THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

April 5, 2022

Via email: chrystia.freeland@fin.gc.ca; Consultation-Legislation@fin.gc.ca;

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

Dear Minister Freeland:

Re: February 4, 2022 Draft Legislation Pertaining to Reportable Transactions, Notifiable Transactions and Enhanced Audit Powers

I am writing on behalf of the Canadian Bar Association to comment on the above-noted provisions in the Draft Legislation released on February 4, 2022.

The CBA is a national association of more than 36,000 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 noted provisions because, if adopted in their current form, they will compromise solicitor-client privilege. This is a fundamental and foundational element of the Canadian justice system, the preservation of which benefits all Canadians. We urge you to modify these provisions to fully protect the privilege. The CBA's Taxation Law Section and Ethics Subcommittee set out our representations more fully in the attached submission, but this issue is of importance for the legal profession as a whole.

The Taxation Law Section, through its participation in the Joint Committee on Taxation of the CBA and CPA Canada, has commented on several other elements of the February 4, 2022 Draft Legislation in a separate submission to your Department.

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 lawyers are able to fulfill their duties to their clients with undivided loyalty. We would be pleased to meet with you or your officials should you wish to discuss our submission.

Sincerely,

(original letter signed by Stephen Rotstein)

Stephen Rotstein

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

Submission of the Canadian Bar Association on the February 4, 2022 Draft Legislation Pertaining to Reportable Transactions, Notifiable Transactions and Enhanced Audit Powers (the "Draft Legislation")

I. Mandatory Disclosure of "Reportable Transactions" and "Notifiable Transactions"

1. Existing subsection 237.3(2) of the *Income Tax Act* (Canada) (ITA) imposes an information reporting obligation in respect of "reportable transactions". Among those subject to this reporting obligation is every "advisor" who is entitled to certain contingent and other fees in respect of a reportable transaction. An "advisor" is defined to mean 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 another person, and can therefore include a lawyer.

2. Existing subsection 237.3(4) provides that, if multiple parties are subject to the information reporting obligation under subjection 237.3(2), disclosure by one party is treated as disclosure by all parties subject to the obligation.

3. A person subject to the information reporting obligation who fails to comply with subsection 237.3(2) is liable to a penalty under existing 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.

4. Existing subsection 237.3(17) provides, for greater certainty, that a lawyer (defined to include a Québec notary) who is an advisor in respect of a reportable transaction is not required to disclose in an information return in respect of the transaction any information in respect of which the lawyer, on reasonable grounds, believes that a client of the lawyer has "solicitor-client privilege". Subsection 232(1) defines "solicitor-client privilege" for this purpose as meaning the right, if any, that a person has in a superior court in the province where the matter arises to refuse to disclose an oral or documentary communication on the ground that the communication is one passing between the person and the person's lawyer in professional confidence.

5. The Draft Legislation proposes amendments to section 237.3 that are intended to broaden its application in several material respects. Among other things, the Draft Legislation proposes to:

a. amend the existing definition of "reportable transaction" as well as other relevant definitions, which will result in the information reporting obligation applying to a far broader range of transactions;

b. significantly increase penalties under subsection 237.3(8) on a person who fails to comply with subsection 237.3(2);

c. significantly accelerate the deadline for filing an information return disclosing the reportable transaction to the Canada Revenue Agency (CRA);[1] and

d. eliminate the relieving rule at subsection 237.3(4) such that reporting by one person will no longer discharge another person's obligation to report.

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[1] Under existing subsection 237.3(5), an information return in respect of a reportable transaction is required to be filed by a person subject to the reporting requirements by June 30 of the calendar year following the calendar year in which the transaction first become a reportable transaction. Under revised subsection 237.3(5), a person (including an advisor) in respect of whom the reporting obligation exists must file an information return disclosing significant information in respect of the reportable transaction within 45 days of the earlier of: (i) the day the person entering into the reportable transaction becomes contractually obligated to enter into the transaction, and (ii) where there is no contractual obligation predating the transaction, the day that person enters into the transaction.

