THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

Office of the President
Cabinet du président

November 22, 2022

Via email: fin.minfinance-financemin.fin@canada.ca; chrystia.freeland@canada.ca

The Honourable Chrystia Freeland, P.C., M.P.
Deputy Prime Minister and Minister of Finance
Finance Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Dear Minister Freeland:

Re: Proposed Income Tax Amendments Compromise Solicitor-Client Privilege

On behalf of the Canadian Bar Association, I am writing to express our serious concerns about proposed amendments to the *Income Tax Act* (ITA) that compromise solicitor-client privilege.

The Canadian Bar Association (CBA) is a national association of over 37,000 lawyers, Québec notaries, law students and law professors. The CBA is the voice of the legal profession and is dedicated to supporting the rule of law and improving the administration of justice in Canada, which includes an independent Bar and respect for solicitor-client privilege.

It is important to state at the outset that we support the objectives of the proposed ITA amendments, namely to effectively counter aggressive tax avoidance, money laundering and other criminal activities. However, changes are required to clarify certain provisions to achieve these objectives and uphold the fundamental principle of solicitor-client privilege.

The CBA's ethics, professional responsibility and taxation experts have detailed their concerns in previous submissions.[1]

We believe that the provisions, as drafted (including in Bill C-32, *Fall Economic Statement Implementation Act*), would not withstand constitutional scrutiny given the jurisprudence from the Supreme Court of Canada. The requirements to disclose information are substantially the same as

[1] See Letter to Minister Freeland (April 5, 2022) on how proposed revised *reportable transaction* and new *notifiable transaction* measures compromise solicitor-client privilege. See online: Explaining why proposed reporting obligations for trusts in the July 2018 draft legislation compromise solicitor-client privilege.

the government's previous attempt to subject lawyers to the FINTRAC regime. In its 2015 decision in *Canada (Attorney General) v. Federation of Law Societies of Canada*,[2] the Supreme Court of Canada clearly ruled this was not allowed.

Our concerns and recommendations are summarized in the attached document.

The Federation of Law Societies of Canada shares similar concerns. Given the urgency and significance of the issue, the CBA and Federation request a meeting with you at your earliest convenience to discuss our recommendations.

Yours sincerely,

(original letter signed by Steeves Bujold)

Steeves Bujold, he/him-il/lui

CC: The Honourable David Lametti, P.C., M.P., Minister of Justice; mcu@justice.gc.ca

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[2] 2015 SCC 7

Proposed Income Tax Amendments Compromise Solicitor-Client Privilege

I. Importance of Solicitor-Client Privilege

Solicitor-client privilege is a quasi-constitutional right that has been repeatedly affirmed by the Supreme Court of Canada as fundamental to the rule of law, access to justice and the proper administration of justice.

This principle allows clients from all walks of life to communicate freely and in confidence with their lawyers, in a trusted environment, in order to receive the best legal advice possible. Protecting full and frank communication between lawyers and their clients promotes the public interest in the observance of law, and respect for the administration of justice.

II. Income Tax Act Amendments Compromising Solicitor-Client Privilege

The proposed changes to the ITA address:

1. Revised reporting obligations for "reportable" transactions and new requirements for "notifiable" transactions
2. New reporting obligations for trust accounts.

1. Revised reporting obligations for "reportable" transactions and new requirements for "notifiable" transactions

The draft legislation[3] expands reporting obligations for reportable transactions and imposes new reporting obligations for notifiable transactions. Many "advisors" who help a client with a reportable transaction or notifiable transaction are subject to the reporting obligation. An "advisor" includes lawyers, accountants and other third-party advisors.

Recognizing the importance of solicitor-client privilege, the ITA confirms that a lawyer who is an advisor on these transactions is not required to disclose any information covered by the privilege.

The issue is that the new rules impose reporting obligations on other persons who advise on the transaction, including accountants and other third-party advisors.

It is common for accountants or other third-party advisors to work closely with a lawyer in giving advice on tax matters. Therefore, it is common for information protected by solicitor-client privilege to be in the possession of accountants or other third-party advisors. In fact, courts have recognized the importance of extending solicitor-client privilege to communications between accountants and lawyers, so accountants are best able to perform their own duties to their clients.

