

Blakes

2023 CPTS Fall Lecture Series

Potpourri of CRA Audit
and Tax Litigation Topics

October 11, 2023

Ahmed Elsaghir & Abbey Kind

Agenda

1. CRA Audit Topics:

- a) Oral Interviews
- b) Privilege

2. Tax Litigation Topics:

- a) Adverse Inferences
- b) Expert Evidence



CRA Audit Topics



Oral Interviews

Oral Interviews – Overview

- CRA has various powers

- “inspect, audit or examine any document...” (s. 231.1(1)(a))
- “examine any property or process, or matter relating to, a taxpayer...” (s. 231.1(1)(b))
- “enter any premises or place where any business is carried on...” (s. 231.1(1)(c))
- “require a... person to give... all reasonable assistance, to answer all proper questions...” (s. 231.1(1)(d))
- “require that any person provide... any information... or any document” (s. 231.2(1))
- “to make such inquiry as the person may deem necessary with reference to the administration or enforcement of the Act” (s. 231.4(1))
- “make... one or more copies” of any document that has been seized, inspected, audited, examined or provided (s. 231.5(1))
- “require that a person... provide any foreign-based information or document” (s. 231.6(2))

Oral Interviews – Overview

- CRA has the ability to require a person to answer all “proper” questions
 - to answer questions orally
 - to answer questions in writing
- Meaning of “proper”?
 - Given a broad interpretation
 - Must relate to the administration or enforcement of the ITA. Cannot be used to determine penal liability under section 239
 - Queries into the mental state or *mens rea* required to prove ITA offences are not proper
 - Questions that are speculative or argumentative, clearly irrelevant, or that could reveal privileged information may be considered improper
- Limitations?
 - Privilege, relevance, fishing expeditions, etc.

CRA's Ability to Compel Oral Interviews – Cameco

- **Facts**

- In the course of an audit regarding the application of the transfer pricing rules, the CRA requested that employees of Cameco, including those of its foreign subsidiaries, attend interviews and to answer questions orally.
- Cameco refused to require its employees to answer orally but did offer to respond to questions in writing.
- When the taxpayer did not comply with the request, the Minister brought a summary application in the Federal Court for a compliance order under subsection 231.7(1) to direct Cameco to comply.

CRA's Ability to Compel Oral Interviews – Cameco

- **Federal Court Decision**

- The Federal Court dismissed the Minister's application.
- The Minister appealed the Federal Court's decision to the Federal Court of Appeal.

- **Federal Court of Appeal Decision**

- **Main Issue on Appeal:** Whether the Minister can require employees of a corporation to attend for interviews and compel oral answers to questions posed by CRA auditors.
- **Minister's Arguments:**
 - The power afforded by paragraph 231.1(1)(a) to "inspect, audit or examine the books and records of the taxpayer" includes the ability to compel oral interviews of a taxpayer or employees.
 - The Minister argued that the Latin root of the word "audit" means "to hear", which implies an element of orality.
 - The ability to compel oral answers is integral to the Minister's audit powers in the context of a self-reporting system.

CRA's Ability to Compel Oral Interviews – Cameco

- **Federal Court of Appeal Decision**

- The FCA concluded that paragraph 231.1(1)(a) cannot be interpreted so as to permit the Minister to compel oral interviews of a taxpayer or its employees concerning its tax liability.
- **FCA's Reasoning:**
 - The ordinary meaning of "audit" is not oral examination.
 - Paragraph 231.1(1)(d) (as it read at the time) only required the owner or manager of the property or business and any other person on the premises or place to answer all proper questions relating to the administration or enforcement of this Act. The FCA emphasized that the disposition of this appeal turns on the scope of the power in s. 231.1(1)(a).
 - Reading the power in s. 231.1(1)(a) in the context of s. 231.1(1)(d) reinforces the intention of Parliament that the Minister has, at a minimum, full, unimpeded access to the records of the taxpayer.

