




THE CRA AUDIT: WHAT TO DO WHEN THE CRA COMES KNOCKING



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▼ CRA Basic Facts

- CRA conducts more than 120,000 audits each year
- Collects \$11 billion in taxes, penalties, and interest
 - 2/3 of which involves cases of aggressive tax planning by large and multinational corporations, and by high net worth individuals

▼ What We Have Recently Seen

- More fishing expeditions
- Coordinated and uncoordinated efforts by the CRA
- Different CRA sections taking turns auditing the same taxpayer
- An increase in projects
- Auditors and teams specially trained for a particular industry
- CRA asking for significant amounts of documents to be produced quickly

▼ What We Have Recently Seen

- CRA asking the taxpayer to create new documents to assist auditor
- More transfer pricing audits
- A greater focus on cross-border transactions, regardless of whether the parties are related
- Lengthy delays
- CRA auditors getting the law completely wrong



PART I

WORKING WITH AUDIT DIVISION

▼ Audit:

- Why invest time and money during an audit?
 - Easy and early opportunity to limit issues
 - Avoid bad publicity
 - Lengthy delays in Appeals Division

▼ Audit: Tips

- Build rapport with the auditor
- Try to understand and respond directly to auditor's position
- Select a single taxpayer “Point Person”
- Answer questions only when you have full answer
- If auditor is going to seek a ruling, help with facts
- Meet deadlines (all the time)

▼ Audit: Using Legal Counsel

Legal counsel can be useful during an audit:

- Usually in background
- Importance of advocacy
- Importance of privilege
- Counterpoint to the single internal “Point Person”
- Provide advice on law
- Benefit from lawyer’s experience

▼ Audit: Waivers

- Basics about waivers:
 - Extends the reassessment period
 - Sometimes benefits taxpayer
- Practical tips about waivers:
 - Limit its scope to the agreed upon issue to be audited
 - Consider attaching a notice of revocation
 - Cannot revoke the revocation of a waiver

▼ GAAR Committee

- GAAR Committee must approve GAAR reassessments
- Process:
 - Avoidance auditor at local TSO interacts with taxpayer
 - Local TSO refers to GAAR & Technical Services at HQ
 - GAAR & Technical Services refers to the GAAR Committee
 - GAAR Committee approves/disapproves applying GAAR as a primary or secondary assessing position

▼ Transfer Pricing Review Committee

- Transfer Pricing Review Committee must approve application of:
 - S. 247(2)(b) and (d) re-characterization provisions and
 - Transfer pricing penalties
- Process:
 - International auditor at local TSO interacts with taxpayer
 - Local TSO refers to the International Tax Directorate (ITD)
 - The ITD refers to the Transfer Pricing Review Committee

▼ GAAR & Transfer Pricing Committees

- Auditor prepares a statement of facts and requests taxpayer's comments
- Committee generally requests written submissions about tax analysis at relevant times

▼ Audit: Tips

If taxpayer and auditor disagree on law and taxpayer is confident of its position:

- Can ask the auditor to seek an internal legal opinion
 - Legal opinion may come from DOJ or CRA Legal Services
 - Taxpayer does not have access to the opinion



PART II

WORKING WITH APPEALS DIVISION

▼ Object to a Reassessment

- Taxpayer can object to a reassessment to the CRA's Appeals Division
- Appeals Division's mandate is:

“To provide a fair and impartial process to resolve disputes, service complaints and requests for relief arising from decisions made under the legislation and programs administered, and services provided by the CRA.”

▼ Notice of Objection

- Object by serving a Notice of Objection
- Notice of Objection goes to the Appeals Officer
- Serve a Notice of Objection even if the taxpayer is seeking assistance from the competent authority

▼ Basic Content of Notice of Objection

- Complete and attach correct CRA form
 - T400A for ITA; GST159, E413, or E414 for ETA matters
- State facts, issues, reasons and relief
- Attach copy of Notice of Reassessment

▼ Special Rules for Large Corporations

- ITA has unique rules for “large corporations”
 - Taxable capital employed in Canada >\$10 million
- ITA governs large corp’s Notice of Objection:
 - Reasonably describe each issue
 - State facts, reasons, and relief sought in respect of each issue
 - Appeals to Tax Court are limited to issues and relief stated in the Notice of Objection

▼ Tips for Preparing a Notice of Objection

- Good time to involve legal counsel
- Ask for Audit Report (T20) and working papers
- Address auditor's position and concerns head on
- Avoid being verbose
- Attach relevant documents with pages numbered
- Contemporaneously submit access to information request

▼ Appeals Division

- Notice of Objection goes to Appeals Officer
 - Appeals decisions independent of audit function
 - Decisions are based on legislation and policy
 - Auditor not usually contacted
 - Matter referred back to audit if taxpayer provides new & relevant documents



PART III

CRA REQUESTS FOR INFORMATION

▼ CRA Access to Docs & Info

CRA has broad powers to obtain docs & info:

