

Comité mixte sur la fiscalité de  
l'Association du Barreau canadien  
et de

Comptables professionnels agréés du Canada

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**Objet : Mémoire concernant les pouvoirs d'audit proposés dans le budget 2024 inclus dans les propositions législatives d'août 2024**

Ce mémoire présente les commentaires du Groupe de travail sur les pouvoirs d'audit du Comité mixte sur la fiscalité de l'Association du Barreau canadien et de Comptables professionnels agréés du Canada (« Comité mixte ») en ce qui concerne les pouvoirs d'audit.

Les membres du groupe de travail sur les pouvoirs d'audit qui ont participé à la discussion et contribué à la préparation de ce document :

- Thomas Brook – EY
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**Au sujet du Comité mixte**

Par l'entremise du Comité mixte sur la fiscalité, Comptables professionnels agréés du Canada (CPA Canada) collabore avec l'Association du Barreau canadien (ABC) pour offrir au gouvernement fédéral des commentaires sur les lois fiscales. Depuis plus de 70 ans, cette collaboration entre CPA Canada et l'ABC offre régulièrement au ministère des Finances des commentaires sur les aspects techniques des nouvelles lois fiscales. Nous suggérons également des améliorations pour simplifier et améliorer les lois

fiscales actuelles.

Nous tenons à vous remercier de l'attention que vous porterez à ce mémoire. Nous espérons que vous trouverez nos commentaires utiles, mais nous serions heureux d'avoir l'occasion de discuter avec vous, à votre convenance, de ce document et de nos préoccupations.

Nous vous prions d'agréer, Madame, Monsieur, nos salutations distinguées.



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Présidente, Comité sur la fiscalité  
Comptables professionnels agréés du Canada



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Cc : Arif Virani, procureur général du Canada et ministre de la Justice

**Audit Powers Working Group of the Joint Committee on Taxation of the  
Canadian Bar Association and Chartered Professional Accountants of Canada**

**Submission Regarding Proposed Audit Powers in Budget 2024  
Included in the August 2024 Draft Legislation**

**Background**

Budget 2024 proposes several changes to the *Income Tax Act*<sup>1</sup> (**ITA**) to “enhance the efficiency and effectiveness of tax audits and facilitate the collection of tax revenues on a timelier basis”<sup>2</sup>. These proposed amendments were included in the August 2024 Draft Legislation and include enhanced information gathering provisions, two new penalties for non-compliance and changes to the normal reassessment period to extend the time that the Minister has to reassess a taxpayer in certain situations.

We support the government’s objective of maintaining regulatory compliance and maximizing efficiency in the audit process. However, the proposed amendments in the August 2024 Draft Legislation present challenges and impediments for taxpayers that should be brought to the Government’s attention. We believe that these proposed provisions do not include appropriate procedural protections or appeal rights, are overbroad and are unnecessarily onerous for taxpayers. Instead of providing certainty and predictability for taxpayers, these proposed amendments create uncertainty and lend themselves to abuse. Several of the proposals can infringe fundamental rights owed to all Canadians including solicitor-client privilege and *Charter* rights and thus are vulnerable to Court challenge.

The “Audit Powers Working Group” (**APWG**) was struck by the Joint Committee on Taxation to review these proposals and make a submission to the Department of Finance with suggestions for improvement. The APWG has identified concerns which have been divided into four categories: 1) enhanced information gathering; 2) the penalty for a notice of non-compliance (**NNC**); 3) the automatic penalty for a compliance order; and 4) the suspension of the normal reassessment period (“tolling”). For each category, recommendations have been made to improve the legislation.

We believe that these rules need to strike a better balance between facilitating efficient audits and the rights of taxpayers to protect their interests by protecting privileged communications from disclosure and meaningfully challenge the Minister’s decisions where appropriate.

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<sup>1</sup> *Income Tax Act*, RSC 1985, c.1 (5<sup>th</sup> Supplement) as amended.

<sup>2</sup> Canada, Department of Finance, *Tax Measures: Supplementary Information* (Ottawa: Department of Finance, 2024) at 31.

## **Executive Summary**

The following table summarizes the concerns and recommendations in the four categories, which are further detailed in the submission below:

Category	Concern	Recommendation
<b>1. Enhanced Information Gathering</b>	Compelling answers under oath requires greater procedures to ensure Charter rights are protected.	Legislative safeguards must be included in the legislation to protect taxpayer rights.
<b>2. Penalty for the NNC</b>	The NNC penalizes taxpayers for legitimate reasons for non-compliance without any defences. The appeal process creates inconsistencies, and the penalty unduly targets unsophisticated taxpayers.	The legislation should replace the administrative appeal process with a substantive right of appeal to the Federal Court.
<b>3. Automatic penalty for a compliance order</b>	The penalty for a compliance order creates inequities and requires a case-by-case analysis that should be determined by the Federal Court when a compliance order is granted.	The legislation should allow the Federal Court to impose penalties in the case of a successful compliance order based on egregious conduct.
<b>4. Suspension of the normal reassessment period</b>	There are different tolling period results where the NNC is vacated by the Minister versus the Court. Tolling related to non-arm's length persons creates undue uncertainty.	There should be no tolling if a Court vacates the NNC.  The tolling period for non-arm's length parties should be removed or amended to require some connection to the information being requested.

### **1. Enhanced Information Gathering**

#### **a) Power to compel responses orally, under oath or affirmation or by affidavit**

Proposed section 231.41 would provide the Minister with the authority to require a person to provide responses orally, under oath or affirmation or by affidavit to a domestic requirement letter, a foreign-based information or document requirement letter, or queries posed under the general audit power. Equivalent provisions are to be proposed for other tax statutes, including the Excise Tax Act (**ETA**) but no proposed legislation has been drafted.

First, the power to compel testimony under oath or affirmation is unnecessary because the Canada Revenue Agency (**CRA**) already has extensive powers to (i) compel taxpayers to produce documentation when requested and (ii) punish taxpayers who provide false or misleading information. For instance:

- The ITA contains administrative penalties that can be assessed on taxpayers that do not respond to audit information requests.<sup>3</sup>

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<sup>3</sup> For example, paragraph 162(7)(b) allows the CRA to assess a penalty on a taxpayer that has failed to comply with a duty or obligation imposed by the ITA or regulation.

