

Tax

CRA tax audit and criminal tax evasion investigation: What are taxpayers' Charter rights?

By David Rotfleisch



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(August 19, 2020, 2:30 PM EDT) -- In part one of this series, regarding the case of *Softcom Solutions v. Attorney General of Canada* 2020 ONSC 3290, I discussed Canadian software reseller Softcom and its promoters, Sonya Zenz and Wally Dove, who bought software for the retail industry, called Retail Manager, for \$1.5 million from a company in the Cayman Islands. The software was poor and they hired a software engineer to fix it; the software engineer billed Softcom \$11,000 for his services back in 1996.

Canada Revenue Agency (CRA) eventually gave Retail Manager a valuation between \$0 and \$22,000, as opposed to the \$1.5 million claimed by Softcom in its tax filings. This meant substantial denial of capital cost tax allowances for Softcom and its investors, as well as the eventual criminal investigation for tax evasion against Zenz and Dove.

The main CRA tax auditor was John Haisanuk; he came into contact with this file because Softcom applied for a tax shelter identification number in 1995. Haisanuk conducted a tax audit of Softcom from 1996 to 1999.

On May 30, 1997, Haisanuk referred the Softcom case to CRA's Special Investigation Unit to conduct a criminal tax evasion investigation. Haisanuk would later testify he had no knowledge or evidence of Softcom's criminal tax evasion in 1996, even though he had a suspicion of it.

Although CRA has very broad powers, different rules apply for normal tax audits for compliance and criminal tax evasion investigations, which trigger *Canadian Charter of Rights and Freedoms* protections for Canadian taxpayers.

So, if these CRA measures were carried out in the context of a criminal investigation, they would constitute Charter violations unless the taxpayers were informed that they were being investigated criminally and consented to such investigations without coercion.

Therefore, the key legal determination came down to whether Haisanuk was conducting a criminal tax investigation as an agent of the CRA's Special Investigation Unit from 1996 until he referred the case to CRA's Special Investigation Unit on May 30, 1997.

Did Softcom meet legal factors of *R. v. Jarvis* [2002] 3 S.C.R. 757?

The *Jarvis* decision pointed out that the existence of a merely reasonable ground for suspicion of criminal activity in the mind of the government investigator is insufficient to make a non-criminal investigation into a criminal one. Instead, judges must look at a whole host of factors:

- a) Did the authorities have reasonable grounds to lay charges? Does it appear from the record that a decision to proceed with a criminal investigation could have been made?
- b) Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?

- c) Had the auditor transferred his or her files and materials to the investigators?
- d) Was the conduct of the auditor such that he or she was effectively acting as an agent for the investigators?
- e) Does it appear that the investigators intended to use the auditor as their agent in the collection of evidence?
- f) Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer's *mens rea*, is the evidence relevant only to the taxpayer's penal liability? and
- 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?

The *Jarvis* ruling also expressed a concern that judges ought not to shackle government administrators' ability to impose non-criminal, administrative penalties. This presumption in favour of the government was further affirmed in *The Queen v. Tiffin et al.* 2008 ONCA 306, which states when the predominant purpose of a CRA tax investigation is neither clearly criminal nor regulatory/non-criminal, then the court must resolve the case in CRA's favour.

The court should only hold CRA to be conducting a criminal investigation when the predominant purpose of the investigation is clearly a criminal one. Applying the *Jarvis* factors, Justice Paul Schabas ruled in favour of the CRA on several key grounds.

First, Haisanuk's conduct during the tax audit was consistent with his own statement that he was primarily concerned with seeking documentation to support the taxpayers' position. Second, Haisanuk had nothing more than a mere suspicion that criminal wrongdoing had been done and had no reasonable and probable grounds to lay criminal charges.

Lastly, Haisanuk's contact with CRA's Special Investigation Unit was consistent with non-criminal tax audit conduct.

The last factor is arguably the most important takeaway from this case as it pertains to the application of the *Jarvis* test for future CRA criminal tax evasion investigations. The taxpayers in this trial focused on the repeated contacts initiated by Haisanuk with CRA's Special Investigation Unit to argue that the predominant purpose of his investigation was criminal since 1996.

Justice Schabas found the predominant purpose in these communications with the Special Investigation Unit was to seek advice for the tax audit. Particular emphasis was placed on the fact that CRA's Bellevue Special Investigation Unit officer Peter Heryat advised Haisanuk to continue his tax audit plan, as well as the taxpayers' failure to provide all the required documentation to the tax auditor.

Furthermore, the transfers of binders of Softcom documentation from Haisanuk to Terry Harder at CRA's Calgary Special Investigation Unit and then to Heryat were insufficient to constitute a transfer of Softcom's tax file or material to the Special Investigation Unit. The court considers the tax file to be transferred to the Special Investigation Unit only when a formal referral was made and the entire tax file was transferred.

There is no neon line test for the boundary between a normal tax audit and a criminal tax investigation. But the focus is clearly on the predominant purpose of the investigation.

This is part two of a two-part series. Part one: Difference between a CRA tax audit and a criminal tax investigation.

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