
The Power To Audit Is the Power To Destroy: Judicial Supervision of the Exercise of Audit Powers

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ABSTRACT

The authors of this article address the serious problem of lack of effective recourse for Canadian taxpayers where they are subject to the abusive exercise of audit and/or assessment powers by tax officials. While the Federal Court of Appeal has zealously affirmed the Tax Court of Canada's exclusive jurisdiction to determine the validity of a tax assessment, it has also held that the Tax Court's exclusive jurisdiction does not include the power to consider questions of process. The unfortunate result of these two lines of jurisprudence is that tax auditors largely have licence to act with near-impunity.

The authors argue that Parliament surely did not intend to empower tax officials to victimize taxpayers through abusive audits, and that the power of the courts to review administrative action exists *precisely* in order to provide a remedy when tax officials exercise their powers improperly. A review of the relevant provisions of the Income Tax Act confirms that the jurisdiction conferred by Parliament upon the Tax Court of Canada is broad enough to include the ability to vacate an assessment issued following an abusive audit or unfairness in the assessment-issuing process. The authors urge the courts to seriously reflect upon the current state of the law and to take steps to set the record straight.

KEYWORDS: AUDITS ■ TAXATION ■ POWER ■ ASSESSMENTS ■ APPEALS

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[T]he power to tax involves the power to destroy.

Chief Justice Marshall, *McCulloch v. State of Maryland* (1819)

INTRODUCTION

Both the courts and the popular media have documented cases in which the abusive exercise of audit and/or assessment powers has driven taxpayers to bankruptcy.¹ The recent (and ongoing) case of *Leroux v. Canada Revenue Agency*,² for example, concerns a Kafkaesque audit that spanned 13 years in which, inter alia, Canada Revenue Agency (CRA) auditors took the taxpayer's original documents, shredded them, then proceeded to refuse the taxpayer's deductions on the grounds that he did not have adequate supporting documentation. The resulting assessments and collection proceedings eventually led to the collapse of the taxpayer's substantial business empire.

Even though the majority of tax officials are conscientious and play a vital role in the administration of the tax system, abusive audits can and do occur for a variety of reasons. Some cases have involved personally motivated malevolence toward a taxpayer,³ some have involved administrative blunders within the tax department (such as lost documents or inaccurate record keeping),⁴ while others simply result from inadequate training or supervision of the auditor. The possibility of an audit going off the rails can only be increased by recovery-based performance metrics such as the "tax earnings by audit" (TEBA) measure used by the CRA, which motivates tax auditors and their superiors to find creative ways to extract as much tax from their "clients" as possible.

Unfortunately for the Canadian public, the Federal Court of Appeal has repeatedly frustrated taxpayers' efforts to rely on the court's supervisory jurisdiction when

1 In addition to the cases discussed in the article, see Paul Ryan, *Quand le fisc attaque : Acharnement ou nécessité* (Montréal : Les Éditions La Presse, 2012), at chapter 6. In the provincial context, the problem of abusive audits was also raised during the public consultations on Bill 107, which reconstituted Quebec's revenue service as an agency: see "Consultations particulières et auditions publiques sur le projet de loi n° 107 — Loi sur l'Agence du revenu du Québec," in Québec, Assemblée nationale, *Journal des débats de la Commission des finances publiques*, September 22, 2010, CFP-81, at 5-6, 9, and 13-14.

2 2012 BCCA 63; varying 2010 BCSC 865.

3 *Main Rehabilitation Co. v. Canada*, 2004 FCA 403; leave to appeal to the Supreme Court of Canada dismissed January 27, 2005, SCC file no. 30739; and *Chhabra v. The Queen*, 89 DTC 5310 (FCTD).

4 *Leroux*, supra note 2; *Gallant v. The Queen*, 2012 TCC 119 (in which the CRA's form contained errors that led a taxpayer to claim an excessive deduction); and *Agence du revenu du Québec c. Groupe Enico inc.*, 2011 QCCA 1924 (involving an inflated assessment resulting from significant calculation errors followed by two aborted garnishment actions).

faced with abusive, capricious, or unlawful conduct on the part of federal tax officials in the process leading to an assessment.⁵ On the one hand, the Federal Court of Appeal has zealously affirmed the Tax Court of Canada's exclusive jurisdiction to determine the validity of a tax assessment; on the other hand, the Federal Court of Appeal has held that this exclusive jurisdiction does not include the power to consider questions of process.

The regrettable result of these two lines of jurisprudence is that CRA auditors largely have licence to act with near-impunity. They can propose and issue assessments and reassessments for substantial amounts of tax not justified by the law or the facts. They can drag out an audit for years, making expansive, repetitive, and costly requests for information, extorting waivers of the statutory limitation periods while under threats of immediate assessment action. They can issue gratuitous requirements to banks and third parties, causing the taxpayer embarrassment and potentially putting his or her sources of financing at risk. However, a taxpayer in Canada has virtually no recourse in administrative law against an auditor on the warpath. At best, a taxpayer *may*, in some cases, launch a civil action for damages against the CRA, which, as discussed below, makes for a very poor substitute.

This cannot be the law. Parliament surely did not intend to empower tax officials to victimize taxpayers through abusive audits, and the power of the courts to review administrative action exists *precisely* in order to provide a remedy when government officials exercise their powers improperly. Indeed, a review of the relevant provisions of the Income Tax Act⁶ confirms that the powers conferred by Parliament upon the Tax Court of Canada are certainly broad enough include the ability to vacate an assessment issued following an abusive audit or unfairness in the assessment-issuing process. It is long past time to correct the current unfortunate state of the law.

BACKGROUND TO JUDICIAL REVIEW OF ADMINISTRATIVE ACTION

Judicial review of administrative action has its origins in ancient writs dating back to the Middle Ages, according to which the king or queen would commission a judge to investigate allegations of misconduct by his or her official representatives

5 This article focuses on taxes imposed by federal legislation, enforced by the CRA, and subject to supervision by federally constituted courts. However, the principles apply, *mutatis mutandis*, to provincial taxes enforced by provincial revenue authorities, particularly in Quebec, which administers its own income and sales tax system through the Agence du revenu du Québec (ARQ). The jurisprudence from the Quebec courts on the judicial supervision of the exercise of audit powers remains very limited, and it remains to be seen whether the principles adopted by the Federal Court of Appeal will be endorsed by the Quebec courts.

