Federal Court  Cour fédérale

Date: 20190625

Dockets: T-473-06
T-474-06

Citation: 2019 FC 853

Ottawa, Ontario, June 25, 2019

PRESENT: The Honourable Mr. Justice Barnes

Docket: T-473-06

BETWEEN:

ALLAN JAY GORDON

Plaintiff

and

HER MAJESTY THE QUEEN

Defendant

Docket: T-474-06

AND BETWEEN:

JAMES A. DEACUR AND ASSOCIATES LTD.
AND JAMES ALLAN DEACUR

Plaintiffs

and

HER MAJESTY THE QUEEN

Defendant

JUDGMENT AND REASONS

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I. Background – The Allegations

[1] In these proceedings, Allan Jay Gordon, James A. Deacur and Associates Ltd. [JAD] and James Allan Deacur seek damages from the Government of Canada based on pleaded allegations of tortious conduct arising out of a Canada Revenue Agency [CRA] criminal investigation. That investigation began in late 1995 and culminated in the indictment and prosecution of Messrs. Deacur and Gordon on five counts of fraud, attempted fraud and possession of the proceeds of crime. The charges they faced related to their preparation of 31 scientific research and experimental development [SR&ED] claims submitted on behalf of a number of taxpayer clients seeking to obtain substantial tax credits[1].

[2] After a lengthy preliminary hearing, that ran intermittently between May 27, 1999 and April 29, 2003, Messrs. Deacur and Gordon were committed to stand trial. Nevertheless, on September 24, 2004 the prosecution ended when Crown counsel entered a stay of proceedings.

[3] Messrs. Deacur and Gordon are aggrieved by the conduct of the CRA employees who conducted the subject investigation [the JAD investigation] and they assert several causes of action including negligent investigation, breach of Charter rights, misfeasance in public office, malicious prosecution and intentional interference with contractual relations. No allegations are made against the CRA for the work performed by its auditors and by virtue of s 152(8) of the *Income Tax Act*, RSC, 1985, c 1 (5th Supp) [ITA] this Court has no authority to entertain a

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[1] The SR&ED Program was a federal tax incentive program administered by the CRA intended to stimulate research and development in Canada. Qualified SR&ED expenditures were required to meet stipulated science and financial conditions and all first-time claims were subject to audit.

collateral attack on the correctness of any such assessment even if it is alleged to have arisen through an abuse of process: see *Roitman v R*, 2006 FCA 266 at paras 19-20 and 25, [2006] FCJ No 1177. The earlier pleadings of malicious prosecution against the Crown Prosecutors, defamation and perjury, were either struck from the Statements of Claim by Order of Case Management Prothonotary Kevin Aalto dated October 26, 2012 or abandoned. Nevertheless, the Plaintiffs argued throughout the trial about the conduct of the Crown prosecutors, particularly with reference to disclosure. I have not taken those assertions into account.

[4] The conduct of this proceeding has been extremely acrimonious both before and during the trial. That acrimony in no small measure stems from the visceral and contemptuous opinions that Messrs. Deacur and Gordon hold of the CRA investigators and of the quality of their work. Those views are strongly expressed in the pleadings. Mr. Deacur's Statement of Claim includes allegations of arbitrary and oppressive conduct, falsification of records, malicious falsehoods, unlawful seizure of property, wilful blindness and incompetence directed at numerous CRA officials. Mr. Gordon's Statement of Claim is similar in tone and content. He alleges that CRA investigators knowingly made false accusations and lied about their conduct. In paragraph 66 he asserts that the lead investigator, Patricia Northey, made "false allegations" as part of a "fraudulent scheme…to profit from her dishonest behaviour". Many other allegations of incompetence and dishonesty are set out throughout Mr. Gordon's pleading and were frequently repeated by Mr. Gordon throughout the trial. The Plaintiffs' Post-Trial Brief is similarly replete with allegations of corruption and dishonesty – mainly, but not exclusively, directed at Ms. Northey.

[5] Notwithstanding the Plaintiffs' broad pejorative characterizations of the CRA investigation, the particulars of the "misconduct" and "negligence" they assert are reasonably discrete. They complain that CRA investigators failed to follow fair procedures including some that were recommended in the CRA TOM II Manual or in the CRA Declaration of Taxpayer Rights[2] . Their complaints include the following:

(a) A failure to invite Messrs. Deacur and Gordon to attend for an interview or to make potentially exculpatory submissions in advance of charges being laid.

(b) A failure to notify Mr. Gordon 30 days in advance of charges that he was a target of the investigation.

(c) A failure to turn the investigation over to the RCMP once it became clear that charges under the *Income Tax Act*, RSC, 1985, c 1 (5th Supp.) [ITA] were not warranted.

(d) The borrowing of records from some taxpayers in support of the investigation.

(e) The intimidation of certain JAD employees and taxpayer clients as a means of obtaining incriminating information.

(f) The mischaracterization of Mr. Deacur as a potential threat in order to obtain RCMP support for the execution of search warrants.

(g) A failure to use form T-134 as the accepted means of referring suspect files to Special Investigations.

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[2] The TOM II Manual contains a set of procedural guidelines for the conduct of CRA Special Investigations, extracts of which are found in Exhibits P-18, P-105, P-107, P-108 and P-111. The CRA Declaration of Taxpayer Rights is a statement of principles that are said to be owed generally by the CRA in its dealings with taxpayers including the right to fair and consistent application of the ITA.

(h) The assignment of the investigation to Ms. Northey whose experience grade was below the rated complexity of the case.

(i) A failure to refer the suspect files for a reassessment before the laying of charges.

(j) An alleged mixing of the CRA audit function with the investigation.

(k) The theft of Ms. Northey's vehicle containing investigative records.

(l) A supposed failure by the CRA to supervise Ms. Northey in the conduct of the JAD investigation.

(m) The alleged misstatement of evidence given by JAD employee, Patrick Wong, to CRA investigators.

[6] More generally Mr. Gordon's and Mr. Deacur's theory of liability is based on allegations that Ms. Northey, her colleagues and her supervisors lacked even a rudimentary understanding of SR&ED rules and practices and therefore fundamentally mischaracterized their methods as unlawful. According to this view, the CRA investigators failed to understand the law insofar as it permitted an SR&ED claim to be made on the strength of an after-the-fact recorded entry of an account payable and/or based on fair market valuations instead of bare wages. This lack of basic knowledge, they say, caused the investigators to focus on matters that fell well within the law and which could not reasonably have raised any legal or compliance concerns. They also assert that their impugned accounting methods were validated by some CRA auditors and were ultimately vindicated by three client SR&ED appeals that were allowed after the criminal proceeding was stayed.

[7] It goes without saying that the onus of proof for every element of the alleged causes of action rests with the Plaintiffs.

II. Background – The Trial, the Witnesses and the Evidence

[8] The trial of these actions took place in Toronto between October 15, 2018 and December 20, 2018. Twenty-three witnesses testified and 461 exhibits were introduced. Oral argument and a few remaining evidentiary matters were concluded during the week of February 4, 2019. Detailed written submissions were subsequently provided by the parties and have been carefully considered. The two actions were tried together and this single set of reasons applies to both proceedings.

[9] These actions have been underway in this Court since March 2006 and, for the most part, concern matters dating back to the early 1990s. After the passage of more than 20 years, the quality of witness testimony left much to be desired. As one would expect, the memories of most witnesses had faded or were, in places, non-existent. Fortunately, the available documentary record is reasonably robust and permits the Court to understand much of what took place even where the witnesses could not fully describe it from memory.

[10] The evidentiary record in this case also includes many statements and statutory declarations taken by CRA investigators from persons who were not called as witnesses. That evidence would be inadmissible as classic hearsay if it were received as proof of the truth of its contents. Considerable care must, therefore, be taken as to the use to which this evidence can be put. It cannot be considered for its truth but only as evidence of what the CRA investigators

understood about the merits of the case going forward. The conduct and motivations of the investigators in pursuing the investigation and in recommending the laying of criminal charges can be evaluated on the basis of what they learned and recorded from these sources. Similarly, the fact that some clients had expressed reservations about JAD's methods only serves to establish that those concerns had been raised with JAD representatives. Whether the concerns were valid is not the issue, but only that Messrs. Deacur and Gordon had been told that some clients and JAD employees were uncomfortable with their approach to the presentation of SR&ED claims.

[11] Mr. Gordon frequently asserted that many witness statements were coerced by the investigators and contain errors, if not falsehoods. However, he led no evidence to support those allegations and he failed to establish any material mistakes in what the investigators recorded. This is not entirely surprising because the witness statements conform closely to the documentary record and to the essential facts that Mr. Deacur and Mr. Gordon somewhat reluctantly acknowledge. It was, of course, open to the Plaintiffs to call any of these witnesses to testify about the accuracy of their recorded statements or to speak to the CRA's investigative methods but, with the exception of Messrs. Savelli and Durst, no JAD clients testified. And in the case of those witnesses no evidence of intimidation or material inaccuracy was developed. Similarly, the Plaintiffs called only two JAD employees – Ron Worthington and Kyle Bondergaard. Mr. Bondergaard said it was unsettling and unnerving to be read his rights in the course of his interaction with CRA investigators but he did not otherwise take issue with their approach. Mr. Worthington was also given a Charter caution but acknowledged that the approach was not "abusive or anything" [p 1292]. Several former JAD employees who

presumably had relevant evidence to offer – notably Patrick Wong – were not called and their statements to CRA investigators were, therefore, left unchallenged.

[12] What the witness evidence consistently indicated to CRA investigators was that JAD frequently employed a strategy involving backdated records to support asserted transactions that did not take place at the relevant time and to thereby maximize the value of SR&ED claims on behalf of some of its clients. By virtue of the use of contingency fee agreements, this approach also had the potential to maximize JAD's fees. The information also indicated to CRA investigators that JAD's clients were either mostly unaware of the methods or were reassured by JAD representatives that those methods were acceptable and lawful.

III. The Credibility of Ms. Northey

[13] It is very apparent that Messrs. Deacur and Gordon hold Ms. Northey in profound contempt and largely, if not wholly, responsible for the criminal prosecution. Throughout this proceeding, they accused her of incompetence, malice, dishonesty and corruption. Mr. Gordon's feelings towards Ms. Northey are particularly visceral. During his cross-examination of her, he frequently accused her of dishonesty and, on one occasion, he told her she was a "crook". What is particularly disturbing about these allegations is that they are entirely baseless. They are opinions based on personal enmity alone.

[14] Ms. Northey consistently gave a reliable history of relevant events – a history that accords with the documentary record. She was not prone to exaggeration, speculation or hyperbole. She testified in a straightforward manner, explaining her actions and decisions

through the investigation. Her evidence was also markedly consistent with that given by the several other CRA witnesses who were also involved in the JAD investigation.

[15] The impression I have of Ms. Northey is one of fairness, competence, diligence and thoroughness. Her investigation was intelligently conducted and carefully recorded. Notwithstanding her AU2 status in 1995, I am satisfied that Ms. Northey was well qualified to lead the JAD investigation and the CRA's confidence in her abilities was not misguided or misplaced.

[16] I note as well that Ms. Northey's considerable abilities have not gone unnoticed within the CRA. This is evidenced by her subsequent rapid rise through the employment ranks and by the consistently favourable views of her abilities as related by her many colleagues who testified.

[17] I reject unreservedly the Plaintiffs' contention that Ms. Northey's investigation was improperly motivated, dishonest or incompetent. To the contrary, it was proficiently and fairly conducted. Ms. Northey established that she was at all times careful and highly professional. Her memory of relevant events was much better than most of the other witnesses. This is unsurprising given her central role in the JAD investigation, her practise of diligently recording her work and her intervening attendance over a period of several weeks as a witness in the criminal preliminary hearing. Where Ms. Northey's evidence conflicts with the evidence of any other witness, I accept her testimony. In the end, however, there were few evidentiary conflicts of any significance. What happened at that time is well documented and mostly not seriously

disputed by Messrs. Deacur and Gordon. It is the characterization of what took place where the disagreement mostly lies in this case.

[18] I would add that the Plaintiffs' allegation that Ms. Northey was on a personal mission to falsely and maliciously build a prosecution case by intimidating JAD's employees and clients is belied by the myriad of investigators who were assigned to conduct witness interviews and by the evidence they acquired. The idea that Ms. Northey was motivated by the receipt of modest acting pay and was able to co-opt her many colleagues into intimidating witnesses is both manifestly implausible and wholly unproven. As described later in these reasons, Ms. Northey's work was also carried out under active CRA supervision at the highest levels. This belies the Plaintiffs' assertion that she fabricated an untenable prosecution theory that was patently inconsistent with established accounting and tax principles.

[19] The Plaintiffs' specific suggestion that Ms. Northey was motivated to prolong her investigation because she was receiving additional income from an acting AU4 assignment has no evidentiary foundation. In fact, the record discloses that the Deacur file was given priority and, despite its breadth, it moved forward with relative dispatch. This can be seen from Exhibit D-53 where the Chief of Special Investigations in Hamilton, Rick Michal, directed an interview "blitz" to keep the investigation moving along. This was accomplished by assigning more investigators who were expected to put some of their other work on hold. It is perhaps in recognition that this financial motivation theory is baseless that it is now alleged in the Plaintiffs'

Post-Trial Brief at paragraph 698 that the malicious object of the investigation was to block legitimate SR&ED claims[3].

IV. Background – The Investigation

[20] The CRA's concern about the Deacur approach to SR&ED claims initially arose out of multiple, routine SR&ED audits across several CRA offices in and around the Greater Toronto Area. Those audits revealed a pattern of suspicious conduct that was thought worthy of further examination. The identified audit concerns involved high and unsupported labour valuations and the use of backdated taxpayer records. These early audit concerns were raised well before Ms. Northey became involved in the investigation and they informed the decision taken in consultation with numerous CRA officials in November 1995 to launch the investigation into JAD's methods. What is also evident is that the full extent of JAD's backdating of taxpayer records had not, at that point, been uncovered [eg see Exhibit D-383].

[21] In the earliest stages of the investigation, Ms. Northey had no involvement. After she was assigned as lead investigator by Mr. Michal many other investigators and supervisors actively assisted. For many months during the investigation, Ms. Northey was on two maternity leaves and was not involved at all. Furthermore, multi-level reviews and approvals were required at every major decision-point including the decision to launch an investigation, the approval of the Primary Report, the decisions to seek and to issue search warrants (including the required judicial authorization), the approval of the Prosecution Report and the decision, in

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[3] The Plaintiffs did not, however, abandon their allegation that Ms. Northey and other unnamed CRA investigators were financially motivated to prolong the JAD investigation [Post Trial Brief para 531].

consultation with the Crown prosecutors, to lay criminal charges. Once charges were brought, the authority to continue the prosecution rested with counsel for the Attorney-General and ultimately with the Judge who committed Messrs. Deacur and Gordon to stand trial.

V. The JAD Methods – Backdating of Client Records

[22] In order to assess the reasonableness and lawfulness of the CRA's conduct, it is necessary to understand what the Plaintiffs were doing in the presentation of their clients' SR&ED claims to the CRA and the basis on which they say it was justified. It is only with an appreciation of JAD's methods that I can determine whether there were reasonable and probable grounds to initiate and continue the JAD investigation to the point of a prosecution.

[23] The evidence indicates that JAD promoted itself as a SR&ED specialist firm. It actively solicited SR&ED work and ultimately was responsible for filing several hundred claims on behalf of many taxpayer clients. Many of these clients had little, if any, knowledge of the SR&ED program and had no reason to document the work they were doing or to isolate its costing.

[24] For most of the cases that ultimately became the subject of the prosecution, Messrs. Deacur and Gordon attempted to overcome the absence of documentation by creating the evidence after-the-fact. For some clients, they set up non-arm's length companies to create the appearance of a sub-contracting relationship. These arrangements also involved the creation of invoices to support the existence of an ostensible subcontract. In these cases there had never

been an actual intention by the client at that time to outsource the R&D work to a third party, nor was there any realistic expectation that the subcontract invoices would ever be paid.

[25] Problems with JAD's SR&ED methodologies were identified by a number of auditors working independently out of different tax offices. Several of the early audit reports involving JAD clients refer to the use of backdated records including corporate histories all in support of claimed management fees.

[26] Ms. Northey testified that from her review of this initial audit material a pattern emerged involving fictitious records and entries in support of many JAD-prepared SR&ED filings. This is borne out by several 1995 audit reports. A December 1995 memo from a Toronto West auditor to Mr. Michal, listed the following problems:

(a) falsehoods;

(b) backdating of documents;

(c) no payments ever made;

(d) use of associated (possibly shell) corporations to legitimize claims;

(e) inflated expenses; and

(f) no SR&ED performed. [Exhibit D-383 at Tab 69]

[27] References to inflated claims, tax manipulation and backdating can be seen throughout a compendium of early audit materials contained in Exhibit D-383, notably at Tabs 6, 51, 55, 57, 68 and 72. A letter from a client, Tim Curtis, described the claim prepared by JAD in the following way:

> It was obvious to all informed parties that the claim was not legitimate and hence I did not pursue it. The expenses declared were not incurred specifically for R&D but rather related to work I had completed in the course of normal business which provided me with much need [sic] information for the development of my ideas.
>
> I believe that in good faith I entrusted Deacur And Associates to act on my behalf. If they have taken advantage of the system to the extent that I would surmise, then I believe I would be remiss if I did not do my part to expose them to the authorities. It gives the accounting profession a bad reputation. [Exhibit D-383, Tab 70]

[28] The JAD method of supplying or using companies and ostensible invoices after-the-fact to support inflated management fees was, according to client interviews, widespread. Exhibit D-418 contains 88 witness statements taken by CRA investigators. This method was described by many JAD clients as can be seen at Tabs 7, 8, 9, 11, 12, 13, 14, 15, 16, 17, 18, 20, 21, 22, 23, 25, 26, 27, 28, 29, 30, 32, 33, 34, 35, 38, 40, 41, 42, 43, 44, 45, 55, 77, 78, 79, 80, 81 and 82.

[29] Not all of JAD's clients appear to have been comfortable with what was going on. For instance, the bookkeeper for JAD client, Bale-Eze Inc., told the CRA he was so concerned about the method being used by JAD that he resigned as an officer for the two companies involved [Exhibit D-418 at Tab 19]. A similar concern expressed by the accountant for Martinville Hockey Sticks Inc. is noted at Tab 36.

[30] Several JAD employees also expressed reservations about its methods of documenting SR&ED claims [Exhibit D-418, Tabs 84, 86 and 87]. JAD employee Patrick Wong told CRA investigators that Mr. Deacur had advised him to set up a management company to support inter-

corporate management fees and to use shell companies owned by JAD. His statement to the CRA included the following:

> 4) I was trained to do the SR&ED claims by Allan Gordon, who I believe is a manager at James A. Deacur & Associates Ltd. Allan Gordon is also a Chartered Accountant and works out of the Langstaff location,
>
> 5) Allan Gordon provided me with Revenue Canada Taxation Interpretation Bulletins, Information Circulars and an information package regarding SR&ED. Gordon told me to read the information and to ask him any questions I might have. I asked Gordon for the technical part of the SR&ED claims and he provided me with sample technical reports,
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> ...
>
> 10) The first claim that I did was Martinville Hockey Sticks Inc., in Summerstown, Ontario. I had not seen the contract signed between Martinville and James A. Deacur & Associates but was aware that the accounting fee was in the range of 30% of the SR&ED refund that the client was to receive. The file was assigned to me by James Deacur. I prepared the 1991 and 1992 T661 claim based on fair market value (FMV) claiming SR&ED expenditures of $66,422. in 1991 and $111,010. in 1992. I did not prepare the 1993 T661 claim dated March 30,1994 as I had left their employment by then. Allan Gordon reviewed the claims that I had prepared. Gordon told me to change to use FMV for the claiming of SR&ED wages as I had prepared as actual wages in the beginning. Gordon also told me that if I did the claim by actual cost, the client would get a lower refund. On Martinville's file, I was instructed by both Allan Gordon and James Deacur to use the fair market value in calculating the cost of the work done instead of actual pay. James Deacur told me that they had prepared claims in the past this way and that they were approved by Revenue Canada. After this client I told every other client I worked on this as well. The T661 SR&ED claims for the taxation years 1991, 1992 and 1993 referred to above are attached as Exhibit "B",
>
> 11) Based on the instructions I received from James Deacur and Allan Gordon I prepared the invoice dated December 15, 1993 from 1017837 Ontario Limited to Martinville Hockey Sticks Inc "for services rendered for research and development regarding wages and salaries in 1993" totaling $154,960. The Ontario numbered company was already set up by Deacur's daughter and I just typed the invoice like I was instructed to do on the desktop computer in the office. I did not prepare any journal entries or working papers for 1017837 Ontario Limited. I do not believe that the client, Denis Flaro at Martinville Hockey Sticks even agreed to the claiming of this $154,000. "management fee" as a SR&ED expenditure. I did not see the undated letter to Dennis or the March 29, 1994 letter to Denis Flaro, both signed by James Deacur with regards to this management fee. A copy of the invoice dated December 15, 1993 and the two letters to Dennis Flaro referred to above are attached as Exhibit "C",
>
> 12) Allan Gordon instructed me that the fair market value for SR&ED wages was to be determined based on how much the client would be charged if they had to subcontract the work. With respect to the hours used, I was instructed to tell the clients that they should record the hours every time they did SR&ED and provide me with the list of hours by project. I never checked the T4's of the clients that I worked on to verify that the management fee amounts had been reported or paid,

13) James Deacur told me that if a client had high expenses, it would be worthwhile for me to set up a management corporation for the client and charge inter-corporate management fees between the two corporations. I asked Deacur about the new corporation having to pay tax on the management fee they reported and Deacur never gave me an answer. James Deacur just instructed me to prepare the invoices supporting the inter-corporate management fee. I prepared them on the computer in Deacur's offices in WordPerfect,

14) James Deacur told me that he had about 3 to 5 shelf corporations on hand in his offices that can be used at any time. Deacur's daughter Kelly-Ann, was a legal secretary and had provided these corporations to James Deacur. I never updated the minute book of these corporations; that work was done by Kelly-Ann Deacur,

...

19) With regards to the Caber Mor Holdings file, I spent over 40 hours on this file but did not complete the T661 SR&ED claims. I did prepare the two fax's to Caber Mor dated December 21, 1993 and February 2, 1994 requesting information, and I prepared the three accounting working papers with the management fee hours listed and the rate of $60. and $65. per hour. I did not prepare the invoice from 1031783 Ontario Limited to Caber Mor dated November 30, 1993 for R&D services totaling $146,625. I also did not prepare the two page working paper titled "Pat Wong" dated Feb 14/94 that referred to the management fee of $146,625. I did have a meeting with Maurizio Ulgiati who was to take this file over when I left Deacur's employment, to explain to him the status of the file. A copy of the two fax's and my working papers referred to above are attached as Exhibit "G" is and the invoice dated November 30, 1993 and the Feb 14/94 notes referred to above are attached as Exhibit "H",

20) With regards to the Signet Marketing Inc. file, I prepared T661 SR&ED claims for the 1992 and 1993 taxation years claiming expenditures of $63,472. and $102,361. respectively. I do not know if the SR&ED claims filed with Revenue Canada are the same ones that I prepared as they are dated June 8, 1994; after I had left Deacur's employment. The expenditures claimed did include wages at a fair market value (FMV) rate of $75. per hour. The FMV for management fees was discussed with Signet's owner John Savelli Jr. at a meeting I had with him on January 4, 1994. I have notes in my appointment book from January 7th to 10th/94 re the R&D for Signet. I received information from Savelli by fax's dated December 20, 1993 and January 7, 1994 to prepare the SR&ED claims; see attached Exhibit "I". I prepared the accounting working papers on the computer for the SR&ED expenditures. A copy of the working papers titled "Signet Marketing - PW" and dated 13-Jan-94, 14-Jan-94, and 31-Jan-94 are attached as Exhibit "J". The working papers include a summary of the hours by project and year at the $75. per hour rate; for a total of $225,000. for the years 1991, 1992 and 1993. I would have prepared an invoice for $225,000. for the management fee from Signet Marketing to the related company 755894 Ontario Limited. Attached as Exhibit "K" is a copy of an invoice that I prepared from 755984 Ontario Limited to Signet Marketing, dated January 11, 1993 for $95,349. for the 1993 R&D. I also prepared the revised financial statements for Signet Marketing Inc. and 755984 Ontario Limited; see copy of fax dated January 31, 1994 that I sent to our Georgetown office; attached as Exhibit "L". I am not sure if I prepared the accounting working paper dated 07-Feb-94 listing adjusting entries; the format appears to be the same as my working papers except for my initials "PW"; attached as Exhibit "M" is a copy of the working paper,

21) At one of my meetings with John Savelli Jr at Signet Marketing, Savelli told me that he had talked to his accountant, Paul Yanover, and was told by the accountant that the management fees claimed for SR&ED were not proper. Savelli did not want to proceed with the claim as he thought the claim was a fraud and the company would have to pay extra taxes. Based on the call, Savelli had a telephone conversation directly with James Deacur. I received from Savelli a letter addressed to James A Deacur & Associates Ltd. dated January 19, 1994 outlining his concerns. The letter was passed on to James Deacur. Deacur replied to the letter in a letter dated January 20, 1994 satisfying Mr. Savelli's concerns and I then completed my work on the file. Attached as Exhibit "N" are copies of the letters dated January 19th and 20th, 1994,

22) After approximately two months of working on these SR&ED files I became skeptical and called the Revenue Canada office. I called Kirby Wong, who worked at the North York Tax Services Office in the SR&ED section to confirm what I was doing on the files and found out that using the fair market value of wages for SR&ED was incorrect,

23) In addition, while working on the Signet Marketing file I called another Chartered Accountant I knew, Randy McLockan from Ernst & Young. Per my notes on January 17, 1994 in my appointment book, I asked McLockan's help to confirm if Signet was a legit claim and was advised that it could probably be fraudulent unless the management company paid tax on the management fees received from the R&D company and management fees have to be supported by the effort, I DID NOT SPECIFICALLY MENTION SIGNET TO MCLOCKLAN BUT USED THIS CLIENT AS AN EXAMPLE TO ILLUSTRATE HOW THE MANAGEMENT FEES WORKED,

24) After my discussion with Randy McLockan I began to look for new employment. I subsequently left Deacur's employment on February 16, 1994. I did not tell James Deacur why I was leaving but just told him that the SR&ED job was not right for me.

