

Federal Court



Cour fédérale

Date: 20150605

Docket: T-908-12

Citation: 2015 FC 714

Ottawa, Ontario, June 5, 2015

PRESENT: The Honourable Mr. Justice Campbell

BETWEEN:

MINISTER OF NATIONAL REVENUE

Applicant

And

BP CANADA ENERGY COMPANY

Respondent

ORDER AND REASONS

[1] The present Application concerns a demand made by the Applicant Minister (Minister) pursuant to s. 231.1(1) of the *Income Tax Act*, RSC 1985, c. 1 (5th Supp.), as amended (*Act*), requiring the Respondent (BP Canada), a publicly traded company, to provide records that describe its uncertain tax positions to assist the Minister in conducting its present and future tax audit responsibilities. BP Canada objects to providing the records. The Minister brings the present Application pursuant to s. 231.7(1) of the *Act* to obtain an order compelling BP to provide the records.

[2] The present Application is supported by the Affidavits of Ms. Dawn Temple, Large File Case Manager for the Minister, and Mr. Steven M. Ingram, past Senior Tax Advisor to BP Canada, who were both instrumentally involved in the subject matter under review.

I. Overview of the Present Application

[3] In written argument, Counsel for the Minister provides the following overview:

The Minister of National Revenue is conducting an audit of BP Canada Energy Company and seeks production of certain of BP's working papers for purposes of the audit. The working papers were prepared by BP's in-house staff and they list uncertain tax positions, thereby identifying areas at the highest risk of loss of tax revenue. The Minister seeks production of these working papers to verify whether BP has complied with the *Income Tax Act*.

As with all other taxpayers in Canada, BP is required by law to file a tax return and to estimate its tax payable. The Minister has a statutory duty to verify whether taxpayers' self-assessments of tax payable are accurate.

In order to assist the Minister in carrying out her statutory duty, Parliament has provided the Minister with broad information gathering powers. The Supreme Court of Canada has stated that these include the power to “inspect, audit or examine a wide array of documents, reaching beyond those that the Income Tax Act otherwise requires the taxpayer to prepare and maintain”. The Supreme Court of Canada has also held that it is the prerogative of the Minister to decide whether she will conduct an audit and the form that audit will take.

The documents at issue in this application are accounting documents generally called tax accrual or tax reserve working papers. A taxpayer who takes uncertain tax positions must create prescribed accounting entries known as “reserves”, which represent the tax and interest that may be payable if that position is found to be incorrect. A tax reserve for an uncertain tax position is only created if, in the taxpayer's opinion, the Minister is unlikely to accept the taxpayer's position.

In the course of the Minister's audit of BP and related corporations, the Minister asked BP to produce its tax accrual working papers. The documents were produced with the list of uncertain tax

positions redacted. The Minister brings this application to obtain a compliance order under s. 231.7(1) of the *Income Tax Act* requiring BP to produce unredacted copies of the documents.

(Minister's Memorandum of Fact and Law, paras. 1-5 [Footnotes omitted])

[4] More precise details of the Minister's request are as follows:

Publicly traded corporations such as BP p.l.c. the ultimate parent company of the respondent, are required for financial reporting and other regulatory purposes to prepare consolidated financial statements in accordance with generally accepted accounting principles ("GAAP"). To prepare financial statements that comply with GAAP, the corporation and its subsidiaries must calculate reserves to account for contingent tax liabilities. Those calculations must include an estimate of the liability BP would face if the Minister were to challenge uncertain positions on BP's self-assessed tax return. The calculations are supported by working papers.

The working papers maintained by BP identify the issues [the Issues Lists] which BP knows may merit adjustment. BP's list of uncertain tax positions would identify the areas at highest risk for loss of tax revenue. The Minister seeks disclosure of this list to verify whether BP's uncertain tax positions are compliant with the *Act*.

(Minister's Memorandum of Fact and Law, paras. 31-32 [Footnotes omitted])

[5] The Minister considers BP Canada as a "a large filed audit" and, thus, it is audited on an annual basis. Specifically, Ms. Temple, the Minister's Manager of the BP Canada Audit Group at the time relevant to the present Application, states the audit value of the unredacted working papers sought to be produced:

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 unredacted working papers that CRA has asked for during the 2005, 2006 and 2007 audits [specifically related to Query 2005-10.1, Query 2006-10.1, and Query 2007-10.1] will assist the CRA to verify BP's taxable income. 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.

[...]

Production of the unredacted working papers for 2005, 2006 and 2007 will also assist in the audit of subsequent taxation years.

[Emphasis added]

(Affidavit of Dawn Temple dated May 30, 2012), paras. 5, 44 and 45)

[6] In addition, in the course of oral argument, Counsel for the Minister explained the concern behind the request for the production order being sought:

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.

(Transcript, p. 11)

[7] The Minister and BP Canada both agree that the Issues Lists provide a “roadmap” to target audit resources on issues of concern.

II. Issues for Determination

[8] The issues for determination with respect to the scope and applicability of s. 231.1(1) and s. 231.7 the *Act* are as follows:

1. As argued by BP Canada, is the Minister entitled to compel BP Canada to disclose the Issues Lists for the purpose of expediting the Minister’s future audits?

