



**Submission of the
Federation of Law Societies of Canada
to the
Senate Standing Committee
on National Finance**

***Trust Reporting Amendments to the Income
Tax Act
Bill C-32, Fall Economic Statement
Implementation Act, 2022***

Ottawa, November 21, 2022

The Federation of Law Societies of Canada

1. The Federation of Law Societies of Canada (“the Federation”), on behalf of its member law societies, appreciates the opportunity to provide comments to the Senate Standing Committee on National Finance on aspects of Bill C-32, *Fall Economic Statement Implementation Act, 2022* (“Bill C-32”).¹
2. The Federation is the national association of the 14 law societies mandated by the provinces and territories to regulate Canada’s legal profession in the public interest. Together our member law societies regulate more than 136,000 lawyers, 4,200 notaries in Quebec and Ontario’s nearly 10,600 licensed paralegals. An important role of the Federation is to express the views of the governing bodies of the legal profession on national and international issues relating to the administration of justice and the rule of law. This has resulted in the Federation developing an established history of advocating for robust protection of solicitor-client privilege and the independence of the legal profession.

Introduction

3. The Federation supports the government’s overall policy objectives of promoting fairness in the income tax system through amendments to the *Income Tax Act* (“ITA”). However, measures enacted to achieve these objectives must respect fundamental legal and constitutional protections that are essential to the functioning of Canada’s justice system.
4. Specific provisions under Bill C-32 would require legal professionals to report to the Canada Revenue Agency (“CRA”) on separately held trust accounts, including personal and financial information of their clients. This requirement would infringe upon solicitor-client privilege and the duty of loyalty that legal professionals owe to their clients by putting them in a potential conflict of interest with their clients. As outlined below, the Supreme Court of Canada has held that legal professionals, when acting in that capacity, must not be required to report their clients’ affairs to the government. Given this law certain provisions under section 35 of Bill C-32 are unlikely to survive a constitutional challenge.
5. The proposed new trust reporting requirements as applied to legal professionals are also unnecessary for the government to achieve its policy objectives as the beneficiaries of separately held trust accounts are already required to provide information to the government.

Proposed Reporting on Legal Professionals’ Trust Accounts

6. The proposed amendments to the ITA, set out in section 35 of Bill C-32, would require legal professionals (among others) to file a tax return to the CRA for an express trust that is resident in Canada notwithstanding that it may meet one of the exceptions to filing a return listed in the existing subsection 150(1.1) of the ITA. The return must include identifying information on the beneficiaries of the trust including names, addresses, and financial information.

¹ Online: <https://www.parl.ca/legisinfo/en/bill/44-1/c-32>.

7. The proposed new section 150(1.2)(c) of the ITA would exempt a legal professional's general, or pooled, trust account from the new trust reporting requirements. By exempting general trust accounts from the new trust reporting regime, the government appears to recognize, at least in part, the importance of preserving solicitor-client privilege and the duty of loyalty that legal professionals owe to their clients. However, the Bill does not exempt from the regime trust accounts that are held separately for a particular client or clients even though the principles noted above apply equally to all trust accounts whether they are pooled or separately held.²
8. While the proposed new section 150(1.4) of the ITA purports to exempt from disclosure information that is subject to solicitor-client privilege, this blanket provision is ambiguous and not sufficient to prevent the likely breaches of the privilege as legal professionals attempt to comply with the obligation to report information on separate trust accounts. As discussed in detail below, the Supreme Court of Canada has held that both basic personal information (names, addresses etc.) and accounting information may be privileged. At the very least, the requirement to file returns for separate trust accounts creates uncertainty about what could be included in a return without violating solicitor-client privilege. At worst, the positive obligation to file a return for a separate trust account creates a real threat to privileged information.
9. The amendments also do nothing to address the conflict that the reporting obligation will create between the duty of loyalty that legal professionals owe to their clients and the requirement to report trust account information to the CRA.
10. To ensure robust protection of solicitor-client privilege and to ensure that the fundamental principle of the duty of loyalty is not undermined, the proposed section 150(1.2)(c) of the ITA should be amended to exempt *all* trust accounts held by legal professionals from the obligation to report to the CRA – general trust accounts and those separately-held.

The Law on Solicitor-Client Privilege in Canada

11. The Supreme Court has held that solicitor-client privilege is essential to the proper administration of justice and must be as near absolute as possible. The Federation has successfully acted as intervenor before the Supreme Court in its most authoritative cases on solicitor-client privilege.³
12. Solicitor-client privilege encompasses information exchanged for the purpose of giving or receiving legal advice – and this includes basic personal information about clients. The proposed reporting requirements for separately held trust accounts are in direct conflict with the Supreme Court of Canada's decision in *Chambre des Notaires*. At issue in that case

² It should be noted that trust accounts – whether general or separately-held – can be used only for very limited purposes. All law societies in Canada restrict the use of trust accounts to purposes directly related to the provision of legal services and any funds held in trust must be paid out as soon as practicable after the legal services have been completed. Failure to comply with these requirements can result in disciplinary action against a legal professional including suspension and potentially disbarment.

³ See *Canada (Privacy Commissioner) v. Blood Tribe Department*, 2008 SCC 44 (CanLII); *Alberta (Information and Privacy Commissioner) v. University of Calgary*, 2006 SCC 53; *Canada (Attorney General) v. Chambre des Notaires*, 2016 SCC 20 (CanLII) ("*Chambre des Notaires*").

was whether the CRA could compel production of information or documents relating to clients of notaries practicing law in Quebec. The CRA justified its requests under a provision of the ITA defining solicitor-client privilege as all communications between legal professionals and their clients in professional confidence save for the accounting records of the legal professionals.

