

## Reviewing CRA Audit and Collection Powers: an Examination of the Federal Court's Jurisdiction

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## Overview

JURISDICTION OF THE TAX COURT	JURISDICTION OF THE FEDERAL COURT
<i>Tax Court of Canada Act</i>	<i>Federal Courts Act</i>
<ol style="list-style-type: none"> <li>1. Appeals under the <i>Income Tax Act</i></li> <li>2. Applications for Extension of Time to file Notice of Objection</li> <li>3. References</li> <li>4. Questions</li> </ol>	<ol style="list-style-type: none"> <li>1. Crown Relief Claims</li> <li>2. Collections</li> <li>3. Applications for Judicial Review</li> </ol>

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## Tax Court: Appeals under the *Income Tax Act*

- A Notice of Appeal is always in respect of a disputed assessment or reassessment. The Notice must raise all of the issues that the taxpayer may have with respect to the taxation year.
- Procedures for appeals:
  1. Informal Procedure
    - a. Simplified version
    - b. Must made election in Notice of Appeal
    - c. Amount of federal tax and penalties in dispute per tax year cannot exceed \$25,000 or the loss being determined cannot exceed \$50,000.
  2. General Procedure
    - a. Exchange Documents
    - b. Engage in examinations for discovery
    - c. Apply to Court for a hearing date when all of the pre-hearing stages are complete.

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## Tax Court: Appeals under the *Income Tax Act* Notice of Assessment, Reassessment, or Additional Assessment

- To understand the Appeal process, it's important to first understand what constitutes a Notice of Assessment, Reassessment, or Additional Assessment.
  1. Assessment
  2. Reassessment
    - Any subsequent recalculation of a taxpayer's tax for the year, interest, and penalties after an assessment has been fixed.
  3. Additional Assessment
    - Results in two valid assessments for that particular taxation year.
    - Does not affect the status of the assessment or reassessment existing at the time.
    - The taxpayer must file an additional notice of objection, objecting the additional assessment.

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## Tax Court: Appeals under the *Income Tax Act* Disposing of Appeal

The Court can only dismiss/allow the appeal and either:

1. Vacate the assessment
  - a. Assessment is void and not legally effective
  - b. Vacated reassessment: taxpayer's liability is restored to the previous assessment or reassessment for the particular taxation year.
2. Vary the assessment
  - a. Modifying the disputed assessment or reassessment in accordance with the terms of the order of the Tax Court.
  - b. no reassessment of the taxation year is issued to implement the Tax Court's decision.
3. Refer the assessment back to the Minister for reconsideration and reassessment
  - a. Taxpayer is issued a reassessment by the Minister for the taxation year in dispute.

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## Tax Court: Appeals under the *Income Tax Act*

### Grounds for Determining Appeal

- The Act is not explicit in the manner in which the Tax Court is to come to its disposition.
- The Court must determine the validity and correctness of the assessment based facts and the applicable provisions of the Act.
- The Court cannot look to any other facts, including the conduct of the parties, *which are not* directly related to the contested assessment.
- Section 166: assessment shall not be vacated by reason only of any irregularity, informality, omission or error.

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## Federal Court: Crown Relief Claims

### 1. Collections

- a. Section 223: Certificates
- b. Section 225.1: Jeopardy Orders

### 2. Information Gathering

- a. Section 231.1: Inspect books and records of taxpayer
- b. Section 231.2: Require Information from any person in relation to administration or enforcement of the Act.
- c. Section 231.7: compliance order to require a person to provide any access, assistance, information or document sought by the Minister under section 231.1 or 231.2.

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## Certificates

- Certificate allows the Minister to register, with the Federal Court, that an amount of income tax, CPP, and EI payable by the taxpayer has not been paid. The effect of this certificate is, that once issued, as if a judgment had been obtained in the Federal Court.
- Once a certificate has been issued, the Minister can proceed with other collection actions, such as registering liens on real property (per section 223 of the Act) or assessing director's liability for unpaid payroll (per section 227.1 of the Act).
- Note: There is no procedure to contest the certificate in the Federal Court, *Gadbois* 2002 FCA 228.
  - The only recourse available to the taxpayer is to contest the assessment that lead to the outstanding liability through the objection/appeal process, *Canada (Attorney General) v. Klassen* 2007 SKQB 393.

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## Jeopardy Orders

- An order of the Federal Court authorizing the Minister to undertake collection actions without being subject to the collection restrictions found in section 225.1 of the Act.
- Application is done on an *ex parte* basis.
- Can be sought before an assessment is issued.
- Taxpayer can file an application for review within 30 days of being served the order from the Federal Court.

