# TAX ADMINISTRATION

# 2648. SARS right to information

# OCTOBER 2017 – ISSUE 217

In the matter of *BP Canada Energy Company v Minister of National Revenue (CPA of Canada intervening)* 2017 FCA 61 (judgment delivered 30 March 2017), the Court had to consider a lower court judgment in terms of which BP Canada Energy Company (BP) had been ordered to provide unredacted copies of its 'tax account working papers' to an auditor conducting a tax audit.

**Background**

BP had to produce estimates for inclusion in its UK holding company's annual financial statements of 'uncertain tax positions' and determine the potential liability if the positions should not be accepted by the tax authority, including any penalty or interest. These papers supported an account called the 'Tax Reserve'. The judgment summarises their purpose and content in paragraph 6, in the following terms:

*'They reflect, among other things, the uncertain tax positions adopted by BP Canada in filing its tax returns, also referred to as "soft spots", as well as the corresponding analyses behind the contingent tax reserves.'*

The auditor had asked for information supporting the Tax Reserve balance. BP had responded by providing redacted copies of the tax account working papers reflecting the estimated liability if the uncertain positions should not be accepted. The amount of the liability so reflected was greater than the liability reflected in the Tax Reserve account. BP provided an explanation for the differences that was apparently accepted. However, the auditor insisted that she had a right to demand an unredacted copy of the tax account working papers.

In addition to the tax account working papers demanded under the audit, the auditor also demanded the tax account working papers for years of assessment that were not part of the audit.

The Federal Court held that the Minister of National Revenue had an unrestricted right to demand the information.

**The arguments**

BP argued that the relevant provision of the Canadian law is a fact-finding tool. Its purpose is to identify facts relevant to the assessment of a taxpayer's liability to tax. The Minister's stated intention was that the documents were required to provide a roadmap for subsequent audits. This was not permitted by the regulation.

Alternatively, BP said, the lower court had discretion as to the nature and extent of the information to be disclosed and its failure to exercise that discretion *'would bestow upon the Minister an "unqualified right" to require taxpayers to disclose any issues identified in preparing their tax returns… Such a right would be available even in the absence of a reasonable basis for considering that the information sought is relevant in determining whether the tax return under audit is correct.'*

CPA Canada was largely concerned with the integrity of audited financial statements if National Revenue had unrestricted access to the tax account working papers, as this would undoubtedly lead to a reluctance on the part of companies to prepare such documents and share them with auditors.

The Minister maintained that the disclosure of details of uncertain tax positions with which the Minister may disagree promotes efficiency and falls within the ambit of 'administration or enforcement of the Act'. The Act requires broad powers to obtain information and make use of available risk assessment techniques. He therefore urged that the lower court's finding was consistent with the relevant regulation.

**The judgment**

The judgment, delivered by Noël CJ, first examined the policy statement of Canadian National Revenue (at paragraph 21). This stated clearly that the Minister had the power to request tax account working papers, but that such requests are not made routinely.

The extremely broad language of the provision gave the Minister access to any documented information …. However, Noël CJ explained, the issue was not whether the information could be accessed … but whether the subsection allowed general and unrestricted access to this information…'

The judgment then went on to state the facts. Noël CJ identified that the tax account working papers contained the following:

- A statement of the issue;
- The analyses that led to the issue being identified as uncertain;

- The amounts by which the liability to tax would increase if the minister assessed the transactions and succeeded on appeal; and
- The reserve reflecting the total of those contingencies.

BP had supplied the auditor with the relevant working papers but had redacted the identification and analysis components. In other words, items 3 and 4 were supplied and items 1 and 2 were redacted.

However, the facts had to be assessed on an interpretation of the law in its context. At paragraph 57, Noël CJ expressed the canons of interpretation to be applied:

*'As in all such cases, the words of subsection 231.1(1) must be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament…'*

In considering the relevant legislation, it was considered that, on a literal reading of the words in the regulation, the use of the information on uncertain tax positions to plan audits appears to be a permitted purpose.

