CRA to acquire strong new audit powers

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As part of Budget 2024, the Department of Finance Canada (Finance) introduced proposed legislation to significantly enhance the Canada Revenue Agency's (CRA) audit powers (see previous article here summarizing the initial proposed changes).

On August 15, 2025, Finance announced changes to the proposed legislation (the 2025 Changes). While the 2025 Changes soften some of the hard edges of the Budget 2024 proposals, the application of CRA's new powers remains a concern.

What you need to know:

- Budget 2024 proposed that when CRA is successful in seeking a compliance order at the Federal Court against a taxpayer, CRA can impose a penalty of 10 per cent of the aggregate tax payable for each year in respect of which the order relates. The 2025 Changes provide that:
    - the penalty can be vacated or reduced at CRA's discretion if "disproportionate or unfair", and
    - the penalty would not apply where the taxpayer had a "reasonable belief" that solicitor-client privilege applies.
- Budget 2024 proposed that CRA auditors can issue at any time a Notice of Non-Compliance (NoNC) when unsatisfied with a taxpayer's responsiveness during audit, with an accompanying penalty of up to $25,000. The 2025 Changes provide that:
    - the NoNC will be deemed vacated where a review of the NoNC by CRA requested by the taxpayer exceeds 180 days, and
    - the penalty will not apply where the taxpayer had a "reasonable belief" that solicitor-client privilege applies.
- Budget 2024 proposed that CRA auditors can compel taxpayers to attend interviews and provide written statements under oath or affirmation. This proposal was not modified by the 2025 Changes. Should this proposal be enacted, CRA will need to modify its longstanding policy of not allowing recordings of interviews by CRA auditors.

Harsh penalties for compliance orders

Where, in CRA's view, a taxpayer fails to comply with a document or information request during an audit, the CRA can apply for a compliance order at the Federal Court. If the Court issues the compliance order, the proposals first introduced by Budget 2024 would enable CRA to assess a penalty of up to 10 per cent of the aggregate amount of tax payable for each taxation year in respect of which the order relates. The penalty does not apply if the amount of tax payable is less than $50,000.

The practical impact of the penalty will be to make it effectively impossible, or very risky, for many taxpayers to refuse to provide information during an audit where CRA threatens a compliance order. The threat of a compliance order application will be very potent.

The penalty is potentially huge and could in some cases lead to insolvency or bankruptcy. For example, if the taxpayer sold significant assets during the year to which the compliance order applies, the impact of the penalty would be disproportionate. Large blue-chip corporations with significant yearly revenues could also see a big impact if such a penalty were applied.

The penalty is also unmoored from the specific issue that led to the compliance order. Disputes over documents or information during a CRA audit often focus on very specific items unrelated to the overall tax bill. Yet the penalty would apply to the overall taxes owing.

In this new reality, seeking advice from legal counsel will become important for taxpayers dealing with the threat of a compliance order during audit.

CRA discretion to vacate or reduce penalty

The 2025 Changes, responding to significant criticisms of the Budget 2024 proposals, give CRA the power to vacate or vary the 10 per cent penalty on compliance orders, or to reduce the penalty, where CRA determines that the penalty is "in the circumstances, disproportionate or unfair". CRA can exercise this power only where a taxpayer objects to an assessment of the penalty. Taxpayers should consider obtaining legal advice in preparing such an objection and dealing with the resulting tax dispute.

It is unclear how CRA or the courts will interpret this new, discretionary power. For example, would financial hardship from the penalty be a cause for determining that it is disproportionate, and if so how much hardship is needed?

While this measure could soften the potential blow of a 10 per cent penalty, it is unlikely to mitigate the risk for many taxpayers that comes with compliance order applications.

Solicitor-client privilege carve-out

The 2025 Changes also introduced a carve-out from the 10 per cent penalty on compliance orders where "one of the reasons for not complying with the requirement was the taxpayer's reasonable belief that the information, documents or answers were protected from disclosure by solicitor-client privilege".

