

Tax

Taxpayers cleared to pursue negligence claim against CRA in Myers v. Canada (Attorney General)

By **David Rotfleisch**



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(December 15, 2022, 2:28 PM EST) -- The entitlement of Canadian taxpayers to hold the Canada Revenue Agency (CRA) liable for egregious tax audits and tax enforcement actions remains a new and blossoming concept in Canadian tax law.

Canadian courts only recognized that the CRA owes a duty of care to Canadian taxpayers in 2014, following the judgment of the B.C. Supreme Court in *Leroux v. Canada Revenue Agency* [2014] B.C.J. No. 780. The Quebec Superior Court took an even bolder step when it recognized in *Ludmer et al c. Attorney General of Canada* 2018 QCCS 3381 that the CRA could be held liable for negligence, for the manner in which it exercises its powers when conducting a tax audit of Canadian taxpayers.

The CRA is afforded broad powers to investigate and make assumptions concerning a Canadian taxpayer's income and tax liabilities, with or without supporting documentation.

On the extreme end of CRA tax audit powers, the "Net Worth" audit methodology has been developed as a tool by CRA to determine a taxpayer's unreported income where the taxpayer has inadequate books and records to support their filed returns, or there is a serious discrepancy in a taxpayer's financial affairs and spending habits when compared with reported income.

The Net Worth audit methodology is a particularly blunt and inaccurate tax method of assessing a taxpayer's income and has been recognized by Canadian courts as a method of "last resort" to audit a taxpayer where no other available method will fulfil CRA's mandate.

Where the CRA oversteps boundaries and takes controversial legal positions against a taxpayer, the results can be absolutely devastating for a taxpayer. The right to hold the CRA accountable for missteps and abuses of power, and in particular when faced with the full force of the CRA's powers through a Net Worth audit, has now come to a head in the case of *Myers v. Canada (Attorney General)* [2022] B.C.J. No. 775.

Following a successful appeal before the B.C. Court of Appeal, the taxpayer appellants in *Myers* have earned the right to continue their negligence claim against the CRA for their treatment by the agency during a Net Worth audit. While the taxpayer's civil claims against the CRA have not yet been heard in court, that they have earned the right to continue their case against the CRA is another victory for Canadian taxpayers against unreasonable, careless and potentially malicious tax audits.

The appellants, Darrell Myers and Leah Murchie-Myers, were subject to a search warrant executed by the RCMP in 2008 on a property owned and rented out by the appellants, which led to discovery of a cannabis grow operation. Neither of the appellants were charged with a criminal offence as a result of the search. Over the following years, the appellants were subjected to increasingly aggressive CRA tax audits.

The appellants twice requested that the CRA release the tax audit records to them. CRA refused, alleging they could not be released due to a criminal investigation against the appellants.

Myers and Murchie-Myers launched a civil claim in 2019 against the CRA alleging Charter breaches (on the basis they were colluding with the RCMP to share information retrieved under subsection 231.1(1) and 231.2(1), violating their right to freedom from self-incrimination) and abuse of process (which has since been abandoned), negligence and misfeasance in public office.

The appellants had based at least part of their claim of the unlawful use of the Net Worth audit methodology by CRA during the first and second audits.

At the B.C. Supreme Court, the CRA argued the notice of claim should be struck, arguing that the claim was a collateral attack. Specifically, the orders and decisions made could only be dealt with by the Tax Court and the Federal Court.

The hearing judge stayed the misfeasance and negligence claims relating to the first audit and struck the claims related to the second audit. The judge concluded the challenge to the use of the net worth methodology was in essence an appeal of the tax assessments resulting from the first and second audits, and that ruling on the continuation of the second audit was a matter exclusively for the Federal Court. The claims for the first audit were stayed until the Tax Court appeal could be heard, and use of the Net Worth methodology ruled on.

On appeal, the appellants argued that the B.C. Supreme Court judge erred in two ways:

1. Characterizing the civil claims as an attempt to avoid the effect of the tax assessments; and,
2. Assuming the Tax Court and Federal Court had exclusive jurisdiction to determine the lawfulness of tax assessments and decisions made by CRA officials.

The Court of Appeal allowed the appeal in full for the appellants for the following reasons:

1. The hearing judge mischaracterized the appellants' pleading as a collateral attack.
2. The hearing judge erred in finding that only the Tax Court and the Federal Court have jurisdiction to determine the lawfulness of the CRA's actions in the course of auditing the appellants' taxes, including the use of the Net Worth audit methodology.

With a successful ruling from the B.C. Court of Appeal in favour of the litigants, Myers and Murchie-Myers are free to pursue their negligence case against the CRA before the B.C. Supreme Court.

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