LIFE AFTER *JARVIS* — JUST HOW MUCH HELP MUST YOU "VOLUNTARILY" GIVE THE CANADA REVENUE AGENCY?

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Society recognizes that privacy rights must be compromised to allow the State to administer and enforce an efficient and effective income tax regime. The question is — just how great should that compromise be? How much financial information should the State be allowed to require from its constituents to prepare, maintain and disclose on a "voluntary" basis for income tax purposes? Most importantly, for what purposes should this information obtained by the State be legitimately used, given the Charter *and the criminal law privacy protections contained therein? In particular, can the State use its mandatory compliance powers to obtain information which would then be used to further a criminal investigation? Where is the line drawn?*

Although the 2002 Supreme Court of Canada decision in Jarvis *provides some clarification and guidance, it does not go far enough in setting out the proper balance between a person's right to privacy and the State's need for disclosure in the income tax context. The purposes of this article are: (a) to provide a brief overview of a person's obligations to voluntarily provide both information and assistance to the State as part of the operation of the income tax regime, (b) to critically analyze the* Jarvis *decision in conjunction with previous jurisprudence to gain insight as to when the State will lose the ability to compel a person to assist it in its administration and enforcement duties, (c) to examine some post-*Jarvis *decisions to see how the State and the courts have responded to and applied the principles as set out in* Jarvis, *and (d) to provide some suggestions on how taxpayers, advisors and the Canada Revenue Agency might approach matters of this nature in the future.*

La société reconnait que les droits de la protection des renseignements personnels doivent être compromis pour permettre à l'État de gérer et d'exécuter un régime efficace et efficient d'impôt sur le revenu. La question consiste à déterminer l'importance de ce compromis. Combien d'information financière les citoyens devraient-ils préparer, maintenir et divulguer « volontairement » à l'État pour l'impôt sur le revenu ? Et surtout, à quelles fins cette information obtenue par l'État devrait-elle servir légitimement compte tenu des dispositions de protection contenues dans la Charte *et le droit criminel ? Plus précisément, l'État peut-il utiliser ses pouvoirs de conformité obligatoire pour faire avancer une enquête criminelle ? Où fait-on la distinction ?*

Bien que la décision de la Cour suprême du Canada de 2002 sur l'affaire Jarvis *fournisse une clarification et une direction, elle ne va pas assez loin pour établir l'équilibre entre les droits de respect de la vie privée d'une personne et le besoin de divulgation d'un État dans le contexte de l'impôt sur le revenu. Le but de cet article est : a) de donner un bref aperçu des obligations d'une personne à fournir volontairement de l'information et de l'aide à l'État dans le cadre du régime d'impôt sur le revenu, b) d'analyser de manière critique la décision* Jarvis *en fonction de la jurisprudence pour mieux comprendre à quel moment l'État ne peut plus obliger quelqu'un à l'aider dans ses tâches d'administration et de d'exécution, c) d'examiner des décisions rendues après l'affaire* Jarvis *pour voir de quelle manière l'État et les cours ont réagi et appliqué les principes énoncés dans Jarvis et d) faire des suggestions sur la manière que les contribuables, les conseillers et l'Agence du revenu du Canada peuvent aborder les questions de cette nature.*

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I. INTRODUCTION

With the exception of a few very wealthy and flamboyant individuals, no one is eager to disclose his or her income and financial wealth. Indeed, this is an area where people are particularly keen to establish and protect a right to privacy. Despite this interest, society also acknowledges and reluctantly accepts that its interest in financial privacy must be compromised to allow the State to administer and enforce an efficient and effective income tax regime.[1] The question is — just how great should this compromise be? How much financial information should the State be allowed to require its constituents to prepare, maintain and disclose on a "voluntary" basis for income tax purposes?[2] Against whom should such disclosure and assistance requirements be imposed? Most importantly, for what purposes should this information obtained by the State be legitimately used, given the *Charter* and the criminal law privacy protections contained therein?[3] In particular, should the State be allowed to use its mandatory compliance powers (as opposed to a judicially sanctioned search warrant) to obtain information which would then be used to further a criminal prosecution? If not, where is the line drawn?

For many years, taxpayers, advisors, the Canada Revenue Agency (CRA)[4] and the courts have only had very general answers to these questions. Essentially, the Supreme Court of Canada's position was that the audit and inspection powers contained in s. 231.1 (the Audit Power) the power to compel further disclosure contained in s. 231.2 (the Requirement Power), and the Minister of National Revenue's (the Minister's) use of these powers, were in accordance with the *Charter* as long as these powers were used in a regulatory as opposed to a criminal context. Given the amount of case law involving these issues, clearly, this position by itself was not sufficient.

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1 This article focuses on *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1 [the *Act*] and associated jurisprudence. Unless otherwise noted, all subsequent statutory references are to the *Act*.

2 The use of the word "voluntary" is somewhat of a misnomer as taxpayers are in fact required by the *Act* to prepare and disclose certain information to the State. Taxpayers do not perform these tasks purely on their own accord. However, the term "voluntary" is used to distinguish information "given" to the State pursuant to these statutory provisions against information "taken" by the State pursuant to a search warrant.

3 *Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c. 11 [*Charter*].

4 Over the years, the primary body responsible for the administration and enforcement of the *Act* has changed from Revenue Canada to the Canada Customs and Revenue Agency to (most recently) the Canada Revenue Agency. As the Canada Revenue Agency is the current organization carrying out these functions, it is the body referred to in this article; the only exceptions are quotes from or referrals to prior case law.

In 2002, the Supreme Court of Canada revisited these issues in *Jarvis*.[5] While the decision does provide some further clarification and guidance, unfortunately, it does not go far enough in setting out the proper balance between a person's right to privacy and the State's need for disclosure in the income tax context — as confirmed by the plethora of cases post-*Jarvis*. The purposes of this article are (a) to provide a brief overview of a person's obligations to voluntarily provide both information and assistance to the Minister as part of the operation of the income tax regime, (b) to critically analyze the *Jarvis* decision in conjunction with previous jurisprudence to gain some insights as to when the Minister will lose the ability to compel a person to assist it in its administration and enforcement duties, (c) to examine some post-*Jarvis* decisions to see how the Minister and the courts have responded to and applied the principles set out in *Jarvis*, and (d) to provide some suggestions on how taxpayers, advisors and the CRA might approach matters of this nature.

II. A BRIEF OVERVIEW OF A PERSON'S DISCLOSURE OBLIGATIONS AND THE CANADA REVENUE AGENCY'S POWERS TO VERIFY

Generally speaking, a person has two initial information and disclosure obligations under the *Act*, namely, the duty to file an income tax return pursuant to s. 150(1)[6] and the duty to prepare and keep adequate books and records to support such a return pursuant to s. 230.[7] Once the tax return is filed (or even if one is not filed), the Minister may then take whatever steps he or she deems appropriate to verify and ensure that the person has in fact complied with the *Act*. Usually, the CRA will simply review the taxpayer's return as filed and issue an assessment pursuant to s. 152; however, in certain instances, the CRA will deem it appropriate to exercise either its Audit Power or Requirement Power.[8]

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5 *R. v. Jarvis*, [2002] 3 S.C.R. 757, 2002 SCC 73 [*Jarvis*].

6 While this is the "general rule," there are many persons who do not have to comply with this rule, such as registered charities and individuals who do not have any taxable income or taxable dispositions during a particular taxation year. See s. 150(1.1) and related sections for further details.

7 Generally speaking, s. 230(1) only requires that a person create, maintain and keep "books and records" necessary to determine "taxes payable under the *Act* or the taxes or other amounts that should have been deducted, withheld or collected." However, as pointed out by Al Meghji & Steven Sieker, "A Contest of Unequals: Recent Developments in Tax Litigation" in Canadian Tax Foundation, *1997 Conference Report: Report of Proceedings of the Forty-Ninth Tax Conference* (Toronto: Canadian Tax Foundation, 1997) 11:1; and Colin Campbell, *Administration of Income Tax*, 2004 ed. (Toronto: Carswell, 2004) at 44, the Minister can also request documents under s. 231.2 "for any purpose related to the administration or enforcement of this *Act*" — which would be broader than the requirement set out in s. 230.

8 Other statutory provisions permit the Minister to obtain further information. Due to time and space limitations, the discussion of these provisions are beyond the scope of this article. See s. 231.3, which sets out the procedures by which the Minister can obtain a search warrant to obtain evidence in support of a tax offence (without any assistance on behalf of the person/taxpayer being searched); s. 231.4, which authorizes the Minister to set up an Inquiry with respect to anything related to the administration and enforcement of the *Act*; s. 231.6, which allows the Minister to issue a Requirement in respect of foreign-based information; and s. 231.7, which allows the Minister to make a summary application to a judge for a compliance order in respect of any information or assistance sought under ss. 231.1 and 231.2. See also Campbell, *ibid.*; William I. Innes, *Tax Evasion*, looseleaf (Toronto: Carswell, 1995); Vern Krishna, *The Fundamentals of Canadian Income Tax*, 8th ed. (Toronto: Carswell, 2004); and F. Barry Gorman, *Canadian Income Taxation Policy and Practice*, 2d ed. (Toronto: Carswell, 2001).

Very generally, the Audit Power contained in s. 231.1 assists the Minister in ensuring that a taxpayer is complying with his obligations under the *Act* in four main ways.[9] First, s. 231.1(1) empowers the Minister to "inspect, audit or examine" the books and records of the taxpayer that he is required to prepare, maintain and keep pursuant to s. 230.[10] Second, it requires the taxpayer or any other person to provide for inspection any document that may relate to either the taxpayer's books and records (or what should be in the taxpayer's books and records) or to any amount payable by the taxpayer under the *Act*. Put another way, through the use of s. 231.1, the Minister is not only able to examine the books, records and other relevant documents within the possession of the taxpayer under investigation but is also able to examine documents held by a third party who is not under investigation but may possess some information related or connected to a taxpayer.[11] Third, s. 231.1 gives the Minister the ability to enter any premises or place (with the exception of the taxpayer's "dwelling-house"[12]) where records or property are kept or business is carried on to conduct the audit or inspection. Finally, it requires that the owner or manager of the property or business or any other person on the premises where the books, records, property or business is carried on to (a) attend the premises/place with the Minister, (b) give the Minister all reasonable assistance and (c) answer any questions asked by the Minister.[13]

Similarly, the Requirement Power contained in s. 231.2 gives the Minister the ability to conscript a person's assistance and information in the administration and enforcement of the *Act*. Very generally, it empowers the Minister to issue and serve a Requirement on a person to provide information or documents to the Minister within a reasonable period of time.[14] It is important to note that, like the Audit Power, the Minister is not limited in using the Requirement Power only against a taxpayer under investigation. It can be used to obtain

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9 Of course, the benefits of investigating a particular taxpayer go beyond ensuring the compliance of only that taxpayer; it has the indirect benefit of "encouraging" other persons to comply with the *Act*. As noted on the CRA website in "Comprehensive Discussion of our Performance," the CRA states that "95% of federal revenues are collected without any audit or collection activities," online: Canada Revenue Agency <www.cra-arc.gc.ca/agency/annual/2001-2002/supplementary-e/Taxa4.html#wp1155077>.

