Date: 20060530

Docket: A-376-05

Citation: 2006 FCA 202

CORAM: **SEXTON J.A.**
EVANS J.A.
MALONE J.A.

BETWEEN:

THE MINISTER OF NATIONAL REVENUE

Appellant

and

ROGER ELLINGSON

Respondent

Heard at Vancouver, British Columbia, on May 9, 2006.

Judgment delivered at Ottawa, Ontario, on May 30, 2006.

REASONS FOR JUDGMENT BY: MALONE J.A.

CONCURRED IN BY: SEXTON J.A.
EVANS J.A.

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REASONS FOR JUDGMENT

MALONE J.A.

I. INTRODUCTION

[1] This appeal concerns the scope of the power granted to the Minister of National Revenue (Minister) under paragraph 231.2(1)(*a*) of the *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) (the Act) in issuing a requirement letter where a suspicion exists as to unreported income and illegal activity. That paragraph permits the Minister, in the administration and enforcement of the Act, to compel any person to provide documents or information, including a return of income or supplementary return.

[2] Paragraph 231.2(1)(*a*) of the Act reads as follows:

Requirements to provide documents or information	Production de documents ou fourniture de renseignements
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, including the collection of any amount payable under this Act by any person, 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,	231.2 (1) Malgré les autres dispositions de la présente loi, le ministre peut, sous réserve du paragraphe (2) et, pour l'application et l'exécution de la présente loi, y compris la perception d'un montant payable par une personne en vertu de la présente loi, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne, dans le délai raisonnable que précise l'avis:
(*a*) any information or additional information, including a return of income or a supplementary return;	a) qu'elle fournisse tout renseignement ou tout renseignement supplémentaire, y compris une déclaration de revenu ou une déclaration supplémentaire;

II. THE DECISION UNDER APPEAL

[3] The Minister appeals the August 4, 2005 order of a Federal Court judge (the Applications Judge) that quashed a requirement letter dated July 20, 2004, issued by an officer in the Special Enforcement Program (SEP), a unit within the Investigations Division of the Canada Revenue Agency (CRA). This requirement letter directed Roger Ellingson to produce his signed income tax returns from 1999 to 2003, as well as signed statements of his assets, liabilities and personal expenses for those same years (the Requirement). Mr. Ellingson did not respond but sought judicial review to quash the Requirement.

[4] The Applications Judge determined that when the Requirement was issued, a penal liability investigation was already underway, giving rise to protection under the *Canadian Charter of Rights and Freedoms* (the Charter) in accordance with the Supreme Court of Canada decision in *R v.*

Jarvis, [2002] 3 S.C.R. 757 [*Jarvis*]. On appeal, it is the position of the Minister that the conduct of the SEP official correctly followed the auditing practices sanctioned by the Supreme Court of Canada in *Jarvis*. Put simply, according to the Minister, based on the facts of this case, the predominant purpose of the Requirement issued to Mr. Ellingson was a pre-audit inquiry and Charter protections do not arise.

[5] While a number of legal errors are raised, the Minister's primary argument is that the Applications Judge ignored key facts and mischaracterized a 1992 Working Arrangement between the Royal Canadian Mounted Police (RCMP) and the Department of National Revenue (now CRA) (the 1992 Working Arrangement). According to the Minister, the Applications Judge erroneously determined that the SEP unit functioning under the 1992 Working Arrangement can only conduct criminal investigations.

III. FACTS

[6] In January 2004, Mr. Ellingson was charged in California with various offences involving an illicit drug importation/distribution operation and the laundering of the proceeds between June 2000 and March 2004. A grand jury indictment was unsealed on April 1, 2004 and the next day a news release was issued by the United States Attorney that included Mr. Ellingson's name.

[7] On or about April 16, 2004, the SEP unit received a copy of a suspicious transaction referral form (the Referral) from the HSBC Bank located at 201 Main Street in Penticton, B.C. The Referral detailed a deposit by Mr. Ellingson into a joint account that he shares with his wife. The transaction

consisted of $5,000, all in twenty dollar bills. Under a part of the Referral entitled “description of suspicious activity” the following bank notation appears:

> Client brought in $5000.00 in cash all in 20s to be applied to two car loans he has with HSBC. The CSR noticed that the money had the distinct odour of marijuanna [sic]. A further review of the loans revealed that client consistently makes payments to the loans by way of cash.

[8] The Referral came from the RCMP Proceeds of Crime unit, but the RCMP did not provide any other information regarding Mr. Ellingson. The Referral was first directed to Darren Wilms, an investigator in the Investigations Division of the CRA. As part of his regular duties in checking local newspaper articles, Mr. Wilms had previously located a newspaper article published on April 7, 2004, by the Penticton Herald which referred to Mr. Ellingson being indicted in the United States for drug trafficking charges.

