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CRIMINAL LAW, REGULATION & ENFORCEMENT NEWSLETTER

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Inside

TAX EVASION: HARD TIMES, BAD DECISIONS AND HOW TO AVOID THEM

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The era of "easy money" has come to an abrupt end. For some, the timing of the stock market meltdown coincided with their business failures. For others, the slide into a financial abyss happened earlier.

When times of financial crisis arise, people resort to whatever steps they think are necessary in order to protect their companies and themselves. Often, business people decide that paying their fair share of taxes can, or must, wait and as a consequence, this thinking translates into an individual's failure to file their tax returns. Some may think: "So, what if it is only a little money at stake?" For the Canada Revenue Agency (CRA), it matters and the CRA takes no pity on non-filers. Take 3 recent convictions as cases in point. All were relatively "insignificant" failures to file tax returns.

On February 26, 2009, Kevin Mitchell, a consultant from Willow Beach, Ontario pleaded guilty to a single count of failing to file his tax return and was fined $1,500.00 and given 60 days to pay. On the same date, Brian Masson, a commissioned salesman, pleaded guilty to a single count of tax evasion and a single count of GST evasion and he was fined a total of $7,334. And on March 2, 2009, Shirley Wheatley, a registered occupational nurse, pleaded guilty to three counts of failing to file returns and was fined a total of $3,000 and given six months to pay the fine.

The *Income Tax Act* makes the simple act of failing to file a tax return a criminal offence under section 238. The Crown only has to prove that the taxpayer did not file. The legal defence to the charge is based upon the concept of due diligence. Sometimes, a taxpayer can "win" on the basis of this defence. And as everyone knows, success in Court can never be guaranteed. An alternative is to deal with the problem before it becomes criminal in nature. This alternative involves making a voluntary disclosure. If an individual has not filed tax returns for previous years or has not reported all of his/her income, that person can still correct their tax affairs. They will not be penalized or prosecuted if they make a full disclosure before the CRA starts any action or investigation against that person.

The proliferation of non-filing cases has been matched by an ever increasing number of tax evasion cases. The CRA has boosted its numbers working on tax evasion cases whether it be local or international in nature. The phrase: "nowhere to hide" comes to mind. And coupled with this ever growing desire to police the tax reporting scene by the CRA, the Courts have been equally determined to send a message to the public that if convicted of tax evasion: "you, too, could go to jail". Take for example, the sentencing decision in the Moman case.

On March 18, 2009, the Provincial Court of Manitoba sentenced Robert Moman, the sole proprietor of Dream Builders, a proprietorship that specializes in the design and building of sunrooms and occasional general home renovations, to a year in jail and a fine of $97,127.00.

In December 2008, Moman was found guilty of failing to report more than $300,000 of business income for the tax years 1999 through 2002. He also failed to remit approximately $33,000 of GST.

In an era of hard times, it pays to think twice before you “do nothing” or “act unwisely”. And should you find yourself embroiled in a conflict situation with the CRA, contact us. We are here to help.

THE LONG ARM OF THE MINISTER OF NATIONAL REVENUE: REQUIRING PRODUCTION OF INFORMATION LOCATED OUTSIDE CANADA

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Non-compliance with the *Income Tax Act* (“ITA”) may be treated as a civil or criminal matter in some cases. Canada Revenue Agency (“CRA”) officers may use specific powers in order to obtain information relating to a tax audit or criminal investigation. Information and documents gathered by auditors may be turned over to criminal investigators in appropriate cases. Taxpayers who are the subject of an audit or investigation may wish to know the limits of CRA’s information gathering powers. The purpose of this article is to provide an outline respecting this issue and, in particular, the extent to which the CRA may use information gathered in the course of an audit in aid of a criminal investigation and the extent to which CRA may obtain information that is located outside of Canada.

Taxpayers and others are in general obliged to cooperate with auditors who have issued valid requirements to produce documents. A taxpayer who fails to comply with the requirements may be charged with a separate offence under section 238 of the ITA. Where the CRA has failed to issue a valid requirement (for example, by failing to obtain prior judicial authorization for a requirement that relates to information concerning unnamed persons) then a taxpayer may commence an application for an order quashing the requirement.