6 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act. Although this article focuses on the Income Tax Act, essentially similar arguments apply to assessments made under the Excise Tax Act, RSC 1985, c. E-15, as amended, and under various provincial taxing statutes.

and to take corrective action.⁷ Today, five such writs (known as “the prerogative writs”)⁸ form the core of judicial review in Canada:⁹

1. certiorari, which asks the court to quash an official’s decision or action because of an illegality;
2. prohibition, which asks the court to bar an official from making a decision or taking action because of an anticipated illegality;¹⁰
3. mandamus, which asks the court to order an official to make a decision or take action that he or she is obligated to perform;
4. quo warranto, which asks the court to remove an official from office because of a defect in his or her appointment; and
5. habeas corpus, which asks the court to release an individual who has been unlawfully detained.

In the non-criminal context, certiorari remains the most common of these prerogative writs. An application for certiorari rests upon some form of alleged unlawfulness in the official’s decision making. This unlawfulness may be based either on the substance of the decision (that is, the decision was incorrect in law or unreasonable given the facts) or on the process through which the decision was reached (that is, the process was unfair in some respect).¹¹

It bears emphasizing that violations of procedural fairness in the decision-making process can vitiate an otherwise correct or reasonable decision. When the legislature empowers government officials to make decisions, it is presumed that the legislature intends that these decisions be made in a manner consistent with procedural fairness, which includes, *inter alia*, the right for people directly affected by the decision to be informed of and to participate in the process, the right to a decision that

7 See generally S.A. de Smith, “The Prerogative Writs” (1951) 11:1 *Cambridge Law Journal* 40-56. It bears noting that traditionally such proceedings were brought in the sovereign’s name, and in the United Kingdom, judicial review proceedings are still styled “*R. v. [name of official or agency concerned] ex rel [name of plaintiff]*.”

8 The grouping together of habeas corpus, mandamus, certiorari, and prohibition under the label “prerogative writs” was a relatively late development, the first recorded instance being Lord Mansfield’s decision in *Rex v. Cowle* (1759), 97 ER 587 (KB). See de Smith, *supra* note 7, at 53-56.

9 Federal Courts Act, RSC 1985, c. F-7, as amended, section 18(1). See generally Ian Holloway, “‘A Sacred Right’: Judicial Review of Administrative Action as a Cultural Phenomenon” (1993) 22:1 *Manitoba Law Journal* 28-71; and David Phillip Jones and Anne S. de Villars, *Principles of Administrative Law*, 5th ed. (Toronto: Carswell, 2009), at 9-13.

10 Prohibition is closely related to certiorari, and in Quebec, the two writs have been regrouped into the single action of “evocation before judgment.”

11 For a review of the history of how certiorari grew to encompass the review of unfair acts, starting with *Nicholson v. Haldimand-Norfolk Regional Police Commissioners*, [1979] 1 SCR 311, see Jones and de Villars, *supra* note 9, at 223-39.

is not tainted by a reasonable apprehension of bias on behalf of the decision maker, and the right to a decision rendered within a reasonable delay.

In other words, with any grant of power from the legislature comes an obligation to exercise the power in a manner consistent with procedural fairness, and an exercise of power in a manner inconsistent with procedural fairness can be reviewed by the courts. As Jones and de Villars explain,

[v]irtually all administrative law depends upon two maxims: (a) Parliament is sovereign; and (b) a delegate to whom Parliament has granted powers must act strictly within its jurisdiction, and the courts will determine whether the delegate's actions are *ultra vires*. . . .

The unstated premise is that Parliament never intended its delegate to act contrary to the duty to be fair, or to consider irrelevant evidence, or to ignore relevant evidence, or to act maliciously or in bad faith, or unreasonably. . . .

While it is true that a breach of the duty to be fair appears to be merely a procedural error, committed after the delegate has validly commenced the exercise of the power which Parliament has granted, it would be incorrect to assume that such a procedural error is somehow less important or less substantive than a clear attempt by the delegate to do something completely unrelated to the power granted by Parliament (for example, to build a highway instead of a park). For more than a century the assumption has been that Parliament intends the procedural requirements of natural justice to be observed by certain delegates, as part and parcel of the power granted to them; any default renders the decision void.¹²

Although many pieces of legislation contain “privative clauses” that purport to limit or even exclude the availability of judicial review, the courts have long read such clauses narrowly and do not construe them as ousting their jurisdiction altogether.¹³ Courts invariably assume that, notwithstanding privative clauses, the legislature does not authorize government officials to run roughshod over the rights of members of the public without any meaningful judicial oversight.

On the other hand, not every error made by the administration is actionable. Because the power of the courts to review administrative decisions is discretionary, a court may, in appropriate circumstances, decline relief even when a decision is tainted by some form of illegality¹⁴—for example, when a complaint relates to

12 Jones and de Villars, *supra* note 9, at 248-50 (references omitted); also see generally chapter 8. In Quebec, section 2 of the Act Respecting Administrative Justice, RSQ, c. J-3 (herein referred to as “the AJA”), has elevated this presumption to an express statutory obligation, mandating (inter alia) that “[t]he procedures leading to an individual decision to be made by the Administration, pursuant to norms or standards prescribed by law, in respect of a citizen shall be conducted in keeping with the duty to act fairly.” Section 79 of the Act Respecting the Agence du revenu du Québec, RSQ, c. A-7.003, expressly provides that these provisions of the AJA apply to decisions of the ARQ.

13 Jones and de Villars, *supra* note 9, at 14-15 and 533-44.

14 *Ibid.*, at 655-60.

“[m]inor procedural irregularities which in fact, or in all likelihood, had no effect on the ultimate decision.”¹⁵

It bears noting that under section 18 of the Federal Courts Act,¹⁶ the Federal Court, like its predecessor, the Federal Court Trial Division (collectively “the Federal Court”), has “exclusive” jurisdiction to issue a writ of certiorari, a writ of prohibition, a writ of mandamus, or a writ of quo warranto against any federal board, commission, or other tribunal. The Tax Court of Canada does not have the jurisdiction to issue prerogative writs.