10 Section 231.5(1), *inter alia*, gives the Minister the ability to make a copy of any document he or she examines in the course of an audit. Further, it provides that the Minister may certify such copy, in which case it will have the same probative value as the original document. As noted in Stikeman's Analysis, Canada Tax Service, "Inspections, Searches, Seizures and Inquiries" (TaxNetPro), in effect, this provision allows the Minister to seize documents encountered during the audit without the need of a search warrant under s. 231.3 or the *Criminal Code*, R.S.C. 1985, c. C-46.

11 This is also the case in respect of the Requirement Power set out in s. 231.2 (which will be discussed below). In *Canadian Bank of Commerce v. Canada (Attorney General)*, [1962] S.C.R. 729 [*Canadian Bank of Commerce*], the Court held that the predecessor to s. 231.2 allowed the Minister to validly issue a Requirement on a Canadian bank which was not under investigation to provide information/documents concerning a foreign bank that was the subject of a Revenue Canada investigation (and a customer of the Canadian bank).

12 See s. 231 for the definition of a "dwelling-house." In this case, the Minister must either get the taxpayer's consent to enter the dwelling-house (pursuant to s. 231.1(2)) or obtain a search warrant (pursuant to s. 231.3 or the applicable *Criminal Code* provision). This additional requirement reflects the fact that courts have continuously held that the search of a person's residence is the greatest intrusion by the State after "a violation of bodily integrity." See *e.g. Baron v. Canada*, [1993] 1 S.C.R. 416 at 449-50 [*Baron*].

13 Note that under s. 231.1(1)(b) there is a similar Audit Power in respect of a taxpayer's inventory.

14 Often, such Requirements are issued after more informal attempts to obtain the information sought are frustrated: see E.G. Kroft, "Disclosure to and by Revenue Canada" (Paper presented to the British Columbia Tax Conference, 1991) (Toronto: Canadian Tax Foundation) at 16.

information from "any person," which technically could include not only persons resident in Canada but also non-residents.[15] In *Tower v. Minister of National Revenue*, the Federal Court of Appeal took a very broad interpretation of the Requirement Power and held that it included the ability to solicit all tax planning documents and other files relating to the taxpayer held by the taxpayer's accountant as well as the ability to compel the taxpayer's accountant to provide written responses to questions posed by the CRA.[16] In short, like s. 231.1, s. 231.2 is a very broad and powerful investigative tool in the Minister's arsenal.[17]

Three other provisions complement the powers given to the Minister by ss. 231.1 and 231.2 to conduct audits and investigations. The first confirms and clarifies a person's obligations and responsibilities; the latter two establish penalties for non-compliance. Section 231.5(2) explicitly demands that a person comply with everything that the person is required to under, *inter alia*, ss. 231.1 and 231.2 and prohibits that person from interfering, hindering or molesting (or attempting to do the same to) an official carrying out his duties under the *Act*. While this, in itself, could be viewed as being implicit in ss. 231.1 and 231.2 and therefore redundant, it is noteworthy that s. 231.5(2) also establishes a limited "out" of having to comply with the Minister's inquiries. Specifically, it provides that a person is released from his obligations to comply with ss. 231.1 and 231.2 if the person is "unable to do so." While this defence is not often successful, it should be considered in the proper circumstances.[18] Second, s. 231.7 provides that in cases where the Minister has sought access, assistance or information under ss. 231.1 or 231.2 and has not received it (and there is no solicitor-client privilege issue), the Minister can make a summary application to a judge to order the person's compliance with the Minister's request. If the person does not comply with this court order, then s. 231.7(4) provides that the person may be found in contempt of court. While this provides another approach to ensuring information disclosure and assistance, it is important to note that courts are not always willing to issue such an order

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15 See also s. 231.6 regarding foreign-based information and "Exchange of Information" articles in Canadian bilateral tax treaties.

16 *Tower v. Minister of National Revenue*, [2003] 4 C.T.C. 263, 2003 FCA 307 [*Tower*]. The fact that such tax planning documents likely contained information about the taxpayer's subjective intention in entering into the transactions it did was not a barrier to the Federal Court of Appeal ordering their disclosure under s. 231.2. In the Court's opinion, such information fell within the scope of "any purpose related to the administration or enforcement of this Act" and hence was compellable. See also *Canadian Bank of Commerce*, *supra* note 11, where the Supreme Court of Canada held that the predecessor to s. 231.2 could be used to compel third parties to disclose information regarding persons under audit or inspection.

17 The main exception/qualification to this power within s. 231.2 is contained in s. 231.2(2) (and subsequent provisions) which requires that, in the case of a Requirement for information or documents involving one or more "unnamed" persons, the Minister must first obtain judicial authorization under s. 231.2(3) (and then follow the rules contained in ss. 231.2(4) to (6)). These sections were enacted in response to the Supreme Court of Canada's decision in *James Richardson & Sons Ltd. v. Minister of National Revenue*, [1984] 1 S.C.R. 614, wherein a Requirement issued pursuant to the predecessor to s. 231.2(1) (former s. 231(3)) was struck down on the basis that the section did not allow "fishing expeditions" (at 625).

18 See *e.g. R. v. Gill* (1989), [1990] 40 B.C.L.R. (2d) 360 (B.C. Co. Ct. J.), where a former director of three dissolved corporations was successful in using the "unable to do so" defence in s. 231.5(2) against several charges of not providing signed income tax returns for such dissolved corporations pursuant to a Requirement under s. 231.2. See also *R. v. Arvai*, [1977] C.T.C. 263 (Ont. Prov. Ct), where a taxpayer/businessman having difficulty with the English language and no accounting or financial statement skills was absolved from failing to comply with a Requirement to provide a Statement of Assets and Liabilities for his business.

given the implications for non-compliance.[19] Third, s. 238 creates a summary conviction offence for failing to comply with, *inter alia*, any of ss. 230 to 232. The possible penalties that can be assessed under s. 238 are a fine of not less than $1,000 and not more than $25,000, or a fine as previously described plus imprisonment for no more than 12 months.[20]

In summary, ss. 231.1 and 231.2 give the Minister and the CRA great and broad powers to obtain both information and assistance from not only persons under investigation but also third parties who may have information relevant to those under investigation. Further, it is important to note that — subject to two main exceptions which are beyond the scope of this article — the general rule appears to be that as long as the audit or request is being conducted within the administrative or regulatory context, the person against whom the request has been made has very few to no options to legitimately refuse the request.[21] Indeed, as noted above, if the person does not cooperate, he or she can be subject to various financial penalties and even imprisonment for non-compliance.

Considered from a broad societal perspective, with appropriate interpretation and application by the CRA and the courts, this legislative regime seems appropriate and, indeed, necessary. While no one enjoys paying taxes or the corresponding obligations that go along with it, society as a whole benefits from having an equitable and effective taxation system. Given that the taxation system is based on the principles of self-assessment and self-

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19 In *Minister of National Revenue v. SML Operations (Canada) Ltd.*, [2003] 4 C.T.C. 201, 2003 FC 868, the Court did not grant the Minister's request for an order compelling disclosure under s. 231.7 as it was not absolutely clear to the Court that all of the preconditions to the order were satisfied and the Court was concerned about the serious implications if the order was issued and then not satisfied by the person subject to it.

20 It is interesting to note that although the imposition of s. 238 can result in financial penalties and possibly even incarceration, it has still been characterized by the courts as "regulatory" rather than "criminal" or "quasi-criminal" — see *e.g. Jarvis*, *supra* note 5 at para. 55.

21 There are two main situations in which a person can legally disregard the Minister's powers pursuant to ss. 231.1 and 231.2, namely, where the information being sought is privileged and where the Minister's action or request is not "for any purpose related to the administration or enforcement of [the] Act." With respect to the "privilege defence," under the common law, the *Charter*, and to the extent that s. 232 of the *Act* is still of force and effect (a large portion of s. 232 was rendered constitutionally invalid by virtue of the Supreme Court of Canada's decision in *Lavallee, Rackel & Heintz v. Canada (A.G.)*, [2002] 3 S.C.R. 209, 2002 SCC 61), the State cannot compel a person to disclose information that is the subject of solicitor-client privilege. See Campbell, *supra* note 7 at 258-72; Krishna, *supra* note 8 at 967-73; and Gloria Geddes, "The Fragile Privilege: Establishing and Safeguarding Solicitor-Client Privilege" (1999) 47 Can. Tax J. 799. With respect to the second defence, both ss. 231.1 and 231.2 qualify and limit the Minister's powers to situations where the Minister is exercising the powers "for any purpose related to the administration or enforcement of this *Act*." Consequently, where the powers are not being used for the purposes specified above, it can be argued that the Minister is acting without legal authority and hence any requests for information/assistance can be ignored. While the courts have not comprehensively defined this phrase, two decisions are worth noting here. First, in *Tower*, *supra* note 16 at para. 29, the Federal Court of Appeal, in deciding whether a Requirement issued under s. 231.2 was valid, held that as long as "the requested information may be relevant in the determination of the tax liability of the named taxpayer" (which was admitted by the Court to be a low threshold), it would constitute a "purpose related to the administration and enforcement of the *Act*." This was also the finding in *Canadian Bank of Commerce*, *supra* note 11. Second, in *Jarvis*, *supra* note 5 at paras. 78-94, the Supreme Court of Canada stated that the phrase will not include situations "where the predominant purpose of a particular inquiry is the determination of penal liability" (*ibid.* at para. 88). In other words, once the Minister's or the CRA's efforts move from an administrative or compliance function to a criminal prosecution, it can no longer be stated that the Minister is using ss. 231.1 and 231.2 for "any purpose related to the administration or enforcement of this *Act*."

reporting, it is fragile and exposed; unless there is a workable mechanism in place to reasonably ensure that everyone complies, certain persons will be tempted to shirk their responsibilities. This will increase the burden on the remaining taxpayers, causing them also to consider avoiding their obligations. By requiring taxpayers and other persons to assist the Minister in the administration and civil enforcement of the *Act*, ss. 231.1 and 231.2 assist the State in making sure that this does not happen. The key, however, is to ensure, to the extent possible, that these powers are used in a manner that is consistent with the fundamental values of Canadians and not to the unreasonable detriment of anyone. It is in this respect that the law was deficient prior to *Jarvis* and is still, albeit to a lesser extent, post-*Jarvis*.

III. THE LAW PRIOR TO *JARVIS* — THE *HUNTER V. SOUTHAM INC.*[22] AND *R. V. MCKINLAY TRANSPORT LTD.*[23] DECISIONS

Section 52 of the *Charter* provides that "[t]he Constitution of Canada is the supreme law of Canada, and any law that is inconsistent with the provisions of the Constitution is, to the extent of the inconsistency, of no force or effect." Consequently, if a person wants to challenge the Minister's powers to compel disclosure and assistance "for any purpose related to the administration or enforcement of [the] Act," one of the most obvious ways to do so is by arguing that a particular statutory provision or State action made pursuant to such provision is contrary to the rights and freedoms contained within the *Charter*. While both ss. 7 and 8 of the *Charter* are arguably triggered by the disclosure and assistance obligations created by ss. 231.1 and 231.2, most *Charter* challenges relating to these sections pre-*Jarvis* have relied only on s. 8 of the *Charter*.