For the reasons that follow, I find the answer is “yes”.

2. Should the Court exercise discretion not to compel the Issues Lists?

For the reasons that follow, I find the answer is “no”.

3. Is the Minister’s demand for the Issues Lists unfair to BP Canada?

For the reasons that follow, I find the answer is “no”.

[9] For convenience, s. 231.1(1) and s. 231.7(1) of the *Act* are quoted in *Appendix A* to these reasons.

III. Issue One: Compellability of the Issues Lists

[10] The issue is a matter of law. As such, the Minister argues that the Minister’s long-standing policy on the issue is irrelevant to the legal issue. I agree. However, I find that the

policy is relevant as contextual information with respect to the discretion-based arguments advanced by BP Canada.

A. The Minister's Policy

[11] For many years, the Minister has taken the position that tax accrual working papers, such as those at issue in the present Application, are compellable, but the position has been exercised with non-binding restraint. In 2004, the following confirmation was provided:

Department's Position

It is not the policy or practice of the Department routinely to request audit files from accountants for inspection. Normally, any such request would result only when the auditor's files form part of the taxpayer's records and a proper examination could not be carried out without access to those files.

[...]

It is not the policy of the CCRA to request a general access to accountant's working papers for the purpose of scrutinizing them in the course of conducting an audit.

(Joint Application Record, Vol. III, Ingram Affidavit, Exhibit F, pp. 433 – 434)

[12] On May 10, 2010, the Minister issued a statement entitled "Acquiring Information from Taxpayers, Registrants and Third Parties." In the statement the Minister made two points cogent to the present Application:

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.

[...]

"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).

[...]

Although not routinely required, officials may request tax accrual working papers.

[Emphasis added]

(Joint Application Record, Vol. III, Ingram Affidavit, Exhibit K, pp. 499 – 500, 503)

[13] Thus, in May 2010, the Minister clearly expressed that tax accrual working papers such as those under consideration in the present Application are compellable.

B. The Minister's Position

[14] As a matter of law, the Minister argues:

Canada has a self-assessing and self-reporting system of taxation. Each taxpayer who is required to file a return must estimate the tax payable and report that amount in a return filed with the Minister without notice or demand. While taxpayers are entitled to arrange their affairs in such a way as to minimize their tax burden, some taxpayers use elaborate plans and complex transactions designed to minimize or avoid their tax liability.

The Minister's duty, through her officials at the CRA, is to administer and enforce the *Income Tax Act*. The Minister must determine whether the taxpayer's self-assessment is accurate or whether some item contained in the tax return should be adjusted. The Minister must do so within a limited period known as the "normal reassessment period."

In order to verify taxpayers' self-assessments, Parliament has provided the Minister with broad powers to obtain information and

documents from taxpayers under audit and from other parties. The exercise of these powers to ensure taxpayers pay the correct amount of tax is in the public interest.

The Minister has a statutory duty to assess the amount of tax payable on the facts as she finds them in accordance with the law. The taxpayer under audit cannot be allowed to frustrate the Minister's ability to perform this duty. 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. 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.

Subsection 231.1(1) of the Act is the Minister's primary audit tool for obtaining documents from taxpayers under audit. [...].

Subsection 231.1(1) is one of several provisions that provide the Minister with the power to request and compel production of documents from taxpayers and other parties for purposes of an audit or for other purposes relating to the enforcement and administration of the Act.

Pursuant to subsection 230(1), taxpayers are required to maintain books and records containing information that will enable their tax payable to be determined. However, in conducting an audit, the Minister is not restricted to simply reviewing these documents. The Supreme Court of Canada, in *Jarvis*, noted that the power of inspection afforded the Minister under section 231.1 allows a person authorized by the Minister to “inspect, audit or examine” an assortment of documents which reaches “beyond those that the Act otherwise requires the taxpayer to prepare and maintain”.

The Minister regularly seeks from taxpayers, and from third parties, production of documents that were created and maintained by those persons for other purposes, for example: banking statements, credit card information and corporate reorganization documents in the possession of a bank; financial statements

prepared for and submitted to another regulator; financial statements of a taxpayer's foreign parent corporation; sales records maintained by an online auction house; minute books and other corporate records; transaction documents in the possession of a lawyer; and tax planning documents that are not privileged.

BP was asked to produce its tax accrual working papers pursuant to s. 231.1(l) of the Act. Where, as here, the taxpayer refuses to provide documents in response to an audit query, compliance can be ordered on application under s. 231.7 [...].

(Minister's Memorandum of Fact and Law, paras. 21 – 30
[Footnotes omitted])

C. BP Canada's Position

[15] The following arguments are advanced on the point of law under consideration:

BP Canada submits that the Minister's application should be dismissed. The statutory requirements for the issuance of a compliance order have not been satisfied: the Minister does not require the Issues Lists to fulfill her duty to administer and enforce the Act. The Minister is afforded broad authority to access the information that is (or should be) in the books and records of a taxpayer - the source documents that evidence the transactions and activities that result in the income that is (or should be) reported. However, the Act does not require taxpayers to prepare GAAP financial statements or the reserve analysis reflected therein. The Issues Lists reflect BP Canada's subjective opinion regarding potential tax risk in taxation years that are now statute barred. Any such list cannot be seen as relating to the determination of taxable income under the Act. Moreover, it is obvious that the Minister does not require the Issues Lists because she has successfully completed her audit of each taxation year to date without them.

