

# Current Issues for Accountants and Lawyers Dealing with Revenue Canada

A Presentation to the Edmonton Tax Lawyers  
And Accountants Discussion Group

## Duties and Obligations – “The Bind That Ties”.

Accountants, like other professionals, are often pulled in several directions at once. They have contractual duties imposed upon them by their clients and to the extent those duties are not specifically set out in their contracts they are standardized by their Rules of Professional Conduct. Accountants owe duties to their professional organization, to each other and to a limited extent to other professionals. And they have duties forced upon them by operation of law in the hands of Revenue Canada and ultimately the Tax Court of Canada. It isn't surprising then that occasionally these different forces result in conflict.

One such duty is that of confidentiality.

Tax planning is of necessity, a private matter. The communications between a client and an accountant and much of the work product regarding same are confidential. Unauthorized disclosure of those communications can bring civil liability and professional sanction.<sup>1</sup>

On the other hand, Revenue Canada are a nosy bunch. They believe that some taxpayers, left to their own devices, will fail to disclose revenue and to pay tax. This is not without some measure of justification. Accordingly, Revenue Canada regularly seeks confidential information from taxpayers' accountants.

Revenue Canada's demands will prevail, in most instances, over the taxpayers' rights of privacy in accounting records. As we all know, Revenue Canada has powerful investigative 'weapons' provided them in the *Income Tax Act*:

### S.231.1(1) Power of Inspection

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

- a) inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate

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<sup>1</sup> I.C.A.A. Code of Ethics – Rules of Professional Conduct s. 210

to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act, and

- b) examine property in an inventory of a taxpayer and any property or process of, or matter relating to, the taxpayer or any other person, an examination of which may assist the authorized person in determining the accuracy of the inventory of the taxpayer or in ascertaining the information that is or should be in the books or records of the taxpayer or any amount payable by the taxpayer under this Act,

and for those purposes the authorized person may

- c) subject to subsection (2), enter into any premises or place where any business is carried on, any property is kept, anything is done in connection with any business or any books or records are or should be kept, and
- d) require the owner or manager of the property or business and any other person on the premises or place to give the authorized person all reasonable assistance and to answer all proper questions relating to the administration or enforcement of this Act and, for that purpose, require the owner or manager to attend at the premises or place with the authorized person.”

## 231.2(1) & 231.6(1) Power of Required Production of Documents and Information

### 231.2(1)

“Notwithstanding any other provision of this Act, the Minister may, subject to subsection (2), for any purpose related to the administration or enforcement of this Act, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as is stipulated in the notice,

- a) any information or additional information, including a return of income or a supplementary return; or
- b) any document.”

### 231.6(2)

“Notwithstanding any other provision of this Act, the Minister may, by notice served personally or by registered or certified mail, require that a person resident in Canada or a non-resident person carrying on business in Canada provide any foreign based information or document.”

## 231.3(1) Power of Search & Seizure

“A judge may, on *ex parte* application by the Minister, issue a warrant in writing authorizing any person named therein to enter and search any building, receptacle

or place for any document or thing that may afford evidence as to the commission of an offence under this Act and to seize the document or thing and, as soon as practicable, bring it before, or make a report in respect of it to, the judge or, where the judge is unable to act, another judge of the same court to be dealt with by the judge in accordance with this section.”

#### 231.4(1) Power of Inquiry

“The Minister may, for any purpose related to the administration or enforcement of this Act, authorize any person, whether or not the person is an officer of the Department of National Revenue, to make such inquiry as the person may deem necessary with reference to anything relating to the administration or enforcement of this Act.”

and in the Criminal Code:

#### 487(1) Power of Search & Seizure

“A justice who is satisfied by information on oath in Form 1 that there are reasonable grounds to believe that there is in a building, receptacle or place

- a) anything on or in respect of which any offence against this Act or any other Act of Parliament has been or is suspected to have been committed,
- b) anything that there are reasonable grounds to believe will afford evidence with respect to the commission of an offence, or will reveal the whereabouts of a person who is believed to have committed an offence, or will reveal the whereabouts of a person who is believed to have committed an offence, against this Act or any other Act of Parliament, or
- c) anything that there are reasonable grounds to believe is intended to be used for the purpose of committing any offence against the person for which a person may be arrested without warrant,
  - c.1) any offence-related property,
    - may at any time issue a warrant under his hand authorizing a person named therein or a peace officer
- d) to search the building, receptacle or place for any such thing and to seize it, and
- e) subject to any other Act of Parliament, to, as soon as practicable, bring the thing seized before, or make a report in respect thereof to, the justice or some other justice for the same territorial division in accordance with section 489.1.”