- The ITA provides criminal penalties for failure to comply with audit requests.<sup>4</sup>
- Failure to provide information can disadvantage a taxpayer in subsequent legal proceedings.<sup>5</sup>
- The CRA may apply to the Federal Court for a compliance order to compel taxpayers or other persons to provide any access, assistance, information or document sought by the CRA during an audit<sup>6</sup> after which those taxpayers or other persons could be subjected to contempt of court proceedings and resulting fines or imprisonment.
- The CRA has the authority to make inferences and assumptions and to assess on that basis<sup>7</sup>. The assessment is deemed valid and binding<sup>8</sup> after which the taxpayer then has the onus to “demolish”<sup>9</sup> those inferences and assumptions.
- The ITA and other taxing statutes already contain provisions to penalize taxpayers who provide untruthful answers to the Minister: (i) during an audit, (ii) in response to a requirement letter, or (iii) in a return filed with the Minister.<sup>10</sup>
- Taxpayers can be (and have been) criminally convicted for providing untruthful representations or documents to the CRA during an audit.<sup>11</sup>

Given the broad powers that the Minister already has to compel truthful answers and information from taxpayers, requiring taxpayers to provide information under oath or affirmation does not make it easier for CRA to audit. Rather, the result is increased compliance costs for ordinary taxpayers. Ordinary taxpayers, including individuals and small businesses, will now be required to incur significant costs to hire legal counsel to protect their rights when required to give information under oath or affirmation. This is wholly unnecessary given the existing powers already possessed by the Minister.

Second, the legislation as currently drafted does not contain checks and balances on the use of this power. In the United States, the Internal Revenue Service (**IRS**) has the power to summon various persons including taxpayers, officers, employees or third parties to provide testimony under oath.<sup>12</sup> However, the IRS also provides various procedural protections to ensure that the rights of witnesses are protected including the right to request that proceedings be recorded<sup>13</sup> and the right to be represented

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<sup>4</sup> ITA 238.

<sup>5</sup> For example, ITA 231.6(8) provides that a taxpayer failing to provide certain foreign-based information cannot later use that foreign-based information in subsequent civil proceeding relating to the administration or enforcement of the ITA.

<sup>6</sup> A compliance order may be issued by a judge after a taxpayer is found guilty of an offence under ITA 238(1) after a failure to comply with requests to provide documents to the CRA in the course of an audit. A compliance order could also be issued by a judge on application by the Minister under 231.7(1).

<sup>7</sup> *Minister of National Revenue v. Cameco Corporation*, 2019 FCA 67 at 28.

<sup>8</sup> ITA 152(8).

<sup>9</sup> See generally *Johnston v. Minister of National Revenue*, [1948] S.C.R. 486 (S.C.C.); *Hickman Motors Ltd. v. The Queen*, 97 DTC 5363 (S.C.C.); *Sarmadi v. Her Majesty the Queen*, 2017 FCA 131; and *Eisbrenner v. Her Majesty the Queen*, 2020 FCA 93.

<sup>10</sup> See for example s. 163(2) and s. 239 which deal with administrative and criminal penalties, respectively.

<sup>11</sup> For example, see *R. v. Scholz*, 2020 BCPC 120, aff'd 2022 BCCA 129, and *R. v. Global Enviro Inc.*, 2011 ABQB 32.

<sup>12</sup> 26 USC §7602(a)(2).

<sup>13</sup> Internal Revenue Service, *Internal Revenue Manual* IM 25.5.5.4.4 (31 July 2024).

by counsel.<sup>14</sup> A summons may also not be issued while a matter is under criminal investigation<sup>15</sup> as this would lead to obvious constitutional concerns (which would result in any evidence gathered being inadmissible in Court or a stay of proceedings<sup>16</sup>). We would prefer to see procedural protections included in the legislation rather than having taxpayers rely on administrative policies of the CRA. In any event, this legislation must comply with the rights and freedoms guaranteed by the *Canadian Bill of Rights* or enshrined in the Charter. The Minister of Justice should be consulted before this legislation is presented to the House of Commons (discussed later).

Third, compelled oral testimony under oath or affirmation would disproportionately harm smaller taxpayers. The tax system implicitly recognizes that smaller taxpayers do not have the same means to resolve tax disputes as larger taxpayers. For example, individuals and corporations may file a less detailed notice of objection than a “large corporation”<sup>17</sup>. The Tax Court of Canada (TCC) rules allow taxpayers with disputes involving a relatively small amount of tax to use the streamlined “Informal Procedure.” Informal Procedure allows taxpayers to be self-represented or represented by an accountant and does not require a discovery process. The requirement for compelled testimony under oath would allow the CRA to conduct its own discovery process even though the dispute resolution system in the ITA and the TCC rules forgoes discovery for expediency and cost effectiveness. The power to compel testimony by oath, affirmation or affidavit should be used sparingly.

### **Recommendations for Category 1**

- a) **The proposal to require taxpayers to provide information by oath or affirmation should be abandoned or at least include procedural protections to ensure that the power to compel oral testimony under oath or affirmation is used appropriately**

We are of the view that the proposal to require taxpayers to provide information by oath or affirmation should be abandoned. Should Finance insist on implementing this new power, then at a minimum the same procedural protections afforded to U.S. taxpayers should be afforded to Canadians.

## **2. Penalty for a Notice of Non-Compliance**

Proposed section 231.9 will allow the Minister to send or serve a person with a NNC when the Minister has determined that the person has not complied in full or in part with a requirement issued under one of the sections listed in subsection 231.9(1) (a “Requirement”). A person sent or served with a NNC is liable to a penalty of \$50 for each day the NNC is outstanding to a maximum of \$25,000.<sup>18</sup>

A person who receives an NNC may, within 90 days after the day on which the NNC is sent or served, request in writing to the Minister that the NNC be reviewed.<sup>19</sup> The Minister will vacate a NNC when it determines that it was “unreasonable” to issue the NNC or that the person had, prior to the issuance of the NNC, done everything reasonably necessary to comply with each requirement or notice in respect of which the NNC was issued,<sup>20</sup> Should the Minister confirm or vary the NNC, the person may apply for a

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<sup>14</sup> Ibid at IM 25.5.5.4.2

<sup>15</sup> 26 IRC 7602(d)(1).