6. Separately, the Draft Legislation proposes a new information reporting regime in respect of "notifiable transactions." Under proposed section 237.4, the Minister of National Revenue (MNR) is to have the authority to designate, with the concurrence of the Minister of Finance, transactions and series of transactions as requiring disclosure by taxpayers, advisers, promoters, and certain other persons. Where a transaction, or a series of transactions, is the same as or "substantially similar"[2] to a transaction, or a series of transactions, so designated by the MNR, the transaction, or any transaction in the series, is required to be disclosed to the CRA in prescribed form and manner.

7. Much like the reportable transaction rules at section 237.3, proposed section 237.4 imposes an information reporting obligation on an "advisor" (including a lawyer) who directly or indirectly advises or assists with respect to creating, developing, planning, organizing or implementing the notifiable transaction. Proposed subsection 237.4(8) also imposes penalties for failure to comply. Finally, proposed subsection 237.4(15) provides that a lawyer who is an advisor in respect of a notifiable transaction is not required to disclose in an information return in respect of the transaction any information in respect of which the lawyer, on reasonable grounds, believes that a client of the lawyer has solicitor-client privilege.

8. The revised reportable transaction and new notifiable transaction measures, initially announced in the April 19, 2021 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 fair 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 (i) imperilling solicitor-client privilege, a fundamental element of the Canadian legal system, and (ii) placing lawyers in a conflict of interest and preventing them from fulfilling their duties to their clients with undivided loyalty.[3] While the Department of Finance's goal of promoting a fairer tax system for Canadians is laudable, the fundamental and foundational elements of the Canadian justice system must be protected.

9. 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:
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> 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 . . .

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[2] Proposed subsection 237.4(2) provides that, for the purposes of the definition notifiable transaction, the term "substantially similar" includes any transaction, or series of transactions, in respect of which a person is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy, and is to be interpreted broadly in favour of disclosure.

[3] See letter from CBA President to Minister of Finance, August 27, 2010 Draft Legislation – Information Reporting of Tax Avoidance Transactions, Sept 27, 2010.

> that he should be able to place unrestricted and unbounded confidence in the professional gent, 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.
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> 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.

10. Canadian courts have also recognised that solicitor-client privilege must be as close to absolute as possible to ensure public confidence and retain relevance. 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:

> [T]he possibility of being prosecuted (under s. 238 of the ITA) for failing to provide the CRA with the information it seeks could influence the choice made by a notary or a lawyer to comply or not to comply with a requirement. The threat of prosecution in fact creates a conflict of interests between legal advisers and their clients, pitting the duty of confidentiality owed by legal advisers to their clients against their statutory duty of disclosure to the tax authorities (Lavallee, at para. 40). In this regard, it is, contrary to the AGC's argument, irrelevant that none of the notaries who received requirements have so far been prosecuted for refusing to provide the information or documents being sought. The mere possibility of being so prosecuted under the ITA places those legal advisers in an intolerable situation.[4]

11. Moreover, Canadian case law in tax-related matters has repeatedly recognised that solicitor-client privilege is not necessarily waived in situations where third parties who are not lawyers or legal professionals are involved in assisting a client to obtain legal advice. For example, communications between an accountant and a lawyer with respect to a common client may be protected by solicitor-client privilege. The leading case on this matter remains *Susan Hosiery v MNR*, [1969] C.T.C. 353 (Exch Ct). In that case, the predecessor to the CRA sought disclosure of correspondence between the taxpayer's accountants and the taxpayer's solicitors. The Court, after a review of the law, found the documents to be protected from disclosure:

> Applying these principles, as I understand them, to materials prepared by accountants, in a general way, it seems to me
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> (a) that no communication, statement or other material made or prepared by an accountant as such for a business man falls within the privilege unless it was prepared by the accountant as a result of a request by the business man's lawyer to be used in connection with litigation, existing or apprehended; and
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> (b) that where an accountant is used as a representative, or one of a group of representatives, for the purpose of placing a factual situation or a problem before a lawyer to obtain legal advice or legal assistance, the fact that he is an accountant, or that he uses his knowledge and skill as an accountant in carrying out such task, does not make the

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4 Canada *(Attorney General) v. Chambre des notaires du Quebec*, 2016 SCC 30 at para 56 (Chambre des notaires du Quebec).