Section 8 of the *Charter* provides that "[e]veryone has the right to be secure against unreasonable search or seizure." In interpreting and analyzing this *Charter* protection, the usual starting point is the Supreme Court of Canada decision in *Hunter*.[24] While this case analyzed the search provisions in the *Combines Investigations Act*,[25] Dickson J. stated three principles concerning the State's ability to legally obtain information that are particularly applicable to the issue of when a person is entitled to legally refuse the Minister's request for information and assistance under ss. 231.1 and 231.2 of the *Act*.

First, generally speaking, s. 8 of the *Charter* does not provide an absolute guarantee nor protection against the State's ability to obtain information. Rather, the State's interests in disclosure and the person's interests in privacy must be "balanced" against each other. As stated by Dickson J.:

> The guarantee of security from *unreasonable* search and seizure only protects a *reasonable* expectation. This limitation on the right guaranteed by s. 8, whether it is expressed negatively as freedom from "unreasonable" search and seizure, or positively as an entitlement to a "reasonable" expectation of privacy, indicates that an assessment must be made as to whether in a particular situation the public's interest in being left alone by

22 [1984] 2 S.C.R. 145 [*Hunter*].
23 [1990] 1 S.C.R. 627 [*McKinlay*].
24 *Supra* note 22.
25 R.S.C. 1970, c. C-23.

government must give way to the government's interest in intruding on the individual's privacy in order to advance its goals, notably those of law enforcement.[26]

Second, given the objective and purpose of s. 8 of the *Charter*, there must be a method of preventing unreasonable searches and seizures from occurring before they happen rather than simply a mechanism for determining, after the fact, whether a person's reasonable privacy rights have been violated by the State.[27] In the Court's opinion, this is best accomplished by requiring, when feasible, prior authorization of State action or intrusion by an impartial, informed and objective person acting "judicially" (as opposed to a person who is also part of or carrying on the investigation or intrusion).[28]

Third, as a person's reasonable expectation to privacy increases, so too does the burden that the State must overcome in justifying its legal intrusion and violation of such privacy.[29] Phrased the opposite way, if a person's reasonable expectation of privacy is low, then something less than the "full *Hunter* requirements" set out above will be sufficient to survive *Charter* scrutiny.

In *McKinlay*, the Supreme Court of Canada had the opportunity to refine and apply the *Hunter* principles in an income tax context. In this case, the appellant taxpayers were being audited by Revenue Canada and, in the course of that audit, were served with Requirements for disclosure of information and documents. The taxpayers refused to comply and challenged the Requirements on the basis that the former s. 231(3) (the predecessor to the current s. 231.2), in conjunction with s. 238, violated their s. 8 *Charter* rights.

In denying the appellants' appeal and upholding former s. 231(3), Wilson J., for the majority, first ruled that a Requirement issued and enforced under former ss. 231(3) and 238 constituted a "seizure" despite the fact that the *Act* as a whole is a regulatory statute (as opposed to a criminal or quasi-criminal statute) and that "the purpose of ss. 231(3) and 238(2), when read together, is not to penalize criminal conduct but to enforce compliance with the Act."[30] Without considering the rest of the decision, this finding appeared to bring the Requirement Power under the scope of s. 8 of the *Charter* and hence required adherence to the *Hunter* principles. Aware of this potential interpretation, Wilson J. then clarified the Court's position on which seizures would indeed be subject to *Charter* protection on the basis of reasonable expectation of privacy:[31]

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26 *Hunter*, *supra* note 22 at 159-60 [emphasis in original].

27 *Ibid.*

28 *Ibid.* at 160-67.

29 *Ibid.* at 167-68.

30 *McKinlay*, *supra* note 23 at 641 (the Supreme Court quoting *R. v. Grimwood*, [1987] 2 S.C.R. 755 at 756). This was due to the fact that the former s. 231(3) could (a) be used to compel production of information or documents beyond those required by the *Act* for a taxpayer to comply with his income tax return preparation obligations, and (b) could be used to compel a person not under audit or investigation to produce information or documents regarding another person under audit or investigation. While the current s. 231.2 contains additional and revised powers from the former s. 231(3), the two powers discussed above remain in the current provision.

31 For further elaboration of this point and reference to supporting academic literature, please refer to *McKinlay*, *ibid.* at 645-46.

> Undoubtedly there will be instances in which an individual will have no privacy interest or expectation in a particular document or article required by the state to be disclosed. Under such circumstances, the state authorized inspection or the state demand for production of documents will not amount to a search or seizure within s. 8: see *R. v. Hufsky*, [1988] 1 S.C.R. 621 at p. 638.[32]

In other words, while the use of the Requirement Power constituted a "seizure," because of the low expectation of privacy in respect of the information subject to the Requirement, it would not constitute a "seizure" attracting *Charter* scrutiny and protection.

Second, with respect to the "reasonableness" of a s. 231(3) seizure — especially given the absence of *Hunter*-type requirements as prerequisites for Ministerial use and given the self-reporting/assessment nature of the income tax regime — Wilson J. stated the following:

> Accordingly, the Minister of National Revenue must be given broad powers in supervising this regulatory scheme to audit taxpayers' returns and inspect all records which may be relevant to the preparation of these returns. The Minister must be capable of exercising these powers whether or not he has reasonable grounds for believing that a particular taxpayer has breached the Act.... A spot check or a system of random monitoring may be the only way in which the integrity of the tax system can be maintained. If this is the case, and I believe that it is, then it is evident that the *Hunter* criteria are ill-suited to determine whether a seizure under s. 231(3) of the *Income Tax Act* is reasonable. The regulatory nature of the legislation and the scheme enacted require otherwise.[33]

Consequently, the Supreme Court in *McKinlay* held that a "seizure" made pursuant to the Requirement Power in former s. 231(3) was "reasonable" in the circumstances despite not meeting the *Hunter* criteria. Put another way, the Requirement Power to provide information and documents, generally speaking, does not violate s. 8 of the *Charter*.[34]

As a final point, it is interesting to note that Wilson J. distinguished between the Minister requesting information or documents from a taxpayer and the Minister's authorized representatives (the CRA and RCMP) actually going onto the taxpayer's property to search for and seize such information or documents.[35] In the former case (as noted above), the Supreme Court found a request (in the form of a Requirement) to be accordance with the *Charter*; in the latter case, Wilson J. suggested that more of the *Hunter* conditions would have to be satisfied to survive *Charter* scrutiny. In other words, Wilson J. appears to be saying that the location of the information and the means of acquiring such information from such location will be key factors in determining whether the State action in obtaining disclosure will be in accordance with the *Charter*. While this seems entirely reasonable and consistent with other jurisprudence, she then goes on to state:

> Thus, when the tax officials seek entry onto the private property of an individual to conduct a search or seizure, the intrusion is much greater than a mere demand for production of documents. The reason for this

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32 *Ibid.* at 641-42.
33 *Ibid.* at 648.
34 *Ibid.* at 649-50.
35 *Ibid.* at 649.

> is that, while a taxpayer may have little expectation of privacy in relation to his business records relevant to the determination of his tax liability, he has a significant privacy interest in the inviolability of his home.[36]

With respect, while both the nature of the information and its location are very important to the issue of whether and when the State's interests in the disclosure of information should trump the person's interests in keeping the information private, the way in which the distinction is set out raises some additional issues. For example, if the taxpayer does not reasonably have a *Charter*-protected privacy right in respect of certain information or documents (due to such information being required by s. 230 or being necessary in order to calculate that taxpayer's tax liability), should the taxpayer be able to protect such information or documents (and require the Minister to obtain a search warrant under s. 231.3) simply by keeping them at his home? Further, should the Minister be able obtain disclosure of information without all of the *Hunter* requirements being present by simply issuing a Requirement for information or documents as opposed to physically searching and seizing such information or documents? These are difficult questions which appear to be left open given Wilson J.'s comments above.

In summary, prior to the *Jarvis* decision, the Supreme Court of Canada's view on the *Act* compelling voluntary disclosure and assistance (under s. 231.2 and by extension, s. 231.1) was that, generally speaking, it was in accordance with s. 8 of the *Charter*. Looking at the big picture, in a self-reporting regulatory regime such as the one created for the calculation and collection of income tax, such provisions are both necessary and integral to ensuring the *Act*'s effective and efficient operation. Further, in such a regulatory regime where a person is required to create and maintain certain books and records as well as make regular disclosures to the State, that person's reasonable expectation of privacy must be considered to be low in comparison to the State's interests in and benefits from being able to obtain disclosure. Consequently, it appears reasonable that a very low threshold is required for these administrative and enforcement provisions to survive *Charter* scrutiny.

While it appears clear from both *Hunter* and *McKinlay* that in a non-criminal context the Minister can legally use the Audit and Requirement Powers very broadly ("for any purpose related to the administration or enforcement of [the] Act") to compel disclosure and assistance from a person, unfortunately, these decisions did not end all of the discussion and uncertainty in this area of tax law. Many of the questions posed in the Introduction still remained unanswered.[37] While the Audit and Requirement Powers generally pass *Charter* scrutiny without the imposition of *Hunter* requirements, could these powers be used in a manner or in a particular set of facts that would violate the *Charter*? How does one distinguish between "criminal" and "non-criminal" investigations in the income tax context? Should the Minister be able to use information legitimately obtained through the use of the Audit and Requirement Powers to support a criminal prosecution? What, if any, disclosure must the Minister provide to the taxpayer when an administrative or compliance audit turns

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[36] *Ibid.*

[37] For a good pre-*Jarvis* discussion/analysis of the issues, see William I. Innes & Matthew G. Williams, "Protections Against Self-Incrimination in Income Tax Audits, Investigations, and Inquiries" (2001) 49 Can. Tax J. 1459.

into a criminal investigation? These were the primary issues that were faced by the Supreme Court of Canada in *Jarvis*.

IV. MISAPPLICATION OF THE *MCKINLAY* PRINCIPLES

Before moving on to the analysis of the *Jarvis* decision, one important point is worth noting. In *McKinlay*, the appellant taxpayers were not attacking the particular information being sought pursuant to the Requirements; they were attacking the Requirement Power itself. Consequently, even though *McKinlay* found that former s. 231(3) was in accordance with s. 8 of the *Charter*, using the contextual approach implicit in *Hunter*, it appeared to still be open for a person to argue that the *McKinlay* principles were only general in nature and that particular information sought by a Requirement in particular circumstances could constitute a violation of a person's s. 8 *Charter* rights. Unfortunately, the case law has not always agreed with this reasoning. A case in point is the Federal Court of Appeal decision of *AGT Ltd. v. Canada (Attorney General)*.[38]

In *AGT*, the appellant taxpayer AGT Ltd., a telecommunications corporation, in the course of being privatized from a Crown corporation into a normal commercial entity, applied to Revenue Canada for an advance tax ruling concerning the appropriate valuation of its depreciable assets. Later (and after having received the advanced tax ruling from Revenue Canada), AGT Ltd. made a confidential submission and application to the Canadian Radio-Television and Telecommunications Commission (the CRTC) to determine what amount it could charge its customers for telecommunications services rendered in the upcoming year. In making this "Revenue Requirement" application, AGT Ltd. factored in its estimated income tax liability, along with other expenses, costs of capital, *etc.* Evidently, AGT Ltd.'s estimated income tax liability in the CRTC application was higher than its liability as set out in its income tax returns. When Revenue Canada became aware that there was a difference in the amounts in the two sets of documents during the course of an audit (without knowing exactly how much the difference was and the reasons for the discrepancy), it tried to obtain AGT Ltd.'s submission from the CRTC. When the CRTC refused to release the documents on the basis that they were documents of "confidential status" by virtue of a decision made by the CRTC pursuant to its statutory powers, the Minister issued a Requirement demanding disclosure from AGT Ltd. itself. AGT Ltd. refused.