<sup>16</sup> See discussion below with respect to the penalty under subsection 231.7 with respect to potential charter remedies.

<sup>17</sup> ITA 165(1.11).

<sup>18</sup> Proposed subsection 231.9(11).

<sup>19</sup> Proposed subsection 231.9(4).

<sup>20</sup> Proposed subsection 231.9(6).

judicial review of the Minister's decision. The Federal Court would then either confirm the decision or vary or vacate the NNC if the judge determines that the Minister's decision was "not reasonable".<sup>21</sup>

We have several concerns with the proposed NNC regime.

First, we have concerns that the NNC may be issued against taxpayers that have complied with their lawful obligations under the ITA, or who have made reasonable and *bona fide* efforts to do so. The penalty can be applied when it was "reasonable" for the Minister to conclude that a person has not complied with a Requirement. The penalty may be justified against taxpayers that choose to ignore requests for information without justification.

However, proposed section 231.9 does not appear to permit consideration of the legality of the underlying Requirement. In practice, many disputes with respect to purported non-compliance by a taxpayer with a Requirement relate not to factual questions of whether the taxpayer has complied with the Requirement or had taken reasonable steps to do so, but to legal questions as to whether or not the taxpayer was required to comply with such Requirement. There are a number of instances where a taxpayer could lawfully refuse to respond to a Requirement including where the Requirement seeks information (i) that is subject to privilege, (ii) in respect of unnamed third parties without proper judicial authorization under subsection 231.2(3), (iii) which is sought for the purposes of a criminal investigation (in violation of sections 7 of the *Charter*),<sup>22</sup> or (iv) which is *ultra vires* the CRA's audit powers (i.e., where information is not sought for the *bona fide* purposes of administering the ITA).

One area of frequent disputes between taxpayers and the tax authorities is over the production of privileged documents. Under the proposed NNC regime, if a taxpayer refuses to provide information on the basis that the information is subject to privilege, and the Minister does not agree that the information is privileged, the Minister could issue an NNC on the basis that the taxpayer has "not complied" with the Requirement. This could have a chilling effect on the ability of taxpayers to make *bona fide* privilege (or other) claims, and raises significant constitutional concerns.

The Supreme Court of Canada has held that solicitor-client privilege is "fundamental to the justice system in Canada" and must be "jealously guarded and only set aside in the most unusual circumstances, such as a genuine risk of wrongful conviction."<sup>23</sup> The Minister should not be permitted to issue an NNC – which it can do without judicial authorization – when a taxpayer has refused to provide information on the basis of solicitor-client privilege. The issuance of an NNC in these circumstances could pressure the taxpayer into "waiving" privilege rather than go through the lengthy and time-consuming process required to dispute the NNC. Since such a compelled waiver is not a valid waiver, the production of documents arising from the issuance of an NNC in those circumstances would likely be considered to constitute an unreasonable search or seizure in violation of s. 8 of the *Charter*.

Second, we also have concerns that the proposed standard of review – reasonableness – may lead to inappropriate results and is unworkable in some cases. Reasonableness review focuses on the decision made by the decision maker (e.g., the Minister) including the justification offered for it and not on the

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<sup>21</sup> Proposed subsection 231.9(8).

<sup>22</sup> *R. v. Jarvis*, 2002 SCC 73, at para. 96.

<sup>23</sup> *R. v. McClure*, 2001 SCC 14 at para. 2, repeated again in *Pritchard v. Ontario (Human Rights Commission)*, 2004 SCC 31 at para. 17.

conclusion the court itself would have reached.<sup>24</sup> Reasonableness review is based on “judicial restraint” and serves “to uphold the rule of law, while according deference to the statutory delegate’s decision”.<sup>25</sup> It is not clear the extent to which a reviewing court will consider the validity of issuing the Requirement in its reasonableness review.

There are two ways of reading proposed section 231.9. One reading presumes the underlying Requirement was validly issued and that the taxpayer was required to comply with it, such that the only issue for the Minister or the Federal Court to assess on appeal is the taxpayer’s compliance with the Requirement, and the reasonableness of the determination of non-compliance. Under this reading, both the Minister and the Federal Court lack jurisdiction under proposed section 231.9 to consider the legality of the underlying requirement or whether the taxpayer was required to comply with it. An alternative reading of that section is that the Minister or the Court could consider such issues, but only in assessing the reasonableness of the issuance of the NNC and/or the taxpayer’s steps to comply with it or the reasonableness of the Minister’s decision to uphold the NNC.

Under either reading of these provisions, their effect is to deny taxpayers an opportunity to assert a meaningful defence to the imposition of a penalty. Under the first reading, the lawfulness of the Requirement or of the Taxpayer’s non-compliance is simply irrelevant to what the Minister and/or the Federal Court may consider on appeal. If this reading is correct, the proposal is simply untenable and an affront to the rule of law. While the second reading would permit consideration of such arguments, it subjects them to an inappropriate standard of review. Considerations of the legality of a Requirement or of a taxpayer’s *Charter* right to refuse to comply with one (e.g., under sections 7 or section 8 of the *Charter*) are questions of law “that are of fundamental importance and broad applicability”, with significant legal consequences for the justice system as a whole or for other institutions of government”, subject to review on a standard of correctness.<sup>26</sup> As the Supreme Court noted in *Vavilov*, subjecting such decisions to a correctness standard “is necessary for the proper functioning of the justice system”.<sup>27</sup> Under this second reading, the standard of review of reasonableness is incompatible with that objective, and again, is inconsistent with the rule of law. Under either reading of proposed section 239.1, the proposed standard of review is untenable.