CRA's Ability to Compel Oral Interviews – Post-Cameco

- **Legislative Amendments**

- In response to the FCA's decision in Cameco, Budget 2021 proposed amendments to the Tax Act to give CRA officials the authority to require persons to answer questions orally.
- The legislative changes came into effect on December 15, 2022.
- Paragraph 231.1(1)(d) now reads as follows:

231.1(1) An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act,

...

(d) require a taxpayer or any other person to give the authorized person all reasonable assistance, to answer all proper questions relating to the administration or enforcement of this Act and

(i) to attend with the authorized person, at a place designated by the authorized person, or by video-conference or by another form of electronic communication, and to answer the questions orally, and

(ii) to answer the questions in writing, in any form specified by the authorized person; ...

Privilege

Blakes

Categories of Privilege

- **Solicitor-Client Privilege**

- Confidential communications (including documents) between solicitors and their clients for the purpose of seeking, formulating or giving legal advice.

- **Common Interest / Deal Privilege → Exception to Solicitor-Client Privilege**

- Separately represented parties with common legal interests may share information with each other and their respective attorneys without waiving solicitor-client privilege.

- **Litigation Privilege**

- Communications made and documents prepared with specific litigation in mind, whether contemplated or ongoing, the dominant purpose of which is to assist in the litigation.

- **Settlement Privilege / Without Prejudice Communications**

- Protects the confidentiality of communications and information exchanged for the purpose of settling a dispute.

Canada (National Revenue) v BMO Nesbitt Burns Inc, 2022 FC 157

- **Federal Court Decision**

- The Minister brought a summary application seeking an order requiring the Respondent to comply with the Minister's Request for Information to provide an unredacted copy of a document titled "Master Summary Pricing Model" (the "**Spreadsheet**").
- The Respondent, BMO Nesbitt Burns Inc., opposed the order and claimed solicitor-client privilege over the redacted portions of the Spreadsheet.
- The Federal Court found that the Respondent did not meet its burden to establish that the redactions in the Spreadsheet reveal the legal advice or are otherwise solicitor-client communications.
- The Federal Court held that the Spreadsheet is not protected by solicitor-client privilege and granted the Minister's summary application. The Respondent was ordered to produce an unredacted copy of the Spreadsheet.

BMO Nesbitt Burns Inc v Canada (National Revenue), 2023 FCA 43

- **Appeal to the Federal Court of Appeal**

- BMO Nesbitt Burns Inc. appealed the Federal Court's decision to the Federal Court of Appeal. The Appellant argued that the Federal Court's order to produce the unredacted Spreadsheet would reveal privileged legal advice.
- It was undisputed that the Appellant had received legal advice and such advice was privileged.
- At issue was whether the Appellant met the burden of proving that providing the unredacted Spreadsheet would reveal the privileged legal advice.
- The Federal Court of Appeal agreed that this burden was not met.

632738 Alberta Ltd v The King, 2023 TCC 117

- **Facts**

- The Appellant was assessed under subsection 103(1) (partnership reallocation provision).
- The Appellant's officer refused to answer certain questions during oral examination on discovery ("**Disputed Questions**") that were designed to elicit the reason or purpose for which certain transactions were undertaken on the grounds that the information was protected by solicitor-client privilege.
- The Respondent (the Crown) brought a motion for an order directing the officer to answer the Disputed Questions.

- **Position of the Respondent**

- The Respondent submitted that the nature of the reassessment – which requires a determination of the principal reason for the allocation of income by a partnership – put into issue the reason for that income allocation and certain other transactions and therefore counsel was entitled to examine the officer in respect of those reasons.
- The Respondent submitted that the Appellant was misusing solicitor-client privilege in refusing to answer questions about the purposes of certain transactions.
- The Respondent also submitted that, if solicitor-client privilege otherwise would apply, the Appellant had implicitly waived privilege.

