

# FEATURED PERSPECTIVE

## Canada Revenue Agency Declares Open Season On Taxpayer Information

by Steve Suarez



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The Canada Revenue Agency's provocative (and successful) effort to obtain the taxpayer's tax accrual working papers in *Minister of National Revenue v. BP Canada Energy Co.*

indicates that the CRA now considers those materials to be fair game for use as an audit roadmap for tax purposes. Unless overturned, the decision will leave a taxpayer's subjective assessment of its uncertain tax positions (and any other tax analysis) completely exposed to demands for disclosure from Canadian tax authorities, unless protected by lawyer-client privilege. Those preparing that kind of confidential and sensitive tax analysis would be well advised to do so within the scope of lawyer-client privilege, which is not lost under Canadian law when disclosure is made to the taxpayer's external auditors for the limited purpose of completing its financial statements.

If there is one Canadian court proceeding that the tax and business communities should be following in 2015, it is the Canada Revenue Agency's most recent success in obtaining sensitive and confidential tax information in *Minister of National Revenue v. BP Canada Energy Co.*, 2015 FC 714 (2015). Because the case deals with the administration of the Canadian tax system generally rather than a particular technical issue, it affects all taxpayers, not just those in a particular indus-

try or facing a relatively narrow substantive question. It also involves important and competing policy considerations that go to the heart of what limits should exist on tax authorities' ability to obtain information and documents and how those powers interact with other, nontax obligations of taxpayers.

While the case deals with tax accrual working papers (TAWP) created as part of the process of generating financial statements, ultimately the principle at stake extends to any form of taxpayer analysis of the strengths and weaknesses of tax positions taken (except for that protected by lawyer-client privilege). If left undisturbed, the Federal Court's judgment in *BP Canada* effectively lowers the bar regarding what the CRA is entitled to demand of taxpayers to anything the CRA wants, so long as the purpose of the demand relates to the administration or enforcement of the tax statute and the information demanded is not protected by lawyer-client privilege. It will indeed be open season on taxpayer information.

The document at stake in *BP Canada* is perhaps the most sensitive and confidential that a taxpayer has: a self-generated list of issues that the taxpayer subjectively believes might successfully be challenged by the CRA, in this case prepared for the purpose of establishing reserves for uncertain tax positions (UTPs) in its financial statements. While the CRA has consistently reserved the right to demand production of those and other documents prepared for that purpose (TAWP), as a practical matter historically it has not done so other than in truly exceptional circumstances. That is because people have generally acknowledged that there is something not quite "cricket" about the CRA using purely subjective analysis that has been prepared to comply with financial statement requirements against the taxpayer to identify and pursue potential

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audit issues. The CRA's pursuit of issues lists in *BP Canada* for the admitted purpose of simply having a roadmap for auditing future years constitutes an abrupt break with that practice — and a throwing down of the gauntlet, as it were. If the CRA is ultimately successful in this case, it is difficult to imagine what information it would be unable to obtain, and it is not surprising that the taxpayer felt it had no choice but to refuse production and force the courts to determine the legal limits of the CRA's information-gathering powers under the Income Tax Act (Canada).

It may or may not be the case that under existing law, the CRA was indeed entitled to the compliance order from the Federal Court that it obtained in *BP Canada* requiring the company to provide the issues lists. Answering that question involves:

- detailed interpretation of the relevant statutory provisions to resolve the numerous legal questions raised; and
- identification and consideration of the factors and policy issues relevant to the court's discretion whether to grant the compliance order on the facts.

The reasoning and analysis in *BP Canada* is so dissatisfying as a basis for resolving those issues that the taxpayer could be forgiven for believing that its arguments were not fully and fairly considered. Courts must grapple with the text of the statute and the facts as they find them, and this proceeding clearly involved several challenging issues on which very little authority exists; it was not an easy case. However, whatever the law is, it simply can't be what is set out in the judgment, and hopefully an appeal will be pursued. Whatever the result of this case, the issues at stake are of such importance to the Canadian tax system that it is essential for the courts to set out a better and more coherent legal framework for establishing the respective rights and obligations of the CRA and taxpayers.

