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## Vern Krishna: Tax law chips away at the tradition of solicitor-client privilege



VERN KRISHNA | March 15, 2016 1:07 PM ET



Legal privilege, which started as an evidentiary rule in the common law, is now a constitutional doctrine in Canada.

Professional communications between taxpayers and their legal advisers are privileged from disclosure to third parties. Legal privilege, the oldest common law right, is a fundamental principle of justice that grants a protection from disclosing evidence.

Our courts zealously protect privilege, even in the face of recent government legislation to compel disclosure of suspected money laundering transactions. Subject to a few exceptions most notably in tax law, neither counsel nor the client can be compelled to disclose the contents of such communications where they were intended to be confidential.

And note that the definition of counsel includes not just barristers and solicitors, but also their law clerks, their agents and even interpreters.

The purpose of legal privilege is to promote uninhibited communications between professionals so that they can render services in an effective manner. Thus, privilege is essential to the well being of a free society.

There are many skilled professionals who render confidential advice and information, yet who are not protected by class privilege. The law accords special status to legal privilege, much to the chagrin of accountants and financial advisers who handle vital and sensitive confidential financial information.

Legal privilege, which started as an evidentiary rule in the common law, is now a constitutional doctrine in Canada. Most recently, in a decision involving the Federation of Law Societies of Canada, the Supreme Court concluded that certain provisions of the Criminal Code and the Proceeds of Crime (Money Laundering) and Terrorist Financing Act limited the liberty of lawyers in a manner that was not in accordance with the principle of fundamental justice relating to the lawyer's duty of committed representation.

The privilege extends to litigation, settlement discussions, and solicitor-client transactions. It also applies to those situations in which a document or information is shared with persons other than the client and the lawyer, provided that they have a common interest with the client in the same anticipated or current litigation.

However, in tax law — which is a world unto itself — the income tax statute restricts the right in several aspects. Tax law presumes that the Minister's assumption of fact underlying an assessment is deemed correct, unless the taxpayer demolishes the assumption by prima facie evidence. This is a form of reverse onus on the taxpayer.

In case called *Dr. Mike Orth*, 2014 FCA 34, for example, the taxpayer claimed deductions for legal fees paid in respect of his business and investment planning. The test for deductibility in tax law is whether the taxpayer incurs the legal expenses for the purpose of earning income from a business or property, and is not on account of capital or personal expenses. The court considered the phrase "business and investments" to be ambiguous in that it might refer to either an income earning or capital purpose.

The taxpayer could disclose the particulars of its legal expenses, but only by waiving its solicitor and client privilege. The Federal Court of Appeal accepted the privilege claims as valid, but dismissed the appeal because the taxpayer refused to waive the claim of solicitor and client privilege with respect to evidence that could resolve the dispute.

The court therefore gave the taxpayer Hobson's choice: waive your privilege or lose your case.

Tax law also excludes from privilege a lawyer's accounting records, including supporting vouchers and cheques, which are not considered confidential communications. This seemingly innocent exclusion of "records" is in fact very broad. It not only includes accounts, but also agreements, books, charts, tables, diagrams, invoices, letters, memoranda, statements "and any other thing containing information." The only restraint is that the record must pertain to "accounting," which in itself can have varied meanings.

Ultimately, it is a question of fact whether a document is "an accounting record." Solicitors' charge sheets, and statements of accounts, are not accounting records and, therefore, may be the subject of a claim of privilege. However, accounting records such as ledgers, books of accounts and supporting documents cannot be privileged.

A detailed statement of account, and computerized dockets, can be a beacon to an auditor as to the underlying nature of a tax plan, and shine a light on areas of concern if they are particularized.

Hence, the tax lawyer's dilemma: provide detailed accounting to keep the client informed, but leave a road map showing the tax auditor the path to areas that warrant closer scrutiny.

In the result, privilege, the oldest common law right, which is considered to be a fundamental principle of justice in criminal law, is curtailed in tax law in the interests of revenue collection. Tax lawyers are advised to remember the difference when rendering tax advice.

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