632738 Alberta Ltd v The King, 2023 TCC 117

- **Tax Court of Canada Decision**

- No implied waiver of privilege.
 - A taxpayer does not put its state of mind at issue merely because it opposes an assessment that is based on a section of the Act that contains an intention or purpose test.
 - A state-of-mind implied waiver requires more than the fact that the Appellant's purpose for entering into the transactions is at issue in the appeal. The implied waiver requires the Appellant to take the positive step of relying, in its pleadings or during trial, on legal advice that it previously obtained from its counsel.
 - The questions were relevant but the Appellant is not required to answer Disputed Questions where the reasons were informed by legal advice or constituted advice from a lawyer, such that those reasons are subject to solicitor-client privilege.
- **Notice of Appeal was filed with the Federal Court of Appeal on August 21, 2023.**

Gaudreau v The King, 2023 TCC 115

- **Facts**

- Individuals, including the Appellant, disposed of their interest in an insurance company.
- The sale was structured as a hybrid sale and the Appellant claimed the capital gains deduction.
- The Minister reassessed the Appellant, reporting the sale of the Appellant's interest in the insurance company as a deemed dividend pursuant to subsection 84(2) rather than a capital gain.
- During discovery, the Appellant revealed the existence of a memorandum related to the hybrid sale prepared by an accounting firm for the purchaser ("**Memorandum**") (the Appellant was the vendor).
- The parties agreed that the Memorandum is not subject to solicitor-client privilege.

- **Position of the Appellant**

- The Memorandum should not be produced because:
 - it was prepared by the accounting firm for the purchaser;
 - it contained only a description of transactions of which the Minister was already aware of and matters of "subjective opinion"; and
 - it contained no mention or discussion of subsection 84(2).

Gaudreau v The King, 2023 TCC 115

- **Tax Court of Canada Decision**

- It was determined that the documents did not contain privileged information or solicitor-client information.
- TCC stated that the preferred approach to the interpretation of subsection 84(2) involves an examination of the circumstances surrounding the transaction in question. After finding that the Memorandum was potentially relevant, TCC held that it should be produced as it was not protected by privilege.
 - It was necessary for the Minister to examine the steps that led to the liquidation of the business where there was a winding up of a business and a distribution of property to shareholders.
 - The Memorandum was potentially relevant as the document contained direct or indirect information relating to the winding up of the business.

Solicitor-Client Privilege Takeaways

- Solicitor-client privilege protects all communications, whether written or oral, between a solicitor (*i.e.*, a lawyer) and a client that are directly related to the seeking, formulating or giving of legal advice.
 - Internal documents in respect of legal advice including the development of strategy, the assessment of risk or the consideration of obligations might be protected by the privilege.
 - However, once a client has determined a course of action and has begun to implement that course of action, documents created during the implementation phase might not be protected by privilege.
- Solicitor-client privilege applies only to communications provided by a lawyer in the course of the lawyer's legal practice, and does not attach to advice provided by a lawyer in respect of purely business matters.
- A step-plan memorandum prepared by purchaser or vendor's accountants may be ordered to be produced where it includes information that is relevant to the surrounding circumstances.

Tax Litigation Topics



Adverse Inferences

Adverse Inferences

- At trial, an adverse inference can be drawn from a party's failure:
 - to call a witness, if:
 - the witness's evidence would have been central to establishing an important fact, or
 - the witness's evidence would have been superior to other similar evidence
 - to provide a key document
- *Prima facie* case must be established prior to an adverse inference being drawn.
 - Judge must be dissatisfied with the evidence before the court or have doubt
- An adverse inference will not be drawn where:
 - there is a risk of reversing the burden of proof (e.g., Minister's burden for gross negligence penalties), or
 - there is a risk of interfering with the strategic litigation choices of the parties

Adverse Inferences

- *Fiera Foods, 2023 TCC 140*
 - “I fail to see how the Appellant can be expected to track down individuals with first-hand knowledge of the activities of [certain payees the Appellant providing taxable supplies to] for a trial almost ten years after the end of the Relevant Period.”
- *1048547 Ontario Inc, 2023 TCC 24*
 - “In the case at bar, the testimony of all the Appellants was central to establishing the nature of the travel expenses made or incurred by Opco and disallowed by the auditor. However, I did not receive any credible explanations justifying [certain of the Appellants’] absence at the hearing. I find that I should draw an adverse inference from their failure to appear and that their testimony would have shown that the travel expenses were personal in nature and not related to Opco’s business.”

