

Tax

Difference between a CRA tax audit and a criminal tax investigation

By David Rotfleisch



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(August 14, 2020, 12:26 PM EDT) -- The *Income Tax Act* gives the Canada Revenue Agency (CRA) the power to investigate criminal tax evasion as well as non-criminal tax issues by way of audit. CRA conducts a relatively small number of criminal tax evasion investigations, compared to the very large volume of non-criminal tax audits, for regular tax compliance.

Of course, the *Canadian Charter of Rights and Freedoms* guarantees a number of criminal procedural rights for anyone charged criminally, including tax evasion. When CRA conducts a criminal tax evasion investigation, these Charter-guaranteed rights would be triggered for the taxpayer under investigation.

***R. v. Jarvis*, Canada's legal test for criminal tax evasion investigation**

The legal test for determining whether a criminal tax evasion investigation has been carried out by the government of Canada is set forth in the 2002 Supreme Court of Canada decision *R. v. Jarvis* [2002] 3 S.C.R. 757.

The *Jarvis* standard for distinguishing the criminal tax investigation from the non-criminal investigation is formulated as a predominant purpose test: an investigation by the CRA is a criminal investigation if a criminal investigation was its predominant purpose.

When CRA is conducting a criminal tax evasion investigation, its tax investigators must respect the taxpayer's criminal procedural rights rooted in the Charter. In a non-criminal investigation, a CRA tax auditor or tax investigator will ask for records and will assess unfavorable tax audit results if the taxpayer does not comply.

However, in a criminal tax evasion investigation, the taxpayer is protected by the constitutional right against self-incrimination. For this reason, CRA has a dedicated department for criminal tax evasion investigation called the Criminal Investigations Program.

***Softcom Solutions v. Attorney General of Canada*: Violation of taxpayer's Charter rights?**

In the Ontario Superior Court decision *Softcom Solutions v. Attorney General of Canada* 2020 ONSC 3290, one of the issues addressed by the Court was whether the CRA's tax auditor's conduct constituted a violation of the taxpayer's Charter rights.

The facts surrounding this case are complex and date to the early 1990s. The taxpayers involved created a tax plan to form a company called Softcom that would purchase retail industry software called Retail Manager. The promoters, Sonya Zenz and Wally Dove, planned to raise money from investors, purchase this software from a company in the Cayman Islands, modify the software for the Canadian market and eventually sell this software to Canadian retailers.

At the time, reselling software was a common form of tax shelter.

This software was initially priced at \$2.2 million by the Cayman Islands vendor. Unable to raise the required financing, the promoters were able to negotiate a reduced purchase price of \$1.5 million. After they brought the software back to Canada, they hired a software engineer, Ron Boyd, to modify the software for Canadian use.

Boyd's involvement with Retail Manager was one of the central factual disputes. CRA alleged Boyd found the original software to be so flawed that he essentially rewrote the code and built useable software from scratch. Boyd billed \$8,700 for his work on Retail Manager, and he billed a total of \$11,000 for his work with Softcom. Furthermore, the software itself as of 1996 was designed to be only compatible with the soon to be obsolete MS-DOS system and not the newer Windows systems.

CRA eventually gave Retail Manager a valuation between \$0 and \$22,000, as opposed to the \$1.5 million claimed by Softcom in their 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.

Soon after the approval of the tax shelter application, Haisanuk further reviewed the material submitted by Dove, discussed with his colleague in CRA's tax avoidance department and decided to audit Softcom further in 1996. The tax audit would last from 1996 to 1999.

From 1996 to 1997, Haisanuk would communicate with other CRA officers in CRA's Special Investigation Unit several times before passing this file completely to CRA's Special Investigation Unit for criminal tax evasion investigation on May 30, 1997.

In late 1996, Haisanuk learned that CRA's Calgary Special Investigation Unit was working on a tax case related to Softcom. Haisanuk contacted Harder and sent him some documentation related to his work on Softcom.

Haisanuk also spoke to CRA's Bellevue Special Investigation Unit officer Peter Heryat about the Softcom tax file in 1997. Haisanuk sent Heryat a binder full of Softcom's documentation. Heryat replied that he recommended that Haisanuk continue with his tax audit and commented there was not much there for a criminal tax evasion investigation.

Lastly, Haisanuk contacted officer Michelle Levac from CRA's business valuation department regarding the valuation of Retail Manager. Levac consulted with another software valuation specialist working for the CRA and was told that the value of the software is entirely dependent on who made the software and their level of experience and expertise.

Levac did not inquire further into who made the original version of the software from Cayman Islands. Instead, she operated on the premise that Boyd had essentially made this software from scratch. Given that Boyd ended up billing Softcom only \$8,700 for software that had very little marketing potential even in 1996, Levac returned to Haisanuk with a valuation between \$0 and \$22,000 for Retail Manager.

On May 30, 1997, Haisanuk referred the Softcom case to CRA 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.

Prior to Haisanuk's referral of the Softcom file to Special Investigation Unit in May 1997, he had employed a number of standard tax audit procedures such as sending out a tax audit questionnaire for Dove to fill, asking the taxpayers for key documentation and conducting a field tax audit.

This is part one of a two-part series. In part two, I will discuss whether CRA was, in fact, conducting a criminal tax evasion investigation and whether the Charter rights of Canadian taxpayers were violated.

David Rotfleisch, david@taxpage.com, is the founding tax lawyer of Rotfleisch & Samulovitch P.C., a Toronto-based boutique tax law firm and is a certified specialist in taxation law. He appears regularly

in print, radio and TV and blogs extensively. With experience as both a lawyer and chartered professional accountant, he has helped startup businesses with tax planning, will and estate planning, voluntary disclosures and tax dispute resolution.

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