THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

Office of the President
Cabinet du président

September 27, 2010

Via email: jflaherty@fin.gc.ca

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance
Finance Canada
140 O'Connor Street
Ottawa, Ontario K1A 0G5

Dear Minister:

**Re: August 27, 2010 Draft Legislation – Information Reporting of Tax Avoidance Transactions**

I am writing on behalf of the Canadian Bar Association to comment on the provisions on information reporting of tax avoidance transactions (Information Reporting Measures) in the Draft Legislation released on August 27, 2010. The Taxation Law Section of the Canadian Bar Association, through its participation in The Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants, has provided comments on several elements of the August 27, 2010 Draft Legislation in a separate submission sent to your Department.

The CBA is a national association of more than 37,000 lawyers, Quebec notaries, law students and teachers. Our mandate includes seeking improvements in the law and the administration of justice, the promotion of fair justice systems and effective law reform and the protection and promotion of the rule of law and the independence of the legal profession.

We have singled out the Information Reporting Measures because, if adopted in their current form, they will create a serious incursion into solicitor-client privilege and will compromise the independence of the legal profession. These are fundamental and foundational elements of the Canadian justice system and the preservation of these elements benefits all Canadians. We urge you to modify these Information Reporting Measures to exclude lawyers and Quebec notaries from the proposed reporting obligation. The Taxation Law Section has set out our representations more fully in the attached submission, but this issue is of importance for the legal profession as a whole.

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We trust our comments will be helpful. The CBA is pleased to contribute to the government's efforts to make the tax system fairer while ensuring that the rule of law is preserved and that lawyers are able to fulfill their duties to their clients with undivided loyalty. We will be pleased to meet with you or your officials should you wish to discuss our submission.

Yours very truly,

*(original signed by Rod Snow)*

Rod Snow

cc: The Honourable Rob Nicholson, P.C., M.P.
Minister of Justice

Encl.

# Submission of the Canadian Bar Association[1] on the August 27, 2010 Draft Legislation pertaining to Information Reporting of Tax Avoidance Transactions

## I. INTRODUCTION

1. Proposed subsection 237.3(2) of the Income Tax Act (ITA) imposes a new information reporting obligation in respect of "reportable transactions". Among those subject to the reporting obligation created pursuant to subsection 237.3(2) is every "advisor" who is entitled to certain fees in respect of a reportable transaction.

2. A person subject to this reporting obligation who fails to comply with subsection 237.3(2) is liable to a penalty under subsection 237.3(8). The amount of the penalty is based on the total of certain fees to which an "advisor" on the reportable transaction is entitled to receive in respect of the reportable transaction.

3. An "advisor" on a transaction or series of transactions means each person who provides, directly or indirectly, in any manner whatever, any contractual protection in respect of the transaction or series, or any assistance or advice with respect to creating, developing, planning, organizing or implementing the transaction or series, to any person (including any person who enters into the transaction for the benefit of another person). Thus, it is understood that lawyers and Quebec notaries[2] will be included in the definition of advisor where they provide assistance or advice to any person with respect to a transaction or series of transactions.

4. The "fees" that (i) serve to identify an advisor who is subject to the reporting obligation created pursuant to proposed subsection 237.3(2) and (ii) are relevant for the computation of a penalty imposed pursuant to proposed subsection 237.3(8) include, *inter alia*, a fee that to any extent

   (a) is based on the amount of a tax benefit that results, or would result but for the application of section 245 (the general anti-avoidance rule) from the avoidance transaction or series, or

   (b) is contingent on obtaining a tax benefit that results, or would result but for section 245, from the avoidance transaction or series, or may be refunded, recovered or reduced in any manner whatever, based upon the failure of the person to obtain a tax benefit from the avoidance transaction or series.

5. The Information Reporting Measures, initially announced in the March 4, 2010 Federal Budget, are aimed at ensuring the integrity of Canada's tax system and improving its fairness. The CBA agrees that all Canadians benefit from a fairer tax system and that a properly functioning self-assessment system depends on proper compliance by taxpayers with the Canadian tax legislation. However, the CBA objects to measures which facilitate the administration of Canada's income tax legislation at the cost of imperilling the independence of the Bar and solicitor-client privilege, two fundamental elements of the Canadian legal system. While the Department of Finance's goal of promoting a fairer tax system for Canadians is laudatory, the fundamental and foundational elements of the Canadian justice system must be protected.

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1 This submission was prepared by the Taxation Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been approved as a public statement of the Canadian Bar Association.

2 In this submission, "lawyer" refers also to Quebec notaries, where appropriate.

## II. REPORTING OBLIGATION

### a. Incursion into solicitor client privilege

6. Pursuant to proposed subsection 237.3(2), a reporting obligation in respect of a "reportable transaction" will be imposed on a lawyer who is entitled to certain fees in respect of the transaction and who provides assistance or advice with respect to creating, developing, planning, organizing or implementing the transaction or series, to any person. This would require a lawyer to disclose a client's confidential information which is otherwise protected by solicitor-client privilege. It is submitted that the objective of making the self-assessment system more robust by requiring lawyers to report their client's transactions must yield to the preservation and protection of solicitor-client privilege.