In summary:

- *BP Canada* seems to indicate that as a practical matter, the CRA has decided to significantly change the rules of engagement with taxpayers in terms of what constitutes fair game.
- If the result of the case stands, since there is no obvious basis to restrict the principle to TAWP, taxpayers being audited should expect to be greeted with a demand in one form or another to identify UTPs, and those who are required to prepare that sort of analysis in preparing their financial statements will need to seriously rethink how that work is done and what form it takes.
- Irrespective of whether the CRA wins or loses this case, a more detailed and analytical approach than is found in the judgment is needed to adequately resolve the legal issues and policy choices raised.

- Ultimately, this case demonstrates the paramount importance of lawyer-client privilege as the only defense to the disclosure of confidential tax data that is consistently respected by the CRA and the courts.<sup>1</sup>

## Facts

The basic chronology of events is fairly simple. BP Canada is a Canadian subsidiary of a European public company. As part of the preparation of its financial statements, BP Canada undertook an internal analysis of potential exposures in the Canadian tax positions it had adopted and established reserves representing potential taxes and interest owing in the event that the positions it had taken were successfully challenged. For obvious reasons, that analysis was highly confidential and potentially prejudicial, reflecting as it did the taxpayer's own subjective opinion of its UTPs.

The CRA became aware of the existence of the TAWP containing that analysis during its audit of the taxpayer's 2005 tax year. Over the course of some two years as the audit proceeded, the CRA made various requests of the taxpayer to turn over the TAWP, initially in connection with an issue that was subsequently resolved. The taxpayer provided the CRA with redacted versions of the TAWP, which sufficed to address the original issue for which the demand arose. However, the CRA's curiosity had been piqued, and it continued to demand full and complete disclosure of the unredacted TAWP (in particular the issues lists), for the purpose of the CRA satisfying itself that it had not "missed something" in its audit.

As the parties continued to spar over the issues lists, the CRA began its audit of BP Canada's 2006 and 2007 tax years and demanded the TAWP for those years as well. The CRA's position was that the 2005 issues list was relevant to the audit of later years, in that it might identify UTPs that should be challenged for those years too. Not surprisingly, the taxpayer continued to refuse disclosure of the issues lists for those years, which the parties agreed constituted a roadmap for the CRA on which to focus its audit resources. The CRA made formal demands for the issues lists under ITA section 231.1(1), with which BP Canada did not comply. The CRA then applied to the Federal Court for an order under ITA section 231.7, forcing BP Canada to turn over the issues lists. The court granted that order in the judgment "to compel BP Canada to disclose the Issues Lists for the purpose of expediting the Minister's future audits."

<sup>1</sup>The scope and importance of lawyer-client privilege in Canada is reviewed in Suarez, "Canada Revenue Agency Forces Taxpayer to Disclose Discussions With Accountant," *Tax Notes Int'l*, May 11, 2015, p. 553.

### The Law

The two ITA provisions relevant to the judgment are sections 231.1(1), which empowers the CRA to obtain information from taxpayers, and 231.7(1), which describes how the CRA can obtain a compliance order from a court to enforce a section 231.1(1) demand. The relevant portion of section 231.1(1) reads:

An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act

(a) inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act.

There are essentially two legal tests inherent in that provision:

- the CRA's purpose in making the demand must be related to the administration or enforcement of the ITA (the purpose test); and
- the document being sought must (or may) relate to either:
  - information that is or should be in the taxpayer's books and records; or
  - any amount payable by the taxpayer under the ITA (the relation test).

When the taxpayer does not comply with such a demand, the CRA is entitled to apply to a court for an order enforcing compliance under section 231.7(1), which reads:

On summary application by the Minister, a judge may, notwithstanding subsection 238(2), order a person to provide any access, assistance, information or document sought by the Minister under section 231.1 or 231.2 if the judge is satisfied that

(a) the person was required under section 231.1 or 231.2 to provide the access, assistance, information or document and did not do so; and

(b) in the case of information or a document, the information or document is not protected from disclosure by solicitor-client privilege (within the meaning of subsection 232(1)).

Thus, the CRA is required to establish that the demand under section 231.1(1) was in fact valid and then to convince the court to exercise its discretion to make the order.