Even where the statutory requirements for a compliance order are met, this Court must additionally find that the circumstances of the application justify the exercise of its discretion to grant the order. BP Canada says that the exercise of discretion is not justified on the facts of this application. First, the disclosure of the Issues Lists would constitute a compulsory self-audit by BP Canada, distorting the operation of the Canadian taxation system. Second, the Minister's own policy and established practice demonstrate that the Issues Lists are not required for the administration and enforcement of the Act. Third, the Minister's requests for the

Issues Lists over the course of relevant audits have been misleading and opaque, contrary to her duty to conduct audits in good faith. Finally, compelling the production of the Issues Lists would be contrary to the public interest in full and frank disclosure of tax risk for financial reporting purposes, without fear of repercussions. Each of these factors weighs against the exercise of discretion by this Court to grant the compliance order requested by the Minister.

(BP Canada's Memorandum of Fact and Law, paras. 7 – 8)

[16] In addition, BP Canada specifically argues that the Issues Lists should not be compelled because to do so fundamentally offends the principles of the self-reporting tax system that the Minister administers as a matter of law:

Self-Audit Is Not Supported by the Scheme of the Act

In this case, the Minister asserts an unfettered entitlement under s. 231.1 to any and all taxpayer information that may be of advantage to the Minister. She takes the position that she may demand access to reserve working papers at any time for the purpose of identifying audit issues. More particularly, she asserts at paragraph 32 of her Factum that the Issues List "would identify the areas at highest risk for loss of tax revenue" and that she "seeks disclosure of this list to verify whether BP Canada's uncertain tax positions are compliant with the Act."

In other words, the Minister asserts that s. 231.1 should be read so as to single out the class of taxpayers like BP Canada that maintain tax accrual working papers, and require those taxpayers to undertake a key part of the CRA's audit function and provide a checklist of issues for the CRA to investigate. The Minister's assertion is incompatible with a properly contextual reading of s. 231.1 within the Act. This asserted interpretation ignores both the statutory context within which the Minister is granted her investigative audit powers in Part XV of the Act and the operating framework of the Canadian tax system which is founded upon self-assessment by the taxpayer and audit by the Minister.

The scope of s. 231.1 has not previously been considered by the courts in the circumstances raised by this Application. However, the context and purpose of this provision are aids to its interpretation. In this case, the starting point for construing the

applicable statutory scheme is that the Canadian income tax system relies on self-reporting; it is not a self-auditing system. Taxpayers are obliged to fully and accurately report their income, and the Minister is charged with the duty of verification.

The common understanding of the roles of the taxpayer and the Minister in the Canadian system is concisely summarized by Vern Krishna as follows:

The income tax system relies primarily upon self-assessment and "voluntary" reporting of tax liabilities. The taxpayer initially determines his or her liability and submits the tax return to the CRA.

...

But that is not the end of the tax process. Although the tax system relies on self-assessment, the CRA has substantial audit and investigative powers to ensure compliance with the Act. ...

The civil audit is an examination for the purpose of verifying the accuracy of the taxpayer's self-assessed income. Such an audit under the CRA's regulatory powers is simply a routine process for verifying the taxpayer's financial information and examining relevant supporting documents. The purpose of the audit is to ensure regulatory compliance, mathematical accuracy and supporting data. If the Agency disagrees with the taxpayer's self-assessed income, it will reassess the taxpayer and charge interest on any deficiency in taxes paid.

[*The Fundamentals of Canadian Income Tax*, 9th (2006) Edition, Thomson Carswell (Toronto) at 956]

Thus, it is the taxpayer who self-assesses and reports income on the applicable information or tax return, and the CRA conducts the often laborious task of auditing those returns.

(BP Canada's Memorandum of Fact and Law, paras. 49 – 52
[Footnotes omitted])

[17] In the course of oral argument, Counsel for BP Canada clearly and capably illustrates the point with the following analogy:

I don't know how many millions of Canadian taxpayers just filed their tax returns in April. Many of these taxpayers are business people. They carry on a business. Their returns are not simple. Somebody is in an oil and gas business. Somebody has a widget manufacturing business. They all file their tax returns. They prepare their tax returns the way the law requires them to: truthfully. They fill in all the boxes, prepare all the statements, sign at the bottom of the return saying, "As a citizen and a taxpayer, I am now sending you my tax return, Mr. Minister. Thank you very much."

The next day, the auditor shows up at the taxpayer's offices. She says, "I am about to start my audit. Before I start my audit because, you know, times are tough: we have to conserve audit resources. Your return is complicated, it has all these issues in there, oil and gas deductions, interest deductibility, financing costs, etc. Before I start my audit, would you please give me a memorandum outlining for me which part of your tax return is controversial, which part of your tax return do you think I should focus on. Just write up a memo, the top five issues. If you do that for me, it will make my audit easier, and it will help me direct the scarce resources that I have.