7. It is essential to the administration of justice and the public's confidence in it that matters communicated between a lawyer and client be held in confidence. The importance of solicitor-client privilege, not only to the client who claims it, but to society as a whole, has been recognised by the Supreme Court in *R. v. McClure*, [2001] 1 SCR 445:

> 32 That solicitor-client privilege is of fundamental importance was repeated in Jones, supra, per Cory J., at para. 45:
>
> The solicitor-client privilege has long been regarded as fundamentally important to our judicial system. Well over a century ago in *Anderson v. Bank of British Columbia* (1876), 2 Ch. D. 644 (C.A.), at p. 649, the importance of the rule was recognized:
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> The object and meaning of the rule is this: that as, by reason of the complexity and difficulty of our law, litigation can only be properly conducted by professional men, it is absolutely necessary that a man, in order to prosecute his rights or to defend himself from an improper claim, should have recourse to the assistance of professional lawyers, . . . to use a vulgar phrase, that he should be able to make a clean breast of it to the gentleman whom he consults with a view to the prosecution of his claim, or the substantiating of his defence . . . that he should be able to place unrestricted and unbounded confidence in the professional agent, and that the communications he so makes to him should be kept secret, unless with his consent (for it is his privilege, and not the privilege of the confidential agent), that he should be enabled properly to conduct his litigation.
>
> 33 The importance of solicitor-client privilege to both the legal system and society as a whole assists in determining whether and in what circumstances the privilege should yield to an individual's right to make full answer and defence. The law is complex. Lawyers have a unique role. Free and candid communication between the lawyer and client protects the legal rights of the citizen. It is essential for the lawyer to know all of the facts of the client's position. The existence of a fundamental right to privilege between the two encourages disclosure within the confines of the relationship. The danger in eroding solicitor-client privilege is the potential to stifle communication between the lawyer and client. The need to protect the privilege determines its immunity to attack.

8. The Supreme Court has also recognised that solicitor-client privilege must be as close to absolute as possible to ensure public confidence and retain relevance. Thus, any incursion into solicitor-client privilege will be circumspect.

9. In *Federation of Law Societies of Canada v. A.G. Canada,* [2001] BCSC 1593, the Federation of Law Societies and the Canadian Bar Association were successful in having the application of certain reporting obligations imposed on lawyers under the *Proceeds of Crime Act* suspended. That legislation purported to require lawyers to report a client's financial transactions on suspicion that the transactions are related to the commission of a money laundering offence. The Supreme Court of British Columbia suspended the application of the reporting provision to

lawyers on the ground that it authorised an unprecedented intrusion into the traditional solicitor-client relationship.

10. The exclusion of lawyers from the Information Reporting Measures in respect of information obtained in a solicitor-client relationship would not hinder the effectiveness of the proposed reporting regime. Subject to this exception, the reporting obligation could continue to apply to every person for whom a tax benefit results from the reportable transaction or who has entered into an avoidance transaction that is a reportable transaction for the benefit of another person for whom a tax benefit results from the reportable transaction, as well as to any promoter in respect of the reportable transaction, in the circumstances defined by the proposed legislation.

**b. Independence of the legal profession**

11. Proposed section 237.3 places lawyers in a conflict of interest and prevents lawyers from fulfilling their duties to their clients with undivided loyalty.

12. Proposed subsection 237.3(8) provides a penalty for non-compliance which may result in a disgorgement to the CRA of all fees paid to an advisor in connection with the reportable transaction. Lawyers cannot be divided in their duty to their clients, and imposing a reporting obligation on lawyers (under threat of penalty) in respect of their clients' tax arrangements will have the unavoidable result of causing lawyers to consider their personal exposure to liability for a penalty when advising a client.

13. This is particularly the case under this reporting regime where the basis for a reportable transaction and reporting obligation rests, *inter alia*, on the existence of an "avoidance transaction". An "avoidance transaction" is identified by weighing the taxpayer's purpose or purposes in engaging in a transaction. As recognised by the Supreme Court in *The Queen v. Canada Trustco Mortgage Co.*, [2005] 2 SCR 601:

> "(...)The words of the section simply contemplate an objective assessment of the relative importance of the driving forces of the transaction. Again, this is a factual inquiry. The taxpayer cannot avoid the application of the GAAR by merely stating that the transaction was undertaken or arranged primarily for a non-tax purpose. The Tax Court judge must weigh the evidence to determine whether it is reasonable to conclude that the transaction was not undertaken or arranged primarily for a non-tax purpose. The determination invokes reasonableness, suggesting that the possibility of different interpretations of the events must be objectively considered." (at para. 28-29)

Lawyers will be placed in the untenable position if their own reporting obligations are factored into, or are perceived as being factored into, their advice and characterization of a client's transaction as an "avoidance transaction". The mere perception that considerations related to a lawyer's own reporting duties and liabilities under this regime might influence the advice given to a client is, in itself, a threat to the independence of the Bar.