### The CRA Policy

In their arguments, both parties referred to the CRA's formal published statement<sup>2</sup> on seeking access to taxpayer information and specifically to TAWP. That CRA policy statement includes the following text:

CRA officials are authorized to inspect, audit, review or examine:

- the books and records of a taxpayer;
- any document of the taxpayer that relates or may relate to the information in a taxpayer's books and records; and
- any document of any other person that relates or may relate to the information in a taxpayer's books and records

that may be relevant to the administration or enforcement of the ITA, ETA, and other relevant legislation. CRA officials are authorized to request and receive any documents needed to conduct a proper inspection, audit or examination, subject to solicitor-client or litigation privilege.

CRA officials have the legal authority to request the relevant documents at any time during an inspection, audit or examination for any purpose relating to the administration or enforcement of the ITA, Part IX of the ETA and other relevant legislation. The term "any purpose" includes acquiring information for the purpose of substantiating the taxpayer's position on a specific issue, and identifying audit issues and concerns with regards to tax at risk.

...

In the context of this policy, "any other person" includes tax professionals and tax preparers, and "any document" includes accountants' and auditors' working papers that relate to a taxpayer's books and records and that may be relevant to the administration or enforcement of the ITA, ETA, and other relevant legislation. Accountants' and auditors' working papers include working papers created by or for an independent auditor or accountant in connection with an audit or review engagement, advice papers, and tax accrual working papers (including those that relate to reserves for current, future, potential or contingent tax liabilities).

...

Consistent with Canada's self-assessment system of taxation, compliance with tax laws is primarily an issue that should be resolved between the CRA and any specific taxpayer. Accordingly, officials will always attempt to collect information

<sup>2</sup>CRA, "Acquiring Information from Taxpayers, Registrants and Third Parties," available at <http://www.cra-arc.gc.ca/tx/tchncl/cqrngnfrmn/menu-eng.html>.



from the most direct source in the least intrusive manner possible. Officials will discuss the issue under review with the taxpayer and afford the taxpayer the opportunity to provide additional factual or relevant information on the issue. This means that officials will target their requests to documents and records (electronic or paper) that, in their view, are necessary for the scope of their review.

Information from third parties will be sought when the taxpayer cannot or will not provide this information, when it is needed by officials to determine the CRA's position on an issue and in accordance with the scope of the review. For example, since accountants' and auditors' working papers relate to a taxpayer's books and records, they may be necessary, although not routinely required, in the determination of a taxpayer's liabilities and entitlements. Officials may narrow the scope of their review, or expand the scope, depending on the existence and nature of compliance issues identified.

...

Officials will also consider five key principles when evaluating the need to request information from a taxpayer, a registrant or a third party: Legislative Authorities, Intent, Relevance, Transparency and Impartiality.

...

Officials will be objective when reviewing any information or documentation obtained during an audit. Officials will not be influenced by any subjective analyses, comments or opinions contained in the information or documentation reviewed.

...

Although not routinely required, officials may request tax accrual working papers. These documents are often prepared by the taxpayer's internal tax or accounting personnel but can include, where necessary, those prepared by an independent auditor or accountant.

Several things are noteworthy about the CRA policy statement:

- its paraphrasing of the extent of the CRA's powers to obtain information is somewhat broader than what the actual text of the ITA supports;
- it acknowledges the primacy of lawyer-client privilege;
- in various places it refers to documents or information that are "necessary for the scope of their review" or "needed to conduct a proper . . . audit," or "needed to determine the CRA's position on an issue";
- it reserves the right to "request" TAWP, while acknowledging that they will not be "routinely required"; and

- it states that CRA officials will not be "influenced by any subjective analyses, comments or opinions contained in the information or documentation reviewed."

### The Judgment

The two questions for the court to address were:

- whether the issues lists were documents that came within the scope of what the CRA is entitled to demand under ITA section 231.1(1); and
- if so, whether the court should exercise its discretion in favor of the CRA to grant the compliance order under ITA section 231.7(1).

The court concluded that the answer to both questions was yes.

#### Issues Lists: Section 231.1(1)

The court's judgment cites liberally from the written arguments of the parties in discussing the scope of section 231.1(1), but provides surprisingly little legal authority or statutory analysis in its own reasons. It begins by identifying (and quoting from) the written submissions made by the Crown on behalf of the CRA:

Where the Minister is conducting an audit in good faith, it is not for the Court or anyone else to prescribe the intensity or the extent of the review. This is exclusively a matter for the Minister, acting through her officials, to decide. It is the Minister's prerogative to look under any stone and to use any risk assessment technique she chooses to identify tax at risk.