The NNC regime is procedurally unworkable in circumstances where a taxpayer has exercised their right to refuse to produce a privileged document in response to a Requirement. If the Minister disagreed with the taxpayer’s privilege claim, she would likely construe the taxpayer’s refusal to produce the document as non-compliance with the Requirement (we note that, this is consistent with the Minister’s current practice of seeking compliance orders to resolve privilege disputes). It is unclear how a reviewing court would review the reasonableness of the Minister’s determination that the underlying document was not privileged. In general, in such judicial review cases, the reviewing court is limited to considering the administrative decision in light of the evidence provided to the administrative decision maker. But here,

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<sup>24</sup> As the Supreme Court of Canada noted in *Vavilov* “[T]he focus of reasonableness review must be on the decision actually made by the decision maker, including both the decision maker’s reasoning process and the outcome. The role of courts in these circumstances is to review, and they are, at least as a general rule, to refrain from deciding the issue themselves. Accordingly, a court applying the reasonableness standard does not ask what decision it would have made in place of that of the administrative decision maker, attempt to ascertain the “range” of possible conclusions that would have been open to the decision maker, conduct a *de novo* analysis or seek to determine the “correct” solution to the problem.” See *Canada (Minister of Citizenship and Immigration) v. Vavilov*, 2019 SCC 65 [“**Vavilov**”] and *Mason v. Canada (Citizenship and Immigration)*, 2023 SCC 21 [“**Mason**”].

<sup>25</sup> *Mason* at 57.

<sup>26</sup> *Vavilov* at paras. 59-62.

<sup>27</sup> *Vavilov*, at para 59.

the Minister is not entitled to review the best evidence, namely the underlying document, does this mean that a reviewing court could not consider such evidence? This is unworkable. A correctness standard of review is required not merely because matters of procedural fairness are reviewed on a correctness standard<sup>28</sup> - although that should be sufficient – but because the alternative is procedurally unworkable.

The proposed standard of review also raises the possibility of inconsistent determinations by the Federal Court in respect of the same fact pattern, which would undermine the rule of law and public confidence in the tax system. For example, a taxpayer asserts that it has fully complied with a Requirement, and the Minister asserts that it has not. Under proposed subsection 231.9(8), the Minister's issuance of an NNC (and the resulting penalty) could be upheld if the Minister's determination under subsection 231.9(6) was considered to be "reasonable". However, under section 231.7, the same Federal Court may reject the Minister's application for a compliance order if it determines that the Minister's position, while reasonable, is not correct. The prospect of a taxpayer being penalized under proposed section 231.9 for a failure that is subsequently determined not have occurred is an affront to principles of fundamental justice and the rule of law.

This is not a hypothetical concern. In the recent case of *Canada (National Revenue) v. Zeifmans LLP*, 2023 FC 1000, currently under appeal before the Federal Court of Appeal, the Minister's decision to issue a requirement under subsection 231.2(1) was upheld as "reasonable" on judicial review by the Federal Court but was subsequently found to be incorrect by the Federal Court when the Minister sought a compliance order under subsection 231.7.

The Minister may also vacate an NNC when the person had, prior to the issuance of the notice, "done everything reasonably necessary to comply with each requirement or notice in respect of which the notice of noncompliance was issued."<sup>29</sup> This language gives broad administrative discretion to the Minister to coerce the taxpayer into providing information over which legitimate legal questions arise, including but not limited to privilege. Furthermore, an "everything reasonably necessary" standard is unrealistically high. A taxpayer should be expected to take reasonable action to comply with a Requirement; however, the taxpayer should not be expected to identify *every* reasonable action to comply with a Requirement. Where taxpayers take reasonable steps to comply with a requirement, but fail to do so, they should not be subject to a penalty merely because the Minister can, with the benefit of hindsight, point to alternative actions taxpayers may have taken to comply with the Requirement. Set out below is an example of such a situation.

#### Example 1 Failure to do everything reasonably necessary

The CRA issues a Requirement – with a 30-day deadline for response – to a corporate taxpayer asking for a copy of a share purchase agreement relating to the cost base of the shares of a subsidiary purchased 30 years earlier. The taxpayer, believing that such records are maintained in files preserved by their corporate secretary group at a third-party storage company, requests delivery of those files. The taxpayer recovers those files and, after sorting through them, reports back to the CRA that it cannot find a copy of that agreement. The 30-day deadline expires and the CRA issues an NNC. The taxpayer appeals and on appeal, the Minister asks the taxpayer if it requested a copy of the agreement from the law firm who assisted them on the original transaction.

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<sup>28</sup> *Law Society of Saskatchewan v. Abrametz*, 2022 SCC 29.

<sup>29</sup> Proposed subsection 231.9(6).

Since the taxpayer did not request a copy of the agreement from the law firm, the Minister could determine that the taxpayer did not do *everything* reasonably necessary to comply with the Requirements and reject the appeal. Here, the taxpayer took reasonable steps to comply with the Requirement. The fact that the taxpayer did not canvass *every* possible reasonable option should not expose the taxpayer to penalty.

Lastly, the NNC penalty will have a disproportionate impact on small taxpayers. Small taxpayers are less likely to assert their rights than larger taxpayers when faced with the prospect of being issued an NNC. Small taxpayers are less likely to have access to specialized legal expertise and resources for protracted legal disputes with the CRA. Indeed, we note, in many instances, the cost of pursuing the proposed NNC appeal mechanism may cost more than the maximum fine imposed thereunder. Many of the Charter concerns we discuss below with respect to the proposed penalty for compliance orders would also arise for small taxpayers subject to an NNC. The threat of a penalty, coupled with the cost and complexity of contesting an NNC, may compel small taxpayers to respond to unlawful CRA demands for information, in breach of their constitutional right against unreasonable searches and seizures. This concern is aggravated under the NNC regime, since the amount of the penalty will accrue during the period in which the taxpayer contests, in good faith, whether they are required to provide further information. Similarly, the proposed penalties may be so disproportionate to the alleged wrongdoing on the part of the taxpayer to constitute a “penal consequence” entitling the taxpayer to greater procedural protection.

