File No. T-1736-14

FEDERAL COURT

BETWEEN:

VIRGINIA HILLIS and GWENDOLYN LOUISE DEEGAN

PLAINTIFFS

and

THE ATTORNEY GENERAL OF CANADA and THE MINISTER OF NATIONAL REVENUE

DEFENDANTS

REPLY ARGUMENT OF THE PLAINTIFFS, VIRGINIA HILLIS and GWENDOLYN LOUISE DEEGAN and SUPPLEMENTAL MEMORANDUM OF FACT AND LAW re CROSS-EXAMINATIONS

Counsel for the Plaintiffs:

Joseph J. Arvay, Q.C.,
David E. Gruber and Arden Beddoes
Farris, Vaughan, Wills & Murphy LLP
PO Box 10026, Pacific Centre South
25th Floor, 700 West Georgia Street
Vancouver BC V7Y 1B3
Tel: 604.684.9151 / Fax: 604.661.9349

Counsel for the Defendants:

Donnaree Nygard, Michael Taylor and Oliver Pulleyblank
Department of Justice
BC Regional Office
900 – 840 Howe Street
Vancouver BC V6Z 2S9
Tel: 604.666.3049 / 604.775.6014 / 604.666.7761
Fax: 604.666.2414
Email: donnaree.nygard@justice.gc.ca

SUBMISSIONS[1]

Article XXVII of the Convention

1. The defendants' effectively submit that the "may be relevant" standard should be taken to allow for fishing expeditions, because maximum surveillance will lead to maximum compliance, and that in turn would promote the goal of combating tax avoidance and evasion. There are several flaws with this position.

2. Firstly, the defendants' proposed construction of the parties' intent utterly ignores the value of privacy. Both Canada and the US are liberal democracies where freedom from intrusion and personal autonomy are foundational values. Moreover, privacy is itself an important tool to promote compliance in self-assessment tax systems, as explicitly recognized by the Supreme Court of Canada:

> As alluded to already, Parliament recognized that to maintain the confidentiality of income tax returns and other obtained information is to encourage the voluntary tax reporting upon which our tax system is based.... The opposite is also true: if taxpayers lack this confidence, they may be reluctant to disclose voluntarily all of the required information....[2]

3. Secondly, if, as the defendants would have it, Financial Institutions ("FI") account information is disclosable under Article XXVII wherever it assists to determine whether the holder is a taxpayer in the other jurisdiction,[3] then Article XXVII would enable unlimited disclosure of everyone's FI account information, since an account on its face may contain no indicia of tax residence in the other jurisdiction yet be held by a taxpayer of the other jurisdiction.[4] The

---

[1] defined terms in these Submissions have the same meaning as in the Plaintiffs' Memorandum of Fact and Law dated May 8, 2015 ("Plaintiffs' Memorandum")

[2] *Slattery (Trustee of) v. Slattery*, [1993] 3 S.C.R. 430 at 444, Plaintiffs' Memorandum Tab 12; see also: *Gernhart v. Canada*, [2000] 2 F.C.R. 292 (C.A.), Plaintiffs' Memorandum Tab B

[3] Defendants' Memorandum of Fact and Law ("Defendants' Memorandum"), paras. 2, 10, 58 and 70-71

[4] Even FI accounts not disclosable under the IGA "may be relevant" on the defendants' theory. For example, CRA is aware that many Canadians have second residences in the US or delivery addresses in the US at which they receive goods not shipped to Canada: Cross-examination of Sue Murray held July 22, 2015 ("Murray Cross"), Tab 2, p. 26, l. 5 to p. 27, l. 8. Accounts held by Canadians using such addresses are not disclosable under the IGA. Similarly, in the due diligence requirements imposed on Canadian FIs, the IGA does not capture all US Persons, such as individuals born in Canada to parents who were US citizens at the time: Cross-examination of Allison Christians held July 23, 2015 ("Christians Cross"), Tab 3, Q. 34.

authorities would then be able to collect for exchange and then use everyone's FI account information for purely domestic compliance purposes – enabling an end run around due process requirements.[5] Such a consequence cannot have been intended when the parties agreed to Article XXVII.

4. Indeed, the extrinsic evidence, in the form of the Technical Explanation, indicates the opposite. The defendants' contention that the Technical Explanation applies only to information "by request," and not automatic exchanges of information, has no foundation in the actual language of Article XXVII, nor any basis in logic. If the "may be relevant" standard was not intended to authorize mass disclosure of bank account information by request, how can it possibly support automatic mass disclosure of the very same information?