CRA auditors cannot use the civil enforcement powers in aid of an ongoing criminal investigation. Where the predominant purpose of CRA’s inquiry is the determination of penal liability, then CRA must use the criminal law enforcement powers set out in the ITA (for example, by obtaining search warrants) to obtain information and documents from a taxpayer. When a taxpayer is subject to an audit, the result of which may lead to a criminal investigation, taxpayers should look for factors which may signal that the CRA has begun a criminal investigation. Where a criminal investigation has been commenced, a taxpayer may be entitled to claim certain rights pursuant to the Canadian Charter of Rights and Freedoms, including the right against self incrimination.

Recent jurisprudence indicates that CRA auditors may require the production of information and documents located outside of Canada. The Federal Court of Appeal in the *eBay Canada Ltd. v Canada, 2008* FCA 348 (CanLII) (“eBay Canada”) decision indicates that where information sharing agreements exist, the CRA may require a Canadian company to produce that information, even if it is located on a server outside of Canada. Canadian companies and companies outside of Canada should consider whether or not they have entered into information sharing agreements that fall within the reach of the long arm of the Minister. The facts relating to the decision are outlined below.

In *eBay Canada* the Minister received a Federal Court order authorizing the Minister to issue a requirement to eBay Canada respecting unnamed persons pursuant to subsection 231.2(3) of the ITA. Section 231.2 provides the Minister with the power to require the production of information or documents for any purpose related to the administration or enforcement of the ITA. (Section 289 of the *Excise Tax Act* has a similar provision which may be used in connection with GST audits.)

eBay Canada was required to produce names, addresses and sales information for unnamed persons (identified as “power sellers”) who had Canadian addresses. Power sellers were persons who had achieved a threshold level of revenue from eBay Canada sales. The CRA suspected that there were approximately 10,000 power sellers, but did not know their identities. The CRA required the information in order to determine whether the power sellers were tax compliant. Information respecting power sellers was stored

on a computer server located outside of Canada. The information was made available to eBay Canada via its computer technology in Canada. eBay Canada had an information sharing agreement with eBay International and its U.S. parent company.

eBay Canada applied to the Federal Court to review and set aside the order authorizing the requirement. It took the position that CRA was seeking to require the production of "foreign-based" information (addressed in section 231.6 of the ITA). eBay Canada argued that CRA was seeking foreign-based information because the information was located on a server located outside of Canada. Section 231.6 defines "foreign-based information or document" which, in part, reads "any information or document that is available or located outside of Canada". In dismissing eBay Canada's application the Federal Court held that the location of the server was irrelevant, that the electronically stored information was available to eBay Canada in Canada and, as such, the required information was not foreign-based.

eBay Canada appealed. In dismissing the appeal the Federal Court of Appeal noted that eBay Canada had entered into an information sharing agreement and that "with a click of a mouse" the information was accessible in Canada by eBay Canada (even though it was stored on a server outside of Canada). It did not agree that information must be downloaded in Canada (not just readable on a computer screen) before it can be said to be "located in Canada". This was rejected as being "formalistic in the extreme". The Federal Court of Appeal held that the information was located in Canada because it was readily accessible in Canada.

Taxpayers should consider their circumstances having regard to the *eBay Canada case*. One result of the *eBay Canada case* may be the issuance of more requirements relating to income tax or GST audits. Another result may be the reaction of the Canadian corporations and corporations outside of Canada who may be may be well-advised to review their information sharing agreements in order to address potential disclosure risk.

ONTARIO COURT LIMITS INTERROGATION POWERS

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The Ontario Divisional Court has held that Ministry of Environment investigators do not have the power to compel a witness to answer questions or produce documents once there is reasonable grounds to believe an offence has been committed. This limitation applies even if the witness is not the subject of the investigation.

The decision effectively brings to an end a practice the MOE has adopted in recent years of obtaining court orders to compel witnesses or employees to answer questions under what have been referred to as "Inco Orders".

