

TAX INFORMATION EXCHANGE AND THE EROSION OF TAXPAYER PRIVACY
RIGHTS

by

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Abstract

The exchange of taxpayer information between revenue agencies has been increasing as a response to globalization and technological advances, which have allowed taxpayers more opportunities for tax avoidance and tax evasion. Tax information exchange allows revenue agencies to take advantage of these same advances. The legal framework through which the exchange of taxpayer information is implemented consists of modifications to existing tax conventions and special Tax Information Exchange Agreements. These tax treaties modify and override domestic privacy laws.

The Canadian income tax system operates within a regime of constitutional privacy protections and statutory privacy protections. A balance has been struck between the right to privacy and the State interest in obtaining personal information in order to administer and enforce the tax system. This thesis examines the information gathering powers of the Canada Revenue Agency and the limits on these powers. These powers are broad because taxpayers generally have a low expectation of privacy in their tax information. This thesis argues that the balance struck domestically is predicated on meaningful procedural protections and remedies and on taxpayer information not being shared with third parties.

This thesis then examines the tax treaty information exchange provisions and their interaction with Canadian law. This thesis argues that these provisions override domestic law without providing any meaningful procedural protections. This thesis concludes that information exchange in its current state is incompatible with the balance struck by the Courts between taxpayer privacy and the revenue authorities' need for information.

Preface

This thesis is original, unpublished, independent work by the author, R.S. Hawkshaw.

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To Sarah

1 Introduction

Canadians deserve to have their personal information protected, particularly when they provide it to the government under legal compulsion...¹

In Canada, the right to privacy is recognized as an important and constitutionally protected right. Privacy is contextual; depending on the circumstances Canadians enjoy greater or lesser degrees of privacy. In the tax context, when dealing with the Canada Revenue Agency (the CRA), Canadians have a low expectation of privacy with respect to business records and other taxpayer information.² However, until recently Canadians have had a high degree of privacy protection for their taxpayer information against third parties who may want to obtain this information from the CRA. Information exchange with foreign revenue agencies represents a generally unremarked upon but dramatic reduction in the privacy protections afforded to taxpayers.

In 2007, Canada amended the *Income Tax Act*³ (the “ITA”) to authorize the disclosure of taxpayer information by the CRA to foreign revenue agencies.⁴ This amendment was accomplished by inserting the underlined portion into subsection 231.2(1):

¹ Office of the Privacy Commissioner of Canada, *Privacy Commissioner’s final report calls for greater care in government handling Canadians’ personal information* (Ottawa: Office of the Privacy Commissioner, 2013), online: <http://www.priv.gc.ca/media/nr-c/2013/nr-c_131029_e.asp>.

² *R v McKinlay Transport Ltd*, [1990] 1 SCR 627 at 649-650, [1990] 2 CTC 103 [McKinlay].

³ *Income Tax Act*, RSC 1985, (5th Supp), c 1, [ITA].

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), of a comprehensive tax information exchange agreement between Canada and another country or jurisdiction that is in force and has effect or, for greater certainty, of a tax treaty with another country, by notice served personally or by registered or certified mail, require that any person provide, within such reasonable time as stipulated in the notice [Emphasis added]

The amendment allows the CRA to collect taxpayer information on behalf of any country that has signed a tax convention or a tax information exchange agreement (TIEA) with Canada. The technical notes related to this amendment do not elaborate on the purpose for this amendment⁵, but it appears to be recognition of existing administrative practice. A related section, section 241, was also amended to allow the CRA to share any information collected with any country that had signed a TIEA or tax convention with Canada.⁶ The CRA has been exchanging information and collecting information on behalf of other countries for some time.⁷ These amendments, in effect, recognize administrative practice and are part of an effort by the OECD and the G20 nations to enhance the exchange of taxpayer information between revenue authorities with the end

⁴ Budget and Economic Statement Implementation Act, SC 2007, c 35 s 63.

⁵ Department of Finance, “Archived - Explanatory Notes Relating to the Budget and Economic Statement Implementation Act, 2007 and Draft Regulations Relating to Tax Information Exchange Agreements” (21 November 2007).

⁶ Subparagraph 241(4)(e)(xii). Prior to 2007 this subparagraph only allowed information to be shared with a country that had signed a tax convention with Canada. There is an amendment in *Technical Tax Amendments Act*, 2012, SC 2013, c 3 that authorizes information sharing under the recently amended *Convention on Mutual Administrative Assistance in Tax Matters* – ratified by Canada on November 21, 2013.

⁷ International Fiscal Association Canada, “Questions for Competent Authorities” online: <<http://www.ifacanada.org/en/resource/9-english-articles/17-questions-for-competent-authority-services-division.html>>.

goal of combatting and deterring tax evasion and tax avoidance. In addition to this amendment, Canada has also been signing TIEAs and amending existing tax conventions and multilateral agreements that require the sharing of taxpayer information in order to increase the scope and frequency of information exchange.⁸

This thesis argues that enhanced information exchange, as it is currently being implemented in Canada, is incompatible with the privacy rights regime that Canada has established for taxpayer information. At first glance, information exchange does not appear to be particularly troublesome. It is well established that taxpayers have a low expectation of privacy in their business and tax records,⁹ and the information is being exchanged to fight fiscal evasion. However, when the justification behind taxpayers' low expectation of privacy and the corresponding ability of the state to pry into taxpayer's affairs is examined more closely, it becomes clear that taxpayers should be entitled to a higher degree of privacy protection in the tax information exchange context than they do in the domestic context. Unfortunately, as this thesis will show, taxpayers are actually entitled to less privacy and fewer protections under the tax information exchange regime than in the case of a domestic audit.

Since the late 1990s, tax information exchange (TIE) between revenue agencies around the world has been growing in importance and frequency.¹⁰ However, to date

⁸ Department of Finance, "Tax Treaties and Tax Information Exchange Agreements" (24 June 2013), online: < <http://actionplan.gc.ca/en/initiative/tax-treaties-and-tax-information-exchange>>.

⁹ *McKinlay*, *supra* note 2 at 649-650.

¹⁰ Arthur Cockfield, "Protecting Taxpayer Privacy under Enhanced Cross-border Tax Information Exchange: Toward a Multilateral Taxpayer Bill of Rights" (2010) 42 *UBC L Rev* 419 at 420 [Cockfield].

there has been a “dearth”¹¹ of literature that attempts “to examine in a comprehensive or critical manner the privacy concerns arising from enhanced TIE”.¹² The growth of tax information exchange and its corresponding impact on taxpayer privacy has resulted in very little academic commentary. What has been written on the subject has either been very general¹³ or has primarily focused on the technological and other processes by which exchange occurs rather than the interaction between the treaties and privacy law.¹⁴ In 2002, Sara McCracken expressed concern that the absence of a requirement in tax treaties to provide notice to taxpayers when their information is exchanged gives tax administrators the potential ability to side step heightened privacy requirements in criminal and quasi-criminal investigations. According to McCracken, the privacy protections present in tax treaties are ineffective without notice to the taxpayer:

In terms of treaty requests for information, most treaties include provisions that guarantee the confidentiality of the information provided; restrict the disclosure of such information to persons involved in tax assessment, collection, enforcement, or prosecution; limit the use of the information to those purposes; and protect trade, business, industrial, and other secrets from release. However, these protections are somewhat illusory because revenue authorities in most countries do not notify taxpayers when an information request is made to or received from a foreign government. Without prior notice of a proposed exchange, taxpayers have no chance to raise any of the points enumerated above as grounds for challenging the exchange, despite their obvious interest in the matter. In this respect, it is difficult to see, for example, how a tax official would know what information the taxpayer considers a trade secret. Furthermore, while revenue authorities are not obliged to exchange highly sensitive information, they remain at liberty to do so. This lack of prior

¹¹ *Ibid* at 452.

¹² *Ibid*.

¹³ Sara K McCracken, “Going, Going, Gone... Global: A Canadian Perspective on International Tax Administration Issues in the “Exchange-of-Information Age” (2002) 50 Can Tax J 1869 [McCracken].

¹⁴ Cockfield, *supra* note 10.

notification becomes increasingly problematic as the number and scope of information exchanges grow.¹⁵

McCracken also raised concerns over taxpayers falling into a privacy protection gap, where taxpayer privacy rights are not protected by the country providing taxpayer information or by the country receiving it:

[When] Canada requests information from another jurisdiction, neither the actions of the foreign administration nor the laws authorizing those actions are subject to Charter scrutiny. The Canadian approach is problematic in that it allows the government to indirectly violate domestic constitutional protections by hiding behind a foreign regime. The ramifications of this position must also be viewed in light of the growing international emphasis on exchange of information through tax treaties and otherwise. If countries intensify their cooperative efforts without considering how foreign authorities go about obtaining requested information, what will happen to domestic rights to privacy and security against unreasonable search and seizure?¹⁶

Both McCracken and Cockfield noted that as tax information exchanged increased, taxpayers were placed at an increased risk of having their information stolen or misused:

While tax treaties and TIEAs normally include language ensuring confidentiality of tax information and protecting other taxpayer interests, this may provide insufficient assurance to taxpayers that their rights will not be abused if a foreign government (or an individual within a foreign country) gains access to their tax information.

In addition, countries may want assurances that any tax information that is provided to foreign governments will not be used for abusive purposes. For instance, China maintains the death penalty for egregious forms of tax evasion, and countries may be reluctant to share tax information with China if this information will assist with the investigation and prosecution of tax crimes that result in capital penalties for taxpayers. Alternatively, countries may not want to share tax information for investigating terrorist offences if this information results in the torture (or rendition to a country

¹⁵ McCracken, *supra* note 13 at 1896.

¹⁶ *Ibid* at 1898.

that engages in torture) or other violation of the human rights of an individual.¹⁷

Because the effort to implement an efficient framework for exchanging information has overshadowed privacy rights, none of these concerns has been addressed. A decade after McCracken raised the issue of illusory procedural protections, a recent report on Canada's tax information exchange framework concluded that taxpayers have only limited procedural protections with respect to tax information exchange and even those limited procedural protections will often be of no help as there is no requirement to notify taxpayers that their information is being sought or exchanged.¹⁸ As the previous research on this subject has taken a high level "bird's eye view",¹⁹ this thesis will examine the tax treaties, the *ITA* and the case law in detail.

1.1 What is Tax Information Exchange

Due to technological advances and increased globalization taxpayers now have at their disposal the ability to securely and easily transfer funds and intangible goods across borders and 'offshore'. Since the 1980s tax havens have increasingly catered to taxpayers seeking privacy and lower (or no) taxes. There is also a host of financial advisors and other professionals capable of advising on and aiding with tax avoidance and tax evasion schemes. Tax information exchange is one of the responses taken by revenue authorities to counteract this phenomenon. Tax information exchange is the exchange of the tax,

¹⁷ Cockfield, *supra* note 10 at 458.

¹⁸ Nik Diksic & Jeffrey Shafer "Exchange of information and cross-border cooperation between tax authorities: Canadian Branch Report" in *Cahiers de Droit Fiscal International* (2013) vol 98b 155-174 [Diksic & Shafer].

¹⁹ Cockfield, *supra* note 10 at 3.

financial and other personal information of taxpayers between the revenue authorities of different countries. This exchange of information is accomplished through bilateral tax treaties and treaties specifically drafted to provide for information exchange (TIEAs). Canada has taken part in the expansion of tax information exchange between countries: signing new tax information exchange agreements (TIEAs), amending the *ITA* and amending existing tax treaties to allow for greater access to information from abroad and allow greater access to the information of Canadians.

These modifications are intended, in part, to combat the use of tax havens by taxpayers. In the past, tax havens did not cooperate with foreign requests for information. Tax havens employed various strategies to shield information from foreign revenue authorities. Techniques that have been employed include simply not recording or collecting any information; exercising discretion available under previous treaties to deny requests for information; privacy legislation and bank secrecy laws; incompatible definitions of tax evasion; and corporate and trust laws designed to promote anonymity. In order to combat these strategies, existing treaties have been amended and new treaties created in order to: remove discretion from decisions regarding information exchange, broaden the amount of information available to be exchanged, and reform or over-ride privacy and secrecy laws.

Tax treaties provide for the reciprocal exchange of information between revenue authorities. There are two types of exchanges of taxpayer information, inbound exchange and outbound exchange. Inbound exchange occurs when taxpayer information is collected abroad and then forwarded to Canada. Outbound exchange occurs when tax

information is collected in Canada and is then sent abroad at the request of a foreign revenue agency. These two forms of information exchange occur in a variety of ways:

1. on request, where one agency requests specific information from another;
2. automatically through the periodic exchange of collected information on a recurring basis;
3. spontaneously, when one agency notices something that may be of interest to another agency in another jurisdiction;
4. during the course of a joint audit of a taxpayer; and
5. informally through working groups and inter-agency contacts.

All of these forms of information exchange are accomplished through tax treaties, which give treaty partners access to the information held by their partner's revenue authorities and to the investigatory powers granted to those revenue authorities, by domestic legislation.

Through the exchange of information, revenue agencies can help each other track down tax evaders, enforce anti-avoidance rules and level the playing field. Tax information exchange can be a vital tool in ensuring the integrity of the tax system and that taxpayers pay their fair share. Modern methods of information exchange enable revenue authorities to take advantage of the same technological advances that allow taxpayers to instantly transfer money around the world. Information that was once consigned to paper and filing cabinets is now routinely digitized. Information on taxpayers can flow across borders just as easily as money can, provided revenue authorities cooperate with one another.

Due to the reciprocal nature of tax treaties, changes meant to fix problems abroad have an effect at home as well. The Canadian income tax system operates within a regime of constitutional privacy protections and statutory privacy protections. A balance has been struck between the right to privacy and the State interest in obtaining personal information in order to administer and enforce the tax system. Tax treaties override and modify the existing privacy regime. When tax information sharing is discussed in Parliament it is always in the context of obtaining information from abroad – information about local tax cheats hiding money and information in tax havens. When the subject of other countries obtaining Canadian tax information does hit the news, it is not popular.²⁰ Even non-tax information being sent abroad is an incredibly sensitive subject and still Parliament has shown little interest in examining or debating tax privacy. The cross border nature of tax information exchange opens up potential gaps in constitutional protections. Just as tax evaders take advantage of gaps in tax codes the network of tax treaties opens up the possibility of taking advantage of gaps in privacy law.

1.2 Thesis Structure and Overview

This thesis is concerned with privacy, the *ITA*, and tax treaties. In order to be able to evaluate whether or not TIE is a justified infringement of Canadian(s) privacy, this thesis examines the *Charter* and other sources of taxpayer privacy, the powers Canada is

20 Barrie McKenna, “Ottawa, U.S. negotiating change to tax reporting” *The Globe and Mail* (28 June 2012), online: <<http://www.theglobeandmail.com/report-on-business/ottawa-us-negotiating-change-to-tax-reporting/article4105490/>>.

making available to foreign revenue agencies through TIE and then the treaties and their commentaries.

1.2.1 Domestic Privacy Law

Chapter 2 provides a definition of taxpayer privacy and explains the origins of taxpayer confidentiality. The chapter analyzes the framework that courts have used to balance the privacy rights of Canadians against the need to obtain information in order to administer and enforce the income tax system. The framework is made up of the *ITA*, case law, and sections 7 and 8 of the *Charter*. This chapter also examines the different expectations of privacy that apply in regulatory and criminal contexts. Taxpayers have a lower expectation of privacy when their information is being sought for a regulatory purpose than they do in a criminal context where their liberty is at stake. This chapter also discusses how taxpayer privacy and confidentiality exist in tension with Canada's self-assessment tax system, which requires full disclosure in order to maintain fairness. Privacy is important both because it is a human right and because protecting privacy increases taxpayer compliance. At the same time revenue authorities require the ability to invade privacy in order to effectively administer the tax system.

Chapter 3 examines, in detail, how the privacy framework examined in Chapter 2 is implemented by the regulatory and criminal investigative powers available to the CRA and now to our treaty partners. The *ITA* grants extensive information gathering powers to the CRA. The Canada Revenue Agency uses these powers in order to administer and enforce Canada's tax system. Like any domestic statute these powers can only be used in Canada. Tax information exchange provides a means to obtain information from abroad.

At the same time tax information exchange also places the CRA's investigatory powers at the disposal of our treaty partners. This chapter also examines some of the CRA's attempts to overcome the restrictions on the use of regulatory investigative tools in the criminal context placed on it by Canada's privacy law. Chapter 2 touches on the administrative law remedies available to taxpayers whose privacy has been violated. Both Chapter 2 and Chapter 3 discuss the obligation the Canadian tax system places on Canadians to disclose personal and private information to the Canada Revenue Agency and the corresponding obligation on the state to respect Canadian taxpayers' privacy.

1.2.2 The Tax Conventions

Chapter 4 provides an explanation of what tax information exchange (TIE) is, its purposes, and how it is implemented through various instruments. It examines the history and growth of tax information exchange, explains the OECD's role as the main proponent of TIE, and traces the OECD's efforts to combat harmful tax competition, aggressive tax avoidance and tax evasion. The role of the G20 and the effects of 9/11 and the 2008 financial crisis on the development of information exchange is discussed. The information exchange features of the three types of tax treaties are examined in detail.

Chapter 5 then examines how these treaties interact with and modify the *ITA* and the privacy regime established in the tax context. This chapter examines how tax information exchange puts Canadian taxpayer's privacy at risk because it allows revenue authorities to sidestep the *Charter* and procedural protections ordinarily imposed on the CRA.

1.2.3 Conclusion

This thesis concludes that the balance between taxpayer privacy and the CRA's information gathering powers established in *McKinlay*, should not be followed in the tax information exchange context. The CRA's broad powers to obtain taxpayer information for domestic purposes were based on certain factors that do not hold true in the international context.

2 What is Privacy and Why is Privacy Important?

2.1 Introduction

Privacy is a “protean concept”.²¹ At its core privacy is the ability to withdraw from society, avoid publicity and to keep secrets.²² The American Supreme Court Justice Louis Brandeis defined privacy as the “right to be let alone — the most comprehensive of rights and the right most valued by civilized men.”²³ For Brandeis the protection of privacy against state intrusion was a required component of human happiness, and necessary to protect individual beliefs, thoughts, emotions and sensations.²⁴ In Canada, privacy is provided constitutional protection by the *Charter of Rights and Freedoms*. The Supreme Court of Canada has stated that privacy is “essential for the well-being of the individual”²⁵ and “[grounded] in man’s physical and moral autonomy”.²⁶ Restraining the government’s ability to pry into the private lives of its citizens is essential to maintaining a democratic state.²⁷ At the same time, there are societal interests that oblige individuals to forgo their right to privacy. This chapter focuses on the statutory and constitutional privacy protections Canadians enjoy in the tax context and the justification for allowing

²¹ *R v Tessling*, 2004 SCC 67, [2004] 3 SCR 432 at para 25 [Tessling].

²² *The Shorter Oxford English Dictionary*, 6th ed sv “privacy” (New York: Oxford University Press, 2007).

²³ *Olmstead v United States*, 277 US 438 at 479.

²⁴ *Ibid.*

²⁵ *R v Dymont*, [1988] 2 SCR 417, 55 DLR (4th) 503 at para 28.

²⁶ *Ibid.*

²⁷ *Ibid.*

the state to invade that privacy. This Chapter argues that the balance struck between the right to privacy, and the need of the state to obtain information is, in the tax context, predicated on the following framework:

- 1) Privacy being protected as much as possible:
 - a. by using collected information for the purpose it was collected for, the administration and enforcement of Canada's income tax system;
 - b. by limiting unjustified invasions of privacy, wherever possible, before they happen rather than after by means of prior judicial review where practicable or necessary, and if prior judicial review is not possible, allowing the taxpayer the opportunity to have the courts scrutinize administrative decisions and actions after the fact and correct them if they were not in compliance with the *Charter*; and
 - c. by having strong privacy protection once information is collected through restrictions on further use or disclosure.
- 2) Drawing a distinction between regulatory investigations and criminal investigations and restricting the use of regulatory powers once there is a criminal or quasi-criminal purpose to an investigation.
- 3) There being no other reasonable alternatives other than invading Canadians privacy in order to achieve the government's objective of verifying compliance with the *ITA*.

This framework is the justification for the CRA's ability to override the right to privacy and pry into the private affairs of Canadians. It establishes a relationship between taxpayers and the CRA. Taxpayers have an obligation to provide information to the CRA

(these obligations will be discussed in chapter 3) and the CRA has a corresponding duty to protect that information and only use that information for the purposes of administering and enforcing the *ITA*.

It is important to examine this relationship and the underlying justification for the CRA's investigatory powers because tax treaties create a different sort of relationship with treaty partners and a competing set of duties. Canada has agreed to the exchange of tax information, and as a result has an obligation to obtain and disclose taxpayer information with other States. This puts the CRA in the position of being responsible for the protection of taxpayer information and being responsible to its treaty partners to share that information.

This chapter will first examine the practical reasons for protecting taxpayer privacy and then the statutory and constitutional privacy protection framework.

2.2 The Practical Reasons for Protecting Privacy

Privacy is important both because it is a human right, and in the tax context because respecting privacy encourages honest and forthright compliance with the *ITA*.²⁸ Neil Brooks and Judy Fudge consider there to be two conditions that need to be satisfied in order to ensure taxpayers willingly turn their information over to the government in a self-assessment system:²⁹

²⁸ *Slattery (Trustee of) v Slattery*, [1993] 3 SCR 430 at 444, 106 DLR (4th) 212 [*Slattery*].

²⁹ Law Reform Commission of Canada, *Search and Seizure Under the Income Tax Act* (Ottawa: Law Reform Commission, of Canada 1985) at 1.

[the] perception of whether Revenue Canada's enforcement powers are sufficient to ensure that it can obtain the information it needs to administer effectively the *Income Tax Act* but also upon [the] perception of whether the powers are necessary and fairly administered. [Emphasis added]

Public confidence that the CRA is respecting taxpayer privacy is necessary as part of ensuring compliance with the tax system. For as long as there has been an income tax in Canada, the confidentiality of taxpayer returns has been argued to be in the public interest:

the public interest emanates from an undertaking on its part, implied by the *Income Tax Act*, toward all income taxpayers that the contents of the returns of none of them will be revealed beyond the circle of officials concerned in administering the statute.³⁰

Privacy is in the public interest because confidentiality increases compliance with the *ITA* and encourages honesty in disclosures. Justice Iacobucci in discussing the confidentiality of tax returns opined that:

By instilling confidence in taxpayers that the personal information they disclose will not be communicated in other contexts, Parliament encourages voluntary disclosure of this information. The opposite is also true: if taxpayers lack this confidence, they may be reluctant to disclose voluntarily all of the required information...³¹

There are two main ways which taxpayer confidence in the income tax system can be shaken, privacy breaches and misuse of taxpayer information.

2.2.1 Privacy Breaches

³⁰ *R v Snider*, [1954] SCR 479 at 483, 54 DTC 1129 [*Snider*].

³¹ *Slattery*, supra note 28 at 444.

