

## **DEFENDING TAX EVASION CHARGES**

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on Tax Evasion under the Income Tax Act (Canada) and the possible challenges to such assessments. Alpert Law Firm is experienced in providing legal services to its clients in tax dispute resolution and tax litigation, tax and estate planning matters, corporate-commercial transactions and estate administration. Howard Alpert has been certified by the Law Society as a Specialist in Estates and Trusts Law, and also as a Specialist in Corporate and Commercial Law.

### **A. SUCCESSFUL DEFENCES TO TAX EVASION CHARGES**

There are certain defences a taxpayer can successfully employ against a charge of wilful tax evasion.

#### **(i) LACK OF REQUIRED INTENTION (MENS REA)**

Since a finding of wilful tax evasion requires the Crown to prove deliberate intention on the part of taxpayer, a common defence against charges of tax evasion is to assert that the taxpayer did not actually possess the intention required for such an offence. Courts have indicated that the guilty mind requirement (i.e. *mens rea*) will not be met if it can be proven that a taxpayer only exhibited carelessness or recklessness without knowledge of the facts constituting the offence.

Case law has indicated that the Courts, in deciding on whether the taxpayer possessed the requisite intent to be convicted of tax evasion, will consider a variety of factors including the taxpayer's level of intellect, general business knowledge, and previous experiences with tax authorities.

#### **(ii) RELIANCE ON A TAX PREPARING PROFESSIONAL**

Another defence against charges of tax evasion is to assert that the taxpayer relied on a tax professional to prepare the faulty tax return and had no knowledge of the facts constituting the offence, and as such, had no intent to evade taxes. Courts have indicated that the intention requirement for tax evasion will not be met if it can be proven that the taxpayer did not have the intention of acquiescing to a faulty return. In general,

the Courts will find that there was a lack of intention on the part of the taxpayer to evade taxes if the taxpayer (i) only exhibited negligence by relying heavily on a tax-preparing professional, or (ii) negligently failed to identify an error in the tax return.

**(iii) IMPROPERLY OBTAINED EVIDENCE**

Section 231.1 of the Act confers upon the Minister and the CRA broad audit and examination powers. Under subsection 231.1(1), an authorized person is permitted to:

- (i) inspect, audit or examine the taxpayer's books, records and documents and any document of any other person that may related to the information that is or should be in the books or records of the taxpayer;
- (ii) examine the taxpayer's inventory and anything else which may assist in determining the accuracy of that inventory;
- (iii) enter any business premises where books or records are kept or should be kept. If the premises are a dwelling-house, a warrant must be obtained pursuant to subsection 231(1)(2); and
- (iv) require the owner, manager or any other person on the premises to give him all reasonable assistance and answer proper questions related to the administration and enforcement of the Act.

A tax audit is an administrative process that does not trigger a taxpayer's rights pursuant to the *Canadian Charter of Rights and Freedoms* ("The Charter"). An investigation however is an adversarial and criminal process which invokes a person's right against self-incrimination. The provisions of the Charter must be considered when tax evasion charges are being investigated by the CRA Investigations Branch due to the threat of imprisonment. As a result, the Minister can no longer use the inspection and requirement powers pursuant to section 231.1 of the Act to compel the production of documents, and must rely instead upon documents obtained pursuant to a search warrant. CRA investigators however can avail themselves of audit information obtained prior to the commencement of the criminal investigation.

A taxpayer may be able to challenge tax evasion charges on the basis that the evidence was improperly obtained as evidence for a criminal investigation under the guise of a civil audit.

## **B. UNSUCCESSFUL DEFENCES TO TAX EVASION CHARGES**

Case law has pointed out that there are a large number of defences against tax evasion which are generally unsuccessful. Such defences include assertions that the individual charged with wilful tax evasion

- (i) did not sign the tax return in question;
- (ii) experienced alcohol or marital problems during the years in question;
- (iii) generally exhibited disorganized and dilatory behaviour;
- (iv) was incapable of dealing with the payment of taxes;
- (v) retained a person who was inexperienced in bookkeeping to be responsible for the taxpayer's books and records from which the erroneous tax return was made; and
- (vi) taxpayer believed that the federal government did not have the authority to collect taxes.