Background

Investigators under provincial statutes have various powers that are set out in the governing legislation. MOE investigators typically rely on powers in the *Environmental Protection Act* and the *Ontario Water Resources Act*. Investigators in other ministries, in turn exercise their powers under "their" legislation such as the *Occupational Health and Safety Act* or the *Securities Act*. These powers are typically much broader than the common law powers of a Peace Officer.

A key distinction in any investigative regime is the point when "reasonable and probable grounds that an offence has been committed" is found to exist. Prior to that point, the right to question, investigate and obtain information is generally quite broad. It includes powers such as can be found in s.156 of the EPA to compel employees or third parties to answer questions, allow access to property, produce documents and allow samples to be taken.

Once "reasonable and probable grounds" exist however, other considerations of fairness to the accused or potential accused come in to play. The decision of the Court of Appeal in *R.v. Inco* in 2001 made it clear for instance, that under the EPA, once such grounds existed, the powers under s.156 of the EPA could no longer be used.

The court in *Inco* however also stated that a new (at that time) section of the EPA (S.163.1(2) - a section that was not directly before it as it came into effect after the facts that gave rise to Inco) would allow for the techniques to be used if application was made to the court for an order to that effect. These are the orders known as “Inco Orders”.

The Branch decision - a new limit

In a decision released this January, the Divisional Court has ruled that “Inco Orders” are not permitted by the EPA and that the court has no jurisdiction to compel a witness such as an employee of a company under investigation to be interrogated and answer questions or produce documents once “reasonable and probable grounds are found to exist”.

Branch, an employee of Clean Harbours, challenged an Inco Order that had been obtained by the investigator on the grounds that such an order was contrary to his right to life, liberty and security of the person under s. 7 of the Canadian Charter of Rights and Freedoms. The court did not rule on the Charter point. Instead, the court found that the plain language of the statute did not authorise the court to issue “Inco Orders”. After reviewing the text of legislative debates at the time the section was introduced, the court held that the section was meant to “enhance” investigative powers and authorise “investigative techniques” such as such as the use of technological “devices” but did not allow the court to force a witness to answer questions under compulsion.

There is of course nothing stopping any investigator from asking questions of anyone even after reasonable and probable grounds are formed. But once that person declines to answer, the powers in s.163.1 of the EPA can no longer be used to compel an answer.

The decision highlights the importance of making sure all employees are aware of their legal rights and obligations. The decision to refuse to answer questions is often exercised reluctantly by companies or employees who feel that exercising that right might appear to be an admission of guilt. But where reasonable and probable grounds that an offence has been committed have already been formed, such considerations must be weighed against the potential serious prejudice that may result from a voluntarily given and possibly incriminating statement. Such a statement made by an employee under Canadian law, is admissible in court against both the employee and the employer with the need for them to testify or to be subject to cross examination. Trying to qualify the statement in any way after the fact may be awkward at best and impossible at worst.

It remains to be seen whether this is the end of the story. Because the decision of the Divisional Court simply dealt with the specific language of the statute and not the underlying Charter issue, it remains open for the legislature to attempt to create an explicit power to compel witnesses to answer questions in a way that will survive Charter scrutiny. Until such time however, MOE Investigators will have one less investigative tool available to them.

WHAT’S HAPPENING AROUND MILLER THOMSON?

On April 6 **Bruce McMeekin** moderated the panel “Preparing for Regulatory Investigations” at the Canadian Corporate Counsel Association spring meeting in Montreal.

Dan Kiselbach spoke on April 21 on “Bringing Customs to the CFO’s Attention – Customs vs. Income Tax” at IE Canada’s Emerging Issues in Customs and Trade Compliance Conference.

David Chodikoff spoke at the April 23 meeting of the Ontario Bar Association on the topic “Tax Debt Collection and the Potentially Long Arm of CRA”.

David will also be a Co-Lecturer for “Taxpayer’s Constitutional Right Audits vs. Investigations”, 9th Managing Tax Audits & Investigations Course, Federated Press, Toronto, Ontario, May 19-20, 2009.

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