"The taxpayer says with a smile to the Minister, "Look. In a self-assessment system, I have to prepare an accurate tax return, I have to remit the correct amount of tax: that is a self-assessment system. Mr. Minister or Madam Minister, over to you. Part of your job is to decide what you want to look at. I know there may be 50 issues in my tax return. You can look at all 50 of them. You can choose to look at two of them. You can look at 10 of them. The power to audit and the responsibility to audit, I emphasize, the responsibility to audit is yours. The responsibility to audit is not mine."

"We have a self-assessment system. We do not have a self-audit system. I have all my books and records here. I have a cancelled cheque for every dollar the business spent. I have an invoice for everything we paid. I have bank statements showing every dollar I received. I will give you access to everything unfettered but you must do your job. Your job is to decide what issues you want to look at. You can't conscript me into identifying for you what it is that you should look at. I have my judgment about my tax return.

My judgment doesn't arise from any dishonesty. It arises because your tax system is complicated."

(Transcript, pp. 64-66, edited for syntax)

D. Conclusion

[18] BP Canada is a taxpayer under the *Act*. As any other taxpayer, BP has serious decisions to make in declaring its taxable income. As any other taxpayer, BP must decide what income is taxable. In instances of uncertainty, BP can choose to not declare certain income as taxable, in hopes that the Minister will not disagree upon consideration.

[19] However, only because it is a publicly traded company, by an authority other than under the *Act*, BP Canada is required to create accounting entries known as "reserves" which represent the tax and interest that may be payable if its decisions prove to be incorrect. The accounting entries are the working papers required to be kept, which include the Issues Lists that identify the tax issues concerning the undeclared income.

[20] In my opinion, BP's objection to divulging the Issues Lists is about accountability. Every taxpayer is accountable to the Minister. That accountability is enforced by an examination of the taxpayer's records on an audit. For an understandable reason, not all taxpayers are audited; it would take unavailable immense resources to do so. Some taxpayers are audited as a matter of course; BP Canada is one among many others. Because it is under constant audit, BP Canada, as a practical matter, is more accountable than other taxpayers. This differential is a matter of fact and is not contrary to the scheme of the *Act*.

[21] BP Canada does not object to accountability; however, through the various arguments presented, it objects to the certainty of accountability that will arise from the disclosure of the Issues Lists.

[22] The following are my findings on the four arguments presented.

[23] First, 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; this point is clearly stated in the Minister's policy statement of May 10, 2010.

[24] Second, as to the Minister's use of the Issues Lists as offending Canada's self-reporting tax system by instituting a system of self-auditing. I am unable to give any weight to this argument. The "conscription of the taxpayer" argument is not apt to the facts of the present case. The Issues Lists were prepared, reflecting an opinion on tax liability based on a choice to create the reserve. The Minister is only asking for the disclosure of the Issues Lists already prepared and is not asking for anything to be prepared. In my opinion, to do so does not instigate the "self-audit" illustrated in the analogy.

[25] Third, as to the Issues Lists not being compellable simply because the *Act* does not require that they be kept. I disagree. The fact that the Issues Lists are required to be kept by an

authority other than under the *Act* is irrelevant. However, they are relevant to the payment of tax under the *Act* because they are an important tax record in BP Canada's possession.

[26] And fourth, as to the Issues Lists not relating to the determination of taxable income under the *Act*. On a literal interpretation of s. 231.1(1), I disagree. 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 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).

[27] Thus, in my opinion, as a matter of law, the Issues Lists with respect to Query 2005-10.1, Query 2006-10.1, and Query 2007-10.1 are compellable.

E. Ramifications

[28] BP Canada makes the following argument under the heading: *Disclosure of Working Papers both Detrimental & Discriminatory* :

In deciding whether to grant the compliance order on a discretionary basis, BP Canada submits that this Court should consider the public policy consequences of granting access to tax reserve information. It is undisputed that tax accrual working papers contain information that enables independent auditors to fulfill their responsibility to "probe, question and exercise [their] professional judgment for the purpose of forming an opinion relative to a corporation's financial statements". Their access to

these records is important for ensuring public and international confidence in the functioning of Canadian and American capital markets.

This was recognized by the Task Force convened by the CICA in connection with the CRA's review of its policy respecting the disclosure of working papers. In November, 2004, the Task Force wrote to the Minister setting out its submissions about the CRA policy. In that letter, it observed that a reversal of the CRA's established practice of not routinely requesting access would lead "companies to seek legal privilege to cloak procedures leading to estimates of tax liabilities," and warned that such would result in "restricted access for auditors to information critical for the assessment of financial statements and required by capital markets."

Routine and unprincipled requests for the list of issues underlying tax accrual working papers would place public companies in an untenable position: required by law on the one hand to reserve for their uncertain tax positions fairly and accurately, and compelled on the other hand to disclose that internal analysis of tax risk to the Minister. Such requests also run counter to the scheme reflected in the Act relating to the Minister's audit function, which is neutral as between various classes of taxpayers. Absent exceptional circumstances, this Court should not exercise its discretion to order the disclosure of such information.