The next question is whether the information falls within the scope of the regulation. To do so, it has to meet three tests:

- Is it part of the books and records?
- Does it relate to information that is or should be in the books and records?
- Does it relate to any amount that may be payable by the taxpayer under the Act?

The court was of the view that the uncertain tax positions likely met the second and third tests.

The extremely broad language of the provision gave the Minister access to any documented information that may assist in carrying out auditing functions. However, Noël CJ explained, the issue was not whether the information could be accessed (at paragraph 67):

*'The real issue is whether subsection 231.1(1) allows general and unrestricted access to this information…'*

The court outlined the context in which the demand for the tax working papers had arisen. The background shows that the auditor had asked for the papers related to the tax reserve and had noted that there was a difference between the *quantum* reflected in

the redacted papers presented to her and the amount of the tax reserve recorded in the financial statements. BP had responded by explaining the difference to her satisfaction.

Noël CJ then concludes by summarising these circumstances in the following terms (at paragraph 74):

*'The record further reveals that when apprised of this demonstration, the auditor commended BP Canada for making it available, but took the position that BP Canada's Tax Reserve Papers had to be produced whether or not the "tax at risk" amounts were a cause for concern ... Therefore, the auditor insisted on compliance in order to complete the 2005 audit. Similar requests were made for the 2006 and 2007 taxation years. The auditor made it clear that these requests were made in order to make the conduct of the audits for those years more cost efficient and confirmed that similar requests would be made for future ... As noted, requests have since been issued for 2008, 2009 and 2010.'* (Notes to Appeal record removed)

The Minister's argument that the auditor had raised legitimate questions and therefore was entitled to the papers was rejected by Noël CJ. The production of information showing the quantum of the uncertain tax positions and the amount of the tax reserve had been followed by a reconciliation explaining the difference between the respective amounts. The auditor had not verified the reconciliation but pressed for production of the tax account working papers.

Herein lay the true issue, as Noël CJ explained (at paragraph 76):

*'However, the fact that BP Canada's analysis effectively puts this concern to rest cannot be questioned as the analysis is part of the record … and the Minister has not seen fit to challenge it nor the conclusion which BP Canada draws from it. '* (Notes to Appeal record removed)

The final issue then was whether the Minister had the right to demand tax account working papers 'without restriction'. If the order of the lower court were to stand, BP Canada would be compelled annually to hand over its tax account working papers and every company that prepared such papers could be similarly compelled to hand them over.

This was not the true purpose of the provision, and the Court concluded (at paragraph 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.'* (Notes to Appeal record removed)

The court then added comment on the self-assessment system, at paragraph 82, emphasising that there is a distinction between self-audit and self-assessment:

*'However, this obligation to "self-assess" does not require taxpayers to tax themselves on amounts which they believe not to be taxable. Faced with an issue that is reasonably open to debate –I emphasize this point insisting on the fact that the case law is replete with decisions which illustrate the coexistence of arguable issues on both sides of the debate –taxpayers are entitled to file their tax return on the basis most favourable to them. This explains why auditors in conducting audits must engage in extensive poke-and-check exercises, and are essentially left to their own initiative in verifying the amounts reported by the taxpayer.'*

The lower court's order effectively compelled BP Canada to self-audit. Noël CJ rejected the lower court's assertion to the contrary (at paragraphs 84 to 85):

*'[84] The Federal Court judge did not believe that his order imposed on BP Canada an ongoing obligation to self-audit. He explained that he did not order BP Canada to prepare documents listing its uncertain tax positions, but to turn over existing ones which reflect this information...*

*[85] With respect, this is a distinction without a difference. BP Canada has no choice but to document its uncertain tax positions annually and the Federal Court judge has confirmed the Minister's access to these documents through legal compulsion every year from 2005 onwards. However one looks at the matter, the decision of the Federal Court judge allows the Minister to compel BP Canada to self-audit.'*

The final assertion of the lower court that the Minister's request was not contrary to policy was also rejected, at paragraphs 102 to 103, where Noël CJ states:

*'[102] The Federal Court judge dismissed this argument based on his reading of the policy. In his view, the Minister, by bringing the application, was "adhering to, and implementing the policy that, without restriction, [TAWPs] are compellable under the Act".*

*[103] With respect, this turns the policy on its head. I agree with the appellant that the policy, as it presently stands, states that the power to access TAWPs, although*

*available to the Minister, will not be used routinely. This is what the words say (see paragraph 21 above) and when regard is had to the tension which the policy was intended to address, they cannot be read otherwise.'* (Notes to the Appeal Record removed)

The court therefore concluded that the Federal Court judge erred in finding that the regulation afforded the Minister unrestricted access to tax account working papers. The policy actually recorded the constraint that is imposed by law on the exercise of the powers.