Legislated penwork is truly more powerful than the sword. It can however, be used as a shield as well. In general, legislation which grants to the State powers over individuals

must be strictly interpreted. Further, confidentiality can be almost absolute if brought under the veil of privilege. Finally, all legislation is tempered by the rights proffered to individuals under the *Canadian Charter of Rights and Freedoms*.<sup>2</sup>

What follows is a discussion of some of the more contentious aspects of the above Income Tax Act provisions and taxpayers' defences.

### Limits of Investigative Authority

The powers of investigation under s. 231 are limited to "any purpose related to the administration or enforcement of the *Act*". The Courts have interpreted that phrase to mean relevance to the tax liability of some specific person or persons, or verification of compliance with the *Act*. Notwithstanding the broad words used, the purpose for which these sections can be used remains narrow.<sup>3</sup>

### What can be Inspected/Produced?

The inspection provisions allow audit and examination of "the **books and records** of a taxpayer and any **document** of the taxpayer or of any other person that relates or may relate to the information which is or should be in the books or records of the taxpayer or to any amount payable by him under this Act,"(231.1(1)(a)). Section 231.2 requires production of "any **document**".

Currently, "**document**" is defined in Section 231 to include "money, securities and any of the following, whether computerized or not: books, records, letters, telegrams, vouchers, invoices, accounts and statements (financial or otherwise)"

It has been said by some that the above definitions do not include tax planning memos and written opinions of the tax accountant. Revenue Canada holds a different view. At a Round Table discussion of the 1990 Canadian Tax Foundation Annual Conference the following statements were made:

"It is the department's general practice to request that accountants produce specific working papers for examination where those papers can reasonably be considered an extension of the client's records. In accordance with section 231.1 of the Act, the department expects accountants to produce these working papers upon request. There has been no recent change to this practice."

<sup>2</sup> Part I, *Constitution act, 1982*, enacted as Sch. B to the *Canada Act, 1982*, (U.K.) 1982, c.11

<sup>3</sup> *Canadian Bank of Commerce v. A.G. Canada* 62 DTC 1237 (S.C.C.)  
*James Richardson & Sons v. The Queen* 82 DTC 6204 (F.C.A.)  
*R. v. Bruyneel* 86 DTC 6119 (B.C.C.A.)  
*McKinlay Transport* 90 DTC 6243 (S.C.C.)

And

“When there is good reason to believe that additional relevant information, including tax-planning documentation, is in the possession of the accountant, and that information has not been provided in response to informal and formal written requests, a requirement under section 231.2 may be issued. Requests for tax-planning documentation are normally limited to circumstances in which the intention or purpose is crucial. This situation usually arises in the context of possible application of anti-avoidance provisions of the Act.”

Revenue Canada’s position has not changed since that discussion. Indeed, proposed changes to the Act may bolster their position.

Bill C-69, proposed certain changes. Although it died on the Order paper there is no reason to believe the changes will not be reintroduced. The Bill amended the definition of “**document**” to read “includes money, a security and a record”. It also added the following new definition of “**record**” to section 248: “includes an account, an agreement, a book, chart or table, a diagram, a form, an image, an invoice, a letter, a map, a memorandum, a plan, a return, a statement, a telegram, a voucher and any other thing containing information, whether in writing or in any other form”.

With the inclusion in the Act of this expansive definition, any doubt existing previously over whether “memoranda” or “plans” fall within the ambit of section 231 will evaporate. The only question will be whether the documents requested are relevant to the tax liability of a taxpayer or are necessary to verify compliance with the *Act*. Obviously, this must be addressed on a document by document basis.

### Confidentiality and Privilege

**“Where legal advice of any kind is sought from a professional legal adviser in his capacity as such, the communications relating to that purpose, made in confidence by the client, are at his instance permanently protected from disclosure by himself or by the legal adviser, except the protection be waived”**

**“The privilege protecting from disclosure communications between solicitor and client is a fundamental right -- as fundamental as the client to counsel itself since the right can exist only imperfectly without the privilege. The Courts should be astute to protect both”<sup>4</sup>**

When is tax advice not legal advice? To be sure, such advice is highly legalistic in nature regardless of the source. Notwithstanding that undeniable fact, our

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<sup>4</sup> *Descoteaux v. Mierzwinski* (1982), 141 D.L.R. (3d) 590 (S.C.C.)

