

REQUESTS AND REQUIREMENTS TO PRODUCE INFORMATION

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on Requests and Requirements under the Income Tax Act (Canada) and the possible challenges to and ramifications of this statutorily compelled production of information.

Alpert Law Firm is experienced in providing legal services to its clients in tax dispute resolution and tax litigation, tax and estate planning matters, corporate-commercial transactions and estate administration. Howard Alpert has been certified by the Law Society as a Specialist in Estates and Trusts Law, and also as a Specialist in Corporate and Commercial Law.

A. SECTION 231 AND ITS SUBSECTIONS

Section 231 of the *Income Tax Act* (the “Act”) generally grants the Minister or a person authorized by the Minister the power to compel the taxpayer to provide them information and documents, to allow for the inspection of documents and for access to businesses where such information, inventory or documents are located. Section 231 of the Act defines documents as including money, a security and a record. A record as defined by section 248 of the Act includes an account, an agreement, a book, a chart or table, a diagram, a form, an image, an invoice, a letter, a map, a memorandum, a plan, a return, a statement, a telegram, a voucher, and any other thing containing information, whether in writing or in any other form, including computer records.

This grant of authority however only extends to audits and civil liability. If the Minister starts a criminal investigation into the activities of the taxpayer, then documents and information can only be obtained under a warrant. When the predominant purpose of the requests or requirements is to further a criminal investigation, then the taxpayer’s rights under the *Canadian Charter of Rights and Freedoms* (the “Charter”) will be engaged. An audit is an administrative process that does not trigger a taxpayer’s *Charter* rights. An investigation however is an adversarial and criminal process which invokes a person’s right against self-incrimination and the rights against unreasonable search and seizure.

The Courts have ruled that information that was compelled using the civil audit provisions is inadmissible once a penal investigation has commenced. A taxpayer’s rights pursuant section 7 of the *Charter*, which protects a person’s right to life, liberty and security of the person, is engaged if statutorily compelled information gathered using the civil audit powers under section 231 of the Act is introduced at a trial for section 239 offences under the Act. This is because of the threat of imprisonment,

which is imposed under paragraph 239(1)(g) for a maximum term of 2 years. As a result, the Minister can no longer use the inspection and requirement powers under section 231.1 and section 231.2 of the Act to compel documents, and must rely instead upon documents obtained pursuant to a warrant.

In addition, since the Minister's use of the civil audit powers amount to a warrantless search, section 8 of the *Charter*, which protects a person's right against unreasonable search and seizure, may also be engaged if a taxpayer's documents are seized in an attempt at a criminal investigation masked as a civil audit. The Courts in their analysis of whether there was a breach of section 8 of the *Charter* will examine, among other things, whether in that particular situation the public's interest in being left alone by the government is greater than the government's interest in intruding in order to advance its goals.

The Courts have ruled that audits and criminal investigations are not mutually exclusive and the Minister may conduct both concurrently. Canada Revenue Agency ("CRA") Investigators however can only avail themselves of information obtained prior to the commencement of the criminal investigation.

From a taxpayer's point of view, the distinction between civil audits and criminal investigations is critical. In practice, a taxpayer who is charged with the criminal offence of tax evasion would often challenge at trial the admissibility of the evidence gathered using the Minister's civil audit powers under section 231.1 and 231.2 of the Act based upon whether it was collected predominantly for assessing civil or criminal liability.

B. SECTION 231.1 INSPECTION, AUDIT AND EXAMINATION POWERS

Section 231.1 of the Act grants the CRA the power to audit and examine documents and to request information as part of an audit. This is commonly referred to as the "inspection powers" of the CRA to verify compliance with the Act. Pursuant to subsection 231.1(1) of the Act a person authorized by the Minister, for any purpose related to the administration or enforcement of the Act has the power to:

- (a) inspect, audit or examine the books and records of a taxpayer and any documents of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act; and
- (b) examine property in an inventory of a taxpayer and any property or process of, or matter relating to, the taxpayer or any other person, an examination of which may assist the authorized person in determining the

accuracy of the inventory of the taxpayer or in ascertaining the information that is or should be in the books or records of the taxpayer or any amount payable by the taxpayer under this Act.

Subparagraph 231.1(1)(c) of the Act also gives the authorized person the power to enter into any premise or place where any business is conducted, where any property is kept or where anything connected to the business, books or records are kept. Subparagraph 231.1(1)(d) of the Act requires that the owner, manager and other people on the premises reasonably assist the authorized person and answer questions relating to do the administration and enforcement of the Act.