At both the Federal Court Trial Division and the Federal Court of Appeal, AGT Ltd. argued, *inter alia*, that its reasonable privacy interests in the CRTC documents (which were not available to the public and had been ruled as being "confidential information" by the CRTC) outweighed the Minister's interests in disclosure. In addition, AGT Ltd. argued that since such documents were not required under the *Act* and would not have been created save for the CRTC Revenue Requirement application, the Minister could not successfully submit that its interests in disclosure outweighed AGT Ltd.'s privacy interests. In other words, while AGT Ltd. accepted the general principles set out in *McKinlay* and *Hunter*, it submitted that in applying those principles to the specific facts of the case, the balancing of interests required by s. 8 of the *Charter* favoured AGT Ltd. as opposed to the Minister.

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38 [1997] 2 F.C. 878 (C.A.) [*AGT*].

The Federal Court of Appeal refused to entertain a s. 8 *Charter* challenge to the particular Requirement and the information requested thereunder; it held that as *McKinlay* had ruled that the Requirement Power (former s. 231(3)) was constitutionally valid in general, no specific *Charter* challenge to a particular Requirement could be sustained. Further, focusing solely on s. 231.2 (in other words, performing statutory analysis rather than *Charter* analysis), the Federal Court of Appeal held that the provision was broad enough to compel disclosure of confidential information prepared for the CRTC, since the information could be relevant to AGT Ltd.'s tax liability.

With respect, the Federal Court of Appeal's method of *Charter* analysis in this case was wrong and inconsistent with previous and subsequent case law. As noted in *Hunter* and *McKinlay* above and as shall be discussed in *Jarvis* below, in balancing a person's rights to privacy with the State's interests in disclosure, "an assessment must be made as to whether *in a particular situation* the public's interest in being left alone by government must give way to the government's interest in intruding on the individual's privacy in order to advance its goals, notably those of law enforcement."[39] Clearly, the Federal Court of Appeal should not have "closed its mind" *ab initio* to even the *possibility* that, in the particular facts of this case, AGT Ltd.'s s. 8 privacy rights could outweigh the Minister's interest in disclosure. Further, it is at least arguable that the Federal Court of Appeal erred in finding that the phrase "for any purpose related to the administration or enforcement of this Act" was broad enough to include information prepared for a non-tax related body (the CRTC) pursuant to non-*Act* rules and regulations. Finally, decisions like this one, made by an appellate court, highlight the uncertainty and difficulty concerning this area of tax law and the need for further guidance and clarification.

V. THE *JARVIS* DECISION[40]

In *Jarvis*, the Business Audit Section of Revenue Canada's Audit Department commenced an audit into Mr. Jarvis' 1990 and 1991 tax returns after receiving an anonymous tip that he might have been under-reporting his income from the sales of his deceased wife's art collection. In the initial stages of the audit, the Revenue Canada Auditor (the Auditor) sought out and obtained information from art galleries that had purchased paintings from Mr. Jarvis concerning the number and financial value of transactions with Mr. Jarvis. She then contacted both Mr. Jarvis and his accountant to inform them of the ongoing audit and to ask them for information and assistance. Later on in the audit, she and her supervisor visited Mr. Jarvis' residence, with his consent, to interview him as part of her audit. Mr. Jarvis answered all of her questions, provided requested information to her (including documents such as receipt books, which the Auditor took for further examination) and gave her signed authorizations to facilitate full access to his bank account. At no time during this interview nor at any earlier time did the Auditor caution Mr. Jarvis respecting his *Charter* rights.

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[39] *Hunter*, *supra* note 22 at 159-60 [emphasis added].

[40] The Supreme Court of Canada also heard and decided *R. v. Ling*, [2002] 3 S.C.R. 814, 2002 SCC 74 at the same time as *Jarvis*. Since *Ling* adds nothing further to the *Jarvis* principles and methodology, it is not discussed in this article.

After reviewing all of the information and documents provided by Mr. Jarvis and obtained from third-party sources, the Auditor suspected that Mr. Jarvis may have fraudulently understated his income by approximately $700,000 over the two years under review. Consequently, the Auditor referred the matter and all the information collected in her files to the Special Investigations Section of Revenue Canada, which investigates and prosecutes tax evasion files.[41] Neither the Auditor nor Special Investigations informed Mr. Jarvis or his accountant of the referral, nor did the Auditor caution Mr. Jarvis as to his *Charter* rights. Mr. Jarvis, assuming that nothing had changed and that he was still being audited, continued to submit information to the Auditor, who then forwarded the information to Special Investigations.[42] On several occasions, though, Mr. Jarvis and his accountant did attempt to inquire with the Auditor as to the status of the audit. For the most part, the Auditor avoided the calls and, when she discussed the phone messages with the Special Investigations Investigator (the Investigator), she was told to "stall" as the Investigator did not want Mr. Jarvis to know that he was under investigation. On one occasion when Mr. Jarvis' accountant actually succeeded in getting through to the Auditor, the Auditor told the accountant that no progress was being made on the audit due to an injury that the Auditor had sustained when biking. On another occasion, the Auditor left a message for Mr. Jarvis' accountant stating that "she had been out of town ... and 'had nothing to report on the file'" and that Mr. Jarvis' file "'has been in a holding pattern due to other work demands including other projects.'"[43]

During this time, the Investigator reviewed the file provided by the Auditor, gathered some further information, and performed her own analysis and calculations to determine whether Mr. Jarvis indeed had intentionally under-reported his income and whether there was sufficient evidence to support a charge of tax evasion under s. 239. At some point, the Investigator concluded that there were reasonable and probable grounds for believing that a criminal offence had been committed and, consequently, commenced preparing an Information to Obtain a Search Warrant (the Information). Over six months after the file had been transferred to Special Investigations, the Investigator swore an Information before a Provincial Court Judge and obtained a warrant pursuant to s. 487 of the *Criminal Code*[44] to search Mr. Jarvis' residence, his place of business (his accountant's residence), and the offices of the Audit Section of Revenue Canada.[45] The search warrant was executed and, based on the information obtained therefrom, the Minister charged Mr. Jarvis with making

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41 For further details regarding the Special Investigations Section, see Information Circular IC73-10R3, "Tax Evasion" (13 February 1987) particularly in para. 7:

> The main responsibility of Special Investigations is to investigate significant cases of suspected tax evasion for the purpose of obtaining evidence of any criminal offence that may have been committed and, where such evidence is found, to prepare the case for prosecution in the courts under section 239 of the Act. A further responsibility is to publicize prosecution convictions as a means of deterring other tax filers from tax evasion and to encourage voluntary disclosures.

42 *Jarvis*, *supra* note 5 at para. 24. The Court notes that there was nothing in the court record to suggest that, once the file had been referred to Special Investigations, the Investigator had ever instructed or suggested that the Auditor obtain any further information from Mr. Jarvis "under the guise of an audit." The information that the Auditor received and passed on to Special Investigations was simply information that the Auditor had requested prior to the file being referred.

43 *Ibid.* at para. 29.

44 *Supra* note 10.

45 Revenue Canada's offices were included in the search warrant in order for the Investigator to obtain the books and records that the Auditor had obtained from Mr. Jarvis during the interview at his house.

false or deceptive statements in an income tax return and wilfully evading or attempting to evade payment of taxes.[46]

At trial, the judge (who, coincidentally, also happened to be the judge before whom the Information was sworn and the warrant granted) held that what started out as an audit had been transformed into a criminal investigation as at a particular time (16 March 1994), which was after the Auditor had obtained information from the third-party art galleries but prior to the initial meeting and interview with Mr. Jarvis.[47] The Court held that from that time forward, Mr. Jarvis was no longer required to comply with the voluntary disclosure and assistance provisions of ss. 231.1 and 231.2 and that his *Charter* protections against self-incrimination and unreasonable search and seizure were fully available to him.[48] As a result of the *Charter* rights violations, all of the information obtained pursuant to ss. 231.1 and 231.2 was excluded from evidence. Without this evidence, Mr. Jarvis was acquitted of all charges.[49]

In deciding this appeal, the Supreme Court of Canada set out to answer four questions, namely:

> Is there an audit/investigation distinction under the ITA? Where is the line between the two functions drawn? To what extent do taxpayers under investigation for ITA offences benefit from the principle against self-incrimination under s. 7 of the *Charter*? Is a s. 8 [*Charter*] violation made out where documents are obtained under colour of the ITA's "audit powers" after a prosecutorial investigation has commenced?[50]

Before answering these questions however, the Supreme Court emphasized the "firmly established principle"[51] that a contextual approach or analysis is required to determine

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46 Sections 239(1)(a) and 239(1)(d) respectively.

47 The Supreme Court, in paras. 38-40, reiterated the trial judge's finding that prior to the time of the Auditor's visit to Mr. Jarvis' residence, the audit had become an investigation since the purpose of the visit was to "[seek] out confirmatory proof of her opinion that this was a matter of serious underreporting of income which should be prosecutorily [*sic*] pursued by Special Investigations" (at para. 38). At that point in time, the trial judge held that the Auditor, although not part of Special Investigations (and without any involvement by Special Investigations), was conducting a criminal investigation as opposed to an audit.

48 This holding was based on *R. v. Norway Insulation Inc.*, [1995] 2 C.T.C. 451 (Ont. Ct. (Gen. Div.)) at paras. 59-81, in which the judge held that while, generally speaking, s. 231.1 is valid legislation that does not violate s. 8 of the *Charter*, this is only the case when the section (and the information obtained thereunder) is used for a regulatory or administrative function. Where the function for which s. 231.1 is used is criminal or quasi-criminal (such as when Special Investigations becomes involved in a criminal investigation), then the s. 8 *Charter* protection against unreasonable search and seizure is invoked and the requirements set out in *Hunter*, *supra* note 22 and *Baron*, *supra* note 12 must be present and satisfied in order to avoid the action being declared unconstitutional and the evidence obtained therefrom excluded pursuant to s. 24(2) of the *Charter*.

49 The Minister appealed this decision and was successful in obtaining an order for a new trial (in addition to findings that (a) only a portion of the evidence obtained by the Auditor had to be excluded by virtue of the *Charter*, and that (b) even with a portion of the evidence excluded, the search warrant was still validly issued and the evidence obtained pursuant to the warrant passed *Charter* scrutiny), [1999] 3 W.W.R. 393. On appeal to the Alberta Court of Appeal, the Court affirmed the summary conviction appeal judge's order for a new trial and made some additional holdings favourable to the Minister ([2001] 3 W.W.R. 271, 2000 ABCA 304).