[Exhibit D-328] [Handwritten and initialled]

[31] Several CRA auditors also testified about their observations and concerns about JAD's methods including Michael Wilson. Mr. Wilson is a long-standing CRA auditor. He testified on behalf of the Defendant. I found him to be a reliable witness albeit with some understandable gaps in his independent recollection of relevant events.

[32] In the mid 1990s, Mr. Wilson was an SR&ED team leader working out of the Belleville office. In that capacity, he had supervisory responsibility for a number of SR&ED claims filed by JAD. Because of the size of many of these claims, they were considered to be high risk warranting close scrutiny. Several of the claims were also based on asserted management fees between two related corporations involving significant amounts somewhat out of step with the

scope of the taxpayers' business activity and with the amount of supporting documentation [p 3933, p 3937 and p 3941].

[33] In some instances the SR&ED claims that were based on management fees were disallowed because of concerns about the reasonableness or legitimacy of the asserted fees. In the case of Bale-Eze Inc., Mr. Wilson denied the management fee claim of $850,375 for the following reasons:

> The item is also considered under subsec. 18(1)(e). This subsection disallows expenses that are contingent. If at the time of it's creation, uncertainties exist in respect of whether the amount can be paid, or the time at which the payment will be made, the liability is in it's nature, contingent upon other events. A conditional obligation has no obligatory force until these conditions are met. The apparent inability to pay the amount, as noted above, supports the contingent nature of the accrual. Therefore, the item is being considered to be a contingent liability and not a deductible expense in the 1993 fiscal year.
>
> During the years in question, the management corporation did not report that it possessed any employees to provide the management services, nor did there appear to be any management organizational structure that would have enabled it to perform the services on behalf of the operating corporation. The management corporation also did not report the earning of the income from performing such activities on the accrual basis for the years 1990 through 1993. [Exhibit D-270]

[34] A management fee claim submitted by JAD on behalf of Bubble Action Pumps Ltd. in the amount of $450,000 was rejected by Mr. Wilson on the same basis [Exhibit D-278].

[35] Mr. Wilson described SR&ED claims filed by JAD on behalf of 687348 Ontario Limited where subcontract expenditures of $450,480, $484,440 and $371,040 were asserted for three taxation years [Exhibits D-280, D-281 and D-282]. Each of these claims was supported by

invoices between two numbered companies for "R & D services rendered" [Exhibits D-284, D-285 and D-286]. In another set of SR&ED claims, asserted management fees between the two numbered companies were reversed for an entirely different set of research projects [Exhibits D-288, D-289, D-290, D-291, D-292, D-293, D-294]. Mr. Wilson described the accounting situation in the following way:

> Q. Can you just explain to us how this worked. So there are two different numbered companies and both filed claims for three years?
>
> A. Yes.
>
> Q. Is that right?
>
> A. Yes.
>
> Q. And the two companies billed each other?
>
> A. Correct.
>
> Q. So which company was supposed to be doing the work and which company was the management company; or do you know?
>
> A. Based on that the science said there was no activity or qualifying activity done, it would be hard to say which corporation was responsible for it.
>
> In that regard, if you have got two closely held companies and you are billing them for hours each way, there's really only Mr. Harcourt was the principal involved in the corporation. By submitting two invoices cross-charging the corporations, he would have spent 7,365 hours in one year working on the R&D, if that was Mr. Harcourt himself, which is why additional information would have been required for a breakdown of these hours and cost on these invoices.
>
> Remember that the standard work week is 2,050 hours, which is what most people look at, a 40-hour work week. If you are doing 60 hours it would again be around 6,000 hours. So to see 7,000 hours in billing for one year is a bit unusual. [pp 3980-3981]

[36] Mr. Wilson was sufficiently concerned about JAD's approach that he wrote to the Manager of the SR&ED audit program in Ottawa describing his findings [Exhibit D-296].

[37] Bonnie Jarrett testified on behalf of the CRA where she continues to be employed. She holds a Chartered Management Accountant designation. She was a well-spoken witness who gave her evidence in an efficient and business-like manner. She is extremely careful, competent and knowledgeable.

[38] Ms. Jarrett was responsible for the financial audit of a JAD-prepared SR&ED claim for Clare Work Stations Inc./Jakry Industries. When she examined the claim, she identified a problem with the two non-arm's length corporations submitting SR&ED claims on the strength of offsetting book entries without any actual expenditure of funds [p 3856 and p 3858]. She was sufficiently concerned that she wrote a memo to head office [Exhibit D-248]. Her testimony on the same point was the following:

> A. I just meant, with no supporting documentation or contracts or validation of expenditures, journal entries can just be made both ways where you have more than one corporation with receivables and payables offsetting each other, resulting in no taxes payable and large R&D claims that never have a cash outlay, never paid, and that was not the intent of the legislation. We are trying to support people doing R&D who have actually spent money on R&D. So people would be getting ITC -- investment tax credit refunds with -- just based on journal entries. And the journal entries weren't limited in dollar. They could be made for hundreds of thousands of dollars because there was no documentation to prove otherwise.
>
> Q. And so if taxpayers -- or when taxpayers don't always submit complete cost allocations for projects, what would be a fair method to calculate the wages for R&D?
>
> A. Based on the T4.

> Q. Okay.
>
> A. But there was no T4 in this case.
>
> Q. And what would be the process of determining what a reasonable dollar amount is when looking at a project where work is done?
>
> A. Look at the number of hours spent on the eligible activities, come up with an hourly rate and times it by the number of hours spent on the activities. Applying reasonableness. [p 3869]

[39] Art Payne was employed for 33 years with the CRA. In the mid-1990's, he worked as a senior investigator and in that capacity he assisted with the JAD investigation. In particular, he was present during many JAD client interviews and was responsible for the preparation of sworn statements taken from many of those witnesses. Much of his testimony concerned his interactions with witnesses and the information they conveyed about JAD's methodologies. What he learned disclosed a pattern of backdating of records to create the illusion of inter-corporate transactions all in support of inflated SR&ED valuations. In many instances JAD client representatives confirmed that JAD had provided shell corporations with backdated ownership information and fictitious invoices for supposed management fees.

[40] Mr. Payne was asked under direct examination about his perception of the JAD investigation and, in particular, Ms. Northey's involvement. He answered that he had no concerns about Ms. Northey's conduct and based on the interviews he conducted, he believed there was evidence to support the investigation [p 4326]. Under cross-examination, he gave the following answer:

> Q. Right, okay. But, I mean, for you as an investigator, I am trying to figure out at what time -- like, let's say you think one calculation method is right, and the tax preparer thinks he could

> use a different one. At what point do you start trying to verify if you're right or the preparer's right?
>
> A. In my experience, I go on the number of statutory declarations we obtained, the stories that we get from those various witnesses. If it looks suspicious to me, especially as a certified fraud examiner, if I am seeing suspicious invoices, if I see corporations that have been backdated, to me that is indication of fraud. So then I would prepare the search information, based on the seized records, of course it's Patricia Northey's case, but based on what she gets together, if she finds additional evidence in those seized records, this shows that there's been interviews held, that there's notes taken, that additional documentation supplied, then she takes that all into consideration before she does her prosecution report. [p 4346]

[41] In their testimony both Mr. Deacur and Mr. Gordon expressed rather benign views of the methods they and others in the firm had used to document SR&ED claims on behalf of many clients. Under direct and cross-examination, Mr. Deacur explained that as long as the SR&ED work had been done by a client, it was largely "irrelevant" how the claim was represented in accounting terms [pp 2160, 2164 and 2187]. Mr. Gordon similarly expressed the opinion that it was legally permissible to advance a SR&ED claim on the strength of a purported contractual obligation that did not exist when the work was carried out. He, too, said the method of recording the transaction was "irrelevant" [pp 3065 and 3108]. In other words, it was appropriate to overcome a lack of documentation in the hands of a client by creating an accounting history that did not exist at the time the SR&ED work was performed. In many cases this was accomplished by furnishing a client with a second related company to serve as an anchor for a supposed SR&ED transaction. That transaction was then represented by an after-the-fact invoice or journal entry recording an SR&ED valuation – a valuation that was typically higher than a valuation based on the wages paid to those carrying out the work at the time. According to Mr. Deacur, the claim could be advanced on the strength of a recorded "payable"

whether or not a legal obligation to pay existed at the time the SR&ED work was performed.

This point is evident in the following exchange under cross-examination:

> Q. Mr. Deacur, in your testimony on Thursday you said:
>
> "We were using shelf or management companies to facilitate basically a post R&D claim because as long as the work was done and it was payable, and it was, if the science qualified and the fair market value was a fair market value or reasonable, then we would deduct that as an R&D expenditure. Then there would be a second corporation receiving funds and then we would have to deal with the taxes in the corporation." [As read]
>
> That was page 117, 16 to 25 of the transcript from last week.
>
> Do you dispute that the legal obligation between the two companies had to be payable at the time that the R&D work was done?
>
> A. It had to be payable. I don't know why you are using the expression "legal obligation". It had to be payable. [p 2177]

[42] Mr. Deacur gave a similar answer under later cross-examination:

> Q. Mr. Deacur, when you say "payable," in your lexicon is that a mere journal entry, an accounting entry that makes something a payable?
>
> A. Well, to be payable a whole set of circumstances would have to occur. There would have to be a genuine attempt at doing an R&D project, right. There would have to be bona fide time spent and it would have to be reasonable. Then there would be the determination of what would be a reasonable amount for -- to allocate for those services for those hours spent, and so it would then have to be accrued, at some point becoming a payable.
>
> Q. So is something more required, such as an obligation or a mechanism to enforce the payment, such as a contract?
>
> A. It has to be real in the sense that what the amount was charged on a reasonable basis and for a reasonable -- on a reasonable project. To then argue -- sorry, the question was?
>
> Q. Is something more required than a mere journal entry to make something payable, i.e., is an obligation or mechanism to enforce the payment, such as a contract, required?

> A. I don't see that between corporations, no.
>
> Q. So company A can put in a journal entry in its general ledger stating that it paid company B $100,000 for management fees, but company A never paid the money and had no contract with company B, and company B received nothing of this transaction. Does that $100,000 constitute a payable amount or is it fictitious?
>
> A. Well, you haven't established the basis for the $100,000. Is there a service rendered. Like we are talking here about a real R&D attempt.
>
> Q. There can't have been --
>
> A. We are not talking about some imaginary doing it just to obtain an R&D tax credit. We are talking about a real attempt. And this is what your -- the question doesn't address the issue of what that amount is for.
>
> Q. The secondary company didn't exist at the time; agreed? In the year?
>
> A. Yes. [pp 2348-2349]

[43] The point that Mr. Deacur misses in the above exchanges is that there could never be a valid "payable" without a legal obligation to pay; and a legal obligation to pay could not be created in circumstances where no intention to contract and no contract ever existed.

[44] Mr. Deacur's explanation for using backdated invoices was similarly unconvincing. In the following exchange, he glossed over the problem in the following way:

> Q. So then what you are saying is it was up to the auditor to catch it?
>
> A. To catch what?
>
> Q. To catch what was really going on?
>
> A. It was up to the auditor to catch that there was R&D.

> Q. And that the R&D was a current, a current expenditure in the year incurred?
>
> A. It had to be payable in the year that the work was done and accrued in that year. Hours were reasonable, rates were reasonable, science was understandable and thought to be R&D. R&D was not a game played on the basis of invoices. R&D is an actual process.
>
> Q. So why were the invoices prepared at all, then?
>
> A. I wouldn't have prepared invoices. I am not a – I don't like – but if the they want invoices to support a – it helps to – it helps.
>
> Q. It helps to make it appear as though those transactions occurred?
>
> A. Well they did because we have got live things. It's not the paperwork, it's the what happened, and it was done at fair market value and it was accrued. [p 2188]

[45] When asked about whether an accrual for accounting purposes required the existence of a legal obligation, Mr. Deacur conceded that he was not qualified to answer [p 2350].

[46] Mr. Gordon also acknowledged that the SR&ED claims JAD presented to the CRA involved "a lot of backdated documents" [p 3206]. Like Mr. Deacur, he testified that a notional payable between two parties could support an SR&ED valuation whether or not an actual transaction existed at the time the work was carried out. Mr. Gordon was also aware that JAD was providing companies to some of its clients to support higher SR&ED valuations based on ostensible contractual arrangements [p 3184]. However, when he was pressed to justify these methods, he gave evasive responses including the following:

> Q. But a payable, by definition, there has to be a legal obligation to pay in a reasonable time?
>
> A. Well, I am not a legal expert with the legal definition. I know a lot of -- there's been a lot of court cases and that's the

> argument; though it's set up as a payable but, you haven't agreed to when it's going to be paid.
>
> So, I mean, you you'd have to get into the whole law of payables. I am sure you don't want me to talk about 20 minutes about payables now. So, no, like, your questions, again, you are trying to take one word and assign it a minute definition. That's not the way the law works. I wish the law worked that way that you could come up with something in 2 minutes and have everybody agree to it. I wish you could do that in law, but that's not the way the law seems to work. [p 3167]

[47] Mr. Deacur and Mr. Gordon testified that there are several legitimate tax and estate planning reasons for using more than one corporation. This device is, in some situations, a lawful way to split income or to protect assets. They also referred to a text book that they and others in their office had relied upon in the development of SR&ED strategies [Exhibit P-104][4]. That text explained in the following way why the use of separate corporations could be useful in the presentation of SR&ED claims:

> One method of maximizing the R&D incentives for a corporate group is set up a separate research corporation to carry out all R&D for the group. This R&D corporation would charge its associated companies an arm's length price for the services that it performs. This procedure has several advantages, including the following:
>
> 1. The research corporation will qualify under the rules for exemption from prescribed expenditures, since all or substantially all of its income will be derived from the sale of research and development.
>
> 2. There would be a certain degree of administrative simplicity in that all of the research and development costs would be accumulated in one place, instead of allocating costs, as might be necessary if the R&D operations were spread throughout the corporate group.

---

[4] Under cross-examination, Mr. Deacur was asked if the book addressed the issue of backdating records in support of a claim and he said "I don't know what it says about that" [p 2230]. He also conceded he had not read the book [p 2231].

> 3. Since the corporation can charge an arm's length price for its work, the group will benefit from increased R&D tax incentives to the extent that the arm's length price exceeds the costs of performing the research and development work.
>
> [Exhibit P-104]

[48] I have absolutely no doubt that the above approach to enhancing an SR&ED claim was, and may remain, a legitimate accounting strategy. The problem is that nothing in what is indicated above can reasonably be taken to justify documenting corporate relationships and transactions that did not exist at the relevant time. Indeed, this distinction appears to be well understood in the tax world. According to a 1994 Canadian Tax Foundation paper entitled *Remedial Tax Planning - What are the Limits*, a distinction is drawn between later documenting an earlier enforceable transaction and attempting to create an appearance of a transaction or a financial relationship that did not exist at all. The dangers associated with the latter approach were described in the following way:

> A simple way to summarize all the material discussed prior to this point is to say that records, legal documentation and information filed with the tax return can only reflect what has happened and no amount of expensive paper produced by professional advisors can make something happen that didn't, or undo something that has. Nonetheless, professional advisors are under continual pressure from their clients to do what may at first glance appear to be the impossible.
>
> If after careful analysis it is clear that a disposition has occurred or no transaction has taken place in a particular period, some advisors may be tempted to assist their clients to put into place documentation of doubtful validity that will attain their client's objective. Alternatively, a sophisticated client may approach a professional advisor and request that the advisor document transactions the client insists have occurred at some point in the past. If the doubtful validity of the former is sustained or the inaccuracy of the latter is discovered, the question arises of the advisor's professional, civil and criminal liability for creating any potential misleading documentation.

> Accountants and lawyers are each governed by self-regulating professional bodies which have promoted rules of conduct and codes of professional ethics. The particular rules have been dealt with by other commentators elsewhere so I will merely summarize here the most pertinent principles. The words used differ but the principle is the same: a professional advisor must not assist or participate in any conduct that is dishonest or fraudulent. This includes preparing documentation or dispensing advice the professional advisor knows is intended to mislead Revenue Canada about the true state of the client's affairs.
>
> Breach of professional standards can bring sanctions from the professional body up to being forbidden to practice one's profession. When you are approaching the outer limits, you should always ask yourself whether this particular client's problem (or his fees) is worth your professional reputation if the transaction you are assisting with or the advice you are giving is intended to or will have the effect of misleading Revenue Canada. [Footnotes omitted.] [Emphasis added.]

[49] The same point was made by Justice D.G.H. Bowman in *Dale v R*, [1994] 1 CTC 2303, 94 DTC 1100, where he distinguished between an attempt to create a state of affairs that did not, in fact, exist and the taking of after-the-fact steps necessary to complete or document an actual or executory legal obligation. Only the latter is acceptable.

[50] The issue of backdating records in support of an income tax filing was considered in *R v Cancor Software Corp*, 6 OR (3d) 577, 14 WCB 2d 562. There a taxpayer was convicted of tax evasion and of making of false statements in a tax return on the basis of what was found to be a sham transaction. The Court described the requirement for a finding of dishonesty in the following way:

> 224 A statement of relevant law in a case such as this would be incomplete if it lacked reference to the explanation by Diplock L.J. of the term '*sham*' in his judgment in *Snook v. London & West Riding Investments Ltd*., [1967] 1 All E.R. 518 at 528.

> I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.

[51] The Court went on to describe behaviour by the taxpayer that bears considerable similarity to the methods employed in this case by Messrs. Deacur and Gordon:

> 216 All of these 'mistakes' were, however explained, certain to mislead any auditor or other investigator from knowing that these parties had no bargain on either of the two stated dates (Feb. 14/84 for C.C.C. and Sept. 1/84 for C.R.I.) and, in fact, had not even met. In the absence of what might come from an additional inquiry of the relationship between these parties, an auditor from Revenue Canada would be left with a trail of paper plainly emphasizing that the Cancor companies had concluded working arrangements with a Canadian corporation titled Compuvest, c.o.b. as IBS (Can.), the latter being a company actively engaged in scientific research in Canada, at least from February 14, 1984 through to August 31, 1984 for C.C.C. and commencing September 1, 1984 for C.R.I., while hidden from view was the participation of I.B.S. Inc. (IBS (U.S.)), the real researcher and which had no relationship with either of the Cancor companies at the times suggested. It is clear from the evidence that throughout this entire period, IBS Inc. did not divert its efforts in any meaningful way from its own research project, Easytalk. Quite aside from the issue of whether or not the scheme would have been denied validity, was the taxing authority not entitled to know the real truth of from where, at what real cost and when purported scientific research had been completed so as to enable it to accept or reject the proposition and, if the latter, then to reject it as factually founded on truthful circumstances that it might then claim to be incompatible with this "incentive" legislation? Surely, this question must be answered in the affirmative.

[52] Under cross-examination, Mr. Deacur failed to offer a tenable explanation for the methods that were of concern to the CRA. As far as he was concerned as long as there was an arguable case to be made for presenting an SR&ED claim, the methods used to support it were

largely irrelevant provided those methods were disclosed to the SR&ED auditors. The same point is made in the Plaintiffs' Post-Trial Brief as follows:

> 220.Our position was simple, the SR&ED was incurred when the work was done. Ms. Northey has indicated in her testimony that the case was not disputing that physical work was done and the time spent on the work.
>
> 221.It is not the documents that make the SR&ED incurred or not. It is the actual work done.
>
> 222.Our belief was if you then agree with a Company that you may be paid one day, that potential of being paid one day was sufficient for an allowable SR&ED claim.
>
> 223.The income tax act under Subcontract payments for SR&ED section 127 indicated that the amounts were incurred even when not paid. The documentation of an accounts payable was sufficient for an amount to be considered a SR&ED subcontract payment and to be incurred.
>
> …
>
> 251.Another dishonest concept by the HMQ is there could be no enforceable claim between the two companies. This concept is nonsense.
>
> 252.If you have two Companies owned 100% by the same person or persons. When the owner agrees with himself this becomes an enforceable contract.
>
> 253. The owner documents in writing that he has accepted the contract. (the journal entries, the financial statements and the tax returns) To indicate that there is no reasonable doubt that there is no enforceable contract is wrong in law.
>
> 254.In Chiu versus Lam Supreme Court of BC Feb 26 2016 (docket 15-2923) they refer to "Fridman The Law of contract in Canada (4th ed.) at pp 16-17 and 20 as follows:
>
> > "Constantly reiterated in the judgments is the idea that the test of agreement for legal purposes is whether parties have indicated to the outside world, in the form of the objective reasonable bystander, their intention to contract and the terms of such contract. The law is concerned not with the party's intentions but with their manifested intentions. It is

> not what an individual party believed or understood was the meaning of what the other parties said or did that is the criterion of agreement; it is whether a reasonable man in the situation of that party would have believed and understood that the other party was consenting to the identical terms."
>
> 255 .There is no law that prevents one from saying I am opening a company in two years and when that company is opened I agree to pay that company a certain amount of money, when I get the money.
>
> 256.When the same person is on both sides of the transaction clearly they are "consenting to identical terms" to say this cannot be an enforceable contract is just not correct in law.
>
> 257.Furthermore if Mr. A did the work and booked the liability in company A to be paid at a future date. If Mr. A sold that Company and the buyer did not extinguish the liability Mr. A could enforce that contract from the unrelated third party buyer as the third party bought the Company with a recorded liability on the books. [Emphasis in original.]

[53] Mr. Gordon adopted a similar position to Mr. Deacur. He, too, suggested that the methods JAD employed were essentially irrelevant as long as a legitimate SR&ED claim could be advanced by the taxpayer. In a few instances, Mr. Gordon did, however, attempt to distance himself from questionable claims. For example, he testified that although he prepared the Armada SR&ED claim, he had "no idea" who had created the backdated invoices [p 3062]. Nevertheless, he was confident that the suspect invoices were intended to support an assignment of future rights from Armada to its related numbered company and had nothing to do with Armada's SR&ED claims. His evidence on the point was the following:

> Q. Mr. Gordon, you would agree with me that it is impossible for 982800 Ontario Limited to have billed Armada for work in 1991 when it hadn't even come into the possession of the Deacur firm until the end of 1992; you agree with that?
>
> A. It's not billing. What I am trying to explain to you, it's not billing for the work. This is an invoice assigning the payable.

> Maybe the people, me and the people involved there are not legal experts. This was the attempt to assign the payable to 982800. That's why, because the auditor himself, Mr. Cardwell, was involved with the company for many years, so he knew what was going on, he was involved in, for those years. So all this invoice is saying or what it attempted to say, I don't know, maybe it doesn't, maybe it's not clear, is that, in 1993, Mr. Heaps just said, you know what, I did work, I want, I want 982800 to get the money. Maybe, maybe there would have been a different way to say it. But that's what this is attempting to say.
>
> Q. So, Mr. Gordon, where on this document does it say anything about an assignment?
>
> A. Well, if you know Mr. Heaps did the work and you know that --
>
> Q. Mr. Gordon, you would agree with me that the company itself wasn't even incorporated until November 1992; correct?
>
> A. November '92, right.
>
> Q. So the company wasn't even in existence at the time?
>
> A. Right.
>
> Q. So what could have been performed?
>
> A. There was nothing performed. This is an assignment. [pp 3067-3068]

[54] I do not accept this explanation. It seems to me to be an attempt to recharacterize the Armada SR&ED claim presumably because Mr. Gordon was solely responsible for its presentation to the CRA. It was, therefore, not a claim he could attribute to others in the office.

[55] The Armada claim was documented to create the illusion that there was a valid contract between Armada and 982800 Ontario Ltd. to support an artificially high SR&ED valuation. The so-called assignments are titled invoices “for services rendered in connection with [a] research and development project” in the respective amounts of $50,000, $60,000 and $60,000

[Exhibit P-92]. If the transactions represented by these invoices were as benign as Mr. Gordon now claims, one is left to wonder why it was necessary to backdate the incorporation history for the numbered company. No purpose would be served by the backdating of those corporate records if what was happening was a future assignment of SR&ED proceeds from Armada to 982800 Ontario Ltd.

[56] The invoices and corporate backdating indicated to the CRA that 982800 Ontario Ltd. was carrying on business during the period the relevant SR&ED work was actually being performed by Armada and they report past transactions, not assignments of future rights.

[57] What the CRA understood about the Armada claims from the investigation was entirely consistent with the content of the relevant documents. In an interview with Armada's principal (William Heaps), the purpose of the backdated documents was said to be to support the SR&ED claims and not to effect an assignment. Mr. Heaps expressed concern about the proposed method but was reassured [Exhibit D-418, Tab 16]. The initial CRA audit of the Armada claims also raised concerns about the methods being employed and noted "a series of unrecorded and previously undisclosed journal entries which bore no relation to GAAP" [Exhibit D-194].