> communications that he makes, or participates in making, as such a representative, any the less communications from the principal, who is the client, to the lawyer; and similarly, communications received by such a representative from a lawyer whose advice has been so sought are none the less communications from the lawyer to the client. (page 5283)

12. The Court also commented on the importance of extending solicitor-client privilege to communications between accountants and counsel in these situations, so that accountants are best able to perform their own duties to their clients.

> I have no difficulty in concluding that the balance of probability is that Mr. Pal and Mr. Wolfe were acting as representatives of the appellant for the purpose of obtaining legal advice on behalf of the appellant from Mr. Goodman concerning the setting up of some arrangement such as that, according to the allegations referred to, the appellant in fact entered into. I think the court may take judicial knowledge of the fact that corporations of all kinds are continuously faced with problems as to what arrangements are advisable or expedient having regard to the intricacies of the tax laws and that, while huge corporations have staffs of lawyers and accountants of their own through whom they seek advice of counsel learned in such special areas of practice, smaller corporations employ lawyers and accountants in general practice to act for them in obtaining special advice in connection with such matters. I have no doubt as to the inherent probability of Mr. Cohen's statements that Mr. Wolfe and Mr. Pal were so acting for the appellant in obtaining Mr. Goodman's advice. (page 5283)

13. It bears noting that *Susan Hosiery* has been repeatedly endorsed in subsequent tax and other cases.[5]

14. As noted above, the reportable transaction rules at section 237.3 and the notifiable transaction rules at section 237.4 both impose mandatory information reporting obligations in certain circumstances on persons who provide "any assistance or advice" with respect to creating, developing, planning, organizing or implementing a transaction or series of transactions. It is quite common for an accountant or some other third party advisor to assist or otherwise work with a lawyer in providing transactional advice to a client or in implementing legal advice. Accordingly, it is common in tax matters for information protected by solicitor-client privilege (and not waived on other grounds) to be in the possession of accountants or other third party advisors.[6] However, the existing exception at subsection 237.3(17) and the new exception at subsection 237.4(15) with respect to information protected by solicitor-client privilege only appear to apply with respect to the disclosure obligation of lawyers, and not to other advisors or to taxpayers themselves.

15. The Draft Legislation appears to depart from the recommendation of the OECD, which we understand to be at least part of the impetus for the mandatory disclosure rules in the first place. In particular, the OECD Mandatory Disclosure Rules, Action 12 Final Report notes, at paragraph 70, the UK and Irish law position on disclosure where there exists a privileged solicitor-client relationship. In those circumstances, the obligation to disclose shifts from the lawyer to the client, unless the client waives privilege. The report goes on to recommend that this approach be followed by countries adopting mandatory disclosure rules.

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5 See, among others, *Southern Railway of British Columbia Ltd. v Deputy Minister of National Revenue*, 91 D.T.C. 5081 (BC SC) at 5082; *Cineplex Odeon Corp v MNR* (1994), 114 DLR (4th) 141 (Ont Ct (Gen Div)) at 114; *Long Tractor Inc. v Canada (Deputy Attorney General)* (1997), 155 DLR (4th) 747 (Sk QB); *Methanex Corp v Canada*, 1996 CarswellAlta 861 (Alta. QB); *Wolch's Guaranteed Foods Ltd (Trustee of) v Wolch* (1994), 24 CBR (3d) 268 (Alta QB); and *General Accident Assurance Co v Chrusz* (1999), 180 DLR (4th) 241 (Ont CA) at paras 104-106, 120.

6 See, for example, *Barrick Gold Corporation v. Goldcorp Inc.*, 2011 ONSC 1325, which recognizes "deal team privilege" in situations where legal advice must be shared with non-lawyer consultants in a deal team at the same time as it is shared with the client, for the advice to be used effectively.