**Does the BP decision have relevance to South Africa?**

This is a welcome judgment that may well have relevance to the exercise of powers by SARS under section 46 of the Tax Administration Act, 2011 (the TAA). Although the wording of the Canadian regulation and the terminology used in the TAA are not identical, there is sufficient similarity for comparison.

It is useful to compare the wording of the Canadian law with that of the TAA.

Regulation 231.1.(a) in Canada states:

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

- *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 …'*

Section 46(1) of the TAA provides:

*'SARS may, for the purposes of the administration of a tax Act in relation to a taxpayer, whether identified by name or otherwise objectively identifiable, require the taxpayer or another person to, within a reasonable period, submit relevant material (whether orally or in writing) that SARS requires.'*

The term in section 46 that causes concern is that SARS may require a person to produce 'relevant material'. This term is defined in section 1 of the TAA as follows:

***'"relevant material"** means any information, document or thing that in the opinion of SARS is foreseeably relevant for the administration of a tax Act as referred to in section 3.'*

*Section 3, in its turn describes what constitutes administration of a tax Act, and powers (a) and (b) of section 3(2) would be relevant to the comparison:*

*Administration of a tax Act means to—*

*(a) obtain full information in relation to—*

*(i) anything that may affect the liability of a person for tax in respect of a previous, current or future tax period;*

*(ii) a taxable event; or*

*(iii) the obligation of a person (whether personally or on behalf of another person) to comply with a tax Act;*

*(b) ascertain whether a person has filed or submitted correct returns, information or documents in compliance with the provisions of a tax Act…'*

**Factual data**

The High Court has pronounced on the application of the definition of 'relevant material' in relation to the provision of factual data. In the matter of *C:SARS v Brown* [2016]78 SATC 255, it was held in the context that a request for information in the form of data was within the scope of section 46. Smith J, at paragraphs 40 to 42, made this abundantly clear:

*'[40]It is in my view similarly manifest that the information sought in the questionnaire constitutes 'relevant material' since it pertains to the respondent's assets, liabilities and expenses. Furthermore, the questionnaire could hardly have been more specific regarding the information which the respondent is required to provide, and I am accordingly satisfied that adequate specificity has been provided as required by the Act.*

*[41]There can also be little doubt that the issuing of the questionnaire was done in the course of the 'administration of a tax Act' since the information sought therein manifestly relate to "the liability of a person or persons for tax in respect of a previous, current or future tax year". (Section 3(a)(i))*

*[42]I am accordingly of the view that the applicant has established all the requisite jurisdictional facts mentioned in section 46. The respondent's contention that the issuing of the questionnaire was a "fishing expedition" is thus untenable. The questionnaire was issued against the background of information to the effect that there may have been non-disclosure of relevant information by the respondent, coupled with the fact that he*

*did not register as a taxpayer or submit tax returns. In my view these factors constituted a sound basis for the issuing of the questionnaire and cannot by any stretch of the imagination be regarded as "a fishing expedition".'*

**Can SARS demand opinions issued by advisors?**

The question at this point that has not yet been interpreted in our courts is the application of the term 'relevant' to the extent that the information may contain or consist of an opinion on the application of the law to a specific set of facts.

Paradoxically, an opportunity arose for a South African court to interpret and apply the term, but the point was not argued in the court. In *A Company & Others v C:SARS* [2014] 76 SATC 321, an application was made to the High Court to restrict the content of information contained in a law firm's invoices to a taxpayer that was to be disclosed to SARS.