[58] The above information is inconsistent with an assignment theory and supports the investigators' interpretation of the Armada SR&ED documentation. Furthermore, on those occasions when Mr. Gordon spoke to a CRA auditor about the Armada SR&ED claims, nowhere was the assignment theory mentioned [Exhibits D-191 and D-194 at p 3].

[59] The CRA auditor assigned to the Armada SR&ED claim was David Cardwell. He testified on behalf of the CRA. I found him to be a reliable witness.

[60] Mr. Cardwell dealt directly with Mr. Gordon and Mr. Heaps. His audit notes were entered as Exhibit D-191. The notes reflect a number of concerns about the validity of the claim including a reference to a failure to follow generally accepted accounting principles.

[61] Mr. Cardwell contemplated imposing penalties and referring the file to Special Investigations but, ultimately, decided against it on the basis that the problems were created by Mr. Gordon and not the taxpayer.

[62] Under cross-examination he was asked if he understood that a valid SR&ED claim could be made on the strength of a "payable". He gave the following response:

> A. The $170,000 was not paid; however, that wasn't my major objection. My major objection was that it was paid -- it was supposed to be to a company which had no -- which wasn't even incorporated when the expenses were supposedly incurred. [pp 3378-3379 and also see p 3381 and 3408]

[63] It is of considerable significance that there is nothing in Mr. Cardwell's audit notes [Exhibit D-191] referring to the Armada SR&ED invoices being characterized by Mr. Gordon as an assignment nor was Mr. Cardwell asked about this issue under cross-examination by Mr. Gordon or Mr. Deacur. Ms. Northey also testified that she saw nothing in the audit files or in the witness accounts supportive of Mr. Gordon's assignment theory [p 5895].

[64] One of the most notable transactions directly involving Mr. Gordon was the SR&ED claim filed by JAD on behalf of Caber Mor Holdings Ltd. [Caber Mor]. Although in the early stages of the preparation of this claim, JAD employee Patrick Wong was involved, the claim was finalized by Mr. Gordon. Nevertheless, despite asserting that there was nothing problematic about the way the Caber Mor SR&ED claims were documented, Mr. Gordon made a concerted attempt to allocate responsibility for its presentation to Mr. Wong. Under cross-examination, he frequently suggested that the way the claim was structured was largely a product of Mr. Wong's imagination and not his own.

[65] A good example of Mr. Gordon's attempts to shift responsibility to Mr. Wong can be seen in the following passage:

> Q. So you would agree with me that, at the very least, by May 25th, 1994, you were involved in the Caber Mor matter; is that fair?
>
> A. What, just tell me what the word, what you mean by "involved"? Is did I have something to do with it at this date? Yes. You would have to give me a fuller definition of involved.
>
> Q. Mr. Gordon, did you write a letter on May the 25th, 1994, to Mr. Chris Chan regarding the Caber Mor Limited SR&ED claim?
>
> A. Well, this is dated May 25th, 1994. Yeah, I would say this is dated May 25th, 1994.
>
> Q. And would you agree that it's related to the Caber Mor Limited SR&ED claim?
>
> A. Yes, it's related to the Caber Mor case.
>
> Q. Okay. And would you agree with me that the first line of this letter refers to a meeting having occurred on May the 25th, 1994?
>
> A. That's what it says, yes.

Q. And did you attend a meeting on May the 25th, 1994, with Mr. C. Chan, of CRA, with regard to the Caber Mor SR&ED claim?

A. I would, I would think yes, by this letter, yes.

Q. Okay. Would you agree with me that, in this letter, you're conveying information to Christopher Chan about the corporate history of 1031783 Ontario Limited, and you are doing so as a representative?

A. But the corporate history, I don't know about the history. I am confirming various information that anybody who has access to the company would see.

Q. Okay. So then you would agree with me, then, Mr. Gordon, that you had access to the corporate records on May the 25th, 1994, or you would not have been able to make these representations?

A. Umm... Yes, I must have got the information. Either I saw -- like, I must have seen something that could have been, this could have been documents in the file that P. Wong put in the file. So I don't know if I went to look at all the documents. It says, I am concluding that P. Wong put this information in the Caber Mor file.

Q. That's what you are concluding, Mr. Gordon?

A. That's what it says here.

Q. Where does it say that Mr. P. Wong put the information in the file? Where does it say that in this letter?

A. Well, it's giving some specific information about the 1031783. As I didn't do any of this file, I am concluding P. Wong did it and he put that information in the file.

Q. Mr. Gordon, I thought we already established that Pat Wong left the firm in February of 1994; isn't that right?

A. Right. So in February, he put this information in the file.

Q. Well, Mr. Gordon, we just went through the letter that went to the taxpayer from Kelly-Ann Deacur, and we went through the corporate filings, and they all happened after Pat Wong left.

> A. What does that have to do with it? He did the file. What, when things got mailed out, I don't know. But I'm, I'm concluding that he had to have done this at an earlier date.
>
> Q. So, Mr. Gordon, we just looked together at the shareholder records. We just looked at them together. And you would agree with me that it wasn't until April of 1994 that the corporate change was filed with the company's branch; isn't that true?
>
> A. Oh, with the company's branch, yes, I agree to that.
>
> Q. And you will agree with me that, while the company was incorporated on May 31st, 1993, that the Caber Mor people were not involved with it on May 31st, 1993?
>
> A. That, I can't, I can't agree or disagree. That's why I am looking specifically what I said, this gives you specific information, which I agree with. It says here the company was incorporated. The shareholders, as of May 25th, 1994, are those shareholders. And, like, I am confirming specific things. I didn't go check out what day they were and didn't happen. I am confirming specific information, and I agree with this letter here. [pp 3215-3218]

[66] The letter that is referred to in the above passage [Exhibit D-177] was written by Mr. Gordon to CRA auditor Chris Chan on May 25, 1994. It clearly misrepresents the corporate history of the numbered company used by JAD and it asserts the existence of a contractual relationship with Caber Mor. This was done by backdating the corporate records of the numbered company to indicate that it was in the hands of the principals of Caber Mor at the time of an SR&ED contract billing between the two companies totalling $146,625. In actual fact, the numbered company was a later creation of JAD. It was accordingly legally incapable of carrying out the SR&ED work on behalf of Caber Mor, let alone of entering into a contractual relationship with that company for the amount claimed. This was a purely fictional arrangement intended to support an inflated and artificial valuation for whatever SR&ED work Caber Mor had done and Mr. Gordon later misrepresented the facts to the CRA auditor.

[67] On April 5, 1994, the CRA wrote to Caber Mor advising that an SR&ED audit would be commenced shortly. On April 18, 1994, JAD registered updates with the Ontario Companies Branch stipulating that three of Caber Mor's officers had been appointed as officers of a JAD-provided numbered company on June 1, 1993. This was clearly done to facilitate a claim for SR&ED management fees between the two companies. This representation to the Companies Branch was false and dishonest. The Caber Mor officers had nothing to do with the numbered company until it was provided by JAD in 1994. Further details of what took place around the Caber Mor SR&ED claim (including Mr. Gordon's direct involvement) were described in the witness statement of Kenneth Bice taken by CRA investigators [Exhibit D-418 at tab 24].

[68] Mr. Gordon's repeated suggestion that Mr. Wong was probably responsible for the creation of Caber Mor documents that Mr. Gordon sent to the CRA was also belied by steps that were taken months after Mr. Wong left JAD. In one such instance, CRA Auditor Chris Chan asked Mr. Gordon for support for Mr. Gordon's earlier assertion that "an enforceable contract for services" existed between Caber Mor and its related numbered company [Exhibit D-183]. Mr. Gordon answered by saying that a contract for service existed between the companies and that Caber Mor "has agreed to pay the amounts" [Exhibit D-184]. Under cross –examination, Mr. Gordon gave the following evasive and implausible evidence about the above exchange:

> Q. So when Mr. Wong left the employ of the James A. Deacur firm in February, you think that he might have anticipated that this fax request would have come on July the 5th from Mr. Chan asking for this clarification? Quoting:
>
> "The fees were incurred by Caber Mor Holdings Limited under an enforceable contract for services." [as read]
>
> Unquote --
>
> A. Where are you reading --

Q. -- he would have anticipated this very question?

A. Well, but this, this answers here, it's like close but no cigar. I mean, it doesn't seem to follow the exact content of the query. So, I mean, it, that's why, you know, I am hesitant because there's similarities, but it's not, it's not exactly. So, umm, you know --

Q. So, Mr. Gordon --

A. Because here they are talking about Caber Mor, and this letter starts talking, or this thing that's attached starts talking about 1031, so I would conclude that Wong prepared some documents. I don't know if he prepared this one.

And then furthermore --

Q. Mr. Gordon, when Wong left in February, the numbered company didn't even belong to Caber Mor.

A. That's your position. I am not agreeing with that. That's number one.

Number two is, I don't, I know in general that Wong left around February, but I don't know if he finished off a few things. It's not so abnormal that you agree to leave but you are going to do a few more things on the file before you're 100 per cent disconnected with the firm. Because, don't forget, these people were on subcontractors. They weren't payroll. So a person was being paid by the hour. So it's not, it's not impossible that Mr. Wong was still doing some work on the file. I, today, I can't remember.

These are all things that should have been gone through at the time. Now I can't remember what Mr. Wong did or what he didn't do, especially because I didn't prepare this claim.

Q. So is it your testimony under oath, Mr. Gordon, that you were talking to Mr. Wong and hiring him out by the hour in July of 1994 to come up with the responses to these faxes and that he did so between July the 5th, 1994, when the fax was sent at 3:30 in the afternoon to the James A. Deacur firm, and he came up with the answer and was able to provide it to you so that it could be faxed the very next day to Mr. Chan; is that your --

A. No. First --

Q. -- is that what you are seriously putting forward?

> A. First of all, your comments are silly. Silly talk. Is, is Mr. Wong could have been -- you, I brought up that you keep on saying he left in February, so I am correcting your constant statements. If you wouldn't have said it ten times, maybe I would have just left it. But when you keep on saying February, February, February, I don't really know if he left in February. So you're trying to make me agree that he left and was gone in February when I don't know if that's true or not. So that's number one.
>
> Number two, how long he stayed around or didn't stay around, I don't know. How much he did here and there, I don't know. And I am saying I am still maintaining the claim is proper. Who put which documents in the file, I don't know because this thing, what, this claim was, like, was a small claim. I was working on million-dollar claims. I was doing Moore Corporation, $22 million claim. I was doing Chef Boyardee, also a multimillion-dollar claim. I was doing Dunlop Tire, another multimillion-dollar claim. So how much time I took out to handle this, I don't remember, and I don't remember if there were five people working on these files doing information. I can't tell you for sure today. So – [pp 3256-3258]

[69] In another exchange under cross-examination, Mr. Gordon effectively conceded that he had no factual basis to support a belief that an enforceable contract obligation for SR&ED expenses ever existed between Caber Mor and the related numbered company:

> Q. – you refer to the intention of the shareholders of Caber Mor. You say that it was the intention of the shareholders that it would be paid by Caber Mor as soon as feasible.
>
> What was the basis of that representation; what conversations did you have with the shareholders of Caber Mor about what their plans were regarding the accounts receivable?
>
> A. Well, I think I only spoke to Ken Bice is the only guy I spoke to there. And, like, just about any of these R&D people, they all thought they were going to make millions of dollars from their inventions. So, umm, they are not doing it because they, they have nothing better to do; they are doing it because they are hoping to make money.
>
> So, theoretically, when this stuff is recorded and when they made their millions, they would eventually potentially move the stuff over to another company, which is standard tax planning because anybody who starts making millions of dollars in a company and is

> involved in manufacturing eventually wants to move the manufacturing -- the money that they are making in manufacturing to another company so it's more creditor proofed. So that's, like, standard sort of tax planning and organization with any company. So I would assume the guy who's thinking he is going to make money would eventually pay it, the guy who thinks he is going to make millions.
>
> Q. So did you assume that, or did he tell you that?
>
> A. Did he tell me what, that he was going to make millions?
>
> Q. No, that he was planning on paying the money.
>
> A. He didn't say. I don't know if he said he is planning on paying the money. Is, he's planning on eventually, when he makes millions, to move some money. So I may have concluded that, after he makes his millions, he would move some money from Caber Mor to the numbered company. So I don't know if he told me he was going to do it or just implied, when he moved his millions -- I mean when he made his millions, he was going to follow what most business people do who own a manufacturing company and move some of it from operations to, like, the sort of the second company.
>
> Q. So when you made this representation to Revenue Canada, you really didn't know; you were guessing?
>
> A. Guessing what? It says that he could pay it as soon as feasible. I don't know if that's a guess. That seems like a common-sense analysis after someone tells you he was making millions.
> [pp 3236-3237] [Emphasis added.]

[70] I do not accept Mr. Gordon's testimony that he was somehow fooled by the contents of the Caber Mor SR&ED file left behind by Mr. Wong. His disavowal of knowledge is inconsistent with his and Mr. Deacur's frequent assertions that the means by which an SR&ED claim was presented to the CRA was irrelevant, provided some SR&ED work had been done by a client. The overwhelming weight of the evidence establishes that Messrs. Gordon and Deacur actively promoted and documented SR&ED transactions between corporate entities that did not exist during the fiscal periods for which claims were later asserted. This was obviously done to

inflate the value of the SR&ED labour singularly performed by clients: labour that would otherwise most likely be valued much lower on the basis of actual wages paid and reported. This also had the effect of increasing JAD's fees.

[71] Messrs. Deacur and Gordon made a plausible argument that it could be acceptable to value a client's SR&ED labour using more generous accounting methods than the CRA was sometimes applying. These other methods included a proxy approach by adding benefit overheads to T4 wages based on a fixed percentage, charging a management fee and using a fair market labour valuation. I agree with Messrs. Deacur and Gordon that any of these methodologies could be attempted. That said, the documentary presentation of any one of these approaches was still required to be accurate and truthful and it was subject to the CRA's requirement that "wages and salaries that are allocated to SR&ED should be reasonable" [Exhibit D-166 at p 6].

[72] Mr. Gordon's frequent declaration that the CRA method of calculating SR&ED labour costs was a fraud on taxpayers is specious and, in any event, irrelevant to this case.

[73] The evidence does not establish that CRA auditors or investigators routinely undervalued the labour costs associated with taxpayer SR&ED claims by failing to account for overhead costs. Indeed, the auditors who testified generally acknowledged that overhead should be taken into account and often it was by one method or another [see, for example, the evidence of John Rohac at p 296].

[74] There is no evidence that the CRA had a policy to discount SR&ED labour and it appears that the auditors were left to develop their own approaches. There is also nothing in the evidence to show that CRA auditors were close-minded to the issue and, even if they were, their methods were disclosed and subject to taxpayer appeal. Furthermore, according to Ms. Northey's assessment of the records and witness statements, JAD representatives never argued that CRA auditors were undervaluing SR&ED labour by failing to include overhead items [Transcript at pp 5950-5951; and p 5506].

[75] At the end of the day this complaint about how the CRA valued SR&ED labour is irrelevant. The CRA investigation of Messrs. Deacur and Gordon did not turn on the existence of a professional disagreement about different labour valuation methodologies. It was always open to JAD to demand that labour overheads be taken into account in valuing their clients' legitimate SR&ED claims. But that was not the source of the CRA's ultimate concern. Indeed, it is disingenuous for Messrs. Deacur and Gordon to characterize the CRA's approach to valuing SR&ED labour as dishonest in the face of their own valuation methodologies that frequently relied on misrepresentations including the backdating of client records. That was the issue that drove the CRA investigation, not some blind adherence by the CRA to an unsustainable labour valuation model. Indeed, JAD's approach mostly did not attempt to value client labour on the basis of actual paid wages. Rather, it was based on a model that included a supposed fair market contract payment between two companies ostensibly doing business together or based on an hourly rate that was divorced from the actual costs of SR&ED labour incurred and reported by a client. Even Mr. Bondergaard who testified on behalf of the Plaintiffs did not believe it was

appropriate for JAD to prepare client invoices or to backdate corporate histories. His evidence bears this out:

> Q. And are you aware that that $775,000 management fee was supported by a single invoice dated February the 28th, 1994?
>
> A. I vaguely recall, yeah.
>
> Q. And would you have prepared that invoice?
>
> A. I don't recall that. I would hope the taxpayer prepared that invoices. We shouldn't be preparing invoices.
>
> Q. And you would agree with me that the two numbered companies that were involved in this particular transaction were companies that were set up by the Deacur firm?
>
> A. No, I'm not aware of the history of these two companies.
>
> Q. Would you be surprised to learn that?
>
> A. We did assist some clients, I believe, in preparing corporations but we wouldn't have created any corporations to backdate, that I'm aware of, the involvement -- when these companies were involved in R&D. These should have been corporations they had years ago. [pp 1423-1424]

[76] I do not agree with Messrs. Deacur and Gordon that their use of a valuation method should be viewed in isolation from the manner in which the claim was documented and presented to the CRA. There was, in fact, a clear purpose served by using corporate and contractual relationships in circumstances where they had not existed. As is pointed out in Exhibit P-104, by using a transactional approach and arms-length pricing, a more generous SR&ED allowance can be obtained. In the absence of a transactional relationship, it would have been more difficult to justify the higher SR&ED costing that Messrs. Deacur and Gordon were presenting to the CRA as fair market valuations.

[77] The suggestion that it would be appropriate to claim a substantial tax credit payment on the strength alone of a backdated journal entry for a claimed SR&ED expense that was never incurred and that the claimant had no intention to pay, is specious. No competent tax accountant could have expected to receive favourable consideration for such an arrangement and it is no surprise to me that the Plaintiffs did not tender expert evidence to validate their approach. Indeed, the CRA Guide to the completion of SR&ED expenditure claims using Form T661 [Exhibit D-166] indicated at the time, that valid expenditures must be "current", "incurred" and "undertaken" or "contracted" by [the Claimant]. This language belies Mr. Gordon's testimony at p 3031 and p 3050 that the requirement for an "incurred" expenditure could be satisfied by nothing more than an after-the-fact book entry. A valid interpretation of the relevant principles can be found in Exhibit D-214.

[78] Mr. Gordon also attempted to justify JAD's backdating of client records by adopting a patently implausible definition of the term "incurred". During his cross-examination of Ms. Northey, he put forward the following definition of that term for her consideration:

> "To become subject to and liable for. To have liabilities imposed by act or operation of law. Expenses are incurred, for example, when the legal obligation to pay them arises." [as read] [p 5638]

He then suggested to Ms. Northey that the definition would be met by the *ex post facto* recording of a journal entry in the books of the taxpayer. According to Mr. Gordon a liability for the purposes of obtaining a tax credit would, thereby, be retroactively created [p 5640]. Ms. Northey then gave the following response:

> Q. When you document something -- when you put a journal entry on the books by the share -- by the -- and the shareholder has

agreed to put that journal entry in and enter it in the books, records, financial statements, is that a liability to you?

A. It's not a genuine liability unless it reflects the actual true transactions of what actually happened in the business. That's the whole method of accounting. Accounting is to record an actual event and what happens in the business. And in this case, just by the mere recording, I could write down today a journal entry that I owe you or owe anyone a lot of money. It doesn't matter that you put the journal entry in, it's just a paper transaction. You have to look behind it, look at the substance of transaction, and what actually occurred and what actually happened.

Just by the mere entry of a transaction doesn't mean that there's a genuine liability, you have to look behind that and see actually what happens. And there's a lot of case law, a substantial amount of case law that talks about journal entries not reflecting what actually truly happened and they have been denied or fraudulent -- they have been determined to be fraudulent.

So when you look at it, it's really about what happened in those corporations, and just by the mere fact of recording a journal entry or a piece of paper or anything on a document doesn't mean that it actually in fact was incurred, that there was a genuine liability.

These people were operating in 1991; they did their business in 1991, it was over in 1991. And they had undertaken transactions in their business which were recorded in their financial statements and they did those things. Then in 1992 they had certain things. They incurred certain costs, they had done certain business, they recorded those, they were there. In 1993, the same thing, James A. Deacur comes in, and associates, yourself included, come in in 1994, and now you create a different set of facts that are not reflective of the true nature of the business and what happened in those years, and it's not a genuine liability even if you record it in the records.

And so that is -- you know, we can adopt this definition, that's fine, but really it's -- a journal entry is to reflect the true events that happened, and just because you record a journal entry doesn't mean that they are true events and they are reflective of what actually transpired. It happens all the time; inflated expenditures, overstated revenues. It happens all the time. [pp 5641-5643]

…

Q. We are going to follow it through here because the issue here is did the people do work that was related to R&D?

A. They did the work in 1991 and they incurred costs in 1991, and those incurred costs were -- in the majority of the cases that we have before the Court they were some small amount of materials. And at times they did pay themselves salary and they did incur costs in regard to their salary and wages, but they did not own those secondary companies and they did not have transactions with those secondary companies in the years in which they were operating and conducting R&D.

So now, after the fact, we come to here's a sec company, here's an invoice. They didn't have any relationship to that company at the time, and therefore, there could have been no genuine liability at the time of those transactions that were alleged.

Q. Now, they did the work is what you said; right?

A. They had done work.

Q. Okay. Now, if they did work -- so are you saying that if they did work and they didn't pay themselves enough salary, so you are saying -- I am trying to figure out if you are saying they incurred a cost or they didn't incur a cost?

A. They incurred the costs in the year for salaries and wages in which they paid themselves in the year or within 180 days of the year end. By the time James A. Deacur & Associates comes in in 1994, the 180 days are gone for 1991, the 180 days are gone for 1992, and they are gone for 1993.

So you are left with actually what actually happened in 1991, and they paid themselves in some cases we see nothing, or in some cases we see, like Blackbrook, 17,000. There's amounts that they have incurred, but what gets claimed with CRA is substantially more, whether it's a wage or whether it's a management fee that's coming into effect.

And the effect of that more is that you're expecting an SR&ED refund of an investment tax credit in the amount of 35 per cent.

Q. I understand your thing, you are going to give these long answers, go ahead. But the substance of it is I disagree with your term "incurred." So we are trying to get you to answer the questions instead of repeating the same thing over and over again. [pp 5643-5645 and see Ms. Northey’s evidence at p 5314]

[79] Ms. Northey did accept that a fair market valuation could be acceptable but only if it was attached to a genuine liability [p 5650 and p 5659].

[80] It is difficult for me to believe that a supposedly knowledgeable and experienced chartered accountant could possibly have held the view expressed by Mr. Gordon about the ethics and validity of the backdating methodology he and Mr. Deacur were using. Ms. Northey's interpretation, on the other hand, is consistent with the law and with generally accepted accounting principles and constituted a sound foundation for the laying of the charges of fraud against JAD and Messrs. Gordon and Deacur in connection with 28 of the 31 SR&ED claims that were referenced in the indictments. All of those matters involved allegations of various forms of misrepresentation of taxpayers accounting histories for which committals to stand trial were entered.

[81] The CRA also had reason to be concerned about JAD's supposed fair market valuations in some of the SR&ED claims that did not involve the after-the-fact creation of inter-corporate transactions. For the handful of those cases (only 3 of which were subjects of the criminal case), Ms. Northey explained the problem in the following way:

> A. In this case with the three companies that went forward on the charges, there was no evidence of the fact that they got paid a different rate for R&D and there was no evidence that they had attributed different cost to R&D in their working papers and the work that they did in the year that they did it. So there's nothing of that.
>
> When you look at the working papers of James A. Deacur & Associates that we seized, there's nothing to say, other than they worked 560 hours on fair market value and then went at the fair market value rate and that was attributable, but those salaries for those individuals at fair market value did not reflect the incurred costs. And we are talking about Patriot now, but the costs that

were attributed were substantially higher than the T4 amounts in this case.

And so when you look at the facts of the case, when you go -- when we went to talk to the representatives of the case, they never once told us that they got paid $80 for R&D and $5 or zero dollars for anything else that they did. So there was no evidence put forward except that you've said and the seized records said they worked 560 hours multiplied by a fair market value rate.

And that didn't tie back into the actual incurred costs, because when you calculated the fair market value rate, the fair market value rate was in fact higher than the incurred costs. And it's clear on the record, and when we went to talk to the clients of the company, the owners of the company, they articulated to us how much they were paid, and when we had talked to them either through the audit or through our investigation.

Q. Well, that's your -- so but we are saying here Mark Durst is a CPA and he was running a company, and he said the rate was reasonable and he said it's a reasonable rate and he agreed to put it forward.

So what I am asking you is a CPA who is running a substantial company says it's a reasonable rate, what I am trying to get from you is where do you go from Gordon is saying it's a reasonable amount, Mark Durst, another CPA, the owner of the company is running it says it's a reasonable amount, where does P. Northey come in to have the authority to say that's criminal, because I am saying what you did is criminal. So tell me why what you did is not criminal. [pp 5664-5665]

…

Q. Gordon says it's reasonable, Mark Durst, the owner of the company who is trying to build a company with 300 employees and has had six years of experience in public practice is reasonable, where do you get off on saying it's not reasonable? Just tell us that.

A. We were looking at the actual evidence of the company and we were looking at the actual expenditures of the company and that's what we were trying to allocate.