## **Recommendations for Category 2**

### **Replace the administrative appeal process for an NNC with a right of substantive appeal to a court**

In our view, the proposed NNC regime will simply create additional disputes and delay the audit process without resolving substantive disputes between taxpayers and the CRA. As noted above, the committee is concerned that the proposed regime, and the administrative appeal process therefrom, by emphasizing the reasonableness of the Minister’s decision to issue an NNC does not permit consideration of the legality of a Requirement in the course of an audit (i.e., its correctness). Taxpayers may have legitimate reasons for refusing to respond to a Requirement which is not properly addressed under the proposed NNC regime. These concerns could be addressed by replacing the proposed administrative appeal process in proposed subsections 239.1(4) through (9) with a right of substantive appeal to an independent court, based on a correctness standard, consistent with the penalty regimes elsewhere in the ITA. Such a process would also align with the compliance order regime under section 231.7, thus avoiding the risk of inconsistent findings by the Federal Court when asked to issue a compliance order and proposed section 231.9. However, since such a process would simply duplicate the existing compliance order regime under section 231.7, it highlights the dubious value of the proposed NNC regime suggesting it should be eliminated entirely.

Furthermore, consistent with the recommendation below with respect to the penalty regime for non-compliance orders, the NNC penalty should not apply to taxpayers whose non-compliance with a Requirement is based on a good faith dispute over the nature and extent of their obligations. Taxpayers – particularly smaller taxpayers – should not be forced to choose between waiving their rights or risking a penalty – this is likely to be a particular concern for small or unsophisticated taxpayers. Taxpayers should only be subject to a penalty where they show an indifference to whether the ITA is complied with or show a wilful, reckless or wanton disregard for the law, similar to the standard imposed for existing penalties. Taxpayers who reasonably dispute their liability to comply with a Requirement or who have

taken reasonable steps to comply with a Requirement should not be penalized simply because a court determines, after the fact, that they have further obligations.

### **3. Automatic Penalty for a Compliance Order**

Proposed subsection 231.7(6) provides for the automatic assessment of a penalty against a person where the Federal Court has issued a compliance order under subsection 231.7(1). The penalty is calculated as 10% of the aggregate amount of tax payable by the taxpayer for each year in respect of which the compliance order was issued. The penalty does not apply if the amount of tax payable for each taxation year to which the compliance order relates is less than \$50,000.<sup>30</sup> The quantum of the penalty is unrelated to the conduct of the taxpayer or the amount of tax in dispute making this provision punitive.

We have several concerns with the proposed penalty.

First, the penalty should not apply automatically. The proposed penalty provision is arbitrary and does not provide discretion for a decision maker to determine an appropriate penalty consistent with the regulatory purposes of the ITA. Nor does it contain a threshold of misconduct to be met before the penalty can be applied. For other penalties, the ITA contains terms to signal egregious behavior such as “culpable conduct”<sup>31</sup> or “gross negligence” which are not found in this proposed penalty.<sup>32</sup> Any penalty should be proportionate both to the taxpayer’s wrongdoing and the amount at tax at issue, consistent with the regulatory purposes of the ITA. A penalty that is “out of proportion to the amount required to achieve regulatory purposes” may constitute a true penal consequence such as to attract the criminal procedural protections of s.11 of the *Charter*.<sup>33</sup>

The following examples illustrate the arbitrary, unfair and disproportionate nature of the proposed automatic penalty.

#### **Example 2 – A substantially compliant CCPC**

An auditor issues a Requirement to a Canadian-controlled private corporation (**CCPC**) asking for 100 documents relating to three taxation years. In each of those taxation years, the CCPC had tax payable of \$200,000. The company provides 95 documents and takes the position that the remaining documents are covered by solicitor-client privilege. The CRA seeks a compliance order, and the Federal Court determines that there is insufficient evidence to establish that two of the documents are privileged. The company would be subject to the automatic penalty even though it was substantially compliant. The amount of the penalty would be based on the amount of tax payable for the relevant taxation years and could be substantial. In this case, the penalty would be \$60,000 (\$200,000 x 10% x 3 years). A penalty does not seem warranted given the substantial compliance of the taxpayer and the *bona fide* nature of the dispute.

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<sup>30</sup> Proposed subsection 231.7(7).

<sup>31</sup> ITA 163.2(1) “culpable conduct”.

<sup>32</sup> ITA 163(2).

<sup>33</sup> *Guindon v. Canada*, 2015 SCC 41 at para. 77.

### Example 3 – A third party requirement

An insurance company with annual tax payable of \$100M receives a requirement for unnamed client information that it believes requires judicial authorization pursuant to subsection 231.2(2). The client information is unrelated to the insurance company's tax payable but relates to a potential dispute between the clients and the CRA over \$1M of tax payable. The CRA obtains a compliance order. The insurance company, which is simply taking steps to protect the legitimate interests of its client, is subject to a penalty of \$10M. The penalty is grossly disproportionate to the conduct of the insurance company, given the *bona fide* nature of the objection and the disconnect between the magnitude of the penalty and the tax in dispute.

In all the foregoing examples, the imposition of the penalty bears no relationship to any wrongdoing or misconduct on the part of the taxpayer, nor any relationship to the amount at tax issue. The penalty simply serves as a sledgehammer to coerce taxpayers into giving up information that they may have a legal basis to retain. The penalty is arbitrary, unfair, and potentially so disproportionate to the regulatory purposes of the CRA as to constitute a “true penal consequence” subject to the procedural protections of the Charter<sup>34</sup>. Indeed, the “administrative” penalty contemplated under proposed section 231.7(6) for failing to comply with a CRA Requirement would, in the above examples, be significantly higher than the *maximum* fine arising as a result of a criminal conviction for wilfully failing to comply with the same statutory provisions (e.g., \$25,000) under section 238, even though a criminal conviction, of necessity requires deliberate, wrongful, non-compliance.