(BP Canada's Memorandum of Fact and Law, paras. 79 – 81
[Footnotes omitted])

[29] By bringing the present Application, the Minister is adhering to, and implementing the policy that, without restriction, working papers are compellable under the *Act*. In the circumstances of the present case, and in view of the conclusion just expressed agreeing with the Minister's position, if concerns arise within the industry, of which BP Canada is a part, it is for the Minister to address the concerns. The Minister is taken to know the ramifications of a successful outcome on the legal issue in the present Application. The public and industry interest is within the Minister's purview, and not the Court's.

IV. Issue Two: Should the Court Exercise Discretion?

[30] BP Canada argues that the Minister's representatives conducted themselves in bad faith during the factual scenario leading to the present Application. BP Canada argues that this bad faith conduct requires that discretion should be applied to deny the order for production of the Issues Lists if compellable according to law (see: *MNR v Greater Montreal Real Estate Board*, 2007 FCA 346 at paragraph 48). The Minister does not contest that the Court has the discretion to deny an order with respect to s. 231.7(1) of the *Act*.

A. The Minister's Perspective

[31] The many discrete elements of the scenario are provided in the following paragraphs of the Minister's Memorandum of Fact and Law:

THE MINISTER'S AUDIT OF BP AND BP'S REFUSAL TO PRODUCE ITS WORKING PAPERS

The CRA conducts restricted or a full compliance audits depending on the size and income of the taxpayer. The CRA generally conducts full compliance audits annually on large corporations such as BP. These audits are called "large file case audits" or "large file audits".

Large file audits are conducted by audit teams. Since 2003, Dawn Temple has been the Large File Case Manager for BP's annual audits. By the fall of 2009, the audit team for BP's large file case audit was staffed by officers from the Calgary Tax Services Office of the CRA including several income tax auditors, a GST auditor, a tax avoidance auditor, an international auditor and an electronic commerce audit specialist.

In the fall of 2009, the team was auditing BP's taxation year ended July 31, 2005 and provided the company with a general audit plan (the "2005 Plan") setting out the issues and entities to be audited, relevant audit procedures, past audit issues, timelines and budgeting concerns. Throughout the 2005 Plan, the reader is advised that changes may be made to any of the items under consideration, including adding other entities, adding other issues,

and auditing specialty issues identified by Tax Avoidance or International Audit. While the 2005 Plan provides a very general list of the records to be made available including, "Minute Books, Taxpayers' Working Papers, Year End Trial Balances and AJE's, Published Annual Reports, Contracts for Major Purchases and sales; AFE's and Invoices; [and] Computerized Data for ECAS Section", it also states that the team would be making requests for information in writing at each monthly update meeting under the authority of subsection 231.1 (1) of the Income Tax Act.

It is common when preparing these general audit plans for the CRA to create its own risk assessment working papers outlining and describing the audit issues and the amounts in issue. During the course of a large file audit, a statement of proposed audit adjustments is continuously updated in order to keep track of the potential changes to the tax liabilities of the taxpayer.

The audit team identified issues considered to be high risk for the oil and gas industry and for BP in particular. The purpose of this was explained by Ms. Temple in her affidavit:

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. [emphasis added in the original]

The 2005 Plan identifies 16 general audit issues for BP, 12 general audit issues for its related corporations, and 30 industry issues. The 2005 Plan also itemizes 16 major adjustments to BP's income from previous audits. Many of the issues and items so identified involved recurring adjustments from prior taxation years.

[redacted]

In the course of verifying certain amounts of interest recorded by BP in its 2005 taxation year, the CRA traced an amount of [redacted] to a particular account in BP's working papers. The [redacted] was an amount that was included in the computation of net income but excluded from the computation of taxable income.

The amount was included in an expense account named "Interest Expense Taxes Payable Disputed Accruals". On March 22, 2010, an auditor issued Query 2005-10 to BP, noting that no records were maintained in BP's electronic database regarding this account, and requesting:

all the original supporting working papers that were created at the time these entries were booked and all related documentation. If not included in the original working papers, please also provide all calculations, any assumptions that were made, the entity involved, taxation year, type of tax, estimate of tax and the interest rate used.

BP resisted producing the requested working papers. First, it provided an explanation without documentation. Then, in response to a further request made by Query 2005-10.1, BP asked to meet with the audit team. Two such meetings were held on May 4 and 6, 2010, during which BP again expressed its resistance to production. One week following the second meeting, BP generated and delivered a memorandum outlining their position, and attached some of BP's working papers in redacted form. The redacted working papers show the amounts of the reserves but conceal the description of the income tax issues for which the reserves were taken.

The CRA observed that there were material differences between the income tax reserve amounts identified in BP's working papers and the tax at issue identified by the CRA in the course of the audit. BP had tax reserves as at June 30, 2005 of [redacted] while the CRA had, by July 2010, identified additional income of only [redacted] for the 2005 tax year. Ms. Temple was "unable to confirm whether the CRA had identified the tax issues identified by BP for 2005" and, having no other means by which to ascertain BP's tax reserves, the CRA repeated its request for the unredacted working papers. BP again refused to provide them.

