

REPORT NUMBER: 1640

Decision of the Federal Court–Trial Required Reading Regarding

Division

Requirements

The taxpayers and BDO applied to the Federal **Background**

Court–Trial Division for a judicial review of the Requirements, and challenged both the validity of the Require-REPORT DESIGNATOR: ctop

The recent decision of the Federal Court of Appeal in *M.N.R. v. Bruce Kitsch, Leslie Tower, Robert Tower* and produced for the CCRA under the Requirements. In *sup-BDO Dunwoody LLP* (2003 DTC 5540; reversing 2002 DTC

port of the application, counsel also argued that the CCRA 7315 [F.C.T.D.]) is required reading for all tax planners.

was not entitled to the disclosure of any documents or information set out in the Requirements because The facts in this case are very straightforward. The tax-accountant–client privilege should apply. If such privilege payers were businessmen who had decided to leave exists, the disclosure of communications between an Canada and give up their Canadian residency. They accountant and his or her client could not be compelled retained the accounting firm of BDO Dunwoody (“BDO”) by the CCRA unless the client consents to the disclosure.

to provide them with a tax planning strategy which would reduce their “departure tax” liability (see paragraph At the Federal Court–Trial Division, Mr. Justice Kelen 128.1(1)(b) of the Income Tax Act (the “Act”)). BDO recom-allowed the application, in part. He held that under section **FAX TO: 815-455-9033 falconpress**

mended that the taxpayers enter into certain investment 231.2 of the Act, the Minister has the right to require the arrangements with the CIBC and borrow amounts ranging production of documents already in existence, but not the from \$77 million to \$141 million which would provide the right to require answers to questions because the section Seq: 3

taxpayers with a significant interest deduction. The tax-does not authorize the Minister to demand responses to payers followed BDO’s tax planning advice and deducted written interrogatories and the Requirements cannot pro-the interest expense in their tax returns.

vide the Minister with the right to conduct a written examination for discovery. In addition, Mr. Justice Kelen held that The CCRA reassessed the taxpayers and disallowed the if any of the documents which were required to be pro-interest deduction. The CCRA also served Requirements duced under the Requirements referred to clients of BDO

under section 231.2 of the Act on the two BDO account-unrelated to the taxpayers, BDO had the right to

expunge ants who had provided the tax planning advice. The the names of such clients before the documents were sub-Requirements required production of a broad range of mitted to the Minister. In respect of the issue of documents in BDO's possession, including all working accountant-client privilege, Mr. Justice Kelen found in paper files, all tax files and planning documents relating to favour of the CCRA and held that the provision of tax the taxpayers and all correspondence in any form to or advice by accountants was not subject to a claim of privi-from the taxpayers. In addition, the CCRA required answers lege.

to certain questions, including the reasons each taxpayer Filename:

D:\reports\dof\part1\frasermilner\fraser1640.dat sought financing through BDO as opposed to a lending institution and the reason financing was required by each **Decision of the Federal Court of Appeal** taxpayer.

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The CCRA was not pleased with the decision of the Federal Court-Trial Division and, therefore, appealed the **Subsection 231.2(1) of the Act**

decision relating to whether Requirements can compel answers to questions and whether expunging names of Subsection 231.2(1) of the Act permits the Minister, for persons not named in the Requirements was permitted.

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any purpose related to the administration or enforcement The taxpayers cross-appealed in respect of the issue of of the Act, to require that any person provide, within such accountant-client privilege.

reasonable time as is stipulated in the notice, (a) any information, including a return of income, or (b) any document The first issue for the Federal Court of Appeal was (emphasis added). It should be noted that a Requirement whether the trial judge was correct in deciding that BDO

can be issued not only to the specific taxpayer, but to any was only required to produce documents and that BDO

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person. It should also be noted that the penalty for failure did not have to respond to written interrogatories from the to comply with a Requirement under section 231.2 of the Minister under Requirements issued pursuant to section Act is set out in subsection 238(1) of the Act and includes a 231.2 of the Act. In this regard, the Federal Court of Appeal **REMOVE**

fine of not less than \$1,000 and not exceeding \$25,000

reversed the lower court and stated in a unanimous judg-

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and/or imprisonment for a period not exceeding 12

ment that because subsection 231.2(1) of the Act deals months.

with both information and documents, it was clear that the 4

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Minister could compel a taxpayer to provide information in The third issue reviewed by the Federal Court of addition to documents. Mr. Justice Malone, who rendered Appeal was whether BDO could claim that the documents the unanimous judgment, took the position that because and information in its possession, in connection with pro-the word “information” is not a defined term in the Act, viding tax advice to the taxpayers, was privileged and, the general definition of “information” found in the Con- therefore, could not be compelled by the CCRA without the consent of the taxpayers. The Federal Court of Appeal cise Oxford English Dictionary of “facts or knowledge pro-REPORT DESIGNATOR: ctop

agreed with the Federal Court–Trial Division that tax advice vided or learned as a result of research or study” should be from accountants (unlike such advice from lawyers) cannot utilized. In other words, the Minister was entitled to set out be considered to be privileged communications. The Fed-a list of questions and the person who receives Require-eral Court of Appeal noted that the Supreme Court of ments under section 231.2 of the Act is required to Canada has recognized a “class” privilege and “case-by-respond, even if there are no documents in existence case” privilege in Gruenke, [1991] 3 S.C.R. 263, which which answer the questions. Interestingly, the Court does broadened the scope of privilege. However, the Court not set any limits as to what type of questions could be repeated its decision in Baron (91 DTC 5055) that privilege asked and acknowledges that the questions may be does not exist in relation to advice given by accountants.

