Solicitor-client privilege: New tax reporting requirements in Canada emphasize costly dilemma

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During a tax audit, the Canada Revenue Agency (CRA) frequently requests information from a taxpayer or their advisors, which is subject to solicitor-client privilege. In the usual course, the taxpayer may choose to waive privilege and disclose such information, or may resist disclosure on the basis of privilege. Privilege disputes with the CRA often end up in the courts to determine what, if anything, must be disclosed: see, for example, *Canada (National Revenue) v. Thompson*.

Recent tax law reporting changes have significantly increased the number of situations where solicitor-client privilege may need to be considered by taxpayers and their advisors. In this article, we highlight the key issues for taxpayers and the options to consider in deciding whether to assert solicitor-client privilege in light of the new rules.

Key takeaway

The new tax reporting requirements are expected to increase the frequency of taxpayers having to face a costly dilemma between waiver of substantive legal rights to expedite complying with the new trust reporting rules, as they will now have to decide on solicitor-client privilege at the time of their annual or regular tax reporting, versus undertaking a proper analysis. We anticipate many clients will simply waive privilege in these situations to avoid incurring additional costs. Once privilege is waived, it is lost forever; if taxpayers are audited at a later date, they may well regret having waived privilege in order to save time and money at the compliance stage. Waiver without adequate consideration of the risks is a trap for the unwary, and would be an unfortunate outcome of the new rules. Don’t wait until a tax audit is commenced to discuss this with your legal advisor: solicitor-client privilege will now need to be addressed well outside of CRA audits.

Recent updates to tax reporting requirements

We have discussed Canada’s tax reporting changes in previous articles. Read more about them in:

- New trust reporting rules are now in effect (January 2024); and
- Bill C-47: Mandatory tax disclosure requirements for taxpayers, promoters and advisors (Aug. 2023)

On November 24, 2023, the Supreme Court of British Columbia granted a temporary injunction suspending the application of the mandatory disclosure rules on the legal profession, pending the outcome of a constitutional challenge brought by the Federation of Law Societies of Canada. However, this relief does not extend to other reporting parties (that is, non-lawyers or non-notaries) or to reporting under the new trust reporting rules, which apply to the 2023 tax year (with the first reporting **due by April 2, 2024**). Of note, the new trust reporting rules apply to lawyers holding "invested" trust funds in client-specific trust accounts, where certain conditions are met. Funds held in general, pooled law firm trust accounts are not reportable.

The new trust reporting rules do not require disclosure of information if it is reasonable to believe that the information is covered by solicitor-client privilege. This, however, requires an assessment to be made of what it is "reasonable to believe" is covered by privilege. There is also no exemption from disclosure of non-privileged information, including, for example, resulting legal agreements. We anticipate that the assessment of what is privileged and what is not will result in increased upfront costs to taxpayers in connection with assessing whether to assert privilege in specific situations.

What is solicitor-client privilege and why does it matter?

Solicitor-client privilege is a quasi-constitutional right concerning oral or documentary communications passing between the client and the lawyer. It is essential to both the administration of justice and the public's confidence 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, has been consistently recognized by the Supreme Court of Canada (see, for example, *R. v. McClure*). In the tax context, solicitor-client privilege allows a taxpayer to seek advice on tax laws without fear of disclosure of the communications to the CRA.

In order for a communication to be protected by solicitor-client privilege, four basic conditions must be met:

1. The communication is between a lawyer and client;
2. The communication is intended to be confidential by all parties;
3. The purpose of the communication must be for the client to obtain the lawyer's advice as to the law (not other matters, such as business or banking advice, which is not privileged); and
4. There must be a professional relationship between the lawyer and client (which is to say, the lawyer must be acting for the client; simply giving a document to a lawyer does not cause it to be privileged).

The client's dilemma

Privilege belongs to the client, and only the client can choose to assert privilege or waive privilege.

In tax matters, the CRA has previously published its views on what would be considered privileged. Although the CRA's guidance may not be correct in all cases, it remains useful to consider: if the CRA does not agree with the privilege claim, a court dispute may be necessary to resolve the issue. Whether information or documents are privileged depends on the specific facts and circumstances of each case, and information that is privileged in one situation may not be privileged in another.

The new trust reporting obligations require information that may otherwise be subject to privilege to be disclosed in connection with annual or regular tax reporting, regardless of whether a CRA audit has been commenced. This means that taxpayers will need to consider whether they wish to assert privilege over any of the information that may otherwise be reportable without context for the risks of waiving privilege. This will, unfortunately, result in increased costs to assess the issues and determine the extent to which a privileged claim is sustainable. Without the context of an active tax audit, many clients may not see the cost-benefit of conducting such a review.

For example, disclosing information in respect of the fact that a law firm holds invested trust funds for a client may not be of great concern, and a client may be willing to waive privilege instead of incurring any costs to determine if and to what extent the information is privileged. However, in other cases, a client may not want the CRA knowing that they consulted with legal counsel, or the subject matter of the legal advice they sought, and a more in-depth review may be warranted.

In summary, a taxpayer may now need to consider the issue of solicitor-client privilege in tax matters long before a tax audit is commenced. All lawyers involved in holding trust funds need to familiarize themselves with the new trust reporting rules, and consider their impact when clients require advice around the potential risks of waiving privilege at the reporting stage.

Contact us

If you have questions about solicitor-client privilege and the new trust reporting requirements, reach out to your BLG lawyer, the authors of this piece, one of the key contacts below, or any member of BLG's Tax Group.

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