S T E P

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DELIVERED BY E-MAIL ONLY

Gerard Lalonde
Director
Tax Legislation Division
Department of Finance Canada
19th floor, East Tower
140 O'Connor Street
Ottawa, Ontario K1A 0G5

Dear Mr. Lalonde,

On behalf of the 2,000 members of the Society of Trust and Estate Practitioners (Canada) ("STEP Canada"), we are pleased to submit our comments in response to the draft legislation that, if implemented in current form, would require reporting of certain transactions ("the Draft Legislation").

This submission supplements the one dated July 7, 2010, in which STEP Canada provided several observations on the proposals preceding the release of the Draft Legislation. Now that the Draft Legislation has been released, we would like to take this opportunity to offer additional comments on two specific concerns: solicitor-client privilege and magnitude of potential penalties.

1. Solicitor-Client Privilege

The Draft Legislation states that an advisor who provides advice or assistance in planning or implementing a reportable transaction, or similarly participates in a series of transactions that includes such a transaction, may be under an obligation to report the transaction. Further, the advisor, if required to report, will be "jointly and severally" liable, or "solidarily" liable under the Civil Code of Québec, with the client for the penalty imposed as a result of non-disclosure of the transaction.

Comments

Solicitor-client privilege is a well-established tenet of Canadian law. It enables clients to seek and receive confidential legal advice and conduct their affairs accordingly. It also extends to the client's agent (*e.g.*, an accountant) when the agent is acting as an essential channel of communication between the solicitor and the client who is seeking legal advice.

Its importance to the proper functioning of our justice system has accorded solicitor-client privilege the highest protection recognized by the courts. The Supreme Court of Canada in *R. v. Lavallee* held that solicitor-client privilege is "a principle of fundamental justice and a civil right of supreme importance in Canadian law" that "must remain as close to absolute as possible to retain its relevance". The significance of solicitor-client privilege was also reaffirmed by the Canada Revenue Agency ("CRA") in the Technical Information Policy, *Acquiring Information from Taxpayers, Registrants and Third Parties*, released in June 2010 ("CRA Policy"). It recognized that privilege can only be waived by the client and noted that solicitor-client communication remains privileged if it is disclosed without the informed consent of the client.

Accordingly, provisions in the Draft Legislation that force advisors to disclose reportable transactions contravene the principle of solicitor-client privilege and the CRA Policy. They also run in contravention to solicitors' provincial statutory responsibility to protect the confidentiality of their clients' affairs and not waive the solicitor-client privilege. Lastly, they may be in violation of section 8 of the *Charter of Rights and Freedoms* and, therefore, void.

Furthermore, the separate reporting duty imposed by the Draft Legislation on solicitors, apart from the duty imposed on their clients, sets them at odds with each other. It places the solicitor in a position of potentially making an assessment that a transaction is reportable, when the client may not share that view, thereby undermining the solicitor-client relationship. The separate reporting obligation is particularly onerous when a specific transaction that a solicitor facilitates represents only one element in a series of transactions occurring over a period of several years. Although that specific transaction may not be reportable and the solicitor may no longer be retained by the client, a previous or subsequent transaction may be deemed to be reportable, thereby tainting all the transactions within the series of transactions and imposing a wide net of culpability on all the solicitors involved with the transactions, including those who are no longer retained by the client.

In addition, since in most provinces the client's file belongs to the client and the advisor may no longer have the client's file at the time a reporting obligation arises, and since the reporting obligation is triggered when a "tax benefit arises", from a practical point of view advisors may be unable to secure the information required to effect reporting compliance.

We also note that any transgression committed by an errant advisor would be caught by the third-party civil penalty regime, which presently exists in the *Income Tax Act* (Canada).

Therefore, STEP Canada recommends that this portion of the Draft Legislation be amended to place the reporting obligation on the person who benefits from the transaction, not the advisor, especially when the advisor is a solicitor or agent facilitating the solicitor-client relationship.

2. Magnitude of the Penalties

Taxpayers are liable for a penalty equal to the total amount of fees charged by their advisors and/or promoters. The penalty to be paid by an advisor or promoter is limited to the total amount of the fees received. However, a review of the penalty regime set out in the Draft Legislation reveals a possibility that the penalties imposed could surpass the amount of any tax benefit derived from a reportable transaction or series of such transactions.

Comments

We are providing a hypothetical example to illustrate our concern. An advisor is approached by a promoter to obtain referrals from the former for a particular tax strategy that is later deemed to involve a reportable transaction. If the advisor refers 100 clients for a fee-per-client of $5,000, the fee and ultimate penalty for the advisor will be $500,000. If each client pays the promoter $25,000, the promoter's fee and penalty will be $2,500,000. A penalty of $30,000, the sum of the advisor and promoters' individual fees per client, will be imposed on each client. Under the definition of "joint and several liability" set out in the Draft Legislation, a client could also be made responsible for payment of this sum if it is not paid by the advisor and promoter, thereby exposing the client to a liability of $60,000. In this scenario, the penalty amount based on fees, notwithstanding the denial of any tax benefit, could total $6,000,000. Ottawa would collect far more revenue than it would by simply denying the tax benefit.

It is assumed that the Department has not created this penalty regime as a way to increase federal revenues beyond an amount that might be obtained from an equitable imposition of penalties. STEP Canada therefore recommends that the penalty regime be reviewed and amended to create a more even-handed set of penalties.

In closing, STEP Canada would like to thank the Department for reviewing these comments on the Draft Legislation and those submitted on July 7, 2010. We trust that you will find our comments useful. We would be pleased to expand upon them at your convenience.

Yours very truly,

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