Courts have distinguished advice and communications between taxpayers and accountants and the same advice between taxpayers and lawyers, extending privilege to lawyer-client communications and denying the same to accountant-client communications.

**“It is not at all strange that solicitor-client communications are privileged insofar as compellable evidence before the Courts concerned while those between an accountant and client are not. The purpose of the solicitor-client privilege is to ensure free and uninhibited communications between a solicitor and his client so that the rendering of effective legal assistance can be given. This privilege preserves the basic right of individuals to prosecute actions and to prepare defences ... I do not think there is an overriding policy consideration of this nature in the case of an accountant-client communication. An accountant may, as a matter of professional ethics, be required to keep communications and other information concerning his or her client confidential. But this is not founded upon the need to ensure an effective system of the administration of justice”**<sup>5</sup>

These principles are undoubtedly well known to those in attendance tonight. It should also come as no surprise that privilege can be extended to communications between a lawyer and an accountant as agent of a client or alternatively between the client and an accountant as agent of a lawyer.<sup>6</sup>

Under common law the solicitor-client privilege extends to all confidential communications and work product provided such privilege has not been waived or lost.<sup>7</sup>

The right of privilege in respect of tax matters has been modified by statute. Section 232 of the *Act* precludes the claim of privilege over “accounting records of a lawyer”. The true meaning of this phrase has been the subject of some conflicting case law.<sup>8</sup> It is fairly safe to assume, however, that it refers to the trust accounting records respecting the taxpayer in question.<sup>9</sup>

Assuming the same principles apply to the agent of the legal counsel and assuming such agent does not hold funds in trust for the client, privilege will then extend to the communications, books, records and documents (regardless of their statutory definition) of an accountant acting as agent of a lawyer or his client so

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<sup>5</sup> *Baron v. The Queen* 91 D.T.C. 5055 (F.C.A.)

<sup>6</sup> *Susan Hosiery Ltd. v. M.N.R.* 69 DTC 5278 (Ex. Cheq)  
*Southern Railway of British Columbia v. Deputy Minister of National Revenue* 91 DTC 5081 (B.C.S.C.)  
*Cineplex Odeon Corporation v. A.G. of Canada* 94 DTC 6407 (Ont. Gen. Div.)

<sup>7</sup> *Cineplex Odeon Corporation v. A.G. of Canada* supra - see note 6  
*Inter provincial Pipeline Inc. et al. v. M.N.R.* 95 DTC 5642 (F.C.T.D.)

<sup>8</sup> *Organic Research v. M.N.R.*, [1991] 1 C.T.C. 417 (Alta. Q.B.)

<sup>9</sup> *Southern Railway of British Columbia v. Deputy Minister of National Revenue*, supra – see note 6  
*Paquette v. M.N.R.* 92 DTC 6394 (F.C.T.D.)

long as those communications, etc. are produced for the purpose of assisting counsel to provide advice to the client or in preparation for litigation.

### Accounting Records v. Accounts

It is our experience that Revenue Canada regularly requests copies of accounts for the purpose of verifying both the amount and the type of services which have been provided to the client.

Some practitioners have adopted the view that Revenue Canada is entitled to solicitors' and their agents' accounts.<sup>10</sup> With respect, I disagree. At the very least, to the extent such accounts describe product, advice, and communications or even the amount thereof, they are privileged. Usually one cannot disclose nonprivileged information from the accounts without also breaching the client's privilege. Therefore, the whole of the documents must remain undisclosed. Support for this position is found in cases both new<sup>11</sup> and not so new.<sup>12</sup>

### Reversing Time

Consider the scenario in which a client requests the assistance of an accountant. The accountant produces work product which draws him to the conclusion that the client needs legal advice. Appropriate steps are taken on the client's behalf and the accountant's role changes to that of agent of the client for the purpose of communicating information. Is the earlier work product, now forwarded to the lawyer as necessary information for the purpose of obtaining legal advice, privileged?

The answer to that question is a qualified "yes".

The British Columbia Court of Appeal, in the case of *Hodgkinson v. Simms*, decided documents assembled by legal counsel for his brief were privileged, notwithstanding they were copies of originals which were not privileged.<sup>13</sup> The Court stated the copies were created with the dominant purpose of being used in the lawyer's brief.<sup>14</sup>

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<sup>10</sup> Rosenberg, T.M. *Reasonable Expectation of Profit and Other Issues of Current Interest (1996 Prairie Provinces Tax Conference)*

<sup>11</sup> *Morley et al v. Revenue Canada* 97 DTC 5264 (N.S.S.C.)