The background was that a SARS auditor had requested details of the line item 'Professional Fees' in the trial balance. In response, the taxpayer had provided a breakdown of the fees specifying the supplier and providing copies of the invoices. However, it had not, at the time of submitting the response, located the lawyer's invoices, and undertook to provide them. When the invoices were located it was discovered that they contained information concerning transactions to which the company or a group entity had been a party.

The taxpayer therefore wrote to SARS and stated that the invoices were protected by legal professional privilege and that they were not obliged to deliver the invoices. SARS rejected this assertion and demanded the production of the invoices. The taxpayer provided SARS with redacted copies of the invoices. At the same time the SARS auditor was informed that no deduction had been claimed in respect of the expenditure incurred in respect of the invoices. SARS again demanded production of the invoices in unredacted form.

The taxpayer then applied to the High Court for an order that the information in the invoices was protected by legal professional privilege.

The point of interest in the judgment delivered by Binns-Ward J is found in paragraph 13:

*SARS explained its annexure of the material as having been to deal with what the Commissioner had apprehended to be a contention by the applicants that the content of the invoices was not relevant to the investigation being undertaken by SARS. Lack of*

*relevance would have afforded a separate ground for resisting its disclosure, quite discrete from that of legal professional privilege. Having regard to the tenor of the correspondence exchanged between the parties, which was annexed to the founding papers, and in which the applicants' right to contend that the information sought was irrelevant was reserved, I consider that the respondent's apprehension of the applicants' position in this respect was reasonably formed. The answering papers were handled sensitively to prevent any unwarranted invasion of the applicants' privacy and, by agreement between the parties, the court was requested to hear the application in camera, which duly happened. In the event, the applicants did not persist at the hearing with any argument that they were entitled to withhold the invoices, or any of the content thereof, for want of relevance. For the purposes of the declaratory relief that they seek in these proceedings the applicants confined the basis of their alleged entitlement to withhold part of the content of the documents to legal advice privilege.*

It is evident that the parties contemplated that a challenge lay against the request for want of relevance. After all, the SARS auditor had requested information relevant to determining the liability to tax in a particular year of assessment and had received sufficient information to satisfy him or her that there had been no unauthorised deduction in relation to the invoices.

There are similarities between these facts and the facts in the *BP Canada* appeal. In the case of *A Company*, the auditor required information to audit a particular line item in the trial balance and identify how the information had been reflected for tax purposes. The response that the amounts reflected on the invoices in question had not been claimed as a deduction should have been sufficient to settle the inquiry and allow the auditor to move on. The auditor, nevertheless, insisted on production of the invoices in unredacted form.

However, the issue of relevance was not argued before the court. Had it been argued, it is submitted that the outcome may well have been that the information contained in the invoices was indeed not relevant material in the context.

**Subsidiaries of foreign listed companies**

The requirement for BP Canada to prepare TAWPs stemmed from the fact that it was a subsidiary of a foreign listed company and, in terms of the accounting standards applicable to the parent company, the latter company was compelled to quantify 'uncertain tax positions'. BP Canada therefore prepared the TAWPs in order to harmonise its accounting principles with those of its parent company.

Similar requirements fall on SA subsidiaries of foreign listed parent companies.

Where a company adopts a filing position in relation to a transaction which may not accord with the interpretations of SARS, it will prepare a document setting out the facts; the possible conflicting interpretations of law in relation to the facts; the reasons for its adoption of an interpretation; a quantification of the potential additional tax, penalty and interest that might be incurred if its interpretation is overturned; and an estimate of the probability that the interpretation might be overturned.

The question whether SARS is entitled to treat such a document as 'relevant information' is yet to be determined under our law. There is an argument that statements of opinion are not 'information'. This was not accepted in the Canadian Federal Court of Appeal, which took the view that the term was to be interpreted broadly. The issue will therefore likely turn on the question whether the contents of such a document are relevant.

**SARS' rights**

The extent of SARS' rights turns on the question whether SARS has an automatic right to be apprised of more than the factual data in order to assess a person to tax. The Canadian judgment takes the view that this is a form of enforcement of self-audit, and is contrary to the principle that a taxpayer may *reasonably* adopt a filing position that exposes it to a lesser tax liability.