The taxpayer has all the information relevant to its tax liability — the Minister does not. If tax accrual working papers are available, the taxpayer knows which issues may merit adjustment and records that analysis in its working papers. In requesting those working papers, the Minister is seeking to perform her obligation to verify the self-assessment despite the information disadvantage inherent in our self-reporting tax system.

Section 231.1(1) is certainly a powerful tool for the CRA to obtain information from taxpayers, having been described thus by the Supreme Court of Canada in *Redeemer Foundation v. M.N.R.*, 2008 SCC 46:

As mentioned above, s. 231.1(1) is broadly worded. It allows access to "information that *is* or *should be* in the books or records of the taxpayer". It thus gives access to information about third parties that is required to be kept by the taxpayer, as well as information that may not be required to be kept but happens to be in the taxpayer's records.

It is true that the broad wording of s. 231.1(1) provides a powerful tool that may reveal a great deal of information about transactions between

the taxpayer under audit and third parties. However, this is business information. Taxpayers have a very low expectation of privacy in their business records relevant to the determination of their tax liability: *R. v. McKinlay Transport Ltd.*, [90 DTC 6243] [1990] 1 S.C.R. 627.

That being said, section 231.1(1) has limits, both within the text itself and based on the manner in which the courts have interpreted the text within the context of Part XV of the ITA (Administration and Enforcement) as a whole. What is most troubling about *BP Canada* is that despite the highly confidential and potentially prejudicial nature of the issues lists and the consequent importance of the case, the analysis does not really come to grips with interpreting the scope of ITA section 231.1(1) and then explaining how the issues lists come within that provision as so interpreted. One might have thought that the court would review and apply the purpose test and the relation test in the text of section 231.1(1), interpreting the statute in context and citing relevant precedents and authority as a basis for the analysis. Unfortunately, there is little evidence of that.

For example, the court might usefully have considered whether purely subjective analysis could be said to “relate to” the taxpayer’s records or books or to any amount payable by BP Canada under the ITA, and what constitutes a taxpayer’s “books and records” under the ITA.<sup>3</sup> The possible application of legal principles established in previous decisions circumscribing the CRA’s powers to demand information might have been analyzed. For example, the court could have considered jurisprudence prohibiting the CRA from using those powers on a “fishing expedition,”<sup>4</sup> which might be a fair characterization of a demand for a list of potentially uncertain tax positions (as opposed to information regarding an already identified issue). While BP Canada did not mount a formal challenge to the requirement under section 8 of Canada’s Charter of Rights and Freedoms, some thought might be given as to how the interpretation of ITA section 231.1(1) should be informed by the privacy expectations arising from that provision, in particular when the information being sought consists of highly confidential and purely subjective analysis rather than factual information genuinely required by the CRA to determine taxes pay-

able. Given the highly sensitive nature of the issues lists and the Crown’s acknowledgement that the CRA’s desire to obtain them is essentially based on convenience and efficiency rather than necessity,<sup>5</sup> a good case can be made for interpreting the law restrictively and pragmatically on these facts.

In that regard, it is essential to acknowledge that issues lists in no way substantively affect the taxpayer’s tax liability — that is, the amount payable under the ITA. That liability was determined when the relevant items of income were earned and the relevant deductible expenditures were incurred. An after-the-fact subjective analysis of the strength of the positions taken on a tax return prepared for financial statement purposes clearly does not in any way change what the taxpayer’s true liability is to pay any amount owing under the ITA (which exists independently of an assessment).

Subjective analysis that (if disclosed) would make the CRA more likely from a practical perspective to review or challenge a particular item but does not itself substantively affect the tax treatment of that item therefore is not relevant to, and as such does not “relate” to, what is or isn’t payable under the ITA.<sup>6</sup> Put another way, the relation test in ITA section 231.1(1) does not say “relates to any information that the Minister believes is or may be useful in administering or enforcing the ITA” or “makes any reference to amounts that are or could be payable under the ITA.” The words of section 231.1(1) are admittedly broad but they have some limits.