<sup>12</sup> *Mutual Life Assurance Company of Canada v. Deputy A.G. of Canada* 84 DTC 6177 (Ont. H.C.)  
*Southern Railway of British Columbia v. Deputy Minister of National Revenue*, supra – see note 6  
*James Dawson Dixon v. Deputy A.G. of Canada* 91 DTC 5584 (Ont. S.C.)

<sup>13</sup> *Hodgkinson v. Simms*, [1989] 3 WWR 132

<sup>14</sup> *Waugh v. Br. Ry. Bd.*, [1980] A.C.521

One might argue, depending on the facts, that the dominant purpose for which the work was produced changes upon the accountant realizing the need for legal assistance. Much would depend on the type of document, the purpose for its production originally, whether it has been disclosed to third parties and at what point in its production legal counsel became involved.

One way of dealing with originals which may or may not be privileged is to send them all to legal counsel who, in the face one or more of the various investigative procedures under the Act, may take appropriate steps.<sup>15</sup>

### Privilege - A Two Way Street

Communications between in-house counsel and an employer have long been held privileged.<sup>16</sup>

More recently, the Ontario Court of Appeal balanced, on the one hand, the right of the taxpayer to full discovery of all documents Revenue Canada relied upon in support of its assessment against, on the other hand, the right of privilege of Revenue Canada to a legal opinion provided by the Department of Justice. The taxpayer in *Pratt & Whitney Canada Inc v. The Queen* pled the requirement for full disclosure.<sup>17</sup> Justice Rand, of the Supreme Court of Canada, in *Johnston v. Minister of National Revenue* had previously stated the following: “It must, of course, be assumed that the Crown, as is its duty, has fully disclosed to the taxpayer the precise findings of facts and rulings of law which have given rise to the controversy.”<sup>18</sup>

The issue was decided, however, in the favor of Revenue Canada and its lawyers. A taxpayer’s right of full disclosure from the Crown is modified by its right to privilege in certain documents particularly when produced by legal counsel to the Minister in contemplation of or preparation for litigation.

### Accountant as Expert

It is not uncommon for expert accounting testimony to be required by legal counsel on issues such as business valuations, GAAP and forensic investigations. Clearly, such accountants’ services are required to assist in preparation of litigation and as such all communications, drafts, working papers and the like are privileged.<sup>19</sup>

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<sup>15</sup> *Regina v. Franklyn Cappell* 92 DTC 6591 s. 232(3.1) ITA

<sup>16</sup> *Crown Zellerbach Canada Ltd. v. Dep. A.G. Canada* 82 DTC 6116

<sup>17</sup> *Pratt & Whitney Canada Inc v. The Queen* 97 DTC 613

<sup>18</sup> *Johnston v. Minister of National Revenue* 3 DTC 1182

<sup>19</sup> *Nova v. Guelph Engineering* (1984), 30 Alta L.R. (2d) 183 (Alta C.A.)

However, the role of the accountant changes if he or she provides a report upon which it is hoped the Court will rely. At that point the accountant is putting himself or herself forward not as agent for one of the advocates, but rather as an independent expert with no alliances. The accountant will be subject to cross-examination on all facets of the expert report and may be required to disclose any earlier drafts in his or her possession and even the initial instructions from counsel.<sup>20</sup>

Knowing this, the accountant as expert and instructing counsel must always be mindful of the possibility their communications may some day see the bright lights of a courtroom. It is simply another reminder to conduct oneself according to the highest professional standards.

### Third Party Requirements

In response to Court rulings prohibiting “fishing expeditions”, ss. 231.2(2) and (3) were enacted.<sup>21</sup> These subsections allowed the Minister, in certain limited circumstances, to apply for Judicial authorization to impose upon any person the requirement to provide information or document(s) relating to one or more unnamed persons. The original legislation provided that before being granted authorization, the Minister had to prove:

- a) the person or group is ascertainable;
- b) the requirement is made to verify compliance with any duty or obligation under the *Act*;
- c) it is reasonable to expect, based on any grounds, information or past experience, that the person or group or any person of the group may have or may be likely to fail to comply with a duty or requirement under the *Act*; and
- d) the information or document is not otherwise more available.

In June of 1996, c) and d) above were repealed. To extend the metaphor, Revenue Canada can now obtain judicial authorization to use drift nets. One would expect a significant Charter challenge to the provisions as they presently stand.

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<sup>20</sup> *Olson (Stuart) Construction Inc. v. Sawridge Plaza Corp. et al.* (1996), 195 A.R. 94 (Alta Q.B.)  
*Vancouver Community College v. Phillips et al.* (1987), 20 B.C.L.R. (2d) 289 (B.C.S.C.).