[9] Mr. Wilms then conducted a search of the CRA electronic database to determine what tax returns Mr. Ellingson had filed in the past. The search revealed that he had not filed any tax returns for the years 1997 to 2003. Once Mr. Wilms determined that the respondent was a non-filer, he directed the referral, newspaper article and the database search to David Matheson, an auditor/inspector in the SEP unit. Mr. Matheson was not provided with the grand jury indictment or the newspaper release issued by the United States Attorney.

[10] The SEP unit is a separate audit unit within the Investigations Division of the CRA that deals with audits of taxpayers where there is an indication that they may have earned income from illegal activities. According to Mr. Matheson the SEP unit does not currently conduct criminal

investigations (see Matheson Affidavit, paragraph 10 of Reasons). However, when an auditor determines during the audit that a criminal offence may have been committed, the file is then referred to an investigator within the Investigations Division.

[11] Mr. Matheson's first task was to gather information to determine whether an audit should be undertaken. Having the sole conduct of this file, Mr. Matheson issued the Requirement on July 20, 2004. This is the only activity undertaken by Mr. Matheson. There is no evidence of any criminal investigation by the Investigations Division nor was Mr. Ellingson ever interviewed by any CRA official.

IV. ANALYSIS

[12] In *Jarvis*, the Supreme Court of Canada was called upon to settle the line of demarcation between audits and criminal investigations for income tax purposes pursuant to subsection 231.2(1) of the Act. Writing for a unanimous court, Iacobucci and Major JJ. wrote as follows:

> Although the taxpayer and the CCRA [now CRA] are in opposing positions during an audit, when the CCRA exercises its investigative function they are in a more traditional adversarial relationship because of the liberty interest that is at stake. It follows that there must be some measure of separation between the audit and investigative functions within the CCRA.
> …
>
> …where the predominant purpose of a particular inquiry is the determination of penal liability, CCRA officials must relinquish the authority to use the inspection and requirement powers under ss. 231.1(1) and 231.2(1). In essence, officials "cross the Rubicon" when the inquiry in question engages the adversarial relationship between the taxpayer and the state. There is no clear formula that can answer whether or not this is the case. Rather, to determine whether the predominant purpose of the inquiry in question is the determination of penal liability, one must look to all factors that bear upon the nature of that inquiry.
> …
>
> …Apart from a clear decision to pursue a criminal investigation, no one factor is necessarily determinative in and of itself, but courts must assess the totality of the

> circumstances, and make a determination as to whether the inquiry or question in issue engages the adversarial relationship between the state and the individual. [emphasis added]
> ….
>
> …the test cannot be set at the level of mere suspicion that an offence has occurred. Auditors may, during the course of their inspections, suspect all manner of taxpayer wrongdoing, but it certainly cannot be the case that, from the moment such suspicion is formed, an investigation has begun. [emphasis added]
>
> (See *Jarvis*, paragraphs 84, 88, 93 and 90)

[13] This predominant purpose test is not a bar to the Minister conducting parallel criminal investigations and audits (see *Jarvis* at paragraph 97). However, the timing of such processes is important. Auditors can share information they obtain with CRA investigators, provided that the information was gleaned prior to the start of the criminal investigation. At that stage, the adversarial relationship arises and Charter protections are engaged. At paragraph 103 of *Jarvis*, the Supreme Court of Canada summarized the law in the following words:

> …as previously stated, it is clear that, although an investigation has been commenced, the audit powers may continue to be used, though the results of the audit cannot be used in pursuance of the investigation or prosecution. (See also *R. v. Ling*, [2002] 3 S.C.R. 814 at paragraph 30)

[14] *Jarvis* requires a reviewing court to consider what the dominant purpose in issuing a requirement was: the conduct of an audit or the pursuit of an investigation. This is a two step test. The first step is to determine whether there is a clear decision to pursue a criminal investigation based on the evidence. If the answer to the first step is yes, the inquiry ends there and the power to issue a requirement can no longer be exercised by the Minister (see for example *Kligman v. Canada (Minister of National Revenue*), 2004 FCA 152).