Following those events, the audit team undertook audits of BP's 2006 and 2007 taxation years. General audit plans were also prepared and submitted in respect of these two years. The 2006 Plan and the 2007 Plan were similar in form and substance to the 2005 Plan. As the issue concerning BP's tax accrual working papers was already alive from the 2005 audit, specific requests were made for the same documents for the 2006 and 2007 audits.

BP refused to provide anything in response other than redacted working papers. The redactions were akin to those made in the

2005 working papers: BP's description of the tax issue for which the reserve had been taken was redacted. The amounts of tax at risk were not redacted. BP's tax reserves as at June 30, 2006 were [redacted] and as at June 30, 2007 had increased to [redacted]. Again Ms. Temple was unable to confirm whether the CRA had identified the same tax issues in its risk assessment that BP identified in its working papers.

(Minister's Memorandum of Fact and Law, paras. 6 – 17
[Footnotes omitted])

[32] Counsel for the Minister provides the following explanation for the requests made of BP Canada:

THE PURPOSE OF THE REQUEST FOR BP'S TAX ACCRUAL WORKING PAPERS

The unredacted working papers that CRA has asked for during the 2005, 2006 and 2007 audits will assist the CRA to verify BP's taxable income. The working papers will identify areas where there is the greatest likelihood of questionable tax positions. 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.

BP's 2005 working papers were not initially sought for this purpose during the audit of the 2005 taxation year. They were initially sought for purposes of verifying whether BP was properly excluding interest of [redacted] from taxable income in 2005. Since the 2005 and 2006 taxation years have already been reassessed, this information is no longer being sought for purposes of auditing the 2005 and 2006 taxation years, but rather for purposes of auditing subsequent taxation years.

[Emphasis added]

(Minister's Memorandum of Fact and Law, paras. 18 – 19
[Footnotes omitted])

B. BP Canada's Perspective

[33] BP Canada argues that the Minister's representatives conducted the scenario with bad faith. The argument is based on an opinion that the Minister's true intentions, as held and played out by the audit team, were not divulged during the course of the exchanges with BP Canada's representatives in the scenario.

[34] On the face of the affidavit evidence, there was nothing untoward in the exchanges which took place, albeit, on a contentious topic. In the course of a respectful exchange leading to the present Application, numerous requests were made for the Issues Lists with respect to the 2005, 2006, and 2007 Queries under consideration. In the course of the process, BP tried to satisfy the Minister's persistence by accommodating as much as it felt it could. In the end, BP supplied the Minister with a copy of the working papers, but with the key Issues Lists being redacted.

[35] However, BP Canada argues that the scenario was conducted with an underlying pernicious intention to mislead on the part of the Minister's officials. This position is clearly stated in BP Canada's written argument:

Court Should Not Exercise Discretion to Grant the Compliance Order

If this Court were to find that the Issues Lists are within the scope of the documents required to be produced under s. 231.1 (contrary to the submissions above), the Court must additionally be satisfied that the exercise of its discretion to grant the order sought by the Minister is justified in the circumstances of this Application. As noted in *Greater Montreal REB* in the analogous context of the Minister's information gathering powers under s. 231.2, the Court must be "satisfied that the information or documents are *required* for a tax audit conducted in *good faith*. This good faith guarantees that the MNR will act *judiciously* in the exercise of its audit power". [Emphasis added in original]

BP Canada submits that the issuance of a compliance order would not be just and appropriate in this case. The Issues Lists are not required for the Minister to conduct her audit, nor has the Minister acted in good faith in requesting the Issues Lists during the conduct of the relevant audits. In short, she is not acting judiciously in the exercise of her audit power in relation to her request for the Issues Lists, having regard to the information she has requested and received to satisfy her actual audit inquiry (*i.e.*, to determine whether the change in BP Canada's account for interest on its tax reserves was properly excluded from taxable income).

Disclosure of Issues Lists Facilitates an Unauthorized Fishing Expedition

The evidence in this case shows that the Minister has engaged in a fishing expedition. This is made clear by the fact that her purpose for seeking disclosure of the Issues Lists has continuously shifted over an extended period. She continually misled BP Canada into believing that she was not seeking details regarding its uncertain tax positions, and it was only after BP Canada had disclosed its tax accrual working papers that the Minister admitted she no longer sought to verify its taxable income for the 2005 Taxation Year, but sought instead to obtain a "road map" for auditing future taxation years.

In contrast to the somewhat jaundiced view of BP Canada reflected in the excerpt from the 2005 Audit Plan that is cited at paragraph 12 of Minister's Factum [sic], the evidence in this Application demonstrates that BP Canada has maintained a history of compliance. As noted in that very Audit Plan, BP Canada has engaged in transactions having substantial economic justification that are normal in the industry in which it operates and "that seem reasonable".

BP Canada co-operated with the Minister throughout the audit process for each of the Taxation Years and took proactive measures to resolve the issues at hand. It is uncontroverted that BP Canada provided copies of its working papers to the Minister in a proactive attempt to resolve the Minister's professed concern that the entries in the Interest Reserve Account represented taxable interest income. It did so only after having received repeated assurances that the Minister was not seeking details as to its uncertain tax positions and that she was not "hunting for new tax issues." However, as Ms. Temple confirmed on cross-examination, the Minister later demanded access to the Issues List for 2005 Taxation Year because she wanted to "see what issues BP

identified as uncertain so that she [Ms. Temple] [could] use that as a roadmap to target audit resources [...] for 2007 and subsequent years."

