CRA's Access to Tax Accrual Working Papers

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BP Canada Energy Company v MNR, 2017 FCA 61

EDITORIAL NOTE - The FCAs reasoning in this decision - that interpreting subsection 231.1(1) as giving the Minister the power to have routine access to a taxpayer's uncertain tax positions would interfere with provincial financial disclosure laws - is unsound. Persons are expected to abide by all laws that apply to them and it seems problematic for a court to read down one law because taxpayers may then fail to abide by other laws. Such legal-arbitrage by taxpayers should not be condoned. It is interesting to see what the SCC will decide if this decision is appealed and how parliament will react to such a decision.

The Federal Court of Appeal considered whether or not the Federal Court (2015 FC 714) was correct in ordering BP Canada to produce internal accounting documents (Tax Accrual Working Papers) to the Minister pursuant to subsection 231.7(1) of the *Income Tax Act* for purpose of assisting the Minister in conducting an ongoing audit of the taxpayer. The Federal Court of Appeal rules that "the documents ordered to be produced, given the purpose for which they were sought, are beyond the reach of the Minister" (para 4).

Tax Accrual Working Papers are highly sensitive and often contain uncertain tax positions taken by public corporations in filing their tax returns as well as opinions as to the likely outcome should such positions be challenged by the CRA. This information is then used to take tax positions, and to establish reserves to ensure sound and fair financial reporting. In this case, the taxpayer refused to comply with the order, taking the position that "disclosure of its Tax Reserve Papers would not only provide the Minister with a roadmap to its uncertain tax positions, but the Minister would also gain access to the analyses behind those positions" (para 10).

ANALYSIS

The court began by outlining the type of information contained in TAWPs as:

- papers created for independent auditors to assist with the process leading to the certification of financial statements in accordance with GAPP;
    - this is a requirement imposed under provincial securities legislation;
- their purpose is to identify uncertain tax positions;
    - these are positions that are capable of being successfully challenged by the Minister;
    - they contain an opinion as to the likely outcome of a challenge;
- uncertain tax positions are used to provide for reserves which will allow the independent auditors to certify that the financial statements fairly and accurately reflect the financial situation of the corporation;
    - the reserve is meant to neutralize the distortion that results from the position;

The FCA also agreed that subsection 231.7(1) could not have been drafted in broader terms, but the use of this apparently broad power must relate to the Minister's administration or enforcement of the ITA. In this case, the Minister wants access to the TAWPs to facilitate audits, and this appears to be an authorized purpose.

Once it is shown that the Minister is acting for an authorized purpose, the court must look for one of three demonstrations to trigger the application of 231.1(1):

- The document being sought is part of, or is in, the books and records of the taxpayer;
- The document being sought relates or may relate to the information that is or should be in the books and records of the taxpayer; or
- The document being sought related or may relate to any amount payable by the taxpayer under the Act.

Although uncertain tax positions in TAWPs are not recorded by reason of an obligation arising under the ITA, they relate or may relate to information that is in the books and records of the taxpayer. The requirement to disclose any document that relates or may relate to information that can be found in the books or records kept under the ITA must be necessity include documents other than those that are required to be kept under the ITA. However, the FCA stated that the issue is not "whether the information revealed by BP Canada’s Tax Reserve Papers could be accessible under the Act" but rather whether subsection 231.1(1) "allows general and unrestricted access to this information" (para 67).

The auditor sought access to the details of the TAWPs after discovering that the tax at risk amounts identified by the taxpayer were significantly higher than the amounts the auditor proposed to add to the taxpayer's income. The documents were sought to complete the audit and make the audit more cost efficient. The Minister took the position that the uncertain tax positions should be seen as aggressive positions given that they were risked at 100%, but the Court noted that there is "no correlation between this percentage and the soundness of the positions to which it relates" as reserve optimization is a conservative approach to financial reporting (para 77).

The Federal Court of Appeal disagreed with the Federal Court and stated:

> 80] In my view, subsection 231.1(1), properly interpreted, does not make papers such as these compellable “without restriction”. When one examines the context and purpose of subsection 231.1(1), it is clear that Parliament intended that the broad power set out in subsection 231.1(1) be used with restraint when dealing with TAWPs. It follows that the decision of the Federal Court judge must be set aside.

The FCA referred to the nature of the Canadian tax system - being a self-assessment system - and said that although taxpayers are required to self-assess, this "does not require taxpayers to tax themselves on amounts which they believe not to be taxable" (para 82). Where an issue is reasonably up for debate, taxpayers are entitled to file their tax returns on a basis that is most favourable to them (para 82). Auditors must be left to their own initiative in verifying amounts reported by taxpayers and, although entitled to be provided with all "reasonable assistance" (paragraphs 231.1(1)(d)), "they cannot compel taxpayers to reveal their 'soft spots'" (para 82). To hold otherwise would be to compel the taxpayer to self-audit on an ongoing basis (para 83).

In enacting subsection 231.1(1), the FCA did not believe that it was Parliament's intention to vest the Minister with sweeping powers that would undermine the obligations imposed by securities legislation requiring reliable financial disclosure (para 87). The CPA, as intervener, argued that if this unrestricted access to TAWPs is granted, then:

publicly-traded corporations would, as a direct consequence, tend to refrain from documenting issues for their external auditors and be less candid in disclosing their tax risks [and i]nducing less disclosure of tax risks to auditors is detrimental to Canadians, be they individuals, corporations or governments, as it necessarily results in less protection by reason of the decreased reliability of financial statements.

The FCA referred to two US decisions where access was granted by to TAWPs and courts stated that this would not negatively affect financial disclosure. The Court distinguished those cases and stated that the US experience shows that general and unrestricted access to TAWPs would negatively impact financial reporting and impose an obligation on taxpayers that they do not have (para 95). The FCA stated that the Federal and Provincial powers must be read in harmony such that the power granted pursuant to subsection 231.1(1) of the ITA cannot be used to imperil the integrity of the financial reporting system put in place by the provinces (para 98).

This means that the Minister cannot invoke subsection 231.1(1) to gain general and unrestricted access to a taxpayer's TAWPs, and therefore cannot enlist taxpayer's who maintain these documents to perform the core aspect of audits conducted under the ITA (para 99). The Minister does have the power to access TAWPs, but this power cannot be used routinely (para 103). The FCA also noted that the Minister was acting contrary to its own published policy not to seek routine access to a taxpayer's uncertain tax positions.

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