However, the exception to not disclose information protected by solicitor-client privilege in the ITA applies only to lawyers. This means that information clearly covered by solicitor-client privilege but now in the hands of accountants and other third-party advisors could be disclosed.

This would make clients vulnerable by exposing their privileged information – information given confidentially by clients to their lawyers on the understanding that it would remain as such. This would allow the government to do indirectly what it recognizes it cannot do directly and disregard the original protection of confidentiality.

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[3] Draft legislation was initially released in February 2002 and subsequently in August 2022.

If the amendments are enacted, it may mean that lawyers, acting prudently to safeguard their clients' confidentiality could reconsider sharing as much information with third-party advisors.

Excluding solicitor-client privileged information from the reporting measures would not hinder the effectiveness of the rules. The reporting obligations would continue to be comprehensive, and the CRA could continue to collect other (non-privileged) information about reportable transactions and notifiable transactions. In addition, individuals and corporations already have disclosure obligations under FINTRAC and other beneficial ownership registry requirements.

It is more effective to obtain information directly from individuals and corporations rather than through lawyers.

Compelling the disclosure of solicitor-client privileged information, under threat of penalty, by persons who validly possess the information is unconstitutional as it undermines a fundamental aspect of our legal system and ultimately, the public's confidence in its ability to obtain comprehensive legal advice.

Recommendation

1. Amend the exception for solicitor-client privileged information in existing subsection 237.3(17) and proposed subsection 237.4(15) to specify, for greater clarity, that the information reporting requirements do not apply to any information in respect of which the person subject to the reporting obligation (not limited to a lawyer), on reasonable grounds, believes solicitor-client privilege applies.

2. New reporting obligations for trust accounts

The proposed new rules in Bill C-32, *Fall Economic Statement Implementation Act*, impose new reporting obligations on a broad group of trusts.[4] These trusts would be required to file annual tax returns to report the identity of all trustees, beneficiaries and settlors of the trust, and each person with the ability to exert control over trustee decisions.

Bill C-32 recognizes the importance of solicitor-client privilege and exempts "lawyers' general trust accounts". However, "client-specific trust accounts" are not exempted. As explained below, the absence of a bright-line exemption for client-specific trust accounts is problematic.

The proposed legislation contains a limited exception for disclosure of information that is subject to solicitor-client privilege. However, this exception (which is ambiguous in scope) is inadequate, impractical and risks placing lawyers in a conflict of interest with their clients.

In some circumstances, the proposed legislation would require a lawyer to disclose, among other things, the name of the client and the amount received from that client. This disclosure would violate the client's reasonable expectation of confidentiality in connection with their dealings with lawyers.

The proposed legislation may also place lawyers and their clients in a conflict of interest. The lawyer's obligation to file a return may conflict with the duty of confidentiality owed to the client, as well as make it difficult to give unbiased advice on the scope of the client's privilege.

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[4] The Government first announced its intention to impose new filing and reporting obligations for certain trusts in the 2018 federal budget. Draft legislation was released in July 2018, February 2022 and August 2022. Bill C-32 was introduced in the House of Commons on November 4, 2022.

In a tax context, the Supreme Court of Canada has strongly criticized attempts to impose penal sanction for non-disclosure of information that places legal advisors in a conflict with their clients (see *Canada (Attorney General) v. Chambre des notaires du Quebec*, 2016 SCC 30 at para 56).

In addition to solicitor-client privilege and conflict of interest concerns, the proposed reporting obligations for client-specific trusts would impose unreasonable reporting burdens on lawyers, with limited benefit to the CRA.

We anticipate that compliance with the proposed legislation will be especially problematic for real estate lawyers. For example, it is common for deposits to be received from hundreds of unit purchasers for a single condominium development. Since provincial laws require that lawyer trust accounts be maintained for those deposits, Bill C-32 could require law firms to file tens of thousands of returns per year on account of condo projects alone. This would be financially and administratively onerous and impractical, both for law firms and the CRA. It could ultimately result in higher purchase prices (counter to the government's objective of increasing affordable housing) because of higher transaction costs related to the reporting obligation, with limited benefit to the CRA.