Indeed, the distinction between subjective analysis and information substantively relevant in determining what the taxpayer’s amount payable is can be found in the CRA’s own written arguments to the court (quoted above) citing the “information disadvantage inherent in a self-assessing system.” It is fair to observe that the CRA needs effective means to obtain information known only to (or most likely to be possessed by) the

<sup>5</sup>See the affidavit of the CRA auditor quoted by the court:

Risk analysis and assessment is a standard audit procedure employed by CRA whereby CRA reviews information concerning a taxpayer in order to determine the areas where there may be a loss of tax revenues. This procedure is generally done at the start of an audit and continues throughout the audit. The goal of this procedure is to determine the areas of highest risk for loss of tax revenue and to focus CRA’s audit resources on these areas. This is an efficient and cost effective manner to reduce the amount of necessary field audit work. . . . The working papers will identify areas where there is greatest likelihood of a questionable tax position in those years and in subsequent taxation years. This information will assist in the identification of areas of highest risk for loss of tax revenue and will focus the CRA’s audit resources on these areas.

<sup>6</sup>In another context, the CRA successfully convinced the Federal Court of Appeal that the term “relating to” “necessarily imparts an element of relevance.” *Owen Holdings Ltd. v. The Queen*, 97 DTC 5401 at 5403 (FCA).

<sup>3</sup>ITA section 248(1) defines the word “record” to include “an account, an agreement, a book, a chart or table, a diagram, a form, an image, an invoice, a letter, a map, a memorandum, a plan, a return, a statement, a telegram, a voucher, and any other thing containing information, whether in writing or in any other form.”

<sup>4</sup>In *R. v. He*, 2012 BCCA 318, the British Columbia Court of Appeal concluded that this limitation applied to ITA section 231.1(1) demands. *BP Canada* simply expresses the court’s conclusion on this point by stating that “an audit is not an expedition.”

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taxpayer in order to determine if what the taxpayer actually owes under the ITA is different than what it has reported in its tax return. However, if the CRA has access to the same factual information the taxpayer does via its information-gathering powers under the ITA (plus vast amounts of information on other taxpayers), it is difficult to justify interpreting ITA section 231.1(1) as broadly as the CRA asserts. Whatever *informational* disparity may exist, the CRA is certainly not under an *analytical* disadvantage relative to taxpayers (quite the opposite, given the CRA's resources). If the CRA has the same factual data that taxpayers do, it should be able to do its own analysis.

Instead, the court's analysis of the scope of ITA section 231.1(1) consists of a series of confusing and unsupported statements with no obvious link to the text of the provision:

- "As to the Minister not needing the Issues Lists to conduct and conclude a comprehensive and complete audit. This might very well be true, except for the fact that the Minister wants them, not only to expedite the audit process, but also for use in its continuing and future auditing of BP Canada. The need is for the Minister to determine."
- The issues lists "are relevant to the payment of tax under the [ITA] because they are an important tax record in BP Canada's possession."
- "The Minister is only asking for the disclosure of the Issues Lists already prepared and is not asking for anything to be prepared."<sup>7</sup>

The court does not explain how any of those statements (assuming them to be true) are germane to the interpretation of section 231.1(1). Whatever the correct formulation of the test is for the CRA to obtain information or documents under section 231.1(1), it is not "the Minister wants them" or "they are an important tax record in the taxpayer's possession."

The one portion of the judgment that does cite previous jurisprudence to assist in interpreting the ITA is similarly flawed:

I find that the working papers, containing the Issues Lists, are documents that: have a purpose related to the enforcement of the *Act* being taxation accountability (see: *Tower v MNR*, 2003 FCA 307 at paragraph 29); relate to information in BP Canada's records; and also relate to an amount payable by BP Canada under the *Act*. Regardless of the fact that tax accrual working papers contain subjective analyses of tax risk, together with factual information upon which tax reporting is founded, I

<sup>7</sup>In fact, in *Minister of National Revenue v. Tower*, 2003 FCA 307, cited in *BP Canada*, the Federal Court of Appeal rejected that distinction, concluding that the CRA's information-gathering powers under ITA section 231.2 include requiring taxpayers to answer specific questions and in so doing to generate new documents, not merely disclose existing ones.

find that the working papers under consideration fall within the scope of s. 231.1(1) because they are relevant to BP Canada's intention in creating the reserves (see: *Tower* at paragraph 31).