- Domestic requirements
 - CRA may request any information or document, including for unnamed persons
- Foreign-based requirements
 - CRA may request information or a document that is available or located outside of Canada

▼ CRA Access to Docs & Info

- Rare to successfully refuse CRA's request
- CRA can ask court to compel taxpayer to produce
- If CRA asks for outrageous amount of documents and information:
 - Be cautious
 - Determine whether anything is privileged
 - Consider arguing proportionality
 - Try to narrow "first round" of documents

***BP Canada Energy Company
v. Canada (National Revenue)***

2017 FCA 61

▼ *BP Canada Energy Company*

- Said:

Minister cannot compel the taxpayer to disclose uncertain tax positions reflected in its tax accrual working papers (“TAWPs”)

▼ ***BP Canada Energy Company***

- Facts:
 - During audit, BP gave CRA certain schedules from its confidential TAWPs
 - “Issues Lists” were redacted from schedules
 - CRA said it was entitled to Issues Lists
 - BP said ‘no’

▼ ***BP Canada Energy Company***

- Minister went to FC to compel production
 - Admitted that auditor's purpose was to use Issues Lists as a "road map" for audits of BP's future taxation years
- FC ordered BP to produce Issues Lists
- BP appealed to FCA

▼ ***BP Canada Energy Company***

- FCA allowed the appeal:
 - Issues Lists not compellable
 - “Beyond the reach of the Minister”
 - S. 231.1(1) does not make TAWPs compellable "without restriction"

▼ ***BP Canada Energy Company***

FCA said:

- Context indicates that Parliament intended the broad power set out in s. 231.1(1) to be used with restraint when dealing with TAWPs
- The financial reporting obligations under provincial securities legislation form part of the broader context
- Parliament cannot have intended the power under s. 231.1(1) to be used to imperil the integrity of that financial reporting system
- While it is a self-assessing tax system, the obligation to self-assess does not require taxpayers to self-audit

***IGGillis Holding Inc. v.
Canada (National Revenue)***

2018 FCA 51

▼ ***IG Gillis Holding Inc.***

- FCA overturns FC:
 - Solicitor-client privilege (“SCP”) is not waived when an opinion provided by a lawyer to one party is disclosed, on a confidential basis, to other parties with sufficient common interest in the same transactions.

▼ ***IGGillis Holding Inc.***

- Solicitor-client communications are privileged
 - General rule is that privilege waived if the privileged communications are shared with a third party
- Exception to this rule is common interest privilege

▼ ***IGGillis Holding Inc.***

Common interest privilege:

- Privilege can be preserved where a party shares *privileged* communications with a third party that has a common interest in completing a commercial transaction
 - to convince the other party to complete a transaction
 - or
 - in working cooperatively with another party to obtain a regulatory approval

▼ ***IGGillis Holding Inc.***

“Litigation Privilege”:

- Different from SCP
- Protects communications between a lawyer and third parties for the purpose of preparing for litigation
- Preparation for litigation must be the dominant purpose of the communication
- Expires with the litigation

▼ ***IGGillis Holding Inc.***

- Facts:
 - Two parties engaged in a commercial transaction
 - Each party had its own tax counsel
 - Both tax counsel cooperated on a single tax memo containing a legal opinion
 - Each party was provided with a copy of the tax memo

▼ ***IGGillis Holding Inc.***

- Facts:
 - During the audit, CRA issued a Requirement for a copy of the tax memo
 - Taxpayer claimed SCP and refused to produce
 - CRA applied to FC to compel production
 - Argued that privilege waived when tax memo shared with other party

▼ ***IGGillis Holding Inc.***

- FC ordered the tax memo to be produced:
 - First found that tax memo was covered by SCP
 - But SCP lost when tax memo was disclosed to other party
 - Held that common interest privilege is not an exception because it is not a valid component of SCP doctrine

▼ ***IGGillis Holding Inc.***

- FC:
 - Was concerned that privilege was being misused
 - Relied on U.S. case law and academic writing
 - Said common interest privilege limited to litigation privilege
- Taxpayer appealed to FCA

▼ ***IGGillis Holding Inc.***

The issue for the FCA:

Does SCP continue to apply to a legal opinion disclosed to a person who is not the client of the lawyer who wrote the opinion but who is involved in common transactions with the client of that lawyer?

i.e., Is common interest privilege a valid legal principle?

▼ ***IG Gillis Holding Inc.***

- FCA agreed with the FC that:
 - The tax memo is protected from disclosure under SCP, subject to whether the privilege has been waived or is protected by common interest privilege

▼ *IGGillis Holding Inc.*

- FCA considered the ITA provisions governing Requirements, which include that:
 - ... a person does not have to disclose a communication if the person has a right in a **provincial superior court where the matter arises** to refuse to disclose the communication on the grounds of solicitor-client privilege
- Commercial transaction in this case arose in Alberta and B.C.