50 *Jarvis*, *supra* note 5 at para. 45.

51 *Ibid.* at para. 63.

whether and to what extent the *Charter* will apply to "the values at stake in the particular context."[52] This was necessary given that neither of the two freedoms contained in ss. 7 and 8 of the *Charter* is absolute and, consequently, "[t]he scope of a particular *Charter* right or freedom may vary according to the circumstances."[53] More specifically, in the case of s. 7 of the *Charter*, a person's right to be protected against self-incrimination has to be balanced against the "opposing principle of fundamental justice suggesting that relevant evidence should be available to the trier of fact in the search for truth."[54] Similarly, in the case of s. 8 of the *Charter*, a person is only guaranteed a "reasonable" expectation of privacy.[55] Referring to previous decisions, the Court wrote as follows:

> The context-specific approach to s. 8 inevitably means, as Wilson J. noted in *Thomson Newspapers, supra* at p. 495, that "[a]t some point the individual's interest in privacy must give way to the broader state interest in having the information or document disclosed". Naturally, if a person has but a minimal expectation with respect to informational privacy, this may tip the balance in the favour of the state interest: *Plant, supra*; *Smith v. Canada (Attorney General)*, [2001] 3 S.C.R. 902, 2001 SCC 88.[56]

Finally, in a regulatory or administrative context, the Court held that *Charter* rights must also be balanced with the State's and the public's interest in having a desirable administrative scheme that works efficiently and effectively.[57]

In short, the Supreme Court confirmed that in deciding the outcome of this case and others of this nature, the entire context in which the issues arose would be critical. More specifically, the Court appeared to be advocating a two-part contextual analysis, namely: (1) the context of the particular sections in issue in relation to the *Act* as a whole,[58] and (2) the context of the application of those sections to the particular facts at bar.[59] While the *McKinlay* case had decided in a particular factual context that former s. 231(3) was in accordance with the *Charter* (part one of the two-part contextual analysis), this did not prevent the Court from coming to a different conclusion in the case at bar (part two).[60]

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52 *Ibid.* at para. 61, quoting *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154 at 209. Contrast this with the Federal Court of Appeal's approach in *AGT, supra* note 38 discussed above.

53 *Ibid.* at para. 63.

54 *Ibid.* at para. 68. Section 7 of the *Charter* provides that "[e]veryone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice." At para. 67, the Court reiterated the point that the *Charter* protection against self-incrimination has been held to be "an elemental canon of the Canadian criminal justice system ... [that] finds residual expression under s. 7 [of the *Charter*]."

55 *Ibid.* at para. 64. In *R. v. Plant*, [1993] 3 S.C.R. 281 at 293, the Supreme Court listed several factors that should be used in assessing whether a person's privacy rights are "reasonable" and hence protected under s. 8 of the *Charter*, namely:

> Consideration of such factors as the nature of the information itself, the nature of the relationship between the party releasing the information and the party claiming its confidentiality, the place where the information was obtained, the manner in which it was obtained and the seriousness of the crime being investigated allow for a balancing of the societal interests in protecting individual dignity, integrity and autonomy with effective law enforcement.

56 *Jarvis*, *supra* note 5 at para. 71.

57 *Ibid.* at para. 68.

58 *Ibid.* at para. 62.

59 *Ibid.* at para. 65.

60 *Ibid.* at para. 73.

Moving on to the particular questions before the Court, with respect to the first question — does the *Act* distinguish between an "audit" and an "investigation"? — the Supreme Court confirmed that, while the *Act* as a whole is regulatory or administrative in nature, it also contains provisions (such as s. 239) which possess "at least the *formal* hallmarks of criminal legislation, namely, prohibitions coupled with penalties."[61] This finding, along with the existence of the s. 231.3 search warrant provision (in addition to the Audit and Requirement Powers), led the Court to the conclusion that Parliament intended ss. 231.1 and 231.2 to be used in respect of "compliance and civil reassessment concerns"[62] and s. 231.3 to be used for "offences against the *Act*, and not with auditorial verifications."[63] Coming at the matter from a different angle but with the same result, the Supreme Court also held that the words "for any purpose related to the administration or enforcement of this Act" in ss. 231.1 and 231.2 could not be interpreted to include the investigation and prosecution of s. 239 offences.[64] Consequently, a distinction indeed existed between an audit and an investigation under the *Act*. This is well summarized by the Court as follows:

> Although the taxpayer and the CCRA are in opposing positions during an audit, when the CCRA exercises its investigative function they are in a more traditional adversarial relationship because of the liberty interest that is at stake. In these reasons, we refer to the latter as the adversarial relationship. It follows that there must be some measure of separation between the audit and investigative functions within the CCRA.[65]

With respect to the second question — when does an audit turn into an investigation? — the Supreme Court rejected the case law advocating a "reasonable and probable grounds"[66] or "reasonable suspicion" test[67] as being too far on one side of the spectrum, and the "actual

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61 *Ibid.* at para. 59 [emphasis in original].

62 *Ibid.* at para. 74.

63 *Ibid.* at para. 83. The Court was also very influenced by the similarities of s. 231.3 to the search warrant provisions in s. 487 of the *Criminal Code*, *supra* note 10. In fact, the Minister had relied on s. 487 of the *Criminal Code* rather than s. 231.3 of the *Act* to obtain the search warrant against Mr. Jarvis. Further, the Court held at para. 81 that "[t]he existence of a prior authorization procedure where the commission of an offence is suspected creates a strong inference that the separate statutory inspection and requirement powers are unavailable to further a prosecutorial investigation."

64 *Ibid.* at para. 78. This is in contrast to s. 231.3(1), which makes direct reference and applies to "the commission of an offence under this Act."

65 *Ibid.* at para. 84.

66 For cases advocating this approach, see *e.g. R. v. Bjellebo*, [2002] 3 C.T.C. 39 (Ont. Ct. J. (Gen. Div.)); *R. v. Pheasant*, [2001] G.S.T.C. 8 (Ont. Ct. J.); and *R. v. Chusid* (2001), 57 O.R. (3d) 20 (Sup. Ct. J.). Under this test, an audit or inspection would be characterized as a criminal investigation at that point in time when the Minister had reasonable and probable grounds to suspect that an offence under the *Act* had been committed. The Court rejected this test as it felt that it would prematurely and indiscriminately remove the Minister's discretion and ability to conduct civil audits or reviews to encourage and enforce compliance with the *Act* — see *Jarvis*, *ibid.* at paras. 85, 89. Further, it could be argued that while the existence of "reasonable and probable grounds" could indicate the possibility of a CRA investigation, the *Charter* only protects against actual (as opposed to potential) infringements of protected rights and freedoms.

67 For cases advocating this approach, see *e.g. R. v. Roberts* (1998), 42 W.C.B. (2d) 152 (B.C. Prov. Ct.) and *R. v. Dial Drug Stores Ltd.* (2001), 52 O.R. (3d) 367 (Ct. J.). Similar to the reasons for rejecting the "reasonable and probable grounds" test (set out *ibid.*), the Court rejected a test providing that an audit or inspection would be characterized as an investigation at that point in time when the Minister merely suspected (or a reasonable person would suspect) an offence had been committed. Even more so than in the case of a "reasonable and probable grounds" test, the Minister would be unable to perform its administrative compliance duties under the *Act*; in addition, having the "trigger" released so quickly would also make it extremely difficult for the Minister to obtain enough information and evidence to

charge" test[68] as being too far on the other. Instead, it adopted, refined and enunciated the "predominant purpose" test, which provides that:

> [W]here the predominant purpose of a particular inquiry is the determination of penal liability, CCRA officials must relinquish the authority to use the inspection and requirement powers under ss. 231.1(1) and 231.2(1). In essence, officials "cross the Rubicon" when the inquiry in question engages the adversarial relationship between the taxpayer and the state.[69]

While the Supreme Court did not (and, arguably, could not) set out an exhaustive or determinative list of when the "Rubicon would be crossed" and the predominant purpose test satisfied, it did list the following factors which could be used to make this determination:

> In our opinion, the following list of factors will assist in ascertaining whether the predominant purpose of an inquiry is the determination of penal liability. Apart from a clear decision to pursue a criminal investigation, no one factor is necessarily determinative in and of itself, but courts must assess the totality of the circumstances, and make a determination as to whether the inquiry or question in issue engages the adversarial relationship between the state and the individual.
>
> In this connection, the trial judge will look at all factors, including but not limited to such questions as:
>
> (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?

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satisfy the requirements for a warrant under either the *Act* or the *Criminal Code* — see *Jarvis*, *ibid.* at para. 90.

[68] For a case advocating this approach, see *e.g. R. v. Coghlan* (1993), [1994] 1 C.T.C. 164 (Ont. Prov. Div.). Under this test, an audit would not become a criminal investigation until actual charges were laid by the Minister. Understandably, for reasons opposite to those set out for rejecting the "reasonable and probable grounds" and "reasonable suspicions" test, the Supreme Court was not prepared to support this test. Whereas in the former cases, the Court was concerned that such tests would be too restrictive on the Minister and its duty to ensure the efficient and effective operation of the *Act*, in the latter case, the Court was concerned that it would give too much power to the Minister and open up the possibility for abuse by prosecutors. Further, consistent with its decision in *Hunter*, the Supreme Court wanted a test that would prevent inappropriate (and unconstitutional) investigations from commencing, rather than having to try to find an appropriate remedy after the fact — see *Jarvis*, *ibid.* at para. 91.

[69] *Jarvis*, *ibid.* at para. 88. For some history of the "predominant purpose" test prior to the *Jarvis* case, see Innes & Williams, *supra* note 37 at 1468-69.

> (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?[70]

Applying these factors to the case at bar, the Supreme Court held that while some of the Auditor's conduct was definitely not "praiseworthy," her conduct was not for the predominant purpose of obtaining evidence to support a criminal prosecution under s. 239.[71] Rather, her work up to the point of formally referring the file to Special Investigations was for the predominant purpose of determining whether such a referral to the criminal branch of the CRA was appropriate in the circumstances.[72] Consequently, the Court held that all of the information she obtained pursuant to ss. 231.1 and 231.2 up to the point of the referral to Special Investigations was obtained in accordance with the *Charter*.[73]

With respect to the third question — to what extent (if any) does the protection against self-incrimination assist a taxpayer under an investigation by Revenue Canada? — the Supreme Court held that it was indisputable that Mr. Jarvis' s. 7 *Charter* rights were triggered by the threat of imprisonment if convicted of tax evasion under s. 239.[74] Consequently, once the audit became an investigation, the following consequences resulted:

> First, no further statements may be compelled from the taxpayer by way of s. 231.1(1)(*d*) for the purpose of advancing the criminal investigation. Likewise, no written documents may be inspected or examined, except by way of judicial warrant under s. 231.3 of the ITA or s. 487 of the *Criminal Code*, and no documents may be required, from the taxpayer or any third party for the purpose of advancing the criminal investigation. *CCRA officials conducting inquiries, the predominant purpose of which is the determination of penal liability, do not have the benefit of the ss. 231.1(1) and 231.2(1) requirement powers.*[75]

However, as the Supreme Court also found that the vast majority of Revenue Canada's actions were pursuant to an audit rather than an investigation, Mr. Jarvis' s. 7 *Charter* rights in relation to such were held not to have been violated.