Despite clear directions from the courts not to, CRA auditors routinely request privileged information such as legal opinions from taxpayers. In addition, privilege can be in a grey zone: it is unclear whether privilege attaches to a document and a court decision may be needed to decide the matter. One of the criticisms of the 2024 Budget proposals was that taxpayers would be faced with either sending potentially privileged information to the CRA, or risk facing a massive penalty for losing a compliance order application.

The carve-out for solicitor-client privilege in the 2025 Changes attempts to deal with these criticisms. This latest proposal has two problems. First, it only applies to solicitor-client privilege. There are other types of privilege, such as litigation privilege, that are equally important but not covered by the proposal. Second, the proposal refers to the taxpayer's "reasonable belief" that the information was subject to solicitor-client privilege. This leaves sizeable room for disputes over whether the taxpayer's belief that the document was privileged was reasonable, or not. If enacted, this carve-out will increase the importance of consulting legal counsel to ascertain whether documents are subject to solicitor-client privilege, and to establish grounds for a reasonable belief that the documents are subject to solicitor-client privilege.

Notices of non-compliance

The Budget 2024 proposals would also enable CRA to issue NoNCs, where CRA determines that a person has not complied in whole or in part with requirements issued by CRA during an audit. The NoNC remains outstanding until the CRA decides that it is not.

While an NoNC is outstanding, a penalty of $50 per day applies, up to a maximum of $25,000 (so 500 days).

Taxpayers can apply for a review of the NoNC by the CRA, and CRA has 180 days to complete the review and notify the taxpayer of its decision. Taxpayers can further apply to a judge for a review of unfavourable CRA decisions.

The NoNC penalty is a potentially pernicious tool at the hands of CRA. The legislation as drafted provides little by way of guardrails for CRA to issue NoNCs. Essentially, they can be issued to anyone at CRA's discretion during an audit, no matter the person's circumstances (for instance, NoNCs could be issued to seniors or low-income taxpayers). The second-level review by CRA provides only modest comfort: the review will be done by another official not independent from CRA. Further review by a judge is of course available, but the costs and delays of going to court (with possible motions and appeals) could make paying a $25,000 penalty a cheaper option.

The 2025 Changes attempted to address some of the concerns expressed in reaction to the 2024 Budget proposals. First, if CRA does not complete its second-level administrative review of the NoNC within 180 days, the NoNC will be deemed never to have been issued.

Second, and similar to the proposal for the compliance order penalty, there is now a carve-out for solicitor-client privilege where the taxpayer had a "reasonable belief" that information was subject to solicitor-client privilege. The solicitor-client privilege carve-out has the same shortcomings as described above for compliance orders.

While both changes above are welcome, they do little to temper the overall impact of the NoNC proposals which give significant power to CRA auditors to impose up to $25,000 penalties on taxpayers they view as uncooperative. The path to challenging the penalty for taxpayers, as contemplating by the proposals, is uphill and potentially costly – as noted few taxpayers will be able to shoulder the burden of going to Court to challenge a $25,000 penalty assessment.

Interviews under oath or affirmation

Following the addition of basic interview powers in 2022, the 2024 Budget proposals would enable the CRA to question taxpayers orally, under oath or affirmation, or compel taxpayers to provide affidavits. These proposals were not modified by the 2025 Changes.

CRA's longstanding policy is not to allow recording of interviews. Auditors are instructed to leave if taxpayers attempt to use recording devices. This makes interviews inefficient and unreliable as evidence-gathering exercises, because reliance is on the memories and notes of interview participants, which can differ widely especially after passage of time.

Serious issues could arise if CRA does not adapt its administrative practice where interviews are to be conducted under oath or affirmation. Perjury is an offense under the *Criminal Code*, and given the seriousness of potential charges a verbatim record of an interview under oath must be available for the taxpayer. In other forums where testimony is provided under oath or affirmation, such as examinations for discovery or in courtroom testimony, recordings are always made. In the United States, where an interview is under oath and there may be criminal consequences, the IRS Audit Manual states that there is a right to have a transcript of an interview.

Taxpayers under audit should consult with legal counsel before attending an interview under oath or affirmation with CRA or providing an affidavit.

Contact us

If you have any questions about the new CRA audit powers reach out to Patrick Reynaud or Laura Warrington, or another member of BLG's Tax Group to assist you.

By

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