In the past, widespread breaches of the confidentiality were not possible. It is difficult to smuggle thousands of paper records out of an office. Even if the records could be obtained they would still need to be sorted through and searched. With the widespread digitization of government records that is no longer a barrier. Millions of files can be loaded onto a portable hard drive or even a cell phone and those files can be quickly and easily searched by computer instead of by hand. In response to questions from the Opposition, the federal government has revealed that in the past ten years the federal government has suffered more than 3,000 privacy breaches affecting at least 725,000 Canadians. Only 13% of those breaches were reported to the Privacy Commissioner. Those numbers do not include any data from the Canada Revenue Agency.³² The CRA took the position that it would not be able identify the breaches it had suffered within the 45 day deadline for response and so did not submit a report.³³ It has subsequently come to light that the CRA does not have any tracking system to monitor when taxpayer information has been accessed by its employees or to track fraud or misuse of taxpayer information.³⁴

³² Jordan Press, “Government data breached thousands of times in last decade, documents say” *Montreal Gazette* (25 April 2013), online: <<http://www.montrealgazette.com/news/national/Government+data+breached+thousands+times+last+decade/8284404/story.html>>.

³³ Althia Raj, “Canada Privacy Breaches: More Than A Million Canadians May Have Had Data Compromised” *Huffington Post* (23 April 2013), online: <http://www.huffingtonpost.ca/2013/04/23/canada-privacy-breach-charlie-angus_n_3142560.html>.

³⁴ Jordan Press, “Revenue Agency policing staff’s access to records” *Ottawa Citizen* (19 September 2013) A15.

The CRA has had issues with privacy breaches in the past.³⁵ Perhaps the most famous incident involved Toronto broadcasters Pierre Berton and Charles Templeton. Berton and Templeton were made an offer by a private investigator who claimed to be able to obtain any person's records with ease:

In November, 1977, I received a telephone call from a man who gave his name as Jim Lilly and represented himself as a private detective. He informed me that he had access to tax files at the Department of National Revenue and that he would reveal to me how the leaks worked if I would meet with him.³⁶

As proof of the leak, Mr. Lilly obtained the tax records of a number of people named by Berton and Templeton, most notably the current Speaker of the House, and the leader of the Opposition. Berton and Templeton reported on the leak and in later investigations found that obtaining both personal and corporate tax files was a relatively simple matter.³⁷ More recent examples of privacy breaches at the CRA include:

1. Member of Parliament and hockey star Ken Dryden's tax records (along with other famous hockey players and other taxpayers) being posted online by a former CRA employee.³⁸

³⁵ Dean Beeby, "Rogue tax workers snooped on ex-spouses, family members" *Toronto Star* (20 June 2010), online: <http://www.thestar.com/news/canada/2010/06/20/rogue_tax_workers_snooped_on_exspouses_family_members.html>.

³⁶ Charles Templeton, *An Anecdotal Memoire* (1982), online: <<http://www.templetons.com/charles/memoir/chap9.html>>.

³⁷ Ibid.

³⁸ Gregory Bonnell, "Ken Dryden's confidential tax info illegally leaked and posted online" *Canadian Press* (16 December 2006), online: <http://article.wn.com/view/2006/12/19/Ken_Drydens_confidential_tax_info_illegally_leaked_posted_on/>.

2. A CRA employee who accessed the tax records of women in order to find dates.³⁹
3. Altering tax records for personal benefit.⁴⁰
4. CRA employees charging fees to resolve tax disputes.⁴¹
5. Widespread corruption in the Montreal office of the CRA.⁴²

Tax information exchange presents additional challenges for revenue authorities. The more agencies and individuals with which private information is shared, the more likely a breach, either inadvertent or deliberate.

2.2.2 Deliberate Government Misuse of Information

In addition to the risks of losing taxpayer information through misadventure or theft, there is also the risk of the politicization of the tax system. The tax authorities have broad powers, some police-like in nature, and of course, access to all sorts of information. The use of this information, as well as the conduct of audits and investigations, which

³⁹ Chad Skelton, “B.C. tax collector combed personal info for potential dates” *National Post* (3 March 2009), online: <<http://www.nationalpost.com/related/topics/collector+combed+personal+info+potential+dates+report/1350025/story.html>>.

⁴⁰ Arthur Weinreb, “Former Canadian tax auditors charged in restaurant shakedowns” *Digital Journal* (2 May 2012), online: <<http://digitaljournal.com/article/324072>>.

⁴¹ Canadian Press, “Canada Revenue employee faces fraud charges” *CBC News* (22 November 2010), online: <<http://www.cbc.ca/news/canada/toronto/story/2010/11/22/canada-revenue-agency-charges.html>>.

⁴² Daniel Leblanc, “Informant was key to charges in CRA corruption case” *The Globe and Mail* (16 November 2012), online: <<http://www.theglobeandmail.com/news/national/informant-was-key-to-charges-in-cra-corruption-case/article5357441/>>.

involve further prying into personal affairs, have to be perceived to be fair and non-partisan in order to maintain confidence in the tax system. Unjustified fishing expeditions or audits that appear to be politically motivated provide an additional incentive to cheat, game the system or conceal things. This is especially relevant in Canada where the revenue authorities ultimately report to a member of the current governing political party, the Cabinet Minister responsible for National Revenue.

The sort of private information held by the government is a powerful tool that can be used to discredit critics and discourage dissent. One notable case in Canada involves the abuse of medical records by government officials. Officials at the Ministry of Veteran's Affairs leaked the psychiatric and medical information of veterans in order to discredit them when they spoke out against a new compensation scheme for injured soldiers.⁴³ This sort of abuse of private information can be devastating. The veteran targeted in this case described the effects as leaving him and his wife:

in a "humiliating state of powerlessness and vulnerability" and in "constant terror" of what the department, which controlled 100 per cent of his income at the time, would do next. . . . Because veterans on disability are financially dependent on Veterans Affairs, he said it can be very scary to challenge the department. He described the reaction to a 2006 phone call from the department urging him not to take his concerns to the minister. "This struck terror into our hearts, fundamental terror," he said.⁴⁴

⁴³ Bill Curry, "Privacy breach at Veterans Affairs 'struck terror in our hearts'" *The Globe and Mail* (23 August 2012), online:

<<http://m.theglobeandmail.com/news/politics/privacy-breach-at-veterans-affairs-struck-terror-in-our-hearts/article4326721/?service=mobile>>.

⁴⁴ Ibid.

In the tax context, the government of Argentina, a country with which Canada has a tax treaty, and with which Canada exchanges tax information, uses tax investigations to silence critics. The President of Argentina when faced with criticism on monetary policy, published in a popular daily newspaper, gave a nationally broadcast speech in which she called her critics out by name and discussed their tax situation and stated that their criticism would have tax consequences, namely audits. She had obtained the information on her critics by instructing the head of the Argentinian tax agency to turn it over.⁴⁵

In Canada, targeted audits of environmental charities have drawn accusations of political bias. Both the Minister of Natural Resources and the Minister of the Environment mentioned an environmental charity in public statements. They accused the charity of money laundering and acting on behalf of foreign interest to undermine Canada. Soon after the Minister of National Revenue announced that the government was taking steps to ensure that environmental charities were operating legally and a series of audits was underway to ensure compliance with the *ITA*. The perception was that the audits were politically motivated and opponents of government policy were being singled out for scrutiny.⁴⁶ The Canada Revenue Agency took the perception seriously and attempted to address the issue through an interview:

⁴⁵ Daniel Politi, “The Taxman Cometh” *International Herald Tribune* (13 July 2012), online: <<http://latitude.blogs.nytimes.com/2012/07/13/the-argentinian-government-unleashes-the-tax-agency-on-its-critics/>>.

⁴⁶ Shawn McCarthy, “CRA audits charitable status of Tides Canada amid Tory attack” *The Globe and Mail* (7 May 2012), online: <<http://www.theglobeandmail.com/news/politics/cra-audits-charitable-status-of-tides-canada-amid-tory-attack/article4105719/>>; Peter O’Neil, “How the Conservatives’ brief love affair with environmentalism came to an ugly end” *The Vancouver Sun* (7 June 2012), online:

[Interviewer]: Given recent headlines around Tides Canada, there's a growing perception that audits of Charities may be politically motivated or instigated. What are your thoughts on that and what triggers an audit?

[CRA]:The Directorate is responsible for monitoring the operations of registered charities to make sure they comply with the requirements of the Income Tax Act. Audits are an important element of this process. The process for identifying which charities will be audited is handled by the Charities Directorate itself and is not subject to any political direction whatsoever... I can assure registered charities that the CRA always conducts these activities with fairness, professionalism, and integrity.⁴⁷

Nevertheless the audits are still widely considered to have been politically motivated.⁴⁸

The Internal Revenue Service (IRS) of the United States was also recently embroiled in a scandal due its employees allegedly singling out certain tax exempt social welfare groups for special scrutiny and inappropriate questions about donors. These groups were selected for scrutiny if they fit the profile of being a conservative or 'tea party' group. Tea Party groups seeking tax-exempt status were investigated more than other groups of different political affiliation.⁴⁹ President Obama had to replace the agency's acting chief Steven Miller, stating that:

<<http://www.vancouver.sun.com/business/part+conservatives+brief+love+affair+with+environmentalism+came+ugly/6728822/story.html>>.

⁴⁷ Andy Levy-Ajzenkopf, "A conversation with Cathy Hawara – Director General of the Charities Directorate" *Charity Village* (24 September 2012), online:<https://charityvillage.com/Content.aspx?topic=A_conversation_with_Cathy_Hawara_Director_General_of_the_Charities_Directorate&last=158>.

⁴⁸ Jonathan Gatehouse, "When science goes silent" *Maclean's* (2 May 2013) online: <<http://www2.macleans.ca/2013/05/03/when-science-goes-silent/>>.

⁴⁹ Associated Press, "IRS's integrity at stake in scandal over screening of conservative groups" *CBC News* (17 May 2013), online: <<http://www.cbc.ca/news/business/story/2013/05/17/business-irs-backgrounder.html>>.

"I will not tolerate this kind of behaviour in any agency but especially in the IRS, given the power that it has and the reach that it has into all of our lives"⁵⁰

The U.S. Department of Justice and the FBI are both investigating the matter.⁵¹

2.2.3 The Origins of Taxpayer Privacy

The collection of income tax goes hand in hand with concerns over the invasion of privacy. When the British first levied income taxes to help pay for the Napoleonic Wars the tax commissioners were required to swear the following oath:

...I will not disclose any Particular contained in any Schedule of Income or any Evidence or Answer given by any Person who shall be examined or make Affidavit respecting the same, except in such Cases and to such Persons only when it shall be necessary to disclose the same for the purposes of this Act or in order to, or in the Course of, a Prosecution for Perjury committed in such Examination or Affidavit."⁵²

The oath was necessary to allay privacy concerns. The tax commissioners would be prying into areas of life previously kept private. Accompanying the keeping of tax records was the worry that they would be put to some other use. When the taxes were repealed, the tax records from the period were publicly burned.⁵³

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² *Income Tax Act*, 1799, 39 George III, c 13, s 22.

⁵³ Jonathon Freidland, "The Trouble with Tax" *BBC* (21 October 2003), online: http://www.bbc.co.uk/radio4/history/longview/longview_20031021.shtml; (Although HMRC says they were pulped rather than burned) Her Majesty's Revenue & Customs, "A Tax To Beat Napoleon" (1999), online: <http://www.hmrc.gov.uk/history/taxhis1.htm>.

As a result of these privacy concerns, tax systems to this day provide some degree of protection to basic privacy rights.⁵⁴ In Canada, these rights are explained (but not created) by the Taxpayer Bill of Rights. Article 3 of the Taxpayer Bill of Rights provides that “[taxpayers] have the right to privacy and confidentiality.” The explanatory notes for the Taxpayer Bill of Rights go on to explain that the Canada Revenue Agency will “protect and manage the confidentiality of [taxpayer’s] personal and financial information.”⁵⁵ As well access to this information will be restricted only to employees who require access to perform their duties.⁵⁶ The Taxpayer Bill of Rights also highlights the fact that the CRA is accountable to taxpayers and taxpayers have a right to be informed about decisions the CRA makes regarding the taxpayer: “When we [the CRA] make a decision about your tax or benefit affairs, we will explain that decision and tell you about your rights and obligations.”⁵⁷

However, the Taxpayer Bill of Rights does not create any rights or have any legal effect; it is meant to increase taxpayer awareness of their existing rights provided by other legislation and serve as a customer service guarantee.⁵⁸ In Canada the chief sources of privacy rights in the tax context are section 241 of the *ITA* and section 7 and section 8 of the *Canadian Charter of Rights and Freedoms*.

⁵⁴ OECD, “Taxpayers' rights and obligations – A survey of the legal situation in OECD countries” (Paris: OECD, 1990).

⁵⁵ Canada Revenue Agency, RC17, “Taxpayer Bill of Rights Guide: Understanding Your Rights as a Taxpayer” (2009).

⁵⁶ *Ibid.*

⁵⁷ *Ibid.*

⁵⁸ Canada Revenue Agency, “Taxpayer Bill of Rights: Questions and Answers” online: <<http://www.cra-arc.gc.ca/gncy/txpyrbllrghts/tbrfq-eng.html#q4>>.

2.2.4 Section 241 of the *Income Tax Act*

When Canada introduced its first income tax statute, the *Income War Tax Act, 1917*,⁵⁹ modeled after the British statute, it contained a provision on tax secrecy. This provision was found in section 11:

No person employed in the service of His Majesty shall communicate or allow to be communicated to any person not legally entitled thereto, any information obtained under the provisions of this Act, or allow any such person to inspect or have access to any written statement furnished under the provisions of this Act.

It contains the same elements as the British oath: the requirement to keep tax information secret, and an exception to this secrecy where necessary. However, where the British oath required secrecy and only allowed disclosure for the purposes of enforcing or administering the tax act, the Canadian provision allowed information to be shared with anyone “legally entitled” to it. This section was not invoked in any decision relating to taxpayer privacy or information until *The Queen v Snider*.⁶⁰ In *Snider*, the Minister of National Revenue was issued a subpoena for the tax returns of a defendant in a criminal case. It was argued that any subpoena issued by the court made the holder “legally entitled” to the information and therefore the privacy section did not apply. The Minister argued that revealing taxpayer information would be contrary to the public interest and violate the privacy provision (which by then was found in section 121 of the *ITA*). In *Snider* the Rand J. held that there was little to no privacy interest in tax records once they are turned over to the government:

⁵⁹ SC 1917, c 28.

⁶⁰ *Supra* note 30.

The disclosure of a person's return of income for taxation purposes is no more a matter of confidence or secrecy than that, say, of his real property which for generations has been publicly disclosed in assessment rolls. It is in the same category as any other fact in his life and the production in court of its details obtained from his books or any other source is an everyday occurrence. The ban against departmental disclosure is merely a concession to the inbred tendency to keep one's private affairs to one's self. Now that, in this competitive society, is a natural and unobjectionable tendency but it has never before been elevated to such a plane of paramount concern.

The most confidential and sensitive private matters are daily made the subject of revelation before judicial tribunals and it scarcely seems necessary to remark on the relative insignificance to any legal or social policy of such a fact as the income a man has been able to produce.⁶¹

The words “legally entitled” were read very broadly:

The prohibition of the statute is against disclosure to others than the departmental staff charged with the assessment but since the public interest in the administration of justice transcends that of any individual in the details of his ledger account, the ban is to be taken to be directed against a voluntary disclosure only and has no application to judicial proceedings.⁶²

Since the provision only prevented “voluntary disclosures” any party who could show a legal entitlement to a taxpayer’s information could obtain it.

In response the government amended the section as a result of privacy concerns stemming from application of the *Snider* decision. This amended section is now found in section 241 of the *ITA*. These amendments effectively limited *Snider* to criminal trials.

The section was amended after *Snider* to read as follows:

241(1) Except as authorized by this section, no official or authorized person shall

⁶¹ *Ibid* at 484.

⁶² *Ibid*.

(a) knowingly communicate or knowingly allow to be communicated to any person any information obtained by or on behalf of the Minister for the purposes of this Act, or

(b) knowingly allow any person to inspect or to have access to any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act.

(2) Notwithstanding any other Act or law, no official or authorized person shall be required, in connection with any legal proceedings,

(a) to give evidence relating to any information obtained by or on behalf of the Minister for the purposes of this Act, or

(b) to produce any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act.

Subsection 241(2) was intended to prevent the disclosure of taxpayer information in civil litigation as well as in other circumstances. Subsection 241(3) contained an exception, which allowed the disclosure of information in criminal cases. However, subsection 241(4) still contained the words “legally entitled”:

S. 241(4) An official or authorized person may,

...

(c) communicate or allow to be communicated information obtained under this Act, or allow inspection of or access to any book, record, writing, return or other document obtained by or on behalf of the Minister for the purposes of this Act, to or by any person otherwise legally entitled thereto;

The amended confidentiality provision was put to the test in *Glover v Minister of National Revenue*.⁶³ *Glover* concerned a child custody dispute. Mrs. Glover had won an interim order of sole custody of her two children. Her husband took the two children and went into hiding. Years later during divorce proceedings Justice Lerner granted Mrs. Glover full custody of the children. Mr. Glover did not attend the proceedings, and Mrs.

⁶³ [1981] 2 SCR 561, [1982] CTC 29, [*Glover*].

Glover had not seen her children for years. Justice Lerner ordered Revenue Canada to provide the “particulars of the addresses of the respondents Paule Wenenn and James Glover pursuant to *The Family Law Reform Act*”.⁶⁴

The Minister of National Revenue objected to the order to turn over the tax information on the basis that “the disclosure of any information received in connection with the administration or enforcement of the *Income Tax Act* would be prejudicial to the public interest.”⁶⁵ The Minister also argued that the post-*Snider* amendments prevented the disclosure. As in *Snider*, Mrs. Glover argued that she was “legally entitled” to the information. With regards to section 241 the court held that:

Section 241(3) limits the effect of s. 241(1) and (2) by stating that those subsections do not apply in respect of criminal proceedings or in respect of proceedings relating to the administration or enforcement of the *Income Tax Act*. If one views s. 241(3) conversely along with the two previous subsections, it is a clear statement of parliamentary policy that no information obtained for the purpose of the Act shall be communicated and no official or authorized person shall be required to give evidence relating to such information in any non-*Income Tax Act* civil legal proceedings.⁶⁶

When faced with the “legally entitled” language in paragraph 241(4)(c) the court declined to follow *Snider*, instead holding that the order did not make her legally entitled to any information because:

[s]uch an approach, when applied to the *Income Tax Act*, would, in my view, give far too wide a meaning to the words “otherwise legally entitled” and once again the result would be to ignore or subvert the limitations imposed by the section in its attempt to ensure the confidentiality of the

⁶⁴ *Ibid* at para 5.

⁶⁵ *Ibid* at para 25.

⁶⁶ *Ibid* at para 12.

information secured and received by the Revenue Department under the Act.⁶⁷

Even in the face of an extremely compelling need for information, at this point in time the Minister was willing to argue and the court was willing to rule that taxpayer privacy was more important than reuniting Mrs. Glover and her children. Section 241 exists to protect Canadian taxpayers' information from disclosure to third parties and to prevent tax information collected for the purposes of administering or enforcing the *ITA* from being used in any other context.

Glover is the high water mark of taxpayer information confidentiality provided by the *ITA*. Section 241 remains a powerful legal impediment for Canadian citizens who want access to taxpayer information. However, since *Glover*, exceptions allowing disclosure to other government agencies have been added to section 241. This disclosure is available for the purposes such as policy formulation⁶⁸ or the administration of programs linked to the income tax.⁶⁹ All of these exceptions to the general rule of confidentiality require that the information be used for a specified purpose and that the information be disclosed to an "official" or "authorized person" both of which are defined in subsection 248(10) as persons working for either the federal or provincial governments.

⁶⁷ *Ibid* at para 18.

⁶⁸ *ITA*, supra note 3 s 241(4)(d)(i).

⁶⁹ *ITA*, supra note 3 s 241(4)(d)(ii)-(viii).

There is also an exception for providing information to the Canadian Security Intelligence Service, the RCMP, or the Financial Transactions and Reports Analysis Centre of Canada relating to threats to national security and terrorism:

An official may provide,...

- (b) designated taxpayer information, if there are **reasonable grounds** to suspect that the information would be relevant to
 - (i) an investigation by the Canadian Security Intelligence Service of whether the activity of any person may constitute threats to the security of Canada, as defined in section 2 of the Canadian Security Intelligence Service Act,
 - (ii) an investigation of whether an offence may have been committed under
 - (A) Part II.1 of the Criminal Code [Terrorism], or
 - (B) section 462.31 of the Criminal Code [Laundering the Proceeds of Crime], if that investigation is related to an offence under Part II.1 of that Act...[Emphasis added]⁷⁰

Even in cases of suspected terrorism, the *ITA* still requires that there be reasonable grounds to suspect a crime has been committed before information will be passed on.

For tax information exchange purposes there is an exception found in subparagraph 241(4)(e)(xii):

- (4) An official may
 - (e) provide taxpayer information, or allow the inspection of or access to taxpayer information, as the case may be, under, and solely for the purposes of,
 - (xii) a provision contained in a tax treaty with another country or in a comprehensive tax information exchange agreement between Canada and another country or jurisdiction that is in force and has effect;

This exception removes any privacy protection section 241 could have provided Canadian taxpayers with regards to tax information exchange. This amendment is totally

⁷⁰ *ITA*, supra note 3 s 241(9).

at odds with the balance that has been struck in the past with regards to section 241 and the sharing of taxpayer information with third parties. In addition as will be discussed later in this Chapter in the *Charter* discussion, the CRA's extensive information gathering powers were justified in part because of the strong protection provided by section 241. Eliminating that protection undermines the justification for those powers.

2.2.5 Section 241 Summary

Section 241 represents a balance between the privacy interest of the taxpayer and the interest of the Minister to be allowed to disclose taxpayer information “to the extent necessary for the effective administration and enforcement of the Income Tax Act and other federal statutes referred to in subsection 241(4).”⁷¹ The section was intended to allow information to be disclosed to third parties only in “exceptional”⁷² and “prescribed situations”⁷³ Except for the recent amendment allowing the CRA to share Canadian information with any treaty partner that remains the case.

2.3 The *Charter*

The most powerful source of privacy protection in Canada is the *Charter of Rights and Freedoms*. The *Charter* privacy jurisprudence has established that there are different types of privacy, different sources of privacy, and that privacy protection is contextual.

⁷¹ *Slattery*, supra note 28 at 444.

⁷² *Ibid.*

⁷³ *Ibid.*

Every privacy conflict involves identifying the type of privacy infringed, the source of protection and then weighing the various factors applicable to the type and the source. The *Charter* provides constitutional protection for human rights. The two sections of the *Charter* that are most relevant to taxpayer privacy are Section 7 and Section 8. Section 7 protects the right to life, liberty, and security of the person. Section 8 protects against unreasonable search and seizure. Section 7 has been found to only apply in the criminal context and Section 8 in both the criminal and regulatory context.⁷⁴

2.3.1 Types of Privacy

Charter jurisprudence has recognized three broad types of privacy interests worthy of protection. These interests are personal privacy, territorial privacy, and informational privacy.⁷⁵ These types of privacy are not mutually exclusive; they can overlap and lower and higher courts can and do disagree which type of privacy is being infringed.⁷⁶

Although all three types can be engaged in the tax context, the most likely type of privacy to be infringed is informational privacy.

Personal privacy is concerned with the human body. It is the right not to be touched, strip searched, or subjected to medical examination without permission.⁷⁷ This form of privacy is generally afforded the most protection of the three.⁷⁸ The invasion of

⁷⁴ *R v Jarvis*, 2002 SCC 73, [2002] 3 SCR 757, 219 DLR (4th) 233 at para 88 [*Jarvis*].