broader than the questions the Minister could ask during a The Federal Court of Appeal noted that for case-by-case pretrial examination for discovery in the context of an privilege, the Supreme Court of Canada took into account income tax appeal.

the following four factors:

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Based on this finding, it appears that the CCRA can (a) The communications must originate in a confi- issue Requirements to any taxpayer, or his or her tax dence that they will not be disclosed.

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advisor in connection with a proposed assessment of his or her client, and ask for all types of information, including (b) The element of confidentiality must be essential to the full and satisfactory maintenance of the a technical analysis of any tax strategy utilized, an analysis relation between the parties.

of arguments in support of a tax position, and an analysis of areas of concern or technical weaknesses in a tax strategy.

(c) The relation must be one which in the opinion In addition, the CCRA can ask subjective questions relating of the community ought to be sedulously fos-to the views of the taxpayer and his or her tax advisor on tered.

virtually any issue related to a potential tax liability. This is the case, even if there are no documents in existence (d) The injury that would inure to the relation by the which provide the information requested, and even if it disclosure of the communications must be would take the taxpayer or his or her tax advisor a signifi-greater than the benefit thereby gained for the correct disposal of litigation.

cant amount of time to respond to the Requirements.

The Federal Court of Appeal could not justify Filename: D:\reports\dof\part1\frasermilner\fraser1640.dat
The second issue which the Federal Court of Appeal accountant–client privilege under any of these four factors dealt with in the appeal was whether BDO could redact and compared the client–accountant relationship with cer-

(i.e., remove) confidential references and information in tain relationships to which case-by-case privilege had been documents listed in the Requirements in respect of per-Time: 16:22

recognized, including certain communications between sons other than the taxpayers. As noted above, in the Fed-individuals and their doctors, sexual assault therapists and eral Court–Trial Division, it was held that BDO could redact clergy. The Court noted that Canadian society puts a much the names of individuals other than the taxpayers. How-higher value on the physical, mental and spiritual integrity ever, the Federal Court of Appeal noted that once BDO had of a person than on personal wealth, and that the worst Date: 4-AUG-04

assembled the documents set out in the Requirements, it that could happen if a person is discouraged from seeking was discovered that there was nothing to be redacted and, income tax advice from an accountant because of the lack therefore, the issue was moot. The Federal Court of Appeal of privilege, is that the person might fail to take advantage refused to provide guidance on this question and stated of a tax-saving opportunity. It is interesting to note that that if a dispute should arise in the future about the right to counsel had informed the Court that in the United States, a redact a document required under section 231.2 of the Act, class privilege had been afforded to all federally authorized Username: morrison

another court would deal with the question. The lesson to tax practitioners, including accountants, with respect to tax be learned by tax planners in this regard is that care should advice given to their clients. However, the Federal Court of be taken in preparing documents, including internal mem-Appeal pointed out that from a Canadian perspective, this **REMOVE**

oranda which name more than one client (e.g., a general was of no consequence, and that the enactment of class



internal tax planning memorandum for a tax strategy to be privilege for accountants is better left to be dealt with by used by various clients).

Parliament than by the courts.

Lessons to be learned

the ability to hold formal Inquiries and which provides a level of protection to taxpayers in connection with questions—Unless this case is successfully appealed to the questions being asked during the Inquiry, appears to be an Supreme Court of Canada, the present law in Canada is unnecessary section in the Act because it would be easier that the CCRA can issue Requirements under section 231.2

for the CCRA to utilize section 231.2 of the Act. It is also of the Act to taxpayers and their tax advisors, not only interesting to speculate as to how the CCRA will utilize this REPORT DESIGNATOR: ctop

requiring that documents be produced, but also requiring decision in the future and whether sophisticated taxpayers answers to virtually any questions which the CCRA con-requiring tax advice will select a tax advisor based on the sides necessary in reviewing the taxpayer's affairs. The tax-fact that in Canada, unlike the United States, only solic-payer and/or his or her tax advisors will be required to itor—client privilege is recognized.

respond to the questions at their own expense or face the penalties discussed above, unless privilege can be claimed, and privilege cannot be claimed if the advice is provided

— Jules L. Lewy is a Tax Partner with the Toronto Office by an accountant. In this regard, it is interesting to note that of Fraser Milner Casgrain LLP and a member of the section 231.4 of the Act, which provides the Minister with Editorial Board of the CCH Canadian Tax Reporter **FAX TO: 815-455-9033**
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