Adverse Inferences

- *Bowker, 2021 TCC 14*

- “No one is in a better position to provide evidence on Mrs. Bowker’s knowledge of DeMara’s activities and the circumstances which may have raised suspicions than Mrs. Bowker herself. [...] The Court would certainly have appreciated if the respondent had called Mr. Bowker to testify; however, the respondent also chose not to call Mr. Bowker to testify.”

- *Deyab, 2020 FCA 222*

- “The only objection set out in Mr. Deyab’s memorandum to the drawing of an adverse inference by the Tax Court Judge is the alleged failure of the Minister to first establish a *prima facie* case that Mr. Deyab had made a misrepresentation that was attributable to neglect or carelessness. In this case, substantial sums were transferred from M.D. Consulting to Mr. Deyab and his family which were not included in his income and were not reflected in the shareholders’ loan account. The Minister had, therefore, established a *prima facie* case that Mr. Deyab had made a misrepresentation in not including these amounts in his income for the years in question. [...] As a result, there is no basis to interfere with the drawing of an adverse inference against Mr. Deyab for failing to call his accountant or bookkeeper, or presenting a properly completed shareholders’ loan account reconciliation.”

Expert Evidence

Expert Evidence

- Section 145 of the TCC Rules (General Procedure)
- Forms of Expert Reports:
 - a) a solemn declaration made by a proposed expert witness under section 41 of the *Canada Evidence Act*;
 - b) a written statement signed by a proposed expert witness accompanied by a certificate of counsel indicating that counsel is satisfied that the statement represents evidence that the proposed expert witness is prepared to give in the matter; or
 - c) a written statement in any other form authorized by direction of the Court in a particular case and for special reasons.
- Contents of Expert Reports:
 - a) set out in full the evidence of the expert;
 - b) set out the expert's qualifications and the areas in respect of which it is proposed that they be qualified as an expert witness; and
 - c) be accompanied by a certificate in Form 145(2) signed by the expert acknowledging that they have read the Code of Conduct for Expert Witnesses set out in Schedule III and agree to be bound by it.
- Hot Tubbing (Experts' Panel)
 - Practice Note 22

Expert Evidence: The Scope of Lay Opinions is Expanding

- *Bell Telephone Company of Canada v The King, 2023 TCC 45*
 - The TCC excluded the parties' expert reports because it found that analyzing the Ontario energy market did not require technical expertise. Both electrical engineers testified as lay witnesses and the TCC relied on their testimony to conclude that the taxpayer had received a singly supply of electricity instead of multiple supplies.
 - Notice of Appeal was filed with the Federal Court of Appeal on May 12, 2023.
- *Canada (AG) v Mosaic Forest Management Corporation et al., 2022 FCA 216*
 - The FCA allowed the CFO to testify to the pricing used in the forestry industry.
 - The FCA held that lay witnesses may express an opinion where they meet the following criteria:
 - The lay witness is in a better position than the trier of fact to form a conclusion;
 - The conclusion is one that a lay person can make;
 - The lay witness has the necessary experience to draw the conclusion; and
 - The opinion is a “compendious mode of stating facts that are too subtle or complicated to be narrated as effectively without resort to conclusions”.
 - While the case management judge had concluded that the CFO's affidavit resembled an expert report without the expert qualifications the FCA allowed the CFO's affidavit which included data from industry reports and domestic and export markets to estimate the cost for another company to process logs.

Questions?

Blakes

For more information, please contact:



Ahmed Elsaghir

Associate, Calgary

+1-403-260-9655

ahmed.elsaghir@blakes.com



Abbey Kind

Associate, Calgary

+1-403-260-9616

abbey.kind@blakes.com

Blakes

Blakes Means Business