JUDICIAL REVIEW OF AUDIT DECISIONS

Nowhere does the Income Tax Act expressly state that taxpayers have no public-law recourse against the abusive exercise of audit powers by tax authorities.¹⁷ The bar to judicial review of abusive audit practices flows instead from the convergence of two distinct lines of jurisprudence: the first essentially holds that taxpayers cannot question the validity of an assessment in the Federal Court; the second holds that the Tax Court of Canada lacks the jurisdiction to vacate an assessment owing to abuses committed in the process of its issuance.

The inability of the Federal Court to review the conduct of tax officials leading up to an assessment flows from the decision in *MNR v. Parsons et al.*¹⁸ *Parsons* involved a group of taxpayers who had served as directors of an active corporation. The tax office reassessed the directors personally for taxes owed by the corporation on the theory that the directors were personally liable under section 159. The taxpayers sought to quash the reassessments through certiorari, arguing that section 159 did not apply to corporate directors and thus the reassessments against them were issued without legal authority. The taxpayers were successful before the Federal Court, which held that the “fundamental question of the Minister’s legal authority to make the assessments”¹⁹ remained amenable to judicial review notwithstanding the statutory appeal process created by the Act. The Federal Court of Appeal disagreed, however, holding that “the only way in which the assessments made against the respondents could be challenged was that provided for in sections 169 and following of the *Income Tax Act*.”²⁰

The Federal Court of Appeal reprised *Parsons* in *MNR v. Devor*,²¹ a case in which the taxpayer alleged that he had been threatened with immediate reassessment action

15 Ibid., at 659.

16 Supra note 9.

17 Note that in the Quebec context, a provision limiting judicial review of audit-related decisions by provincial tax authorities appears in section 41 of the Tax Administration Act, RSQ, c. A-6.002. The courts have yet to consider the scope of this provision.

18 84 DTC 6345 (FCA); rev’g. 83 DTC 5329 (FCTD).

19 Ibid., at 6346 (FCA).

20 Ibid.

21 93 DTC 5098 (FCA).

unless he signed waivers of the normal reassessment period. He was denied a 24-hour delay to verify the information contained in the waivers, and when he discovered that the waivers contained incorrect information, tax officials refused to correct them. Reassessments then followed, with the CRA renegeing on a commitment to allow the taxpayer to make representations. The taxpayer applied to quash the reassessments through certiorari and sought an injunction barring any further reassessment action. The Federal Court of Appeal, overruling the prothonotary and the Federal Court, allowed a motion to dismiss, reasoning that the validity and scope of the waivers could be dealt with in the context of a statutory appeal before the Tax Court of Canada.²²

The Federal Court of Appeal reiterated these conclusions in *The Queen et al. v. Optical Recording Laboratories Inc.*²³ This case concerned a taxpayer who failed to object to or to pay a mid-year assessment, essentially because he had apparently been induced by the CRA to believe that he did not have to take any action until the end of the taxation year. After the CRA initiated collection action, the taxpayer sought certiorari against the assessment and consequent collection instruments, as well as prohibition of any further collection action. The Federal Court, holding that the issues raised far exceeded the scope of the Tax Court of Canada's appellate jurisdiction, granted the taxpayer's motion:

The issues to be determined here are much broader than, and different from, matters of extension of time to appeal, the validity of a notice of assessment and appeal therefrom. The issues here raise questions of fundamental administrative illegality, unfair treatment and estoppel which engage the superintending jurisdiction of a superior court, such that even if this Court's disposition of them be ultimately judged to be wrong, the Court's decision to entertain them should be seen to be correct. . . .

The respondents, by illegal abuse of authority and false inducements, are clearly estopped from taking any benefit from their sudden garnishments of the applicant's accounts. They are justly estopped even in public law and even although the benefit taken is not for personal gain but for the public purse. The principle of estoppel here is closely akin to that other long and hardy fibre in the web of our law, *ex turpi causa non oritur actio*. The Minister cannot be permitted to put a taxpayer to prejudicial disadvantage by invocation of illegal administrative means of the Minister's own invention, which unlawfully induced the taxpayer into a highly vulnerable position. The circumstances here do not support the decision to issue the garnishments nor the instruments themselves.

The actions of the Minister and his officials are so infected with error of law, illegal conduct, excess of jurisdiction and unfair pouncing without reasonable or any notice,

22 For cases in which taxpayers have argued (unsuccessfully) in the context of a statutory appeal before the Tax Court of Canada that a waiver should be declared void since it had been allegedly extorted through improper pressure of CRA officials, see, for example, *Pearce v. The Queen*, 2005 TCC 38; *Nguyen v. The Queen*, 2005 TCC 697; *McGonagle v. The Queen*, 2009 TCC 168; *aff'd*, 2011 FCA 145; and *Taylor v. The Queen*, 2010 TCC 246. See also *Smerchanski v. Minister of National Revenue*, [1977] 2 SCR 23.

23 90 DTC 6647 (FCA); *rev'g*, 86 DTC 6465 (FCTD).

that those impugned decisions and acts which affect the applicant adversely ought all, in justice, to be quashed.²⁴

The trial judge was careful to note that his quashing of the assessment itself was “severable” from the rest of his judgment in case that particular aspect of his decision ran counter to *Parsons*.²⁵ In such a case, the rest of his judgment, which quashed the various collection instruments and prohibited any further collection action, would stand.

The Federal Court of Appeal, however, reversed this decision in its entirety, holding that any judicial review of an assessment in the Federal Court *as well as related collection action* was barred by subsection 152(8), which states that an assessment is “deemed valid” until varied or vacated through the statutory objection and appeal procedures.

The *Parsons* line of jurisprudence reached its logical conclusion in *Canada (Attorney General) v. Webster*,²⁶ where a taxpayer sought judicial review of an assessment on the grounds of procedural unfairness in the objection process. (Essentially, the appeals officer had failed to disclose information to the taxpayer, preventing him from making effective representations.) The Federal Court of Appeal, reversing the Federal Court, refused to allow the application for judicial review to proceed,²⁷ on the grounds that the taxpayer’s only possible recourse was to the Tax Court of Canada:

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.²⁸

The Federal Court of Appeal added in obiter that the Tax Court of Canada also had no jurisdiction to vacate an assessment on purely procedural grounds and that, consequently, a taxpayer had *no recourse in administrative law* against an assessment issued in a procedurally unfair manner:

24 Ibid. (FCTD), at 6471 and 6475.

25 Ibid., at 6475.

26 2003 FCA 388; leave to appeal to the Supreme Court of Canada dismissed December 19, 2003, SCC file no. 30095.

