MINISTER OF NATIONAL REVENUE v. BP CANADA ENERGY COMPANY

Re: Disclosure of Tax Accrual Working Papers

The recent decision of the Federal Court of Canada in the case of *Minister Of National Revenue v. BP Canada Energy Company*[1] vividly illustrates how the Canada Revenue Agency (the "**CRA**") is becoming increasingly aggressive in its audit practices, supported by broadly-worded statutory powers and accommodating courts.

BP Canada is a Canadian subsidiary of BP p.l.c., a European public company in the oil & gas business. For financial reporting and other regulatory purposes, each corporate member of the group is required to prepare financial statements in accordance with generally accepted accounting principles. In particular, each such corporation must calculate reserves to account for contingent tax liabilities. Those calculations supported by working papers, or tax accrual working papers ("**TAWP**"), must include an estimate of the tax liability the corporation would face if the tax authorities were to challenge uncertain tax positions reported on the corporation's self-assessed tax return.

In the case of BP Canada, the TAWP's were prepared by internal accountants to identify the issues which BP believed might merit adjustment. During the course of a regular audit by a team of CRA tax auditors, the existence of the TAWP's came to their attention. The CRA considered these documents would disclose uncertain tax positions of BP Canada, which in its view meant the highest risk for loss of tax revenue and, therefore, the CRA would focus its audit resources in those areas.

Accordingly, the CRA made a demand for disclosure of the TAWP's under the authority of subsection 231.1(1) of the Income Tax Act (Canada) (the "**ITA**"), which in summary form empowers the CRA to obtain documents and other information from the taxpayer (a) if the purpose of the demand is related to the administration or enforcement of the ITA (the "**Purpose Test**"), and (b) the aforesaid documents or other information relate to information that is in the taxpayer's books and records (or should be there), or relate to any amount payable by the taxpayer under the ITA (the "**Relation Test**").

Following BP Canada's partial compliance with the demand and its refusal to give a complete disclosure, the CRA sought a court order from the Federal Court of Canada under subsection 231.1(7) to compel BP Canada to comply completely with the demand.

Among the submissions by BP Canada to resist the CRA's demand was the citation of the published policy of the CRA regarding TAWP's. The CRA stated that while they believed that they are empowered to obtain any document of the taxpayer that meets the Purpose Test and the Relation Test, including TAWP's, they established certain self-imposed restraints. First, tax auditors are supposed to be objective when reviewing any information or documentation obtained during an audit. They are not to be influenced by any subjective analyses, comments or opinions contained in the material so obtained. Second, the CRA stated that, although not routinely required, officials may request TAWP's.

BP Canada submitted that the CRA was not following its own policy, and that these TAWP's were subjective analyses and did not meet the Relation Test, as the tax liability of the corporation was to be determined based on an objective analysis of the positions set out in its tax returns.

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[1] 2015 FC 714

Moreover, the CRA failed to meet the Purpose Test, as the CRA acknowledged that it did not require these papers for its current audit but sought them to expedite the current and future audits.

In addition, BP Canada argued that this request amounted to a "fishing expedition", something the courts have not permitted the CRA to do in the past.[2]

In support of its application for the court order, counsel for the Minister of National Revenue argued that:

> "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. Where 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."[3]

In addition, counsel for the Minister argued that the court should exercise its discretion under subsection 231.7(1) once it has determined that the TAWP's are compellable, on the basis that where large corporations take positions that are on the line, these are the very transactions that the CRA and, ultimately, the Tax Court of Canada should be able to review. Otherwise, the shareholders of BP win and the taxpayers of Canada lose — which would clearly be an unfair result.

Based on a cursory analysis of the parties' arguments, the court held in favour of the Minister. BP Canada is appealing the decision.

Two comments bear mentioning. First, while it is true that the CRA should have effective means to obtain information known only to the taxpayer in order to determine if the taxpayer has been compliant; nevertheless, once the CRA has done its audit and possesses the same factual information as the taxpayer, there is no disadvantage. In particular, there is no analytical disadvantage as compared with taxpayers who make their own subjective risk analysis, given the vast resources available to the CRA.

Second, this case serves as a warning to all taxpayers that even sensitive, confidential, tax-related information prepared for internal risk-assessment purposes will be compellable in a court of law, subject to one important exception — solicitor/client privilege. This privilege protects confidential communications between a lawyer and client made for the purpose of seeking or providing legal advice. In addition, the doctrine of limited waiver permits a taxpayer to disclose privileged information to its external audit firm for the limited purpose of allowing them to complete the taxpayer's financial statements, without that disclosure constituting a waiver (and, therefore, a loss) of privilege.[4]

Lorne H. Saltman
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[2] See *James Richardson & Sons v. M.N.R.*, [1984] 1 S.C.R. 614 (Supreme Court of Canada), and *R. v. He*, 2012 BCCA 318 (British Columbia Court of Appeal).

[3] *Ibid*, Paragraph 14.

[4] See *Philip Services Corp. (Receiver 699 v. Ontario Securities Commission*, 77 O.R. (3d) 209 (Ontario Divisional Court).