As the issues relating to the Refund Interest, the Interest Reserve Account, the CRA Risk Assessment, and the audit of the 2005 Taxation Year were resolved or abandoned one after the other, without any reference to the Issues List, it became apparent to BP Canada that the CRA, and Ms. Temple in particular, had requested "original supporting working papers" for purposes of facilitating subsequent audits of BP Canada. Mr. Ingram describes the evolution of the requests, under cross-examination, in the following terms:

Q [...] Ultimately, it was apparent to you that the reason CRA was seeking this was for purposes of issue identification?

A Ultimately, yes. [...] Well, and that was, frankly, quite disheartening when I finally heard that, because throughout the whole process, I had been given multiple reasons why they wanted these documents. They wanted them to resolve the interest query, they wanted them to tie into a risk assessment, which ultimately proved to be an exercise in futility, and they wanted to tie in to the total tax to be reassessed. Those were the three reasons that they gave and we were trying to deal with as they came up. So it wasn't until fairly late in the game that Mr. Shelton finally told us and it became clear to me, as is stated in my affidavit, that all those reasons really didn't matter anymore. They - it was just [they] were after the issues.

In BP Canada's submission, the evidence overwhelmingly suggests that issue identification was the overriding, if not the only, purpose motivating the CRA from the time that it formulated the Interest Reserve Account Query. Although Ms. Temple professed under cross-examination to be uncertain as to the nature of the Interest Reserve Account, she issued the initial Query with a detailed description of documents sought. That description necessarily called for the production of tax accrual working papers. Indeed, Ms. Temple repeatedly insisted that all along she requested un-redacted copies of the working papers (i.e., the Issues List):

What I'm seeking is the working papers. I requested during the audit to complete my audit which have

been redacted. I want the unredacted working paper[s]. I want the working paper[s] in original form because that's what I requested on the initial query from the audit and that's what I want.

Ms. Temple confirmed that this purpose was crystallized in May 2010, when she first looked at the redacted version of the Issues List, and yet this purpose was not communicated to BP Canada until the Minister had commenced this Application, almost 2 years after the fact. She stated that the efforts undertaken by BP Canada to respond to her purported audit concerns were "of no consequence," because she believed that she was entitled to it "no matter what." Ms. Temple asserted to Mr. Scott Shelton, a CRA official from whom she takes direction, that "[t]he Income Tax Act provides me - provides - forces them to provide me with the original document." She accordingly maintained her request, despite having confirmed the longstanding policy and practice of the CRA not to routinely request tax accrual working papers, and the application of the Policy Statement to the information requested in this case.

This court may have regard to the history of the requests for the Issues Lists in deciding whether it would be just and appropriate to grant the order under s. 231.7 on a discretionary basis. Over the course of the 2005 audit, Ms. Temple articulated to BP Canada a series of mutually inconsistent and misleading excuses for her request for the Issues List. Her behaviour suggests that she was well aware that the request for the Issues List was outside the legitimate scope of her audit power under s. 231.1. BP Canada submits that this Court should decline to exercise its discretion in light of the auditor's bad faith with respect to the Issues List requests.

(BP Canada's Memorandum of Fact and Law, pp. 65-73)
[Footnotes omitted]

[36] In the course of oral argument, Counsel for BP Canada went further in his description of Ms. Temple's conduct by referring to it as a "charade" (Transcript, p. 118).

C. Conclusion

[37] I am unable to give any weight to BP Canada's arguments.

[38] First, with respect to the fishing expedition argument, in my opinion, an audit is not an expedition. In particular, in the course of the audit of BP Canada, the Minister focussed on a specific issue: the contents of the Issues Lists of the tax accrual working papers. Therefore, the Minister's interest was specifically to obtain a clear roadmap to be used for current and future audits.

[39] And second, 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? In the course of argument, neither Counsel for the Minister nor Counsel for BP Canada directed attention to, or relied upon, evidence that the issue of a bad faith motive was ever directly addressed to Ms. Temple. BP Canada's argument is based on a belief of her ill motive. In my opinion, it is not possible, or fair, to make a finding on motive without providing the individual involved an opportunity to present an explanation. Without this opportunity being provided, the risk of an error in reaching a conclusion on such an issue is high.

[40] In my opinion, BP Canada's perspective is based on speculation. Equally as speculative is the following possibility based on Ms. Temple's affidavit evidence (Joint Application Record, Vol. I, pp. 5 – 17). The Minister's policy that working papers are compellable, with restraint, was a dominant feature in how the scenario unfolded. At the outset, the auditors expressed legitimate concerns about the audit, and, therefore, more information was demanded. At that stage, adherence to the Minister's policy of applying restraint to not usually seek working papers was dominant. In the middle of the process, that policy consideration abated in favour of gaining the information the working papers contain. And, at the end of the process, the Minister's policy was

applied, without restraint: a full-out demand was made for the Issues Lists, not only for the purposes present at the time, but into the future.