Because in the Income Tax Act in the SR&ED legislation it says if you are getting paid partially for R&D and partially for work in your business, then you have to attribute a reasonable portion to what you spent in R&D. And so when we went back and looked at

> the payroll records of Patriot Computers we were trying to establish what he actually spent during the year before he got involved with James A. Deacur & Associates, what he had actually spent in the year, and then how many hours he worked in his company versus how many hours that he worked in R&D, and made a reasonable determination of what was expenditures specifically attributable to R&D. That's the approach that we took on these cases, and it was based on the facts of the company and what was told to us by the representatives of the company. [pp 5666-5667 and also see pp 5675-5676]

[82] The above views were reasonable in the circumstances, although proving a fraudulent intent in the absence of a clear misrepresentation represented an additional hurdle. This may have been the reason why the eventual prosecution focussed primarily on matters involving fictional transactions supported by backdated records.

[83] The inescapable fact is that the relative weakness of three of the cases taken forward to prosecution does not constitute a legal excuse for the conduct alleged in the remaining 28 cases. Even without those three cases, those that remained involving misrepresentations in support of substantial claims provided a reasonable foundation for the investigation and the eventual laying of charges.

[84] In conclusion, I reject the Plaintiffs' evidence about the validity of their methods of documenting the SR&ED claims that were of concern to the CRA. That evidence was self-serving and inconsistent with what any reasonable person let alone a chartered accountant would consider justifiable. The Plaintiffs' backdating of documents in these cases to support higher SR&ED valuations was, quite simply, indefensible and inconsistent with generally accepted and well-known accounting methods.

VI. Did the CRA Validate JAD's Methods?

[85] Messrs. Deacur and Gordon contend that their methods were validated in several ways by the CRA. On some occasions they say that CRA auditors approved what they were doing by allowing some of the claims as presented. For three SR&ED claims that had been denied on reassessment by auditor John Rohac, the Plaintiffs rely on the success of their subsequent appeals which reinstated initial audit approvals. These appeal outcomes, they say, represent an implicit acceptance of the propriety of backdating records to establish a value for SR&ED claims and undermine the CRA rationale for the prosecution. The Plaintiffs also rely on statements attributed to two retired CRA auditors who they say explicitly accepted the impugned JAD SR&ED methodology – Ronald Moore and Joseph Goldstein.

[86] Mr. Rohac was called as a witness by the Plaintiffs. He is a certified management accountant and, since 1990, he has been employed by the CRA as an auditor. Notwithstanding understandable gaps in memory, I found Mr. Rohac to be a truthful and reliable witness.

[87] Mr. Rohac was asked about his method for valuing the cost of labour during an SR&ED audit. His basic approach to calculating an hourly labour rate was to take an employee's T4 income for the year and divide by 2000 hours. The hourly rate would then be multiplied by the number of hours spent by the employee in the applicable year in the performance of SR&ED work. He could not recall if he was instructed to take this approach or if there was a CRA policy directive to support this method. He testified that "I tried to use what audit technique I could come up with what I needed" [p 290].

[88] Mr. Rohac was closely questioned about the need to include labour overhead items in calculating a true labour cost. He acknowledged that an allowance for overhead was valid and that the application of an overhead proxy amount represented by a percentage of paid wages was also acceptable [p 304, 430 and pp 372-373].

[89] Under questioning by Mr. Gordon, Mr. Rohac also acknowledged that an SR&ED claim could be made on the basis of a contract fee between two related companies. However the premise of the questions and Mr. Rohac's answers was that actual SR&ED work had been done by one company on behalf of the other [transcript p 406]. Under questioning by Messrs. Deacur and Gordon, Mr. Rohac was never asked to comment on a scenario that resembled their method of documenting a supposed payable between two companies that were never in a contractual relationship at the pertinent time. Indeed, in the situation of an audit Mr. Rohac completed for the JAD client, CDD-REM, he was never asked under direct examination how the SR&ED claim actually compared to the methods that were of concern to the CRA investigators. Under cross-examination, it was established that the CDD-REM claim involved a fee between extant companies for actual work performed under contract with no backdating of documents [transcript p 432-433]. In the result nothing Mr. Rohac did in connection with the CDD-REM audit is relevant to the cases that ultimately became the focus of the CRA's investigation and the criminal charges.

[90] Messrs. Deacur and Gordon are critical of Mr. Rohac's re-audits of some of the SR&ED claims that were, however, the subject of CRA concern [para 72 of the Fresh as Amended Statement of Claim in T-474-06 and para 75 of the Fresh as Amended Statement of Claim in

T-473-06]. One of those was a claim by Markeck Manufacturers Inc [Markeck] where Mr. Rohac reduced the previously approved SR&ED credit from $26,250 to $7,231 [Exhibit D-9]. This re-audit was carried out on the strength of a statutory declaration provided by Markeck's president, Mike Djurinec, to CRA investigators raising a number of issues of concern about JAD's suggested approach to the presentation of the claim. On the advice of another accountant, Mr. Djurinec declined to effect Mr. Deacur's suggestion for certain accounting entries because they were deemed "unreasonable" [Exhibit D-418 at tab 34 para 33]. Mr. Rohac's audit concluded as follows:

> The evidence indicates that the billing from the related companies was not for bona fide R&D activities and were issued to increase qualified expenditures for the ITC calculation. Also since an expenditure for SR&ED was never made by Markeck, the full amount of billings from Subo Inc. and 457356 Ontario Limited are disallowed notwithstanding the original audit results. [Exhibit D-9]

[91] Mr. Rohac testified that, based on the information at hand, he would not have done anything differently.

[92] Mr. Rohac similarly re-audited the SR&ED claims by Roglen Holdings Ltd [Roglen] based on a statutory declaration provided by Ronald Lowther. Mr. Lowther told CRA investigators that the Roglen claim was put together by Mr. Deacur. Mr. Rohac's audit report summarized Mr. Lowther's sworn evidence in the following way:

> A Statutory Declaration was signed by R.W. Lowther, dated November 14, 1996. In this declaration Ron stated in paragraph 19 that he did not own Roglen until after he met Deacur in August 1993. He also stated in para. 21 that he back dated the signing the minute book. In para. 30 Ron stated that he did not own 998801 in 1992 because he did not meet Deacur until August 1993. In para 68 Ron stated that he opened a business bank account

(5000501) with the Laurentian Bank of Canada in the name of Roglen Holdings which was used only to deposit Government of Canada cheques. In para. 72 & 73 Ron stated that 998801 never had its own account and no money was ever exchanged between Roglen and 998801.

CONCLUSION: F'1993 - All subcontract fees are disallowed as neither Roglen nor 998801 were owned by Ron or Tony Lowther during the fiscal period ended July 31,1993. Therefore since they did not own the companies, the companies could not be performing R&D for the Lowthers, and there is no basis for the claim. All previously approved expenditures are disallowed since the original audit & appeals were misrepresented.

F'94

998801 issued to Roglen two invoices dated December 31,1993 for $40,000 each. The total of $80,000 is the total sales of 998801 for the year.
During the interview on October 17, 1996 between Ron Lowther and Connie Bailey and Art Payne of the department, Mr. Lowther said that 998801 Ontario does not have its own bank account, it has never had any letterhead and it is a shell corporation. In addition the only entries in the bank account for Roglen pertain to the R&D. This indicates that 998801 was just set up to legitimise R&D billings to increase the credits.

In addition, in para 38 of the stat dec, Ron stated that the projects met their objectives as of July 31,1993 and by December 1993 were approved for distribution. The science report in the TF98 for F'1993 states that patents were applied for and pending. This raises questions as to the actual R&D performed between August 1, 1993 & December 31, 1993) which is F'1994.

In paragraph of the stat dec., Ronald Lowther stated that no money was ever exchanged between Roglen and 998801.

CONCLUSION: 998801 was just a shell company which did not perform any R&D.
Therefor the billings are not bona fide R&D billings. In addition in paragraph 73 of the stat dec., Ronald Lowther stated money was never exchanged between Roglen & 998801 which means that an expenditure did not occur.
Also, Ron Lowther stated that the work was completed as of August 31, 1993. Since only a desk review was performed for F'94, it is possible that this fact would not have been picked up based on only a such a cursory review.

> Based on these facts the billings from 998801 to Roglen are an ineligible R&D expenditure. [Exhibit D-13]

[93] Mr. Rohac's re-audit of the SR&ED claim of Signet Marketing Inc. [Signet] was similarly supported by a statutory declaration from Signet's President, John Savelli [Exhibit D-14]. That statement disclosed that Mr. Deacur had recommended the creation of a management company to support an allowance for a management fee with Signet. JAD provided a numbered company for that purpose. Mr. Rohac denied those parts of the Signet SR&ED claims that were based on management fee billings because he understood the two companies had no business relationship during the relevant periods [Exhibit D-15].

[94] Having looked at the evidence Mr. Rohac had before him during his re-audits of the Markeck, Roglen and Signet accounts, I am satisfied that he had a reasonable basis for those reassessments. I reject any suggestion that he performed that work under direction with a closed mind or with an ulterior motive. More importantly, I accept his evidence that his work on JAD SR&ED claims was not carried out in support of the CRA criminal investigation. While he relied on information obtained by CRA investigators, he was simply performing a legitimate audit function – a function that did not influence the course of the investigation or the laying of criminal charges. In short, his reassessments are irrelevant to the issues before me.

[95] Messrs. Deacur and Gordon contend, however, that their methods were vindicated by successful appeals from Mr. Rohac's re-audits of the Signet, Markeck and Roglen claims, after the criminal prosecution was stayed. I do not agree.

[96] Those appeal outcomes do not amount to a repudiation of the JAD investigation or the prosecution. Each of the appeals was resolved with an informal settlement that simply reinstated the initial audit favouring the taxpayers. Nothing in the appeal reports expressly endorses the backdating methods that had been employed by JAD. In fact, all of the appeals are reported to be "without prejudice" negotiated settlements with the named taxpayers.

[97] The appeals officer, Elaine Collingwood, testified that there were evidentiary uncertainties in each of the files including a limitations issue that could have barred Mr. Rohac's reassessments after 3 years [p 6022]. Inasmuch as Mr. Rohac had not addressed the limitations issue or prepared a s 152 Report, the audits were considered to be vulnerable if taken forward to Tax Court. The uncertainty of the likely outcomes of these cases is also borne out by the explanations recorded at the time in the respective settlements with the taxpayers [Exhibits D-452, D 453 and D-451]. Ms. Collingwood's testimony was to the same effect:

> A. Again, we are not saying that the taxpayer is correct or that CRA is correct. We are saying that the facts of the case are unclear. And we weigh and look at the risk of the -- make a risk assessment with respect to the files, and if this file were to proceed to Tax Court, would we be able to support the assessments? And if we are unclear or unsure of that, again, the benefit of the doubt is given to the taxpayer and we reverse the assessment. But I never made the decision with respect to the file. [p 6039]

[98] Ms. Collingwood went on to say that nothing in the appeal outcomes was intended to endorse or justify the methods JAD had used to present the initial claims [p 6044].

[99] I accept Ms. Collingwood's explanation of the rationale for allowing these three appeals. These were pragmatic resolutions with no *ex post facto* significance to the reasonableness of the earlier JAD investigation and prosecution.

[100] Ronald Moore was, at the time of the JAD investigation, the Director of Operations for the CRA working from CRA headquarters in Ottawa. In that role, he provided training and advice on the technical aspects of investigations.

[101] Mr. Moore now lives in Nova Scotia. He did not testify in this proceeding because of health considerations, but I allowed his testimony from the preliminary hearing to be introduced in his absence. That evidence was given under oath at a time much closer to the relevant events than today and it carries an air of reliability. Nevertheless, the testimony could not be tested by the Defendant in this proceeding and that is a factor that goes to its weight.

[102] It is argued by Messrs. Deacur and Gordon that Mr. Moore's preliminary hearing testimony also endorsed their methods of documenting SR&ED claims.

[103] Mr. Moore's supposed acceptance of the JAD approach to documenting SR&ED claims is said to arise from an exchange in response to a lengthy and multi-part hypothetical put to him in cross-examination. One element of the hypothetical assumptions given to Mr. Moore indicated that the SR&ED method under consideration involved the use of a management company in support of a fair market value billing. Mr. Moore was then asked to accept the following proposition:

> Q. Now, accept from me that there is evidence before the court that in many cases – do you remember the reference to management company and "Stretching your Tax Dollar," the booklet I showed you?
>
> A. I recall.
>
> Q. Okay, That in many of the cases the transfer of that management company to the people, because people do R&D, to the people who actually did the R&D was done retrospectively. So accept that from me from me that that is the evidence. [Exhibit P-459, Vol 103 at p 72]

[104] The full hypothetical scenario Mr. Moore was asked to consider takes up about three full pages of the transcript and concludes with the following exchange:

> Okay. Based on all of those things that you accept from me, for the purpose only of your answer to this question, back in the days when you were an auditor would you have had any problem with any of the things that I've just mentioned?
>
> A. Uh, it's been a long time, as I said before, since I've been an auditor. That would be back in about 1970 or '71. And certainly I didn't deal with R&D and all the provisions that are in there now. With my limited knowledge – I mean, listening to what you have said, accepting what you have said, but I have to qualify it that I do not have the technical expertise to really know, first of all, the ins and outs of R&D and all the rest of that.
>
> Q. Right.
>
> A. Let alone corporate T-2 accounting or filing returns, which I honestly wouldn't be able to fill out myself. And not having a complete knowledge of this, or very little if any knowledge of this case to know the type of things that you yourself are looking to find out from the prosecution report, the mens rea and the things that are supposedly alleged by the crown. It's very difficult for me to answer. But to be fair to all sides I would say that if everything you have just pointed out was correct, uh, <u>and there were no other facts. There was nothing else to support it, I would not have a problem with it.</u> [Exhibit P-459, Vol 103 at p 73] [Emphasis added.]

[105] As Mr. Moore said, his highly qualified response fell well outside of his area of expertise. Furthermore, this evidence cannot be accepted as an endorsement of the specific practises that were employed by JAD to present the SR&ED claims that were the subject of most of the criminal charges. A vague allusion to a retrospective transfer of a management company fails to even remotely describe the JAD practise of backdating corporate and transactional records to represent a state of business affairs that never actually existed. There were several material facts that were withheld from the hypothetical question put to Mr. Moore, all of which readily fell within his reservation "…and there were no other facts". This evidence does not support an argument that the JAD methods were justified.

[106] Mr. Goldstein is a retired CRA auditor. He testified as a witness for the Defendant. In 1994 he was working as an SR&ED auditor in the Toronto North office. His supervisor was Kirby Wong. In 1994, Mr. Goldstein was assigned to conduct an SR&ED audit for JAD client, Permalite Skylights Inc. [Permalite]. In that capacity he completed an audit checklist which included a notation that the claim did not include a related party transaction [Exhibit D-207 at p 3]. Mr. Goldstein allowed the claim as presented [Exhibit D-208].

[107] Mr. Gordon was involved in the presentation of the Permalite SR&ED claim. In the Plaintiffs' Post-Trial Brief at paragraphs 442 and 503, Mr. Goldstein's Permalite audit is cited as evidence that JAD's backdating methods were acceptable. Mr. Gordon's Reply pleading also attributed statements to Mr. Goldstein that the specific method of creating a backdated corporate contractual relationship was permissible. This assertion is inconsistent with the results of an SR&ED audit Mr. Goldstein conducted for JAD client 837974 Ontario Limited. That claim

involved an asserted related party transaction for 1993 involving a management fee of $80,000. Of that amount Mr. Goldstein allowed only $5000 based on the lack of evidence that the work was actually performed during the period in question [Exhibit D-210 and Mr. Goldstein's evidence at p 3520].

[108] When Mr. Goldstein was asked in direct examination whether Mr. Gordon's attributions were valid, he denied them in the following series of answers:

> A. All I can say is, all audit transactions have to have source documentation, and I -- and I would never give out -- I would not comment, make any comments, accounting or any of that, during my audits. I am strictly there to audit. And I never -- and especially with regarding source documentation, everything, all transactions have to have source documentation.
>
> Q. Okay, and then the next comment is:
>
> "Also, the CRA SR&ED auditor agreed that there was no need for payment and further agreed that no second company was necessary at the present time." [as read]
>
> Do you have any comment about that?
>
> A. I go back to what I said just previously, I would not, under any circumstances, comment on any accounting methods, whatever a taxpayer does, it's not my responsibility. Mine's just to audit.
>
> Q. And then the next comment:
>
> "Also, the CRA SR&ED auditor, Goldstein, agreed that it was allowable to claim an expense today and set up a company in the future in order for the expense claimed today to go to the company which was to be set up in the future." [as read]
>
> Do you have any comment about that?
>
> A. That's totally opposite to accounting principles that I'm aware of, and so I'm not -- again, that's not the purpose of my audit is to give out any types of tax advice, and it goes against accounting principles that I know. [pp 3510-3511]

[109] It is of considerable significance that Mr. Goldstein was not cross-examined on this evidence. To the extent that Mr. Gordon's testimony differs with Mr. Goldstein's testimony, I accept Mr. Goldstein's version.

[110] Ms. Northey was closely cross-examined about the Permalite SR&ED claim and credibly explained why it was considered to be legally objectionable [pp 5715-5721].

[111] I do not accept the Plaintiffs' contention that Mr. Goldstein's audit of Permalite provided some validation of their methods or that he said anything to that effect to Mr. Gordon.

[112] In summary, there is nothing in the evidence to establish that JAD's backdating methodologies were in some way validated by CRA auditors or on appeal.

VII. JAD's Methods Were Disclosed

[113] Messrs. Deacur and Gordon seek to excuse their backdating of records by saying these methods were laid open for the auditors to see and this negated any criminal intent. While it is certainly true that, on some occasions, JAD's methods were discovered by auditors, in many cases, they were not. Examples of this can be seen in Exhibits D-194, D-81, D-270 and D-271 where the auditors had concerns about the corporate relationships and the claimed management fees but did not uncover the backdating of records. On another occasion when JAD representative Kyle Bondergaard was asked for an explanation about an "apparent contradiction in the company's time-line", he claimed to have no explanation: see Exhibit D-215. In the audit of Bridlewood Heat, the auditor, Mary Ann Girard asked if there were any written contracts to

support the SR&ED claim and was told by or in the presence of Mr. Bondergaard that there were only “verbal contracts”. In fact there were no contracts. On June 16, 1995 Mr. Bondergaard advised Ms. Girard that the general ledger for the company could not be found and may not exist [Exhibit D-224].

[114] Ms. Girard testified on behalf of the CRA. She was a strong witness and, by all appearances, very capable. For a number of years she worked as a CRA SR&ED auditor. She audited the Bridlewood SR&ED claim filed by JAD. Ms. Girard had a number of concerns in connection with the large SR&ED valuation submitted in the amount of $775,000. She repeatedly requested supporting documentation but, apart from a single computer generated invoice, nothing was provided [p 3673 and p 3675].

[115] Ms. Girard characterized her audit concerns in the following way:

> A. Well, first of all, the concerns would be that there's large management fees with no documentation presented and that the company that they were supposedly managements fees were being contracted by, the documentation for the revision, reinstatement of their companies were done after the fact of the year-end of the corporations. And because the year-end here is February 28th, '93, and February '94, and the documentation for the company being transferred to the numbered, the 16 -- whatever the numbered company, the numbered company, was after the fact, was in November of '94, that was all done in '94, so it looks like the information has been backdated. And the other fact that, in '93, that the management fees were supposedly paid -- or contracted for in '93, but they didn't get onto the -- they got onto the '94 tax returns as opposed to the '93 tax returns. [p 3686]
>
> …
>
> A. Well, it appeared to me, as an auditor, that the -- all the documentation were falsified in that this was just a claim to do -- to claim an R&D expenditures. The taxpayer, I state, had been approached by Deacur & Associates and said that, you know, that

> they had eligible claims. But from what our review showed, that no documentation could be supplied, so it just appeared that they couldn't support anything. [p 3688]

[116] Ultimately the Bridlewood claim was denied by the science auditor but the financial concerns were not dispelled.

[117] Mr. Devendra Kohli was an experienced SR&ED auditor who reviewed the JAD claim filed on behalf of Canadata Computer Systems Inc. [Canadata]. His testimony described an unusual presentation involving identical cross-billings between Canadata and a related numbered company. The supporting invoices created an appearance that each company was doing SR&ED work on behalf of the other for identical fees [see p 4573-4574]. Mr. Kohli's contemporaneous notes record a request for backup records to describe the services performed by the companies and to support the asserted valuations [Exhibit D-371]. JAD provided some documents but not the entirety of what Mr. Kohli had requested. To the best of his recollection, JAD representatives offered no explanation for the absence of supporting records [p 4584]. Exhibit D-372 is a chart representing Mr. Kohli's understanding of the structure of the transactions. He was sufficiently troubled by what he saw that he discussed a referral to tax avoidance with his team leader [p 4586].

[118] Mr. Kohli described his audit concerns as follows:

> A. Well, what we were seeing is whether the expense was a legit expense, especially the contractors part, which have been claimed and then, again, the management fee arrangement that they have got it in one year as an expense and then it becomes a revenue to the company, there seems like a scheme and, so, a scheme to avoid the tax. If you look at it, in this case by shifting the year ends, the tax liability of the numbered company goes to

> zip. But on Canadata side they earn ITCs on that. So I think that was part of it, because it was appearing to be given, the employees of Canadata given at the, looking at the financial statement and the other information, whether the expense is reasonable and so on. So at that point it's initial referral, internal referral that was made and it was made -- my team leader said "well, we should make it", I said "okay". [p 4589]

[119] Mr. Kohli's referral to tax avoidance described the problem as follows:

> 3. Canadata has claimed R&D Expenditures for the work done by Ont Ltd:
>
> Jan 31, 92 $316,716
>
> Jan 31, 93 $298,371
>
> Jan 31, 94 $168,254
>
> The Expenditures were set up as year end accruals backed by Invoices from Ont Inc.
>
> 4.On the other side Canadata has accrued Management fee (Income) from Ont Ltd:
>
> Feb 28, 92 $316,716
>
> Feb 28, 93 $298,371
>
> Feb 28, 94 $168,254
>
> No cash was transacted, instead the amount is adjusted to the payable set up (discussed in Paragraph 3).
>
> 5. The effect of the transactions to Canadata is that the R&D Expenditures are claimed in one year and are reversed to Management Fee income in the subsequent year.
>
> 6. Because both the transactions fall under the same fiscal year the effect of the transactions is nil to Ont Inc. On one hand it is being reflected as Income and on the other as Management Fee Expense. As such no income is reported by Ont Ltd.
>
> 7. Ont Inc. has no employees of its own. The only income or expenses are because of the transactions (discussed in Paragraphs 2 & 3 above) with Canadata. No other business is carried out by Ont Ltd.

> 8. Ont Ltd. has invoiced Canadata for work done by Jim Macdonal and Peter Knight who are full time employee/subcontractor during the years under review. Jim & Peter neither did any work for Ont Ltd. nor got paid from it.
>
> 9. The whole exercise was done to jack up the R&D Expenditures of Canadata and claim ITC on that.
>
> 10. If Ont Ltd. only did R&D work for Canadata and Canadata managed Ont Ltd, there is no real trasaction [sic] suggesting R&D work for Canadata was ever done.
>
> 11. Being unassessed files, the time is of essence in the case, hence we are **disallowing the R&D Expenses claimed** under the following sections of the Act:
>
> **i. 18(1)(a) - No actual expense was incurred.**
>
> **ii. 18(1)(e) - It was a contingent liability.**
>
> **iii. 67 - Unreasonable expenses under the circumstances.**
> [Exhibit D-373]

[120] It is very apparent from the audit materials produced that Mr. Kohli was not told by JAD representatives that the numbered company and the supporting SR&ED invoices were after-the-fact JAD creations intended to inflate the value of the Canadata's claim to tax credits. It was only at the point that CRA investigators interviewed the owner of Canadata that the true picture emerged [Exhibit D-418 at tab 25, paras 12-20]. Ultimately, the claim was rejected because the asserted work did not qualify under the SR&ED program [Exhibit D-374].

[121] Ms. Northey also disputed the Plaintiffs' assertion that JAD's backdating methods were on full display to CRA auditors. Her testimony on this issue is consistent with the documentary record which showed that the auditors were frequently unaware that the SR&ED documents provided by JAD recorded fictional inter-corporate transactions.