Existing Restrictions on Lawyers' Trust Accounts

Lawyers and notaries are already heavily regulated when holding clients' funds in trust accounts. They are subject to comprehensive rules of professional conduct imposed and enforced by Canada's law societies that prohibit them from engaging in or facilitating unlawful conduct in any way. They are also subject to comprehensive financial and accounting regulations.

Measures to ensure that lawyers comply with law society regulations include annual reporting obligations, practice reviews and financial audits. Law societies also have extensive investigatory and disciplinary powers that include the ability to impose penalties up to and including disbarment when members fail to abide by law society rules and regulations. Lawyers and notaries who wittingly participate in criminal activity are also subject to criminal charges and sanctions.

The prospect of lawyers' trust accounts being used in a manner that frustrates the CRA's ability to administer the ITA is extremely remote. Any income earned on amounts held in lawyers' trust accounts is generally subject to T5 reporting, so the CRA is already aware of income earned.

An exception for all lawyers' trust accounts would not impair the CRA's ability to enforce the ITA, and an exception is appropriate in view of the constitutional importance of protecting solicitor-client privilege.

Recommendation:

2. Amend proposed subsection 150(1.2)(c) to specifically exempt from the filing obligation any trust account maintained by a lawyer or notary in accordance with the rules of professional conduct governing them (which includes trust accounts maintained for particular clients).

III. Closing Comments

We understand and appreciate that authorities require sufficient information to determine taxpayers' tax liabilities to effectively counter aggressive tax avoidance, tax evasion, money laundering and other criminal activities. However, these measures must be balanced with 1) respect for solicitor-client privilege, and 2) allowing lawyers to fulfil their duties to their clients without placing them in a conflict of interest.

The confidentiality of the solicitor-client relationship is essential to the functioning of the justice system and access to justice, as the Supreme Court of Canada ruled in *Canada (Privacy Commissioner) v. Blood Tribe Department of Health*, [2008] 2 SCR 574:

> Solicitor-client privilege is fundamental to the proper functioning of our legal system. […] Experience shows that people who have a legal problem will often not make a clean breast of the facts to a lawyer without an assurance of confidentiality 'as close to absolute as possible' […]. It is in the public interest that this free flow of legal advice be encouraged. Without it, access to justice and the quality of justice in this country would be severely compromised.

The requirements to disclose information are substantially the same as the government's previous attempt to subject lawyers to the FINTRAC regime. In *Canada (Attorney General) v. Federation of Law Societies of Canada*,[5] the Supreme Court of Canada clearly ruled this was not allowed.

In that case, the Supreme Court of Canada recognized as a principle of fundamental justice that the state cannot impose duties on lawyers that undermine their duty of commitment to their client's cause. The duty is fundamental to the solicitor-client relationship and how the state and the citizen interact in legal matters. The legal professional's duty of commitment to the client's cause is essential to maintaining confidence in the integrity of the administration of justice.

The state cannot impose obligations on lawyers that undermine their compliance with the duty, either in fact or in the perception of a reasonable person. The proposed legislative changes threaten this bedrock principle.

In addition, lawyers' and notaries' use of trust accounts is already heavily regulated and subject to comprehensive rules of professional conduct imposed and enforced by Canada's law societies. The government should not subject the legal profession to a second regime – especially given the Supreme Court of Canada decision in *Federation of Law Societies of Canada*.

Compelling disclosure of solicitor-client privileged information, under threat of penalty, by persons who validly possess the information (i.e., accountants and third-party advisors) is arguably unconstitutional.

Lawyers' general trust accounts and "client-specific" trust accounts should be treated in the same manner. Not exempting client-specific trust accounts from the filing obligation fails to respect solicitor-client privilege and raises fundamental legal and constitutional issues. Based on the principles in *Chambre des notaires*[6], it follows that any legislation that could abrogate privilege in this manner would be struck down by a court.

Solicitor-client privilege is a quasi-constitutional right and is fundamental to the rule of law and the proper administration of justice. It will be vigorously defended by the legal profession and justice system stakeholders.

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[5] 2015 SCC 7

[6] 2016 SCC 30