⁷⁵ *Tessling*, supra note 21 at para 20.

⁷⁶ *Ibid* at para 27.

⁷⁷ *Ibid* at para 21.

⁷⁸ *Ibid*.

bodily privacy will be rare in the tax context, but it could be engaged by the disclosure of medical or psychiatric records to substantiate a claim for a medical tax credit for instance.

Territorial privacy is based on the common law notion that one's house is one's castle. It is where intimate and private activities occur.⁷⁹ It protects places where a person has a reasonable expectation of privacy against entry and search by the state. Territorial privacy has expanded beyond just the home. Territorial privacy now also protect places of business, cars, yards, and even prison cells (to a certain extent) based on how reasonable an expectation of privacy a person may have in the space.⁸⁰ In the tax context this form of privacy is engaged when the revenue authorities seek to search a home or a business.

Informational privacy protects personal information. It has been defined as “the claim of individuals, groups, or institutions to determine for themselves when, how, and to what extent information about them is communicated to others”.⁸¹ It protects a person's dignity and autonomy by allowing them to control a “biographical core of personal information” and protects an individual's intimate lifestyle, and personal choices from state scrutiny.⁸² Informational privacy is the type of privacy most commonly infringed in the tax context. Tax records contain reams of personal information and tax audits and investigations can be very invasive and highly revealing:

⁷⁹ *Ibid* at para 22.

⁸⁰ *Ibid* at para 23.

⁸¹ *Ibid*.

⁸² *R v Plant*, [1993] 3 SCR 281, 8 WWR 287 at 293.

Simply put, . . . an investigation into all cash received and all cash spent is necessarily, in today's modern world, a window into most of a person's private life.⁸³

Audits can go beyond just cash received and cash spent. An investigation could cover searches of computers, emails, and phone records, or even a full investigation into a person's lifestyle.

2.3.2 Section 7

Section 7 provides that:

Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.

Section 7 provides protection against compelled testimony and self-incrimination. In the tax context, a criminal investigation triggers the application of taxpayers' section 7 rights.

This means that the regulatory powers in section 231.1 (audits) and section 221.2 (requirements for information) can no longer be used to obtain information or documents or statements from the taxpayer or other third parties. Instead the CRA must use judicial warrants obtained under section 231.2 of the *ITA* or section 487 of the *Criminal Code*.⁸⁴

The specifics of audits, requirements and search warrants are discussed more fully in Chapter 3 of this thesis. Broadly speaking the audit and requirement powers are more intrusive on privacy than a search warrant, and search warrants are more difficult to

⁸³ *Del Zotto v Canada*, [1997] 3 FC 40, 147 DLR (4th) 457 at para 37 (FCA) appeal allowed [1999] 1 SCR 3 [*Del Zotto*].

⁸⁴ *Jarvis*, supra note 74 at para 2.

obtain. The point at which an investigation by the CRA switched from a regulatory investigation to a criminal investigation was an open question until 2002, and the *Jarvis* decision.

Jarvis definitively established that the use of the *ITA*'s regulatory information gathering powers after a criminal investigation had begun is a violation of *Charter* rights.⁸⁵ In *Jarvis*, the CRA received a tip that the taxpayer had unreported income earned from the sale of his late wife's paintings. Acting on the tip the CRA audited both the taxpayer and the estate of the taxpayer's wife. During the course of the audit, the CRA obtained information from third parties and from interviews with the taxpayer. The taxpayer was not cautioned during the interviews. In the course of the audit it became apparent that the taxpayer had substantial unreported income. The auditor transferred her file to the Special Investigations Section tasked with investigating tax evasion.

The taxpayer was not informed that his file had been passed from the audit branch to the Special Investigations Section. On one occasion bank information that had been previously requested during the audit was sent to the auditor who then forwarded the information to the Special Investigations Section. The auditor was instructed not to inform the taxpayer that his file had been transferred and to stall if contacted by the taxpayer. The auditor did stall and told the taxpayer that his file was in a holding pattern and that there had been no new developments. Search warrants were executed by the special investigator and the taxpayer was subsequently charged with tax evasion.

⁸⁵ *Ibid* at para 88.

At trial, the judge held that much of the information obtained during the audit process would not be admissible and that the search warrants violated the taxpayer's rights under section 7 of the *Charter*. The trial judge found that after a certain point in the audit the auditor's predominant purpose had become an investigation rather than an audit. The auditor was primarily seeking proof of tax evasion with the goal of turning the file over to the Special Investigations section. These findings were appealed, eventually reaching the Supreme Court of Canada. The main issue in the appeal was the extent to which the use of audit powers to build a criminal case against a taxpayer infringes on *Charter* rights.

The court's solution to the tricky question of when a regulatory audit becomes a criminal investigation is a contextual "predominant purpose" test. The court listed the following factors as potentially determinative:⁸⁶

1. Did the authorities have reasonable grounds to lay a charge?
2. Does the record indicate that the authorities could have made a decision to proceed with a criminal investigation?
3. Was the general conduct of the authorities consistent with the pursuit of a criminal investigation?
4. Had the audit files been transferred to investigators?
5. Was the auditor effectively acting as an agent for the investigators?
6. Does it appear that the auditor was used as an agent in the collection of evidence?
7. Was the evidence sought relevant to taxpayer liability generally, or was it relevant only to penal liability?

⁸⁶ *Ibid* at para 94.

8. Are there any other factors that lead to the conclusion that a compliance audit had become a criminal investigation?

The court stressed the need to apply the test in such a way that does not place “procedural shackles on regulatory officials” by restricting the use of audit powers once there was the faintest suspicion of wrong doing.⁸⁷ At the same time, courts should not be too lax in the application of the test because doing so would “promote bad faith on the part of the prosecutors”⁸⁸ and

[q]uite conceivably, situations may arise in which charges are delayed in order to compel the taxpayer to provide evidence against himself or herself for the purposes of a s. 239 prosecution. Although the respondent argued that such situations could be remedied by the courts, we view it as preferable that such situations be avoided rather than remedied. It is for this reason that the test is as set out above.⁸⁹

Jarvis also established that a criminal investigation could use information from audit that was discovered before the criminal investigation was commenced. Criminal investigations and audits may also be conducted concurrently but the criminal investigation cannot use any of the information gathered through the use of audit powers.⁹⁰ The predominant purpose test applies to the use of the audit and requirement powers of the CRA on behalf of our treaty partners. If a treaty partner informed the CRA that the treaty partner was seeking the information for the purposes of a criminal investigation, the CRA would not be able to use the *ITA*'s audit and requirement powers. However, a treaty partner may be able to use the section 231.4 ministerial inquiry powers

⁸⁷ *Ibid* at para 89.

⁸⁸ *Ibid* at para 91.

⁸⁹ *Ibid* at para 91.

⁹⁰ *Ibid* at para 97.

for the same purpose. A ministerial inquiry has the power to compel testimony and the production of documents, and in the tax context is used to gather information about tax evaders.⁹¹ They are private investigations⁹² and do not have the power to assess penalties or decide guilt.

In *Del Zotto*, decided only two years prior to *Jarvis*, the Supreme Court was faced with a ministerial inquiry that had been struck in order to obtain evidence of tax evasion by Mr. Del Zotto. The Supreme Court overturned the Federal Court of Appeal, which had ruled that such a use of the inquiry powers violated the *Charter* rights of Mr. Del Zotto. The Court instead adopted the reasons of the dissenting Strayer JA. Strayer JA had found that the use of the inquiry powers did not violate section 8 of the *Charter* (discussed below) and did not violate section 7 of the *Charter* if third parties were compelled to testify.⁹³ It would be a violation if Mr. Del Zotto was compelled to testify, but only if his testimony was used in a subsequent criminal trial.⁹⁴ Therefore the correct time to raise a section 7 challenge would be at any later criminal trial, not during the inquiry.⁹⁵ This creates the possibility of a loophole that will be discussed in Chapter 4 of this thesis.

2.3.3 Section 7 Summary

The section 7 jurisprudence establishes that a taxpayer's privacy rights have more weight in a criminal context, and as such preclude the use of the CRA's regulatory

⁹¹ Canada Revenue Agency, Information Circular 73-10R3, "Tax Evasion" (13 February 1987) at para 25.

⁹² *Guay v Lafleur*, [1965] SCR 12 at 16, [1964] CTC 350.

⁹³ *Del Zotto*, supra note 83 at paras 9-10.

⁹⁴ *Ibid* at paras 30-35.

⁹⁵ *Ibid*.

investigatory powers. The courts have recognized there is a risk that the revenue authorities may be tempted to delay a criminal investigation or conceal the purpose of an investigation in order to retain access to those regulatory investigative powers. The courts chose to impose a duty on investigators so that they have a duty to stop using regulatory powers once the predominant purpose of an investigation was criminal or quasi-criminal. In order to protect Canadian taxpayers privacy, the revenue authorities have a duty to prevent unwarranted invasions of privacy before they happen, rather than rely on Canadian courts to fix them after they occur.

2.3.4 Section 8

Section 8 of the *Charter* provides that:

Everyone has the right to be secure against unreasonable search or seizure.

It is this section that guarantees privacy protection with regards to state intrusions. *Hunter v Southam Inc.*⁹⁶ is the seminal case for section 8 analysis. This was the first time section 8 was considered by the Supreme Court of Canada. The case concerned the search and seizure powers contained in the *Combines Investigation Act*.⁹⁷ These powers are similar to the powers in the *ITA*. The Director of Research and Investigations Branch authorized a search of the offices of the *Edmonton Journal*, a newspaper owned by Southam Inc. The search was challenged on the grounds that the search, and the subsequent removal of documents from the offices violated section 8 of the *Charter*.

⁹⁶ *Hunter et al v Southam Inc*, [1984] 2 SCR 145, 11 DLR (4th) 641 [*Hunter*].

⁹⁷ RSC 1970, c C-23.

Hunter established that section 8 of the *Charter* exists “to protect individuals from unjustified state intrusions upon their privacy.”⁹⁸ This protection is not absolute though. It protects a reasonable expectation of privacy from an unreasonable search:

The guarantee of security from unreasonable search and seizure only protects a reasonable expectation.⁹⁹[emphasis in original]

Legitimate state interests can override an individual’s right to privacy. *Hunter* set the threshold for this override quite high:

The state’s interest in detecting and preventing crime begins to prevail over the individual’s interest in being left alone at the point where credibly-based probability replaces suspicion. History has confirmed the appropriateness of this requirement as the threshold for subordinating the expectation of privacy to the needs of law enforcement.¹⁰⁰

Hunter also established that the proper body to carry out the assessment of when probability replaces suspicion is a judicial one, and the proper time to carry out that assessment is prior to state action. A system of prior judicial authorization is required in order to accomplish this:

The purpose of a requirement of prior authorization is to provide an opportunity, before the event, for the conflicting interests of the state and the individual to be assessed, so that the individual’s right to privacy will be breached only where the appropriate standard has been met, and the interests of the state are thus demonstrably superior. For such an authorization procedure to be meaningful it is necessary for the person authorizing the search to be able to assess the evidence as to whether that standard has been met, in an entirely neutral and impartial manner.¹⁰¹

⁹⁸ *Hunter*, supra note 96 at 160.

⁹⁹ *Ibid* at 159.

¹⁰⁰ *Ibid* at 167.

¹⁰¹ *Ibid* at 162.

Chief Justice Dickson also held that administrators and investigators are ill-suited to make these decisions. Their interest in enforcement prevents them from being impartial arbiters.¹⁰² In addition, decisions being made about an individual's privacy must be reviewable by a court:

A provision authorizing such an unreviewable power would clearly be inconsistent with s. 8 of the *Charter*.¹⁰³

Any decision as to whether or not to obtain taxpayer information or share taxpayer information that is not reviewable by a court violates section 8 of the *Charter*.

2.3.5 Regulatory or Criminal Purpose

Hunter set a very high standard for privacy protection. The courts quickly recognized that prior judicial authorization would be unworkable in many regulatory contexts. The Supreme Court addressed this issue in two cases, *Thomson Newspapers*¹⁰⁴ and *R v McKinlay Transport*.¹⁰⁵ *Thomson Newspapers* again involved the *Combines Investigation Act* and *McKinlay Transport* was concerned with the requirement powers in the *ITA*.

Thomson Newspapers was concerned with section 17 of the *Combines Investigation Act*¹⁰⁶, which contained the power to compel testimony under oath and the production of documents. The court determined that the *Combines Investigation Act* and section 17

¹⁰² *Ibid* at 146, 166.

¹⁰³ *Ibid* at 166.

¹⁰⁴ *Thomson Newspapers Ltd v Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 SCR 425, 67 DLR (4th) 161 [Thomson Newspapers].

¹⁰⁵ *Supra* note 2.

¹⁰⁶ RSC 1970, c C-23.

were regulatory in nature. It did criminalize certain behavior but only for the purposes of ensuring compliance with the *ITA*. The court also held that the privacy interest in business records was low, and the seizure of those records for regulatory purposes was reasonable. Finally, the court concluded that standard set in *Hunter* was too strict for regulatory investigations.¹⁰⁷

Decided at the same time, *McKinlay Transport Ltd.* extended this reasoning to the audit and investigation powers of the *ITA*. In the course of an audit the CRA issued the taxpayers requirements for information pursuant to section 231(3) (now found in section 231.2). At issue was whether or not the audit powers of the CRA constituted a search or seizure, and if so, whether they violated the taxpayer's section 8 rights.

The Court found that the use of the audit powers in the *ITA* did constitute a seizure and that taxpayers are entitled to section 8 protection on the grounds that:

s. 231(3), even construed narrowly in accordance with prior authority, envisages the compelled production of a wide array of documents and not simply those which the state requires the taxpayer to prepare and maintain under the legislation. Second, the legislation contemplates that parties who are not the subject of an investigation or audit can be compelled to produce documents relating to another taxpayer who is the subject of such investigation or audit. Thus, compelled production reaches beyond the strict filing and maintenance requirements of the Act and may well extend to information and documents in which the taxpayer has a privacy interest in need of protection under s. 8 of the *Charter* although it may not be as vital an interest as that obtaining in a criminal or quasi-criminal context.¹⁰⁸

However, the court distinguished *Hunter v Southam Inc* on the basis that the *ITA* is a regulatory statute because its function is to control “the manner in which income tax is

¹⁰⁷ *Thomson Newspapers*, supra note 104 at 535.

¹⁰⁸ *McKinlay*, supra note 2 at 642.

calculated and collected.”¹⁰⁹ The audit powers and the linked offence for non-compliance with a requirement for information are not criminal or quasi-criminal in nature; instead the purpose of these sections is to enforce compliance with the *ITA*.¹¹⁰

The regulatory character of the *ITA* makes untenable the *Hunter* requirement for prior authorization supported by reasonable and probable grounds that an offence has been committed. First in order to maintain the integrity of the income tax system the revenue authorities must be able to perform random monitoring and spot checks. The Court held that “often it will be impossible to determine from the face of [a] return whether any impropriety has occurred in its preparation.”¹¹¹

Second, the Court found that taxpayers have a reduced expectation of privacy in their business and tax records and that in this case taxpayer privacy is protected by section 241:

At the same time, the taxpayer’s privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records, or the information contained therein to other persons or agencies.¹¹²

Section 241 has been extensively amended since *McKinlay* was decided, adding a long list of exceptions to the privacy protection it once provided. It is arguable that section 241 no longer provides as much of a justification for the reasonableness of a reduced expectation of privacy in tax information. Section 241 now allows the disclosure of taxpayer information to other Canadian or provincial agencies (although generally for

¹⁰⁹ *Ibid* at 641.

¹¹⁰ *Ibid* at 641.

¹¹¹ *Ibid* at 648.

¹¹² *Ibid* at 650.

purposes related to the administration of the *ITA* or related acts), and to law enforcement in cases of terrorism or threats to national security where there are reasonable grounds for such disclosure. With both those types of disclosure the information is being transferred for a specific purpose, to a Canadian official or authorized person, subject to Canadian privacy laws; the federal *Privacy Act*,¹¹³ PIPEDA,¹¹⁴ provincial privacy laws¹¹⁵ and the *Charter*. In the first category of exceptions, the information is being used for equivalent purposes (the administration of the Canadian tax system). The second category, national security or terrorism investigations is more troublesome but is tempered by the requirement for reasonable grounds, instead of wholesale transfers on request. The exception for the disclosure of taxpayer information to the revenue agencies of other countries in section 241 however, clearly does not protect the taxpayer's privacy interest "as much as possible"¹¹⁶ any longer nor is it the "least intrusive method"¹¹⁷ of ensuring compliance. Taxpayer information, and any protection Canadian laws might afford it, is leaving the country. Unless there is some protection contained in the tax treaties that mirrors section 241 as it was when *McKinlay* was decided (there is none, and this will be discussed further in Chapters 4 and 5 of this thesis) then *McKinlay* should not be relied on as a justification for a reduced expectation of privacy in the TIE context.

¹¹³ *Privacy Act*, RSC 1985, c P-21.

¹¹⁴ Personal Information Protection and Electronic Documents Act, SC 2000 c 5 [PIPEDA].

¹¹⁵ See for example, Freedom of Information and Protection of Privacy Act, RSBC 1996, c 165; Freedom of Information and Protection of Privacy Act RSO 1990, c F.31.

¹¹⁶ *McKinlay*, supra note 2 at 650.

¹¹⁷ *Ibid* at 649.

There is one case that suggests that sharing or wide publication of taxpayer records would be in breach of section 8 of the *Charter*. *Gernhart*¹¹⁸ involved the publication of taxpayer information. Prior to *Gernhart*, whenever a taxpayer appealed an assessment by the CRA to the Tax Court, subsection 176(1) of the *ITA* required all returns, notices, and notifications in a taxpayer's file to be forwarded to the Tax Court. Once received by the Tax Court they became court documents. Rule 16 of the *Tax Court Of Canada Rules* provides that:¹¹⁹

...person may, subject to appropriate supervision, and when the facilities of the Court permit without interfering with the ordinary work of the Court,
 (a) inspect any Court file relating to a matter before the Court; and
 (b) on payment of \$0.40 per page, obtain a photocopy of any document on a Court file.

Section 176(1) combined Rule 16 had the effect of making available to the general public the tax information of every taxpayer who appealed an assessment.

The Federal Court of Appeal ruled that

subsection 176(1) of the Act constitutes a significant intrusion on the privacy interests of an individual. Even if one assumes that only a small degree of privacy attaches to a taxpayer's return, that small degree of privacy would inevitably be shattered by disclosing the taxpayer's return to the world at large.

...

In my view subsection 176(1) permits an "unreasonable seizure." While the subsection is contained in the *Income Tax Act*, and while a tax return is generally subject to a low expectation of privacy, the degree of intrusion on a taxpayer's privacy interest is potentially enormous. Subsection 176(1) of the Act creates the potential for "any person" to view a taxpayer's return, whether or not the return is eventually tendered as evidence at trial.

¹¹⁸ *Gernhart v Canada*, [2000] 2 FC 292, [2000] 1 CTC 192 (FCA), [*Gernhart*].

¹¹⁹ Tax Court of Canada Rules (General Procedure), SOR/90-688a.

This intrusion, in turn, is not counterbalanced by a sufficiently important government objective.¹²⁰

The court struck down section 176 in its entirety. This decision makes clear what was implied in *McKinlay*, the more broadly a taxpayer's information will be disseminated and the greater the risk it will be exposed to third parties, the greater the corresponding government objective must be in order to outweigh the taxpayer's privacy interest.

2.3.6 Charter Summary

The courts have adopted a contextual approach to balancing the competing interests, on one hand the individual and societal interest in protecting information privacy, and on the other the state's interest in obtaining and using the information.¹²¹ Factors such as the type of information, who has the information and what relationship they have with the person claiming a privacy interest in the information, where the information is being held, how the information will be obtained, and why the information is being sought all must be balanced on a case by case basis.¹²² In the tax context the state interest is usually the administration of the *ITA* (regulatory) but the interest may also be criminal.

If the state's interest is clearly criminal, then section 7 of the *Charter* applies and the CRA must use the more restrictive criminal search and seizure powers. If the state's interest is a mix of regulatory and criminal then the predominant purpose test determines

¹²⁰ *Ibid* at paras 34, 41.

¹²¹ *Plant*, supra note 56 at 293.

¹²² *Ibid*.

whether or not the audit powers may be used. If the state interest is purely regulatory than the audit powers are available and any information that is collected may be used in a subsequent criminal investigation.

2.4 Conclusion

Taxpayer privacy is important both because it is a human right, and because of the potential for misuse of personal information if it falls into the wrong hands. Taxpayer privacy in Canada is protected both by the *Charter* and by section 241 of the *ITA*. Section 241 provides protection against the unauthorized disclosure of or access to taxpayer information. Exceptions exist to this protection for administrative purposes such as administering programs related to the *ITA* or developing public policy. As well, law enforcement is allowed access in the case of reasonable suspicion of terrorist activities or a threat to national security. Recently, a broad exception for the purposes of information exchange has been added.

The *Charter* provides limited privacy protection in the regulatory context, but in cases involving tax evasion or other criminal charges provides a high degree of protection. Privacy protection is more limited in the regulatory context due to the practical requirements of administering the *ITA*: the need for random audits and access to taxpayer information to verify compliance. Further justification for a lowered degree of privacy protection is found in the parallel protection provided by section 241 of the *ITA* once information is collected.

The privacy framework that has been established in the tax context is a compromise driven by necessity. The taxpayer privacy provision initially copied from the British

income tax system protected the privacy of taxpayer information once collected for public policy reasons – to ensure cooperation and compliance by protecting taxpayer information. The *Charter* then constitutionalized that protection, restricting not only when information could be disclosed but also the circumstances of collection. The CRA's regulatory powers were found to be constitutional for the following reasons:¹²³

1. The information was being sought for a specific regulatory purpose, the administration and enforcement of the *ITA*,
2. There is no other way to make the self-assessment system function.
3. There was a strong section 241 that restricted the disclosure of collected information to third parties.

In addition, the following factors can be drawn from the reasoning in related decisions:

1. when administrators are tasked with enforcing a regulatory scheme they are unsuited to making decisions about privacy;¹²⁴
2. certain types of decisions require judicial oversight or prior judicial approval;¹²⁵
3. if at all possible unwarranted invasions of privacy should be prevented;¹²⁶
4. taxpayers have a greater expectation of privacy when their information will be used in a criminal investigation; and¹²⁷
5. taxpayers have a greater expectation of privacy in situations where section 241 does not apply, and information will be shared broadly.¹²⁸

¹²³ *McKinlay*, supra note 2 at 648-650.

¹²⁴ *Hunter*, supra note 96 at 164.

¹²⁵ *Ibid* at 160.

¹²⁶ *Ibid*.

¹²⁷ *Jarvis*, supra note 74 at para 87.

There is also an underlying assumption in all of these decisions that if there is an unwarranted invasion of privacy, or an administrator makes an incorrect decision, it can be remedied by Canadian courts, in Canada.

¹²⁸ *Gernhart*, supra note 118 at para 41.

3 Regulatory and Criminal Investigatory Powers

3.1 Introduction

Tax information exchange treaties require that treaty partners share information they have collected and use their own audit and investigatory powers to collect information on behalf of a requesting state. These powers are found in the *ITA* and consist of regulatory powers and criminal investigation powers. This chapter will examine the information gathering powers Canada has placed at its treaty partners' disposal.