[122] When Mr. Gordon asked her what she made of the fact that some CRA auditors had allowed some of the JAD's impugned SR&ED filings, she gave the following answer:

> A. We did, actually. When I, when I interviewed the -- so I received the referrals from the auditors, and then when I went out to interview the auditors, I was asking them how they disposed of the files. That was part of the questionnaire. And as part of the questionnaire, I found out, yes, we negotiated. We saw that the other day when we saw section 67, whether it's reasonable or not, we saw it negotiate away. We saw it again in Permalite even in '92 and '93 where they allowed a portion of it. And so at this point in time, November 1st, 1996, we had already started interviewing the clients; so we were getting the true picture from the clients of what had actually happened, and we had also done the search which was in July 1996, so we had that information as well. So we knew what the auditors were saying. We had the seized records, and so we knew what was in your working papers regarding the clients, and we had also had discussions with the -- sorry, the, with the clients. And so when we looked at all those pieces of information, we saw that the auditors weren't given all the details surrounding the secondary companies.
>
> So we had, as I mentioned, the key documents in the seizure were the letters from Wanita and Kelly-Ann Deacur which were dated 1994 saying you owned these companies back in 1991. We never saw any of those pieces of information in the audit files.
>
> Even when we look at Permalite and we see Jack Goldstein, and he is allowing, in 1991, $40,000, but we know that it's related to a company from the investigation and from the seized records that doesn't come into effect until late 1993 or early 1994. So the auditors are allowing these things, the management and inflated wages, but what we have that they don't have is those documents, we have some of the invoices which weren't shared with the auditor in some cases, and we know that they are all backdated. So that's why we are saying some offices negotiate and allowed, which we knew were inflated and non-existent, and we found it based on the evidence that we had gathered during the investigation. [pp 5856-5858]

[123] I accept that it was understood by JAD and its clients that every SR&ED claim would be subjected to science and financial audits. However, I reject the argument that this expectation clearly belied a criminal intent because the backdating of records would be routinely discovered

by the auditors. Ms. Northey had considerable evidentiary support for her belief that CRA auditors were misled by many of JAD's presentations of client SR&ED claims and I accept her testimony about her understanding of the auditors' actual experience:

> THE WITNESS: Right. So in this case, the tax returns were filed, and the T661s and the T2038s which are required, they were filed, and they did show management fees of a substantial portion. So they were subject to audit, and the auditors went out. And we saw that information Thursday when I was talking about it. The auditors go out and say, "Okay, yeah, management fees are there. It's big. So tell me about them. What happened?" And then the secondary company was put forward.
>
> They were told that the secondary company actually did the work and, as a result, billed to the primary company, and that was the SR&ED claims. In the first file or in one of the first files that were filed, CRA picked it up right away and said, "Uh, uh, uh, you can't do this", and that was Armada. But that didn't seem to resonate with our folks, James A. Deacur & Associates, and they continued to file in this manner.
>
> When we saw from the auditors, auditors were trying to take a stab at disallowing it, some had uncovered, Christopher Chan uncovered that the secondary corporation didn't exist, but a lot of other auditors were attacking the issue or trying to resolve the issue based on a reasonable factor, which is, are the fees reasonable in the circumstances, which is section 67. But they -- very few of the auditors had actually uncovered that these documents were backdated. And when they were asking about the secondary companies, the secondary companies were being put forward, and there's a correspondence with -- from James A. Deacur & Associates to CRA saying, "No, these are part of a valid contract. They are incurred during the years". And we saw that on both Caber Mor, and we saw it as well on -- I think it was Roglen, where two letters are sent to the agency after the auditor makes inquiries, and it's explained to them that, no, this is a legitimate contract, it's duly noted in the books and records, it's available, it's legitimate, so, you know what are you going to do about it?
>
> And the auditors say, "Well, I think it's a bit high, so I am going to challenge the dollar value of it". But they didn't get to the underlying fraud, which was backdating corporations, it didn't exist at all. They were just trying to address it from a "is the amount reasonable for what was done?" They didn't actually

> identify that these corporations were backdated, they didn't exist at the time, and only got involved as a result of the contracts.
>
> And a lot of times the auditors didn't have a copy of the contract, so they didn't have an understanding of when this taxpayer got involved with Deacur & Associates for the first time and didn't have an appreciation that they got these companies from Deacur & Associates and that these companies were backdated to show ownership in 1990. So what was being put forward to them was that "Hey, these companies were incorporated in 1990. They existed the entire time of the operation of the SR&ED, and, as a result, we can bill our time through a secondary company and just push it over there". But they didn't actually truly uncover -- only except in very limited circumstances did they uncover that these transactions could never have happened because that corporation came into being for the taxpayer a much later date than when the actual SR&ED happened. And so that was the mens rea, the intent and how they deceived the auditors. [pp 5231-5233]

[124] In several cases, JAD's backdating of corporate histories was not discovered by the CRA until after search warrants had been executed: see the testimony of Ms. Northey at p 5239.

[125] The evidence further discloses that Mr. Bondergaard was often sent as a JAD representative to client audits and when he was asked for additional support, he responded with resignation and little, if any, follow-up: see Exhibits D-215, D-258, D-302 and the testimony of Todd Ferguson at p 4040; Michael Cross at p 3589 and p 3597; Devendra Kohli at p 4573 and Bonnie Jarrett p 3856. In an internal JAD memo sent to Mr. Bondergaard, the SR&ED claim submitted on behalf of 498824 Ontario Inc. is described as "a mess" [Exhibit D-75]. That memo also contains the following telling admission about JAD's corporate backdating:

> This is the holding Co. for Herb Waldie that he purchased from Ross Young to use for the Waldie claim. Ross Young assured us that he didn't file 1992 returns so we have his resignation as March 7/91. Rev. Can. called and said there is a major discrepancy with the dates – Ross Young did in fact file 1992 returns and the Ministry considers his resignation as Dec 2/92. I spoke with Jim and he said to give it to you. We need to redo the

> returns and also change the answers to Did the corporation change? Has the major business activity changed?

[126] Under cross-examination Mr. Bondergaard agreed that Exhibit 75 was sent to him for follow-up but he professed to have no recollection of the reported problem of inconsistent corporate histories [pp 1436-1447].

[127] Mr. Waldie's statutory declaration given to CRA investigators described this transaction in the following way:

> — I first met Thompson in April 1994 at a friends business.
>
> — Thompson told me that a stove project I had been working on would [*sounded like it would] qualify for R&D.
>
> — Thompson told me that Deacur & Assoc. were the professionals in the claiming of R&D and that they would guide me through the process of filing a R&D claim.
>
> — About a week later on May 04, 1994, I signed an engagement letter with Deacur & Assoc., a copy of which is attached hereto as Exhibit 1.
>
> — Deacur & Assoc. was going to charge me a fee of 35% of the R&D refund I was to eventually receive.
>
> — [*It was] ~~Thompson~~ suggested to me [*by a Deacur & Assoc. representative] that I would need a second company to obtain the maximum benefit on the R&D claim and to claim a management fee for my time on the projects.
>
> — There was no charge for the company as the cost would be included in the 35% fee Deacur & Assoc. was charging me.
>
> — Marie Bujold of Deacur & Assoc. office faxed me on June 27, 1994 to say that she was going to prepare my R&D claim and the things she would need to do it. A copy of her fax transmission is attached hereto as Exhibit 2.
>
> — At Marie Bujold's request I prepared schedules of hours I and my sons had put into several projects. I had not originally kept a log of hours so I made intelligent estimates.

— I had no invoices or records for materials expended on the projects as I had used spare pieces or made minor purchases to make them.

— At no time did I sub-contract out the work or have sub-contractors working for me.

— Between September 06 and September 14, 1994 I received from Deacur & Assoc. the amended 1993 T2 return for 920704 Ontario Ltd. for the R&D claim. I signed them and returned them to Deacur & Assoc. as they instructed.

— In this return there was a statement of earnings for 920704 Ontario Ltd. which was prepared by Deacur & Assoc. It showed income of $351,400.00 and subcontract expense of $351,400.00. A copy of the statement of earnings is attached hereto as Exhibit 3.

— During this same time period I also received a 1993 T2 Tax Return for 498824 Ontario Inc. which I also signed and returned to Deacur & Assoc.

— I had never heard of 498824 Ontario Inc. prior to this time period.

— In this return there was a statement of earnings for 498824 Ontario Inc. which was prepared by Deacur & Assoc. It also showed income of $351,400.00 and subcontract expense of $351,400.00. A copy of the statement of earnings is attached hereto as Exhibit 4.

- The effect of these statements of earnings was that the numbered companies were charging each other for a subcontract expense, which were the aforementioned management fees.

— As it turned 498824 Ontario Inc. was the company Thompson previously had told me I would need. I had not heard of 498824 Ontario Inc. prior to receiving the T2 tax return.

- Also, about the same time as I received the T2 tax returns, I also received a letter dated September 07, 1994 from Wanita Deacur along with enclosures, a copy of which is attached hereto as Exhibit 5.

— The letter pertained to my acquisition of 498824 Ontario Inc.

— The letter requested I sign the share certificates and Minute Book pages and return them to her. I did so.

— All the documents forwarded to me were back dated to March 07, 1991.

— I questioned the back dating and Thompson told me that we could back date everything to the beginning of the R&D. I trusted Deacur & Assoc. judgment in this matter and I relied entirely on them.

— Thereafter I received two invoices from and prepared by Deacur & Assoc. in support of the aforementioned subcontract expenses claimed within the T2 returns of 498824 Ontario Inc. and 920704 Ontario Ltd.

— The numbered companies were charging each other for hours spent on various projects by myself and my two sons. Each invoice totalled $351,400.00 for a total of $702,800.00.

— Each invoice was back dated to December 31, 1993.

— A copy of these invoices is attached as Exhibits 6 & 7 respectively.

— I cannot remember the exact date I received these invoices from Deacur & Assoc. but I do remember it was after I had received the September 07, 1994 letter from Wanita Deacur.

— I trusted the back dating of these documents was all right because I had all ready been told by Thompson that we could back date to the beginning of the R&D.

— The R&D claim was subsequently audited by Revenue Canada and the entire claim was disallowed.

— In no way did I instruct or direct Deacur & Assoc. in the preparation of the R&D claim or the returns.

— At all times I trusted the fact that (as they had represented themselves to be) they were professionals in the submission and preparation of R&D claims. [Exhibit D-377, Tab 11] [*text is handwritten]

[128] CRA auditor, Ms. Girard, also described the failure to produce supporting records in the following exchange at p 3673:

Q. And what, if any, information did you receive?

> A. We didn't receive any, that I recall. I kept asking, we asked, we asked for it several times. And they always said they thought they had it, but when it really came down to it, we never did receive anything further than this one piece of documentation with regards to the expenditures, which was this invoice. This invoice that you gave me.

[129] The picture that is left is not one where JAD was drawing the CRA's attention to its methods. Rather, Messrs. Deacur and Gordon knew their methods were questionable but elected to take their chances with getting some of the claims through audit. This attitude is reflected in some measure in Exhibit D-420 where a senior JAD representative reported to a client that the management fee strategy had received "mixed results".

[130] The weight of the evidence contradicts the Plaintiffs' evidence that their methods were open and transparent. If the backdating of client records was irrelevant or permissible, as they now suggest, the auditors' questions should have immediately elicited full disclosure. There is, however, nothing in the audit records indicating that when supporting records were requested JAD representatives willingly volunteered information about their methods or the accounting rationale for those methods. Instead the auditors were left to figure out what was going on without any meaningful assistance from the assigned JAD representatives and in some cases they were met with obfuscation [see Exhibit D-182, D-386, D-76 and D-184].

[131] In summary, I reject the Plaintiffs' argument that their backdating methods were freely and fully disclosed to CRA auditors. Although those methods were uncovered by some of the assigned auditors that was not by virtue of full and timely disclosures by JAD representatives.

[132] I accept that Ms. Northey had a reasonable basis for her belief that CRA auditors were often unaware of the true state of business affairs behind the JAD-prepared SR&ED claims and that much of what the CRA later learned came out of the JAD investigation.

VIII. The Allegations of Negligence

[133] The Plaintiffs contend that there were numerous investigative errors made by CRA investigators in the conduct of the JAD investigation. The alleged lapses they rely upon are set out in these reasons at paragraph 5. The same matters are also said to be evidence of malice. More generally, the Plaintiffs argue that Ms. Northey and her superiors fundamentally misunderstood what JAD was doing in the presentation of the SR&ED claims that became the subject of the criminal charges and why JAD's methods were lawful and permissible.

[134] I have already dealt with the issue of the validity and propriety of the Plaintiffs' accounting theories and practices. Their backdating of client records was wholly unjustified in accounting terms and constituted misrepresentations. Ms. Northey and many other CRA officials reasonably believed that those presentations were at least *prima facie* fraudulent and they had a substantial evidentiary foundation for the decision to recommend charges. Notwithstanding this conclusion, I will address the question of whether CRA Special Investigators conducting a criminal investigation in the nature of the JAD investigation are subject to a duty of care founded in negligence. I will then consider the specific allegations of negligence/malice advanced by the Plaintiffs.

IX. Standard of Care – Negligence

[135] The Plaintiffs allege that the Defendant is liable based on a cause of action framed in negligence. In particular, they say that the JAD investigation was seriously flawed and negligently carried out.

[136] The CRA argues that the many authorities that have shielded its auditors from a private law duty of care ought to be applied to CRA investigators. It is argued that the same policy concerns apply and justify the same level of immunity. Unlike police investigations into crime, CRA investigators are, it says, subject to broader public duties aimed at collecting revenue and enforcing a multi-faceted regulatory scheme.

[137] The policy concerns that arise from the CRA audit function have been frequently recognized. A good example can be seen in *783783 Alberta Ltd v Canada (Attorney General)*, [2010] AJ No 783 at paras 45-48, 2010 ABCA 226:

> 45 The relationship between the tax assessors and any taxpayer is primarily to ensure that the taxpayer is fairly assessed. The tax assessors also have a general duty to the government they work for, and indirectly to the general public. But overall, the relationship is not one where the tax assessors should be responsible for protecting taxpayers from losses arising from competitive disadvantages of the type pleaded. The assessors' duty is directed elsewhere: *Syl Apps Secure Treatment Centre v. B.D.*, [2007] 3 S.C.R. 83, 2007 SCC 38 at para. 28.
>
> 46 However, even if the necessary foreseeability and proximity could be established, policy considerations preclude any private law duty in tort. The Canadian income tax system is based on self-reporting by each taxpayer, followed by an assessment by the Canada Revenue Agency. The relationship between each taxpayer and the assessor is personal and private. The importance of the privacy provisions in the *Income Tax Act* was confirmed in *Slattery*, and while those privacy provisions do not foreclose this

> action, they are a relevant policy consideration at this stage of the analysis. Imposing a duty on the assessor to account to one taxpayer for the way it assessed another taxpayer impedes on the relationship in an unacceptable way.
>
> 47 The argument assumes that the Canada Revenue Agency has no discretion in the way that it assesses any taxpayer, and that in any tort action like this the plaintiff could demonstrate that a particular assessment is "wrong". This presupposes that there is only one answer to any income tax question. But the *Income Tax Act* is long and notoriously complex. In many instances the self-reported tax liability of the taxpayer will call for an exercise of judgment by the taxpayer, often based on professional advice. Likewise, the response of the tax assessor will often require an exercise of judgment and common sense. Sometimes compromises will be necessary, and disputed tax liability will be settled by the taxpayer and the assessor. It would unreasonably interfere with this system of taxation if a third party could later appear and argue that the assessment was "wrong".
>
> 48 There are many provisions in the *Income Tax Act* that could, if not properly applied, provide a competitive advantage to one taxpayer over another. Recognizing a duty of care in tort in such circumstances would expose Canada to liability to an unidentifiable group for an indeterminate amount: *Design Services Ltd. v. Canada*, [2008] 1 S.C.R. 737, 2008 SCC 22 at para. 62. Significant resources would have to be diverted to dealing with inquiries and complaints about the application of particular rules of taxation, many of which inquiries would have to go unanswered because of the privacy provisions of the *Act*. The plaintiff points out that s. 19 of the *Income Tax Act* is a much more obvious and focussed attempt to provide an incentive to one industry than possibly any other provision in the statute. It also notes that its claim is limited to a few taxation years, and arises out of the unusual change of control of the SEE Magazine defendants. But if any privately-owed duty in tort to assess taxpayers is recognized, it would be difficult, if not impossible, to draw a line between some sections of the statute, and others. If, in principle, a private law duty of care exists, the circumstances in which that duty could be triggered are unlimited.

[138] I would add to the above considerations that an audit is carried out within a complex statutory framework that contains a right of appeal. This was part of the rationale for refusing to

recognize a private law duty of care in connection with an audit in *Canus Fisheries Ltd v Canada*, 2005 NSSC 283 at para 100, [2005] NSJ No 413.

[139] Two additional points of concern that arise in many of the audit cases are the presence of opposing interests and the myriad of factors that apply to the assessment of tax: see *Leighton v Canada*, 2012 BCSC 961 at paras 54 and 58, [2012] BCJ No 1354; *Deluca v Canada*, 2016 ONSC 3865 at paras 60 and 64, 267 ACWS 3d 339; and *Canus*, above, at para 73. In the result, the vast majority of these cases have held that no duty of care in negligence is owed by the CRA in the performance of routine auditing.

[140] There does not appear yet to be any definitive judicial recognition in Canada of a private law duty of care in connection with the work of CRA investigators. There are, however, some observations in recent authorities that the decision in *Hill v Hamilton Wentworth (Regional Municipality Police Services Board)*, 2007 SCC 41, [2007] 3 SCR 129, dealing with police investigations might well be applicable to CRA criminal investigations.

[141] In my view the kind of investigation that was carried out in this case more closely resembles a police investigation than an income tax audit such that a private law duty of care can arise.

[142] The purpose of a CRA investigation is not directed at the assessment of amounts owing under the ITA. Rather, the focus of a CRA special investigation is solely to determine whether charges ought to be laid under the ITA or the *Criminal Code*, RSC, 1985, c C-46 [*Criminal*

Code]. Such an investigation is also not concerned with competing interests that may arise as among different classes of taxpayers. Indeed, I cannot identify any ITA regulatory functions that arise under such an investigation beyond the bare enforcement of the law.

[143] In my view the circumstances in *Hill*, above, that led the Court to impose a negligence standard on the police in the conduct of a criminal investigation are closely, if not perfectly, analogous to the kind of investigation that was carried out in this case. I can identify no principled rationale for distinguishing the work of the police in *Hill* from the work of the CRA investigators in this case. Both investigations were targeted at specific suspects for conduct that was thought to be criminal. Both carried serious penal consequences. No apparent tax collection or regulatory functions were being fulfilled by the investigators in this case. In fact, Messrs. Deacur and Gordon were tax preparers and not taxpayers and could just as easily have been investigated by the Royal Canadian Mounted Police [RCMP] for fraud as by the CRA. Furthermore, a third-party tax preparer has no right of recourse to the Tax Court to test the validity of his work. That right rests with the taxpayer.

[144] When one examines closely the policy considerations that were applied by the majority in *Hill*, above, in recognition of a private law duty of care, it is difficult to identify any meaningful distinctions with the circumstances of this case.

[145] The relationship between the CRA investigators and Messrs. Deacur and Gordon was personal, close and direct. It was not concerned with "the universe of all potential suspects" but, rather, they had been "singled out" [*Hill*, above, para 33].

[146] Messrs. Deacur and Gordon each had a critical personal interest in the conduct of the investigation. Their freedom and reputations were directly at stake [*Hill*, above, para 34].

[147] A sloppy but not malicious CRA investigation invites carelessness and can lead to a wrongful conviction [*Hill*, above, para 36].

[148] A private law duty of care by CRA investigators is consistent with the spirit of the *Charter* with its emphasis on liberty and fair process [*Hill*, above, para 38]. Indeed, the CRA investigation in this case was carried out in conformity with *Charter* and *Criminal Code* obligations. The application of the Charter to a CRA special investigation was earlier recognized in *R v Warawa*, [1997] AJ No 989 at para 9, 208 AR 81, in the following passage:

> 9 Therefore when a matter is referred to the S.I. path it is a criminal investigation. In that regard the Federal Court of Appeal in *Zotto v. The Queen* (1997), 97 D.T.C. 5328 at p. 5331 said:
>
> > "It can hardly be a surprise that lower courts have consistently held that when a case is put in the hands of S.I., even if the statute is otherwise a regulatory one, the case at that moment becomes a criminal investigation: ..."
>
> The case goes on to make reference to five lower court decisions. Any doubt on this issue is resolved by Revenue Canada's own policies (Ex. 41) where the Objectives and Goals of S.I. are spelled in a manual called TOM 11(10). It states at p. 1112 in part as follows:
>
> > "1.The objective of Special Investigations is to plan and administer criminal investigation programs that will provide maximum deterrence to non-compliance by investigating, penalizing, prosecuting and publicising significant cases in all categories of taxpayers for deliberate or willful evasion practices."

> S.I. is performing a function like that of the ordinary policeman. It is their job to investigate and where appropriate prosecute crimes. I have concluded therefore that when a matter is referred to S.I. the target or suspect of the investigation is entitled to the appropriate common law and Charter protections available to someone suspected of a crime.

[149] A duty of investigation in accordance with the law does not conflict with the presumed duty to take reasonable care toward the suspect [*Hill*, above, para 41].

[150] No important non-speculative negative policy consequences would arise by holding CRA investigators to the same standard of care that applies to an equivalent police investigation [*Hill*, above, para 43]. Indeed no compelling reason has been advanced by the CRA for negating an identical duty of care [*Hill*, above, paras 47 and 48].

[151] CRA investigators are concerned primarily with gathering and evaluating evidence. The fact-based investigative character of a CRA investigation distances it from a judicial or quasi-judicial role [*Hill*, above, para 49].

[152] The discretion inherent in a CRA investigation can be taken into account in formulating the standard of care but does not justify the denial of a duty *per se* [*Hill*, above, para 51]. An appropriate standard of care allows room to exercise discretion without incurring liability in negligence [*Hill*, above, para 54].

[153] There is a significant likelihood that the negligence of CRA investigators will cause serious harm to those who are targeted. Unlike the audit function, suspects under CRA

investigation can be imprisoned, their livelihoods affected and their reputations irreparably damaged. It is worth noting that the prosecution brought against Messrs. Deacur and Gordon was by way of indictment for fraud for which prison sentences could have been imposed [*Hill*, above, para 70].

[154] Holding CRA investigators to the standard of the reasonable, similarly-placed investigator is consistent with the legal duty that applies to other professionals working in like circumstances [*Hill*, above, para 72].

[155] The idea that a CRA investigation may be analogous to a police investigation also finds some support in *McCreight v Canada (Attorney General)*, 2013 ONCA 483, 116 OR 3d 429. That decision concerned a motion to strike and is not a definitive pronouncement on the issue. However, the Court recognized the possibility of such an outcome in the following passage:

> [60] In my view, in this case, the motion judge erred in concluding that it was plain and obvious that the respondent CRA investigators did not owe a duty of care to McCreight and Skinner, policy considerations would foreclose such a duty in any event and, therefore, the negligence claim had no reasonable prospect of success and should be struck.
>
> [61] Firstly, given the Supreme Court's ruling in *Hamilton-Wentworth* that, in certain circumstances, police officers may owe a duty of care to their suspects, surely it is not plain and obvious that a CRA investigator owes no such duty when operating under [page 444] *ITA* provisions that attract criminal sanction and under the *Criminal Code*. The same analogical reasoning applies to any residual policy rationale that could negate such a duty.

[156] The case of *Grenon v Canada Revenue Agency*, 2017 ABCA 96, [2017] 6 WWR 146, also dealt with a motion to strike a pleading of negligence against the CRA in the performance of its audit functions. The plaintiff argued unsuccessfully that the reasoning in *Hill*, above, and

McCreight, above, should be applied. The Court refused to apply those cases on the basis that to do so would "squeeze the regulatory context of the CRA's audit authority into" the exceptional circumstances found in *Hill*, above, [para 20]. Nevertheless, the Court in *Grenon* made the following observations about the potential for applying a negligence standard to the work of CRA investigators:

> 22 *Hill v Hamilton-Wentworth* does not assist the appellant beyond confirming the point that a government actor, exercising its powers under a statute with a public purpose, may bring itself into a relationship of proximity through its specific dealings with a plaintiff, a point not contested in this appeal or by this Court. *Hill v Hamilton-Wentworth* involved an exceptional set of circumstances. Moreover, there were particular considerations relevant to proximity and policy applicable to the relationship in that case which are not present here. Those included the likelihood of imprisonment, the legal duties owed by the police under the *Charter*, and the importance of balancing the need for police to be able to investigate effectively with the protection of the fundamental rights of a suspect or accused person.
>
> 23 In *McCreight*, individual accountants faced charges under both the ITA and the *Criminal Code*. Relying on *Leroux* and *Hill v Hamilton-Wentworth*, the Court concluded that it was "not plain and obvious that a CRA investigator owes no such duty when operating under ITA provisions that attract criminal sanction and under the *Criminal Code*": *McCreight* at paras 60-62.
>
> 24 To the extent that *McCreight* involves the possibility of criminal sanction, the case is distinguishable and more analogous to the criminal investigation at issue in *Hill v Hamilton-Wentworth* than to the audit functions of the CRA. In our view, the chambers judge was correct to reach that conclusion. To the extent that the appellant argues *McCreight* purports to extend negligence beyond criminal investigations and further into the regulatory context to recognize an audit by the CRA under the ITA triggers a private law duty of care, we decline to follow it.

[157] I am satisfied on the facts of this case that the negligence standard of care should be applied. The circumstances fall squarely within the framework analysis identified in *Cooper v Hobart*, 2001 SCC 79, [2001] 3 SCR 537, and in *Hill*, above. The foreseeability of harm to

Messrs. Deacur and Gordon arising from this investigation would have been readily apparent. They were, after all, the specific targets of the investigation and their freedom and reputations were directly at stake.

[158] The *prima facie* proximity requirement is also satisfied. The CRA investigators would have known that their actions could harm the Plaintiffs. The relationship between CRA and Messrs. Deacur and Gordon was close and direct. They had been singled out and their critical personal interests were engaged. They had an expectation that the investigation would be conducted in a competent manner.

[159] There are also no identifiable conflicts between the existence of a private law duty of care and an over-arching public duty beyond those that were addressed and dismissed in *Hill*, above. There are certainly no unique policy considerations that arise from a CRA investigation such that a real potential for negative policy consequences could be said to exist. Just as the Court observed in *Hill*, above, the potential for negative repercussions is dubious.