<sup>21</sup> *James Richardson & Sons Ltd. v. M.N.R.*, [1984] CTC 345 (S.C.C.)

## Canadian Charter of Rights and Freedoms

Section 8 of the Charter guarantees us the right to be secure against unreasonable search or seizure.

Sections 7 and 11 provide, among other things, that we cannot be compelled to give evidence against ourselves.

The powers of investigation and information access granted Revenue Canada through sections 231.1 and 231.2 of the *Act*, as they existed prior to the amendments discussed above, which are search and seizure powers, have been deemed reasonable.<sup>22</sup>

It is said that we have a low expectation of privacy in respect of documents prepared for the primary purpose of determining the amount of tax owed by us and that, given the nature of our self reporting system, Revenue Canada must have these investigative powers to administer the system and fulfill its obligations to the citizens of Canada.

However, Revenue Canada must limit its use of those powers to a regulatory context.

In *R. v. Norway Insulation* an auditor, working on the advice of a member of Revenue Canada's Special Investigations group, obtained information which ultimately provided the basis for a search warrant.<sup>23</sup> His purpose in obtaining the information was not his routine audit but in fact was to assist Special Investigations. In excluding all evidence caught by the warrant the Court stated:

“...there appears to be a public interest to be served in ensuring that public officials who possess the ability to lay charges in quasi-criminal matters not be allowed unfettered powers of collecting evidence beyond the point where they have turned their minds from mere administration or regulation to prosecution.”

This case has been followed since in Alberta. Two very detailed decisions of Alberta Provincial Court Judge Fradsham in similar fact circumstances as the *Norway* case produced an identical result.<sup>24</sup> All of the evidence collected by Revenue Canada was excluded from use in evidence at Mr. Jarvis' tax evasion trial. The tainted evidence included verbal information provided by the taxpayer,

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<sup>22</sup> *McKinlay Transport*, supra – see note 3

<sup>23</sup> *R. v. Norway Insulation* 95 DTC 5328 (Ont. Gen. Div.)

<sup>24</sup> *R. v. Jarvis*, [1997] 5 WWR 461 and *R. v. Jarvis*, [1997] A.J. No. 636, Docket No. 60325974P10101,00102, 0103, 0104, 0105

documents obtained through a warranted search of the taxpayer's home, his accountant's home, and a Revenue Canada office, and records from the taxpayer's bank pursuant to a 231.2 Requirement.

The lesson of these cases is to inquire without fail, upon receipt of a request for cooperation or a requirement for information, as to the purpose of the request/requirement/demand. If the purpose goes beyond routine investigation of the tax liability of some specific person or persons or verification of compliance with the *Act*, your duty of confidentiality to your client may override your duty of strict compliance with the *Act*.

### Inquire no more

The Federal Court of Appeal recently eliminated the s.231.4 Inquiry as an investigative tool in the case of *Del Zotto et al. v. The Queen et al.*<sup>25</sup> The following are some comments by the majority of the Court:

“As I see it the s. 231.4 process is inherently oriented towards criminal prosecution.....” (p. 472)

“National Revenue....has no special right [to conduct a criminal investigation] merely by setting up an inquiry under s. 231.4, a procedure which establishes no safeguards for the taxpayer. The hearing officer appointed is not a judicial officer, nor are there any rules for the inquiry, except such guidance (see TOM) as suits the Crown. Although the taxpayer is entitled to counsel, “unless the hearing officer ....orders otherwise”, there is some doubt whether such an administrative proceeding the counsel would be entitled to question witnesses.” (p. 474)

“...I am of the view that s.231.4 of the Act violates s. 8 of the *Charter* and that striking the provision down under s.52.1 of the *Constitutional Act*, 1982 is an appropriate remedy”(p.474)

The majority of the Court determined the Inquiry process was merely a backdoor form of quasi-criminal or criminal investigation and was not to be tolerated in the light of the guarantees under the *Charter*.

### **Conclusion**

There is no one conclusion to be drawn from these cases. Revenue Canada must continue the unsavory task of enforcing our tax laws in order that we all don't retire to collective bankruptcy. As professionals, we must continue our high wire balancing act juggling the

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<sup>25</sup> *Del Zotto et al. v. The Queen et al* (1997), 147 DLR (4<sup>th</sup>) 457

rights of our clients, our professional duties and our duties to the law. The game continues.

Donald P. Mallon B.Sc., LL.B.