In the tax context in Canada, the government's information gathering powers are divided into regulatory audit powers, and criminal investigative powers. The distinction between regulatory and criminal powers is important because, as discussed in Chapter 2, taxpayers are entitled to a lower degree of privacy protection in the regulatory context than in the criminal context. The Canada Revenue Agency can make use of the following powers in a regulatory context: administrative search powers, requirements for information, inquiry powers, and requests foreign-based information. In addition to these active powers, the CRA also collects information through the self-assessment and self-reporting system set up by the *ITA*. In a criminal context the CRA has the power to obtain search warrants, either through the *ITA* or through the *Canadian Criminal Code*¹²⁹ but

¹²⁹ RSC 1985, c C-46 s 745.

due to section 7 of the *Charter* can no longer use the regulatory powers to gather information for the purposes of a criminal investigation.

3.2 Regulatory and Investigatory Powers

The Canadian income tax relies on a system of self-assessment and self-reporting:

...the *Income Tax Act* was based on the principle of self-reporting and self-assessment. The Act could have provided that each taxpayer submit all his or her records to the Minister and his officials so that they might make the calculations necessary for determining each person's taxable income. The legislation does not so provide, no doubt because it would be extremely expensive and cumbersome to operate such a system.¹³⁰

This system requires that taxpayers submit tax returns, information returns, and keep records. Various third parties, employers and financial institutions for example, are also required to report on taxpayers and transactions. These returns and records are the backbone of the self-assessment system. The CRA has regulatory powers in order to ensure compliance with this system. These audit powers allow the CRA to inspect records and information, or if specific information does not exist, to demand its creation. These powers are among the broadest information gathering powers available to any revenue agency in the world.¹³¹

3.2.1 The Requirement to File a Return

¹³⁰ *McKinlay*, supra note 2 at 648.

¹³¹ OECD, *Tax Administration in OECD and Selected Non - OECD Countries: Comparative Information Series*, (Paris, OECD, 2008) at 134.

The first and simplest information gathering tool the CRA has is the requirement for every taxpayer to file a return.¹³² The requirement to file a return is found in subsection 150(1):

... a return of income that is in prescribed form and that contains prescribed information shall be filed with the Minister, without notice or demand for the return, for each taxation year of a taxpayer

Section 150 requires returns be filed by corporations, individuals (living and deceased), trusts, and estates. In addition to tax returns, there are a host of required information returns prescribed by regulations, such as:

1. Employers who must file T4 and T4a forms
2. Any person who pays a dividend, interest on certain investments, or some types of royalties must file a T5 Return of Investment Income¹³³
3. Many payments made to non-residents (especially payments passive income) must be reported¹³⁴
4. Trustees must file reports¹³⁵
5. Securities brokers must report purchases and sales they make on behalf of others.¹³⁶
6. There is a complex reporting scheme covering tax shelters and tax shelter promoters.¹³⁷

¹³² Subject to certain exceptions in subsection 150(1.1). For example an individual who does not owe tax for the year does not need to file. However, subsection 150(2) provides that the Minister may demand that a taxpayer provide a return.

¹³³ Income Tax Regulations, CRC, c 945 s 201 [Income Tax Regulations].

¹³⁴ *Ibid* s 202.

¹³⁵ *Ibid* s 204.

¹³⁶ *Ibid* s 230(2)-(6).

7. Foreign reporting – Sections 233.2 through 233.6 require information returns for foreign property, foreign trusts, and foreign affiliates.

This system of reporting and cross-referencing is very effective in preventing tax evasion by employees.¹³⁷ Matching and comparing these various information returns and tax returns allows the CRA to spot discrepancies and target audits. This form of cross-referencing has been highly effective in reducing some forms of tax evasion.¹³⁸ It is this sort of information that is and will be exchanged automatically and routinely between revenue authorities either on a bilateral basis or potentially on a multilateral basis. This information is already being collected, already digitized and already amenable to cross-referencing and computer matching. Between the returns filed by taxpayers and the reports filed by third parties the CRA has a substantial amount of information on hand to exchange with foreign revenue authorities.

3.2.2 The Requirement To Keep Books and Books and Records

There is a corresponding requirement to maintain records to support the returns that are filed. Section 230(1) of the *ITA* requires that every person carrying on business in Canada, and every person required to pay or collect taxes, keep records and books of account at their place of business or residence in Canada. The books and records are required to contain enough information to enable the Minister to determine what taxes are payable or should have been deducted, withheld, or collected. These records must be

¹³⁷ *Ibid* s 231; *ITA*, *supra* note 3 s 237.1.

¹³⁸ Canada Revenue Agency, Information Circular 71-14R3, “The Tax Audit” (June 18, 1984) at para 8.

¹³⁹ *Ibid*.

maintained for the periods prescribed by regulation¹⁴⁰ or as set out in the *ITA*¹⁴¹ (generally 6 years). Section 248(1) of the *ITA* defines a “record” as including:

“an account, an agreement, a book, a 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”

CRA policy is that books and records should be supported by “source documents” such as:

“sales invoices, purchase invoices, cash register receipts, formal contracts, credit card receipts, delivery slips, deposit slips, work orders, dockets, cheques, bank statements, tax returns, and general correspondence whether written or in any other form.”¹⁴²

However, the *ITA* does not specify the form the books and records need to take, only that they be sufficient “to enable the taxes payable under the act to be determined.”¹⁴³ The books and records required by the *ITA* can be examined by the CRA using its audit and investigatory powers.

3.2.3 Audits

¹⁴⁰ *Income Tax Regulations*, *supra* note 133 s 5800.

¹⁴¹ *ITA*, *supra* note 3 s 230(4)-(8).

¹⁴² Canada Revenue Agency, Information Circular 78-10R5, “Books and Records Retention/Destruction” (June 2010) at para 7 [Canada Revenue Agency – Books and Records].

¹⁴³ *Merchant (2000) Ltd v Canada (Attorney General)*, 54 DTC 6416, [2000] 3 CTC 291 (FC) at para 13.

An audit is an inspection of a taxpayer's returns, books and records and if applicable a taxpayer's place of business.¹⁴⁴ The CRA's audit program focuses on businesses, professionals, corporations and trusts. Taxpayers who earn employment income have fewer opportunities to evade taxes because their employers must report employee wages, and withhold and remit taxes on their behalf to the CRA.

An audit can be restricted in scope, covering just a taxpayer's returns, or can extend to cover anything from bank accounts, contracts and investments through appointments. Employees and employers may also be questioned. The authority to conduct an audit is found in section 231.1 of the *ITA*, which provides that a person authorized by the Minister may for any purpose related to the administration or enforcement of the *ITA*:

1. Inspect, audit, or examine a taxpayer's books and records.
2. Inspect, audit, or examine any document of a taxpayer that may relate:
 - a. to information that is or should be in the taxpayer's books and records
 - b. to any amount of tax payable by the taxpayer
3. Inspect, audit, or examine any document of any third party that may relate:
 - a. to information that is or should be in the taxpayer's books and records
 - b. to any amount of tax payable by the taxpayer
4. Examine any property, process, or matter of the taxpayer or any third party that may assist:
 - a. in determining the accuracy of an inventory of the taxpayer, or

¹⁴⁴ Canada Revenue Agency – Books and Records, *supra* note 138 at para 20.

- b. in ascertaining information that is or should be in the books and records of the taxpayer, or
- c. in ascertaining any amount of tax payable by the taxpayer.

The CRA may enter into any location in the course of conducting their field audit where:

1. books and records are kept (or should be kept)
2. any property is kept, or
3. any location where business is carried or anything is done in connection to that business.

The CRA can also require any owner, manager, or anyone else in a location to provide reasonable assistance in their investigations and answer questions.

3.2.4 Limitations on the Audit Powers

There are some limitations on the audit powers. Subsection 231.1(2) requires the consent of the occupant in order to enter any dwelling-house. In the alternative, the CRA may seek a warrant to enter a dwelling-house under subsection 231.1(3) In order to obtain the warrant the revenue authorities must make an ex parte application to a judge of a superior court and show that:

1. there are reasonable grounds that the information being sought is in the house
2. entry is necessary in order to enforce or administer the *ITA*, and
3. entry has already been refused or there are reasonable grounds to believe entry will be refused.

The judge may issue a warrant authorizing entry, or issue an order requiring the occupant of the house to provide reasonable access to information or property held in the house, or

make another order at the judge's discretion. This requirement for a warrant is due to the higher expectation of privacy taxpayers have with regards to their territorial privacy.

The other restriction on the use of the audit power is that it must be used for the purposes of the administration or enforcement of the *ITA*. Similar language is found in the other audit powers. This means the audit powers cannot be used for the purposes of another act or for a non-tax investigation. This language has also been held to restrict the use of these powers to instances where there is a “genuine and serious inquiry into the tax liability of some particular person or persons”¹⁴⁵ rather than a general survey into compliance, or a fishing expedition.¹⁴⁶

3.2.5 Requirements for Information

The CRA can also issue a requirement for information. Section 231.2 allows the CRA to require any person to provide any information, or any document that it requests. Like an audit, a requirement must be for the purposes relating to the administration or enforcement of the *ITA*. The requirement power is very broad in scope. The CRA has the power to request information from any person, including third parties such as accountants, lawyers¹⁴⁷ and financial auditors. The types of information that can be requested go beyond just examining books and records and includes the creation of new

¹⁴⁵ *James Richardson & Sons v MNR*, [1984] 1 SCR 614 at 624, [1984] CTC 345, [Richardson].

¹⁴⁶ *Ibid* at 624; *R v He*, 2012 BCCA 318, 2012 DTC 5129 at para. 54.

¹⁴⁷ Subject to claims of privilege.

documents and the requirement to answer questions.¹⁴⁸ However, section 231.2 also states that a requirement may also be issued for the purposes of:

a comprehensive tax information exchange agreement between Canada and another country or jurisdiction that is in force and has effect or, for greater certainty, of a tax treaty with another country

Ordinarily only information that is or may be relevant to the determination of a taxpayer's liability under the *ITA* may be requested.¹⁴⁹ Furthermore, like the audit power, a requirement for information must be sought in regards to a genuine and serious inquiry into a taxpayer's tax liability. It cannot be used as part of a fishing expedition or general survey on taxpayer compliance.¹⁵⁰

3.2.6 Requirements and Third Parties

Subsection 231.2(3) of the *ITA* restricts the ability to issue requirements for information about unnamed third parties. If the CRA is seeking information or a document about an unnamed person or group of unnamed persons, from a third party, it must seek judicial authorization. In order to obtain the authorization a judge must be satisfied by information on oath that:

1. the person or group is ascertainable, and
2. the requirement is made to verify compliance by the person or group of persons in the group with any duty or obligation under the *ITA*.

¹⁴⁸ *Tower v Minister of National Revenue*, 2003 FCA 307, [2004] 1 FCR 183 at para 20.

¹⁴⁹ *ITA*, *supra* note 3 s 231.2(1).

¹⁵⁰ *Richardson*, *supra* note 145 at 625.

This limitation is also intended to prevent unwarranted fishing expeditions.

3.2.7 Ministerial Inquiry Powers

The CRA also has the authority under section 231.4 to strike an inquiry with reference to anything relating to the administration or enforcement of the *ITA*. The hearing officer of an inquiry has the power to:¹⁵¹

- Summon witnesses
- Compel testimony under oath,
- Compel the production of documents
- Hire experts to assist the inquiry
- Make a report

This inquiry power has been used in the past to investigate and gather evidence of tax evasion.¹⁵² An inquiry is used:

...in Special Investigations cases where persons who are considered able to give evidence concerning transactions or practices constituting tax evasion are reluctant to furnish voluntary explanations or are so closely related to the tax filer under examination, by family relationship or business association, that they will not for fear of recriminations or financial loss, give information unless compelled to do so.¹⁵³

Again, like the other regulatory powers the ministerial inquiry power is limited to being used for the administration and enforcement of the *ITA*.

¹⁵¹ *Inquiries Act*, RSC 1985, c I-11, ss 4-5.

¹⁵² *Del Zotto*, *supra* note 83.

¹⁵³ Canada Revenue Agency, *supra* note 89 at para 25.

3.2.8 Request for Foreign Based Information

The CRA also has the authority under section 231.6 to require that any person resident in Canada or carrying on business in Canada provide to the CRA any “foreign-based information or document”. Foreign based information or a foreign document is defined as “any information or document that is available or located outside Canada and that may be relevant to the administration or enforcement of this Act”.¹⁵⁴ There is a key difference between section 231.6 and the ordinary section 231.2 requirement power. Section 231.6 does not contain any provisions related to obtaining foreign-based information about unnamed third parties. It has been argued that this lack of equivalent provisions prevents its use in situations where the CRA is seeking foreign-based information about unnamed third parties.¹⁵⁵ This would allow the CRA to obtain information on unnamed third parties without having to seek prior judicial authorization. Unfortunately when presented with this argument in *eBay Canada Ltd. v MNR*¹⁵⁶ (discussed below) the Federal Court of Appeal declined to rule on it, as the matter was

¹⁵⁴ *ITA*, supra note 3 s 231.6(1).

¹⁵⁵ Michael Ziesmann, "Gone Fishing: An Analysis of CRA Powers and Policies Relating to the Use of Fishing Expeditions in Information Gathering" (2008 - 2009) vol 58, no 1 Canadian Tax Journal at 13.

¹⁵⁶ *eBay Canada Ltd. v MNR*, 2008 FCA 348, [2010] 1 FCR 145 [*eBay Canada*].

decided on other grounds.¹⁵⁷ It is still an open question as to whether or not Parliament intended to restrict the use of requests for foreign-based information in these cases.

3.2.9 When Information Located Abroad is Accessible in Canada

There is also the possibility that foreign based information may be accessible by way of an ordinary requirement for information. This issue of whether or not information is located in Canada or abroad was considered in *eBay Canada Ltd. v MNR*. In *eBay Canada*, the CRA was seeking information on Canadian eBay sellers from eBay Canada. The CRA was attempting to determine the taxes owed by high volume Canadian eBay vendors who may not have reported the income from their sales. eBay vendors are able to conduct their business using pseudonyms and can operate ‘under the table’ with very little paper trail.

The information on these high volume vendors was held by eBay Canada’s parent company, which was located in the United States. The Federal Court of Appeal held that the information was located in Canada, because eBay Canada could download and access the information from its parent company’s servers:

...with the click of a mouse, the appellants make the information appear on the screens on their desks in Toronto and Vancouver, or anywhere else in Canada. It is as easily accessible as documents in their filing cabinets in their Canadian offices. Hence, it makes no sense in my view to insist that information stored on servers outside Canada is as a matter of law located outside Canada for the purpose of section 231.6 because it has not been

¹⁵⁷ *Ibid* at para 53.

downloaded. Who, after all, goes to the site of servers in order to read the information stored on them?¹⁵⁸

Given that the information was easily obtainable in Canada, the CRA was able to use the ordinary section 231.2 requirement power to obtain it. Although this decision makes a great deal of sense, it also broadened the scope of the section 231.2 requirement power to allow access to (potentially) any information held on any computer, anywhere in the world, provided it can be obtained or accessed in Canada.

There is also the potential for a mismatch between the CRA's ability to gather domestic information and its ability to gather foreign-based information if, in the future, a court addresses the issue of whether a requirement for foreign based information can be used to obtain information on unnamed third parties and finds that it can be used in such a fashion. *eBay Canada* sets up a situation where information on unnamed third parties held abroad but accessible in Canada is (potentially) available to the CRA by both an ordinary requirement for information and a requirement for foreign based information. As discussed above, a requirement for information on unnamed third parties would require prior judicial authorization (in order to prevent unjustifiable fishing expeditions), whereas a requirement for foreign-based information does not require prior judicial authorization.

3.3 Criminal Search and Seizure Powers

The audit and requirement powers are only available to the CRA for regulatory purposes. The CRA must make use of its criminal search and seizure powers when an

¹⁵⁸ *Ibid* at para 48.

investigation's predominant purpose is criminal.¹⁵⁹ Section 231.3 of the *ITA* allows the CRA to apply to a superior court or federal court judge for a search warrant. The warrant allows the CRA to search for any document or "thing that may afford evidence as to the commission of an offence under this Act."¹⁶⁰ The CRA may seize anything specified in the document as well as anything else it finds during the course of its search and examination that it believes "on reasonable grounds affords evidence of the commission of an offence under this Act".¹⁶¹ Anything seized that was not specified under the warrant must be brought to a judge for judicial control and review.¹⁶² A section 231.3 warrant must specify the offence for which it was issued, identify the building, receptacle or place that will be searched, and it must identify the person alleged to have committed the offence.¹⁶³ It also must be "reasonably specific as to any document or thing to be searched for and seized."¹⁶⁴ The CRA may also obtain a search warrant by way of section 487 of the *Criminal Code*. Section 487 contains the same substantive restrictions but allows the issuance of a warrant by a provincial court judge or justice of the peace.

3.3.1 CRA Attempts to Circumvent These Restrictions

These restrictions greatly narrow the circumstances in which a search warrant can be obtained. Criminal investigations do not have access to the sweeping audit powers.

¹⁵⁹ *Jarvis*, *supra* note 74 at para 88.

¹⁶⁰ *ITA*, *supra* note 3 s 231.3(3).

¹⁶¹ *Ibid* s 231.3(5).

¹⁶² *Ibid* s 231.3(5).

¹⁶³ *Ibid* s 231.3(4).

¹⁶⁴ *Ibid*.

The temptation to use audit powers in a criminal context has in the past resulted in attempts by the CRA to sidestep taxpayers' *Charter* protections.

In *Norway Insulation Inc*,¹⁶⁵ a taxpayer's audit file was referred to the Special Investigations Branch after a routine audit discovered that the taxpayer, Norway Insulation, had unreported sales. The Special Investigations Branch concluded that sales had likely been concealed and that criminal charges were justified. However, the investigators referred the matter back to the audit branch in order to obtain more information for the purposes of applying for search warrants. The validity of the warrants was challenged on the basis that the warrants had been obtained through an audit that violated the taxpayer's section 8 *Charter* rights. The court held that:

Section 231.1(1) is designed as a regular audit tool to ensure compliance with the Act. It is not designed to gather evidence for the purpose of a criminal prosecution. It should not be used to bootstrap the Ministry investigators into a position where they can obtain a warrant which would otherwise be unattainable.¹⁶⁶

The court quashed the warrants on the basis that they violated section 8 of the *Charter*.

In *R v Saplys*¹⁶⁷ the CRA's Special Investigations Branch (which handles tax evasion) attempted to revive a stalled criminal investigation into a land development company (Axiom) by handing it back to the Audit Branch. Special Investigations requested that the Audit Branch perform an in depth audit and pass the information back to Special Investigations. The CRA assigned the audit to an employee who was not made

¹⁶⁵ *R v Norway Insulation Inc*, 95 DTC 5328, 23 OR (3d) 432 (Ont Gen Div).

¹⁶⁶ *Ibid* at 438.

¹⁶⁷ *R v Saplys*, (1999), 132 C.C.C. (3d) 515, 60 CRR (2d) 272 (Ont Gen Div).

aware of Special Investigations' previous investigation or current interest, or the fact that Axiom was suspected of fraudulent activity. The CRA intended to circumvent the taxpayer's privacy rights by isolating the auditor in this way.¹⁶⁸ After the audit was complete the information was turned over to Special Investigations. Based on the audit results, charges were laid and search warrants were issued.

Axiom contested the CRA's use of its audit powers to further a criminal investigation. The Crown argued that the audit was not improper because the auditor (Mr. Hui) had been insulated. He had been kept in the dark about the true purpose of the audit and did not know about the previous criminal investigation. The court took a dim view of this argument, holding that:

For a state agency to permit an auditor embarking upon an apparent compliance audit to be insulated from knowing the true nature of his assignment in order to further a stale or stymied criminal investigation runs counter to the notion of a state agency utilizing its powers to obtain compliance by citizens with taxing statutes for another purpose, *viz.*, to further a criminal investigation, so as to bypass citizens' rights protected under the *Charter*.

It is particularly repugnant when the tax regime is founded on initial self-assessment and the regulatory branch of the tax administration is understood by taxpayers and their advisors as having responsibility for compliance and not for investigation into suspected criminal wrongdoing and the gathering of evidence in such investigations. The courts are the guardians of the rights and freedoms under the *Charter* and the fundamental values of a free society that inspire them. To allow the insulation of Hui's [the CRA auditor] audit in furtherance of SI's criminal investigation would, in my opinion, give SI *carte blanche* to engineer substantial impairment, if not eradication, of the *Charter* rights of taxpayers under investigation by the simple expedient of using an unwitting auditor to conduct an apparent compliance audit for the predominant purpose of aiding a criminal investigation.¹⁶⁹

¹⁶⁸ *Ibid* at para 39.

¹⁶⁹ *Ibid* at paras 22-23.

In *R v Harris*,¹⁷⁰ the issue was close cooperation between the RCMP and the CRA. The RCMP discovered a substantial sum of money in the possession of Mr. Harris in the course of a criminal investigation. At trial, the searches, which had turned up the money, were ruled illegal, and Mr. Harris was acquitted. The RCMP informed a branch of the CRA with which it works closely (the Special Enforcement Branch) about the money. The CRA issued requirements for information to Mr. Harris regarding the money. Mr. Harris refused to comply and was charged with failure to comply under section 238(1).

At trial, the CRA argued that it was conducting a regulatory audit, and Mr. Harris was not entitled to *Charter* protections against search and seizure or the right to silence.

The court disagreed, holding that:

[c]learly, the function of the *Income Tax Act* here as it was used with the "assistance and support of the Department of the Solicitor General, represented by the R.C.M.P." in all fairness cannot be said to be solely regulatory or administrative. ... The appellant would have the Court turn a blind eye to the close working relationship between the Department of National Revenue and the R.C.M. Police existing under the Special Enforcement Program. With respect, I am not prepared to do that. It is not the function of the *Income Tax Act* alone which must be considered in this case (as it was in *McKinlay*); rather, it is the function of the *Income Tax Act* in conjunction with the Special Enforcement Program which must be considered. I am in agreement with the Court below which found that *McKinlay* is distinguishable, and further, that in the context of this case there is a criminal or quasi criminal function apparent in the procedures and methods which were followed.¹⁷¹

¹⁷⁰ *R v Harris*, 95 DTC 5653, [1995] BCWLD 2162 [*Harris*].

¹⁷¹ *Ibid* at para 9.

Because these cases and the actions of the government officials involved took place in Canada, their actions were reviewable by our courts and the *Charter* breaches correctable.

3.4 Conclusion

The CRA has a variety of investigatory tools at its disposal. Those tools are supposed to be used in the course of a genuine and serious inquiry into taxpayer liability and are not intended to be used to conduct general surveys of compliance. Although it was held in *McKinlay* that judicial authorization is not required in the use of audit powers, two of the audit powers contain specific provisions allowing for judicial review. Subsection 231.2(2) requires that the Minister obtain judicial authorization prior to obtaining information on unnamed persons from third parties. Subsection 231.6(4) allows a taxpayer to seek judicial review of a request for foreign-based information. From this it can be inferred that prior judicial authorization and ready access to judicial review are not incompatible with the administration and enforcement of the *ITA* and is appropriate in certain circumstances.

In addition, the use of these tools use is subject to *Charter* restrictions. The key trigger for increased *Charter* protection is the start of a criminal investigation. Consistent with Chief Justice Dickson's observation in *Hunter*¹⁷² that administrators tasked with enforcing an Act lack impartiality when it comes to privacy, the CRA has in the past taken steps to avoid or circumvent these *Charter* protections.