[160] In fact, the JAD investigation was not concerned with fulfilling a broader regulatory purpose involving conflicting duties of the sort described in *Los Angeles Salad Co v Canadian Food Inspection Agency*, 2013 BCCA 34, 40 BCLR 5th 213. In that case the attempt to impose a duty of care upon food inspectors to food retailers was said to create an untenable conflict with the paramount interest in protecting public health. Similar concerns about balancing the private interests of individuals while attempting to regulate in the public interest were expressed in *Ernst v Alberta Energy Regulator*, 2017 SCC 1, [2017] 1 SCR 3, *R v Imperial Tobacco Canada Ltd*,

2011 SCC 42, [2011] 3 SCR 45 and *Edwards v Law Society of Upper Canada*, 2001 SCC 80, [2001] 3 SCR 562. Accordingly, even in a situation where a public agency or official knows that a lack of care in the performance of public duties may create a risk of harm to third parties, a private law duty of care to those parties will rarely, if ever, be recognized: see *Cooper*, above.

[161] In contrast to the above authorities, the JAD investigation was simply an exercise of fact-finding and law enforcement. Beyond its deterrent value, a special investigation of this sort does not involve the application of any particular public policy or the exercise of a broad public interest discretion. It also serves no direct tax collection purpose.

[162] I find that what went on in the JAD investigation was equivalent to a police investigation leading to the laying of charges and a prosecution under the *Criminal Code* for fraud. As such the reasoning in *Hill*, above, applies. I, therefore, adopt and adapt the following statement taken from *Hill* describing the standard of care to be applied in this case:

> 73 I conclude that the appropriate standard of care is the overarching standard of a reasonable [CRA investigator] in similar circumstances. This standard should be applied in a manner that gives due recognition to the discretion inherent in [a CRA] investigation. Like other professionals, [CRA investigators] are entitled to exercise their discretion as they see fit, provided that they stay within the bounds of reasonableness. The standard of care is not breached because a [CRA investigator] exercises his or her discretion in a manner other than that deemed optimal by the reviewing court. A number of choices may be open to a [CRA investigator] investigating a crime, all of which may fall within the range of reasonableness. So long as discretion is exercised within this range, the standard of care is not breached. The standard is not perfection, or even the optimum, judged from the vantage of hindsight. It is that of a reasonable [investigator], judged in the circumstances prevailing at the time the decision was made — circumstances that may include urgency and deficiencies of information. The law of negligence does not require perfection of

> professionals; nor does it guarantee desired results (Klar, at p. 359). Rather, it accepts that [CRA investigators], like other professionals, may make minor errors or errors in judgment which cause unfortunate results, without breaching the standard of care. The law distinguishes between unreasonable mistakes breaching the standard of care and mere "errors in judgment" which any reasonable professional might have made and therefore, which do not breach the standard of care…

[163] The CRA relies in the Ontario Court of Appeal decision in *495793 Ontario Ltd (Central Auto Parts) v Barclay*, 2016 ONCA 656, [2016] OJ No 4615, for the proposition that expert testimony will usually be necessary to determine the content of the standard of care in a case of alleged police investigative negligence.

[164] According to the decision in *Barclay,* above, the general rule requiring expert evidence is subject to two exceptions: for non-technical matters of which the ordinary person may be expected to have knowledge and for conduct that is so egregious that it is obvious that the standard of care has not been observed.

[165] In this case, no expert evidence has been tendered by Messrs. Deacur and Gordon to explain where the theory of the CRA investigation came up short, or more importantly, how JAD's methods arguably conformed to generally accepted accounting practises in relation to SR&ED claims. That failure does not prevent the Court from examining non-technical investigative lapses but it is a real concern where Messrs. Deacur and Gordon assert that the CRA investigators misapplied the ITA and failed to understand that their methods fell within the bounds of the law.

[166] Having found that a cause of action framed in negligence is theoretically available to the Plaintiffs, I will next address their specific allegations of investigative misconduct.

X. The Legal Significance of the TOM II Manual

[167] Messrs. Deacur and Gordon contend that the CRA investigators failed to apply or misapplied several procedural steps set out in the TOM II Manual and that these errors are proof of malice and negligence. Their process concerns do not, however, cast doubt upon the substantive reliability of the evidence that was amassed by CRA investigators and which supported of the laying of charges. As noted already in these reasons, Messrs. Deacur and Gordon do not dispute or deny the methods they employed in support of their clients' SR&ED claims. What they dispute is the reasonableness of the CRA's characterization of those methods as fraudulent. In the result, the correction of these process "errors" would not have meaningfully altered the course of the investigation or its outcome. Indeed, the requirement for a causal link between an investigative error and the outcome of the investigation is a significant liability limitation. There is, after all, no tort of "unfairness". Mistakes or errors of judgment occurring in the course of a complex CRA criminal investigation are to be expected. As the Court observed in *Hill*, above, no criminal investigation will be perfect and not every lapse or series of errors will constitute actionable negligence. Furthermore, a criminal investigation inevitably involves uncertainty based on memory issues or other unanticipated evidentiary weaknesses. That is why investigative conduct must be examined on the strength of what the investigators reasonably believed at the time about the strength of the case and not with the benefit of hindsight or the outcome of the prosecution. This point was recently addressed in *Samaroo v Canada Revenue Agency*, 2019 BCCA 113 at para 44, 20 BCLR 6th 107:

> [44] First, a trial judge must take care in retroactively viewing the facts because the way in which evidence at a criminal trial develops may shed a different light on the circumstances known at the time the prosecution was initiated. This is particularly important when issues of credibility are involved, since it is inherently difficult to predict how the ultimate trier of fact may assess evidence. Evidence may emerge in unpredictable ways, and so on, as explained in *Miazga* at para. 76.

Furthermore, a negative inference cannot be drawn from the bare fact that charges are stayed: see *Wong v Toronto Police Services Board*, [2009] OJ No 5067 at para 60, 183 ACWS 3d 89, *Miazga v Kvello Estate*, 2009 SCC 51 at paras 75-76, [2009] 3 SCR 339, and *German v Major*, 1985 ABCA 176 at paras 21-22, 20 DLR 4th 703.

[168] Of additional significance is that many of the Plaintiffs' asserted process errors did not run afoul of the TOM II Manual guidelines which throughout recognize the need for flexibility and call for the exercise of discretion. At the time of the JAD investigation, the TOM II Manual also focussed on investigations of taxpayers and not tax preparers. In the result many recommended procedures had no direct application to the JAD investigation: see Ms. Northey's testimony at p 5954. Furthermore, the TOM II Manual is a set of guidelines that have no binding legal effect and their breach is not evidence per se of a wrongful prosecution or negligence: see *R v Eddy*, 2016 ABQB 42 at paras 138-139, [2016] AJ No 131 and *R v Maleki*, 2007 ONCJ 186 at para 11, 73 WCB 2d 606. The same is true for the CRA Declaration of Taxpayer Rights which is nothing more than a set of aspirational principles. Notwithstanding the above, I will address each of the Plaintiffs' process concerns.

XI. The Failure to Interview Messrs. Deacur and Gordon

[169] The Plaintiffs assert that the CRA investigators failed in their duty to interview them to obtain their side of the story before laying charges. The factual part of this assertion is technically correct. The CRA's last communication to Mr. Deacur before the laying of criminal charges only indicated that a recommendation had been made to the Department of Justice to prosecute the "alleged fictitious management fees and inflated wages" and that he would be notified of the decision [Exhibit D-115]. Mr. Gordon received no advance warning of likely charges. In the roughly 2-year period between the start of the investigation and the recommendation to bring charges, neither Mr. Deacur nor Mr. Gordon was asked for an explanation.

[170] There was at the time, however, no obligation to interview the subject of a CRA investigation before the laying of criminal charges and there can be valid reasons not to do so in particular cases. This point is addressed in a 1994 memorandum from CRA Special Investigations in CRA headquarters in Ottawa [Exhibit P-19], stating that the Chief of Special Investigations has the option of deciding whether or not to conduct a final interview. One stated reason for not conducting a final interview is that the subject is aware of all the facts. One other weakness to the Plaintiffs' argument is that the focus of much of the TOM II Manual is on taxpayer investigations and has no direct application to an investigation involving tax preparers. According to Mr. Michal, the TOM II Manual was a guideline and a certain amount of creativity was required in its application. In the JAD investigation most of the subject taxpayers were interviewed and provided signed or sworn statements. Furthermore, as the Alberta Court of Appeal noted in *German*, above, at para 41, it would be a "remarkable proposition that the only

reasonable way to investigate a crime is to put the prosecution case to the accused before charge and ask for an explanation". The same point was made in *Wong*, above, at para 59:

> 59 A police officer need not exhaust all possible avenues of investigation or inquiry, or interview all potential witnesses, prior to making an arrest. Nor is a police officer required to obtain the accused's version of events or otherwise establish that the accused has no valid defence before being able to form reasonable and probable grounds.

[171] The same point is made in *Barclay*, above, at paras 51-52:

> [51] The function of police is to investigate incidents which might be criminal, make a conscientious and informed decision as to whether charges should be laid and present the full facts to the prosecutor: *Wong*, at para. 56. Although this requires, to some extent, the weighing of evidence in the course of investigation, police are not required to evaluate the evidence to a legal standard or make legal judgments. That is the task of prosecutors, defence lawyers and judges: *Hill*, at para. 50.
>
> [52] Nor is a police officer required to exhaust all possible routes of investigation or inquiry, interview all potential witnesses prior to arrest, or to obtain the suspect's version of events or otherwise establish there is no valid defence before being able to form reasonable and probable grounds: *Kellman v. Iverson*, [2012] O.J. No. 2529, 2012 ONSC 3244 (S.C.J.), at para. 16; *Wong*, at para. 59.

[172] Furthermore, nothing prevented Mr. Deacur or Mr. Gordon from seeking clarification of the CRA's concerns or asking for a meeting with the investigators to justify their methods. Mr. Deacur was represented by counsel and, if he was truly perplexed about why he was under investigation, he or his counsel could have requested a meeting. Under cross-examination, Mr. Deacur acknowledged that he took no such step [transcript pp 2127-2129]. I do not accept as an excuse for this failure Mr. Deacur's bare assertions that "there was nobody to ask" [p 2127] and the investigators "didn't care to know what we were going to say" [transcript p 2130]. During the course of the investigation, he had no basis to make such an assumption. In fact,

Ms. Northey testified that she spoke with Mr. Deacur and his counsel a number of times during the investigation and not once did they attempt to explain or justify JAD's methods [p 5983 and p 5135]. On one occasion when Mr. Gordon did write to the prosecutors, his complaints amounted to nothing more than an unfocussed rant about Ms. Northey [Exhibit P -163].

[173] The suggestion that Mr. Deacur was left completely in the dark about the CRA's concerns is also not borne out by what he knew when his clients' SR&ED claims were being prepared and submitted. In a number of cases, he received negative feedback from clients and from his own staff about the propriety of some of the methods being used and about the CRA's reactions to those methods.

[174] In the case of Martinville Hockey Sticks Inc., JAD prepared alternate SR&ED claims for the client's consideration. One of those options was more aggressive than the other [Exhibit D-127]. In September 1994, the client advised Mr. Deacur that the CRA auditor was troubled by the more aggressive approach involving the use of "a holding company and inflating the wages" [Exhibit D-130]. Some care is required in the treatment of this evidence because it is inadmissible for the truth of its contents (i.e. whether the stated concerns were valid). It is, however, relevant to the issue of Mr. Deacur's awareness in 1994 of potential problems with his SR&ED methods and his contention that he had no idea about what was of concern to the CRA at that time.

[175] There is also an internal JAD memo dated December 8, 1994 referring to a meeting with a CRA tax avoidance auditor concerning the Clare Works' SR&ED claim. That memo referred

to a problem with "simultaneity" and the fact that "no contracts exist for the inter-company changes". The author of the memo concluded with the following warning:

> D. ALLAN'S IMPRESSION:
>
> My limited understanding of the tax implications colour my impression. However, in view of the unstable nature of the client and the tax avoidance auditor's strong assertions, pursuit of the claim will undoubtedly take us down a lumpy road. [Exhibit D-131]

[176] On February 20, 1996, the solicitor for Pinnco Elevator Industries Limited advised Mr. Deacur that, having reviewed the SR&ED claim with the CRA auditors and "on the advice of counsel", the claims were withdrawn in their entirety [Exhibit D-132].

[177] John Savelli was sufficiently nervous about the JAD approach to the preparation of an SR&ED claim for Signet Marketing Inc. that he tape recorded his discussion with Mr. Deacur and Wayne Small on January 31, 1994. In the course of that conversation, the following concern was raised:

> What they are checking is that yes you billed this and is this reasonable and is this accounting practice acceptable.
>
> So in essence what he is saying is that at some point, we could be checked and that they are going to take me off in handcuffs. He didn't say it like that, but that's what he implied, he didn't say anything thing [sic], Paul [Yanover, the Signet accountant] is very selective in what he said, he at no point said that there is any fraud, but he definitely implied that this didn't look kosher.
>
> WS – What Jim's experience has been in the past is that most of these individuals are brain dead.
>
> JS – This is for my personal usage of course. [Exhibit P-26]

[178] The issue of a potential fraud in connection with the Signet Marketing Inc. SR&ED claim was also raised in correspondence between Mr. Deacur and Mr. Savelli in early 1994. In Exhibit D-122, Mr. Deacur answered Mr. Savelli's apparent concerns from an earlier letter. Mr. Deacur responded in the following way:

> 5. Since the tax credit is not processed on a self assessing basis but must be audited twice by Revenue Canada I don't see the basis for the question. If a fraud has been committed and that is the reason for any future required to repay, I would have to answer for my involvement but I would assume no responsibility for your actions if they were constituted to be fraudulent.

[179] CRA audit concerns about the authenticity of the contract or management fees being claimed by JAD clients were also brought to the attention of JAD representatives albeit without the auditors' full understanding of what was going on: see Exhibits D-61, D-168 and D-183.

[180] A 30-day letter was sent to JAD on November 13, 1997 to the attention of Mr. Deacur [Exhibit D-115]. It did not identify the party or parties who were the subject of potential charges beyond the obvious inference that JAD was a target. Mr. Gordon complains that he was not specifically informed that he was a target of the investigation. However, Mr. Gordon was a part owner of JAD and was instrumental in the JAD's development of the SR&ED methodologies. He would certainly have been privy to Jacques Belanger's letter to JAD and it could not have come as much of a surprise to either Mr. Deacur or Mr. Gordon when they were personally charged.

[181] Finally, Ms. Northey gave a very reasonable explanation as to why she did not interview Mr. Deacur: see p 5244-5245. Mr. Gordon was not invited for an interview because the decision

to charge him was made in consultation with Department of Justice counsel after the investigation was effectively over [p 5557 and p 5815-5816].

[182] Against this evidence I reject the Plaintiffs' contention that they had no idea about the nature of the CRA's concerns about JAD's methods and that the investigation would most assuredly have come to an end had they only been given an opportunity to explain. Such an interview would most likely have led to the magnification of the CRA's concern and not its elimination. If Messrs. Deacur and Gordon had a valid exculpatory explanation for their actions and methods, it is inexplicable that it was never articulated to the CRA or to the prosecutors nor was one offered up in the form of a plausible explanation during this trial.

XII. The Failure to Reassess

[183] Much the same problem arises from Mr. Deacur's complaint that the CRA ought to have reassessed the impugned SR&ED claims before criminal charges were laid. According to Mr. Deacur, this failure was in breach of the TOM II Manual where it was stipulated that taxpayer reassessments are to be carried out before the laying of charges. This provision, however, is based on the need to assess penalties against a taxpayer and has no obvious connection to the investigation of a tax preparer. Mr. Michal's evidence indicated that this purpose would not have been served by a reassessment of the JAD clients' SR&ED claims [p 969 and p 971]. Ms. Northey did ask, before taking maternity leave, that reassessments be completed for several of the impugned claims; but this was the responsibility of the auditors and not the investigators and her request was apparently not met. Ms. Northey also testified that it

was not a requirement to do reassessments in advance of a criminal prosecution because under the ITA the Minister can reassess at any time [Transcript p 5918]

[184] Although the CRA did elect to hold certain JAD client Notices of Objection in abeyance pending the completion of the criminal case, the option of taking those cases directly to the Tax Court remained. Notices of Objection could also have been filed for any of the SR&ED claims that were the subject matter of the criminal charges and those, too, could have been taken directly to the Tax Court. No appeals were taken by JAD on behalf of any clients until after the charges were stayed.

[185] If Messrs. Deacur and Gordon honestly believed that all of their methodologies were consistent with generally accepted accounting principles, their failure to present a case for early independent judicial adjudication is difficult to understand and undermines this TOM II Manual process concern. Presumably, one or more of the Deacur clients would have cooperated with early appeals because some Notices of Objection were ultimately dealt with on appeal.

XIII. The Failure to Transfer the JAD Investigation to the RCMP

[186] The Plaintiffs' complaint that the TOM II Manual required the CRA to turn this type of investigation over to the RCMP is equally without merit. The applicable provision did not require a referral to the RCMP and the CRA practice was generally to keep technical tax investigations in-house. It is also doubtful that the RCMP had the required SR&ED expertise to assume conduct of the JAD investigation. For that reason and for reasons of confidentiality, the TOM II Manual indicated that the initial referral of tax refund cases ought to go to CRA Special

Investigations and not to the RCMP. Ms. Northey testified that the CRA generally only referred cases to the RCMP where a forensics analysis was required (eg fingerprinting, document forgeries, etc.) [p 5427].

XIV. Intimidation of Witnesses

[187] The repeated allegation that CRA investigators intimidated witnesses is contradicted by the testimony of the investigators who were involved in that exercise. For example, Paul Porteous testified that he interviewed about 30 witnesses. No one declined an interview or asked to end an interview because of feeling uncomfortable [p 4677]. He described the process as follows:

> Q. And then what do you do next in terms of preparing the stat dec after you have written all this information down?
>
> A. Well, first of all, I would ask if they wanted to sign a statutory declaration. And then I would move to writing down or taking my notes and formulating them into a statutory declaration based on their words. So, basically, I was taking their words from my notes and putting them down on a statutory declaration for income tax purposes.
>
> Q. And then once you put those words down onto a statutory declaration, what happens next?
>
> A. Well, then I -- basically what I would do is I would have the individual or the claimant read the statutory declaration, make any changes they wanted to make, cross things out. It was their statutory declaration. It was all their words, not mine. So they could change it if they wanted. Then they would sign it if they wanted, which everybody did. And then that would be taken with the file back to the office and would be turned into -- I guess it would be Art Payne or Patti Northey or my boss, Dave McFarlane. [pp 4678-4679]

[188] Mr. Porteous was asked under cross-examination by Mr. Deacur about two instances of JAD client interviews where the witnesses were not completely forthcoming. His notes from

those interviews suggest that some pressure may have been applied to encourage a greater level of cooperation. There is nothing about the exchanges, however, that remotely suggests that these witnesses provided anything other than truthful evidence. In any event, in the conduct of a criminal investigation persuasive questioning or strategies to elicit cooperation are to be expected. The process is, after all, not a tea party. No witness was compelled to answer questions but an uncooperative third party witness could be subjected to a requirement to produce [p 4859].

[189] Mr. Porteous was asked to review the content of several witness statements he had taken in the course of the JAD investigation. Those statements described in detail the backdating methods that JAD representatives had employed. Many involved the use of after-acquired shell companies and fictitious invoices in support of the inflated management fees. Mr. Porteous expressed the view that these methods were "to say the least, it's dubious" [p 4685].

[190] In some instances JAD clients told Mr. Porteous that they were sufficiently troubled by JAD's methods that they declined to proceed [pp 4706, 4710, 4744 and 4749]. At least one JAD accountant told Mr. Porteous that he was uncomfortable with JAD's practices [pp 4741-4743]. Mr. Porteous believed that JAD's methods were fraudulent [p 4749].

[191] Mr. Ferguson, who accompanied Mr. Porteous to several client interviews, described Mr. Porteous as direct with his questioning but polite [p 4049].

[192] There is simply nothing in the evidence to establish that witnesses were intimidated by CRA investigators. Although some taxpayers were notably uncomfortable about being drawn into a criminal investigation that reaction can be attributed more directly to JAD's aggressive accounting methods than to the enquiries of the CRA officials who were lawfully examining their SR&ED filings.

XV. Mr. Deacur Said to be Volatile

[193] In a letter dated July 3, 1996 [Exhibit P-24], Mr. Michal requested RCMP assistance in the execution of search warrants at four locations occupied by JAD. In that letter, Mr. Michal justified the need for RCMP involvement by stating that Mr. Deacur was "known to be volatile". Under questioning, Mr. Michal admitted that he had no basis to characterize Mr. Deacur in this way. His explanation for having done so was that the RCMP would not routinely assist the CRA in the execution of search warrants unless additional justification was provided.

[194] It is clear that Mr. Michal held no reasonable belief that Mr. Deacur presented any risk and it was inappropriate to mischaracterize Mr. Deacur in this way for the purpose of achieving an administrative benefit.

[195] At the same time, this event does not suggest that the CRA's investigation was carried out for some improper purpose or, more specifically, that the JAD search warrants were unlawfully obtained or executed. Whether or not the presence of the RCMP was justified says nothing about the reliability of the evidence that the investigators obtained during these judicially authorized searches.

XVI. Alleged Mixing of the CRA Audit Function and the Special Investigations

[196] The only evidence before me of supposed mingling of CRA audit work and the JAD investigation concerns the presence of auditors and investigators at some meetings with JAD clients. In some of those situations a JAD representative was present and was prudently and appropriately given a Charter warning. Those meetings took place after the search warrants were executed and involved client interviews conducted by the investigators. There is no evidence to establish that the presence of a CRA auditor tainted the process and, even if it had, the problem would be relevant only to the criminal prosecution and not to the issues arising in this proceeding. There is simply no evidence that CRA investigators were attempting to exploit auditing authority as a means of obtaining evidence in support of a pending prosecution.

[197] Messrs. Deacur and Gordon argue that in at least one case (Permalite) Special Investigations directed CRA auditor, Paul Porteous, to deny a JAD claim in full [Exhibit D-378]. This, they say, is proof of an improper purpose and an inappropriate level of interference in the audit functions by the investigators. Mr. Porteous was asked about his audit note and he explained it in the following way:

> Q. Again, I am going to direct your attention back to the statement next to "audit concerns".
>
> "Special investigations has requested the file put through and the claim disallowed in full." [as read]
>
> Who wrote this notation?
>
> A. I did.
>
> Q. And could you please explain for me why you wrote this notation on your T20 auditor's report?

A. Yes. When I looked at the file in front of me, which was Permalite, a 1994 claim, I saw information from Jeff Weryho. And I consulted my then supervisor -- Mr. Hill's passed away since -- and he suggested, and I suggested to him as well, that I go down to special investigations because the draft copy of Mr. Fiannaca, the president of Permalite, was drafted as -- a statement was in the, in the file along with a notation that I believe of what special investigations had done or were doing.

So I took it upon myself to go down to the special investigations section and discuss with Mr. Weryho. Mr. Weryho informed me that, yes, this is part of the years that were under investigation. This claim for '94 was not filed until 1996, I believe. And that's why I ended up with it because it came in late, and it was not part and parcel of the investigation at that point, I assume. I was not in investigations at that time, so I can't really tell you whether it was or wasn't.

But from my point of view as an auditor for R&D, I went down and discussed this with Mr. Weryho. Mr. Weryho told me this is part of the file and suggested that the claim be disallowed as it was part of all the other claims, the other years that were already under investigation.

So I went back before my supervisor that this was, in fact, under investigation. So I was told to disallow in full the claim and to refer to special investigations, and then the file -- when I put the file through, I made a notation, I put a notation on it within the folder to the data centre to process the revised T2SA and revised claim, and then if there was any information or if there was any questions, to refer to Patti Northey, the lead investigator of the case, in special investigations because I really had no business auditing it. It was, that's why, in part, it became a desk review.

…

Q. And so at the conclusion of this desk audit, can you please tell me what, if any, instructions you received to disallow the claim?

A. Well, as I said, it was Jeff, Mr. Weryho and I discussed with the claim, and he said, he suggested it be disallowed. I talked with -- I went back up to our area, I talked with my then-supervisor, Keith Hill, and he agreed. And I said that was my feeling, and then I disallowed it. [pp 4758-4760; p 4763]

[198] Having heard Mr. Porteous, I am satisfied that the above evidence accurately describes his interaction with investigator, Jeff Weryho, and that it was ultimately Mr. Porteous who decided how to proceed. To the extent that Keith Hill's preliminary hearing testimony may differ, I prefer Mr. Porteous' recollection. Mr. Hill was not directly involved with Mr. Weryho and his evidence was second-hand. In any event, this is a minor audit issue that in no way detracts from the work of the investigators.

[199] Mr. Porteous also testified that in the course of his audit work he had no involvement with Ms. Northey [p 4768].

[200] It was, of course, open to the taxpayer to appeal Mr. Porteous' audit decision up to the Tax Court if it was believed to be unjustified.

XVII. The Theft of Ms. Northey's Vehicle and Investigative Records

[201] Messrs. Gordon and Deacur argue that Ms. Northey was negligent by leaving some records in her vehicle while it was parked overnight at her home. The vehicle was stolen but recovered the next day. Ms. Northey testified that all of the missing records were similarly recovered [pp 5866-5867]. This event has no relevance to any issue arising in this case and it is specious to suggest otherwise.

XVIII. Failure to Supervise

[202] Messrs. Deacur and Gordon have repeatedly alleged and testified that Ms. Northey was on an unsupervised and malicious frolic completely unmindful of her legal duties. On other

occasions they have said that what happened to them was the result of a conspiracy among many CRA officials to pursue a malicious investigation and prosecution.