Compliance proceedings are the only mechanism in the ITA for taxpayers and CRA to resolve disputes as to the legality of CRA demands for information at the audit stage. Penalizing taxpayers for being unsuccessful will discourage them from advancing *bona fide* disputes and asserting their legitimate rights. This is particularly true for third party Requirements, where the person subject to the Requirement (and potential penalty) is not the person whose interests and rights are at stake. As noted above, with respect to the proposed NNC regime, in many instances, compliance proceedings arise as a result of *bona fide* disputes as to the CRA's legal entitlement to the information requested. The threat of an automatic penalty if unsuccessful in compliance proceedings may coerce taxpayers to comply with unlawful CRA requirements (e.g., requests for privileged information, requests for information about unnamed third parties without judicial authorization, etc.) rather than risk an enormous penalty if their *bona fide* position is determined to be incorrect.

Where the threat of penalties compels production of information that CRA is not entitled to obtain, the demand for such documents constitutes an unreasonable search and seizure contrary to section 8 of the Charter. Not only does that possibility raise concerns about the constitutional viability of the proposed penalty regime, it also raises the concern that information obtained from a taxpayer under the threat of such penalties (which, in theory, could be all information obtained through CRA demands for information, since failure to comply with such demands could result in compliance proceedings and a potential penalty) could result in the granting of *Charter* remedies against the CRA, including (i) excluding of evidence obtained by the CRA, (ii) in criminal cases, obtaining a stay of proceedings against the taxpayer, or (iii) vacating of the CRA's re-assessment of the taxpayer.<sup>35</sup>

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<sup>34</sup> A “true penal consequence” triggers Charter protection under Section 11. The SCC has stated that a “true penal consequence” could exist if “the amount at issue is out of proportion to the amount required to achieve regulatory purposes.” See *Guindon v. Canada*, 2015 SCC 41 at 77 [Guindon].

<sup>35</sup> See *O'Neill Motors Ltd. v. R.* 1995 CANLII 10935 (TCC), *aff'd* *Canada v. O'Neill Motors Ltd. (C.A.)*, 1998 CANLII 9070 (FCA).

Second, the proposed compliance order penalty would treat similar taxpayers differently. For instance, partnerships generally do not pay income tax and would not normally have any tax payable under the ITA. Similarly, many trusts are administered in such a way as to have minimal tax payable for a relevant year (e.g., by allocating income to beneficiaries). Such entities would fall below the *de minimis* threshold of \$50,000 of tax payable for the compliance order penalty to apply. For example, an accounting firm structured as a professional corporation would have income tax payable and be potentially subject to the penalty. However, an accounting firm structured as a limited liability partnership would never have income tax payable and therefore avoid the penalty. Similarly, a mutual fund corporation which unsuccessfully disputes a Requirement could be subject to a penalty whereas a mutual fund trust which unsuccessfully disputes an identical Requirement in identical circumstances would not. The different results in these circumstances are arbitrary and unjustified.

### **Recommendations for Category 3**

#### **Assess the compliance order penalty only in cases of egregious conduct**

The proposed compliance order penalty would apply automatically without regard to the wrongdoing or misconduct on the part of the taxpayer, nor with any relationship to the amount of tax at issue. The proposed penalty is arbitrary, unfair, and potentially so disproportionate to the regulatory purposes of the ITA as to constitute a “true penal consequence” requiring increased procedural protections. Furthermore, the threat of a penalty may compel taxpayers to comply with unlawful CRA requests for information, violating taxpayer’s rights against unreasonable search and seizure under the Charter. We believe that this penalty should only apply in egregious cases of non-compliance, consistent with the other penalty provisions in the ITA. Any penalty should be imposed on a discretionary basis and carefully tailored to the regulatory purposes of the Act based on the taxpayer’s circumstances.

The preferred alternative would be to amend subsection 231.7(3) to allow a judge to impose a penalty not exceeding a specific amount, where the conduct of the taxpayer giving rise to the compliance order is determined by the judge to show an indifference to whether the ITA is complied with or shows a willful, reckless or wanton disregard for the law, similar to the standard imposed for existing penalties under the ITA. In assessing the amount of the penalty, the nature of the taxpayer’s misconduct should be considered and not the taxpayer’s tax payable for the year (which might be unrelated to the dispute or the failure to comply). Such a standard should be sufficient to penalize wrongful conduct without forcing taxpayers to choose between asserting their rights or avoiding a potentially significant penalty.

Alternatively, or in addition to the preferred alternative, if the Minister is concerned that the sanctions for contempt of court are too modest to compel compliance with compliance orders (which, we note, the proposed penalty regime does nothing to address, since it applies when a compliance order is issued, not when the taxpayer fails to comply with it), the Government could provide for more rigorous sanction for non-compliance with a compliance order. This would catch situations such as in *Canada (Minister of National Revenue) v. Middleton*, 2006 FC 455, *Canada (Minister of National Revenue) v. Marshall*, 2006 FC 788, *Canada (National Revenue) v. Cicarelli*, 2018 FC 644, and *Canada (National Revenue) v. Becelaere*, 2007 FC 409. Indeed, the obvious solution would be to delete section 231.7(4) and subject taxpayers who fail to comply with a compliance order to general criminal penalties for non-compliance with their obligations under the ITA in section 238 or to create a separate offense for such non-compliance with a compliance order with appropriate criminal sanctions. We note that, once a compliance order has been issued, the concerns above with respect to *bona fide* disputes between taxpayers and the CRA significantly disappear as there has been a final judicial determination of the taxpayer’s rights and obligations vis-à-vis the underlying CRA demands for information. In our view a

criminal sanction for wrongful non-compliance, along with the stigma associated with such a conviction, would be more effective at deterring such behaviour than a mere administrative penalty.

