclose any oral or documentary communication between the person and the person's lawyer in professional confidence. However, the Courts have held that in certain circumstances "solicitor-client privilege" may not extend to the accounting information such as the trust account records of a solicitor.

There are two types of solicitor-client privilege: litigation privilege and legal advice privilege. The former protects all communications between the client, the solicitor and third parties involved in or contemplating litigation. Legal advice privilege protects communications between the client, the solicitor and third parties that relate to the seeking, formulation or giving of legal advice. The communication must be "professional communication in a professional capacity". This privilege extends also to communications with people with whom the solicitor interacts professionally, such as an articling student.

In order to qualify for protection, the documents in question must be a communication between a solicitor and a client that involves legal advice, where it was intended to be confidential. Facts contained in those documents, which may be discoverable, are not protected. Privilege is not automatically given to documents because they are in the possession of a lawyer.

Solicitor-client privilege is seen is being crucial for the administration of justice, in an adversarial system. The goal of solicitor-client privilege is to assure open communication so that there can be effective legal assistance, to further proper

administration of justice and to adequately prepare prosecutions or defences.The Courts have stated that there is a fundamental rule of privilege that is to be interfered with as little as possible. For example, where there is some doubt as to the purpose of communication (i.e. whether it qualified as legal advice) then the benefit of the doubt should go towards maintaining privilege. Privilege can be waived, however the waiver must be done by the client or a person with the authority to waive protection. Inadvertent or unknowing disclosure to a third party also does not automatically waive privilege.

**1. *Paquette v. M.N.R.*, 92 DTC 6394**

In this case before the Trial Division of the Federal Court, the client's solicitor was sent a request under section 231.2 of the Act, for all of his client's trust account records. This client had previously been fined for not complying with another request for documents and this fine was paid by the solicitor. The client instructed his solicitor to refuse this second demand on the basis of solicitor-client privilege. The solicitor argued that: (i) the demand made did not comply with section 231.2 of the Act; (ii) was invalid; (iii) was not made as part of an on-going inquiry; and iv) the exemptions under paragraph 232.1(e) of the Act could not apply in determining solicitor-client privilege.

The Federal Court dismissed the taxpayer's motion and held that the Minister was permitted to examine the trust account records of the solicitor related to the client. The Court found that the client owed the Minister taxes and that for several years there had been an ongoing inquiry into how to collect the outstanding money. The demands made with respect to unnamed persons were not made subsequent to judicial authorization pursuant to subsection 231.2(2) of the Act and were therefore invalid. The Federal Court also held that solicitor-client privilege did not extend to lawyers' trust account records in the circumstances of this case.

**2. *Archibald Morley v. Canada (Revenue)*, 97 DTC 5264**

In this Supreme Court of Nova Scotia, the law firms asked for a determination on the issue of whether the CRA was entitled to copies of either the legal accounts rendered to clients and clients' trust account ledgers. The law firms were served with a requirement pursuant to section 231.2 of the Act for information including all legal invoices, copies of trust accounts, statements of adjustments on the purchase or sale of properties and information regarding mortgages and disbursements.

The Court held that the legal accounts were privileged and were not to be released to the CRA. The Court noted that these accounts nearly always contained reference or a description of the services rendered by the solicitor and as such, were privileged solicitor-client communications. However, the Court found that trust account

records were exempt by paragraph 232(1)(e) of the Act from the claim of solicitor-client privilege and thus had to be released to the CRA.

## C. NO ACCOUNTANT-CLIENT PRIVILEGE

While confidential information between an accountant and a client is not subject to privilege, there is an exception where the information was given to the accountant as an agent of the client for the purpose of obtaining legal advice for the client. The privilege here is not the creation of an accountant-client privilege but an extension of solicitor-client privilege through an agency relationship.

The lack of privilege stems from the lack of an express provision in the Act protecting communications between an accountant and a client. Privilege in this case is not seen as being a necessary part of ensuring the fair administration of justice, as in the case of the privilege between lawyers and their clients.

### 1. *Cineplex Odeon Corp v. Canada*, 94 DTC 6407

In this case before the General Division of the Ontario Court, the corporate taxpayer filed an application asserting privilege for documents that the Minister sought to have produced under section 232 of the Act. These documents, comprising of correspondence and notes of meeting between various solicitors and accountants, had already been found to be protected by solicitor-client privilege in an earlier Court decision. Some of these documents had been furnished to an accountant at an accounting firm for legal advice. The accounting firm then acted as an external auditor for the taxpayer. Some of the privileged documents became part of the accounting firm's audit team's files. The Minister argued that the disclosure of these documents to the audit team constituted disclosure to a third party and thus privilege was lost. The taxpayer countered that the disclosure was not to a third party or in the alternative, that the disclosure was inadvertent and that only the client is capable of authorizing disclosure.

