Is the disclosure ruling in Birchcliff a ray of light for Canadian taxpayers in GAAR disputes?

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The Canada Revenue Agency (CRA) must disclose to taxpayers how specific provisions of the Income Tax Act (Act) were abused whenever it applies the general anti-avoidance rule (GAAR) in a dispute, the Tax Court of Canada has ruled. And advisers say taxpayers could benefit from this information in future GAAR cases.

In its motion ruling in the Birchcliff Energy case, the Tax Court allowed the taxpayer's request for the CRA to disclose what policy – object, spirit and purpose – underlying the tax provisions at issue had led it to deem the GAAR was applicable.

"I think the likelihood is that this development will lead, eventually but maybe not soon, to a better sense of what the CRA is going after under GAAR – if only because the CRA reaction to the decision may well be to be more careful to disclose their asserted statutory scheme at the audit or assessment level," said Mark Meredith, of KPMG.

Birchcliff Energy

Birchcliff Energy, an oil and gas exploration company, argued that to make a GAAR assessment, the CRA must have assumed as a fact what the policy of specific provisions of the Act were and how that policy was abused.

The CRA has a duty to disclose the precise findings of fact and rulings of law which have given rise to the controversy.

Birchcliff said that knowing the policy relied upon by the CRA and the alleged abuse of the policy would:

· Allow it to prepare for discoveries and trial knowing what abuse it is alleged to have committed, and knowing whether it is accused of a single abuse that offended all 10 provisions in dispute, or the CRA assumed that more than one abuse occurred;

· Prevent it from being taken by surprise regarding what abuse(s) it is alleged to have committed; and

· Limit the generality of the reply and thereby reduce the time and expense involved in the dispute.

The CRA contended that the policy was a conclusion of law, not fact and that only allegations of fact must be disclosed in particulars.

It also said disclosing the policy would not help Birchcliff because the CRA could still argue a different policy at trial.

Motion ruling and implications

The court separated the elements of the policy into the actual policy that would be argued and decided at trial (true policy) and the fact that the CRA relied on a particular policy when determining that the GAAR should be applied (historical policy).

The court ordered that the CRA must disclose what policy the assessor relied upon in making the assessment as a material fact. However, the CRA is not bound to rely on that policy at trial.

Former Tax Court chief justice Donald Bowman, of Fraser Milner Casgrain, said he would recommend all taxpayers whose transactions are being subjected to a GAAR attack to ask the CRA to disclose the policy upon which GAAR is being applied.

This is something Meredith agrees with.

"I would ask [for this disclosure] every time now. The less focused the CRA answer, or the more it changes its position, the more it is apparent that the policy on which it seeks to rely is not clear. That can only be a good development," said Meredith.

Daniel Sandler, of Ernst and Young, said this newly available information might be useful in assessing whether a transaction may offend the CRA, though such information is already available from the tax authorities to a certain extent in other forums regarding their position on various transactions, particularly disclosures on matters the GAAR Committee has considered and where they have recommended application of the GAAR. The GAAR Committee is a non-statutory advisory committee of the CRA tasked with ensuring appropriate and consistent application of the GAAR.

Since the information gathered during the discovery process before litigation is not made public it will be difficult for taxpayers to build a body of information about how and in what circumstances the CRA is trying to apply the GAAR, unless taxpayers were to share this information in future.

The information could be obtained if it was made a part of the trial record. If the discovery becomes relevant to the trial then it could be referred to in a judgment and then by other taxpayers.

But Bowman is unsure how much practical assistance taxpayers could glean from the information.

"I think it is open to question whether such a body of information would, as a practical matter, be of much assistance," said Bowman.

"Whether GAAR applies or not is, in my experience, very much a visceral or perhaps olfactory reaction, although the courts seldom say so in so many words. However, I suppose that having that information available cannot hurt," he added.

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