[15] If there is no clear decision, then the trial judge must embark on a search to determine whether the inquiry or question in issue gives rise to an adversarial relationship. All factors are to be examined including, but not limited to, the questions as framed by the Supreme Court of Canada in *Jarvis* (hereafter "the Jarvis Factors"). The Jarvis Factors include: At the time of issuing the Requirement were there reasonable grounds to lay charges? Could the decision to proceed with a criminal investigation have been made based on the record? Was the general conduct of the authorities consistent with a criminal investigation? Were the files transferred to investigators? Was the auditor an agent for the investigators or intended to be used as such? Was the evidence sought relevant to the taxpayer liability generally? Were there are any other circumstances or factors which would lead the trial judge to believe that the audit had become a criminal investigation?

[16] In the present case, there is no evidence of a clear decision by either the RCMP or the Investigations Division of the CRA to embark on a criminal investigation. The record is silent on this point. Accordingly an inquiry in accordance with step two of Jarvis must be conducted. Instead of proceeding in that fashion, the Applications Judge chose to state the issue in the following words:

> …the sole question for determination is as follows. "When the Auditor made the decision to issue the Requirement, was a penal liability investigation under way?" If the answer is 'yes', on the authority of *Jarvis*, it is agreed that the Auditor acted beyond his jurisdiction.

[17] That is clearly an error of law. As indicated in *Jarvis* at paragraphs 97 and 103, audits and investigations are permissible on parallel tracks. The issue of whether the Applications Judge correctly applied the relevant case law to whether the CRA had the jurisdiction to send the Requirement is a question of law, which suggests the least deferential standard of review (see *Zenner v. Prince Edward Island College of Optometrists*, 2005 SCC 77*)*.

[18] I turn now to an analysis of the *Jarvis* factors relevant to the Requirement issued to Mr. Ellingson; the key question being whether its predominant purpose was to further a criminal investigation against him. In this analysis, the standard of proof as to whether his Charter rights have been engaged is on a balance of probabilities (see *R. v. Collins*, [1987] 1 S.C.R. 265).

Factor A – Reasonable Grounds to Lay Charges

[19] At the time the Requirement was issued, the inquiry by the CRA through its audit function was responding to mere suspicion of unreported income from illegal activity. While it was open to the CRA to conduct both a criminal investigation and audit, the evidence does not show that the CRA were doing both. Rather the evidence is that the pre-audit inquiry was but a first step in determining whether Mr. Ellingson was a non-filer for the taxation years 1999 to 2003. Accordingly, I can see no basis on the present evidence to conclude that the CRA had reasonable grounds to lay criminal charges under the Act at this early stage.

Factor B – Basis to Proceed with Criminal Investigation

[20] While Mr. Matheson was unaware of the indictment at the time he issued the Requirement, presumably the Referral and the grand jury indictment could provide a basis upon which an investigation under the Act could be commenced by the RCMP or criminal investigators within the CRA. This factor favours Mr. Ellingson.

Factor C – General Conduct

[21] The general conduct of the CRA with respect to Mr. Ellingson is also not consistent with the pursuit of a criminal investigation, in that the CRA did not issue a search warrant or conduct an interview. Rather its conduct is consistent with simply gathering information to determine whether to commence an audit.

Factor D – Have the Files Been Transferred to Investigators

[22] Whether a file has been transferred to an investigator is yet another factor in determining whether an adversarial relationship exists. However, by itself it is not conclusive (see *Jarvis* at paragraph 92). The present case does not involve a situation where the file is first transferred from the audit to investigation section and then returned to the auditor who then issues a requirement for documents. In such circumstances, the Supreme Court of Canada has directed that courts must pay close attention to determine whether an investigations section has truly declined to pursue the case or whether the auditor is merely collecting information on its behalf.

[23] Here, the file relating to Mr. Ellingson has only been acted upon by Mr. Matheson. It is his undisputed evidence that while the file could have been transferred to the Investigations Division if he had determined that an offence had been committed, that was not done in this case. While it is true that Mr. Matheson does work as an auditor in the SEP unit, which is part of the Investigations Division, the current policy indicates that the SEP unit only conducts audits and Mr. Matheson said that he had never conducted a criminal investigation. Accordingly, there is nothing in this record to suggest that information was exchanged that could give rise to an adversarial relationship.

Factors E and F – Auditor as Agent of Investigators

[24] There is also no evidence of any conduct by Mr. Matheson which could suggest that in his audit function he was being used as an agent of the Investigations Division or the RCMP in the collection of evidence. Rather, the record suggests that there was no contact once Mr. Matheson assumed conduct of the file.

Factor G – Evidence Sought Relevant to Penal Liability Only

[25] In my analysis, the information sought in the Requirement is relevant to Mr. Ellingson's tax liability generally and is not only relevant to penal liability. It contains what can only be viewed as a normal CRA request in a situation where the taxpayer has not filed any tax returns and little or no financial information is available. For example, it sought the actual tax returns for the relevant years so as to be reviewed or verified by Mr. Matheson. It also sought information regarding income sources, assets, liabilities and personal expenditures also necessary so as to determine whether a net worth assessment was warranted. Again, in and of itself, this factor does not point to an adversarial relationship.