5. The defendants' attempt to paint the IGA itself as extrinsic evidence of a broader intention of the parties in agreeing to Article XXVII[6] is without evidentiary foundation. In fact, as set out in the Supplemental Report of Allison Christians,[7] the IGA is not an agreement between the same "parties" to the Convention since, on the US side, it has not been submitted for ratification to the US Senate, which was a party to the Convention. Indeed, the constitutional validity of the IGA in the US is dubious, and that validity is a matter currently being litigated there.

6. Thirdly, the defendants' position relies on seeking to locate the IGA within an emerging "international consensus" on automatic information exchange, from which it actually radically departs. In all other examples of this emerging consensus, information is only automatically exchanged where the individual maintains an FI account in the disclosing jurisdiction and there is an indication of actual residence in the receiving jurisdiction.[8] This is the same basis upon which information has been automatically exchanged between Canada and the US for decades prior to the IGA.[9]

---

[5] Murray Cross, Tab 2, p. 33, l. 6 to p. 34, l. 11
[6] See for example paras. 57 and 90 of the Defendants' Memorandum
[7] Supplemental Affidavit of Allison Christians sworn July 20, 2015, Ex. A and B, Plaintiffs' Motion Record filed July 22, 2015, Tab 1, Appendix A
[8] Murray Cross, p. 19, l. 17 to p. 23, l. 1; Cross-examination of Stephanie Smith held July 21, 2015 ("Smith Cross"), Tab 1, p. 12, l. 16 to p. 13, l. 1 and p. 23, ll. 6-20
[9] Murray Cross, Tab 2, p. 11, ll. 9 to 25 and p. 12, l. 19 to p. 13, l. 9

In this situation, the taxpayer is doing something international, by banking or investing in a foreign jurisdiction.

7. By contrast, the plaintiffs are banking and investing at home. While one might legitimately believe there is a heightened risk of avoidance or evasion where a taxpayer maintains foreign FI accounts,[10] there is no such indicia of increased risk to justify the disclosure of Canadian FI information of Canadian residents.

8. For information to be exchanged automatically beyond the situation of holding a foreign FI account, there must, to meet the "may be relevant" standard, be factual indicia that raise a legitimate concern about avoidance or evasion. Such indicia could be present where CRA possesses information relevant to a "tax treaty gap."[11] The defendants' contention that CRA cannot know the "tax treaty gaps" is ludicrous. Taxpayers themselves must be able to know them to be able to self-assess and apply the double taxation rules under the Convention.[12] Surely then CRA can know them.[13] But if true, the answer is that automatic disclosure must be limited to the situation where the address on the FI account is in the receiving jurisdiction, as has been the practice for decades and consistent with the "international consensus."[14]

9. Lastly, the defendants' position on Article XXVII confuses means and ends. Admittedly, one of the purposes of information exchange under the Convention is to combat tax avoidance and evasion, in order to ensure fairness and to enable funds to be raised for the common welfare.[15] Promoting compliance with self-reporting requirements is a means to the end of combating avoidance and evasion; but compliance with them is not, as the defendants would have it, an end in itself.

---

[10] All the experts agree that the purpose of FATCA was to identify people actually in the US holding foreign accounts: Staines report at Defendants' Motion Record Tab 1, p. 24 and the references in the Plaintiffs' Memorandum, paras. 80-81.

[11] The term "treaty gap" may also be described as a" systemic difference where income could arise for US purposes where it in Canada:" Christians Cross, Tab 3, Q. 174.

[12] Murray Cross, Tab 2, p. 24, ll. 16-23

[13] Christians Cross, Tab 3, QQ. 222-26

[14] It is also the case that none of the information that Canadian financial institutions are required to collect and hand over to the CRA and to the IRS would reveal the "treaty gaps:" Christians Cross, Tab 3, QQ. 234-37

[15] Harris, *Canadian Income Taxation*, 4th Ed. (Toronto: Butterworths, 1986) at 26-27, Tab D

10. As exemplified by the plaintiffs, there is no reason to attribute *mala fides* on the part of a person who does not self-report or self-assess in respect of a nil liability. Though the defendants assume the plaintiffs are citizens of the US who therefore owe compliance obligations under the domestic laws of the US, the plaintiffs themselves do not consider the fact of their birth in the US subjects them to the laws of a foreign state, whose citizenship they have never accepted or acknowledged. On its face, there is no legitimate reason for Canada to help a foreign state identify and punish them for failing to file forms they do not believe the foreign state had any right to demand of them, particularly where, as here, there is no reason whatsoever to believe they are engaged in tax avoidance or evasion.