¹⁷² *Supra* note 96.

Chapter 4 will now examine the three types of tax treaty and show how those tax treaties override privacy protections built into the *ITA*, and potentially sidestep the application of the *Charter* either by moving an investigation offshore and outside of the *Charter*'s jurisdiction or by allowing a criminal investigation to be disguised as a regulatory one in the same manner that the CRA has attempted domestically in the past. The result is that tax treaties grant to our treaty partners broader access to Canadian taxpayer data domestically than is available to the CRA while at the same time granting to the CRA broader investigatory powers abroad than are available to them at home.

4 Tax Information Exchange

4.1 Introduction

In the previous chapters, this thesis has discussed how the balance between taxpayer privacy rights and state requirements for information in order to administer and enforce the tax system has been struck in Canada. Canadians have a low expectation of privacy in their business and financial records when the state interest is regulatory, the information is being used for tax purposes, and the information collected is protected against unauthorized disclosure to third parties. Canadians privacy interests weigh more strongly when those circumstances are changed. As we have seen, privacy interests are stronger when the information is being disclosed publicly,¹⁷³ or is being sought by third parties¹⁷⁴ or is being sought for a criminal purpose.¹⁷⁵

International tax information exchange changes both the balance of interests and the context in which taxpayer information is obtained or disclosed. When another country requests a taxpayer's information or is automatically or spontaneously sent that information, the State interest at stake is no longer (just) the administration and enforcement of the Canadian tax system. The information is being collected and disclosed for the benefit of a foreign State and the administration of foreign tax system. This cooperation may at some future date help Canadian tax authorities when they require information from a foreign revenue agency. While this sort of quid pro quo may

¹⁶⁰ *Glover, supra* note 63.

¹⁷⁴ *Gernhart, supra* note 118.

¹⁷⁵ *Jarvis, supra* note 74.

be advantageous to the Canadian tax system it is an entirely different purpose from that advanced and accepted in *McKinlay Transport*.

Sharing information internationally is also a dramatic change from *McKinlay Transport* where the court presumed that information gathered by the CRA would not be shared at all. As this chapter will show, the tax information exchange provision in the treaties envision sharing on different scales, from targeted requests for information about a single taxpayer to wide-ranging automatic bulk exchanges of information covering millions of taxpayers.

Even the purpose of a request for taxpayer information may or may not be clear. The determination as to whether or not a request is valid and whether it is for regulatory or criminal purposes is left up to the revenue authorities that are exchanging information. This chapter will discuss the protections against abuse that are in existing tax treaties and their shortcomings.

Part one of this chapter examines why states are increasingly interested in obtaining and disclosing taxpayer information internationally and the contexts in which information exchange occurs. Information exchange has become increasingly important because of globalization, which has resulted in the growth and increasing co-ordination of tax havens, harmful tax competition and the internationalization of crime, corruption, and terrorism. Part two of this chapter examines the common features of the three main types of tax treaties: bilateral tax conventions, bilateral tax information exchange agreements (TIEAs), and the multilateral *Convention on Mutual Administrative*

Assistance in Tax Matters (the Multilateral Convention).¹⁷⁶ Part three of this chapter examines each of those types of treaty in more detail.

4.2 Part I: The Growth of Information Exchange

4.2.1 Globalization

The key driver for an increased desire in taxpayer information exchange is economic globalization. The IMF defines economic globalization as the series of

“technological advances that have made it easier and quicker to complete international transactions—both trade and financial flows. It refers to an extension beyond national borders of the same market forces that have operated for centuries at all levels of human economic activity—village markets, urban industries, or financial centers.”¹⁷⁷

These technological advances have made the location where a range of goods are produced and services provided increasingly flexible. One aspect of this technological advancement is the ability to invest or place money anywhere in the world and still have the ability to access it with the click of a mouse, or the swipe of a credit card. Taxpayers can now easily and securely place their money in a tax haven or take advantage of secrecy jurisdictions. Sophisticated advice is available to help taxpayers structure transactions to exploit differences and conflicts between countries’ tax systems.¹⁷⁸

¹⁷⁶ *Supra* note 6.

¹⁷⁷ IMF Staff, “Globalization: Threat or Opportunity?” (April 12, 2000), online: International Monetary Fund <<http://www.imf.org/external/np/exr/ib/2000/041200to.htm#II>>.

¹⁷⁸ OECD, “Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues” (Paris: OECD, 2012).

Easy access to tax avoidance and tax evasion abroad is one driver for an increased state interest in taxpayer information exchange. Instead of having most or all relevant portions of a taxpayer's tax information contained within Canada, a taxpayer's affairs and finances might be spread around the globe, either deliberately to avoid taxes or just as a natural result of the changing world. At the same time, globalization has made international tax information exchange feasible on a broad scale. It is far more efficient to collect and search through electronic records than it is through paper ones. Digitized tax information can be stored in databases, searched, analyzed and sent around the world to other revenue agencies.

4.2.2 Harmful Tax Competition

In an increasingly globalized environment some jurisdictions have begun to actively compete for foreign investment using their tax systems. Governments must now create investor friendly climates in order to compete for investment projects and attract scarce capital. Financial deregulation and trade liberalization has increased the global pool of wealth but has also created the possibility of capital flight.¹⁷⁹ As a result, most States now routinely offer special tax rates, tax structures, or tax holidays to attract foreign investment, either from individuals or corporations.

¹⁷⁹ JC Sharman, *Havens in a Storm: The Struggle for Global Tax Regulation*, 1st ed (Cornell University Press, 2006) at 3 [Sharman].

Harmful tax competition is the aggressive bidding for or poaching of other countries tax bases.¹⁸⁰ Harmful tax competition was explicitly recognized as an issue in 1996 at a G7 heads of state summit in Lyon. At the summit the OECD was called on to respond a new and emerging problem, harmful tax competition.¹⁸¹ Harmful tax competition combines issues that the OECD had turned its eye towards in the past but had had difficulty achieving consensus on solutions or collective action in addressing: international tax competition, tax havens, tax evasion, and aggressive tax avoidance.¹⁸² The OECD published its *Report on Harmful Tax Competition* in 1998 (the “OECD Report”).¹⁸³

In the OECD Report, the OECD describes harmful tax competition as being the result of globalization. Globalization has encouraged the broadening of tax bases and a general lowering of rates. The OECD views this trend towards what it calls modern and neutral tax systems as a positive thing.¹⁸⁴ On the other hand it has also had the effect of giving companies and individuals greater freedom to minimize and avoid taxes. It has also allowed countries to structure their tax policies in such a way as to divert mobile financial capital, services and intangibles. This has led to harmful tax competition in the form of tax base poaching.

¹⁸⁰ OECD, "Harmful Tax Competition: An Emerging Global Issue"(Paris: OECD, 1998) [OECD, “Report”] at 16.

¹⁸¹ Sharman, *supra* note 179 at 14, 17.

¹⁸² Caroline Doggart, *Tax Havens and Their Uses* (London: The Economist Intelligence Unit, 1985) at 84.

¹⁸³ *Supra* note 180.

¹⁸⁴ OECD, “Report”, *supra* note 180 at para 26.

The OECD Report identifies two types of countries that engage in harmful tax competition: tax havens, and countries with harmful preferential tax regimes. A tax haven is able to finance its public sector by levying only nominal taxes, and offers itself as a place for non-residents to avoid tax in their home country.¹⁸⁵ Tax haven countries that do not have a large welfare state to support have more freedom to tailor their tax policies to attract mobile capital.¹⁸⁶ A country with harmful preferential tax regimes is a country that collects substantial corporate and individual taxes but has instituted a tax practice that has spillover effects, (redirecting financial flows from other countries through tax policy decisions) “so substantial that they are concluded to be poaching other countries’ tax bases”.¹⁸⁷ Both types of countries act as pass-throughs or conduits by exploiting a combination of low or no tax rates and some form of lack of information exchange, either explicitly through bank secrecy laws, or a policy of non-cooperation or less obviously through lax audits or lack of oversight and administrative capability.

This lack of information impedes other countries’ efforts to collect taxes they are rightfully owed, by allowing taxpayers to take advantage of tax haven ‘features’ such as lax audits, secret favourable tax rulings, and other administrative policies designed to enable avoidance or evasion.¹⁸⁸ To address this problem, the OECD Report recommended the development and improvement of tax information exchange. Tax information exchange with tax havens is a solution to tax poaching in that it lessens the ability for taxpayers to conceal income and evade taxes. Tax information exchange was

¹⁸⁵ *Ibid* at para 42.

¹⁸⁶ *Ibid* at para 29.

¹⁸⁷ *Ibid* at para 31.

¹⁸⁸ *Ibid* at para 80.

implemented through changes to existing tax treaties (as well as new OECD model treaties and the commentaries that those treaties are based on) that strengthened information exchange. The report also led to the creation of Tax Information Exchange Agreements (TIEAs). TIEAs are treaties designed to establish information exchange with tax havens. It also led to changes to the OECD multilateral Convention on Mutual Administrative Assistance in Tax Matters to expand information exchange and led to more OECD members ratifying this Convention.

Tax information exchange and especially tax information exchange with countries branded as tax havens obviously has a role to play in preventing tax evasion. The secrecy provided by tax havens and harmful preferential tax regimes and the ease of accessing funds via an untraceable credit card makes tax evasion less risky. International tax evasion allows individuals and business to benefit from public spending in their residence country or in the source country they are doing business in without having to contribute to the public purse.¹⁸⁹ Canada has embraced information exchange (TIEAs in particular¹⁹⁰) as a way to raise revenue without having to raise taxes. Finance Minister Jim Flaherty has framed the issue as a policing issue:

People shouldn't be hiding money from the Government of Canada. Some people do that offshore...And sometimes it makes sense to invest more resources for example in the Canada Revenue Agency so that we are better at policing the minority of Canadians who do not pay their fair share. So we're looking at that side of it.¹⁹¹

¹⁸⁹ *Ibid* at para 24.

¹⁹⁰ Department of Finance, "Canada Signs Agreements to Combat Tax Evasion" (17 November 2010), online: < www.fin.gc.ca/n10/10-107-eng.asp>.

¹⁹¹ Cited in Bill Curry, "Flaherty warns of 'significant' hit to federal revenue" *The Globe and Mail* (8 March 2013), online: < <http://www.theglobeandmail.com/report-on->

The hope is more information from abroad will lead to more audit and enforcement actions. Although Canada does not collect data on or calculate the tax gap (the amount of revenue that is not collected due to taxpayer non compliance), estimates from other OECD members countries place the tax gap at between 7% (the UK) and 14% (the US) of theoretically collectable revenues.¹⁹²

4.2.3 Crime and Terrorism

As discussed in the previous chapter, the police, intelligence services and other regulatory bodies make use of taxpayer information that they are able to obtain domestically. Crime, like business, has been subject to the same processes of globalization. The secrecy provided by tax havens and harmful tax regimes has been decried as facilitating the laundering of drug money¹⁹³, terrorist financing,¹⁹⁴ and corruption in the developing world.¹⁹⁵ These issues and the desire for law enforcement to have access to information held abroad have had an impact on the development of tax information exchange. The OECD followed up the 1998 Report on Harmful Tax

business/economy/flaherty-warns-of-significant-hit-to-federal-revenue/article9518448/>.

¹⁹² Paul Mcleod, “PBO still waiting for numbers from Canada Revenue Agency” *The Calgary Herald* (6 March 2013), online: <<http://thechronicleherald.ca/canada/886263-page-frustrated-in-bid-to-calculate-tax-gap>>.

¹⁹³ Sharman, *supra* note 179 at 31-32.

¹⁹⁴ *Ibid* at 36.

¹⁹⁵ Norway, *Commission on Capital Flight from Poor Countries, Tax havens and development Status, analyses and measures* (Norway: Commission on Capital Flight from Poor Countries, 2009) at 82.

Competition with efforts to reduce and eliminate bank secrecy laws in tax havens.¹⁹⁶ At the same time, the Financial Action Task Force, an organization with a mandate to combat money laundering and terrorist financing that operates out of the OECD headquarters in Paris released a parallel series of blacklists.¹⁹⁷ On the treaty side, these efforts resulted in language that prevents bank secrecy or confidentiality laws from barring compliance with a request for information. As well, so-called notwithstanding clauses were proposed for the confidentiality articles contained in all three treaties. These new clauses allow taxpayer information obtained through the treaties to be used for non-tax purposes.

4.3 Tax Treaties

4.3.1 The Three Types of Treaty

The OECD proposed solution for all of these problems is tax information exchange. Because tax information exchange is carried out mainly under the auspices of bilateral or multilateral treaties (although it can also be carried out informally or via domestic legislation) this chapter will examine the model treaties developed by the OECD because they are the models used by Canada when negotiating treaties. Those treaties are the *Model Tax Convention on Income and Capital*¹⁹⁸ (Model Convention), the

¹⁹⁶ OECD, *Improving Access to Bank Information for Tax Purposes*, (Paris: OECD, 2000).

¹⁹⁷ Financial Action Task Force, *List of Non-Cooperative Countries or Territories*, (Paris: FATF, 2000).

¹⁹⁸ OECD, *Model Tax Convention on Income and on Capital 2010: Full Version*, (Paris: OECD, 2012) [OECD, *Commentary*].

*Model Agreement on Exchange of Information on Tax Matters*¹⁹⁹ (Model Agreement), and the *Convention on Mutual Administrative Assistance in Tax Matters*.²⁰⁰ Canada uses the Model Convention and its commentary for its bilateral tax treaties, the Model Agreement and its commentary for its Tax Information Exchange Agreements (TIEAs) and is a signatory to the *Convention on Mutual Administrative Assistance in Tax Matters*.

Canada currently has 92 tax conventions in force, 8 under negotiation or re-negotiation, and 3 signed but not in force.²⁰¹ These tax conventions are primarily concerned with the elimination of double taxation and are negotiated with countries in order to facilitate international business and investment but contain articles that address information exchange. In addition to these tax conventions, since 2008 Canada has entered into 18 TIEAs which are in force and 4 which are signed but not in force, and has entered into negotiations with 8 other countries.²⁰² TIEAs are solely concerned with tax information exchange and are concluded with countries ordinarily considered tax havens. Canada has signed TIEAs with the following countries: Anguilla, Aruba, the Bahamas, Bermuda, the Cayman Islands, Costa Rica, Dominica, Guernsey, Isle of Man, Jersey, Netherlands Antilles, San Marino, St. Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, and Turks and Caicos Islands. Canada has entered into negotiations with

¹⁹⁹ OECD, *Model Agreement on Exchange of Information on Tax Matters*, (Paris: OECD, 2002) [OECD, *Model Agreement*].

²⁰⁰ OECD, *Convention on Mutual Administrative Assistance in Tax Matters* (Paris: OECD, 2011) [OECD, *Multilateral Convention*].

²⁰¹ Department of Finance, “Notices of Tax Treaty Developments” (1 November 2013), online: <http://www.fin.gc.ca/treaties-conventions/treatystatus_-eng.asp>.

²⁰² Department of Finance, “Tax Information Exchange Agreements: Notices of Developments” (27 January 2014), online: <<http://www.fin.gc.ca/treaties-conventions/tieaaerf-eng.asp>>.

Antigua and Barbuda, Bahrain, Belize, British Virgin Islands, Brunei, Cook Islands, Gibraltar, Grenada, Liberia, Liechtenstein, Montserrat, Panama, Uruguay, and Vanuatu.

As of writing, 64 countries have signed the *Convention on Mutual Administrative Assistance in Tax Matters*.²⁰³ This Convention is a multilateral instrument designed to increase tax co-operation and information exchange among all of its signatories. It is intended to provide a single legal basis for information exchange on a wider range of taxes than the current web of bilateral treaties. By signing this convention, Canada does not need to update and or amend older tax treaties it has with any fellow signatories in order to broaden tax information exchange.

4.3.2 The Common Features of Tax Treaties

4.3.2.1 Competent Authorities

These treaties all share some common features. The first is the designation of a ‘competent authority’, which is responsible for exchanging information. This competent authority deals directly with the other state’s competent authority. The competent authority is tasked with exchanging information. The competent authority is also the body that has the discretion to refuse an exchange if it falls into one of the few

²⁰³ OECD, Status of the Convention on Mutual Administrative Assistance in Tax Matters and Amending Protocol (Paris: OECD, 2013), online: < http://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf >.

limitations to information exchange. Canada's treaties name the Minister of National Revenue and the Minister's authorized delegates as the competent authority. In Canada the exchange of information is handled by the Competent Authority Services Section of the International Tax Directorate.²⁰⁴ In addition, the OECD encourages training ordinary auditors to spot files with international tax issues and then forward these files to the Competent Authority Services Section for evaluation.²⁰⁵ This raises the issue of a particular audit shifting from being predominantly for the purpose of administering the Canadian income tax system to being conducted for the purposes of spontaneous exchange with a treaty partner – a shift in context that should trigger a different level of privacy protection.

4.3.2.2 Forms of Exchange of Information

All three treaties also make use of one or more forms of information exchange. There are three main forms of information exchange: on request, automatic and spontaneous. On request means that one state's tax administrators requests the information on specific taxpayers from another state's tax administrators. Unless the request triggers a very limited set of exceptions, the requested state is obliged to obtain and share the requested information. The CRA receives 159 requests for information a year and makes 148 requests a year on average.²⁰⁶

²⁰⁴ Canada Revenue Agency, Information Circular 71-17RS, "Guidance on Competent Authority Assistance Under Canada's Tax Conventions" (1 January 2005) at para 5.

²⁰⁵ OECD, "Manual on the Implementation of Assistance in Tax Collection: Module 2" (Paris: OECD, 2007) at 3 [OECD, "Manual: Module 2"].

²⁰⁶ Diksic & Shafer, *supra* note 18 at 167.

Automatic exchange generally involves the bulk exchange of the information of many individual taxpayers. Typically the information is in relation to passive income (interests, dividends, royalties, pensions). It can also be used to send more general data on changes of residence, purchases and sales of property, and VAT refunds.²⁰⁷ The OECD has announced that it is redoubling its efforts to spread the use of automatic information exchange, with the goal of implementing widespread multilateral information exchange.²⁰⁸ Canada shares more than one million records a year with 25 different countries via automatic information exchange.²⁰⁹ The information is not shared because of any particular suspicion; instead it is shared because it can be, and because it is viewed as providing a deterrent to tax evasion.²¹⁰

Spontaneous exchange is “the provision of information to another contracting party that is foreseeably relevant to that other party and that has not been previously requested”.²¹¹ Tax officials are trained to recognize and then pass on to the competent authorities of other countries any information that they feel could be of use to these countries.²¹² The OECD lists as an example of relevant information to be passed on, any cross border business dealings conducted in such a way that there may be a tax savings –

²⁰⁷ OECD, "Manual on the Implementation of Assistance in Tax Collection: Module 3" (Paris: OECD, 2007) at para 2.

²⁰⁸ OECD, “Automatic Information Exchange: What it is, How it Works, Benefits and What Remains to be Done” (Paris: OECD, 2012) at 5, 8 [OECD, “Automatic Information Exchange”].

²⁰⁹ Diksic & Shafer, *supra* note 18 at 167.

²¹⁰ OECD, “Automatic Information Exchange”, *supra* note 208 at 19.

²¹¹ OECD, “Manual: Module 2”, *supra* note 205 at 1.

²¹² OECD, "Manual on the Implementation of Assistance in Tax Collection: General Module " (Paris: OECD, 2007) at para 18 [OECD, “Manual: General Module”].

so potentially every single cross border transaction.²¹³ Spontaneous information exchange raises serious privacy concerns. If it is actively implemented, and auditors are effective in spotting and forwarding information to the competent authorities, then every single file and every single audit conducted in Canada is done with a secondary purpose. If it is accepted that information gathering done on behalf of a foreign revenue agency should be subject to a different balance of privacy rights and state interest in information, then spontaneous information exchange raises similar issues to the use of audit powers to further a criminal investigation. Although the CRA no longer makes statistics on spontaneous information exchange public, in 2002 the CRA received 18 pieces of information spontaneously and sent 22 pieces of information abroad.²¹⁴

4.3.2.3 Other Forms of Information Exchange

There are also non-traditional forms of information exchange. There are simultaneous tax audits which are coordinated audits carried out by more than one country at the same time on the same taxpayer with information exchanged between tax administrators before during and after the audits. Tax examinations abroad enable auditors to travel to a different country to observe or actively participate in audits abroad. Finally there are industry wide exchanges of information where information on entire

²¹³ OECD, “Manual: Module 2”, *supra* note 205 at para 2.

²¹⁴ Diksic & Shafer, *supra* note 18 at 168.

economic sectors is exchanged.²¹⁵ The *Model Convention* and the *Convention on Mutual Assistance* both authorize these other forms of information exchange.

4.3.2.4 Obligation to Exchange Information

All three treaties provide for the mandatory exchange of information and the exchange of information is not limited to information that tax administrators already have or normally collect. If a treaty partner requests information that is not currently available, the requested tax administration is required to use any and all information gathering powers that it has.

There are certain limitations to the obligation to exchange information built into the treaties. All of these limitations are discretionary in nature; the requested party does not have to refuse a request and the OECD urges tax administrators to err on the side of exchanging information rather than not.²¹⁶ The first limitation is the principle of reciprocity, the idea that countries should not be able to take advantage of another country's tax system to obtain more information than they could under their own domestic laws.²¹⁷ The OECD commentaries state that the treaties allow a competent authority to refuse to provide information to a country, where the requesting country

²¹⁵ OECD, "Manual: General Module", *supra* note 212 at para 20.

²¹⁶ OECD, *Commentary*, *supra* note 198 at C(26)-9.

²¹⁷ *Ibid* Article 26(3); OECD, *Model Agreement*, *supra* note 199 Article 7(1); OECD, *Multilateral Convention*, *supra* note 200 Article 21(2)(a), 21(2)(c).

would be precluded by law from obtaining the information under its own domestic law.

However, those commentaries go on to state that:

[Too] rigorous an application of the principle of reciprocity could frustrate effective exchange of information and that reciprocity should be interpreted in a broad and pragmatic manner.²¹⁸

The treaties also contain a clause that states that there is no obligation to carry out measures at variance with domestic laws and practices.²¹⁹ A state should not be required to do any more, or any less than it would if its own tax were at stake. However, this clause is modified to provide that secrecy and privacy laws should not be a barrier to the exchange of information. The CRA has never refused a request due to these provisions and its domestic law powers are broad enough that these principles do not restrict the exchange of information.²²⁰

The second limitation is one based on public policy, namely that requests motivated by racial or political or religious persecution, or requests that touch on state secrets may be refused.²²¹ The Commentaries on the OECD Model Convention state that this should only rarely be invoked and only in “extreme cases”.²²² A request can also be refused if it would reveal trade, business and other secrets. However, the Commentary suggests that tax administrators should either view the confidentiality imposed by the treaties as protecting those secrets from unauthorized use, or in certain limited cases,

²¹⁸ OECD, *Commentary*, *supra* note 198 at C(26)-10.

²¹⁹ OECD, “Manual: General Module”, *supra* note 212 at para 48.

²²⁰ Diksic & Shafer, *supra* note 18 at 155, 172.

²²¹ OECD, *Commentary*, *supra* note 198 Article 26(3)(c); OECD, *Model Agreement*, *supra* note 199 Article 7(4); OECD, *Multilateral Convention*, *supra* note 200 Article 21(2)(d).