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70 *Jarvis*, *ibid.* at paras. 93-94 [emphasis in original].

71 *Ibid.* at para. 101.

72 *Ibid.* at para. 103.

73 *Ibid.* at paras. 104-105. There was some banking information that the Auditor obtained pursuant to ss. 231.1 and 231.2 after the file had been transferred to Special Investigations. The Supreme Court held that in obtaining this particular information, the Auditor had violated s. 7 of the *Charter* (for reasons to be discussed further in this article) and hence the information was to be excluded from the criminal proceedings against Mr. Jarvis. This decision overturned the trial judge's finding that prior to even meeting Mr. Jarvis, the audit had turned into an investigation. The reversal on this issue was entirely within the Supreme Court's power as it also held (relying on its decision in *Canada (Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748) that the determination of whether an inquiry was auditorial or investigatory in nature is a question of mixed fact and law (*Jarvis*, *ibid.* at para. 100).

74 *Jarvis*, *ibid.* at para. 67

75 *Ibid.* at para. 96 [emphasis added].

Finally, with respect to the fourth question — can Revenue Canada use its audit and inspection powers in conjunction with (or in furtherance of) a criminal investigation without violating s. 8 of the *Charter*? — the Supreme Court made two important points. First, relying on its decision in *McKinlay*, it reiterated the point that "taxpayers have very little privacy interest in the materials and records that they are obliged to keep under the ITA, and that they are obliged to produce during an audit."[76] Second, once the Minister has validly obtained information pursuant to its audit and inspection powers, there is no reasonable expectation of privacy that would prevent the CRA from using such information in a criminal prosecution.[77] Given that the Supreme Court had already determined that nearly all of the information (copies of sales transactions, receipt books, bank statements) and assistance that the Auditor had received was during the course of the audit and, in the case of the physical records, required under s. 230, the Court held that s. 8 of the *Charter* had not been violated.[78]

Overall, the Supreme Court of Canada's decision in *Jarvis* is a welcome addition to the jurisprudence on audits, investigations and the *Charter*. Its adoption and refinement of the predominant purpose test and the corresponding factors, while not definitive, at least gives taxpayers, advisors, the Minister and the courts some much-needed guidance on when the Minister can and cannot legally use the Audit and Requirement Powers in the administration and enforcement of the *Act*. However, in addition to the predominant purpose test being somewhat vague and uncertain in its application, which will be illustrated using case examples in the next section, the judgment is deficient in two main respects.

First, the Supreme Court erred in finding that, in the facts at bar, the Auditor was not conducting an investigation triggering full *Charter* scrutiny and protection. As noted above, in deciding the case largely in favour of the Minister, the Court found that the Auditor's predominant purpose was not to conduct a criminal investigation but rather to determine whether a criminal investigation should be commenced. With respect, this distinction is too subtle and opens the possibility for future misuse and misinterpretation by the Minister and its delegates as well as uncertainty on behalf of the public. What is the difference between conducting an investigation and conducting an inquiry into the determination of whether an investigation should be commenced? Is not the latter part-in-parcel of the former? If the Court's goal was to draw a clear line between administrative or regulatory compliance procedures on the one side and procedures directed to the goal of criminal sanction on the other, then arguably, the Court failed in deciding to place an inquiry into the merits of commencing an investigation on the compliance side. With all of the cases that are brought before the courts alleging *Charter* violations and requesting the exclusion of evidence obtained through such violations, the Supreme Court needed to send a message to the Minister that questionable use of the voluntary disclosure powers would not be tolerated. It failed in this regard.

Second, while the Supreme Court was very strict and definite in prohibiting the CRA from using ss. 231.1 and 231.2 in the context of a criminal investigation, surprisingly, it was also

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[76] *Ibid.* at para. 95.

[77] *Ibid.*

[78] *Ibid.* The only exception was the banking information obtained after the audit had been transformed into an investigation — see *supra* note 73.

rather comfortable with allowing the CRA to conduct a parallel audit and criminal investigation of the same taxpayer.[79] This too is problematic as it raises some practical, if not principled, concerns. The Audit and Special Investigations sections are both contained within the CRA under the authority and supervision of the Minister. Given this, will the public appreciate and believe that there are two separate and distinct sections of the CRA that conduct audits and investigations respectively, or will the public view both sections as being part of the same body and hence one and the same? More particularly, will the public have the faith and confidence to believe that when they provide information to the Audit section "voluntarily," such information will not somehow be accessible to and used by Special Investigations in a potential criminal prosecution? Shifting focus from public perception to Ministerial action, what steps has the CRA taken and what controls have been implemented to ensure that there will be no inappropriate "information sharing" between Audit and Special Investigations in the course of parallel inquiries? Further, who will act as an internal yet independent watchdog to ensure no violations occur? If such parallel inquires are acceptable, what is a taxpayer to do when both functions are being conducted by the same CRA official? Finally, aside from a possible limitations issue, what detriment would be suffered by the Minister if the courts required audits and investigations to be conducted consecutively rather than concurrently? Given all of these concerns, the Supreme Court's suggestion to allow parallel audits and investigations is far from desirable.

VI. A SAMPLING OF DECISIONS AFTER *JARVIS*

It is impossible to fully assess and appreciate the impact of *Jarvis* on the current administration and enforcement of the *Act*. However, by examining some of the post-*Jarvis* cases, it may be possible to get some indication of taxpayers', the Minister's and the courts' reactions to *Jarvis*. Four cases have been selected on the basis that they either add to or clarify the principles set out in *Jarvis*, or that they contain something that may be of assistance to taxpayers and their advisors in dealing with voluntary disclosure and assistance in the income tax context.

A. *STANFIELD*[80] AND *BINING*[81] — WHAT FUNCTION IS THE MINISTER PERFORMING AND HOW DO YOU FIND OUT?

In the *Stanfield* case, the Minister was initially engaged in the audit of several taxpayers (including Mr. Stanfield) who were participating in tax loss arrangements.[82] Due to the proliferation of these arrangements, many of which did not withstand scrutiny when challenged in court, the Minister decided to make auditing such arrangements and their

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79 *Ibid.* at para. 97. As long as the auditors are using the "voluntary" disclosure and assistance sections for the predominant purpose of determining a taxpayer's tax liability and the investigators are not using the information obtained by auditors after the criminal investigation has started for its criminal investigation, the Supreme Court states that the *Charter* will not apply either to restrict the auditors from using ss. 231.1 and 231.2 or to exclude evidence used by the investigators in its prosecution of an offence under the *Act*.

80 *Stanfield v. Minister of National Revenue*, [2004] 3 C.T.C. 125, 2004 FC 584 [*Stanfield*].

81 *R. v. Bining*, [2003] 4 C.T.C. 165, 2003 FCA 286 [*Bining*].

82 The decision does not contain many details as to these tax loss arrangements other than to state that they involved currency and commodity transactions straddling a year-end (*Stanfield*, *supra* note 80 at para. 6).

participants a national project. Eventually, a meeting was held between the Audit and Special Investigations sections of the CCRA and, as a result of the information shared at this meeting, the decision was made to have Special Investigations take over these files to determine whether criminal offences had been committed by the participants. The Audit section was instructed to and did discontinue their audits and transfer their audit files to Special Investigations.

Approximately one year after commencing the investigations, Special Investigations instructed the Audit section to recommence their audits of the tax loss participants. In so doing, the auditors, pursuant to s. 231.2, issued Requirements (in the form of a questionnaire) to the participants asking for a great deal of information.[83] Included with the Requirement questionnaire was a letter which contained the following statement:

> Please be advised that a criminal investigation regarding the promotion of transactions of the type claimed on your income tax return has been undertaken. You are not under investigation at the present time but we wish to advise you that any information submitted may be provided to our Investigations Division for review.[84]

At this time, there was a regular exchange of information between the Audit and Special Investigations sections concerning the participants as well as instructions flowing from Special Investigations to Audit as to the audit approach to be taken.[85] In addition, Special Investigations retained many of the tax returns of the participants while the audits were proceeding.

Mr. Stanfield and many of the other participants who received the same Requirement questionnaire were understandably concerned and confused as to their rights and obligations in the circumstances. As a result of *Jarvis*, they knew that while they had an obligation to comply with the Requirement if it was made in the course of an audit, they did not have to comply if the Requirement was issued in connection with an investigation. Given that they had been subjected to an audit, then an investigation, then (apparently) a continuation of the original audit, coupled with the statement (set out above) attached to the Requirement itself, they were unsure of the proper approach to take. Consequently, they made an application for judicial review of the Requirement and a declaration that it was invalid and unlawful on the grounds that the Minister was, in fact, conducting a criminal investigation and hence, according to *Jarvis*, could only obtain such information through a search warrant under s. 231.3 or the *Criminal Code*. Pursuant to their application for judicial review, they cross-examined one of the auditors who, when questioned concerning whether an audit or investigation was being undertaken, would not or did not have the necessary information to

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[83] Prothonotary Hargrave noted that the Requirements were very thorough and comprehensive, requiring not only the books and records, but also the answers to many questions that were "not something dictated by the needs of and drafted by the Audit Division, but rather is a far more pointed and searching request for information which could well have bearing on the criminal investigation" (*ibid.* at para. 38).

[84] *Ibid.* at para. 1.

[85] *Ibid.* According to para. 14 of the decision, Special Investigations may have had some input in the drafting of the letter accompanying the questionnaire and, in particular, the advice of the criminal investigation and that the recipient was not at that point under investigation.

answer. As a result, a motion was brought for further information from the Minister as well as for an order to compel the auditor to re-attend for further cross-examination.

In addressing the motion, the Court reviewed the principles set out in *Jarvis* and commented on the practical difficulty of determining whether the "adversarial relationship had been crystallized" and the "Rubicon crossed."[86] However, after reviewing all the facts and circumstances, the Court concluded that there was at least cause for alarm that investigations were still being carried on and, consequently, granted the motion for further information and cross-examination.[87]

This case is important for two main reasons. First, it serves as a "real life" example of how audits and investigations are carried on and the practical difficulties associated with trying to determine when one ends and the other begins. Unfortunately, more often than not, the facts and circumstances are complicated and equivocal rather than clear and precise. Second, and more importantly, this case illustrates that a person can seek judicial review to try to clear the confusion and uncertainty in determining whether he has an obligation to comply with a Minister's demand for information and assistance.

In *Bining*, like *Stanfield*, the taxpayer was faced with a Requirement to provide information under threat of penalty pursuant to s. 238. Also like *Stanfield*, the taxpayer challenged the Requirement on the basis that the Minister was conducting an investigation rather than an audit and hence, pursuant to *Jarvis*, the Minister was prevented from using s. 231.2 in furtherance of the investigation. What distinguishes *Bining* from *Stanfield* is that in *Bining*, there was never any formal action or participation taken by Special Investigations on his file (or at least none noted in either the Trial or the Federal Court of Appeal decisions). Instead, Mr. Bining used logical reasoning rather than evidence of actual action or participation to support his challenge to the legality of the Requirement.