16. Excluding solicitor-client information from the information reporting measures in the text of the legislation would not hinder the effectiveness of the proposed rules. Subject to this exception, the reporting obligations would continue to be comprehensive, and the CRA could continue to collect other (non-privileged) information with respect to reportable transactions and notifiable transactions. By contrast, purporting to compel the disclosure, under threat of penalty, of solicitor-client privileged information by persons who are validly in possession of such information is arguably unconstitutional because it undermines one of the most fundamental aspects of our legal system and ultimately, the public's confidence in its ability to obtain comprehensive legal advice in relation to their tax affairs.

17. Moreover, confidential information or knowledge that is in the possession of a lawyer, client or other person may be subject to solicitor-client privilege without meeting the definition of that expression in the ITA (which is limited to certain oral and documentary communications). For example, the fact that a lawyer was engaged by a particular client to provide legal advice may well be privileged in itself, even though the existence of the engagement may not constitute a "communication" and as such arguably not fall within the statutorily defined expression.[7] Indeed, the Supreme Court of Canada has explicitly rejected a category-based approach to solicitor-client privilege that distinguishes between a fact and a communication.[8] The Supreme Court of Canada[9] also has specifically considered the ITA definition of "solicitor-client privilege" and ruled that certain aspects of the definition are unconstitutional and invalid. Nevertheless, that definition continues to be used in the ITA and it has never been amended to address the findings of the Court.

18. Further, as noted above, the proposed revisions to subsection 237.3(5) will, at a high level, require persons entering into reportable transactions to file information returns disclosing significant information in respect of the reportable transaction within 45 days of the earlier of: (i) the day the person entering into the reportable transaction becomes contractually obligated to enter into the transaction; and (ii) where there is no contractual obligation predating the transaction, the day that person enters into the transaction. Similarly accelerated deadlines apply to others required to disclose the reportable transaction, including advisors, and a similar accelerated reporting regime is also contemplated at proposed subsection 237.4(5) in respect of notifiable transactions.

19. As a practical matter, a person (including an advisor) could, as a result of the accelerated deadlines, be required to file an information report prior to a transaction even being completed. In the CBA's view, it is not appropriate that persons be required to file information returns in respect of transactions that have yet to occur for at least two reasons:

a. First, such a requirement may, in certain instances, put parties in direct conflict with other obligations not to disclose until a transaction closes. This may be true, for example, in the securities law context, where the disclosure of material non-public information is strictly circumscribed and where failure to comply with the relevant limitations may give rise to financial and penal consequences.

b. Second, while it may be assumed that solicitor-client privilege does not apply to completed transactions on the basis that such transactions are objective facts, contemplated transactions that have yet to be consummated can be considered the "unperfected" product of solicitor-client privilege and should therefore not be subject to disclosure by a lawyer.

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7 See *R. v. Budd*, [2002] OTC 893 at para. 14.

8 See *Canada (National Revenue) v. Thompson*, 2016 SCC 21 at para. 19.

9 See *Chambre des notaires*, supra note 3.

RECOMMENDATIONS

1. **The CBA recommends that the exception for solicitor-client privileged information in existing subsection 237.3(17) and proposed subsection 237.4(15) be broadened to specify, for greater certainty, that the information reporting requirements do not apply in respect of any information in respect of which the person subject to the reporting obligation, on reasonable grounds, believes solicitor-client privilege applies.**

2. **The CBA further recommends that the ITA definition of "solicitor-client privilege" either should be removed entirely or drafted in a manner that conforms with the legal meaning of the expression that has been developed under applicable Canadian case law. The Department of Finance should also clarify that, where a lawyer would not be required to provide any information under the reporting rules on the basis of solicitor-client privilege with the possible exception of the fact that the lawyer has been engaged, the fact that the lawyer has been engaged need not be disclosed.[10]**

3. **The CBA further recommends that proposed subsections 237.3(5) and 237.4(5) be revised to remove the requirement for any person to file information returns in respect of transactions that have yet to be completed. In the alternative, the measures should at the very least be amended to exclude lawyers from any obligation to make any information return in respect of transactions that have not been completed. As a consequence of this recommendation, the CBA also recommends that the existing subsection 237.3(4), which provides that disclosure by one party is treated as disclosure by all parties subject to an obligation to report a reportable transaction, be reinstated, and that a similar rule be included in section 237.4 with respect to notifiable transactions.**