27 The taxpayer had made a motion for an extension of time to file his application for judicial review, which was the procedural subject-matter of the *Webster* decision.

28 Supra note 26, at paragraph 20.

I would add that the right to appeal an income tax assessment to the Tax Court is a substantial one. The mandate of the Tax Court is to decide, on the basis of a trial at which both parties will have the opportunity to present documentary and oral evidence, whether the assessments under appeal are correct in law, or not. If the assessments are incorrect as a matter of law, it will not matter whether the objection process was flawed. If they are correct, they must stand even if the objection process was flawed.²⁹

The Supreme Court of Canada refused leave to appeal, leaving *Webster* as the leading case today on the unavailability of judicial review of assessments issued by federal tax authorities in the Federal Court.

The Federal Court of Appeal confirmed in *Main Rehabilitation Co. v. Canada*³⁰ its dictum in *Webster* that the Tax Court of Canada has no jurisdiction to consider “flaws” in the assessment process. In *Main Rehabilitation*, a corporate taxpayer appealed an assessment issued following a “protracted and abusive audit” that had been instigated by a false tip from a disgruntled shareholder who happened to be a friend of the auditor’s supervisor. The taxpayer sought to have the assessment “stayed” as an abuse of process. The Federal Court of Appeal confirmed a Tax Court of Canada decision striking the appeal, on the grounds that it was “plain and obvious that the Tax Court does not have the jurisdiction to set aside an assessment on the basis of an abuse of process.”³¹ Once again, the Supreme Court of Canada denied leave to appeal.³²

29 Ibid., at paragraph 21.

30 Supra note 3. See also *Milliron v. Canada*, 2003 FCA 283, and *R v. Sinclair*, 2003 FCA 348.

31 *Main Rehabilitation*, supra note 3, at paragraph 6.

32 *Main Rehabilitation* followed *Taylor v. The Queen*, 95 DTC 591 (TCC); aff’d. 97 DTC 5120 (FCA); leave to appeal to the Supreme Court of Canada dismissed [1997] 3 SCR xiv. The *Taylor* case involved a municipal official who had been charged with embezzling around \$500,000. The publicity surrounding the case prompted a tax audit, in the course of which tax officials repeatedly represented to the taxpayer that if he pleaded guilty and paid restitution, he would not be subject to tax on the misappropriated amounts or consequent interest and penalties. Relying on this understanding, the taxpayer pleaded guilty and was made subject to a restitution order. The CRA then reneged on its promises and reassessed the taxpayer for the full amounts stolen, plus interest and penalties. In his statutory appeal before the Tax Court, the taxpayer asked the court to vacate the reassessment on the theory of promissory estoppel. While the court held that the substantive requirements of promissory estoppel had been made out, it refused to vacate the assessment, reasoning that the liability to pay tax is imposed by the Act, the minister has a statutory duty under subsection 152(1) to assess tax accordingly, and “[t]he doctrine of estoppel is therefore not applicable to the issue of taxes” (ibid., at 596). The Federal Court of Appeal reaffirmed this conclusion in a brief oral judgment, and (as noted above) the Supreme Court denied leave to appeal.

A discussion of the theory of estoppel in public law and the reluctance of the jurisprudence to extend the remedy in tax matters lies beyond the scope of this article. See, however, *Goldstein v. The Queen*, 96 DTC 1029 (TCC) and its progeny; Greg Weeks, *Estoppel and Public Authorities: Examining the Case for an Equitable Remedy*, University of New South Wales Faculty of Law Research Series 2010, Working Paper 70 (Sydney: University of New South Wales Faculty of Law, December 2010) (<http://law.bepress.com/unswwps-flrps10/art70>); Glen Loutzenhiser, “Holding Revenue Canada to Its Word: Estoppel in Tax Law” (1999) 57:2 *University of Toronto Faculty of Law Review* 127-64; and *Shafmaster v. United States*, docket no. 12-1726 (1st Cir. 2013).

The Federal Court of Appeal reiterated its holding in *Main Rehabilitation in Superior Filter Recycling Inc. v. Canada*³³ and in *Luciano v. Canada*,³⁴ an appeal in which a taxpayer alleged (inter alia) that the CRA appeals officer had failed to undertake a proper investigation and correct “obvious” errors in the matter. The Federal Court of Appeal recently reiterated *Main Rehabilitation* in *Ereiser v. Canada*,³⁵ a case in which CRA officials intentionally prepared (and later issued) an inflated reassessment in an attempt to coerce the taxpayer to plead guilty to criminal charges even though no criminal proceedings had yet been initiated.

Since *Main Rehabilitation*, the Tax Court of Canada has repeatedly reiterated that it has no power to provide a remedy for abusive conduct by tax officials leading up to the issuance of an assessment, no matter how egregious the misconduct may be.³⁶ For example, in *Faber v. The Queen*, the Tax Court of Canada struck out the taxpayer’s allegations of potentially very serious misconduct against the auditors and other officials handling his case:

In Section F of the Notice of Appeal under the heading: Reasons Upon Which The Appellant Intends to Rely, set forth at paragraphs 49 to 55, inclusive, constitute [sic] a complaint with respect to the conduct of the CRA audit team and other officials of CRA, including those in the Appeals Division and the Collections Department who are accused of racial profiling, malicious intent, harassment and breach of confidentiality. None of those paragraphs contain any material capable of affecting the validity of the assessments issued for the taxation years at issue.³⁷

In addition, in *Hardtke v. The Queen*,³⁸ the Tax Court of Canada considered a case in which a taxpayer sought to vacate an assessment issued only after an allegedly inordinate and unjustifiable delay that not only resulted in the accumulation of substantial interest but also precluded the taxpayer from defending himself, since his computerized accounting records had been corrupted after a lapse of time. The Tax Court of Canada, relying on *Webster* and *Main Rehabilitation*, struck the claims relating to the delay in issuing the assessment.³⁹

33 2006 FCA 248.

34 2008 FCA 26.