[41] Under examination by Counsel for BP Canada, Ms. Temple was very frank: early on she had made a decision that access must be gained to the Issues Lists. There is nothing nefarious about forming this opinion, not expressing it, and continuing to attempt to gather the information needed with restraint in mind. There is also nothing nefarious about finally applying the Minister's policy to make an outright demand for the Issues Lists. Perhaps frustration played a role in the approach that changed over time due to BP Canada's unwillingness to provide the Issues Lists. There is no way to know, on a balance of probabilities, which speculation is closer to the truth without having the benefit of a complete examination and cross-examination on the precise issue of motive.

[42] It is important to note that the alleged bad faith conduct had no impact whatsoever on the outcome of the exchange. The scenario began with a request for further information, which moved to a demand for the Issues Lists, and ended with an unfulfilled demand for the Issues Lists. In my opinion, the Minister gained no advantage, and BP suffered no prejudice, having gone through the process. It ended the way it started.

[43] I am unable to find that BP Canada was in any way seduced into giving over the redacted working papers. In my opinion, the evidence points toward the conclusion that BP Canada's strategy was to cooperate with the information requests made by the Minister's representatives, and to ultimately provide the redacted working papers, based on a hope that the Minister might

be satisfied and give up its demand for the Issues Lists. The exchange was professionally and seriously conducted with no power imbalance.

[44] As a result, in my opinion, no supportable finding can be made on the existing evidence that the Minister's officials made the demands for the Issues List in bad faith. Therefore, I dismiss BP Canada's request for discretion to be applied to not grant the order for production of the compellable Issues Lists.

D. Unfairness to BP Canada

[45] The argument is as follows:

Further, the Minister's request for the Issues Lists is inherently not an impartial one. Impartiality connotes the equitable treatment of all taxpayers. The Minister can only request tax accrual working papers from those corporations that are subject to the additional level of diligence applicable to corporations that choose, or are required to prepare their financial statements in accordance with GAAP. In this case, the Minister seeks to turn BP Canada's own diligence against it and deputize BP Canada to audit itself by compelling the disclosure of its own tax risk assessment. BP Canada submits that this Court should not exercise its discretion to permit the Minister to do so.

(BP Canada's Memorandum of Fact and Law, para. 78)

[46] I am unable to give any weight to the argument. While BP Canada is a taxpayer in a different position from taxpayers who do not have contingent liability reserves, BP Canada is in the same position as others who do have contingent liability reserves. In my opinion, this form of distinction does not constitute inequitable treatment. As noted above, the Minister's policy does not discriminate: all taxpayers are subject to the application of s. 231.1(1) and s. 231.7.

[47] 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.

V. The Result

[48] For the reasons provided, I find that the Minister is entitled to compel BP Canada to disclose the Issues Lists for the purpose of expediting the Minister’s future audits.

ORDER

THIS COURT ORDERS that:

A compliance order is hereby granted under s. 231.7(1) of the *Income Tax Act* for the production of the Respondent's working papers requested by the Minister of National Revenue in Query 2005-10.1, Query 2006-16, and Query 2007-6 pursuant to s. 231.1(1) of the *Act*.

Costs are reserved, and will be determined in a separate order following consideration of the submissions of Counsel.

"Douglas R. Campbell"

Judge

APPENDIX A

The following provisions of the *Income Tax Act*, RSC 1985, c.1 (5th Supp.) as amended, are at issue in the present Application:

231.1 (1) 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, [...]

231.7 (1) 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

231.1 (1) Une personne autorisée peut, à tout moment raisonnable, pour l'application et l'exécution de la présente loi, à la fois :

a) inspecter, vérifier ou examiner les livres et registres d'un contribuable ainsi que tous documents du contribuable ou d'une autre personne qui se rapportent ou peuvent se rapporter soit aux renseignements qui figurent dans les livres ou registres du contribuable ou qui devraient y figurer, soit à tout montant payable par le contribuable en vertu de la présente loi;

231.7 (1) Sur demande sommaire du ministre, un juge peut, malgré le paragraphe 238(2), ordonner à une personne de fournir l'accès, l'aide, les renseignements ou les documents que le ministre cherche à obtenir en vertu des articles 231.1 ou 231.2 s'il est convaincu de ce qui suit

a) la personne n'a pas fourni l'accès, l'aide, les renseignements ou les documents bien qu'elle en soit tenue par les articles 231.1 ou 231.2;

b) s'agissant de renseignements ou de documents, le privilège des

from disclosure by solicitor-client privilege (within the meaning of subsection 232(1)).

communications entre client et avocat, au sens du paragraphe 232(1), ne peut être invoqué à leur égard.

FEDERAL COURT
SOLICITORS OF RECORD

DOCKET: T-908-12

STYLE OF CAUSE: MINISTER OF NATIONAL REVENUE v BP CANADA
ENERGY COMPANY

PLACE OF HEARING: TORONTO, ONTARIO

DATE OF HEARING: MAY 11, 2015

ORDER AND REASONS: CAMPBELL J.

DATED: JUNE 5, 2015

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