²²² OECD, *Commentary*, *supra* note 198 at C(26)-14.

redact some of the information in order to maintain secrecy.²²³ A state may also decline the exchange of information based on information being protected by solicitor-client privilege, but tax administrators should define this protection as narrowly as possible.²²⁴ Again the CRA has never refused a request as a result of these provisions. Conversely it has refused to provide an explanation on how it interprets or administers these provisions.²²⁵

All of these exceptions to the requirement to exchange information are sensible. Nonetheless, their effectiveness in protecting taxpayers is limited by the fact that the decision to refuse a request is made by the competent authorities. This is an issue for two reasons. First, the competent authority is unlikely to have all the facts required to make a determination that for example, a request for information is politically motivated. Unless a taxpayer is informed of a request and provided a chance to contest its propriety, the competent authority is unlikely to learn of an issue. If the request involves turning over information already collected for domestic use, or obtaining information from a third party, the taxpayer may never have the opportunity to contest a request.

Secondly, the competent authority making the determination on whether or not to exchange information is in a cooperative relationship with its counterparts in the requesting state, and an adversarial one with taxpayer. As was held in *Hunter*, a government agency that acts as administrator and enforcer will not be an impartial

²²³ *Ibid* at C(26)-12, C(26)-13.

²²⁴ *Ibid* at C(26)-13

²²⁵ Diksic & Shafer, *supra* note 18 at 173.

arbiter.²²⁶ The CRA's role in enforcing the tax system precludes it from being a neutral and detached party. As discussed above, the CRA has never refused a request for information on the basis of these exceptions. The CRA has expressed the view that the existing protections in the *ITA* are sufficient to protect taxpayers from abuses such as fishing expeditions.²²⁷ This view is incorrect. As will be discussed below, taxpayers are not protected by the provisions of the *ITA* when the CRA obtains information on behalf of a foreign state or shares information it has already collected.

4.3.2.5 Privacy Law Overrides

The treaties also contain language intended to ensure that certain privacy or secrecy laws do not interfere with a request. The treaties are intended to override bank secrecy laws, laws surrounding fiduciary duties, and tax secrecy or tax confidentiality laws.²²⁸

4.3.2.6 Confidentiality of Information Received

All the treaties contain language intended to safeguard taxpayer privacy rights. Information is to be treated as secret or confidential and used only for tax purposes. At the same time all three treaties contain a notwithstanding clause (optional in *Model Convention*) that allows the use of taxpayer information for non-tax purposes with the permission of the relevant competent authority.

²²⁶ *Hunter, supra* note 96 at 169.

²²⁷ *Diksic & Shafer, supra* note 18 at 165.

²²⁸ OECD, *Model Convention, supra* note 198 Article 26(5).

4.3.2.7 Procedural Rights and Safeguards

The three treaties recognize that a taxpayer may be entitled to notification that a request has been made,²²⁹ if required by domestic law, and if it would not frustrate attempts to gather and exchange information. According to the Commentary:

Some countries' laws include procedures for notifying the person who provided the information and/or the taxpayer that is subject to the enquiry prior to the supply of information... Notification procedures should not, however, be applied in a manner that, in the particular circumstances of the request, would frustrate the efforts of the requesting State. In other words, they should not prevent or unduly delay effective exchange of information.²³⁰

Canada does not currently require that a taxpayer be notified of a request for information from abroad or that their information has been transferred to another country. This lack of notification is troubling. Notification would provide the opportunity for oversight, and provides transparency and accountability.²³¹ Notification would give the taxpayer an opportunity to contest an improper request or correct erroneous information (in the case of mistaken identity for instance). The confidential nature of requests, coupled with the lack of a notice requirement, also raises the issue of the reviewability of a decision on whether or not to share a taxpayer's information. Without notice it is unlikely that a decision over a particular taxpayer's privacy and information will ever be scrutinized, which for practical purposes renders the decision unreviewable and afoul of the holding in *Hunter* that decisions must be reviewable in order for a search or seizure to be

²²⁹ OECD, *Commentary*, *supra* note 198 at C(26)-8, para 12.

²³⁰ *Ibid* at C(26)-12, para 14.1.

²³¹ *R v Tse*, 2012 SCC 16, [2012] 1 SCR 531 at paras 82-84 [*Tse*].

reasonable.²³² Notification could also serve to address the *Charter* concerns that the exchange of information with foreign countries raises. Because notification gives the opportunity to contest an improper request and promotes transparency and oversight it can render an otherwise unreasonable search and seizure reasonable.²³³

4.3.2.8 Persons Covered

All three treaties are intended to cover anyone resident in the contracting state's territory, anyone carrying on activities in either state and even third parties who are not resident and not carrying on activities in either state but whose information is available and potentially required to obtain a complete picture.²³⁴ For example, in the case of a transfer pricing issue, the OECD would consider information on a non-resident or non-involved third party who may have information on comparable prices as falling into the scope of information that can be requested even though there may be no connection to the taxpayer being investigated.²³⁵

4.3.2.9 Non-treaty-based Information Exchange

In addition to exchanging taxpayer information through treaties, tax administrators meet and confer through OECD-sponsored events and other working

²³² *Hunter, supra* note 96 at 166.

²³³ *Tse, supra* note 231 at paras 83-84

²³⁴ OECD, "Manual: General Module", *supra* note 212 at para 28.

²³⁵ *Ibid.*

groups such as the Joint International Tax Shelter Information Centre (JITSIC),²³⁶ the Seven Country Working Group on Tax Havens,²³⁷ and the Leeds Castle Group.²³⁸ These organizations are focused on tax administration operations. They allow revenue authorities to meet and exchange information and strategies in order to help tax administrators develop the capability to pursue tax evasion and identify aggressive avoidance. Fostering good relations with foreign tax administrators is a laudable goal, but complicates the dual role the treaties assign to the competent authorities. The competent authorities are supposed to cooperate and exchange information in as efficient and broad a manner possible while at the same screening out improper requests and protecting taxpayer privacy. As in *Hunter* this dual role puts their impartiality into question.

²³⁶ JITSIC consists of Australia, Canada, Japan, the UK and the USA. The focus of the group is the curbing of international tax avoidance and the use of tax shelters.

²³⁷ The Seven Country Working Group on Tax Havens consists of Australia, Canada, Germany, France, Japan, the UK and the USA. Members share research and information on current cases and promoters of tax havens. They also conduct joint training.

²³⁸ The Leeds Castle Group consists of Australia, Canada, China, France, Germany, India, Japan, South Korea, the UK, and the US. Members regularly meet to discuss compliance challenges faced by tax administrators.

4.4 The Treaties

4.4.1 The Model Convention

4.4.1.1 Overview

The Model Convention is the model that states use when negotiating bilateral tax treaties to eliminate international double taxation. Its primary purpose is to divide tax revenues between source and residence countries and to reduce or eliminate double taxation. It also contains provisions for assisting in the collection of tax revenues and on exchanging information. These provisions have become increasingly emphasized since the 1998 OECD Report.

Article 26 of the Model Convention deals with information exchange. Article 26 of the Model Convention both authorizes and requires the exchange of information between treaty partners. Article 26 consists of five paragraphs. Paragraph 1 mandates the exchange of information. Paragraph 2 covers the confidentiality of the information that is exchanged. Paragraph 3 contains some limits on the requirement to exchange information, namely that there is no requirement for a requested state to go beyond its own internal laws or administrative practices in gathering information. Paragraph 4 clarifies that a requested State is required to collect and obtain taxpayer information if requested to do so, even if the information is not required for the requested State's domestic tax purposes. Finally paragraph 5 contains provisions designed to prevent the use of the limitations in paragraph 3 in the case of bank secrecy or other secrecy laws.

Paragraphs 4 and 5 were added in 2005 as a result of the OECD's 1998 report and the successor report on Improving Access to Bank Information for Tax Purposes.²³⁹

4.4.1.2 The Main Rule

The main rule is found in paragraph 1 of Article 26:

1. The competent authorities of the Contracting States **shall** exchange such information as is **foreseeably relevant** for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws **concerning taxes of every kind and description** imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. **The exchange of information is not restricted by Articles 1 and 2.** [Emphasis added]

Paragraph 1 does a number of things. It makes the exchange of information mandatory ('shall exchange'). It sets the scope of information to be exchanged (any information that is 'foreseeably relevant'). Finally it overrides the residency provision in Article 1 and the taxes covered provisions in Article 2 and requires information exchange for all taxes, not just taxes covered by the convention.

4.4.1.3 Scope

The standard for what must be exchanged is any information that is "foreseeably relevant" which "is intended to provide for exchange of information in tax matters to the widest possible extent".²⁴⁰ Paragraph 1 does not specify the form that this information exchange is to take because it is drafted to be open ended. The OECD Commentary makes it clear that all three major forms (requested, automatic, and spontaneous) are

²³⁹ *OECD, Commentary, supra* note 198 at C(26)-14, paras 19.6, 19.10.

²⁴⁰ *Ibid* at C(26)-2, para 5.

intended as well other forms such as general information related to tax administration or tax evasion schemes.²⁴¹

4.4.1.4 Jurisdiction and Taxes Covered

Paragraph 1 overrides Article 1 and Article 2. Article 1 restricts the application of the Convention to residents of the contracting States. Article 2 restricts the application of the treaty to specific taxes (typically taxes on income and capital). Without this override mandatory information exchange would be limited to persons resident in either state and be limited to income and capital gains taxes. This override means that Article 26 information exchange also includes VAT and sales taxes in addition to the taxes on income and capital.²⁴² It also catches persons who are not necessarily resident in either State but still have information in one State. The broad ‘foreseeably relevant’ standard and the lifting of the residency and taxes covered provisions create a very wide net of possible information exchange.²⁴³

4.4.1.5 Confidentiality of Information Exchanged

Paragraph 2 requires that any information that is exchanged be “treated as secret in the same manner as information obtained under the domestic laws of that State...”²⁴⁴

²⁴¹ OECD, “Manual: General Module”, *supra* note 212 at para 18.

²⁴² OECD, *Commentary*, *supra* note 198 at C(26)-2, para 5.

²⁴³ *Ibid.*

²⁴⁴ *Ibid* at para 2.

This includes not just the response to a request, but also any information that is provided in the request itself.²⁴⁵ The information may only be disclosed to:

...persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above.

This means freedom of information requests for information on the types or amounts of requests for information, or the amount of information exchanged are blocked by the treaty. Preventing freedom of information requests hampers the ability for effective oversight on what and how much is being transferred in the same way that the lack of a notification requirement does. Freedom of information is an essential part of maintaining accountability of administrators.²⁴⁶

This provision is also troublesome because when information is sent abroad via the treaty it ceases to be protected by Canadian privacy law, instead it is the receiving state's law that protects it. Although privacy protection for taxpayers is nearly a universal feature of income tax systems around the world the degree of privacy protection varies.²⁴⁷ Three of our treaty partners, Mexico, Brazil, and China stand out as offering very little privacy protection.²⁴⁸ Even fellow OECD members such as the U.S. and members of the E.U. offer less protection to their taxpayers than Canada does.²⁴⁹

²⁴⁵ *Ibid* at C(26)-7, para 11

²⁴⁶ *Dagg v Canada*, [1997] 2 SCR 403, 148 DLR (4th) 385 at para 61.

²⁴⁷ *Supra* note 54.

²⁴⁸ *Cockfield*, *supra* note 10 at 24.

²⁴⁹ *Ibid*.

Paragraph 2 is intended to protect taxpayer privacy. Accordingly it restricts the use of information exchanged to tax purposes. Paragraph 2 is also intended to protect the requests themselves from freedom of information requests and other forms of oversight.²⁵⁰ The OECD defends sending personal and business information across borders and between tax administrations on the grounds that it will be kept secret and will not be used for any ‘non-tax’ purpose when sent abroad. On this basis, privacy concerns are balanced against the need to gather information to administer and enforce tax laws.²⁵¹ However, recent amendments to Article 26 have added the following notwithstanding clause to paragraph 2:

Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use.²⁵²

The purpose of this notwithstanding clause is to allow the sharing of tax information received by tax authorities from abroad with law enforcement and other agencies.²⁵³ The notwithstanding clause requires the consent of the supplying State’s competent authority to do so. Competent authorities are “generally be expected to authorise such use for other purposes if the information can be used for similar purposes in the supplying State”.²⁵⁴

²⁵⁰ OECD, *Commentary*, *supra* note 198 at C(26)-8, para 12.

²⁵¹ *Ibid* at C(26)-12, para 19.1.

²⁵² OECD, "Update To Article 26 of the OECD Model Tax Convention and its Commentary" (Paris: OECD, 2012).

²⁵³ OECD, *Commentary*, *supra* note 198 at C(26)-8, para 12.3.

²⁵⁴ *Ibid*.

4.4.1.6 Limitations to Information Exchange

Paragraph 3 places limits on the requirement to exchange information. Paragraph 3 provides that:

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (*ordre public*).

Subparagraphs a and b make it clear that a requested State does not have to go beyond its own administrative practices or break or violate its laws in order to fulfill a request. In addition, these two subparagraphs also allow a requested State to provide no more than what the requesting State could obtain under its laws and administrative practices. The intention behind these provisions is to encourage reciprocity, in order to prevent a State that collects little to no information domestically from taking advantage of a treaty partner with broader information gathering practices.²⁵⁵ Subparagraph c allows a competent authority to refuse a request that would reveal business secrets or violate public policy. However, the OECD commentary suggests that the reciprocity provisions

²⁵⁵ *Ibid* at C(26)-10, para 15.

and the business secret provisions should rarely if ever be invoked as a reason for not exchanging information.²⁵⁶

4.4.1.7 Audit Powers and Privacy Overrides

Paragraphs 4 and 5 were added to the Convention in 2005:

4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.

5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

Paragraph 4 is intended to make it clear that requested states are required to use all audit and investigatory powers available on behalf of a requesting state. Paragraphs 4 and 5 were also intended to clarify the limitations contained in paragraph 3.²⁵⁷ Paragraph 4 also clarifies that the limitations in paragraph 3 are not intended to prevent the exchange of information when a requested state has no domestic interest in the tax information requested. Paragraph 5 was added at the same time as paragraph 4 and also limits the application of the limitations found in paragraph 3. Paragraph 5 is intended to

²⁵⁶ *Ibid* at C(26)-12, paras 19.2, 19.4.

²⁵⁷ *Ibid* at para 19.6.

prevent bank secrecy laws, fiduciary duties and other secrecy laws from being used to block information exchange due to paragraph 3(c).²⁵⁸

4.4.2 Tax Information Exchange via the Model Agreement

4.4.2.1 Overview

The *Model Agreement for Tax Information Exchange* is a treaty designed to implement a more limited form of exchange of information and typically only covers information exchange on request. These treaties are referred to as TIEAs (tax information exchange agreements) and are negotiated with countries which do not have a comprehensive income tax system, or with countries where one party does not want to enter into a more robust bilateral tax treaty with the other. Automatic and spontaneous information exchange is not required under these treaties because they are of limited use if one country does not routinely collect taxpayer information.

4.4.2.2 Structure

The Model Agreement consists of 16 articles. Like Article 26 it is solely concerned with information exchange. However, where the Multilateral Convention relies on broad language in a few short paragraphs, the Model Agreement lays its provisions out in great detail

4.4.2.3 Scope

The scope of information exchange under the Model Agreement is found in Article 1:

²⁵⁸ *Ibid* at C(26)-15, para 19.10.

The competent authorities of the Contracting Parties shall provide assistance through exchange of information that is foreseeably relevant to the administration and enforcement of the domestic laws of the Contracting Parties concerning taxes covered by this Agreement. Such information shall include information that is foreseeably relevant to the determination, assessment and collection of such taxes, the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters. Information shall be exchanged in accordance with the provisions of this Agreement and shall be treated as confidential in the manner provided in Article 8. The rights and safeguards secured to persons by the laws or administrative practice of the requested Party remain applicable to the extent that they do not unduly prevent or delay effective exchange of information.

As with the Model Convention the standard for what should be exchanged is any “foreseeably relevant” information. This provision also specifically states that administrative practices or laws designed to protect rights (such as privacy rights) will be overridden if they would prevent or delay the exchange of information.

4.4.2.4 Jurisdiction

Article 2 provides for what information a State is required to obtain on request and from whom. States are required to provide any information that is held by its authorities or in the possession or control of any persons or entities within its territorial jurisdiction regardless of residency or nationality.²⁵⁹

4.4.2.5 Taxes Covered

Article 3 identifies the taxes covered. By default the taxes covered are taxes on income or profits, taxes on capital, taxes on net wealth, and estate, inheritance or gift

²⁵⁹ OECD, *Model Agreement*, *supra* note 199 Article 2.

taxes. This can be modified by negotiation between the two contracting States. The taxes covered in Canada's TIEAs vary with some agreements covering information exchange with regards to "all taxes imposed or administered by the Government of Canada"²⁶⁰ and others covering a subset such as the TIEA with Guernsey which covers "all taxes on income and on capital imposed or administered by the Government of Canada"²⁶¹ The former is more recent language intended to correspond with the language in paragraph 1 of Article 26 of the Model Convention ("taxes of every kind and description"). Article 3 also contains a provision, which extends information exchange to any future substantially similar taxes that may be imposed.²⁶²

4.4.2.6 Requirement to Exchange Information

The requirement to exchange information is found in Article 5. The provisions in Article 5 are quite specific, unlike the Model Convention which relies on administrative practice and the OECD commentaries to flesh out its general terms. Article 5 consists of 6 paragraphs. Paragraph 1 lays out the requirement to exchange information:

1. The competent authority of the requested Party shall provide upon request information for the purposes referred to in Article 1. Such information shall be exchanged without regard to whether the conduct being investigated would constitute a crime under the laws of the requested Party if such conduct occurred in the requested Party.

²⁶⁰ *Agreement between Canada and the Republic of Costa Rica for the Exchange of Information on Tax Matters*, 12 August 2011, Can. T.S. 2012 No. 19.

²⁶¹ *Agreement Between the Government of Canada and the States of Guernsey, Under Entrustment From the Government of the United Kingdom of Great Britain and Northern Ireland, for the Exchange of Information on Tax Matters*, 19 January 2011, Can TS 2012 No 4.

²⁶² OECD, *Model Agreement*, *supra* note 199 Article 3(2).

Paragraph 1 makes it clear that information exchange under TIEAs is to occur by request only. Paragraph 1 references Article 1 to make clear that information exchange is to take place both for criminal and civil tax matters, even if the conduct being investigated would not be criminal in the requested State.

Paragraph 2 of Article 5 makes it clear that the requested party has to go beyond turning over what information it may have in its possession and actually gather information:

2. If the information in the possession of the competent authority of the requested Party is not sufficient to enable it to comply with the request for information, that Party shall use all relevant information gathering measures to provide the applicant Party with the information requested, notwithstanding that the requested Party may not need such information for its own tax purposes.

This provision is necessary because many tax havens do not collect income taxes, and so do not keep tax records, or collect information for their own tax purposes. The Model Agreement also provides definitions for information, (“any fact, statement or record in any form whatever”²⁶³) and a definition of information gathering measures, (“laws and administrative or judicial procedures that enable a Contracting Party to obtain and provide the requested information”²⁶⁴).

Paragraph 3 is intended to ensure that information that is exchanged meets any legal evidentiary requirements that the requesting State may have. It requires the requested State to provide authenticated copies and witness depositions if requested. Paragraph 4 goes on to require that tax havens ensure that their tax authority has the

²⁶³ OECD, *Model Agreement*, *supra* note 199 Article 4(1)(m).

²⁶⁴ *Ibid* Article 4(1)(l).

authority and ability to obtain and provide information that is held by banks, by fiduciaries, agents, trusts, ownership information for all of the above, and the ability to obtain information on and identify beneficiaries. Paragraph 4 is intended to ensure that tax havens which sign TIEAs actually have the capacity to exchange information.

Paragraph 5 of Article 5 contains a list of requirements that a requesting State must satisfy when making a request for information. These requirements demonstrate the ‘foreseeable relevance’ of information and prevent fishing expeditions. These requirements match what the OECD suggests a requesting country include in a request for information made under the Model Convention.²⁶⁵ Paragraph 5 provides that the requesting State must include in a request:

5. ...

- (a) the identity of the person under examination or investigation;
- (b) a statement of the information sought including its nature and the form...;
- (c) the tax purpose for which the information is sought;
- (d) grounds for believing that the information requested is held in the requested Party or is in the possession or control of a person within the jurisdiction of the requested Party;
- (e) to the extent known, the name and address of any person believed to be in possession of the requested information;
- (f) a statement that the request is in conformity with the law and administrative practices of the applicant Party, that if the requested information was within the jurisdiction of the applicant Party then the competent authority of the applicant Party would be able to obtain the information under the laws of the applicant Party or in the normal course of administrative practice and that it is in conformity with this Agreement;
- (g) a statement that the applicant Party has pursued all means available in its own territory to obtain the information, except those that would give rise to disproportionate difficulties.

²⁶⁵ OECD, “Manual: Module 2”, *supra* note 205 at para 5.

There is however a caveat on paragraph in the commentary to the Model Agreement. Paragraph 5 should be “interpreted liberally in order not to frustrate effective exchange of information.”²⁶⁶ If certain information is missing or unavailable this should not be used as a pretext to decline or delay responding to a request.²⁶⁷

4.4.2.7 Declining a Request

Article 7 of the Model Agreement clarifies when a request for information may be declined. It gives the requested party the discretion to answer or not answer. The OECD stresses in the commentary that the requested State should “carefully weigh the interests of the applicant Party” before declining a request.²⁶⁸

The relevant paragraphs of Article 7 are 1, 2, 3, and 4. Paragraph 1 embodies the reciprocity principle:

1. The requested Party shall not be required to obtain or provide information that the applicant Party would not be able to obtain under its own laws for purposes of the administration or enforcement of its own tax laws. The competent authority of the requested Party may decline to assist where the request is not made in conformity with this Agreement.

This provision is intended to prevent the requesting party from obtaining more information than it would be able to in its own jurisdiction. It also provides the basis by which a request that does not conform with Article 5 may be declined.

²⁶⁶ OECD, *Model Agreement*, *supra* note 199 at para 57.

²⁶⁷ *Ibid* para 64.

²⁶⁸ *Ibid* para 71.

Paragraphs 2 and Paragraphs 3 allow a request to be declined if it would disclose a trade or business secret, or reveal confidential client / solicitor communications.

Paragraph 4 allows a request to be denied for public policy reasons. These provisions match those in Paragraph 3 of Article 26 of the Model Convention.

4.4.2.8 Confidentiality of Information Exchanged

Article 8 governs the confidentiality of exchanged information. The Model Agreement uses the term ‘confidential’ whereas the Model Convention uses ‘secret’. The OECD commentary states that it considers these two terms to be synonymous.²⁶⁹

8. Any information received by a Contracting Party under this Agreement shall be treated as confidential and may be disclosed only to persons or authorities (including courts and administrative bodies) in the jurisdiction of the Contracting Party concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by this Agreement. Such persons or authorities shall use such information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. The information may not be disclosed to any other person or entity or authority or any other jurisdiction without the express written consent of the competent authority of the requested Party.

Article 8 explicitly authorizes the use and disclosure of exchanged information for both civil and criminal tax purposes. It also allows the use of exchanged information for non-tax purposes with the consent of the requested competent authority. This confidentiality covers requests as well as information, and requires that requests be kept secret as well.