35 2013 FCA 20.

36 See, for example, *Santerre v. The Queen*, 2005 TCC 606, at paragraph 15: “Clearly, the way in which the Appellant’s docket was processed is deplorable and it is necessary to acknowledge a degree of negligence on the part of tax authorities in this regard. I understand why the Appellant may feel that he was treated unfairly. However, I am not in a position to grant him the remedy sought, that is, to vacate the assessments.” That said, some Tax Court of Canada judges have opined that egregious behaviour in the course of an audit by tax authorities could have an impact on any eventual order of costs in an appeal, although the correctness of this theory is open to discussion. See *Landry v. The Queen*, 2009 TCC 399; rev’d. 2010 FCA 135.

37 2007 TCC 177, at paragraph 17.

38 2005 TCC 263.

39 The Federal Court of Appeal came to a similar conclusion soon afterward in *Lassonde v. Canada*, 2005 FCA 323.

THE UNSATISFACTORY STATE OF THE LAW

With respect, the Federal Court of Appeal's narrow view of the Tax Court of Canada's powers is not consistent with the Tax Court's statutory jurisdiction.

The power of the CRA to issue assessments appears in section 152:

152(1) The Minister shall, with all due dispatch, examine a taxpayer's return of income for a taxation year, assess the tax for the year, the interest and penalties, if any, payable and determine

(a) the amount of refund, if any, to which the taxpayer may be entitled by virtue of section 129, 131, 132 or 133 for the year; or

(b) the amount of tax, if any, deemed by subsection 120(2) or (2.2), 122.5(3), 122.51(2), 122.7(2) or (3), 125.4(3), 125.5(3), 127.1(1), 127.41(3) or 210.2(3) or (4) to be paid on account of the taxpayer's tax payable under this Part for the year. . . .

(4) The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if [list of exceptions omitted].

Although a taxpayer's obligation to pay tax arises directly from the Act itself and not from an assessment *per se*,⁴⁰ the issuance of an assessment is an administrative act that produces important legal consequences, including subjecting a taxpayer to statutory collection action as well as starting the clock running on objection and appeal limitation periods. The authority of the CRA to issue assessments (and thus to avoid having to sue taxpayers in civil court for tax owed) is defined and circumscribed by the Act.

Although the Act does not expressly state that an assessment can be issued only following a procedurally fair inquiry into the facts by the CRA, such a requirement is presumed to be present in *all* statutory grants of power.⁴¹ It is always presumed that Parliament does not intend to empower public officials to exercise their powers abusively and run roughshod over the rights of the public.

The type of fairness required of the CRA in the issuance of an assessment varies according to the scope of the examination undertaken and the degree of difference from the taxpayer's reporting position. The CRA enjoys broad discretion to decide how thoroughly to review a particular taxpayer's return and may legitimately decide (as in most cases it does) to eschew any in-depth inquiry and undertake no more than

⁴⁰ See subsection 152(3).

⁴¹ Indeed, in the landmark case of *Johnston v. Minister of National Revenue*, [1948] SCR 486, at 490, the Supreme Court of Canada spoke to the obligation of the CRA to disclose its precise findings of fact and law in support of an assessment: "It must, of course, be assumed that the Crown, as is its duty, has fully disclosed to the taxpayer the precise findings of fact and rulings of law which have given rise to the controversy."

a simple check of the computations.⁴² If the CRA is going to challenge a taxpayer's return, however, it has an obligation to provide an explanation and, particularly for large adjustments, to make appropriate inquiries and permit the taxpayer to make representations. Simply, the CRA does not have the authority under the Act to issue assessments without following fair procedure.

Sections 169 and 171 confer upon the Tax Court of Canada jurisdiction to vacate or vary an assessment:

169(1) Where a taxpayer has served notice of objection to *an assessment* under section 165, the taxpayer may appeal to the Tax Court of Canada to have *the assessment* vacated or varied after either

- (a) the Minister has confirmed the assessment or reassessed, or
- (b) 90 days have elapsed after service of the notice of objection and the Minister has not notified the taxpayer that the Minister has vacated or confirmed the assessment or reassessed [emphasis added]. . . .

171(1) The Tax Court of Canada may dispose of an appeal by

- (a) dismissing it; or
- (b) allowing it and
 - (i) vacating *the assessment*,
 - (ii) varying *the assessment*, or
 - (iii) referring *the assessment* back to the Minister for reconsideration and reassessment [emphasis added].

Sections 169 and 171 clearly specify that the Tax Court's jurisdiction relates to an assessment, not merely the underlying tax liability. Nowhere does section 169 or 171 state that an appeal of an assessment to the Tax Court of Canada is limited to questions of substance, and nowhere do they exclude the jurisdiction to vacate an assessment issued unlawfully owing to an abusive process.

Subsection 152(8) states that "[a]n assessment shall, subject to being varied or vacated on an objection or appeal under this Part and subject to a reassessment, be deemed to be valid and binding notwithstanding any error, defect or omission in the assessment or in any proceeding under this Act relating thereto." This provision reinforces the exclusive jurisdiction of the Tax Court of Canada to rule on the legality of an assessment; however, it does not impose any limits on this jurisdiction.

Section 166 provides that "[a]n assessment shall not be vacated or varied on appeal by reason only of any irregularity, informality, omission or error on the part of any person in the observation of any directory provision of this Act." The use of the term "directory" confirms that this provision insulates assessments from challenge based on defects of form or procedure that do not materially prejudice the taxpayer.⁴³

42 See, for example, *Provincial Paper, Limited v. MNR*, 54 DTC 1199, at 1201 (Ex. Ct.).

43 See, for example, *The Queen v. Ginsberg*, 96 DTC 6372 (FCA); leave to appeal to the Supreme Court of Canada dismissed February 20, 1997, SCC file no. 25520; and *Kyte v. The Queen*, 97 DTC 5022 (FCA).

However, on its own terms, this provision does not apply to procedural errors that *do* cause prejudice to a taxpayer and that represent a serious divergence from Parliament's intention that tax collection take place in an orderly manner that respects the basic rights of the public. Presumably, such reassessments *can* be "vacated or varied on appeal."