Factor H – Other Circumstances – The 1992 Working Arrangement

[26] Key to the Applications Judge's order was his determination that regardless of Mr. Matheson's personal intention, his role as auditor was tainted by the 1992 Working Arrangement. That document obliges the RCMP and the CRA to act in concert to disrupt and combat organized crime in the enforcement of the Act. This, according to the Applications Judge, can only mean

cooperative investigations and a sharing of information with the ultimate purpose to impose penal sanctions. Respectfully, I do not read the 1992 Working Arrangement and the surrounding exhibits in that light, especially when the unrefuted evidence of Mr. Matheson is considered.

[27] As early as 1972, the Department of National Revenue, Taxation and the Department of the Solicitor General had a signed protocol in place with the stated objective to disrupt and combat organized crime through criminal prosecutions only. That protocol was replaced by the 1992 Working Arrangement with the same objective, but with a methodology expanded beyond criminal prosecutions to include: identifying those earning income from illegal activities and determining their position in the criminal community, carrying out preliminary investigations in relation to case development, carrying out audits towards assessment/re-assessment where the criteria for tax evasion prosecution is not met and providing the maximum information to the Collections Division in order to maximize actual collection of taxes, penalties and interest.

[28] The Applications Judge found it difficult to understand how stemming the activities of organized crime could be carried out other than by investigations for the purpose of imposing criminal sanctions. However, it is self-evident that auditing those involved and issuing a reassessment for taxes, interest and penalties is also highly disruptive to organized crime.

[29] The Applications Judge also gave no weight to a subsequent 2002 publication by the CRA dealing specifically with the Specific Enforcement Program (SEP Manual). While that publication does not have the force of an act or regulation, it can be used to provide legal context and inform

decisions. Here, the SEP Manual is a helpful source for discerning the operation of the SEP and should be accorded some weight.

[30] The first paragraph of the SEP Manual casts doubt on the currency of the 1992 Working Arrangement, and the relevance of the case of *R. v. Harris*, [1995] B.C.J. No. 1467, relied on by the Applications Judge. It states: "This [SEP] program has evolved through the years and its focus has shifted from a criminal to a mainly civil approach." Whatever the situation in 1972 or 1992, the SEP program had evolved by 2002 into one primarily focusing on civil audits rather than criminal investigations.

[31] Two specific sections of the SEP Manual are instructive. Section 20.4.1 and subsection 20.4.2(2) read as follows:

> SEP audits are carried out to determine, as accurately as possible, the taxes, duties, interest and penalties payable under the law by those persons earning income from illegal activities. SEP audits will also be carried out as means to determine the flow of funds, in an effort to uncover other members of the specific criminal organization for Tax compliance enforcement purposes.
> Audits will be completed to the issuance of applicable assessments and penalties, except those with the necessary indication of tax evasion which will be referred to the Criminal Investigation Program (CIP) on form T134 for investigation.

[32] Clearly, separate audit and investigative units do function within the CRA, a fact recognized by other courts which chose not to follow the decision in *Harris* (see *R. v. Lin* (1997), B.C.J. No. 1277 and *R. v. Xidos* (1999), 181 N.S.R. (2d) 381).

[33] This change in focus of the SEP unit is also evident from Mr. Matheson's evidence that since at least the time when he joined the SEP unit in 2001, it only conducts audits and not criminal investigations. Accordingly, there is no evidentiary basis for the Applications Judge's conclusion that at the time that the Requirement was issued in 2004 the SEP unit could only conduct criminal investigations. In reaching that conclusion, the Applications Judge chose to marginalize and ignore Mr. Matheson's evidence and the above provisions of the SEP Manual.

[34] Accordingly, considering the Jarvis Factors, as well as the 1992 Working Arrangement and the SEP Manual and based on a balance of probabilities, I am unable to conclude that Mr. Matheson was acting in any way beyond mere suspicion when he issued the Requirement. On the present facts, an adversarial relationship simply does not arise.

[35] In this circumstance, the appeal should be allowed, the order of the Applications Judge dated August 4, 2005 should be set aside and the Requirement issued by the CRA on July 20, 2004 should be restored. The Minister should have his costs both on appeal and in the Federal Court.

"B. Malone"

J.A.

"I agree.
J. Edgar Sexton J.A."

"I agree.
John M. Evans J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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DATED:	May 30, 2006

APPEARANCES:

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