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## Jeopardy Orders

- On a review, the Federal Court will determine whether there are reasonable grounds to believe that the collection of all or any part of an amount would be jeopardized by the delay, *The Queen v. Golbeck 90 DTC 6575*.
- The burden is on the taxpayer to first establish that there are reasonable grounds to doubt that the collections of all or any part of the amount assessed against them will be jeopardized.
- If the taxpayer is successful, the burden then shifts to the Minister to justify the jeopardy order, by demonstrating on a balance of probabilities that it is more likely than not that the collection would be jeopardized, *MNR v. Patry 2012 FC 977* and *MNR v. Grenon (Trust of) 2015 FC 1050*

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## Jeopardy Orders

- One other alternative argument is whether the Minister would be better served making such an application in the provincial court instead of the Federal Court.
  - See *MNR v. Abu-Taha 2001 FCT 76*
  - There is concurrent jurisdiction with respect to jeopardy orders between the Federal Court and the provincial courts.
    - The review goes to the court that issues the jeopardy order
- Federal Court's decision is final – no appeal is possible.

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## Information Gathering

- Section 231.1 of the Act allows the Minister to inspect the books and records of a taxpayer or any other person and grants the Minister a wide berth as to what documents and records it can review as part of its audit function
  - Record is defined expansively in 248(1) of the Act
- 231.1(2) requires the Minister to get a warrant in order to enter a residence
- The requirement must provide the taxpayer with a reasonable time to comply but what is reasonable is dependent on circumstances  
*Joseph v. MNR* 1985 CarswellOnt 915, [1985] 2 C.T.C. 164, 51 O.R. (2d) 658, 20 D.L.R. (4th) 577, 85 D.T.C. 5391, 20 D.L.R.(4th) 577 (Ont. S.C.)

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## Information Gathering

- Section 231.2: Require Information from any person in relation to administration or enforcement of the Act (or any tax treaty).
- Where the Minister wishes to require the person to provide information with respect to one or more unnamed persons, the Minister is required to obtain authorization from the Federal Court.
  - The powers of the Minister here are very broad and the courts tend to limit them only where the Minister is attempting to go on a “fishing expedition”.
    - See *James Richardson & Sons Ltd. v. Minister of National Revenue*, [1984] 1 SCR 614; *Canadian Bank of Commerce v. Canada (Attorney General)*, [1962] SCR 729.

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## Information Gathering

- Section 231.6 deals with “foreign-based information or documents”
  - Defined to be any information or document that is available or located outside of Canada that may be relevant to the administration of the ITA (231.6(1)).
- Such a request can be reviewed by a judge of the Federal Court within 90 days after service of the notice.

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## Information Gathering

- Section 231.7: compliance order to require a person to provide any access, assistance, information or document sought by the Minister under section 231.1 or 231.2.
- In this application, the Minister must establish that the person was required under either section 231.1 or s. 231.2, to provide the access, assistance, information, or document and did not do so and that the information or document is not protected by solicitor-client privilege.

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## *MNR v. BP Canada Energy Company 2015 FC 714*

- Facts:
  - As part of its audit of the 2005 tax year, CRA requested the tax accrual working papers of the taxpayer.
  - BP originally resisted providing them and instead provided a redacted version that contained the amounts of the reserves but not the reason why the reserves were taken.
  - CRA determined that there were material differences between the amounts listed in the reserves and the issues identified by CRA during its own audit (CRA's amount was smaller than BP's reserves).
  - CRA repeated its request and made new requests for the 2006 and 2007 tax years.
  - Again, BP only provided redacted versions.
  - 2005 and 2006 were reassessed, leaving the need for the tax accrual working papers for the audit of the 2007 and subsequent taxation years.

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## *MNR v. BP Energy*

- Issues before the court were:
  - Is the Minister entitled to compel BP to disclose the tax accrual working papers for the purpose of expediting the Minister's future audits?
  - Should the Court exercise discretion not to compel the documents?
  - Is the Minister's demand unfair to BP?

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## *MNR v. BP Energy*

- Minister relied on subsection 231.1(1) of the ITA and its broad wording.
- BP argued that providing the working papers would be akin to conducting a self-audit on behalf of the Minister.
  - Thus contravening the fundamental construct of the self-assessing tax system, where the taxpayer reports its income to the best of its ability and the Minister reviews those filings at its discretion.
- BP further argued that because BP, as a publicly-traded company was required to calculate its tax reserves, that CRA's request singled out a specific class of taxpayers with additional audit obligations.
- The Federal Court rejected BP's arguments.

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## *MNR v. BP Energy*

- BP also argued that regardless of whether the working papers are compellable, the Minister acted in bad faith and asked the court to exercise its residual discretion to not issue a compliance order.
  - BP argued that the Minister acted in bad faith and that the request amounted to a fishing expedition.
  - BP argued that the Minister's reasoning as to why it required the working papers (initially for 2005, then for subsequent years) was evidence that the Minister was acting in bad faith.
- The Court rejected BP's argument on this point based on a lack of evidence regarding the Minister's intent.