II. Enhanced Audit Powers

20. Existing section 231.1 sets out the scope of a CRA auditor's authority to seek in-person assistance and responses to oral questions at a taxpayer's premises. The provision authorizes an auditor to enter a taxpayer's business premises to "inspect, audit or examine" the books and records of a taxpayer, and in that context to require the "owner or manager of the property or business and any other person on the premises" to give the auditor "reasonable assistance" and answer "proper questions relating to the administration and enforcement" of the ITA. Section 231.2 gives auditors the power to compel taxpayers as well as third parties to provide documents and answer certain questions in writing.

21. The Federal Court of Appeal in *Canada (National Revenue) v. Cameco Corporation*, 2019 FCA 67 (Cameco) found that the audit authority under section 231.1 did not authorize the CRA to compel persons to submit to oral interviews or to answer wide-ranging questions orally. The Draft Legislation appears to be designed in response to Cameco. Among other things, the Draft Legislation:

a. redefines the category of persons required to provide reasonable assistance and answer questions orally as a "taxpayer or any other person", and not just the "owner or manager" of the business or a person who is on the property or business premises where the auditor conducts an examination of business records;

b. authorizes a CRA auditor to compel the attendance of "a taxpayer or any other person" at a place designated by the auditor (and not just the business premises) or "by video-conference or by another form of electronic communication" to answer to proper questions relating to the administration or enforcement of the ITA;

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10 Such clarification could potentially be provided through explanatory notes.

c. authorizes the auditor to compel the answer to proper questions relating to the administration or enforcement of the ITA in writing "in any form specified" by the auditor; and

d. authorizes the auditor to require a taxpayer or any other person to provide "all reasonable assistance with anything the authorized person [i.e., the auditor] is authorized to do" under the ITA

22. Although statutory overrides to judicial decisions are not uncommon in the tax context, they should, as a general rule, be limited to achieving necessary policy objectives while not disrupting the basic legal rights of individuals. In this respect, the CBA recognises that Parliament has a legitimate interest in allowing CRA auditors to efficiently collect facts and information in the course of an audit. However, the CBA is concerned that the expanded CRA audit powers in section 231.1 are overreaching and lack appropriate legal safeguards, particularly with regard to compelling oral interviews. A tax audit has, until now, generally been understood to be an administrative process, not a legal proceeding akin to an examination on discovery. Mandatory oral interviews change that dynamic significantly, and may put interviewees (including the taxpayers under audit, but also third parties) in the vulnerable position of feeling compelled to disclose information they are not legally obligated to provide, such as information protected by solicitor-client privilege.

23. The CBA believes that individuals required to submit to oral interviews by any governmental authority should, at the very least, be advised of their right to be assisted by legal counsel or another representative. Allowing lawyers or other representatives to be present during an oral interview would not unduly interfere with the CRA's fact-finding, but would provide some protection to the rights of taxpayers, including their right to keep certain information confidential to the extent legally permitted.

24. Moreover, the CBA believes that the expansion of the CRA's audit powers under section 231.1 to require "any person" to provide reasonable assistance and to answer questions orally or otherwise should not apply to lawyers. In no circumstances should lawyers be compelled to provide information protected by solicitor-client privilege to the CRA. In this regard, subsection 232(2) provides that a lawyer prosecuted for failing to comply with a requirement under section 231.2 with respect to information or a document will be acquitted if the lawyer establishes that they had reasonable grounds for believing that the information or document sought was protected by solicitor-client privilege and communicated to the CRA her refusal to comply with the requirement. The Draft Legislation has not proposed to amend subsection 232(2) to apply for the purposes of audit requests under section 231.1, which appears to be an oversight.

RECOMMENDATIONS

4. **The CBA recommends that proposed section 231.1 be amended to explicitly provide that a person required to submit to an oral interview under subparagraph 231.1(1)(d)(i) has, and is to be advised of, the right to be assisted by legal counsel or another representative.**

5. **The CBA further recommends that subsection 232(2) be amended to apply for the purposes of section 231.1.**