The relevance of the information must be determined in the light of the facts and circumstances, having regard to '… the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production.' (per Wallis JA *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) at paragraph 18).

The *Explanatory Memorandum on the Objects of the Tax Administration Bill, 2011* summarises the purpose and known information in its discussion on what constitutes 'relevant material' at paragraph 2.2.1.8:

*'The term "relevant material" is important for information gathering under Chapter 5 and means any information, document, or thing that is foreseeably relevant for tax risk assessment, assessing tax, collecting tax, or showing noncompliance with an obligation under a tax Act or showing that a tax offence was committed.*

*The standard of foreseeable relevance, which is inter alia regarded by the OECD as the standard in the context of specifying the information that should be exchanged between countries, is intended to provide for the procurement of information in tax matters to the*

*widest possible extent and, at the same time, to clarify that revenue authorities are not at liberty to engage in "fishing expeditions" or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. This is a narrower term than "may be relevant", which is the standard used in some tax jurisdictions.*

*Risk assessment, as reflected in clause 44, is one of the premises of SARS' audit selection process and involves assessing the risk profile of taxpayers ("risk assessment") and then allocating resources in accordance with the risk profiles ("risk-led resource allocation") which should result in more targeted audits. Risk assessment also assists in addressing emerging tax risks in real-time, which should enable SARS to provide tax certainty to taxpayers sooner and quicker guidance on tax matters and to reduce the need for protracted forensic audits (typically some years after targeted transactions occurred). Risk-driven processes should also limit disputes and reduce the incidence of tax underpayments and understatement penalties or administrative non-compliance penalties. Obtaining real-time "relevant material" from taxpayers is key to effective risk management of taxpayers.'*

Far from asserting an unrestricted right, the explanation emphasises the need for foreseeable relevance and the avoidance of unwarranted requirements to obtain information by way of so-called 'fishing expeditions'.

**SARS guide on access to audit files**

In December 2016, SARS issued an external guide relating to access to audit files. The contents of this document provide indications of SARS' policy stance. It is noteworthy that SARS views itself as having an unrestricted right to information in audit files, but states that, as a matter of policy, it will exercise the rights with restraint, as illustrated in the following extract from page 4:

*'There is no general restriction on SARS requiring information contained in an audit file. However SARS respects the unique relationship between the taxpayer and its statutory auditors; and therefore undertakes not to call for audit files as a matter of routine or without obtaining approval from a senior official. Policies and procedures have been put in place within SARS to govern such requests…'*

It is vital to financial markets that corporate reporting is as open and transparent as possible. The assertion that SARS has an unrestricted right to information in audit files has a negative connotation. It places auditors and their clients in a difficult position. The client may be less inclined to communicate candidly with the auditor if it considers that SARS has *carte blanche* to inspect the audit files. In turn, the withholding of information

adversely affects the integrity of the financial statements and the auditor's opinion in relation to such statements.

The impression is created that the determination of relevance is apparently the exclusive domain of SARS. The definition of 'relevant material' refers to the items in question being those which '*in the opinion of SARS* are foreseeably relevant'.

This somewhat paradoxical requirement bears examination –

- The opinion of SARS is subjective, in the sense that it reflects a conclusion at which SARS, through its officials, has arrived.
- On the other hand, foreseeability is, by nature, objective. It indicates that something is 'able to be foreseen or predicted'

(www.en.oxforddictionaries.com).

**Conclusion**

It is therefore submitted that SARS does not have an unrestricted right to call for access to audit files. Firstly, it is a matter of record that the power is to be exercised with restraint. Secondly, before it may exercise the power, it must be able to establish that the information in the audit files is foreseeably relevant to the determination of a liability to tax or establishing compliance with a tax Act.

To do so, SARS must be in a position to identify with reasonable specificity the information required and the reasons that make the information predictably relevant.

**PwC**

**TAA: section 1 definition of 'relevant material', sections 3 and 46**

**EM of Objects to the Taxation Laws Amendment Bill, 2011**

**SARS external guide: Access to audit files**

https://www.saica.co.za/integritax/2017/2648._SARS_right_to_information.htm