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## MNR v. BP Energy

- The Court also rejected BP's argument regarding the unfairness of the request.
  - Essentially BP is unlike other taxpayers, in that it is required to prepare these documents unlike most taxpayers.
- BP has appealed this decision – hearing is scheduled for February 21<sup>st</sup> in Toronto.

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## Solicitor-Client Privilege

- Solicitor-Client privilege is both a rule of evidence and an substantive rule of law, *Descoteaux v Mierzwinski* [1982] 1 S.C.R. 860.
- Essentially, privilege prevents the production of communications between a solicitor and client to be disclosed.
- Solicitor-client privilege occurs where *legal advice* of any kind is sought from a *professional legal advisor in their capacity as such*, the communications relating to that purpose, *made in confidence* by the client (Wigmore, *Evidence* (McNaughton rev., 1961)).
- No independent accountant-client privilege exists in Canada.

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## Solicitor-Client Privilege

- While certain documents may be privileged, the facts contained therein may not be privileged.
  - For example, balances from financial statements or general ledger that are used as part of communications between solicitor and client may not be privileged if those balances were prepared during normal course of engagement and not particularly requested by lawyer.
  - See *Susan Hosiery Ltd. v. MNR* [1969] 2 Ex. C.R. 27, 69 D.T.C. 5278 (Can. Ex. Ct.)

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## Solicitor-Client Privilege

- Solicitor-Client privilege may cover communications between lawyer and any third parties (including accountants) where the third party was acting as the taxpayer's agent, *Redhead Equipment Ltd. v. Canada* 2014 SKQB 172.
- It would also further apply to communications where the third party employs an expert in assembling information provided by the client and in explaining that information to the lawyer, *General Accident Assurance Co. v. Chrusz* (1999), 45 OR (3d) 321 (Ont. C.A.).
  - Case dealt with situation whereby the client's financial advisor met with the client's lawyer to discuss tax planning for the client.
  - However, doesn't apply to communications where third party is providing their professional knowledge.

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## Solicitor-Client Privilege

- Example:
  - Accountant calls lawyer and discusses potential tax plan for mutual client developed by the accountant.
  - Such communication may not be privileged because tax plan utilized accountants professional tax accounting knowledge.
    - Risk is accountant may not be said to be client's agent in this matter.
    - However, if seeking legal advice on matter, may be privileged.
  - However, if the lawyer contacts the accountant and requests specific information from the accountant, that communication would be privileged on the basis the accountant is acting as the taxpayer's agent.
    - Although again, the specific facts requested may, themselves, not be privileged.

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## Solicitor-Client Privilege

- Subsections 231.2(1) and 231.7 are inapplicable to lawyers and notaries in their capacity as legal advisors, *Canada (Attorney General) v. Chambre des Notaires du Québec* 2016 SCC 20.
- Solicitor-Client privilege is also defined in the ITA in subsection 232(1).
  - the exception of a lawyer's accounting records from the definition of solicitor-client privilege in the Act, was also found to be unconstitutional in the same case and its companion case *Canada (National Revenue) v. Thompson* 2016 SCC 21.

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## Solicitor-Client Privilege

- Subsections 232(3) and (3.1) provides specific procedures for lawyers to claim privilege prior to the seizure or examination of documents.
  - Essentially, document(s) must be placed in a package and sealed and identified that these are documents protected by privilege.
  - Package must be held and preserved until reviewed by a judge.

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## Solicitor-Client Privilege

- Evidence in support of claim of solicitor-client privilege must be produced by party asserting privilege.
  - In other words, the party must provide evidence why the communication was made in furtherance of the seeking of legal advice.

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## Solicitor-Client Privilege

- In *MNR v. Iggillis Holdings Inc. and Ian Gillis et al.* 2016 FC 1352, CRA sent a requirement for information to two parties to a transaction.
- The parties refused to disclose a memo that was prepared by one's tax lawyer and sent to the other's tax lawyer.
  - The two were working on optimizing the tax structure for both sides.
- The parties claimed that there was common interest privilege on the document.
  - Common interest privilege essentially means that there is privilege over communications shared between parties where they have a common legal interest.
    - Such a privilege generally exists in litigation (for example, when two accused persons are represented by different lawyers in a criminal case).
- The Federal Court rejected the argument of the parties.
  - There were a number of reasons why it was rejected including concerns that it would only protect the parties who enter into the most abusive transactions.
- The taxpayer has appealed to the Federal Court of Appeal and is in the early stages of the appeal as of the time of this presentation.