That is confusing, to say the least. To begin with, the purpose test included in ITA section 231.1(1) speaks to the purpose of the CRA's demand, not the purpose of the documents themselves. Moreover, BP Canada's purpose in creating the issues lists was clearly the preparation of financial statements, not the administration or enforcement of the ITA. BP Canada's taxes owing and the positions it took on its tax returns were unaffected by what was included in the issues lists or whether or not the issues lists were created at all. For the same reason, the statement that the TAWP come within section 231.1(1) "because they are relevant to BP Canada's intention in creating the reserves" is similarly baffling. On what basis is an intention to create a financial statement reserve that does not affect taxes owing under the ITA relevant to section 231.1(1)? The balance of that paragraph simply states conclusions rather than engaging in any analysis.<sup>8</sup> Is the court saying that any document in the taxpayer's possession constitutes the "books or records of the taxpayer," and if so, why is section 231.1(1) not worded that way?

Moreover, citing *Tower* as authority is perplexing. To begin with, *Tower* involved the interpretation of a different provision (ITA section 231.2(1)), which has the same purpose test but does not have the relation test.<sup>9</sup> Further, *Tower* dealt with factual information being sought by the CRA, not purely subjective analysis such as the issues lists, and involved the pursuit of a previously identified specific issue rather than a search for taxpayer-identified issues of potential controversy. The cited portions of *Tower* address whether "the requested information may be relevant in the determination of the tax liability of the named taxpayer" (which the issues lists are not, as noted above), and note that "tax planning information can shed light on intention" and may therefore substantively affect the amount of taxes owed when specific issues are present.<sup>10</sup> None of those factors exist in the case of the issues lists, making it

<sup>8</sup>"I find that the [TAWP] . . . relate to information in BP Canada's records; and also relate to an amount payable by BP Canada under the *Act*."

<sup>9</sup>Both of the cited paragraphs from *Tower* appear in the portion of the judgment titled "Issue c): Were the Requirements issued for the purpose of the administration and enforcement of the *Act* within the meaning of section 231.2?" which concludes "For the foregoing reasons, in my analysis the Applications Judge correctly determined that the Requirements were issued for the purpose of the administration and enforcement of the *Act*." Nowhere does *Tower* refer to "taxation accountability."

<sup>10</sup>Such examples cited in *Tower* of how information revealing taxpayer intention may substantively affect taxes owing include interpreting contracts, determining whether persons deal at arm's length, determining fiscal residence, determining the deductibility of interest, and applying the general antiavoidance rule.



difficult to understand how *Tower* supports the conclusions reached. Put simply, *Tower* involves a different provision on very different facts and does not address the relation test.

A further potentially relevant issue is the impact of the CRA policy statement. While administrative policies may not legally bind the CRA the way the ITA does, neither are they irrelevant. The jurisprudence is clear that “administrative policy and interpretation are not determinative but are entitled to weight and can be an ‘important factor’ in case of doubt about the meaning of legislation.”<sup>11</sup> Moreover, as a matter of administrative law, the courts have required the CRA to observe the factors set out in its own policies or guidelines when making decisions or exercising its discretion.<sup>12</sup>

The CRA policy statement refers to documents or information that are “necessary for the scope of their review” or “needed to conduct a proper . . . audit,” or needed “to determine the CRA’s position on an issue.” Necessity is a much different standard than convenience or efficiency. The CRA policy statement also provides that CRA officials will not be “influenced by any subjective analyses, comments or opinions contained in the information or documentation reviewed.” Yet the issues lists contain literally nothing other than the taxpayer’s own subjective assessment regarding potentially uncertain tax positions. If the CRA will not be influenced by subjective opinions, why then is it demanding to see issues lists that contain nothing else?

#### Compliance Order: Section 231.7(1)

Having decided that the issues lists were compellable under ITA section 231.1(1), the court then concluded that it should exercise its discretion to issue a compliance order in favor of the CRA under ITA section 231.7(1). The taxpayer cited several factors it believed made the issuance of a compliance order inappropriate:

- the CRA had not acted in good faith because it had allegedly misled the taxpayer in its requests for the issues lists as to its purpose and motive in wanting to see them;
- disclosure of the issues lists was not necessary for the CRA to conduct a full and fair audit;
- the CRA’s pursuit of the issues lists for the purpose of using them as an audit roadmap amounted to an “unauthorized fishing expedition”;<sup>13</sup>

- pursuit of the issues lists was contrary to various elements of the CRA policy statement;
- forcing the disclosure of TAWP discriminated against corporations required to prepare financial statements that include reserves for UTPs because it put them in a worse position relative to other taxpayers; and
- forced disclosure of TAWP would create adverse public policy consequences because it would be likely to result in financial statements of diminished quality.