²⁶⁹ *Ibid* para 94.

4.4.3 Tax Information Exchange via the Convention on Mutual Administrative Assistance in Tax Matters

4.4.3.1 Overview

The Convention on Mutual Administrative Assistance in Tax Matters is a joint project of the OECD and the Council of Europe. It is a multilateral treaty with 64 signatories including Canada.²⁷⁰ It is intended to bolster the existing tax treaty network (that tends to be largely bilateral in nature) and increase information exchange among signatories.

Originally this Convention was only open to members of the OECD or the Council of Europe. However, the Convention was modified in 2010 to allow any state to petition to become a signatory. The Multilateral Convention differs from the two model conventions in that it is a multilateral instrument. It is also drafted in a less open-ended fashion than the Model Convention but it envisions information exchange that is just as broad as the Model Convention. The 2010 amendments were intended to bring the information exchange provisions in the Multilateral Convention in line with those contained in Article 26 of the OECD Model Convention.²⁷¹

4.4.3.2 Scope

The scope of assistance to be carried out under the Multilateral Convention is set out in Article 1 paragraphs 1 and 2:

²⁷⁰ *Supra* note 203.

²⁷¹ OECD, *Revised Explanatory Report to the Convention On Mutual Administrative Assistance in Tax Matters* (Paris: OECD, 2010) at 1 [OECD, *Explanatory Report*].

1. The Parties shall, subject to the provisions of Chapter IV, provide administrative assistance to each other in tax matters. Such assistance may involve, where appropriate, measures taken by judicial bodies.
2. Such administrative assistance shall comprise:
 - a. exchange of information, including simultaneous tax examinations and participation in tax examinations abroad;
 - b. assistance in recovery, including measures of conservancy; and
 - c. service of documents.

Paragraph 1 provides the object of the Convention, mutual assistance in tax matters, and paragraph 2 provides the forms that assistance will take. The assistance (information exchange, collection and service) is subject to the limits in Chapter IV of the Convention. Chapter IV contains Article 21, which details the limits to the obligation to exchange information and Article 22, which details the secrecy provisions of the Convention.

4.4.3.3 Jurisdiction

Article 1 paragraph 3 deals with what information and which persons are covered by the Convention. Essentially any person who has information within a Party state is covered. It stipulates that the assistance will be provided regardless of nationality or residency.²⁷² This is intended to have the same effect as the jurisdictional provisions in paragraph 1 of Article 26 of the OECD *Model Convention* – casting as wide a net as possible in order to catch as many persons as possible.²⁷³

²⁷² OECD, *Multilateral Convention*, *supra* note 200 Article 1(3).

²⁷³ OECD, *Explanatory Report*, *supra* note 271 at 4.

4.4.3.4 Taxes Covered

Article 2 of the Multilateral Convention provides that all forms of taxes except for customs duties and import / export duties are covered by the Convention. Customs and import / export duties are covered by the International Convention on Mutual Administrative Assistance for the prevention, investigation and repression of customs offences.

4.4.3.5 Requirement to Exchange Information

The obligation to exchange information is found in the first paragraph of Article 4:

The Parties shall exchange any information, in particular as provided in this section, that is foreseeably relevant for the administration or enforcement of their domestic laws concerning the taxes covered by this Convention.

This provision provides for the broad exchange of information because the Multilateral Convention covers all taxes (save trade duties) and because this provision also uses the OECD's new foreseeably relevant standard. Unlike Article 26, the Multilateral Convention explicitly provides a (non-exhaustive) list of the forms of information exchange that are authorized by the convention. The listed forms are:

- Exchange upon Request (Article 5),
- Automatic Exchange (Article 6,)
- Spontaneous Exchange (Article 7)
- Simultaneous Tax Examinations (Article 8)

- Tax Examinations Abroad (Article 9)

The convention also covers assistance in the collection of taxes and information exchange on where a taxpayer has assets in order to aid with collection may also take place.²⁷⁴

4.4.3.6 Limits to the Exchange of Information

The limits to what and when information can be requested are contained within Article 21. The provisions in Article 21 contain the same limitations as found in paragraph 3 of Article 26. States are under no obligation to comply with a request if: it breaches the principle of reciprocity; would be at variance with laws and administrative practice of either state; would be against public policy; and if it would disclose a trade or business secret or legal confidence. As in Article 26 the limitations are not mandatory, the competent authority may comply with a non-conforming request if they so choose.

4.4.3.7 Confidentiality

Article 22 of the Multilateral Convention contains similar secrecy provisions to the two OECD Model treaties. It provides that information exchanged will be treated as secret and used only for tax purposes unless permission is granted by the competent authority under the notwithstanding clause. However, there are two key differences. First it specifically states that the secrecy laws that apply will be the State's that has the more restrictive of the two States that are exchanging information:

²⁷⁴ *Ibid* at 29.

1. Any information obtained by a Party under this Convention shall be treated as secret in the same manner as information obtained under the domestic laws of that Party, or under the conditions of secrecy applying in the supplying Party if such conditions are more restrictive.

This differs from both of the OECD model treaties, where it is the recipient State's secrecy laws that govern the use of information. Given that Canadian privacy laws tend to be stronger than our treaty partners' laws, this is a positive development.²⁷⁵

The second difference is contained in the notwithstanding clause. In addition to the use of information for non-tax purposes and by other government agencies the Multilateral Convention allows for sharing of information on a multilateral basis:

4...Information provided by a Party to another Party may be transmitted by the latter to a third Party, subject to prior authorisation by the competent authority of the first-mentioned Party.

This addition to the notwithstanding clause expands the scope of information exchange from a two party to potentially every signatory of the Multilateral Convention.

4.5 Conclusion

The information exchange provisions in tax treaties authorize information exchange on as broad a scope as possible. These provisions also contain some limits in order to protect privacy. These limits are: the confidentiality of information received, the restriction on the use of information exchanged to tax purposes only, the reciprocity

²⁷⁵ Cockfield, *supra* note 10 at 24.

principle, the variance clause and the various public order exceptions to information exchange. In practice these limits do not actually provide much in the way of additional privacy protection. At the same time these information exchange provisions are intended to shield the contents of requests for information from the scope of freedom of information laws, and override any privacy or secrecy laws that could interfere with the exchange of information. In addition there has also been a trend towards the inclusion of a notwithstanding clause which allows revenue authorities to use exchanged taxpayer information for non-tax purposes. Chapter 5 will now discuss how these limits are of little practical use to taxpayers.

5 Privacy and the Exchange of Information

5.1 Introduction

Canada collects and exchanges information on behalf of foreign revenue authorities on the premise that taxpayers have a low expectation of privacy in their tax information, and the government has the right to access that information, even on the behalf of foreign revenue agencies.²⁷⁶ This premise is based on the Supreme Court of Canada's decision in *McKinlay*, discussed in Chapter 2. The CRA's broad regulatory powers were found to be constitutional based on the following reasoning:²⁷⁷

In my opinion, s. 231(3) provides the least intrusive means by which effective monitoring of compliance with the *Income Tax Act* can be effected. It involves no invasion of a taxpayer's home or business premises. It simply calls for the production of records which may be relevant to the filing of an income tax return. A taxpayer's privacy interest with regard to these documents *vis-à-vis* the Minister is relatively low. The Minister has no way of knowing whether certain records are relevant until he has had an opportunity to examine them. At the same time, the taxpayer's privacy interest is protected as much as possible since s. 241 of the Act protects the taxpayer from disclosure of his records or the information contained therein to other persons or agencies.

This reasoning cannot apply in the context of information exchange with foreign revenue authorities. *McKinlay* was dealing with a specific regulatory purpose, the administration and enforcement of the Canadian income tax system. Random audits and spot checks were found to be the *only* effective means of enforcing and administering the *ITA*. Finally the

²⁷⁶ Diksic & Shafer, *supra* note 18 at 164-165.

²⁷⁷ *McKinlay*, *supra* note 2 at 650.

privacy interest at stake was being measured against the Minister's interest with 3rd party access by other agencies specifically prevented at that time by section 241.

Chapter 2 also examined a number of other privacy principles established by the courts. First taxpayers have a greater expectation of privacy in situations where section 241 does not apply and their information will be shared broadly.²⁷⁸ Second, taxpayers have a greater expectation of privacy when their information will be used in a criminal investigation and when the predominant purpose of an investigation becomes criminal, regulatory powers are no longer available.²⁷⁹ Third, administrators that are tasked with enforcing a regulatory scheme are unsuited to making judicial decisions about privacy.²⁸⁰ Finally, if at all possible unwarranted invasions of privacy should be prevented prior to them occurring.²⁸¹

This chapter will show how the above framework breaks down in the context of information exchange. The low expectation of privacy in tax information established by *McKinlay* with regards to the Minister in the domestic context is not appropriate in the information exchange context. Taxpayers should be entitled to a greater level of privacy protection than they are currently receiving in order for information exchange to be “reasonable”.

²⁷⁸ *Gernhart, supra* note 118 at para 41.

²⁷⁹ *Jarvis, supra* note 74 at para 87.

²⁸⁰ *Hunter, supra* note 96 at 164.

²⁸¹ *Ibid.*

5.2 The Income Tax Act and Tax Treaties

Tax treaties in Canada have a dual nature. They are negotiated and signed with other states but are also passed as Acts of Parliament. In order to comply with public international law, when a tax treaty is implemented as a statute in Canada, the implementation legislation will contain a provision to the effect that in the case of any inconsistency between the tax treaty and other domestic laws, the tax treaty will prevail. This is important because provisions in the *ITA* that restrict the use of audit and investigatory powers have been held to conflict with information exchange provisions contained in tax treaties.²⁸²

The audit and inspection powers contained in section 231.1 are to be used “for any purpose related to the administration or enforcement” of the *ITA*. On the face of it, it would appear that the use of these powers at the request of a treaty partner would not be related to either the administration or enforcement of the *ITA* and the CRA would be precluded from using them. This question was addressed in *Pacific Network Services Ltd.* There the CRA had issued a requirement for information (pursuant to section 231.2) on behalf of France. France had requested the information via Article 26 of the *Convention between Canada and France for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital.*²⁸³ At that time section 231.2 could only be used “for any purpose related to the administration or enforcement” of the *ITA*.

²⁸² *Pacific Network Services Ltd v Canada (Minister of National Revenue)*, 2002 FCT 1158, 56 DTC 7585, [*Pacific Network Services*].

²⁸³ 11 May 1977, Can TS 1976 No 3.

The Federal Court analyzed this restriction and decided that the Court was not being called upon to determine whether or not a request from a foreign state would be authorized by the *ITA*. Instead it held that

[t]he proper question to be answered in the present case is not whether the purposes mentioned in Article 26 of the *Canada-France Income Tax Convention* are covered by subsection 231.2(1) of the Act, but whether, in order to satisfy a request for information made for any purpose mentioned in paragraph 1 of Article 26 of the *Canada-France Income Tax Convention*, Article 26 of the *Canada-France Income Tax Convention* contemplates the use by the Minister of administrative measures, such as the power conferred by subsection 231.2(1) of the Act, where the requested information is not already in possession of the Minister.²⁸⁴

Essentially the Court was asking itself whether the treaty overrode the *ITA*. The taxpayer argued that a plain reading of Article 26 would not give the Minister the authority to issue requirements because the Article mentions the “exchange” of information not the gathering of new information.²⁸⁵ The taxpayer also pointed to different language in the US-Canada Convention, which specifically called for information to be obtained.²⁸⁶ The Court rejected the taxpayer’s argument and turned to the OECD Commentaries to help interpret Article 26. The court found the *ITA*’s restriction of the requirement power to purposes related to the administration or enforcement of the *ITA* to be inconsistent with the commentary to Article 26 that specified that treaty partners would use all available

²⁸⁴ *Ibid* at para 11.

²⁸⁵ *Ibid* at para 16.

²⁸⁶ *Ibid* at para 18.

administrative measures in order to fulfill a request for information.²⁸⁷ The tax convention between Canada and France was found to override the limitation in the *ITA*:

...if there is any "inconsistency" between Article 26 of the *Canada-France Income Tax Convention* and the limitation to "any purpose related to the administration or enforcement of the [*Income Tax*] Act" found in subsection 231.2(1) of the Act, then the "purposes" mentioned in paragraph 1 of Article 26 of the *Canada-France Income Tax Convention* must "prevail to the extent of the inconsistency" as provided by subsections 2(2) of the *Canada-France Income Tax Convention Act, 1976* and 10(2) of the *Income Tax Conventions Act, 1976*.²⁸⁸

As a result of finding this inconsistency between the *ITA* and the treaty, treaty-based requests do not need to be related to administration or enforcement of the *ITA* in order for the requirements to be valid.

In coming to this conclusion the court failed to consider why there was a restriction in the *ITA* on the use of the audit powers "for any purpose related to the administration or enforcement". In reading those words out of the *ITA* for the purposes of information exchange the Federal Court ignored the fact that they play a part in making the audit powers constitutionally valid. They are present in the *ITA* in order to restrict the use of audit powers. In *James Richardson & Sons* the Supreme Court held that:

The language of s. 231(3) of the *Income Tax Act* is unquestionably very broad and on its face would cover any demand for information made to anyone having knowledge of someone else's affairs relevant to that other person's tax liability. It would, in other words, if construed broadly, authorize an exploratory sortie into any taxpayer's affairs and require anyone having anything to contribute to the exploration to participate. It would not be necessary for the Minister to suspect non-compliance with the Act, let alone to have reasonable and probable grounds to believe that the Act was being violated as required in s. 231(4). Provided the

²⁸⁷ *Ibid* at para 32.

²⁸⁸ *Ibid* at para 12.

information sought had a bearing (or perhaps even could conceivably have a bearing) on a taxpayer's tax liability it could be called for under the subsection.²⁸⁹

In order to prevent random surveys or fishing expeditions by the CRA the Supreme Court held that the words “for any purpose related to the administration or enforcement” must be interpreted narrowly.²⁹⁰ Those words and the narrow interpretation given to them are a part of what makes the use of the audit powers constitutional. When the Supreme Court considered whether the use of audit powers constituted an unreasonable search and seizure and a violation of *Charter* rights it remarked on its previous jurisprudence on the words “for any purpose related to the administration or enforcement” and noted that although the provision was broad on its face:

once the appropriate rules of statutory interpretation had been applied to the subsection, it was not to be construed so broadly.²⁹¹

Without those words and the narrow interpretation given to them by the court, there would have been no way for the Supreme Court to find that the audit powers in the *ITA* “provides the least intrusive means by which effective monitoring of compliance with the *ITA* can be effected.”²⁹² The Federal Court did not consider that the purpose clause of the requirement power is part and parcel of what makes the Minister's access to taxpayer information a reasonable search and seizure and therefore constitutionally valid.

If the reasoning in *Pacific Network Services* continues to be followed, Canada's tax treaties may also override the restrictions in subsections 231.2(2) and (3) relating to

²⁸⁹ *Richardson*, *supra* note 145 at 622.

²⁹⁰ *Ibid* at 625.

²⁹¹ *McKinlay*, *supra* note 2 at 639.

²⁹² *Ibid* at 649.

requirements for information about unnamed persons. Recall that subsection 231.2(2) prevents the Minister from issuing a requirement to a 3rd party relating to one or more unnamed persons unless judicial authorization is obtained in accordance with subsection 231.2(3):

(3) On ex parte application by the Minister, a judge may, subject to such conditions as the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection 231.2(1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") where the judge is satisfied by information on oath that

(a) the person or group is ascertainable; and

(b) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under this Act.

In order to prevent fishing expeditions, the unnamed person or group must be ascertainable, and the requirement must be made to verify compliance with the *ITA*. The issue was raised in *Pacific Network Services* and, although the case was decided on other grounds, the Court stated in *obiter* that:

...the authorization mentioned in subsection 231.2(3) of the Act applies to a requirement issued for a purpose related to the administration or the enforcement of the Act. This is not the case here. It is apparent that any information relating to unnamed persons cannot and will not be used by the Minister under the Act, but will simply be transmitted to the competent authorities of France pursuant to a request made under Article 26 of the Canada-France Income Tax Convention and for the purposes stated at paragraph 1 of said Article 26.²⁹³

²⁹³ *Pacific Network Services*, *supra* note 282 at para 53.

If followed, this line of reasoning would allow foreign revenue authorities greater access to Canadian taxpayer information than the CRA enjoys. It would also authorize sweeping fishing expeditions on behalf of treaty partners. A treaty partner could request information on an unascertainable group of taxpayers as part of a general survey or check on compliance. Although the CRA could not undertake this action domestically, the court clearly accepts that even though the Canadian tax authorities would be prevented from requesting the same information in the same circumstances France (or any of Canada's other treaty partners) could do so. Since the CRA would be gathering information as required by the information exchange provisions in Canada's tax treaty it could ignore the restrictions on fishing expeditions in the *ITA*. Following *Pacific Network Services*, similar language in the other audit powers that restricts their use to the administration and enforcement of the *ITA* would not provide a barrier to Canada's tax treaty partners requesting that the CRA use its other powers.

5.3 Prior judicial authorization

In *McKinlay* the court recognized that requiring prior judicial authorization for every audit would paralyze the administration of the income tax system. This does not hold true in the international context. The CRA receives on average 159 requests for information a year and in turn requests information 148 times a year. The bulk of these requests involve only two treaty partners, the U.S. and the U.K.²⁹⁴ Given the low number of requests, requiring some form of prior judicial authorization and requiring that taxpayers be notified would not cause the system to seize up.

²⁹⁴ Diksic & Shafer, *supra* note 18 at 167.

Prior judicial authorization of automatic information exchanges would be difficult given the millions of records exchanged annually. However, there is no reason not to allow notification of these exchanges in order to provide taxpayers with notice, and with an opportunity to challenge the exchange of their information, or to correct errors (cases mistaken identity for instance). This would allow for an after-the-fact challenge or an opportunity for judicial review.

5.4 Disclosing Collected Information to Third Parties

The Supreme Court of Canada also based its decision to allow broad access to taxpayer information in *McKinlay* on the presence of section 241. Section 241 at that time restricted the ability of third parties to access that information. Now of course, not only does section 241 allow the exchange of information, the majority of Canada's tax treaties allow the information to leave Canada and to no longer be subject to Canadian privacy laws. Further, there are no provisions allowing (let alone requiring) the CRA to follow up on Canadian information in order determine that it hasn't been misused or leaked. Even if provisions of this sort existed, it is doubtful the CRA would have the institutional capacity to do so, given its inability to track information leaks at home, comply with requests from the Privacy Commissioner, or effectively monitor its own employees.²⁹⁵

²⁹⁵ Office of the Privacy Commissioner of Canada, *Audit of Canada Revenue Agency* (Ottawa: Office of the Privacy Commissioner of Canada, 2013).

5.5 The Importance of Notice

The decision as to whether or not a particular exception to information exchange may apply is at the sole discretion of the revenue authorities. The commentaries that accompany the treaties encourage revenue authorities to err on the side of exchanging information and to assume that requests from treaty partners are valid. According to the CRA, it has never refused a request for information and presumably, in its view, has never received an improper request.²⁹⁶ We must take the CRA's word for this because the treaties also protect requests for information from public scrutiny by exempting them from freedom of information laws and oversight.

The commentaries also make it clear that requests for information are intended to be secret, as is the information contained within requests.²⁹⁷ That information can cover such things as justifications on how information requested would be available to the requesting country under its own administrative practices and laws, or explaining how the principle against self-incrimination is not engaged by a request.²⁹⁸

The decision to comply with a request or to make a request is in the hands of the CRA. It is the gatekeeper for requests, responsible for refusing improper requests. It is also in a reciprocal relationship with its counterparts; its cooperation is required to obtain information in turn. This cooperation is encouraged by the treaty commentaries and by participation with the various working groups discussed earlier. In addition, requests for information are typically made to third parties rather than taxpayers themselves. The

²⁹⁶ Diksic & Shafer, *supra* note 18 at 173.

²⁹⁷ OECD, *Commentary*, *supra* note 198 at C(26)-7, paras 11-12.

²⁹⁸ *Ibid* at C(26)-11, para 15.2

same holds true with information that is automatically exchanged. There is no requirement for the CRA to notify taxpayers that their information has been requested. There may be no challenge to an improper request issued to an uninterested third party. The only way a taxpayer would know of the request is if the third party informs the taxpayer.

The issue this creates is one of lack of notice. This lack of notice seriously affects the remedies available to Canadian taxpayers if their rights are violated. A country making a request of Canada could neglect to mention (either through ignorance or deliberately) that the request is being made with regards to a criminal investigation into tax evasion. The body tasked with deciding whether or not the request complies with requirements for requests under the relevant tax treaty is the CRA. The CRA also decides whether or not to use its powers on behalf of the requesting party. Once the CRA makes that decision, it is unclear whether or not a taxpayer can effectively challenge the CRA's use of audit powers to gather information for an improper request. The commentary to the OECD Model Convention encourages a lenient approach for the vetting of requests for information, stating that:

Unless otherwise agreed to by the Contracting States, **it can be assumed** that the requested information could be obtained by the requesting State in a similar situation if that State has not indicated to the contrary.²⁹⁹
[Emphasis added]

²⁹⁹ *Ibid* at C(26)-12, para 18.1.

If a request appears legitimate on its face, the CRA is under no duty to investigate further. There is no avenue for a taxpayer to require the CRA to investigate further or look behind a request.

The ordinary recourse a citizen has in the face of an improper exercise of discretion or use of powers by a government official would be the administrative law remedy of judicial review. Effective judicial review of the CRA's decisions requires notice to the taxpayer. The treaties give the CRA and their treaty partners the discretion on whether to exchange information, to determine the validity of a request and whether or not to invoke an exception in order to protect a taxpayer. Lack of notice to the taxpayer insulates the CRA's decision-making from judicial review. If taxpayers discover that their information has been exchanged improperly after the fact, they are left with few options. If the information was sent abroad improperly, the taxpayer will have to deal with a foreign legal system and whatever remedies might exist in that jurisdiction. Seeking judicial review in Canada will not give them a remedy, as the information is already gone.

If the information was brought in domestically and used to assess or reassess the taxpayer, then the taxpayer is also left with no effective remedy. This is due to the fact that Canada currently splits jurisdiction in tax matters between the Tax Court of Canada and the Federal Court. The Tax Court of Canada has exclusive jurisdiction to hear and determine appeals on matters arising under the *ITA* but does not have the ability to consider the process by which an assessment or reassessment was reached. The Federal Court has jurisdiction to perform judicial review of the decisions made by the Minister of

National Revenue and the CRA. However, section 18.5 of the *Federal Courts Act*³⁰⁰ limits the jurisdiction of the Federal Court to provide relief in any circumstance where the *ITA* provides a right of appeal to the Tax Court. Taxpayers are unable to challenge an assessment of liability for tax (or penalties and interest) in the Federal Court:

Despite sections 18 and 18.1, if an Act of Parliament expressly provides for an appeal to the Federal Court, the Federal Court of Appeal, the Supreme Court of Canada, the Court Martial Appeal Court, the Tax Court of Canada, the Governor in Council or the Treasury Board from a decision or an order of a federal board, commission or other tribunal made by or in the course of proceedings before that board, commission or tribunal, that decision or order is not, to the extent that it may be so appealed, subject to review or to be restrained, prohibited, removed, set aside or otherwise dealt with, except in accordance with that Act.