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## Federal Court: Applications for Judicial Review

- Application must be made within 30 days after the time the decision or order was first communicated by the Minister.
- Remedy of last resort
- Test to grant relief:
  1. Acted without jurisdiction, acted beyond its jurisdiction or refused to exercise its jurisdiction;
  2. Failed to observe a principle of natural justice, procedural fairness or other procedure that it was required by law to observe;
  3. Erred in law in making a decision or an order, whether or not the error appears on the face of the record;
  4. Based its decision or order on an erroneous finding of fact that it made in a perverse or capricious manner or without regard to the material before it;
  5. Acted, or failed to act, by reason of fraud or perjured evidence; or
  6. Acted in any other way that was contrary to law.

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## Federal Court: Applications for Judicial Review

- The remedies that are available are the following:
  - Stay & Injunction
  - Quash
  - Writ of Mandamus
  - Declaratory Relief
  - Set Aside & Refer back for Redetermination



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## Stay & Injunction

- On an application for judicial review, the Federal Court is authorized to make any interim orders that it considers appropriate.
- In order for the applicant to be granted an injunction, the applicant must satisfy the three-part test laid out by the Supreme Court in *RJR-MacDonald Inc.* [1994] 1 SCR 311 :
  - The applicant can demonstrate a serious question to be tried;
    - This is a low threshold – simply show it's an arguable case;
  - The applicant will suffer irreparable harm if the relief is not granted; and
    - Refers to nature of the harm, not the size of it;
    - Further harm must be described particularly (cannot be generic in the sense that there will be revenue loss, instead that loss must be explained in some manner);
  - The balance of convenience between the parties favors the applicant.
    - There is a preference to maintain the status quo;
    - But still is a balance between harm to taxpayer in allowing action to continue versus harm to the Minister by preventing action to occur.



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## Quash

- Federal Court does not have the jurisdiction to quash an assessment per section 18.5 of the *Federal Court Act* and 152(8) of the *Income Tax Act*
  - For example, *Garbutt* 2016 FC 1292
- Federal Court does have the ability to quash certain actions of the Minister, such as liens or garnishments
  - See *Johnson v Canada* 2015 FCA 51

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## Writ of Mandamus

- This writ compels the Minister to perform a certain action
- There is a multi-stage test found in *Apotex Inc. v. Canada* [1994] 1 FCR 742 (F.C.A.)
- While generally the writ applies to actions that the minister is required to do, it may also apply on discretionary actions (but in limited circumstances).
- For example, the taxpayer in *McNally v. Canada (National Revenue)*, 2015 FC 767 compelled CRA to issue an assessment when CRA failed to issue an assessment because the taxpayer had participated in a donation scheme CRA was reviewing.

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## Declaratory Relief

- A declaration is a binding judicial statement declaring what the law is with respect to the parties in the matter.
  - a declaration should not be sought in the Federal Court for a matter that would otherwise fall within the jurisdiction of the Tax Court, *Universal Aide Society v. Canada (National Revenue)* 2009 FCA 107.
- However, it could be used to recognize:
  - the existence of agreements between the minister and the taxpayer *Rosenberg* 2016 FC 1376; or
  - to recognize payments made by the taxpayer that CRA does not recognize (see *Associated Mechanical Trades Incorporated v. Canada*, 2014 FC 732).

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## Set Aside and Send Back

- This is the standard relief when reviewing the application of the Minister's discretion, for example with respect to the waiving interest or penalties under subsection 220(3.1).
- If granted, a new decision maker is to review the facts and come to a new decision.
  - Therefore, successfully receiving this relief will not entitle you to the outcome you want
  - Instead, it will simply bring you back before the CRA
  - There is no guarantee that the new decision maker will provide the outcome you request
- The standard of review is reasonableness, not correctness

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## Questions?



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#### Education

David graduated with a J.D. from Osgoode Hall Law School. David also holds a Bachelor of Business Administration from the Schulich School of Business, York University.

#### Background

David M. Piccolo is a Partner in and a co-founder of TaxChambers LLP, a boutique tax law firm located in Toronto. We advise and represent clients from Canada and internationally in all areas of Canadian and US tax law, including corporate and business taxation, international taxation, personal tax and wealth planning, commodity taxes (GST/HST), and SALT (state and local taxes).

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David Piccolo's tax law practice covers all aspects of litigation, including assisting clients in all stages of the dispute resolution process. David assists his clients during tax authorities' audits, in filing administrative appeals, filing appeals to the Tax Court of Canada and Ontario Superior Court of Justice, and the filing of applications to the Federal Court of Canada and Ontario Superior Court of Justice. He also assists clients proactively by resolving their tax issues through Canada's Voluntary Disclosures Program. David's clients include businesses of different industries and backgrounds.

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