While all those arguments are ones that might plausibly be relevant to the grant of a discretionary remedy, the judgment addresses only a few of them, with the result that the reasoning regarding ITA section 231.7(1) is even more sparse and less convincing than the analysis dealing with the scope of ITA section 231.1(1). The court spends most of its time on the bad faith argument, which suggests that as a legal matter the court accepts that the existence of bad faith would definitely be a significant factor in the exercise of its discretion. It stated, “I find that the bad faith argument raises an unresolved serious triable issue: on a balance of probabilities, did the Minister’s officials intend to mislead BP Canada’s officials?”

One might have thought the logical conclusion of that finding would be to convert the compliance order hearing into a trial in order to resolve that relevant factual issue. Instead, the court effectively resolves it in favor of the Crown by dismissing the taxpayer’s complaint and granting the compliance order.

The other issue the court addressed in exercising its discretion to make the compliance order is the perceived unfairness in forcing a taxpayer (or class of taxpayers) that is required to prepare TAWP for financial statement purposes to use them against itself, both in general and relative to other taxpayers who do not need to prepare TAWP. In its memorandum of fact and law, BP Canada noted submissions made to the CRA several years ago by the Canadian Institute of Chartered Accountants expressing concern that disclosure of TAWP would result in “restricted access for auditors to information critical for the assessment of financial statements and required by capital markets.” The taxpayer thus characterized the grant of a compliance order for TAWP as both discriminatory and detrimental as a matter of public policy.

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An audit is not an expedition . . . the Minister focused on a specific issue: the contents of the Issues Lists of the [TAWP]. Therefore, the Minister’s interest was specifically to obtain a clear roadmap to be used for current and future audits.

Apparently once an audit begins, any query (including asking the taxpayer which issues the CRA can most profitably allocate its resources to review) is immune from being characterized as “fishing.”

<sup>11</sup>*Nowegijick v. The Queen*, 84 DTC 5041 at 5044 (SCC).

<sup>12</sup>See Andrew Kingissepp and Trent Henry, “Managing the Confidentiality of Tax Accrual Working Papers,” *Report of Proceedings of 61st Tax Conference*, 2009 Conference Report (Canadian Tax Foundation) 29:1-28 at 29:19 (2010).

<sup>13</sup>The court summarily dismissed (in para. 38) that argument on the meager grounds that:

(Footnote continued in next column.)

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Crown counsel was clearly alive to those arguments and prepared a creative response that the court found persuasive:

On the point of fairness, the question is: “fairness to whom?” I find the more compelling argument is that expressed by Counsel for the Minister, quoted in paragraph 5 of these reasons:

If the CRA does not discover the transactions within the normal reassessment period, there is no scrutiny of the tax compliance with respect to these positions. There is no verification by the CRA, and there is no review by the Tax Court of Canada. If the CRA does not uncover the tax positions in time, the shareholders of BP win, and the taxpayers of Canada lose. If the tax position is discovered and challenged by the CRA, the matter can ultimately be resolved by the Tax Court of Canada as to the propriety.

I submit these are cases that should be reviewed by the CRA and ultimately by the Tax Court of Canada. Where large corporations are taking positions that are on the line, that they are not black and white, these are precisely the types of cases that should ultimately be resolved before the courts.

While superficially attractive, that version of “fairness” essentially translates into “the ends justify the means.” The CRA has ample resources at its disposal to discover transactions within the normal reassessment period: the full disclosure required on tax returns, its information-gathering tools in the ITA, and a small army of auditors and supporting experts (not to mention the fact that taxpayers who have generated TAWPs have generally been subject to careful scrutiny by their audit firms). Every taxpayer has one or more tax positions that have some significant degree of uncertainty, and litigating them all before the courts is impractical. The logical endpoint of the Crown’s argument is that the CRA should be entitled to use whatever means necessary to make sure that all UTPs are reviewed by the CRA and ultimately by the Tax Court of Canada in the name of “fairness.” The law is certainly not as one-sided and simplistic as that; rather, it balances competing interests of the government and individual taxpayers.