14. In *Canada (Attorney General) v. Law Society of British Columbia*, [1982] 2 S.C.R. 307, at pp. 335-336, the Supreme Court recognised the fundamental importance of an independent Bar:

> The independence of the Bar from the state in all its pervasive manifestations is one of the hallmarks of a free society. Consequently, regulation of these members of the law profession by the state must, so far as by human ingenuity it can be so designed, be free from state interference, in the political sense, with the delivery of services to the individual citizens in the state, particularly in fields of public and criminal law. The public interest in a free society knows no area more sensitive than the independence, impartiality and availability to the general public of the members of the Bar and through those members, legal advice and services generally.

15. The Information Reporting Measures are aimed at detecting abusive tax avoidance. Lawyers cannot be made into instrumentalities of the tax authorities to assist in detecting transactions which the tax authorities may consider abusive. Compelling a lawyer, under threat of penalty, to assist the state in this manner undermines the independence of the legal profession and ultimately, the public's confidence in its ability to obtain impartial advice in relation to their tax affairs.

**Recommendation:**

The CBA recommends that lawyers and Quebec notaries be specifically excluded from the ambit of the reporting obligation under proposed subsection 237.3(2) ITA in respect of any information or communications with a client in the context of a solicitor-client relationship.

## III. FEE HALLMARK

16. For purposes of proposed section 237.3, a reportable transaction is an avoidance transaction that features two of three legislatively described "hallmarks", which are intended to reflect certain circumstances that are said to commonly exist when taxpayers enter into avoidance transactions.

17. One such "hallmark" is an advisor's entitlement to a fee that is to any extent based on the amount of a tax benefit that results, or would result but for the application of section 245 (the general anti-avoidance rule) from the avoidance transaction or series.

18. In our view, this hallmark is too broad to function as an indicia of the types of aggressive tax planning that the Department of Finance wishes to identify in a timely manner. The CBA's members, as other professionals, are responsive to the current business environment in which value-based billing arrangements in all services areas are increasingly demanded by clients. Proposed section 237.3's wording encompasses fee arrangements without regard to the degree of connection or proportionality that exists between the fee and the tax benefit; a fee that is *to any extent based* on the tax benefit will be sufficient to contribute towards making a transaction a "reportable transaction". This hallmark is particularly problematic where multi-service firms are retained to provide advice (not exclusively tax advice) and professional services in the implementation of a transaction, since an aggregate fee based to any extent on the amount of the tax benefit can potentially cause a transaction to be a reportable transaction (and can be included in the computation of a penalty amount under subsection 237.3(8)).

19. The CBA Code of Professional Conduct as well as the professional codes of conduct of several governing law societies specifically authorise lawyers to consider the results obtained and the difficulty and importance of a matter in determining a fair and reasonable fee. Thus, where tax considerations are relevant to a transaction for which a lawyer is retained, it would not be exceptional or particularly indicative of aggressive tax planning that some portion of the professional service fee is based on the results obtained in terms of a tax benefit.

20. As well, the information reporting measures recently introduced by the government of Québec in *Bill 96 – An Act to amend the Taxation Act, the Act respecting the Québec Sales tax and other legislative provisions* recognise the following circumstance as an exception to the "fee" hallmark in that tax reporting regime:

> "a transaction in respect of which an agreement has been entered into with a person who is a member of a professional order and under which the result obtained by the person is one of the factors taken into consideration in determining the person's remuneration, in accordance with a provision of the code of ethics adopted by the professional order under the authority of which the person practices the profession."

**Recommendation:**

The CBA urges the Department of Finance to exclude from paragraph (a) of the definition of "reportable transaction" set out in proposed subsection 237.3(1) fee arrangements under which the results obtained by the advisor is one of the factors taken into consideration in determining the advisor's remuneration, in accordance with a provision of the code of ethics adopted by the governing body (law society or professional order) under the authority of which the advisor practices.

Alternatively, if the Department of Finance believes it is not possible to exclude such fees, the CBA recommends that the fee hallmark be changed to capture only those fee arrangements with a clear, direct and substantial nexus with a given tax result (i.e. the tax result is the primary criterion determining the quantum of the fee). Accordingly, we recommend that the fee hallmark be limited to fees that are primarily based on the amount of a tax benefit.

The CBA also recommends that the relevant fee for paragraph (a) of the definition of "reportable transaction" and for the quantum of any penalty be limited to the advisor's fee (or the portion of the advisor's fee) for tax advisory services that directly relate to the tax benefit.