The expansion of the Canada Revenue Agency audit powers and contraction of the taxpayer's rights

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Tabled on April 16, 2024, the federal budget (Budget 2024) includes proposed changes that will expand the scope of the Canada Revenue Agency's (CRA) powers. At first blush, the proposed amendments are intended to incentivize taxpayers to comply with the CRA's requests. However, on closer examination, the new powers under 231.1 and 231.7 of the *Income Tax Act* (ITA) raise questions about the potential for abuse by the CRA, as well as a further erosion of the Taxpayer's Bill of Rights from introducing penalties for non-compliance and extending the normal audit reassessment period.

The proposed amendments in Budget 2024 effectively create a pre-trial discovery process without procedural safeguards. As such, it will become even more crucial to consider involving legal counsel earlier in the process to protect the taxpayer's rights and prevent against providing the taxing authority with more information than required under the ITA.

What you need to know

The proposed amendments to the ITA will enable the CRA to:

- issue a new "notice of non-compliance" at any time they consider that a request has gone unheeded, with a possible penalty of up to $25,000;
- seek a compliance order from the court, and where successful, apply a penalty of 10 per cent of the aggregate amount of tax payable;
- force interviews and written responses to be provided under oath, with no procedural safeguards;
- apply all the new rules to other tax statutes administrated by the CRA (*Excise Tax Act*, *Excise Act, 2001*, *Underused Housing Tax Act*, etc.).

How we got here

In 2019, in the widely referenced case *Cameco* (2019 FCA 67), the Federal Court of Appeal held that the ITA did not authorize the CRA to compel taxpayers to submit to

oral interviews. In response to this loss, the federal government proposed an amendment to the law under the 2021 budget: the power for CRA to request that a taxpayer or "any other person" answer questions, both orally and in writing, under paragraph 231.1(1)(d) ITA.[1] This amendment came into force in Dec. 2022, and denoted a marked expansion of the CRA's audit powers, overriding the Court's ruling in *Cameco*.

The federal government has stated that historically, compliance orders have "generally not been effective in compelling compliance," with the CRA seemingly under the impression that its powers have no teeth. However, since 2001, the compliance powers provided for in the ITA have allowed the minister of National Revenue (Minister) to apply to the Federal Court for a compliance order, the default of which could result in imprisonment. As outlined in section 238 of the ITA, where a person refuses to provide any access, assistance, information or document, and a compliance order is granted under section 231.7 of the ITA, there is the possibility of summary conviction — with financial penalties applicable up to $25,000, or 12 months in prison.

Beyond this, the CRA has always had the ability to simply raise an arbitrary assessment[2]. For example, if a taxpayer is not providing documents or information as requested, CRA could issue an assessment (or reassessment) of tax. The amounts as assessed will be deemed valid and binding until the taxpayer objects to it. This power reverses the usual onus and forces the taxpayer to prove that the amounts assessed are incorrect.

Notices of non-compliance (NoNC)

Budget 2024 proposes to introduce section 231.9 ITA. This new provision would allow the CRA to issue a new type of notice (referred to as "notice of non-compliance") to a person that has not complied with a requirement or notice to provide assistance or information issued by the CRA pursuant to paragraphs 231.1 (1)(d) – (f), subsection 231.1 (2) or subsection 231.1(6). The broad language of these provisions captures **any person**, and not only the taxpayer being audited. This would allow the CRA to send notices of non-compliance to *inter alia* advisors, accountants, employers and spouses of the taxpayer.

A person that does not comply with a NoNC (either by exercising their right to challenge the notice or simply ignoring it) would be penalized at a rate of $50 per day the notice is outstanding, up to $25,000. Any penalties applied would be vacated if the issuance of the NoNC is determined to be unreasonable or that the person had reasonably complied upon reconsideration by CRA, or further statutory right of review by a judge of the Federal Court. However, the CRA would be the first stop in the chain of review, reviewing the reasonableness of its own NoNC, on request of the person.

Perhaps the most troubling component of the new NoNC regime is the extension of time created for the Minister to issue a reassessment. Where a NoNC is issued, the reassessment period for the taxpayer's tax years will be extended by "the period of time the notice of non-compliance is outstanding."[3] This extension of the taxpayer's reassessment period would also apply if the NoNC was issued to a person not dealing at arm's length with the taxpayer, even where the taxpayer is unaware of the issuance of the NoNC. Differently put, if a NoNC is sent, for example, to a child, brother, sister, spouse, common-law partner, corporation controlled by the taxpayer, or a corporation

from a related group, and that person fails to provide the information or documents in response to the NoNC, the taxpayer is heavily penalized by having their reassessment period extended indefinitely. Not only would an unsuccessful challenge expose taxpayers to a penalty of up to $25,000, it would also automatically extend the normal reassessment period with respect to the tax years in issue.

Faced with these options and complexities, many taxpayers might decide to comply once they receive a NoNC, even where legitimate grounds to challenge the notice and avoid providing the requested information or documents might exist. Moreover, the proposals do not distinguish between the situation where a taxpayer refuses to comply with a requirement for information and the situation where the taxpayer simply has no access to the information. In the latter scenario, the taxpayer could still be issued a NoNC, which would be considered "outstanding" and would entail the abovementioned consequences (that is, a penalty, and an extension of the normal reassessment period).