This case concerned certain bank deposits in Mr. Bining's account that could not be reconciled to his reported sources of income. When Mr. Bining refused to answer the Minister's written request for information on the nature and source of such deposits, the Minister issued a formal Requirement compelling the disclosure of such information. In response, Mr. Bining brought a motion to the Federal Court to request a stay of the Requirement pending the hearing of an application for a declaration that the Requirement was an abuse of process and a violation of his rights under ss. 7 and 8 of the *Charter*. In support of his motion, he argued that the only reason the Minister issued the Requirement was that the Minister was conducting an investigation (as opposed to an audit) and wanted the information to assist it in obtaining evidence in support of a charge of tax evasion under s. 239. If the Minister was indeed only concerned with ensuring that Mr. Bining's tax return was in compliance with the *Act*, then Mr. Bining argued, the Minister could have simply issued a Notice of Reassessment under s. 152 including the impugned deposits in income. The fact that the Minister did not issue a Reassessment but instead issued a Requirement for information regarding the deposits indicated to Mr. Bining that the Minister was interested in more than simply civil compliance with the *Act*.

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[86] *Ibid.* at paras. 30-36.

[87] *Ibid.* at paras. 35, 66.

While this argument was rejected at trial,[88] it was accepted by the Federal Court of Appeal. As a result, it now appears available for a person to use "logical reasoning" in addition to actual evidence of an ongoing investigation to support a challenge of the use of the Audit and Requirement Powers.

B. *DWYER*[89] — IS THIS PROCEDURE MORE CONSISTENT WITH AN AUDIT OR AN INVESTIGATION?

In *Dwyer*, the Special Investigations section of Revenue Canada received an anonymous tip that Mr. Dwyer might not have been reporting the interest income on the residential mortgages he was making. Based on this information, a Special Investigations officer (the Investigator) commenced what he described in court as being "the preliminary stage of a criminal investigation"[90] by reviewing Mr. Dwyer's tax returns and examining documents at the Land Registry Office. More notably, he also issued a Requirement to Mr. Dwyer's credit union to provide information and documents on Mr. Dwyer's banking activities. After reviewing the information provided by the credit union and conducting an interview with one of Mr. Dwyer's former mortgage clients, the Investigator decided that there was enough evidence and suspicion of criminal activity (tax evasion) to take the next logical step in a criminal investigation, namely, to obtain and execute search warrants. A few weeks after the search warrants were successfully executed, the Investigator (along with his immediate supervisor) interviewed Mr. and Mrs. Dwyer and, in the course of that interview, cautioned them that they were under a criminal investigation. A few months later, the Investigator issued Requirements to two other financial institutions with which Mr. Dwyer had accounts as well as to a number of solicitors who were involved with his residential mortgages. Approximately a year later, the Investigator swore a criminal Information against Mr. Dwyer, charging him with tax evasion and making false statements on his tax returns. At the same time, the Minister issued civil Reassessments against him for unreported income, interest and gross negligence penalties. While he was acquitted of all his criminal charges at trial, Mr. Dwyer was unsuccessful in overturning the Reassessments in the Tax Court. He appealed the Tax Court's decision to the Federal Court of Appeal.

While there were several issues argued at the Federal Court of Appeal, three are particularly relevant. First, Mr. Dwyer argued that the use of Requirements to obtain the disclosure of information after search warrants had been issued and executed constituted an abuse of process.[91] While it is beyond the scope of this paper to discuss the abuse of process doctrine,[92] what is distressing to note here is that in quickly dismissing this argument, the Federal Court of Appeal accepted without any consideration or analysis that (a) a Special Investigations investigator can act in the dual capacities of an investigator and an auditor in

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88 *Bining v. Her Majesty the Queen*, 2003 D.T.C. 5441, 2003 FTC 689.

89 *R. v. Dwyer*, [2004] 1 C.T.C. 1, 2003 FCA 322 [*Dwyer*].

90 *Ibid.* at para. 64.

91 *Ibid.* at para. 48.

92 For more information on the abuse of process doctrine, see *Blencoe v. British Columbia (Human Rights Commission)*, [2000] 2 S.C.R. 307, 2000 SCC 44; *R. v. D. (T.C.)* (1987), 38 C.C.C. (3d) 434 (Ont. C.A.); *R. v. Miles of Music Ltd.* (1989), 48 C.C.C. (3d) 96 (Ont. C.A.); and *General Foods, Ltd. v. Struthers Scientific and International Corp.*, [1974] S.C.R. 98.

respect of the same file or taxpayer and, (b) following *Jarvis*, it is acceptable for the Minister to conduct a parallel audit and investigation.[93]

With respect to the latter point, it has already been noted that there are some practical concerns. However, with respect to the former point, can there be any reasonable argument that it is correct? While it may be possible to sufficiently compartmentalize the CRA's Audit and Special Investigations sections to protect a person's *Charter* rights, is the Federal Court of Appeal suggesting that it is also possible to sufficiently compartmentalize a person? Surely, this cannot be the case.

Second, Mr. Dwyer also argued that the use of Requirements after search warrants had been obtained and executed violated his rights under ss. 7 and 8 of the *Charter*. Given the Federal Court of Appeal's comments in respect of the first issue discussed above, one might have expected the Court to dismiss this issue as well. Thankfully, the Federal Court of Appeal (correctly) held that at the time the search warrants were issued and executed, the predominant purpose of the CRA's inquiry was the determination of penal liability and, consequently, the use of Requirements after this point breached Mr. Dwyer's *Charter* rights.[94]

Third, Mr. Dwyer argued that when the Investigator issued the Requirement for information to Mr. Dwyer's credit union prior to obtaining the search warrants, the Investigator violated ss. 7 and 8 of the *Charter* as s. 231.2 is not available for use during a criminal investigation and the Investigator himself admitted at trial that he was conducting an investigation when the Requirement was issued.[95] Quite remarkably, the Federal Court of Appeal dismissed this argument. After listing the *Jarvis* factors used to determine whether an audit has been transformed into an investigation, the Court stated that:

> Although Mr. Fransky was of the view that his investigation was the preliminary stage of a criminal investigation, I am satisfied that the conduct of the investigation was consistent with an audit, in that the nature of the evidence sought was relevant to establishing whether or not there was unreported income and went more to Mr. Dwyer's tax liability in general than to the specific *mens rea* of an offence. Even though the "auditor" was also the "investigator", prior to the issuing of the Requirement upon the PCCU[,] there was no evidence which could have justified a transfer of the file to Special Investigations had it originated in the Audit Branch of Revenue Canada. In other words, when the Requirement was served upon the PCCU, the adversarial relationship between the state and the individual had not been engaged, and the predominant purpose of the inquiry could not have been the determination of penal liability.... Thus, I am of the view that the Requirement served upon the PCCU does not constitute an unreasonable search and seizure and, therefore, Mr. Dwyer's rights under sections 7 and 8 of the Charter were not infringed.[96]

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93 *Dwyer*, *supra* note 89 at paras. 56-57.

94 *Ibid.* at para. 94. While the use of the Requirements violated ss. 7 and 8 of the *Charter*, the information obtained from the Requirements were not excluded after the application of s. 24(2) of the *Charter* — see para. 95 for further details.

95 *Ibid.* at para. 58.

96 *Ibid.* at paras. 64-65.

As this final point was revisited (and reversed) by the Federal Court of Appeal in *Kligman v. M.N.R. (C.A.)*,[97] it will be discussed in conjunction with that case.

C. *KLIGMAN*[98] — THE LATEST AND GREATEST WORD ON THE PREDOMINANT PURPOSE TEST?

In many ways, the majority decision[99] of the Federal Court of Appeal in *Kligman* represents a reversal of the Court's unanimous decision in *Dwyer*.[100] While *Dwyer* was very State-friendly, *Kligman* falls more on the side of protecting a person's rights. Consequently, in addition to outlining some of the advances and clarifications that the majority in *Kligman* has made concerning the predominant purpose test, this case has been selected to illustrate some of the uncertainty still present post-*Jarvis*.

Unlike *Dwyer*, the facts in *Kligman* are relatively straightforward. The Special Investigations Division of the CCRA (Special Investigations) was involved in the investigation of four charitable organizations. Pursuant to that investigation, Special Investigations decided to commence a separate investigation against five of the apparent donors to these charitable organizations. Two of the donors were individuals; the other three were corporations. Pursuant to this secondary investigation, Special Investigations issued Requirements to the five donors to provide information concerning the donations they had apparently made. The donors, being concerned with their obligations to comply with the Requirements in the circumstances,[101] brought a motion for judicial review of the Requirements. They argued that the Requirements violated their rights under ss. 7 and 8 of the *Charter*.

At the hearing, the motions judge relied on the *Jarvis* decision, applied the predominant purpose test and held that from the outset, Special Investigations was conducting an investigation. Consequently, with respect to the individual donors, Special Investigations could not use the Requirement power in s. 231.2 to compel the disclosure as this would violate the donors' s. 7 *Charter* rights. However, in the case of the corporate donors, the motions judge held that s. 7 of the *Charter* did not apply and neither did s. 8, due to corporations, in general, having a very low privacy interest in their books and records.[102] The corporate donors appealed this part of the decision stating that they were not protected by the *Charter* and consequently had to disclose the information requested by the Requirements;

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97 [2004] 4 F.C. 477, 2004 FCA 152 [*Kligman*].

98 *Ibid.*

99 It is interesting to note that all three judges sitting on this case felt the need to write their own decisions. In the least, this suggests that even at the Federal Court of Appeal level, there is still some uncertainty and possibly even some confusion over the predominant purpose test and its application.

100 While *Dwyer* was heard and decided prior to *Kligman*, the *Dwyer* case was not even mentioned in any of the *Kligman* judgments — including that of Nadon J.A., who sat on the panel of both appeals. Perhaps this could be interpreted as indicating that the Federal Court of Appeal had moved away from its decision in *Dwyer* and that the principles set out in *Kligman* reflect the better and more current views of the Federal Court of Appeal.

101 One of the charitable organizations under investigation had already been charged with and pled guilty to tax evasion (more specifically, delivering false charitable gift receipts) (*Kligman*, *supra* note 97 at para. 15).

102 This latter finding was based on *Hunter*, *supra* note 22.

the Minister appealed the part of the decision stating that the Requirements against the individual donors were invalid.

Two of the three Federal Court of Appeal judges held that the three corporate donors, in addition to the individual donors, were protected from having to comply with the Requirements.[103] In each of their decisions, the judges comprising the majority held that, properly applied, the *Jarvis* predominant purpose test concerns only whether the Minister was improperly using the Requirement power in a criminal investigation. The test does not concern the person against whom the Requirement is issued.