If the authorized person wishes to enter a dwelling-house (i.e. a place of residence), subsection 231.1(2) of the Act requires the occupant's permission. Otherwise, the Minister may make an *ex parte* application for a warrant under subsection 231(1)(3) of the Act. The judge must be satisfied that entry into the dwelling-house is necessary for the administration and enforcement of the Act.

Penalties for failure to comply with subsection 231.1 of the Act are found in subsection 238(1) of the Act. Upon summary conviction, the taxpayer is liable for a fine not less than \$1000 and not more than \$25,000 or both the fine and a term of imprisonment not exceeding 12 months.

C. SECTION 231.2 REQUIREMENTS

Subsection 231.2(1) of the Act gives the Minister the power to require any person to provide information or documents for any purpose related to the administration or enforcement of the Act. Pursuant to this provision, the CRA can issue a Requirement for Information (sometimes called, colloquially, Requirement letter or demand letter) to any person subject to certain limitations. Subsection 231.2(2) of the Act provides that the Minister shall not require third parties to provide information or documents relating to unnamed persons unless the Minister first obtains the authorization of a judge under subsection 231.2(3) of the Act. Pursuant to subsection 231.2(3) of the Act, before granting the authorization, the judge must be satisfied that the person or group of people are ascertainable and that the requirement is being made in order to verify compliance by the person or group of people with any duty or obligation under the Act .

Case law has established that the existence of a "genuine serious inquiry" into the tax liability of a specific person is a necessary prerequisite for the issuance of a subsection 231.2(1) Requirement notice. Hence, where the CRA is only doing general research into a tax evasion strategy, or engaged in a fishing expedition, Requirement notices may be found invalid.

The taxpayer or third party receiving the requirement notice has 15 days to apply for a judicial review of the judicial authorization. The judge upon review may uphold the requirement, cancel it or modify it so that it meets the conditions of subsection 231.2(3) of the Act. Failure to comply with a requirement letter will result in the penalties pursuant to section 238(1) of the Act.

D. PREDOMINANT PURPOSE TEST

A taxpayer may file an application for a judicial review in respect of a request or a requirement notice. Subsection 18.1(3) of the *Federal Courts Act*, R.S.C. 1985, c. F-7, provides that the Federal Court may grant the applicant certain remedies or orders regarding a decision, order, act, or proceeding, including: (i) declaring it invalid or unlawful; (ii) quashing it; (iii) setting it aside; (iv) referring it back for determination in accordance with such directions as the court considers to be appropriate; (v) prohibiting it; or (vi) restraining it.

A taxpayer may also ask for relief under subsections 24.(1) or (2) of the *Charter*, which allows the court to grant a remedy it considers appropriate and just, and to exclude evidence obtained in a manner that infringed upon any rights or freedoms, respectively.

In determining whether the predominant purpose of a request or requirement was civil or penal, the Supreme Court of Canada in *R. v. Jarvis* has enumerated several factors for consideration in a contextual analysis:

- (a) Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation could have been made?
- (b) Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?
- (c) Had the auditor transferred his or her files and materials to the investigators?
- (d) Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?

- (e) Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?
- (f) Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea*, is the evidence relevant only to the taxpayer's penal liability?
- (g) Are there any other circumstances or factors that can lead the trial judge to the conclusion that the compliance audit had in reality become a criminal investigation?

Other circumstances or factors under (g) were listed by the Federal Court in *Stanfield v. MNR.*:

- (h) Were the criminal investigation and administrative audits being conducted simultaneously or otherwise interconnecting and, if so, for what purpose?
- (i) What was the nature of the flow of information between Audits and Investigations, both during and after the criminal investigation?
- (j) What was the level of importance of the contacts between Audits and Investigations while the criminal investigation was ongoing as well as after it apparently ended?
- (k) Considering the complexity of the factual and fiscal situations in the present case, how does this impact on the predominant purpose to be assessed?
- (l) Without obtaining the documents and information requested, will the Respondent be put in a position whereby it cannot meet its audit functions provided for in the Act?

E. THIRD PARTY REQUIREMENTS AS TO UNNAMED PERSONS

The general rule pursuant to subsection 231.2(2) of the Act is that the Minister shall not impose on any third party a requirement to provide information or any document relating to unnamed persons unless the Minister first obtains judicial authorization. However, where the information sought was needed as part of a *bona fide* audit of a taxpayer, recent case law indicates that the Courts may consider such a

requirement to fall under section 231.1 of the Act instead of automatically being subject to subsection 231.2(2) of the Act.

This issue of the Legal Business Report is designed to provide information of a general nature only and is not intended to provide professional legal advice. The information contained in this Legal Business Report should not be acted upon without the further consultation with professional advisers.

Please contact Howard Alpert directly at (416) 923-0809 if you require assistance with tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions or estate administration.

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