The practical effect of this provision is that a taxpayer may only apply for judicial review of a Minister's decision if the validity or correctness of an assessment or reassessment is not being challenged.³⁰¹ Therefore taxpayers have a limited window of opportunity to challenge the CRA's (or a foreign revenue agency's) conduct on administrative law grounds.

In order for a taxpayer to have any hope of relief, the application for judicial review must be brought before an assessment or reassessment is issued. The Federal Court of Appeal has held that even of cases of CRA misconduct, once an assessment or

³⁰⁰ RSC 1985, c F-7.

³⁰¹ Elizabeth Chasson, "A Challenge to a Reassessment Masquerading as an Application for Judicial Review" Tax Dispute Resolution, Compliance and Administration Conference (Toronto: Canadian Tax Foundation, 2012) at 3.

reassessment has been issued, the underlying conduct leading to that assessment is unreviewable by the Federal Court and the Tax Court.³⁰²

It is argued for Mr. Webster that this was a breach of natural justice for which he is entitled to a remedy, and that the only Court with the authority to give him a remedy for that breach is the Federal Court. The remedy he seeks is an order quashing the confirmation of his assessments, and requiring his objection to be reconsidered. It is common ground that the Tax Court cannot give him that remedy, because its jurisdiction is limited to determining whether the assessments are correct in law.

Counsel for Mr. Webster argued that if the Federal Court is not permitted to consider Mr. Webster's application for judicial review, he will have been deprived of a fair hearing of his objection. It is perhaps more accurate to say that once the objection process was complete, Mr. Webster was deprived of an opportunity to argue in the Federal Court, through a judicial review application, that the Minister has an obligation to conduct the objection process fairly, and that the process followed in his particular case was unfair. However, Parliament has spoken on this matter. Whatever flaws there may have been in the objection process in Mr. Webster's case, it resulted in a decision that can be challenged in only one way, and that is by an appeal to the Tax Court.

In addition to not being able to challenge unfair conduct, a taxpayer is also unable to challenge a reassessment on the grounds that it was issued on the basis of illegally gathered information. The Supreme Court of Canada has also held that the Federal Court does not have the jurisdiction to vacate an assessment even when the assessment is predicated on information obtained improperly or illegally. The CRA is willing to use information that has been obtained illegally or improperly and passed on to it.³⁰³ The CRA is also willing to use information it has obtained in violation of *Charter* rights as

³⁰² *Webster v R*, 2003 FCA 388, 2003 DTC 5701 at paras 20-21.

³⁰³ *Diksic & Shafer*, *supra* note 18 at 173.

the basis for a reassessment.³⁰⁴ Once a decision has been made regarding a taxpayer's tax liability, the only venue available to contest that liability is the Tax Court.³⁰⁵ At the same time, the Tax Court will not engage in any form of judicial review and considers requests to do so to be vexatious.³⁰⁶ The Tax Court has recently also declined to engage in a *Jarvis* predominant purpose analysis to determine whether or not evidence should be inadmissible in a civil trial.³⁰⁷

Notice of the use of investigatory powers is therefore crucial. A taxpayer's procedural protections have a shelf life. Meaningful judicial review in Canada is only available to a taxpayer for the period of time before an assessment or reassessment has been issued. In order to make use of judicial review, taxpayers have to be aware that their rights have been violated and apply for a remedy before the Minister comes to a decision on the taxpayer's tax liability.

5.6 Requests for Information and the *Charter*

In addition to administrative law issues, information exchange also raises *Charter* concerns. While a tax treaty cannot override the *Charter*, use of tax treaties may provide opportunities to sidestep the application of the *Charter*, especially in the context of criminal investigations. It is clear from the cases presented in Chapter 3 that revenue authorities may on occasion differ in their interpretation as to whether or not *Charter*

³⁰⁴ *Piersanti v The Queen*, 2013 TCC 226, 2013 DTC 1183, [*Piersanti*].

³⁰⁵ *Redeemer Foundation v Minister of National Revenue*, 2008 SCC 46, 2008 DTC 6474 at paras 28, 58.

³⁰⁶ *Faber v The Queen*, 2007 TCC 177, [2007] 4 CTC 2004 at para 17.

³⁰⁷ *Piersanti*, *supra* note 304 at para 25

protections should apply. In the case of one of those differences of opinion, the usual remedy would be judicial review, or the exclusion of evidence from a trial (criminal or civil). In the case of information exchange, these remedies may not be available.

As the law currently stands, a taxpayer may not, for the purposes of a Canadian investigation being conducted abroad, have any *Charter* rights or any privacy rights at all. Actions taken on behalf of Canada by foreign officials outside of Canada³⁰⁸, or Canadian government agents outside of Canada, but under the supervision of foreign officials, are not subject to the application of the *Charter*.³⁰⁹ An example of the effect of this is found in *R v Hape*. Mr. Hape was an investment banker under investigation for money laundering. The RCMP suspected him of using a trust in the Turks and Caicos to launder drug money. The RCMP obtained permission to continue their investigation in the Turks and Caicos and worked with a local police superintendent. While there, the RCMP conducted a series of warrantless searches under the supervision of the local superintendent. The searches would have been a violation of Mr. Hape's section 8 *Charter* rights had they been conducted in Canada. However, the Supreme Court held that although the searches were conducted by the RCMP, the *Charter* did not apply abroad. Instead, Canadians abroad should rely on the protections in place in the country in which they find themselves:

When individuals choose to engage in criminal activities that cross Canada's territorial limits, they can have no guarantee that they carry *Charter* rights with them out of the country. As this Court has noted in the past, individuals should expect to be governed by the laws of the state

³⁰⁸ *Schreiber v Canada (Attorney General)*, [1998] 1 SCR 841, 158 DLR (4th) 577 at para 31.

³⁰⁹ *R v Hape*, 2007 SCC 26, [2007] 2 SCR 292.

in which they find themselves and in which they conduct financial affairs — it is the individual’s decision to go to or operate in another country that triggers the application of the foreign law...³¹⁰

This reasoning has the potential to lead to gaps in human rights for Canadians in the tax context. Some countries may not apply the same constitutional protections to foreign investigations that they do to domestic investigations. In *United States v Manufacturers and Traders Trust Co*³¹¹ Canada made a request to the IRS, in order to obtain information for the RCMP. The United States Court of Appeal Second Circuit determined that while such a request would violate constitutional rights if done with regards to an American law enforcement agency, because it was a foreign agency requesting the information, and since any charge would be laid in Canada, American constitutional rights did not apply. In cases such as these a Canadian taxpayer would therefore not have recourse to their *Charter* rights, and no recourse to American privacy rights. A further issue is the fact that the taxpayer may not be aware that information was gathered in such a way that violates their *Charter* rights and will have no opportunity to challenge that conduct until it is too late.

5.6.1 Unilateral Measures to Enhance Information Exchange

The recent intergovernmental agreement (“IGA”) signed between Canada and the United States on the 5th of February 2014, provides an additional example of an

³¹⁰ *Ibid* at para 99.

³¹¹ *United States v Manufacturers and Traders Trust Co*, 703 F 2d 47 (2nd Circuit, 1983).

information exchange measure that raises all of the concerns surrounding prior judicial authorization, notice and potential *Charter* violations.³¹² On March 18, 2010, the United States enacted a unilateral information gathering measure known as the *Foreign Account Tax Compliance Act* (“FATCA”).³¹³

FATCA requires non-U.S. financial institutions to enter into an agreement with the United States Internal Revenue Service to report on accounts held by U.S. citizens (including U.S. citizens not resident in the United States) and U.S. residents (collectively “U.S. person(s)”). FATCA is imposed on non-U.S. financial institutions by way of a withholding tax. Any U.S. payor making a payment to a financial institution that does not have an agreement with the IRS must withhold 30% of the gross payment.³¹⁴

FATCA owes its origins to the scandal surrounding American tax evasion through Swiss banks. It was intended to stop tax haven abuse by American citizens.³¹⁵ FATCA applies to Canadian financial institutions despite the lack of any real concern that U.S. persons in Canada are evading taxes.³¹⁶

³¹² *Agreement Between the Government of the United States of America and the Government of Canada to Improve International Tax Compliance through Enhanced Exchange of Information under the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital*, United States and Canada, 5 February 2014 [“IGA”].

³¹³ PL 111-147 § 501 (2010).

³¹⁴ 26 USC § 1471.

³¹⁵ Allison Christians & Arthur Cockfield, “Submission to Finance Department on Implementation of FATCA in Canada” (March 10, 2014) at 10.

³¹⁶ *Ibid* at 12.

There are an estimated 1 million American citizens who are resident in Canada.³¹⁷ FATCA and its 30% withholding tax present Canadian financial institutions with a dilemma. They must either comply with FATCA, turn over information on account holders and violate Canadian privacy law, or comply with Canadian privacy law and be unable to conduct business with the United States due to the withholding tax.³¹⁸ In order to address this issue, Canada and the United States have entered into the IGA. Under the IGA, the CRA will collect the information required under FATCA from Canadian financial institutions. Then, under the authority of the Canada – U.S. Convention, the CRA will provide that information to the IRS.

Under the IGA, Canadian financial institutions will have a due diligence obligation to identify and report on U.S. persons and entities that are controlled by U.S. persons.³¹⁹ Canadian financial institutions will be required to provide the following information to the CRA:³²⁰

1. the name, address and U.S. tax identification number of each U.S. person that holds an account,
2. account numbers,
3. account balances, and
4. transaction details such as dividends, and interest.

³¹⁷ Barrie McKenna, “Ottawa to give IRS information on Americans living in Canada” *The Globe and Mail* (5 February 2014) online: <<http://www.theglobeandmail.com/report-on-business/international-business/us-business/ottawa-to-give-irs-information-on-americans-in-canada/article16710461/>>.

³¹⁸ Department of Finance, “Canada and U.S. Reach Agreement on *Foreign Account Tax Compliance Act*”(5 February 2014).

³¹⁹ IGA *supra* note 312 at Annex I.

³²⁰ *Ibid* at Article 2.

The term U.S. Person is defined in paragraph 1(ee) of Article 1 of the IGA as:

- (1) a U.S. citizen or resident individual,
- (2) a partnership or corporation organized in the United States or under the laws of the United States or any State thereof,
- (3) a trust if
 - (A) a court within the United States would have authority under applicable law to render orders or judgments concerning substantially all issues regarding administration of the trust, and
 - (B) one or more U.S. persons have the authority to control all substantial decisions of the trust, or
- (4) an estate of a decedent that is a citizen or resident of the United States.

Section 6 of Article 3 requires that Canada and the US enter into an agreement under the mutual agreement procedure provided for in Article XXVI of the Canada – U.S. Tax Convention³²¹ that will provide for automatic information exchange of this information between the CRA and the IRS. The information exchange will be governed by the confidentiality provided for in the Canada – U.S. Tax Convention.³²²

The IGA has been signed but requires an implementation act in order to take effect. This act currently exists in the form of draft legislation.³²³ The draft form of the implementation act also contains amendments to the *ITA* which will make it an offence to

³²¹ *Convention Between Canada and the United States of America With Respect to Taxes on Income and*

on Capital, 26 September 1980, Can TS 1984 no 15.

³²² Section 7 of Article 3.

³²³ Department of Finance, “Legislative Proposals Relating To the Canada–United States Enhanced Tax Information Exchange Agreement” (5 February, 2014) online: <<http://www.fin.gc.ca/drleg-apl/2014/can-us-eu-0214l-eng.asp>>.

fail to provide an American taxpayer information number, a social insurance number or a business number to any person required to file that information with the CRA.³²⁴

Failure to provide identification number

(6) Every person or partnership who fails to provide on request their Social Insurance Number, their business number or their U.S. federal taxpayer identifying number to a person required under this Act or a regulation to make an information return requiring the number is liable to a penalty of \$100 for each such failure, unless

(a) an application for the assignment of the number is made within 15 days (or, in the case of a U.S. federal taxpayer identifying number, 90 days) after the request was received; and

It will be an offence to refuse to supply a bank or financial institution with this information.

FATCA and the IGA exemplify the issues discussed earlier surrounding information exchange and lack of prior judicial authorization, lack of notice and potential breaches of *Charter* rights. First, FATCA and the IGA are the equivalent to a blanket request for information on unnamed taxpayers. Absent the IGA, if the CRA wanted to obtain this information for itself or for the United States under the Canada – US Convention, the CRA would be required to make use of section 231.2 of the *ITA*.

As discussed in Chapter 3, subsection 231.2(3) of the *ITA* mandates prior judicial authorization when the government issues a requirement to a third party, Canadian financial institutions in this case, to provide information on an unnamed person for the purposes of verifying or enforcing compliance with the *ITA*. The IGA and the draft legislation implementing the IGA will sidestep this requirement for prior judicial

³²⁴ *Ibid.*

authorization. American citizens resident in Canada will have most details of their financial lives reported to the CRA.

In addition to having their financial information turned over to the CRA, American citizens in Canada will not be informed or provided the opportunity to object or even correct erroneous information. There is no notice requirement in the IGA. There is no requirement that the CRA or the financial institutions inform those whose information is collected and reported on. There is also no requirement for a financial institution to obtain its customer's consent or consult with a customer prior to reporting. Without notice and without consultation there is the distinct risk that taxpayers whose information should not be collected are caught up by FATCA or that incorrect information is collected. With an estimated one million Americans caught by this regime and an unknown number of others who may be caught by the financial institution's due diligence because they have some indicia of U.S. personhood³²⁵ there will undoubtedly be errors that need correction. These taxpayers will have no opportunity to correct those errors prior to their information being collected and sent to the IRS.

Finally, there is a risk of a violation of a taxpayer's *Charter* rights when the information is forwarded to the IRS. Allison Christians and Arthur Cockfield have raised concerns that information collected under FATCA will be used to press criminal charges pursuant to the Foreign Bank Account Report (FBAR) requirements:

The IGA would have Canada providing personal information on hundreds of thousands of Canadians to U.S. authorities, subjecting each Canadian to potential criminal prosecution for failure to comply with FATCA and/or FBAR. The problem is that neither the IGA nor the Canada-U.S. tax treaty

³²⁵ Christians & Cockfield *supra* note 315 at 36.

provide for any assurances that Canadian taxpayer rights will be afforded equivalent legal protection when personal information is transferred across the border.³²⁶

The IGA serves as a worrying example of how quickly and with how little debate sweeping changes to the exchange of taxpayer information can be implemented.

However, while the IGA has been signed it has not yet been implemented domestically.

The Department of Finance is still receiving comments and submissions on potential issues. It is possible that some of these concerns may be addressed in the implementation act.

5.7 Proposed Solutions

As previously discussed, there has been little critical research done on privacy and information exchange. One author, Arthur Cockfield has proposed two broad solutions for addressing some of the privacy concerns raised in this thesis, one technological and the other treaty based.³²⁷ First, Cockfield suggests that improvements in encryption, IT systems and data processing will help protect taxpayer privacy rights. The first two categories, better encryption and upgraded IT systems will help prevent accidental disclosure of taxpayer data both when it is transmitted between countries and when it is stored by revenue authorities. It will also help prevent outside hackers from obtaining taxpayer information. Cockfield is particularly concerned with transfers to and

³²⁶ *Ibid* at 26.

³²⁷ Cockfield, *supra* note 10 at 36, 39.

with developing countries under TIEAs who may not have robust IT infrastructures in place.³²⁸

Improved data processing and handling would allow revenue authorities to share less information. The current trend, especially with automatic information exchange, is to share everything that is collected, which for most taxpayers is far more information than should be required.³²⁹ Cockfield suggests developing a system that strips out irrelevant information and irrelevant taxpayers from automatic information exchange. This would be accomplished through some form of software that performs a risk analysis based on the taxpayer's likelihood of engaging in tax avoidance or evasion.³³⁰ A further use to which this system could be put that Cockfield does not consider is having it automatically inform taxpayers when their information is sent abroad, giving taxpayers an opportunity to challenge or review that exchange of their information.

Upgrading IT systems and improving computer security and encryption is a necessary but insufficient step towards addressing the privacy risks raised by enhanced information exchange. It would protect the information that has been exchanged from theft or inadvertent disclosure. However it does not prevent the inappropriate collection or misuse of taxpayer information.

Cockfield's second solution is an international charter of taxpayer's rights. Essentially this charter would attempt to shore up or fill in some of what is missing from the tax treaties. The charter Cockfield suggests is based on the Canadian Taxpayer Bill of

³²⁸ *Ibid* at 37.

³²⁹ *Ibid*.

³³⁰ *Ibid* at 38.

Rights discussed in Chapter 2.³³¹ Cockfield suggests that such a charter, if adopted as a multilateral treaty would help plug gaps caused by informal agreements to share information and in the tax treaties themselves:

As mentioned, in recent years many national tax authorities have adopted informal agreements to share tax information in an effort to fight aggressive tax avoidance: the multilateral taxpayer bill of rights would ensure that this sharing will attract a minimal level of legal protection. A multilateral agreement would cover ‘gaps’ where certain bilateral tax treaties or TIEAs with in a country’s network of tax agreements did not sufficiently incorporate protections and safeguards for taxpayer interests.³³²

However, Cockfield also suggests that a multilateral agreement that shores up privacy rights is politically infeasible and proposes an alternative similar to the Canadian

Taxpayer’s Bill of Rights:

Alternatively, a soft law approach could consist of developing a code of conduct to promote taxpayer rights’ for tax authorities to follow when they engage in TIE: the code of conduct would likely be more politically feasible as it would avoid politically-problematic binding tax agreements...

Cockfield recognizes the limitations inherent in his proposed non-binding charter, namely that it would:

Provide insufficient assurances to tax authorities, taxpayers and industry intermediaries that taxpayer rights will be protected (as there will not be any legal recourse to the extent these interests are violated).³³³

However, one benefit Cockfield does not mention is the impact such a charter might have on interpreting Article 26 and the other information sharing provisions contained within

³³¹ *Ibid* at 39.

³³² *Ibid* at 42.

³³³ *Ibid* at 43.

treaties. If declarations similar to Cockfield's charter were signed or even included in the commentaries to the treaties they could at least influence the interpretation of tax conventions when privacy was at stake. Such a charter would fall within the range of extrinsic materials courts are entitled to consider when interpreting tax treaties. An alternative to a multilateral agreement would be to implement domestic legislation to improve the protection of taxpayer privacy rights. The most obvious amendment is one that gives taxpayers notice when their information is exchanged. Second would be the implementation of a system of prior judicial authorization and oversight over specific information requests, both incoming and outgoing.

5.8 Conclusion

McKinlay was concerned with domestic information gathering in a specific context. The statements made in *McKinlay* that taxpayers have a low privacy interest in their tax information should not be viewed as applicable to the information exchange context. First, the information being exchanged is not necessarily for the administration of the Canadian tax system. Second, it has not been shown to be the only effective method of administering and enforcing the Canadian tax system. Third, instead of being protected by section 241, taxpayer information is put at risk when it is sent abroad. Given the lack of procedural protections available to taxpayers, and the limited number of requests made and received by Canada there is no reason why prior judicial authorization and notice to taxpayers should not be a part of our information exchange regime. Implementing authorization and notice would be covered by the clauses in the treaties, which allow countries to conduct information exchange in accordance with domestic law and

administrative procedures and the commentaries that specifically contemplate giving notice to taxpayers.³³⁴

³³⁴ OECD, *Commentary*, *supra* note 198 at Article 26(3), and at C(26)-12, para 14.1.

6 Conclusion

The income tax system relies on voluntary self-assessment. Self-assessment depends on taxpayers being willing to turn their information over to the CRA. Taxpayers will turn their information over to the CRA when the CRA has sufficient enforcement powers and those powers are administered fairly and in a way that respects taxpayer privacy.³³⁵

This thesis has focused on tax information exchange in the context of the second condition, whether or not the powers are fairly administered. It is clear that tax information exchange is necessary to some degree. Tax information exchange is meant in part to level the playing field between taxpayers, who are able to operate globally, and tax administrators who are confined to a single jurisdiction. Tax information exchange can help tax administrators in enforcing domestic tax law against taxpayers who operate internationally.³³⁶ States have an interest in obtaining private taxpayer information by engaging in tax information exchange with tax havens and other countries because reducing or eliminating secrecy is a key element in combatting tax poaching, crime and terrorism, tax avoidance, and tax evasion. In addition, being able to easily obtain information about taxpayers' international activities is required in order to reduce administration and enforcement costs for tax authorities.³³⁷ These interests and goals have shaped tax information exchange treaties in the following ways: increasing the number of

³³⁵ Law Reform Commission of Canada, *Search and Seizure Under the Income Tax Act* (Ottawa: Law Reform Commission, of Canada 1985) at 1.

³³⁶ OECD, "Manual: General Module", *supra* note 212 at para 8.

³³⁷ OECD, "Report", *supra* note 180 at para 23.

countries that engage in information exchange, reducing the scope for refusing an information request, decreasing privacy protections, and broadening the scope of what information can be obtained, whom it can be obtained from and the purposes for which it can be obtained.

The result of these developments is that tax information exchange provisions have been grafted onto a domestic information gathering system. The aim of this thesis has been to consider whether or not this increased exchange of information is compatible with the existing privacy framework that controls what information the government can obtain from or about a taxpayer and the circumstances in which this information can be obtained. The domestic framework is built on the principle that taxpayers have a low expectation of privacy in their personal and business information with regards to the CRA. This low expectation of privacy is overcome by the government's need to obtain information in order to enforce and administer the income tax system. That same proposition, a low expectation of privacy and a pressing need to obtain and share information has been applied to information exchange. However, as this thesis has shown, the balance established between taxpayer privacy and the need to obtain information was predicated on certain conditions that do not hold true in the information exchange context.

First and foremost, the balance was struck with the expectation that third parties would not obtain the information that was collected. This is no longer the case; information that is sent abroad is not protected by the privacy provisions of the *ITA*. Even if it remained subject to Canadian privacy law, the CRA now maintains that it does not owe taxpayers any duty of care, and taxpayers have no ability to demand the penalties for

a breach of privacy being applied.³³⁸ In the current information exchange regime, there is no equivalent to section 241 as it was when *McKinlay* was decided. The CRA has the ability to share information with other revenue agencies and in treaties that have been amended to include the notwithstanding clause, the discretion to allow that information to be used for any non-tax purpose. This is in contrast to the relatively restricted ability of the CRA to share taxpayer information with domestic law enforcement in situations where issues of terrorism or national security are involved.

Second, in *McKinlay*, there was an understanding that it would be impossible to administer or enforce the income tax system without broad audit powers and a corresponding low expectation of privacy. Policymakers have continually pushed for increased information exchange in the international arena without providing much evidence that information exchange is more effective than proposed alternatives, or that it is actually producing results, or that the integrity of the tax system demands the increase of exchange of information. Given the low number of specific requests for information that Canada has historically received and issued, there is no reason why some form of judicial oversight would be impracticable. For automatic and bulk exchanges there is no reason why notice could not be given to taxpayers that their information has been sent to another revenue agency.

Information exchange, whether inbound or outbound, should attract more privacy protection than domestic audits because of the lack of procedural protections, the broad sharing of taxpayer information and the fact that tax information exchange is not essential

³³⁸ *Collins v Canada*, 2011 FCA 140, 2011 DTC 5076 at para 21.

for the functioning of the Canadian self-assessment taxation system. Under the current regime revenue authorities enjoy greater access to taxpayer information and fewer restrictions than when conducting a domestic audit. The opposite should be the case. Taxpayers should have an increased expectation of privacy in their tax information when the government is acting as an agent for a third party and their information will be sent abroad.

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