Indeed, if the government truly believes in the version of “fairness” advanced by Crown counsel, that demonstrates the importance of resolving the competing public policy issues in the appropriate forum: Parliament. If the CRA really wants to change the tax administration landscape as dramatically as this case seems to indicate, it should do so in an open, transparent manner via an amendment to the ITA, such that lawmakers have access to all relevant viewpoints and hearing from all interested parties, and giving them the

ability to make an informed and reasoned decision taking all the implications into account beyond the facts of any specific case.

In terms of those policy considerations, in its memorandum of fact and law, the Crown noted that in *Textron*,<sup>14</sup> the U.S. court rejected the argument that forced disclosure of UTPs would result in compromised financial statements and uncertainty in the capital markets. *Textron* (which was really a case dealing with privilege) does little to inform us in terms of correct policy choices in Canada. To begin with, the tax administration and legislation environment in the U.S. is materially different than in Canada. In the U.S., the IRS has a formal policy of restraint in dealing with TAWP<sup>15</sup> that establishes a standard quite different from demanding TAWP for use as an audit roadmap.<sup>16</sup> The U.S. has also enacted regulations establishing a formal process for reporting UTPs to the IRS in particular circumstances and in a specified form,<sup>17</sup> which largely occupy the field in this area in a transparent, comprehensive manner arrived at after considerable input from various interested parties. If anything, the U.S. experience demonstrates that a purely administrative and discretionary approach to the disclosure of TAWP on a case-by-case basis (and apparently in contravention of tax authorities’ own policy statements on the issue) is not the way to run the tax system of a First World country.

### What Should Taxpayers Do?

Faced with the risk — if not likelihood — that the CRA will demand to see its TAWP or similar subjective and potentially prejudicial analysis on tax positions taken, well-advised taxpayers should ensure that those kinds of sensitive communications and materials are created so as to fall within lawyer-client privilege. As noted recently in Canada<sup>18</sup>:

- solicitor-client privilege protects confidential communications between a lawyer and client made for the purpose of seeking or providing legal advice (including the interpretation of tax statutes); and
- the doctrine of limited waiver permits a taxpayer to disclose privileged information to its audit firm for the limited purpose of allowing its external

<sup>14</sup>*United States v. Textron Inc.*, 507 F. Supp.2d 138 (D.C. R.I. 2007), *aff’d*, No. 07-2631 (1st Cir. Jan. 21, 2009), *rev’d en banc*, No. 07-2631 (1st Cir. 2009), U.S. Supreme Court *cert. denied* (May 24, 2010).

<sup>15</sup>See LMSB-04-0507-044, “FIN 48 and Tax Accrual Workpaper (TAW) Policy Update” (May 10, 2007).

<sup>16</sup>See IRS Announcement 2010-76, 2010-41 IRB 432, “Requests for Documents Provided to Independent Auditors, Policy of Restraint and Uncertain Tax Positions” (Sept. 24, 2010).

<sup>17</sup>See IRS, “Uncertain Tax Positions — Schedule UTP.”

<sup>18</sup>*Supra* note 1.



auditors to complete its financial statements without that disclosure constituting a waiver of privilege.

That being the case, one would expect more taxpayers to undertake the work and analysis involved in preparing TAWP for presentation to their tax counsel in order to obtain the lawyer's *bona fide* assessment of the strengths and weaknesses of the UTPs identified — that is, do the work within the genuine scope of a lawyer-client relationship. Confidential communications and work product created for that purpose should properly come within the scope of solicitor-client privilege, and if disclosure of that work product to external accountants is necessary to complete the taxpayer's

financial statements, the principle of limited waiver should ensure that privilege is not thereby lost.

The CRA's information-gathering powers are broad, and its resources are virtually limitless compared with those of taxpayers. The CRA has shown itself willing to litigate particular cases to establish legal precedents that will be useful to it in dealing with other taxpayers. As such, the CRA has a litigation advantage in terms of resources and benefits that makes going to court over demands for information a practical alternative for very few taxpayers. *BP Canada* shows that lawyer-client privilege is the only reliable means for preventing increasingly aggressive tax authorities from obtaining taxpayers' confidential tax analysis. ♦