11. The defendants' say in answer that deemed tax residence of US Persons under US tax law and the consequences that flow therefrom is a domestic policy choice that is beyond this Court's role to evaluate. But construction of Article XXVII is a matter of international law. And international law does not give the US any presumptive right to impose its domestic tax reporting regime within Canadian territory. As noted by one international law scholar:

> … For there is clearly no general rule of international law granting all states extraterritorial rights in other states. If among any particular states extraterritorial rights exist, they either stem from a treaty or from special customary practice that amounts to consent on the part of the territorial state….[16]

12. The language of Article XXVII cannot reasonably be read as Canada's consent to the US having a right to require adherence to its domestic tax reporting regime as regards activity by Canadian residents occurring solely within Canadian territory, particularly when read harmoniously with Articles XXV and XXVI-A and in the context of a decades-long practice of exchanging FI account information only if there is a foreign address.[17]

---

[16] Anthony D'Amato, "The Concept of Special Custom in International Law", 63 American Journal of International Law, 211-223 (1969), Tab C

[17] Murray Cross, Tab 2, p. 11, ll. 9-25 and p. 12, l. 19 to p. 13, l. 9

Article XXVI-A of the Convention

13. The defendants' approach to Article XXVI-A is narrow and formalistic, which is exactly the sort of approach that the acknowledged leading authority, *Crown Forest*,[18] cautions against. Article XXVI-A represents an unusual bargain to relieve against the strictures of the "revenue rule."[19] The *quid pro quo* is a mutual acknowledgement that each country's own citizens are to be protected absolutely from tax collection by the other. That protection should be read liberally.

14. The defendants explicitly state that disclosure of information under the IGA may permit the IRS to identify deemed US residents who do not report at all and of whom it would otherwise be unaware.[20] Therefore, but for such disclosure, there could be no collection of US tax debts. Furthermore, once it has the account's location and balance, in many cases the US would not need any further information or assistance from Canada to execute against the account.[21] To confine "assistance in collection" in such circumstances only to matters arising after a tax assessment fails to afford the liberal interpretation the Article requires.

Article XXV of the Convention

15. A complete answer to the defendants' submissions on Article XXV is that for domestic Canadian compliance, US citizens resident in Canada are denied the due process rights afforded ss. 231.1 to 231.7 of the *ITA*[22] in respect of their FI account information, while non-US Persons continue to enjoy such rights.[23]

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Dated: July 30, 2015

Joseph J. Arvay, Q.C., and David E. Gruber
Counsel for the Plaintiffs

---

[18] *Crown Forest Industries Ltd. v. Canada*, [1995] 2 S.C.R. 802, Plaintiffs' Memorandum Tab 10

[19] Canada has agreed to assistance in collection provisions with only a few other treaty partners: see Smith Cross, Tab 1, p. 9, l. 3 to p. 10, l. 8 and Exhibit 2.

[20] Defendants' Memorandum, para. 70

[21] Supplemental Affidavit of Robert Wood sworn July 20, 2015, Plaintiffs' Motion Record filed July 22, 2015, Tab 1, Appendix B; Cross-Examination of Robert Wood on Supplemental Affidavit held on July 28, 2015, Tab 4, p. 7, ll. 12-25; p. 8, ll. 1-23, p. 17, ll. 3-25, pp. 18-19; p. 20, ll. 1-8 and ll. 24-25; p. 21, ll. -14; p. 22, ll. 5-21

[22] *ITA*, ss. 231.1-231.7, Tab A

[23] Murray Cross, Tab 2, p. 33, l. 6 to p. 34, l. 11

List of Authorities

Appendix A: Statutes

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 231.1 to 231.7

Appendix B: Cases and Texts/Journals

Crown Forest Industries Ltd. v. Canada, [1995] 2 S.C.R. 802

Gernhart v. Canada, [2000] 2 F.C.R. 292 (C.A.)

Slattery (Trustee of) v. Slattery, [1993] 3 S.C.R. 430

Anthony D'Amato, "The Concept of Special Custom in International Law", 63 American Journal of International Law, 211-223 (1969)

Harris, *Canadian Income Taxation*, 4th Ed. (Toronto: Butterworths, 1986) at 26-27