The boundary of what documents and information the CRA will request is being stretched, and we expect that this new tool in the CRA's toolbox will be used to enforce unreasonably broad or inappropriate document production. The proposed amendments, as well as the broadening powers for the administration and enforcement of the ITA, raise the issue of a potential misuse of these powers. The line between audit and investigative powers may be blurred, and the predominant purpose of a request by the CRA may potentially oscillate from an audit context to a criminal investigation, which is contrary to the Supreme Court of Canada's ruling in *Jarvis* (2002 SCC 73).

Questioning under oath

The ability to send out NoNCs is further complicated by layering on yet another power – the ability to force answers to be provided under oath.

Questions under oath are common during the discovery phase of pre-trial procedures before the courts, including the Tax Court of Canada. However, the Tax Court of Canada rules (and both the common law and civil law) provide for procedural safeguards to protect a taxpayer's rights. Moreover, taxpayers are usually assisted by counsel which further protects their rights when faced with unreasonable or unfair requests. The new power to require information to be provided under oath at the audit stage equates to the CRA being able to conduct a "discovery before discovery" at the audit stage, where many taxpayers are not yet represented by counsel. There are no safeguards in place, and the CRA will be able to bypass a taxpayer's right to have evidentiary issues addressed by the Court during the pre-trial process.

This new power also raises the question of the admissibility of the information obtained under oath or affirmation at the audit stage before courts. This is especially relevant since taxpayers who refuse to comply with such a request could be issued a NoNC, which carries its own penalties. How can courts rely on statements made under the threat of a penalty? Who will administer the oath? Would that be the CRA's employees? Will taxpayers be obliged to appear before a Commissioner of Oaths to respond to audit requests? Will taxpayers be cross-examined on statements made under oath at the audit stage? These are just some of the many questions which stem from the lack of clear guidance on the limitations governing the use of this new power by the CRA.

Compliance orders and penalties

In an effort to further de-incentivize taxpayers from challenging requirements or notices issued by the CRA, Budget 2024 proposes a penalty when the CRA obtains a compliance order against a taxpayer under section 231.7 ITA and the tax owing in respect of one of the taxation years to which the compliance order relates exceeds $50,000. The penalty would be equal to 10 per cent of the aggregate tax payable by the taxpayer in respect of the taxation year or years to which the compliance order relates.

New subsection 231.7 (8) of the ITA would allow the CRA to apply for a compliance order before or after the sending of a NoNC. Under this new rule, a requirement could be both subject of a NoNC (which is reviewable by the court) and an application for a compliance order. **This means that the decision not to comply with a requirement could lead to two separate penalties being applied**: the penalty applicable while the NoNC is outstanding, and the penalty applicable if the CRA is successful in obtaining a compliance order.

Will Revenue Québec follow the CRA?

On April 18, 2024, in Information Bulletin 2014-5, the Québec government announced its intention to harmonize Québec's tax legislation and regulations with the changes relating to income tax (increase in the inclusion rate, introduction of the entrepreneurial incentive, increase in the lifetime capital gains exemption and increase in the HBP withdrawal limit) and to the GST and HST. As for the other changes, including those relating to the CRA's audit powers, the harmonization decisions will be announced at a later date.

Revenue Québec's audit powers resemble the powers provided under current federal tax legislation. Historically, Revenue Québec has been proactive in requesting and collecting information. We can safely anticipate that the Québec legislator will align itself with, or even go beyond, the proposals contained in the federal budget.

Conclusion

If adopted, the proposals included in Budget 2024 would substantially bolster the CRA’s audit powers. The expansion of powers fails to account for the many additions to the CRA’s powers in the last few years (*e.g.*, the ability to compel taxpayers to attend oral interviews) or to the taxpayer’s reporting requirements (*e.g.*, reportable and notifiable transactions, uncertain tax treatments). Instead of allowing these major changes enough time to prove their effectiveness, the government is adding yet another layer of complexity to an already convoluted set of compliance requirements for taxpayers.

Tax legislation is notably complex, and the new audit powers and disclosure requirements will only complicate the process further, as well as increase taxpayers' compliance costs. The introduction of penalties and sanctions for non-compliance reinforces the need for legal advice, incidentally ramping up the cost and complexity of compliance for taxpayers.

The general theme underlying the proposals included in Budget 2024 seems to consist in penalizing taxpayers who seek to limit disclosure only to relevant information and documents. Faced with the prospect of harsh penalties and an extension of the normal reassessment period, many taxpayers will simply comply with the CRA's requirement where they might have valid grounds for refusing to comply.

Contact us

If you have questions about the CRA audit powers, information requests, questioning under oath or the new notice of non-compliance, reach out to your BLG lawyer, the authors of this piece, any of the key contacts below, or any member of BLG's Tax Group.

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Footnotes

[1] At the same time, the federal government proposed an amendment to 237.5 of the ITA, introducing mandatory reporting requirements of uncertain tax treatments under section 237.5 ITA. This was in response to the decision in *BP Canada Energy Co. v Minister of National Revenue*, 2017 FCA 61, where the Federal Court of Appeal confirmed that the CRA could not compel a taxpayer to provide general and unrestricted access to tax accrual working papers which would reveal its uncertain tax positions.

[2] Subsection 152 (7) of the ITA.

[3] 231.8(1)(e) of the proposed legislation.

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