The defence that the tax return under investigation is unsigned and as such is not a "tax return" within the meaning of the Act, is generally rejected by the Courts. In ***The Queen v. Kidd, 74 DTC 6574***, the taxpayer was accused of wilfully evading taxes on the basis that he had deceitfully under-reported his income over several taxation years. In his defence, the taxpayer contended that his failure to sign the tax returns caused the documents to become something other than 'tax returns' and as a result he was not susceptible to evasion charges. The Ontario Superior Court held that the taxpayer could not rely on this defence as the tax return was complete and sufficient enough to illustrate that the taxpayer intended the return to form the basis of his tax assessment.

The argument that an understatement of income or failure to file was a result of alcoholism or marital problems, is a defence that the Courts have generally not accepted. In ***The Queen v. Robson, 79 DTC 5198***, the taxpayer, a successful farmer and university education businessman, was charged with wilful evasion of taxes on the grounds that he intentionally failed to disclose certain income. In his defence, the taxpayer claimed that his failure to disclose income was unintentional due to his excessive use of alcohol and marital problems. The Saskatchewan Provincial Court held that the taxpayer was guilty of tax evasion, finding that the taxpayer could not rely

on this defence as despite the taxpayer's difficulties he was able to operate his farming and business operations.

In ***Sturgess v. The Queen, 84 DTC 6525***, the defence that the taxpayer had not intentionally evaded taxes, by virtue of the fact that the taxpayer was merely disorganized and dilatory, was clearly dismissed by the Court. In this case, the taxpayer who was charged with wilful tax evasion was a medical doctor who had filed a number of his tax returns only after the Minister demanded them. The taxpayer, in his defence stated that he did not intentionally attempt to evade taxes, rather his general disorganized and tardy nature led him to simply not file his tax returns on time. The Federal Court rejected such a defence stating that the evidence indicated that the taxpayer never would have filed his tax returns, nor have paid his taxes, had the Minister not insisted he file his returns. As such, the taxpayer was found guilty of tax evasion.

In ***R v. Wolf, 84 DTC 6033***, the taxpayer was charged with wilfully evading taxes on the basis that he failed to file his tax returns for four consecutive years. The British Columbia Court of Appeal rejected the taxpayer's defence that only failed to file his tax returns because he was unable to pay his taxes, and would have filed his tax returns as soon as he was able to pay the taxes he owed. The Court found that taxpayer's defence was not sufficient to defend against the tax evasion charges, concluding that the taxpayer failed to file his tax returns in order to avoid alerting the authorities that he was not meeting his tax obligations - which fits the definition of tax evasion.

In addition, the Courts have generally rejected the defence that an inexperienced person was responsible for keeping the taxpayer's books and records from which the erroneous tax returns were made. In ***The Queen v. Horowitz, 71 DTC 5350***, the Court outright dismissed such a defence. In this case, the individual charged with tax evasion was an owner of a real estate agency. He argued that his wife's inexperience and carelessness in keeping his books and records caused the errors in his tax return that he had inadvertently failed to notice. The Court, dismissed this defence, and found the taxpayer guilty of tax evasion on the basis that the taxpayer was at the very least wilfully blind in entrusting such an inexperienced person to keep his books and failing to 'notice' large errors in the tax return.

The Courts have been firm in rejecting challenges to the validity of the Act and the Federal Government's ability to impose and collect taxes, as well as in denying the availability of the "natural person" defence. The "natural person" defence provides that each person has two separate identities, a natural person and a legal entity. The taxpayer typically claims that his income has been earned as a natural human being

who is not subject to the Act. No income has been earned by him in his capacity as a legal entity liable to pay income tax under the Act. In ***R. v. Loosdrecht, 2009 DTC 5131***, the taxpayer claimed that the definition of “person” in the Act did not include him as a “natural person”. The Provincial Court of British Columbia held that the taxpayer’s argument that the Act did not apply to the income he earned as a “natural person”, and not as a legal entity, had no basis. The case law was extensive and this defence has never been successful. Previously, the B.C. Court of Appeal held that the ordinary meaning of person is a natural person and the purpose of the statutory definition was to extend the meaning to include other legal entities. The taxpayer was found guilty of all counts of tax evasion since the Crown had proven beyond a reasonable doubt the *actus reus* and the *mens rea* of the offences.

**This issue of the Legal Business Report is designed to provide information of a general nature only and is not intended to provide professional legal advice. The information contained in this Legal Business Report should not be acted upon without the further consultation with professional advisers.**

**Please contact Howard Alpert directly at (416) 923-0809 if you require assistance with tax and estate planning matters, tax dispute resolution, tax litigation, corporate-commercial transactions or estate administration.**

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