With respect, while the result in this case is likely correct (that corporations, like individuals, should have some *Charter*-protected privacy rights), the approach taken by the majority is questionable. As noted in *Hunter* and *Jarvis*, *Charter* rights, including those contained in ss. 7 and 8, are not absolute and must be interpreted and applied contextually by balancing the various competing interests. By simply focusing on the predominant purpose test itself and not the underlying objectives the test is trying to accomplish, the majority is losing sight of the forest by looking only at a particular tree.

In addition to finding that the corporate donors did not have to comply with the Requirements, Létourneau and Nadon JJ.A. for the majority also made several important points which either confirmed or expanded the principles concerning voluntary disclosure set out in prior cases.[104] More specifically, Létourneau J.A. affirmed the *Hunter* principle that a violation of the right against an unreasonable search and seizure should be prevented rather than addressed and remedied after the fact.[105] This is important as it confirms, yet again, that a person has the ability to challenge the validity of a Requirement before complying with it.

In addition (and more importantly) Létourneau and Nadon JJ.A. both emphasized that the various factors listed in *Jarvis* "are designed to assist in the determination of the predominant purpose of an inquiry. *They apply unless there is a clear decision to pursue a criminal investigation.*"[106] More specifically, Nadon J.A. noted that the issue in *Jarvis* was whether and when an audit would be considered to be an investigation.[107] Consequently, the *Jarvis* factors were designed to assist with that and only that particular issue.[108] In cases such as *Kligman* and *Dwyer*, where the decision had been made to commence an investigation and the Special Investigations section of the CRA was involved in carrying out such investigation, there was no need to determine if and when an audit became an

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103 *Kligman*, *supra* note 97 at paras. 6, 59.

104 Due to space and time constraints, the minority decision by Desjardins J.A. has not been discussed in this article. In many respects, it is consistent with the Federal Court of Appeal's decision in *Dwyer*.

105 *Kligman*, *supra* note 97 at para. 3.

106 *Ibid.* at paras. 13 (in the case of Létourneau J.A.) and 48-59 (in the case of Nadon J.A.) [emphasis added]. In his separate reasons, Nadon J.A. focuses almost exclusively on this point in deciding the appeal.

107 *Ibid.* at para. 50.

108 *Ibid.* at para. 49.

investigation.[109] It was an investigation — full stop — and all the *Charter* protections were engaged.[110]

Finally, while not necessary to resolve the appeal, Létourneau J.A. clarified several of the *Jarvis* factors. With respect to the first two factors, namely:

> (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? [and]
>
> (b) Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?[111]

he noted that while a criminal investigation may commence early or late in the inquiry of a person, it is not necessary for there to be reasonable grounds to lay a charge before a court can find that the Minister was conducing a criminal investigation.[112] Indeed, the majority of the Federal Court of Appeal held that a criminal investigation against the alleged donors had commenced immediately when Special Investigations decided to investigate the donors in addition to the charities themselves.[113] Criminal investigations exist when "specific individuals are targeted for the express and exclusive purpose of indicting them"; the results of the criminal investigation (whether a person is charged or not) is not determinative of whether an investigation was undertaken.[114] A contrary position would echo back to the "reasonable and probable grounds" test that was specifically rejected by the Supreme Court of Canada in *Jarvis*.

With respect to the fifth *Jarvis* factor, namely:

> (c) Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?[115]

Létourneau J.A. commented that if a criminal investigation ceased, one would expect the file to be returned to the Audit section of the CRA.[116] By implication, if the matter stayed with the Special Investigations section — as was the case in *Dwyer* — a very sensible presumption would be that the investigation had not in fact ended.

Finally, with respect to the sixth *Jarvis* factor, namely:

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109 *Ibid.* at para. 58.

110 This point is emphasized in Létourneau J.A.'s decision as well. At para. 23, he rejects the Minister's submission that at the time the Requirements were issued, the Special Investigations officer did not have reasonable grounds to believe that an offence had been committed and hence should not be found to have been conducting an investigation. As will be discussed further below, the issue of the existence of reasonable and probable grounds, in Létourneau J.A.'s opinion, is irrelevant in cases like this, where the decision had been made to conduct a criminal investigation and the facts were consistent with this decision (*ibid.* at paras. 11-27).

111 *Ibid.* at para. 28 [emphasis in original].

112 *Ibid.* at paras. 29-32.

113 *Ibid.* at paras. 11, 14-15, 18, 32 and 39-40.

114 *Ibid.* at para. 29, quoting *Starr v. Ontario (Commissioner of Inquiry)*, [1990] 1 S.C.R. 1366 at 1425.

115 *Kligman, ibid.* at para. 34.

116 *Ibid.* at para. 35.

> (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?[117]

Létourneau J.A. acknowledged the difficulty in applying this factor to the present and other cases:

> Even if the evidence is sought to establish the penal liability of the taxpayer, such evidence will generally remain relevant to establish his tax liability and civil penalties. It may be, for example, that the evidence obtained in the context of a criminal investigation of a taxpayer falls short of proving a crime beyond a reasonable doubt, but still reveals irregularities in that taxpayer's compliance with the Act which affect his tax liability. As the U.S. Supreme Court said in the *La Salle Nat'l Bank* case *supra*, at page 2365, "[t]he Government does not sacrifice its interest in unpaid taxes just because a criminal prosecution begins". Thus, it is difficult, if not impossible to say, that the evidence will be, or is relevant, *only* to the taxpayer's penal liability even though this was the primary reason why that evidence was sought and obtained and even though the taxpayer's penal liability was the predominant purpose of the investigation.[118]

Again, very sensibly, what he appears to be stating — in contrast to the Federal Court of Appeal in *Dwyer* — is that practically all investigations will have a supplementary purpose or benefit of obtaining information that can be used to calculate a person's tax liability. This being the case, this factor should be applied carefully in determining whether a particular inquiry constitutes an audit or an investigation.

In summary, while these cases are but a very small sampling of the post-*Jarvis* litigation concerning the issue of taxpayer disclosure to and assistance of the CRA, they illustrate three important points. First, it is clear that the predominant purpose test (and its associated factors) is now the standard by which legitimate State intrusion into Canadians' right to financial privacy is measured and balanced. Second, while the test has been embraced by subsequent courts, it still generates many uncertainties and ambiguities which will have to be resolved and clarified over time. Third, and most importantly, the test gives persons faced with a request for disclosure and assistance of information a basis for challenging and, in the appropriate cases, defeating it.

VII. CONCLUDING REMARKS AND RECOMMENDATIONS

In the income tax context, when the Minister makes a request for information or assistance, can the person against whom the request has been made legally say "no"? Even after the Supreme Court of Canada's decision in *Jarvis*, the general answer to this question is negative — the person must disclose and assist. Although Canada recognizes a general right to privacy of one's financial affairs, when this right is balanced against the State's and public's interest in an efficient and effective income tax regime that operates on the principles of self-assessment and self-reporting, the disclosure of information and provision of assistance will usually prevail. This is reflected in ss. 231.1 and 231.2, and in the courts' interpretation and application thereof, which give the Minister very broad powers of "voluntary compulsion."

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[117] *Ibid.* [emphasis in original].

[118] *Ibid.* at para. 36 [emphasis in original].

Does this mean that a person can never refuse the Minister's request? Fortunately, again the answer to this question is negative. There are four general situations where the Minister's right to disclosure and assistance will be outweighed by a person's right to privacy. The first situation, albeit limited, is where the person is unable to comply with the Minister's request. Section 231.5(2) provides that a person does not have to comply with the Minister's demand for information and assistance where the person is "unable to do so." The second situation is where the Minister's request does not pertain to "any purpose related to the administration or enforcement of this Act." Simply put, the Minister cannot use the broad powers contained in ss. 231.1 and 231.2 for reasons other than the administration and enforcement of the income tax regime. The third situation is where the information sought by the Minister is privileged. A fundamental tenet of the Canadian legal system is that the State cannot compel a person to disclose information that is the subject of solicitor-client privilege. The fourth and final situation, which has been the focus of this paper, is where the Minister's predominant purpose is the determination of penal liability. In this situation, the *Jarvis* case provides that the *Charter* protections against self-incrimination and unreasonable search and seizure will shift the balance of interests to favour the privacy rights of a person, rather than the State's interests in disclosure. This does not mean that the Minister is absolutely barred from obtaining the disclosure; rather, it means that the Minister will have to take additional steps to ensure that disclosure is reasonable and consistent with Canadian values as they are reflected in the *Charter*.

Given the Minister's broad powers to compel disclosure and cooperation and the limited exceptions thereto, how should taxpayers and their advisors approach matters of this nature? First, it is important that everyone be proactive in complying with their obligations under the *Act*, including (and especially) the potential obligation to provide further disclosure and assistance to the Minister on request. A strategy will not be effective if it is sought to be implemented at the time that the Minister asserts its right to conduct an audit or issue a Requirement. Books and records that are necessary as support for the information contained in an income tax return must be created, maintained and made available to the Minister upon demand. However, in contrast, information that is not necessary for this purpose should be reviewed regularly to ensure that it is managed appropriately. Is this information reasonably characterized as being protected by solicitor-client privilege? If so, what steps have been taken to ensure that such privilege is not waived or lost? Is this information particularly confidential and sensitive? If so, perhaps such information should be stored at the person's home rather than a more public location. Is this information necessary or valuable to the person (or the person's clients, suppliers, *etc.*) on an ongoing basis? If not, consideration should be given to disposing of it. Continuous information management is critical given that: (a) the Minister's power to demand disclosure is very broad (for any purpose related to the administration and enforcement of the *Act*); and (b) once information has been validly obtained by the Minister in a compliance context, that information can be validly transferred to and used by the Special Investigations section of the CRA in furtherance of a criminal investigation.

In addition to proper information management, another important way that a person can try to ensure that his privacy rights are respected and maintained is to be diligent and persistent with the Minister in continuously determining for what basis the information is being requested. As noted in *Jarvis* and subsequent cases, in the context of an audit or

compliance inquiry, a person has a legal obligation to assist and cooperate with the Minister's requests; however, in the context of a criminal investigation, a person does not. To the extent possible, persons should attempt to get some representation and assurance from the Minister as to why information or assistance is being requested. As reasons may change over the course of the inquiry, this must be done on an ongoing basis. If the Minister refuses to provide such representation or the person has any doubt that the Minister is requesting disclosure or assistance for any reason other than compliance with the *Act*, the person should not hesitate to have the matter clarified by judicial review prior to making any disclosure. All of these steps should assist in ensuring that a person's privacy rights are properly respected in this post-*Jarvis* world.

On the other side of the equation, the Minister and the CRA must take all the necessary steps to ensure that the use of the Audit and Requirement Powers and the information and assistance derived therefrom are in accordance with *Jarvis* and subsequent case law. Ideally, policies and procedures should be implemented to keep separate and distinct the administrative and compliance activities on one side and the criminal investigations on the other. Strict information transfer and use protocols should be enacted and internally policed to ensure that information obtained through "voluntary" means is not inappropriately used, hence jeopardizing the success of a criminal investigation. Finally, in all possible cases, the CRA should communicate its purposes and objectives of its activities to the affected parties in a timely fashion. In these ways, the Minister's Audit and Requirement Powers will be preserved and available for use "in the administration or enforcement of the Act."