The Court found that the documents were still subject to privilege and the taxpayer did not have to produce them for the Minister. The Court held that the audit team of the accounting firm was sufficiently different from the tax team of that same firm that they must be notionally treated as third parties for consideration of the waiver of privilege. However, the accounting firm had no power or right to waive the legal privilege and that the disclosure was inadvertent as the accountant had put the documents into the audit team's files without regard to the taxpayer's privilege and without knowledge of it. The Court stated that there was a fundamental rule of privilege that was to be interfered with as little as possible.

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## 2. *Belgravia Investments Ltd. v. Canada*, 2002 DTC 7133

The taxpayers in this Federal Court case sought an order for a determination of solicitor-client privilege in relation to documents requested by the CRA. The request was issued pursuant to subsection 231.2(1) of the Act, during the course of an audit concerning investments into companies and potential tax shelters. Documents were provided to the Minister except those over which privilege were claimed. The disputed documents generally were those documents arising between agents, accountants and the solicitors of the taxpayers.

The taxpayers argued that solicitor-client privilege extended to protect confidential information when an agent, including an accountant, was seeking legal advice from a solicitor on behalf of the client. They argued that communications between a client and this agent, when related to the legal advice, was also protected. The Minister argued that there was a distinction between legal and business advice and that privilege only applied to legal matters.

The Court found that some documents were more properly categorized as business advice from accountants regarding proposed investments and transactions, and thus were not privileged. Other documents had their protection waived due to disclosure or involvement with third parties. Those documents that were properly identified as being privileged would not be disclosed to the Minister.

## 3. *Tower v. M.N.R.*, 2003 DTC 5540

In this Federal Court of Appeal case, the taxpayers, who decided to emigrate from Canada, were clients of an accounting firm. Together with the accounting firm, the taxpayers entered into transactions designed to offset the taxable income expected to arise when they ceased to be Canadian residents. The taxpayers were later reassessed and the deductions were disallowed. The Minister then served requirements pursuant to subsection 231.2(1) of the Act on the accounting firm to deliver all tax related files relevant to the taxpayers and to provide written responses to certain questions.

The Federal Court of Canada ordered the accountants and the taxpayers to comply with the requirements, except the demands for written responses or the demands where the accounting firm would have to create new documents, as these were ruled to be outside the scope of subsection 231.2(1) of the Act. Both the Crown and the accountants appealed the decision. Some of the issues to be determined included: (i) whether the Minister could compel answers to questions or the creation of new documents; (ii) whether the requirements were issued for the administration and enforcement of the Act; and (iii) whether the requested material prepared for the

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purpose of tax advice was privileged. The taxpayers also argued that it was time to extend a class-wide privilege for all accountant-client communications; if not, then a case-by-case privilege should be accorded here.

The Federal Court of Appeal allowed the Crown's appeal and dismissed the taxpayers and the accountants' cross-appeals. The Court held that the Applications Judge had erred when he excluded the Minister's written questions. The Court stated that if the Act were to be properly interpreted, it empowers the Minister to seek 'information', which may mean asking questions to elicit knowledge or facts. The Court also ruled that tax planning information was relevant to the determination of tax liability, even if there was information into subjective intention.

The Federal Court of Appeal also upheld the principle that a class privilege for accountant-client communication does not exist. The Court stated that there was no reason for there to be a case-by-case privilege in this case. Even if a chartered accountant is required as a matter of professional ethics to keep his client's communication confidential, the accountant should know that this confidentiality is restricted by the power of the Minister to require disclosure. Confidentiality was also not key for the relationship between the accountant and the client. The taxpayers also failed to show that the relationship between the accountant and the client was one that the community would foster and protect, such as the one between solicitor and client, or doctor and client. The Court distinguished between protecting a relationship where lack of privilege could adversely affect a person's physical, mental or spiritual health and not protecting confidentiality in a relationship where the threat would be to personal wealth. The Court also ruled that there would be no public injury if accountant-client communications continued to be scrutinized by the Minister as past relationships have continued to function notwithstanding the Minister's powers.