



Baytex Energy Corp.'s Tax Strategy Didn't Quite Work

Description

Baytex Energy Corp. ([TSX:BTE](#))(NYSE:BTE) disclosed last week that its ongoing dispute with the Canada Revenue Agency (CRA) could result in the company paying \$134 million in additional taxes. The issue stems from the company being denied millions of dollars in non-capital loss deductions, which could result in it having to pay higher taxes on income earned at some of its subsidiaries over the past few years. That said, the company is not giving in just yet, which could delay these payments for a few more years.

A questionable tax strategy

Baytex Energy's tax issues stem from the purchase of several private companies in 2010. These companies had accumulated a total of \$591 million in losses that Baytex Energy thought it could use to reduce its future income taxes. However, the CRA reassessed the tax filings of Baytex Energy's subsidiaries and subsequently denied millions in non-capital loss deductions.

As a result of this reassessment, the company's tax bill is now expected to reach \$120 million for tax claims going all the way back to 2011. Further, the company could also be on the hook for another \$14 million in interest payments. That brings the total bill up to \$134 million, which is the maximum amount the company expects to have to pay once it exhausts all its options.

Not paying just yet

That said, the company is not about to cut a cheque. Instead, it plans to file a notice of objection for each assessment, which is a process that is expected to take two years. Further, if denied, the company plans to appeal to the Tax Court of Canada, which could take another two years.

Those additional appeals are critical for Baytex. Not only could it result in the company's tax bill being reduced or even dropped, but it buys it some valuable time. That additional time is a life saver because the oil-market meltdown has had a significant impact on Baytex Energy's finances.

Weak oil prices cut deeply into its cash flow, which forced the company to cut investment spending. As a result, it can no longer afford to invest the capital that is required to keep its production flat.

Meanwhile, its balance sheet has been under considerable stress due to its more than \$2 billion in debt. Further, while its banks cut it some slack earlier this year, they also cut the borrowing base of its credit facility from \$815 million to \$575 million. That is a concern because Baytex has borrowed a third of that capacity, which has limited its liquidity and would make it tough for the company to afford to make a \$134 million tax payment right now.

Investor takeaway

Baytex Energy thought it had a solid tax strategy in place when it bought several privately held companies earlier this decade. Unfortunately, the CRA has not agreed, which could end up costing the company millions in additional taxes. While that bill would sting, thankfully Baytex will not have to pay the bill for quite some time because it has not exhausted its appeals. That extra time is something the company needs right now given its tight financial situation.

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