▼ ***IGGillis Holding Inc.***

- FCA concluded that common interest privilege is strongly implanted in Canadian law
- FCA noted that superior courts in Alberta and B.C. have ruled that SCP is not waived when an opinion provided by a lawyer to one party is disclosed, on a confidential basis, to other parties with sufficient common interest in the same transactions.

▼ ***IGGillis Holding Inc.***

- FCA also noted that common interest privilege applies whether the opinion is first disclosed to the client of the particular lawyer and then to the other parties or simultaneously to the client and the other parties.

▼ ***IGGillis Holding Inc.***

- FCA held that the disclosure of the tax memo to the other parties to the proposed transaction did not waive privilege
- Taxpayer's appeal allowed
- No disclosure of tax memo to Minister required

***Canada (National Revenue) v.
Cameco Corporation
2017 FC 763***

▼ *Cameco Corporation*

Court refused to order Cameco's personnel to participate in oral interviews regarding audit:

“The Minister is not vested with unlimited audit powers.”

▼ ***Cameco Corporation***

S.231.1(1) of ITA gives CRA a great deal of power during audit, including:

- Require the owner or manager of the property or business and any other person on the premises or place to "answer all proper questions related to the administration or enforcement" of the ITA

▼ ***Cameco Corporation***

Facts:

- Transfer pricing audits of Cameco's 2010-2012 TY
- Minister demanded oral interviews of 25 personnel from Cameco and its subsidiaries
- Cameco refused, but agreed to written interviews
- Minister went to FC to compel compliance

▼ ***Cameco Corporation***

Court noted that:

- Similar audits had been ongoing for many of Cameco's prior taxation years
- Audits conducted on same factual basis as prior years currently before the TCC
- Cameco had fully complied with the Minister's other audit requests

▼ *Cameco Corporation*

FC denied Minister's application:

- Audit powers are not unlimited
- ITA does not allow for indeterminate number of oral interviews
- Minister doesn't have unlimited right to oral interviews
- Order sought does not meet the principle of proportionality
- Written questions and answers would suffice

***Canada (National Revenue) v.
Paypal Canada Co.***

2017 CarswellNat 6671

▼ *Paypal Canada Co.*

- Minister issued Requirement to PayPal to:
 - produce info & docs relating to certain **unnamed persons** for a specified period
- PayPal did not comply
- Minister asked court to order PayPal to comply

▼ *Paypal Canada Co.*

Court said that to get such an order:

- The Requirement must be needed to verify compliance with the ITA and ETA
- Unnamed persons do not already have to be under investigation or audit
- Do not have to demonstrate that there is a “genuine and serious inquiry”

▼ *Paypal Canada Co.*

- PayPal argued that the Requirement:
 - would interfere with the privacy of PayPal's clients
 - is overly broad and unreasonable
- Court was not persuaded by PayPal
- Court issued Order

▼ *Paypal Canada Co.*

Court said the unknown persons are ascertainable:

- They are corporations and individuals holding a business account with PayPal; and
- They have used PayPal's online payment platform in the course of their commercial activities during the specified period

***Rona Inc. v. Minister of
National Revenue***

2017 FCA118

▼ *Rona Inc.* (GST)

- Regarding requirement for information
- Appeal to FCA of FC order authorizing MNR to serve a requirement for information on registrant's business clients
 - registrant argued at FC that such a requirement would bring the administration of justice into disrepute
 - FC said info already existed / can be provided
- FCA dismissed registrant's appeal
- Leave to SCC refused
- Rona's list of business clients are available to CRA



PART IV

MAXIMIZING CHANCES OF A FAVOURABLE SETTLEMENT WITH THE CRA

▼ Settlement With the CRA

- Many opportunities for settlement
- Settlement is appropriate when there is:
 - An error in all or part of the assessment
 - Minister changes her interpretation of the provision at issue
 - A retroactive amendment to the provision at issue
 - A precedential court decision has been rendered
 - Taxpayer provides new documents

▼ Rules of Settlement

- Settlement must comply with the law and be supported by the facts
- No compromise settlements
- Settlement of issue with the CRA means taxpayer cannot object or appeal
- Appeal to Tax Court if settlement is not possible

▼ Tips for Achieving Settlement

- CRA almost always open to discussing settlement
- Be realistic and pragmatic about your position
- A settlement offer must be principled, but you can be creative

▼ Tips for Achieving Settlement

- When working with the Appeals Officer
 - Demonstrate good faith and openness
 - Try to fill in missing documents
 - Make sure Appeals Officer understands your position
 - Can ask Appeals Officer to seek an internal legal opinion
 - Or ask Appeals Officer to seek HQ advice on policy

▼ Tips for Achieving Settlement

- Come to settlement meetings prepared
 - Always be polite
 - Do not assume that opposing side does or does not understand business
 - Submit offer of settlement ahead of meeting
 - You can settle only some of the issues
 - Do not ignore your case's weaknesses



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