#### **4. Suspension of the Normal Reassessment Period**

Under the ITA, the Minister may reassess a taxpayer within the “normal reassessment period.” Beyond that period, the Minister is only able to reassess a taxpayer in narrowly prescribed circumstances.<sup>36</sup> The normal reassessment period is suspended if the taxpayer seeks judicial review of a request for information or documents or while the Minister is pursuing a compliance order. The existing legislation recognizes that in some situations the CRA may need more time or will not have all the information when assessing. For example, there is a three-year extension for transactions between non-resident, non-arm’s length persons.<sup>37</sup>

The proposed legislation significantly expands the circumstances under which the normal assessment period is suspended (referred to in this submission as “tolling”). The proposed legislation, if enacted, would suspend the reassessment period for additional time periods including:

- the time during which a person who does not deal at arm’s length with a taxpayer has a judicial review pending in respect of a notice of a requirement under subsection 231.2(1) in respect of the taxation year of the taxpayer;
- the time it takes to dispose of an application for a compliance order filed by the Minister for a person who does not deal at arm’s length with the taxpayer in respect of the taxation year of the taxpayer;
- the time that an NNC is outstanding in respect of the taxpayer or a person who does not deal at arm’s length with the taxpayer in respect of the taxation year of the taxpayer; and
- the time that it took for a judge to vacate a NNC sent to or served on a taxpayer or on a person who does not deal at arm’s length with the taxpayer in respect of the taxation year of the taxpayer starting on the date the taxpayer or non-arm’s length person applied to have the NNC reviewed.

##### **a) Different treatment when a NNC is vacated by the Minister than by a court**

As noted earlier, an NNC can be vacated by the Minister or by the Federal Court after judicial review. An unusual feature of the proposed tolling amendment is that the normal reassessment period is not stopped when the NNC is vacated by the Minister but is stopped for the period of time it takes for the Federal Court to vacate the NNC. When an NNC is vacated in either case, the NNC is deemed never to have been sent or served.<sup>38</sup> However, when the NNC is vacated by the judge, the reassessment period is suspended from the date the person applies with the court to vacate the NNC and the date the court disposes of the judicial review.<sup>39</sup>

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<sup>36</sup> See ITA 152(4).

<sup>37</sup> S. 152(4)(b)(iii).

<sup>38</sup> ITA 239.1(9).

<sup>39</sup> See proposed paragraph 231.8(1)(f).

#### Example 4 – Vacating the NNC and tolling

The CRA requests from a Canadian taxpayer 50 documents and provides a due date of 15 days, 30 days before the end of the normal reassessment period. The taxpayer is not able to respond in 15 days. The CRA issues an NNC, and the normal reassessment period is suspended. The taxpayer seeks a second level review.

##### *Outcome #1 – The Minister vacates the notice*

The Minister finds the request to be unreasonable and vacates the notice after 180 days. The notice is deemed never to have been sent and the normal reassessment expired 165 days ago.

##### *Outcome #2 – Federal Court vacates the notice*

The Minister upholds the notice. The taxpayer seeks judicial review, and the Court vacates the notice on the basis that the request was unreasonable. You would expect that the normal reassessment period would have expired. However, even though the taxpayer won, the CRA has an additional 15 days as the normal reassessment period was suspended for the judicial review period. In effect, the CRA extended the normal reassessment period to continue the audit when it would otherwise be precluded from doing so by making an unreasonable request.

#### **b) The tolling period and non-arm's length parties**

As noted earlier, the proposed legislation suspends the normal reassessment period for a taxpayer where a non-arm's length party has applied for a judicial review of an audit requirement in respect of the taxation year of the taxpayer or has been issued an NNC in respect of the taxation year of the taxpayer that has not been vacated by the Minister. The stated purpose of the tolling provisions is to address situations where the CRA is requesting the information it needs to accurately review and reassess a taxpayer's filing position and, because of proceedings to challenge those information requests, the time runs out to properly review the requested information.<sup>40</sup>

There are a number of concerns with these proposed rules.

First, the normal reassessment period of a taxpayer can be suspended for actions beyond the taxpayer's control or because of audit scrutiny of a non-arm's length person with tax issues that have nothing to do with the taxpayer. The connection between the taxpayer and the non-arm's length person is contained in the phrase "in respect of the taxation year of the taxpayer". However, even with this revision, the scope remains uncertain.

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<sup>40</sup> The Budget Supplementary Information states that "[t]hese rules are intended to ensure that the CRA has the time to properly review any information obtained before expiry of the statutory reassessment period fixed by the *Income Tax Act*."

This statement is consistent with the Budget Supplementary Information when subsection 231.8(1) was first introduced in 2018, which states "[c]ontesting requirements for information and compliance orders effectively shortens the period during which the CRA may reassess a taxpayer, thus hampering the ability of the CRA to reassess in a timely fashion and on the basis of complete information."

Second, the scope of what constitutes non arm's length is fluid and uncertain. Taxpayers that are unrelated for tax purposes could still be considered non-arm's length. The determination of whether two or more persons deal at arm's length is a question of fact<sup>41</sup>. Typically, non-arm's length status is determined at a point in time and in relation to a particular transaction or bargain.<sup>42</sup> The scope of factual non-arm's length relationships is unclear and broader than what is generally considered to be a corporate group. For example, the Federal Court of Appeal recently held that a taxpayer was non-arm's length with a third party for the purposes of facilitating a certain transaction, stating that the arm's length test verifies whether the relationship between transacting parties is such that the terms of the deal reflect ordinary commercial dealings.<sup>43</sup> The TCC originally found that the same relationship was arm's length.<sup>44</sup>

Non-arm's length status can also change over time and the proposed provisions do not specify at what point in time that determination is made for these provisions. For example, the CRA may be auditing a transaction between the taxpayer and its former parent company which is arm's length at the time of the audit. It is unclear whether the point in time to determine non-arm's length status is the time of the transaction under audit, the time of the audit, or another time. It is inherently unfair to suspend a taxpayer's normal reassessment period in such potentially broad and changing scenarios.

The legislative proposals appear to be trying to target situations such as where CRA issues a Requirement on a parent company for documents relevant to the subsidiary's tax position. In those situations, the test applied to satisfy full disclosure in a TCC proceeding may provide helpful guidance. This requires a taxpayer to disclose documents within their "possession, control, or power" where control includes documents that the taxpayer has the right to obtain.<sup>45</sup> If information meets that description, the Requirement that was issued to the non-arm's length party can be issued directly to the taxpayer. If not, then the information is genuinely outside the taxpayer's control and tolling the taxpayer's limitation period for that information is unfair.

