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PUBLICATION

Can Tax Authorities Demand Access to Audit Workpapers? Canadian Experience Follows U.S. Rule (2019) 27:3 Canadian Tax Highlights: Canadian Tax Foundation

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Introduction

When a Canadian or U.S.-based multinational finds itself under audit, the taxpayer and the tax authority are often at odds over what documentation is subject to disclosure and what remains beyond the prying eyes of the tax authority. In a landmark series of recent court cases in Canada, the Canada Revenue Agency ("C.R.A.") was given access to accounting workpapers and background documentation for transfer pricing reports to verify a position taken in a client's tax return. This is a major development in Canada. In the U.S., in contrast, the I.R.S. has been given access to workpapers and other information for many years. A comprehensive look at the long history of U.S. transparency may provide a roadmap of what Canadian-based multinationals should expect regarding matters of transparency.

Tax Audits

Whether a taxpayer is resident in Canada or the U.S., it may be subject to an administrative examination to determine whether tax liability has been calculated correctly in the tax return.

When the taxpayer is a large multinational, that tax audit involves a significant investment by the tax authorities in terms of staffing and resources. The examination portion of the audit may involve the issuance of information requests and possibly follow-up summonses that are

intended to obtain data that may be used to test whether the taxpayer's claimed positions are justified under relevant tax law.

In a sense, the multinationals begin their investment long before the audit begins. They have sophisticated tax lawyers on staff and also retain sophisticated outside tax advisors. At the close of the year, the books and records of the enterprise are audited by a major accounting firm for the purpose of providing certification of the reported results.

When a tax examiner requests information regarding a specific transaction, the taxpayer may object on the grounds that the requested documentation is protected – either by attorney-client privilege or under the work product doctrine of privilege. The attorney-client privilege is a common law concept that dates back several centuries. The privilege protects information disclosed by the client to the attorney for the purpose of obtaining legal advice. The work product doctrine states that a party may not discover documents and tangible things prepared in anticipation of litigation or trial by a party or its representative. The work product privilege does not cover material assembled in the ordinary course of business or pursuant to public requirements that are unrelated to litigation or for other non-litigation purposes.[1]

A flash point for disclosure not covered by the work product doctrine is the tax provision analysis that forms part of the audit workpapers in support of a corporate taxpayer's published financial statements. When prepared by the audit firm, the tax provision analysis represents an outside professional's view regarding the expected tax exposure of a corporation in order to arrive at after-tax net profits. The analysis is designed to provide assurance that that the tax provision in the financial statement accurately portrays the financial condition of the company.

Read the full article, published by Ruchelman P.L.L.C. in Insights 6, no. 2 (2019), here, or 'Download PDF' below.

Sunita Doobay is a partner in Blaney McMurtry's corporate/commercial practice focused on cross-border taxation and succession planning. A law graduate of Queen's and New York universities (where she earned her Master's degree), Ms. Doobay holds a Law Society of Upper Canada foreign legal consultant permit to provide U.S. tax advice in Ontario.

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[1] *Hickman v. Taylor*; 329 U.S. 495 (1947); *Wells Fargo v. U.S.*, Civil No. 10-mc- 57 (D. Minn., June 4, 2013).