13. In a unanimous decision, the Supreme Court held that information protected by solicitor-client privilege “cannot be disclosed by a notary or a lawyer in any regulatory context.”⁴ The Supreme Court further held that solicitor-client privilege belongs to the client, and can only be waived by a client; a reporting obligation that is placed solely on legal professionals, under threat of prosecution, puts them in an “intolerable” situation.⁵ Finally, the Supreme Court affirmed that accounting records are inherently capable of containing information that is protected by solicitor-client privilege. In describing the various types of information contained in accounting records, the Court wrote:

“...Client’s names may appear in accounting records... In some cases, those names may be privileged, since the fact that a person has consulted a notary or a lawyer may reveal other confidential information about the person’s personal life or legal problems.”⁶

14. *Chambre des Notaires* is unambiguous: any compelled disclosure of information that identifies a legal professional’s client, even if just by name, breaches that client’s right to solicitor-client privilege. Further, the Supreme Court has held that information protected by solicitor-client privilege may be ordered disclosed only where “absolutely necessary”⁷, a test the Court has described to be “as restrictive a test as may be formulated short of an absolute prohibition in every case.”⁸ The Supreme Court has also held that any legislative provisions that interfere with solicitor-client privilege more than “absolutely necessary” will be found to be unconstitutional.⁹

The Law on the Duty of Loyalty and Commitment to the Client’s Cause

15. Legal professionals owe a duty of loyalty to their clients, a duty that is essential to the integrity of the administration of justice.¹⁰ The duty of loyalty involves the duty to maintain client confidentiality, the duty to avoid conflicts of interest, and the duty of commitment to the client’s cause. In recognizing the duty of commitment to the client’s cause as a principle of fundamental justice, the Supreme Court of Canada in *Canada (Attorney General) v. Federation of Law Societies of Canada* held that the government cannot impose duties on legal professionals that conflict with or otherwise undermine that duty, either in fact or in the perception of a reasonable person.¹¹

⁴ *Chambre des Notaires* at para. 32.

⁵ *Ibid.* at paras. 45 and 56.

⁶ *Ibid.* at para. 74.

⁷ *Descôteaux et al. v. Mierzewski*, 1982 CanLII 22 (SCC).

⁸ *Goodis v. Ontario (Ministry of Correctional Services)*, 2006 SCC 31 (CanLII) at para. 20.

⁹ *Lavallee, Rackel & Heintz v. Canada (Attorney General)*, 2002 SCC 61 (CanLII) at para. 36.

¹⁰ *Canadian National Railway Co. v. McKercher LLP*, 2013 SCC 39 (CanLII) at para. 19; *R. v. Neil*, 2002 SCC 70 (CanLII) at paras. 18-19.

¹¹ *Canada (Attorney General) v. Federation of Law Societies of Canada*, 2015 SCC 7 (CanLII) at para. 103.

16. Pursuant to section 238(1) of the ITA, it is an offence punishable by a fine and/or imprisonment to fail to file a return as required under the Act. The proposed requirement for legal professionals to file returns for separately held trust accounts risks placing legal professionals in a clear conflict of interest with their clients, either in fact or in the perception, by compelling them, upon threat of imprisonment, to provide personal and financial client information to the CRA.

Trust Reporting by Legal Professionals is Not Necessary to Meet the Policy Objectives

17. The government's consultation materials on the proposed amendments do not provide an explanation of the rationale for exempting general trusts accounts but not separately held trust accounts from the trust reporting regime. The proposed legislative amendments merely acknowledge that the proposed section 150(1.2)(c) "provides an exception for a lawyer's general trust account, but not for specific client accounts."¹² While the rationale may lie in the attribution of income earned on separate trust accounts, existing legislative provisions already require beneficiaries (i.e. the clients of legal professionals) to report information on separate trust accounts to the CRA. A provision requiring legal professionals to file information on these trust accounts fails the absolute necessity test established by the Supreme Court, as described above, for justifying any infringement of solicitor-client privilege.
18. Given the requirement for beneficiaries of express trusts to file a return, the Federation states that the inclusion of legal professionals in the trust reporting regime is not necessary to achieve the government's policy objectives.

Conclusion

19. To ensure that the provisions under section 35 of Bill C-32 are legally and constitutionally compliant, preserving the fundamental principles of justice of solicitor-client privilege and the duty of loyalty owed by legal professionals to their clients, the Federation recommends the following:

Amend the proposed section 150(1.2)(c) of the ITA to exempt all trust accounts held by legal professionals, including those maintained separately for a particular client or clients, from the trust reporting requirements under section 150(1) of the ITA.¹³

20. The Federation requests the opportunity to appear before the Senate Standing Committee on National Finance to elaborate on the concerns outlined in this submission and to provide further context for its recommended amendment.

¹² *Explanatory notes of the Legislative Proposals relating to Income Tax Act and Other Legislation*, section 150(1.2), online: <https://fin.canada.ca/drleg-apl/2022/ita-lir-0222-1-n-eng.html>.

¹³ By deleting from the proposed section 150(1.2)(c) the following wording: " , provided the trust is not maintained as a separate trust for a particular client or clients".