Third, if the CRA applies the tolling based on a person being non-arm's length and the taxpayer disagrees (and eventually objects to the reassessment), it is unclear whether the onus is on the Minister to prove these parties were factually non-arm's length (similar to the Minister's onus for establishing misrepresentation) or whether the Minister can rely on assumptions that the taxpayer has the onus to demolish to support the right to toll the limitation period.

Fourth, taxpayers have no way of knowing whether tolling has begun or ended. There is no proposed notification of the taxpayer that a non-arm's length person is engaging in one of these processes (and such a notification could violate section 241 of the Act for providing taxpayer information) so the taxpayer may be unable to track when their limitation period is expiring. The lack of procedural protections for taxpayers who are tolled because of matters involving non-arm's length persons would seem to violate the principles of fundamental justice.<sup>46</sup> At a minimum, we would expect that these

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<sup>41</sup> ITA 251(1)(c).

<sup>42</sup> *RMM Canadian Enterprises Inc v R*, [1997] TCJ No 302 (TCC) at para 39; *McNichol v R*, [1997] 2 CTC 2088 (TCC) at para 16.

<sup>43</sup> *Canada v Microbjo Properties Inc*, 2023 FCA 157 at paras 78 - 90.

<sup>44</sup> *Damis Properties Inc v The Queen*, 2021 TCC 24 at paras 140 - 204.

<sup>45</sup> Tax Court of Canada Rules (General Procedure), Rule 82.

<sup>46</sup> The *Canadian Bill of Rights*, SC 1960, c. 44, s.2(e) provides that every law of Canada, unless stated otherwise, is to be construed and applied as not to abrogate, abridge or infringe or to authorize the abrogation, abridgment or

taxpayers be notified of the tolling and provided the opportunity to make representations with an appeal mechanism.

Moreover, from the perspective of CRA, it is unclear how CRA's systems would attempt to track the extent of the tolling. It seems that any time a judicial review is filed, a compliance order application is filed, or a NNC is issued, the CRA should assess which non-arm's length parties are tolled (at a time when the CRA lacks requested information for reviewing the taxpayer's affairs) and track the tolling in the CRA's systems. This is complicated and difficult to manage.

Limitation periods are meant to promote certainty, avoid stale evidence, encourage diligence, and bring repose.<sup>47</sup> There are exceptions and extensions to limitation periods for situations including misrepresentations, waivers, non-arm's length non-resident transactions, unreported tax shelters, and unreported reportable transactions.<sup>48</sup> Those exceptions are precise and focused — they do not apply to the entire tax return but only to what reasonably may be regarded as relating to the cause of opening a particular taxation year.<sup>49</sup> We commend the efforts in the recent update to the proposed legislation to narrow the tolling of non-arm's length persons to situations where the Minister is requesting information "in respect of the taxation year of the taxpayer". However, even with this revision, the scope remains uncertain and overbroad, for those reasons outlined above. For example, it is not obvious how to determine whether the Minister's information gathering is related to the taxpayer or to a specific taxation year. Further, the tolling applies to the taxpayer's taxation year, rather than issues that can reasonably be regarded as relating to the information requested sought by the Minister through these processes.

These proposals for non-arm's length persons create complexity and uncertainty without addressing the stated purpose of the draft legislation.

#### **Recommendations for Category 4**

##### **a) There should be no tolling if a Court vacates a NNC.**

There is no reason there would be no tolling period when a NNC is vacated by the Minister but a tolling period when a NNC is vacated by the Court.

##### **b) Eliminate the tolling of the normal reassessment period for matters involving non-arm's length persons**

The proposed amendments would toll the normal reassessment period for a taxpayer throughout the time when any non-arm's length person has sought judicial review of information requests,<sup>50</sup> is the subject of compliance order proceedings or has been sent or served a NNC.

We recommend removing the references to non-arm's length persons in the proposed amendments to subsection 231.8(1). However, should you wish to toll the normal reassessment period in circumstances involving non-arm's length persons, we recommend that you clarify what "in respect of the taxation

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infringement of certain rights including *inter alia* the right to a fair hearing in accordance with the principles of fundamental justice for the determination of rights and obligations [Bill of Rights].

<sup>47</sup> *Markevich v Canada*, 2003 SCC 9 at para 17; *Inwest Investments Limited v R*, 2015 BCSC 1375 at para 84.

<sup>48</sup> *Income Tax Act*, ss 152(4)(a)(i), (a)(ii), (b)(iii), (b.1), (b.5) (among others).

<sup>49</sup> *Income Tax Act*, s 152(4.01).

<sup>50</sup> Specifically, requirements under subsections 231.1(1), 231.2(1), and 231.6(2).

year of the taxpayer” means. The condition should require that the tolling only apply to the extent that an assessment can be reasonably regarded as relating to the information requested sought by the Minister through these processes.

### **Additional Comments**

#### **a) Auditor General Review of CRA Audit Powers**

The Government made significant changes to the CRA’s audit powers in 2022. The impact of those audit powers has not been assessed. Nevertheless, the Government is now expanding those audit powers when there has been no assessment to demonstrate that the changes in 2022 were ineffective.

#### **b) Consultations with taxpayers**

Before making significant changes to CRA’s audit powers, greater consultation with taxpayers is needed to understand how the tax system operates and the how the current audit powers are being used.

#### **c) Consultation with the Minister of Justice**

The *Canadian Bill of Rights* requires the Minister of Justice to ascertain whether any proposed legislation introduced in or presented to the House of Commons by a Minister of the Crown complies with the Bill of Rights.<sup>51</sup>

We have copied the Minister of Justice to ensure that the rights guaranteed by the Bill of Rights are protected based on the concerns outlined in this submission.

### **Concluding Remarks and Next Steps**

We appreciate the opportunity to provide this submission. We would be pleased to answer any questions you may have. Please do not hesitate to contact Ryan Minor, Director, Tax at CPA Canada at [rminor@cpacanada.ca](mailto:rminor@cpacanada.ca).

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<sup>51</sup> See Bill of Rights, supra note 47 at s. 3(1).