Consequently, and notwithstanding the Federal Court of Appeal jurisprudence to the contrary, the Tax Court of Canada clearly has the jurisdiction to vacate an assessment issued in violation of procedural fairness. Such an assessment, even if correct substantively, is not authorized by the Act and can be vacated by the Tax Court of Canada on appeal, applying the same principles used in applications for certiorari.

Indeed, the Federal Court of Appeal's judgment in *Parsons* included dicta to this very effect:

The learned judge of first instance held that, in this case, section 29 did not deprive the Trial Division of the jurisdiction to grant the application made by the respondents under section 18 of the *Federal Court Act* because, in his view, the appeal provided for in the *Income Tax Act* was restricted to questions of "quantum and liability" while the respondents' application raised the more fundamental question of the Minister's legal authority to make the assessments. We cannot agree with that distinction. The right of appeal given by the *Income Tax Act* is not subject to any such limitations.⁴⁴

THE QUEST FOR ALTERNATIVES

As a consequence of the *Webster-Main Rehabilitation* line of cases, taxpayers seeking redress for abuse of statutory audit and assessment powers have had to pursue other causes of action (including actions for damages and other public-law remedies) that, in many ways, are simply inadequate.

Action for Damages

In recent years, the courts have seen a number of civil suits against the government alleging damages caused by the abusive conduct of an auditor. Some of these cases have proved successful and have even resulted in the award of punitive damages.⁴⁵ However, since many such suits rely—partly or wholly—on the illegality of an assessment, the CRA has been able to resist these suits on the grounds of the Tax Court of Canada's exclusive jurisdiction.

In *Roitman v. Canada*,⁴⁶ for example, a taxpayer essentially alleged that the CRA used the threat of substantial assessment action to extort a settlement in which the

⁴⁴ *Parsons*, supra note 18 (FCA), at 6346.

⁴⁵ See *Chhabra*, supra note 3; *Longley v. Canada (Minister of National Revenue)*, 1999 CanLII 5750 (BCSC); aff'd. 2000 BCCA 241; and *Joncas c. Agence du revenu du Québec*, 2012 QCCQ 5096.

⁴⁶ 2005 FC 1385; rev'd. 2006 FCA 266; leave to appeal to the Supreme Court of Canada dismissed December 7, 2006, SCC file no. 41274.

taxpayer was assessed for tax that the Act did not actually require him to pay. Since the taxpayer, as part of the settlement, had waived his right to appeal to the Tax Court of Canada, he sued for damages in the Federal Court. The Federal Court of Appeal, reversing the trial judge, allowed a motion to strike the claim, holding that since the substantive correctness of the assessment lay at the heart of the claim, the only appeal possible would have been to the Tax Court of Canada.⁴⁷

As a result of *Roitman*, a taxpayer seeking to sue for damages related to the conduct of an audit must generally either concede the correctness of any assessment at issue or first have the assessment vacated in the Tax Court of Canada.⁴⁸ This requirement, in addition to entailing a duplication of proceedings, can pose almost insurmountable obstacles to a wide variety of potentially meritorious lawsuits against abusive conduct. For example, if an abusive assessment results in a taxpayer's bankruptcy (or the bankruptcy of a corporation of which the taxpayer is a key shareholder) and the trustee-in-bankruptcy elects not to pursue a statutory appeal against the assessment, a taxpayer may have no way to allege and prove the invalidity of the assessment. Such a situation allegedly occurred in *Swift v. R.*⁴⁹

In addition, the jurisprudence remains unsettled as to the degree of fault required on the part of the tax officials to ground an action for damages. While some cases have held that simple negligence is sufficient,⁵⁰ others have held that the taxpayer must prove malice and/or intentional unlawful conduct (which could include conduct with reckless indifference to its lawfulness).⁵¹ In addition to often raising difficult evidentiary obstacles, the higher standard of fault insulates the tax office from responsibility for damages—however catastrophic—caused by improper audit practices arising from accident or inexperience.

47 The Federal Court of Appeal did suggest, however, that the taxpayer should have sought to set aside the settlement agreement in the context of a Tax Court of Canada appeal.

48 See David Jacyk, "The Dividing Line Between the Jurisdictions of the Tax Court of Canada and Other Superior Courts" (2008) 56:3 *Canadian Tax Journal* 661-707, at 700. But also see *Gardner v. Canada (Attorney General)*, 2012 ONSC 1837.

49 2003 FC 1454; rev'd. 2004 FCA 316.

50 *Joncas*, supra note 45; and *Gibbon v. The Queen*, 77 DTC 5193, at 5197 (FCTD).

51 The question arises primarily in common-law jurisdictions, where an action for damages must be characterized as a nominate tort. Historically, the "tort of malfeasance in public office" requires malice (*Chhabra*, supra note 3, at 5314), although more recent jurisprudence has held that malice was no longer an essential element of the tort (*Longley*, supra note 45 (BCSC), at paragraph 85), and that deliberate unlawful conduct (*Leroux*, supra note 2 (BCCA), at paragraph 33) or reckless indifference to the legality of one's actions (see *Obonsawin v. The Queen*, 2004 TCC 3, at paragraph 9) suffices to ground a claim. The tort of "negligence" does not, of course, require malice, although the jurisprudence is divided on whether an action in negligence can lie against employees of the CRA for negligence committed in the course of an audit: contrast *Leroux*, supra note 2 (BCCA), at paragraph 37-42, with 783783 *Alberta Ltd. v. Canada (Attorney General)*, 2010 ABCA 226; *Canus v. Canada Customs*, 2005 NSSC 283; *Footo v. Canada (Attorney General)*, 2011 BCSC 1062; and *Leighton v. Canada (Attorney General)*, 2012 BCSC 961.