[203] The suggestion that Ms. Northey was left unsupervised and that this was acknowledged by her two supervisors is false. In fact, the evidence discloses that Ms. Northey's work and the work of the other assigned investigators was throughout vetted and approved by senior CRA officials.

[204] Mr. Michal testified that although he did not assume day-to-day supervisory responsibility for the JAD investigation, he remained closely involved with it until he left the Hamilton office in 1998. The documentary record also bears this out. Mr. Michal and many other senior CRA officials were parties to a considerable number of reports dealing with the JAD investigation [see, for example, Exhibits D-48 to D-57, D-306 to D-310, D-313, D-315, D-318 and D-325].

[205] Mr. Michal, David McFarlane and Brian Dawe all approved Ms. Northey's Primary Report in June 1996 before it was vetted at CRA headquarters in Ottawa. That report addressed the following concerns:

> Interviews were conducted with each auditor who worked on a file with James A. Deacur & Associates Ltd. as the tax-preparer in order to obtain information relating to the audits that were conducted on the client's SR&ED claims. These claims included the 1990, 1991, 1992, 1993, 1994 and 1995 fiscal periods of the clients.
>
> It was noted from these interviews that there were common concerns regarding the SR&ED claims filed. One of the concerns centered on the use of management fees to inflate SR&ED expenditures. The management fees were calculated based on the

hours that the shareholders were involved with the SR&ED activity multiplied by an arbitrary dollar per hour figure. These management fees were payable to related corporations. In most cases, the amounts were accrued, but were never paid.

It appeared that there was no mechanism for the payment of the management fees, in some cases. The related corporations appeared to be shell corporations. These corporations did not have any books and records. They did not have bank accounts and did not appear to have any business activity. The corporations did not have any employees, and did not pay any salaries. The related corporation had never paid the shareholders any money. It appeared that they existed for no other reason than to facilitate the claiming of the management fees for SR&ED purposes.

In some instances, the related corporation did not report the management fee in their income. If they did report the management fee income, they charged back a management fee expense to the original corporation. This allowed for a non-taxable position in both the corporations.

In the majority of cases, the fiscal year end of the related corporation was one or two months prior to the fiscal year end of the corporation making the SR&ED claim. This allowed for a ten to eleven month delay between the filing of the T2 tax return for the original corporation and the filing of the T2 tax return of the related corporation. Due to the time constraints of the SR&ED program, the auditors did not have any opportunity to follow up with the related corporation to ensure that the management fee was reported.

If the client did not have a related corporation prior to entering into the contract with James A. Deacur & Associates Ltd. or Tibor Gribovsky Company Limited, a corporation was provided.

Another concern was that the wage amounts used for the claims were inflated. Arbitrary figures were used to claim wages instead of using the amounts the employees were paid or T4’d. The shareholders calculated the hours they spent on SR&ED, and a representative at James A. Deacur & Associates Ltd. would multiply the hours by a fair market value determination of the wages. This fair market valuation was usually based on what they had to pay an outside consultant for the SR&ED. These inflated wages were never paid to the employees or the shareholders. These amounts were not T4’d and were never included in income on the shareholder’s T1 tax returns.

[206] Ms. Northey's draft Information for search warrants was sent to the Special Investigations Directorate at CRA headquarters in Ottawa where it underwent a technical review. The Interim Director, R. W. Moore, wrote to Mr. Michal on July 5, 1996 approving search action. His letter reported the following:

> We have completed the technical review of the draft Information pertaining to the above-mentioned case.
>
> As our queries have been satisfactorily addressed and all recommendations have been incorporated in the draft Information, we believe that the required criteria has been met in order to obtain the necessary Search Warrants.
>
> Further, as the authority to approve search requests has been delegated to Directors of Tax Services, you are now responsible for advising your Regional A.D.M.'s office of this overt action, prior to executing the search.
>
> Upon executing the search, please provide us with copies of the Warrants and the Information approved by the Justice of the Peace along with your report of the Search. [Exhibit D-56A]

[207] It is also of significance that Ms. Northey's draft Information for search warrants contains detailed descriptions about JAD's backdating of corporate records to support the SR&ED claims prepared for a number of clients. This information was thus known to those officials who approved the requested searches [Exhibit D-149]. Many CRA investigators were then involved in the searches of JAD's offices and were told what to look for.

[208] Ms. Northey's Prosecution Report was similarly approved by Mr. McFarlane and Mr. Belanger before it went to CRA headquarters in Ottawa for further review and approval. That report disclosed the following concerns about JAD's methods:

> Management fees payable to related corporations were included in the claims for SR&ED. The management fees were based on the number of hours spent conducting SR&ED multiplied by an

arbitrary rate purported to be a Fair Market Value (or FMV) rate by representatives of James A. Deacur & Associates Ltd. This purported FMV rate was determined by representatives of James A. Deacur & Associates Ltd., through discussions with the clients. The rate was ususally [sic] based on an outside consulting rate. (i.e. The rate at which the client could bill their services to a third party.) These fees were never incurred. They were not incurred in the normal course of business.

The related corporations would bill a management fee for SR&ED services to the principle corporation which filed the SR&ED claims. In essence, it appears that the related corporation was conducting the SR&ED and billing a management fee to the principle corporation for the service.

However, these related corporations did not have any employees to conduct the SR&ED activities. They did not have any bank accounts, nor did they have any books and records.

These related corporations were shell corporations. In most instances, the corporations did not exist for the principle company during the time that the SR&ED activities were carried out. The corporations came into existence after the owners of the principle corporations had met with a representative of James A. Deacur & Associates Ltd. The related corporations were obtained from James A. Deacur & Associates Ltd., or the client obtained the related corporations from other sources, based on the advice received from representatives of James A. Deacur & Associates Ltd.

…

In some cases, the related corporations included the management fee in income for tax purposes. Where this occured [sic] the related corporation charged back an administrative fee to the principle corporation. The dollar amounts of both the management fee for SR&ED services and the administrative fee charged-back to the original company were the same or slightly different. As a result of this charge-back, no taxes were owing in the related corporation, and there would have been little or no effect on the taxes owing in the principle corporation.

…

Where the management fees have been claimed, corporate documents (i.e. share certificates, Minute Book documentation such as Minutes of Shareholders meetings, etc.) have been back-

> dated to legitimize the related corporation. Further, fictitious invoices have been prepared by the representatives of James A. Deacur & Associates Ltd. and provided to the SR&ED auditors to support the management fees.
>
> It appears that the only purpose of the related corporation was to be a vehicle by which SR&ED expenditures could be inflated in order to obtain more Investment Tax Credits through the SR&ED claim.
>
> Attached as Appendix I is a lime line of events that led to the filing of SR&ED claims for Bale-Eze Inc., a client of James A. Deacur & Associates Ltd. This provides an example of how the alleged fraud is carried out and is representative of a file prepared by James A. Deacur & Associates Ltd. on behalf of a client that claims fictitious management fees for SR&ED purposes. [Exhibit P-101]

[209] Ms. Northey's Information in support of the criminal charges was drafted in close consultation with the assigned Crown prosecutor. According to Mr. Michal the ultimate authority to lay charges rested with the Department of Justice [p 1002].

[210] Far from leaving Ms. Northey on her own, Mr. Michal continued to be involved. He testified that he considered the JAD investigation to have a high priority and he directed that additional investigative staff be assigned [Exhibit D-53 and testimony at pp 1032-1034]. In the result most of the statements from witnesses were taken by investigators other than Ms. Northey – some 12 investigators in all. Those investigators were aware of the CRA theory of the case.

[211] Mr. Michal testified that he had responsibility for Ms. Northey [p 976] and was receiving regular updates from her including her monthly case plans [p 992, p 994 and Exhibit D-50]. He stated he had no concerns about her work [p 998].

[212] Mr. McFarlane testified for the Plaintiffs. He was Ms. Northey's immediate supervisor. His memory was poor with respect to the extent of his interactions with Ms. Northey but he confirmed he was available to her in an advisory capacity and reviewed certain documents she prepared [pp 2590-2591]. He thought that Ms. Northey was, at some point, reporting directly to Mr. Michal [p 2594]. This was consistent with Ms. Northey's evidence. He confirmed he reviewed the Prosecution Report and the various witness reports along the way [p 2598]. He also corroborated Mr. Michal's evidence about the extent of head office involvement in the investigation [p 2657]. At no time did he testify that Ms. Northey was unsupervised. He also had no concerns about the contents of the Primary Report or the Prosecution Report after reading them [p 2703 and p 2730]. As far as he knew, Ms. Northey followed the required protocols in the conduct of the JAD investigation [p 2731].

[213] What is clear from the evidence is that Ms. Northey's concerns about JAD's backdating of corporate records were not unique to her and they were not hidden from the several senior Special Investigations officials who gave their approvals to take the investigation further.

[214] Ms. Northey's evidence also established that she consulted widely with other CRA officials as she went forward with the JAD investigation. Numerous CRA officials were also actively and directly involved in the investigation.

[215] In June 1996, Ms. Northey consulted with an SR&ED specialist in Ottawa to discuss SR&ED principles for inclusion in the Primary Report and received no negative feedback [pp 5063-5064]. The Primary Report was prepared after 14 JAD clients had been interviewed

[p 5069] so it was by no means a comprehensive summary of the ultimate case. Its primary purpose was to support an application for search warrants. Ms. Northey described it in the following way:

> A. Yes. A primary report needs to be prepared whether we move the file to full scale or not. And it's a summary of all the actions that we have taken on the investigation to date. It's also a summary of all the information we obtained through interviews, through the auditors, how the investigation came about, what was the genesis of the investigation, what investigative steps have we taken to date and also what are the conclusions are based on the information that we obtained.
>
> So that is the primary report. That's a head office document that we send up to them so they have a briefing on what we have done to date, what the issues are and what the allegations are.
>
> And so at also forms the basis if it's decided that we are going to do an information to obtain to secure the records relating to the offences alleged in the primary report and the ITO that we seek to obtain a warrant.
>
> But a primary report is prepared at that stage of an investigation whether we continue on with a full scale investigation or whether the investigation stops at that time. [p 5065]

[216] After receiving head office approval to continue the JAD investigation, Ms. Northey prepared an Information to obtain warrants to search JAD's offices. That document was reviewed by her colleague, Art Payne, and her immediate supervisor, Mr. McFarlane [p 5072]. It was then sent to head office for a technical review. At that stage, Ms. Northey consulted with CRA head office official Tom Sprysa who provided feedback and approval [p 5072]. The Information was also approved by the Chief of Investigations, Mr. Michal, and by the Director of Tax Services, Mr. Dawe [Exhibit D-57]. On July 5, 1996, Ms. Northey filed her application for search warrants in Burlington and the warrants were issued by a Justice of the Peace on July 9, 1996. The warrants were valid for one week. Searches were then conducted on July 10th at four

authorized locations involving four search teams. Numerous records and computer hard drives were seized and inventoried.

[217] Ms. Northey testified that, although Special Investigations wanted to hold any ongoing taxpayer audits in abeyance, the responsible auditors decided to continue their work [p 5094]. This raised a potential concern about an overlap in functions where the auditors could be expected to interact with JAD representatives. Ms. Northey sought advice from head office and from the Department of Justice [p 5096, p 5136 and p 5146]. She also asked the auditors not to discuss the JAD investigation with JAD's clients [p 5117].

[218] After the search warrants were executed, Ms. Northey had a number of discussions with Mr. Deacur's lawyer and with Mr. Deacur. According to Ms. Northey, those discussions presented Mr. Deacur with an opportunity to validate JAD's methodologies but no explanations were offered:

> Q. And during this meeting, did Mr. Shekter present to you any defences or any arguments about the Income Tax Act permitting these kind of transactions?
>
> A. No, he did not. I had many conversations with Mr. Shekter and letters from Mr. Shekter during this time, and I also had conversations with Mr. Deacur during this time. And none of either Mr. Deacur or Mr. Shekter put forward any, you know, any explanations about what they were doing, that they thought it was allowed.
>
> Mr. Shekter's concerns, at this point in time, is about the scope of the investigation. [p 5135 and also see p 5164]

Mr. Deacur did, however, express a concern about the speed of the investigation and questioned the need to hold JAD's records. After a meeting in October 1996 with Mr. Michal,

Mr. McFarlane and Mr. Payne, more investigators were assigned to the case [pp 5143-5144 and p 5148].

[219] In January 1997, Ms. Northey went on maternity leave and the investigation was taken over by Bill Williams. The basis of the CRA's concern about JAD's methods was summarized in an affidavit sworn on June 4, 1997 by Mr. Williams in support of an application for further detention of seized records [Exhibit D-411]. Mr. Williams' affidavit summarized the CRA case in the following way:

> 6. To date 114 clients of Deacur who made SR&ED claims, have been assigned to the investigators and of those clients assigned, 92 have been interviewed.
>
> 7. It has been determined, that of the clients that have been interviewed to date as outlined in paragraphs 6 above, 38 have claimed management fees to a related corporation for SR&ED purposes. Of these related corporations, 20 have been provided to the clients by Deacur. Of the 20 provided by Deacur, it has been determined that 13 of the related corporations:
>
> a) were provided to the client after the client entered into a contract with Deacur;
>
> b) the corporation claiming the SR&ED did not own the related corporation when they conducted SR&ED;
>
> c) share certificates to support the ownership of the related corporation were back-dated prior to the SR&ED taking place;
>
> d) invoices that were provided to support the SR&ED expenditures from the corporation claiming the SR&ED to the related corporation were back-dated to when the SR&ED took place.
>
> 8. Further, it has also been determined, that of the clients that have been interviewed to date as outlined in paragraphs 6 above, 27 have claimed amounts, identified as "inflated

> wages", which grossly exceeded the actual hourly rates paid and reported on the T-4 Employment Slips of employees and managers assigned to the projects for SR&ED purposes.
>
> 9. The findings of the investigation to date indicate that there is an ongoing pattern of Deacur providing corporations to clients in order to facilitate the claiming of management fees as outlined paragraph 7 above and the claiming of inflated wages as outlined in paragraph 8 above.

[220] Ms. Northey did not return to work until September. Shortly after returning, Ms. Northey met with Mr. Williams and Mr. Payne to review the status of the investigation. She was tasked with preparing memos for Mr. Sprysa and the Director of the SR&ED tax incentives program, Mel Machado – both of whom were working at CRA headquarters in Ottawa [Exhibits D-414 and D-415].

[221] As the lead investigator, it fell on Ms. Northey to prepare a Prosecution Report outlining the evidence and the theory of the case [Exhibit P-101]. Included with the Prosecution Report were 88 witness reports [Exhibit D-418]. Ms. Northey did not, however, prepare the Prosecution Report in isolation. She testified that she discussed the content of the JAD Prosecution Report with head office officials representing Special Investigations and SR&ED [p 5196].

[222] Ms. Northey was asked to summarize the various interactions she had had within the CRA and the feedback she had been given. Her testimony was as follows:

> Q. Ms. Northey, you were working with some colleagues in Hamilton with investigations. Did you believe that you had their support for this referral?
>
> A. Yes, I did. I had talked about the case with -- throughout the investigation with Art Payne. I had talked about the investigation and reported to Mr. McFarlane during the

investigation. Mr. McFarlane and Mr. Payne were involved in a substantial amount of interviews with regard to the case. They knew the evidence firsthand, and I was involved with briefing the chief of investigations throughout the investigation as well. And, so, they all had a background and information with regard to this case, and I felt supported by them.

Q. And from time to time, you had worked with investigators from other offices as well in different stages in the proceeding in the investigation?

A. That's correct. Mike Lemmon, of the Toronto East TSO, was assigned to the Deacur investigation to assist with interviews in the eastern side of the province. And I had dealt with investigators with regard to the search warrant from other offices as well, including the information -- sorry, the informant lead which came from the Toronto West investigations office.

Q. And during the two years over which this investigation was conducted, did any of the auditors or any of the investigators that you worked with or that you reported to or that you conducted interviews with express to you any concerns about the underlying basis for the investigation?

A. No.

Q. And at various stages throughout your investigation, including at the detention hearings and at other points, you had been in touch with the Department of Justice. And without getting into solicitor-client privilege-type discussions, were there concerns that you were aware of about the approach that you were taking?

A. No. There was never expressed to me any concerns about the approach or the evidence that we had uncovered.

Q. And, as well, we have gone through at some length the various attendances that you had in court before Justice Clarke and other justices, reporting as to how the investigation was unfolding and what your steps were.

And at any point during those various attendances, had there ever been any suggestion from the Courts that the investigation was misguided or ought to stop or was not being proceeded with in a proper fashion?

A. No, there wasn't. [pp 5197-5198]

[223] Before the Prosecution Report was sent to the Department of Justice, it was reviewed by Mr. Payne, Mr. McFarlane and Mr. Sprysa. After necessary changes were made it went to the Chief of Investigations in Ottawa, Mr. Belanger, for review and approval. After that, it went to Mr. Dawe for review and approval [p 5201].

[224] In November 1997, the JAD investigation was completed and a letter was sent to Mr. Deacur advising him that the case had been referred to the Department of Justice for prosecution. The letter informed him that the proposed charges involved 140 SR&ED claims filed on behalf of 68 clients [Exhibit D-115]. Mr. Deacur's lawyer wrote to Ms. Northey complaining about the conduct of investigators in their discussions with JAD clients. The letter also threatened civil action and invited the CRA to get on with things. Notably it did not attempt to justify the JAD methodologies that were the subject of the investigation [Exhibit D-417]. Indeed, the Plaintiffs have never given a plausible explanation for how Ms. Northey could have perpetrated a legally untenable and malicious investigation without it ever being discovered by the many CRA officials who watched over it, by the Crown prosecutors who approved the charges and by the Judge who presided over the preliminary hearing and committed the Plaintiffs to stand trial.

XIX. ITA Section 239

[225] The Plaintiffs contend that Ms. Northey knew that no offence under the ITA could be made out for the filing of SR&ED claims. Notwithstanding this knowledge they say she, and presumably others reviewing her reports, maliciously continued to allege violations of s 239 of

the ITA. According to this argument, in the absence of a lawful statutory foundation, the JAD investigation was unlawful and invalid from the outset.

[226] The argument that s 239 of the ITA applies only to tax evasion cases and not to tax credit claims is not supported by the language of that provision. While it does refer to the evasion of taxes it also created an offence for making "false or deceptive entries in records or books of account of a taxpayer". This arguably applied to some of the backdated records created by JAD on behalf of its clients and could have plausibly supported a charge. The fact that s 239(1.1) was later added to specifically apply all of the s 239(1) criteria to tax credit and refund cases does not by itself detract from the potential of a s 239(1) prosecution in such cases, albeit limited to situations of falsified records. It was, accordingly, neither negligent nor malicious for the CRA to conduct its investigation with regard to potential charges under the ITA or the *Criminal Code*. In the end and after consultations between Ms. Northey and the prosecutors, the only charges laid were under the *Criminal Code*. However, Ms. Northey remained of the view that s 239(1)(a) of the ITA did apply to the extent that some of the SR&ED claims were advanced in reliance on false or deceptive records: see the testimony of Ms. Northey at p 5201. This was a reasonable position and in no way amounts to malice or negligence. The investigators had a valid legal basis for the investigation and for recommending Criminal Code charges. The fact that charges under the ITA were not brought does not establish that they could not have been brought. It was up to the prosecutors to approve the charges and they did.

XX. Deacur as a "Troublemaker"

[227] Mr. Deacur complains that the CRA considered him to be difficult to deal with and that this characterization motivated the investigation. The documentary references he relies upon, however, do not disparage his reputation. They simply draw attention to the fact that Mr. Deacur had made formal complaints in the past about the slow handling of JAD's SR&ED filings. This type of "heads up" reference is not infrequently seen in government reporting where additional precautions may be warranted going forward or where a complaint may attract political controversy. Mr. Deacur's complaints also concern his interactions with CRA officials in Ottawa and had nothing to do with the conduct of Ms. Northey or the other assigned investigators.

XXI. The Supposed Failure to Use Form T-134 to Support CRA Audit Referrals to Special Investigations and Borrowed Records

[228] Messrs. Deacur and Gordon contend that the CRA failed to follow TOM II Manual procedures by not using form T-134 to refer JAD client audit files to Special Investigations and by borrowing records from some JAD clients. Neither of these complaints supports a finding of negligence let alone misfeasance or malice.

[229] It is apparent from the evidence that form T-134 was not used to refer the many JAD client audit files to the Hamilton Special Investigations office.

[230] During the CRA Tax Preparer Task Force meeting that was convened on November 28, 1995 a decision was taken to locate the JAD investigation at the Hamilton Special Investigations

Unit under the supervision of Mr. Michal. This required the auditors in several Greater Toronto Area offices to send their audit files of concern to Hamilton.

[231] According to the testimony of the Hamilton R&D Coordinator, Marie Giallonardo, form T-134 was not used to support JAD referrals to Hamilton Special Investigations because it was not applicable to tax preparer investigations [p 4103].

[232] Mr. Michal gave similar evidence and confirmed that a decision was taken during the November 28, 1995 Task Force meeting not to require T-134s for each audit file sent to his office [p 1064]. Ms. Northey testified that file referrals came to Special Investigations by a variety of methods including the use of covering memos: see transcript at p 5444 and the evidence of Mr. Moore in Exhibit P -459, November 15, 2001 at p 105. Other evidence indicated that the purpose of form T-134 was to document the date of referrals from audit to Special Investigations to maintain a separation of those functions.

[233] It is also not clear from the TOM II Manual that form T-134 was stipulated in all cases for audit referrals. But even if it was a universally applicable recommendation, it was not legally binding. In the case of the JAD investigation a joint decision was taken not to use the form. The referrals were, however, supported by other documentation in substitution for form T-134.

[234] There is some evidence suggesting that, in a few situations, CRA investigators borrowed records from JAD clients. This may not have been a recommended practice, particularly if the documents were necessary to support a later criminal prosecution. However, there was nothing

unlawful about the practice. It was up to the clients to decide if their records could be handed over on a voluntary basis to the CRA. The Plaintiffs' characterizations of this as a form of intimidation and a theft is completely unjustified [see Plaintiffs' Post-Trial Brief at paras 477 and 646].

[235] In the case of JAD records, search warrants were used and the searches were executed lawfully and appropriately.

[236] Like all of the Plaintiffs' process complaints, these arguments fail because they are legally irrelevant to the asserted claims. There is simply no causal relationship between these challenged procedures and the merits or outcome of the JAD investigation. Procedural lapses are only relevant to the extent that their avoidance could have influenced the outcome of the investigation. The suggestion that a claim to civil damages can be advanced because a recommended administrative step was not followed by a CRA investigator has no merit. Even where an investigator could be truly faulted for a procedural failing, that conduct must still contribute in some way to the resulting harm: see *Hill*, above, at para 93.

XXII. Was Ms. Northey Qualified to Lead the JAD Investigation?

[237] The initial meeting that led to the start of the formal JAD investigation was held at the Toronto West Tax Services Office on November 18, 1995. Present at the meeting were 25 CRA officials from a variety of CRA offices including senior representatives from Headquarters, from Audit and from Special Investigations. Ms. Northey was not among them. Notes of that meeting are in evidence, they disclose a discussion about the JAD approach to the documentation of

SR&ED claims on behalf of its clients. Mr. Michal's notes of the meeting are cryptic, but flagged the following issues of interest:

a) fictitious management fees;

b) inflated management fees;

c) inflated expenses;

d) the use of dormant companies and accrued expenses.

[238] The notes also queried whether the claims involved "false science".

[239] Mr. Michal agreed to assume conduct of the investigation within the Hamilton Special Investigations Unit. It was his responsibility to assign a lead investigator and he chose Ms. Northey.

[240] The Plaintiffs assert that it was improper for Mr. Michal to have assigned Ms. Northey as the lead investigator of the investigation because she was underqualified. According to this argument the complexity of the investigation required an investigator with more experience than Ms. Northey. This, they say, is borne out by the fact that the case had a complexity rating of 33 calling for an investigator at a grade level of AU4. Ms. Northey was qualified two levels below that. The Plaintiffs also complain that Ms. Northey's acting AU4 assignment allowed her to receive additional salary and thus gave her a financial incentive to prolong her investigation.

[241] Mr. Michal testified that Ms. Northey was assigned to the investigation because she expressed an interest in the case and because of workload considerations. His testimony on this issue was the following:

> And it was assigned to her because she just was a free body?
>
> Answer: No. Actually what ended up happening, at one point in time, I believe, I conducted a meeting with some of the senior investigators. They were of a certain grade and level, because at this point in time, the way this case was, it was going to be a bit of it -- it was going to be much more -- a little bit more demanding, and there could be situation where some acting pay might come into play.
>
> So what I did was I conducted a meeting with four or five of the senior investigators and asked who might be interested in it, first of all, and then accept it. You know, if anybody was interested. Then I indicated I'd make a decision as to who the case would be assigned to.
>
> Question: And you picked Patti Northey?
>
> Answer: Patti was the only one that indicated she'd be interested." [As read.]
>
> Now, does this refresh your memory?
>
> A. Yes, it does.
>
> Q. So it seems to be a fair assessment of --
>
> A. But there would have been a prelude to this, in terms of the -- essentially acting could be a sensitive issue within the section, so that in terms of picking a particular individual, if others had taken exception to it, that they'd like to work on the case also, then I'd have to go through some sort of process in order to pick the individual that would end up on the case.
>
> Q. So, these four or five senior investigators, do you have any recollection of who they might be?
>
> A. One might have been Sebastian Albernia.
>
> Another might have been Art Payne; he was a senior investigator still at that point. Possibly Bill Williams.