Prohibition

Until recently, jurisprudence recognized the possibility that a taxpayer could obtain a writ of prohibition against an assessment not yet issued. In *McCaffrey v. The Queen et al.*,⁵² for example, the Federal Court considered an application from a taxpayer who had apparently been subjected to prolonged and multiple audits for the same taxation years. The taxpayer sought, inter alia, “a writ of prohibition, prohibiting Revenue Canada, or any of its agents or employees from conducting any further audits for the years 1988, 1989 or 1990.”⁵³ The Federal Court rejected a motion to strike the claim, observing that

[c]ounsel for the respondent directed my attention to the provisions of the *Income Tax Act* which grant to the Minister and his officials the authority to conduct audits, which is clear. However, the applicant makes serious allegations concerning the Minister’s exercise of that right, and is entitled to bring such complaints before this Court.⁵⁴

The Federal Court recently followed *McCaffrey* in *Tele-Mobile Company Partnership v. Canada Revenue Agency*, in which the taxpayers (collectively “Telus”) sought “a writ of prohibition to prevent the CRA from assessing TELUS for goods and services tax (GST) on the international roaming fees charged by TELUS to its customers from October 2004.”⁵⁵ The Federal Court rejected a motion from the CRA to strike the claim, reasoning that

[w]rits of prohibition are available to prevent authorities from acting beyond their jurisdiction or to prevent unfairness. In this application, TELUS acknowledges that the Minister has the jurisdiction to make the proposed assessments but asserts that it would be unfair to do so. While I acknowledge that TELUS will have a steep hill to climb to convince a Court that the Minister has a duty of fairness in these circumstances and that it was not met, I cannot, at this early stage, say that it is not possible that they may succeed in that climb.⁵⁶

The Federal Court of Appeal reversed the Federal Court’s judgment, however, and struck Telus’s application for prohibition in a succinct judgment:

We note that if prohibition is granted because of these alleged consequences, the Minister cannot issue an assessment—in effect, as a matter of law, the Minister will be obligated to forgive a tax liability that he believes is present, solely because of alleged hardships that the taxpayer will suffer.

52 93 DTC 5009 (FCTD).

53 Ibid., at 5012.

54 Ibid., at 5014.

55 2010 FC 839, at paragraph 1; rev’d. 2011 FCA 89; leave to appeal to the Supreme Court of Canada dismissed March 29, 2012, SCC file no. 34244.

56 Ibid., at paragraph 30 (FC).

In our view, that cannot be. The Court cannot stop the Minister from carrying out his statutory duty under the *Excise Tax Act*, R.S.C. 1985, c. E-15, subsection 275(1) to assess GST payable by law merely because doing so will impose unfair and onerous obligations and financial hardships upon the taxpayer.

To the extent that CRA has exercised its discretion in a manner that has improperly caused TELUS damage, TELUS may have other recourses available to it. To the extent that the exercise of discretion affects the amount of tax owing, TELUS may challenge the assessment in accordance with Part IX of the *Excise Tax Act*, R.S.C. 1985, c. E-15. Alternatively, it may apply for a remission order under section 23 of the *Financial Administration Act*, R.S.C. 1985, c. F-11. Further, it may be able to bring an action in tort to obtain compensation for any damages that were caused by CRA.

In our view, for the foregoing reasons, it is plain and obvious on the facts alleged in the notice of application that TELUS's application for prohibition cannot succeed.⁵⁷

The exact basis of Telus's complaint against the CRA is not clear from the judgments. If Telus was merely alleging "hardship," then arguably the taxpayers were not properly entitled to a writ of prohibition and the Federal Court of Appeal was correct to strike the claim. The Federal Court of Appeal's reasoning, however, appears to articulate a disturbingly broad rule to the effect that the Federal Court cannot in *any* circumstances issue a writ of prohibition to prevent the issuance of an assessment, even in the face of abusive conduct, such as repeated and prolonged audits of the same taxation year or a blatant refusal by an auditor to correct obvious and substantial errors in a proposal.

Mandamus

The jurisprudence has repeatedly recognized that taxpayers can obtain a writ of mandamus to obtain an original assessment (which the CRA is legally obligated to issue "with all due dispatch" upon receiving a taxpayer's initial tax return).⁵⁸ Indeed, in cases where a taxpayer has sought to quash an assessment owing to unreasonable delay, the courts have often held, in obiter, that the taxpayer should instead have brought an application of mandamus against the tax office once a delay started to prove onerous.⁵⁹ Indeed, the Supreme Court of Canada itself made such a comment in *Canada v. Addison & Leyen Ltd.*:

57 Ibid., at paragraphs 4-7 (FCA).

58 *Schatten v. MNR*, 96 DTC 6102 (FCTD); *Nautica Motors Inc. v. Canada (Minister of National Revenue)*, 2002 FCT 422; *Millette c. Québec (Sous-ministre du Revenu)*, 2006 QCCS 3006; and *Ficek v. Canada (Attorney General)*, 2013 FC 502. See also *Burnet v. MNR*, 98 DTC 6205 (FCA) (mandamus to issue a notice of determination).

59 See *Ginsberg*, supra note 43, at 6377; *James v. The Queen*, 2001 DTC 5075, at paragraph 20 (FCA); and *Gretillat v. The Queen*, 98 DTC 1483, at 1487 (TCC).

The Minister is granted the discretion to assess a taxpayer at any time. This does not mean that the exercise of this discretion is never reviewable. However, in light of the words “at any time” used by Parliament in s. 160 *ITA*, the length of the delay before a decision on assessing a taxpayer is made does not suffice as a ground for judicial review, except, perhaps, inasmuch as it allows for a remedy like mandamus to prod the Minister to act with due diligence once a notice of objection has been filed.⁶⁰

On a practical level, however, an application for mandamus has limited usefulness in a prolonged audit dispute, since it all but ensures that the CRA will take the most aggressive position possible to preserve its rights once the case goes to appeal. On the other hand, if a prolonged audit is holding up the processing of an amended return or an application for a loss determination, an action in mandamus can potentially help to break the impasse.⁶¹

Quo Warranto

Canadian courts do not yet seem to have had occasion to consider whether a taxpayer can seek quo warranto against a tax auditor or other ministerial delegate in the tax office who engages in abusive conduct in the course of an audit. Quo warranto generally does not apply to lower-level employees who serve at the pleasure of a superior. Moreover, quo warranto generally requires a defect in the initial appointment of the officer or a failure to meet or maintain a statutory qualification. That said, it is conceivable that if an auditor or other tax official demonstrates manifest unfitness for his or her post, a taxpayer could credibly allege that that individual should never have been appointed in the first place. Some innovation in the law could therefore allow a taxpayer to seek, through an action in quo warranto, the

60 2007 SCC 33, at paragraph 10. This statement can be contrasted with that in *Smerchanski*, supra note 22, at 33, where Laskin CJC made the following statement concerning the responsibility of the CRA under subsection 220(1): “There is a good deal of discretion reposed in the tax authorities as to enforcement of the *Income Tax Act*, and I have no doubt that the courts, within the limits of discretion open them, *would monitor what might appear to be unnecessary severity in dealing with taxpayers despite the fact that they might have been guilty of some wilful breach of law* [emphasis added].” It also bears noting that the CRA has questioned the correctness of the Supreme Court of Canada’s obiter that mandamus may lie to force the processing of an objection (as opposed to forcing the issuance of an assessment), since the taxpayer can always, after 90 days, file an appeal to the Tax Court of Canada while an objection remains pending. See Johanne D’Auray, Wilfrid Lefebvre, and David E. Spiro, “Current Cases,” in *Report of Proceedings of the Fifty-Ninth Tax Conference*, 2007 Conference Report (Toronto: Canadian Tax Foundation, 2008), 6:1-18, at 6:8.