Q. Was Patti Northey at that --

A. And Patti Northey.

Q. Patti Northey.

A. Yes.

Q. I just forgot to ask you: At that time, as the chief of SI, what was your rating, in CRA terms?

A. I believe I was an AU4.

Q. You were an AU4?

A. Yes.

Q. Okay. So then this was a -- the complexity of this case required somebody of your experience and knowledge? We could go over the requirements of the TOM Manual, but it is something suitable for somebody like you, a senior person?

A. I wouldn't say I was a senior investigator; I was a senior manager, which is quite a bit different than an investigator.

Q. Did any of the other investigators have an AU4?

A. I don't believe so. Art Payne may have, but I'm not certain at this point.

Q. Were there any AU3s there at this meeting?

A. I believe Sebastian Albernia might have been acting as an AU3, but he -- some of it also came down to workload, as to depending at what stage their investigations were at at that point in time.

Q. So the purpose of rating the case when assigning it was -- were you trying to match the complexity of the case with the qualifications of the investigator?

A. Qualifications? No, we would rate the case to determine the complexity -- complexity factors to determine whether or not we had an individual that was available to work on that particular case. And if we didn't, then we would basically go down the line in terms of pecking order. And if it really came down to it that we couldn't get anybody to work on it, we might have to essentially say "No." [pp 562-564]

[242] Mr. Michal had no reservations about Ms. Northey's capacity to conduct the investigation and pointed out that others with more seniority were available to her if she needed advice.

[243] In my view, nothing turns on the bare facts that Ms. Northey carried only an AU2 grade level or that she received additional salary from this assignment. The TOM II Manual at that time did state that it was preferable to assign an investigator with a grade level matching the complexity of a file [Exhibit P-18, Article 11(19)3.2], but it also recognized that, on occasion, it may be necessary, because of workload, staff availability, or staff training purposes, to assign cases to staff either above or below the complexity rating of a file [Exhibit P-18, Article 11(19) 3.5(2)]. This was consistent with Mr. Michal's experience [p 1048]. I also do not share the Plaintiffs' concern that Ms. Northey's receipt of a modest increase in acting salary during the period of investigation somehow created a risk of corruption or bad faith. In fact there is no evidence to support this accusation. It is simply speculation and it was soundly refuted by Ms. Northey.

[244] What would be of potential relevance is evidence bearing on the details of the investigation and, in particular, whether there were serious mistakes or errors of judgment made by Ms. Northey and others sufficient to support a finding of misfeasance, malice or negligence. In this case, there were none.

XXIII. Mr. Patrick Wong

[245] Mr. Gordon takes issue with a reference in an initial statement apparently made by JAD employee, Patrick Wong, to CRA investigators. According to that statement, Mr. Wong had

been instructed by Mr. Gordon to use fair market values instead of actual paid wages to document SR&ED claims. Mr. Wong purportedly went on to say that Mr. Gordon had also told him that actual paid wages was the "proper way" to present a claim. Mr. Gordon alleges that this attribution was a "fabricated false statement" and was "essential" to obtaining search warrants. He also alleges in the Plaintiffs' Post-Trial Brief that Ms. Northey knew the statement was false but repeated it [see paras 361-364].

[246] Whether or not Mr. Gordon actually made such an admission to Mr. Wong or whether Mr. Wong mischaracterized what he was told is not particularly important to this case. Even if Mr. Gordon did not make the statement, the investigator who took Mr. Wong's statement was obliged to accurately record what he was told. In the absence of any testimony from Mr. Wong, the statement is not admissible for its truth but only for the fact that the statement was made and recorded. If Mr. Gordon hoped to prove the statement was never made or was deliberately misstated by the investigator, it was open to him to call Mr. Wong. Mr. Wong did not testify which is perhaps not surprising given the nature of his potential evidence about the impropriety of JAD's methods: see Exhibit D-418 at Tab 88.

[247] In the end, this small point of disputed evidence was immaterial to the outcome of the investigation. According to Ms. Northey, nothing came of this issue because when Mr. Wong was interviewed again, he withdrew the "proper way" characterization and said only that Mr. Gordon had told him to use fair market labour valuations in lieu of paid wages [testimony of Ms. Northey at p 5846 and p 5854].

[248] There is simply no basis for Mr. Gordon's assertion that the prosecution against him turned on this issue or that Mr. Wong's initial statement represented the entirety of the CRA's belief that his *mens rea* could be proven [see Plaintiffs' Post-Trial Brief at paras 432-433].

XXIV. Standard of Care – Malicious Prosecution

[249] The Plaintiffs allege that the CRA is vicariously liable for a malicious prosecution carried out by its investigators. In particular, they assert that Ms. Northey was motivated to pursue what she knew to be a legally untenable case solely to obtain additional salary by taking on an acting assignment above her pay-grade.

[250] Among other arguments, the CRA contends that the prosecution of Messrs. Deacur and Gordon was in the hands of the federal prosecutors who approved the charges and conducted the case to its ultimate conclusion. Because the claims against the prosecutors were struck from the Statements of Claim the CRA says that no viable cause of action continues against the CRA or its investigators.

[251] The law of malicious prosecution is well established in Canada. Its constituent elements are four in number all of which must be established by a plaintiff:

(a) The prosecution was initiated by the defendant;

(b) The prosecution was terminated in favour of the plaintiff;

(c) The prosecution was undertaken without reasonable and probable cause; and

(d) The prosecution was motivated by malice or a primary purpose other than that of carrying the law into effect.

[252] It cannot be seriously disputed that Messrs. Deacur and Gordon have met the burden of proving the second element of the test. A stay of prosecution is a favourable termination: see *Miazga*, above, at para 54. The remaining three elements of the test remain in issue.

XXV. Did the CRA Initiate the Prosecution?

[253] I am satisfied on the facts presented that the CRA initiated the prosecution of Messrs. Deacur and Gordon. The legal requirement for initiation is not restricted to those who conduct the prosecution. Liability may also attach to those who were "actively instrumental" in setting the law in motion: see *Miazga*, above, at para 53. Thus the act of withholding or misrepresenting evidence by an investigator for a malicious purpose may support a viable cause of action. This point is made in the following passage from *Pate v Galway-Cavendish & Harvey (Township)*, 2011 ONCA 329, [2011] OJ No 3594:

> 47 It is well-established that a defendant may be found to have initiated a prosecution even though the defendant did not actually lay the information that commenced the prosecution. Although this court has not determined "all the factors that could, in any particular case, satisfy the element of initiation", it has held that a defendant can be found to have initiated a prosecution where the defendant knowingly withheld exculpatory information from the police that the police could not have been expected to find and did not find and where the plaintiff would not have been charged but for the withholding: *McNeil v. Brewers Retail Inc.*, 2008 ONCA 405 at para. 52.

[254] This issue was also recently considered in *Samaroo v Canada Revenue Agency*, 2018 BCSC 324, 8 BCLR 6th 121, overturned on a different issue in *Samaroo* (BCCA), above, where a CRA investigator was found to have been actively instrumental in a prosecution for tax evasion by having taken charge of the investigation and by determining who and what to charge.

[255] In this case many CRA investigators and supervisors were involved in making or approving the critical investigative decisions. This included the preparations for obtaining and executing search warrants, conducting witness interviews and finalizing the Prosecution Report. The JAD investigation was throughout solely in the hands of the CRA up to the point of the preparation of the indictments. Ms. Northey was also directly involved in the drafting of the criminal charges and she swore the Information [Exhibit P-141 and transcript pp 5290-5292]. It is also of significance that the CRA recommended the initiation of the prosecution in the Prosecution Report – albeit not precisely in the form of the eventual charges. Absent the information and recommendations provided by the CRA to the Crown prosecutors, it is clear that the prosecution of Messrs. Deacur and Gordon would not have been undertaken. I am therefore satisfied that the prosecution was effectively initiated by the CRA in the sense that CRA officials were actively instrumental in setting the prosecution in motion.

[256] The two remaining issues are whether the JAD investigation was undertaken and continued to prosecution without reasonable and probable cause and whether it was motivated by malice or for a primarily unlawful purpose.

XXVI. Was the Decision to Initiate a Prosecution Against the Plaintiffs Made Without Legal and Probable Cause?

[257] A party alleging a malicious prosecution bears a very heavy onus to prove that the prosecution was initiated without reasonable and probable cause. In *Samaroo* (BCCA), above, at paras 45-46, the Court of Appeal for British Columbia described the burden in the following way:

> [45] Second, the onus is on the plaintiff to prove an absence of reasonable and probable cause to initiate the prosecution: *Miazga* at para. 70.
>
> [46] Third, the charge approval standard in the criminal context, which in this case is a reasonable prospect of conviction and in the public interest, is a different and higher standard than the standard required for reasonable and probable cause to initiate a prosecution in the tort of malicious prosecution. As explained in *Miazga*, a prosecution is properly initiated if sufficient evidence, available when the decision to prosecute was made, could objectively result in a conviction:
>
> > [64] As alluded to earlier, the standard found in most Crown policy manuals across the country governing the exercise of prosecutorial discretion to commence or continue a criminal proceeding is generally higher than the reasonable and probable cause requirement under the third element of the test for malicious prosecution…. Accordingly, there is nothing discordant about a lower standard grounding civil liability.
>
> [Emphasis in original.]

[258] As previously discussed in these reasons, the CRA had substantial evidentiary support for initiating a prosecution against Messrs. Deacur and Gordon for fraud. The *actus reas* of an offence was reasonably seen to be present in the form of multiple misrepresentations of client records. It would also have been open to a criminal court to find a criminal intent on the basis of inferences drawn from proven circumstances including the magnitude of the scheme, the extent of the disclosure, the gravity of the misrepresentations and the absence of a demonstrable plausible explanation. All of this is not to say that a conviction would have been a certainty; but that is not the requirement. Rather, the test is whether there was sufficient available evidence that, when viewed objectively, could result in a conviction. In my view, that standard was readily met in this case and the Plaintiffs have failed to demonstrate otherwise.

XXVII. Was the JAD Investigation Motivated by Malice or With an Unlawful Purpose?

[259] I accept in principle that the quality of a CRA investigation may be so manifestly deficient that an inference of bad faith or malice may be open to a trier-of-fact. Indeed, actual evidence of malice or bad faith is unlikely to be found on the face of an official record. Such an inference will be more readily available where evidence can be shown to have been wrongly destroyed or falsified.

[260] Messrs. Deacur and Gordon rely heavily on the recent trial decision in *Samaroo* (BCSC), above, where a malicious prosecution finding was made against the CRA for the conduct of an investigator who was found to have been actively instrumental in the initiation of an unsuccessful prosecution for tax evasion. This decision was, however, recently overturned on the merits in *Samaroo* (BCCA), above, and the action was dismissed.

[261] I accept in principle that a finding of malicious prosecution could be made out where a CRA investigator deliberately suppresses or misrepresents evidence to the assigned prosecutor; but no such thing happened in the course of the JAD investigation. In fact, this was not a situation where Messrs. Deacur and Gordon had a materially different story to tell from the one that the CRA had uncovered. They acknowledge that most of the claims that were the subject-matter of the criminal charges involved, with some variation, their creation and use of after-the-fact documentation to support higher SR&ED valuations. With respect to those claims, the parties differ only with respect to the characterization of the employed methodology. The CRA considered it to be fraudulent. Messrs. Deacur and Gordon seemingly accept that their approach

was novel or, perhaps, aggressive but say it fell within the range of generally accepted accounting practice.

[262] As I have already noted in these reasons, the belief by Ms. Northey and her superiors that there were reasonable and probable grounds to bring charges against Messrs. Deacur and Gordon had ample evidentiary support. The methods that JAD employed to present SR&ED claims were wholly indefensible and at least *prima facie* dishonest.

[263] The Plaintiffs have manifestly failed to prove that any CRA official involved in the JAD investigation acted unlawfully or with malice. Every technical lapse they assert was nothing more than the execution of an investigative choice, the outcome of which would not have altered the CRA's perception of the evidence or the course of its investigation. Accordingly, I reject the Plaintiffs' allegation of malicious intent and unlawful conduct.

XXVIII. The Economic Interference Allegations

[264] Messrs. Deacur and Gordon allege that the CRA intentionally and wrongfully caused harm to their business and it is liable for the resulting losses. Their pleadings assert an intentional interference with contractual relations and economic interests (sometimes referred to as the "unlawful means" tort). The scope of application for this intentional tort was described in *AI Enterprises Ltd v Bram Enterprises Ltd*, 2014 SCC 12, [2014] 1 SCR 177, in the following way:

> 74 In light of the examination of the jurisprudence in this country and comparable common law jurisdictions, the trend of authority is towards a narrow definition of "unlawful means". In addition to being consistent with precedent, this approach is also in my view

> desirable in principle. Restricting unlawful means to acts that would give rise to civil liability to the third party (or would do so if the third party suffered loss from them) provides a coherent and rational basis for the development of the unlawful means tort. The limitation of unlawful means to actionable civil wrongs provides certainty and predictability in this area of the law, since it does not expand the types of conduct for which a defendant may be held liable but merely adds another plaintiff who may recover if intentionally harmed as a result of that conduct. While details relating to the scope of what is "actionable" may need to be worked out in the future, the basic contours of liability would be clear: see *Alleslev-Krofchak*, at para. 63. This approach does not risk "tortifying" conduct rendered illegal by statute for reasons remote from civil liability: see OBG, at paras. 57 and 152. The narrow definition of "unlawful means", in short, keeps tort law within its proper bounds.

[265] The essential elements of the tort are an intention to injure the plaintiff's economic interest through the use of illegal or unlawful means causing economic harm: see *Grand Financial Management Inc v Solemio Transportation Inc*, 2016 ONCA 175 at para 62, 395 DLR (4^{th}) 529.

[266] I very much doubt that this tort has any application to the kind of government conduct that took place in this case. The JAD investigation was lawfully initiated on the basis of legitimate concerns about the methodologies JAD was using on behalf of its clients. Anytime an investigation like this is commenced (whether or not charges are brought) there is real potential for financial fallout. The expansion of this tort into the public sphere is not needed or desirable. To the extent that there is a need to control or curtail unlawful or malicious government conduct, it can be managed through the application of the torts of misfeasance in public office or malicious prosecution. Furthermore, the investigation and resulting prosecution of the Plaintiffs

does not constitute an unlawful actionable wrong against a JAD client. The CRA was acting under its statutory mandate to enforce the ITA and it attracts no liability by having done so.

[267] In any event, all of the intentional torts asserted by the Plaintiffs fail for the same reason: there is no evidence whatsoever to establish a malicious or nefarious intent or unlawful conduct on the part of the CRA investigators. In fact, the overwhelming weight of the evidence given by the witnesses and included within the documentary record discloses a thorough, professional and competent investigation. Some of the CRA's initial reservations about JAD's use of fair market SR&ED valuations may not, on their own, have justified a prolonged criminal investigation. But JAD's frequent and flagrant use of back-dated records to inflate many other claims did warrant careful scrutiny and, ultimately, the laying of criminal charges. The fact that the focus of the investigation changed over time with more emphasis on the misrepresented records and less on valuation issues also shows a degree of appropriate reflection and an absence of tunnel vision or intransigence on the part of the CRA.

[268] I would add that, although the Plaintiffs have frequently asserted that CRA investigators encouraged clients to end their business relationships with JAD, they led no evidence to that effect from any of their clients. To the extent that business was lost, it is more likely because the Plaintiffs exposed their clients to considerable risk and inconvenience by filing wholly unjustified SR&ED claims.

XXIX. Breach of Charter Allegations

[269] The Plaintiffs' argument at paragraphs 704 to 707 of their Post-Trial Brief that their Charter rights were violated in some unspecified way has no evidentiary support. Indeed, the JAD investigation was conducted in full conformity with the Crown's Charter obligations including the use of Charter cautions and judicial authorizations for the search and seizure of JAD's records.

XXX. Conclusion

[270] There is no such thing as a perfect investigation. Additional steps and different choices are always available to investigators. For instance, Mr. Michal's mischaracterization of Mr. Deacur in order to obtain RCMP assistance during the execution of search warrants was inappropriate but it does not legally taint or compromise the investigation itself. The searches were lawfully executed under judicial authorization for a proper purpose. Perhaps Mr. Gordon should also have received a personally addressed 30-day warning letter but nothing of legal significance turns on the fact that he did not.

[271] The CRA investigators acted on the strength of the information they were receiving from numerous sources and made reasonable decisions and recommendations based on that evidence. Ms. Northey and her colleagues had no reason to think that what they were being told was suspect or unreliable. Indeed, what they were being told by third party taxpayers and other witnesses was consistent with the documentary evidence that was obtained during audits or seized during the warranted searches of JAD's offices.

[272] There is also no mischief in the fact that the focus of the investigation changed as more evidence was acquired. Ultimately the case came to rest almost exclusively on the problem of backdating of corporate and transactional records. Some of the early audit concerns about JAD's use of inflated SR&ED valuations mostly disappeared as the investigation moved forward. This is not surprising because *mens rea* was more evident in those situations involving fictitious records.

[273] I am satisfied that CRA investigators had sufficient evidence of potential fraud to justify moving the JAD investigation forward, including the searches of JAD offices and ultimately in recommending a criminal prosecution. The reasonableness of the CRA's recommended prosecution is also supported in some measure by the disposition of the case following the preliminary hearing and by the outcome of the Plaintiffs' motion to recover criminal defence costs: see *R v Deacur*, [2009] OJ No 3723, 2009 CanLII 46650 (ONSC).

[274] The motion for costs was refused by Justice Michael F. Brown , in part, for the following reasons:

> [15] The applicants in this case have made a number of submissions regarding the Crown's misconduct in this case. A substantial complaint made by the applicants is that they submit the Crown knew the prosecution could not succeed against them but chose to pursue the prosecution anyway. The applicants submit that the fact that the Crown ultimately stayed the charges against the applicants is evidence of this fact. Compounding all of this, the applicants submit, is that requests to the Canada Revenue Agency ("CRA") and the Department of Justice to explain the methodology used by the applicants in claiming tax credits (the "Deacur methodology") was refused. In essence, the applicants' submission is there was no basis to prosecute them. They submit that the "Deacur methodology" for claiming tax credits was lawful and the Crown and the CRA knew or should have known it.

> [16] In my view, this argument must fail. To begin with, one cannot conclude that charges should never have been laid solely on the basis that they were ultimately stayed by the Crown. There are a variety of reasons why the Crown may decide to stay criminal proceedings that were properly commenced in the first place. While I agree that it may have been preferable had the Crown articulated reasons for the stay on the record, the failure to do so, in my view, does not amount to an abuse of process nor does it prove that the charges should never have been laid by the Crown.
>
> [17] On the record before me I cannot conclude that there was no evidentiary basis for the Crown to prosecute the applicants. Justice Shilton found after a preliminary hearing that there was sufficient evidence to commit the applicants for trial.
>
> …
>
> [22] Justice Shilton's ruling is clear that there was sufficient evidence to justify a prosecution of the applicants. A significant plank in the applicants' submission before me is that the Deacur methodology is lawful and that by prosecuting them the Crown and the CRA committed an abuse of process. However, something more than a *bona fide* disagreement as to the applicable law is required in order to make a costs order: *R. v. Leduc*. In my view, the fact that the applicants were committed for trial, though not determinative, does support the proposition that the Crown in this case had a basis for commencing the prosecution: *Thompson v. Ontario.* [Footnotes omitted.]

[275] Justice Brown also quoted extensively from Justice Shilton's reasons for committing Messrs. Gordon and Deacur to stand trial where legal concerns about JAD's backdating methods were identified.

[276] While these decisions are not determinative of the issues raised in these proceedings, they do detract from the Plaintiffs' argument that their methods were plainly and obviously justified and ought to have been seen to be so by the CRA: also see *Wong*, above, at para 60.

[277] Messrs. Deacur and Gordon are perhaps fortunate that the Crown elected to stay their prosecution. The *actus reus* of a fraud was clearly present. Based on JAD's widespread use of misleading backdated records and an untenable taxation theory, an inference of a guilty intent could also have been reasonably drawn. It seems to me that on the evidence obtained by CRA investigators the only argument potentially available to them was one that was successfully employed in *R v Patry*, 2018 BCSC 1524, 149 WCB 2d 246, where Justice Block entered an acquittal in analogous circumstances on the following basis:

> [82] Counsel submits it is at least arguable that Mr. Patry's tax strategy is and was sound, and therefore it did not constitute tax evasion. Counsel said Mr. Patry was entitled to put forward a plan that was based on a viable interpretation of the legislation. The CRA may disagree with that interpretation, but the mere fact that the CRA disallowed the claimed expenses does not mean that Mr. Patry's interpretation is incorrect.
>
> [83] Defence counsel's main emphasis was that the Crown's case fails on the *mens rea* element. Mr. Patry believed in his strategy, and therefore, the Crown has not proven that Mr. Patry, in carrying out his tax strategy, was "wilfully" evading taxes. He might simply have been wrong about his theory, in which case the necessary mental element is absent.
>
> …
>
> [122] I am satisfied that Mr. Patry's "tax compliance strategy" is and was unsound. Although even a single real estate purchase can, in proper circumstances, amount to an "adventure or concern in the nature of trade" and thus fall within the definition of "business" by reason of s. 248(1) of the ITA (see *Friesen*), resort to the authorities satisfies me that a taxpayer cannot retroactively re‑characterize a real estate purchase so as to make the purchase of property, which at the time was purchased for the purpose of using it as an ordinary residence, an "adventure or concern in the nature of trade". Such a re‑characterization is a scheme having as its sole purpose the reduction of tax otherwise payable, and is ineffective in establishing an "adventure or concern in the nature of trade": *Whent* at para. 27.
>
> …

> [138] Mr. Patry presents as somewhat eccentric, perhaps even odd in some respects. He is *deeply* suspicious of the CRA. He has a high opinion of his abilities and knowledge in the field of income tax and he is stubbornly sure he is right. I must say, however, that his confidence in his abilities is not justified. There are obvious gaps in his knowledge and his analyses are seriously flawed. His "tax compliance strategy" is ample evidence of that. For that strategy, he has taken a few income tax concepts, misread or distorted them, and then strung them together to create a faulty result.
>
> …
>
> [143] I agree that in other circumstances, these matters might well be viewed as evidencing the wilful behaviour necessary for a conviction. But here, three of the behaviours just listed may well have stemmed from Mr. Patry's deep and pervasive suspicion that CRA "had it in" for him as a result of his history with that organization. The Royal Bank "partnership" point I dealt with earlier. As I noted, Mr. Patry said the bank asked him to do it, which is possible but perhaps not likely, but I also conclude it might be that Mr. Patry felt that that was what the bank was effectively asking him to do.
>
> [144] On my assessment of the whole of the evidence, I am left with a reasonable doubt on the matter of the necessary intent for these tax evasion offences. To be more specific, despite my conclusion that Mr. Patry's tax strategy was flawed, I conclude that it is at least possible that Mr. Patry believed he had formulated a viable tax strategy. He cannot be convicted for being wrong, only for knowingly being wrong. The Crown has therefore failed in its proof on this essential point.

The fact that *mens rea* might have been negated in the prosecution of Messrs. Deacur and Gordon based on a wholly untenable but mistaken belief that their methods were sound does not, however, lead to a conclusion that the prosecution was legally unsound. On my assessment of the evidence, the CRA had reasonable and probable grounds for recommending a prosecution. There is no evidence that CRA officials acted unlawfully, maliciously or negligently in the conduct of the JAD investigation. To the contrary, the investigation was thorough, fair, objective and competently carried out. These actions are accordingly dismissed. As previously stated, I

will deal with the issue of costs upon the receipt of further written submissions from the parties. Each of the parties is to file and exchange a submission on the sole issue of costs within 30 days. The submissions are not to exceed 25 pages in length. Mr. Deacur and Mr. Gordon will be entitled to file separate submissions.

JUDGMENT IN T-473-06 and T-474-06

THIS COURT'S JUDGMENT is that:

1. these actions are dismissed; and

2. each of the parties is to file and exchange a submission on the sole issue of costs within 30 days.

"R.L. Barnes"
Judge

FEDERAL COURT

SOLICITORS OF RECORD

DOCKET:	T-473-06
STYLE OF CAUSE:	ALLAN JAY GORDON v HER MAJESTY THE QUEEN
AND DOCKET:	T-474-06
STYLE OF CAUSE:	JAMES A. DEACUR AND ASSOCIATES LTD. AND JAMES ALLAN DEACUR v HER MAJESTY THE QUEEN
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	OCTOBER 15 TO 18, 2018 OCTOBER 22 to 25, 2018 OCTOBER 29 to NOVEMBER 1, 2018 NOVEMBER 5 TO 8, 2018 NOVEMBER 13 TO 16, 2018 NOVEMBER 19 TO 22, 2018 NOVEMBER 26 TO 29, 2018 DECEMBER 3 TO 6, 2018 DECEMBER 10 TO 13, 2018 DECEMBER 17 TO 18, 2018 FEBRUARY 4 AND 6, 2019
ORDER AND REASONS:	BARNES J.
DATED:	JUNE 25, 2019

APPEARANCES:

Allan Jay Gordon	FOR THE PLAINTIFF (ON HIS OWN BEHALF)
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Howard F Morton QC Toronto, Ontario	FOR THE PLAINTIFFS (LIMITED REPRESENTATIONS)

Wendy Linden Rishma Bhimji Kieran Lidhar	FOR THE DEFENDANT (HER MAJESTY THE QUEEN)

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