61 The Federal Court has recently held that an application for judicial review of a flat-out refusal from the CRA to process an application for a notice of determination should be characterized as an action in certiorari rather than mandamus: see *Signalgene R&D Inc. v. Canada (National Revenue)*, 2012 FC 1375, at paragraphs 86-87, and the companion case of *Theratechnologies Inc. v. Canada (National Revenue)*, 2012 FC 1376, at paragraph 76.

destitution of an auditor or other tax official owing to unlawful and abusive exercise of his or her powers.

NEXT STEPS

Ever since the development of the prerogative writs in the Middle Ages, the courts have played a vital role in controlling, through administrative-law procedures, the exercise of government powers and in protecting common citizens from abuses.⁶² The judiciary's vigilance has had important salutary effects for the public. In the immigration context, for example, the landmark decision of the Supreme Court of Canada in *Baker v. Canada (Minister of Citizenship and Immigration)*⁶³ (a 1999 case involving a judicial review of a refused application to stay a deportation order) provoked a "dramatic" overhaul in how Canada's immigration service ensured procedural fairness in its dealings with the public.⁶⁴

Unfortunately, the judiciary is simply not fulfilling this responsibility with regard to the exercise of tax audit and assessment powers.⁶⁵ As David Sherman laments in his annotation to the Tax Court of Canada decision in *Pine Valley Enterprises Inc. v. The Queen*,⁶⁶ the "exclusive but limited" jurisdiction of that court over tax assessments effectively deprives taxpayers of any effective remedy against a wide range of wrongful conduct from tax officials. To remedy this injustice, Sherman proposes expansion of the Tax Court of Canada's jurisdiction to include "matters relating to the CRA's administration of the tax system":

According to Pine Valley's version of the events, the CRA issued a GST assessment that Pine Valley never saw, refused to deal with Pine Valley or its counsel, and proceeded to issue garnishment notices to its clients to collect some \$500,000 of GST including interest and penalties. . . .

The Crown brought a motion to strike significant portions of the Notice of Appeal as not disclosing a valid cause of action in the Tax Court.

62 For a discussion of the history of the prerogative writs, see Holloway, *supra* note 9.

63 [1999] 2 SCR 817.

64 Lorne Sossin, "The Politics of Soft Law: How Judicial Decisions Influence Bureaucratic Discretion in Canada," in Marc Hertogh and Simon Halliday, eds., *Judicial Review and Bureaucratic Impact: International and Interdisciplinary Perspectives* (Cambridge, UK: Cambridge University Press, 2004), 129-60, at 146-52.

65 However, see the recent decision in *JP Morgan Asset Management (Canada) Inc. v. Canada (National Revenue)*, 2012 FC 651 (under appeal), where the Federal Court declined to strike an application for judicial review of the CRA's decision to issue discretionary assessments under subsection 227(10), holding that "[t]he issue in this application is only to review the exercise of a discretion exercised by the Minister which is alleged to have been exercised arbitrarily, unfairly and contrary to the rules of natural justice in a context in which it is alleged to be inconsistent with CRA's own policies" (*ibid.*, at paragraph 36).

66 2010 TCC 324.

Justice Diane Campbell agreed, and struck much of the Notice of Appeal. Details about the audit and assessment process, and collection action undertaken by the CRA, are not relevant to the correctness of the assessment, which is the only issue the Tax Court can determine. . . .

This decision highlights a problem with the Tax Court's limited jurisdiction. Pine Valley's complaints about the assessment process may well be legitimate. If the CRA initiated collection action without having properly assessed Pine Valley, and Pine Valley's business suffered as a result, then Pine Valley may have a cause of action against the CRA. However, such action can only be brought in the Federal Court or in the provincial superior court, under the *Crown Liability and Proceedings Act*. Yet claims in the Federal Court that the CRA has acted unjustifiably are met with the Federal Court saying that it cannot rule on whether the assessment is correct, and therefore must strike out facts related to the correctness of the assessment. . . .

One hopes that in due course the Tax Court's jurisdiction will be expanded to allow it to address matters relating to the CRA's administration of the tax system, to eliminate this problem.⁶⁷

Indeed, the expansion of the Tax Court of Canada's powers to include jurisdiction over all tax-related issues (including collection issues, all forms of judicial review, and even claims for damages for unlawful conduct by tax officials acting in the course of their functions) would enable taxpayers to have all issues relating to a particular assessment heard and dealt with in one action, while providing them with the benefit of the Tax Court's expertise.

That said, the Act already confers upon the Tax Court of Canada the necessary jurisdiction to vacate an assessment issued unlawfully, and the fetters on this jurisdiction imposed by the Federal Court of Appeal are simply not consistent with the Tax Court's enabling legislation. Consequently, even if Parliament does not choose to expand the Tax Court of Canada's powers to include all tax-related issues, there is still room for the law to shed the shackles imposed by the *Webster-Main Rehabilitation* line of jurisprudence. It is difficult to accept that members of the public have no effective recourse in the face of such an obvious wrong as the abuse of audit powers. The time has come for the Federal Court of Appeal to reconsider the wisdom of allowing unlawful assessments issued in contempt of the rights of taxpayers to stand, or for the Supreme Court of Canada to finally set the record straight.

67 David Sherman, annotation to *Pine Valley Enterprises*, in *Taxnet Pro* (Toronto: Carswell) (online).