

# ADVANCING *Issues*

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## The Opportunity of a Generation!

By Alan J. Snowden, Senior Vice President, Corporate Planning Associates

As consumers, we are all inundated with “opportunities” and “limited time offers.” This one may be the most interesting of the summer. There currently exists an attractive tax planning opportunity, but be quick – it may not last long!

“Income Splitting” is one of the few remaining, legitimate tax-planning techniques. This involves a high tax-bracket investor transferring income to a lower tax-bracket family member, in order to increase the family’s after tax income. This strategy is usually thwarted by the “attribution” rules, which attribute income back to the donor. These rules do not apply, however, in the case of a “bona fide” loan.

There are a number of criteria required for the Canadian Customs and Revenue Agency (CCRA) to consider a loan “bona fide,” the most important of which is the need for the borrower to pay reasonable interest. The CCRA is even good enough to prescribe what the minimum reasonable interest rate should be. The prescribed rate, as it is known, is set quarterly in advance. For the three months of July, August and September 2004, the rate has been set at 2%.

Herein lies the opportunity. Only once before, in the last 25 years, has the prescribed rate been this low and it

is highly likely that it will increase as of October 1st, 2004. If a “bona fide” loan is made at 2% before the end of September, that rate is fixed for the life of the loan, irrespective of future increases in interest rates or the prescribed rate. These loans are usually done by means of a demand note, which can be called at any time, thus allowing the lender to retain control over the capital.

So, how much to lend? There is a situation where the benefit is reduced if the income earned by the borrower

reduces the high-income lender’s spousal deduction. Other than this, the question is more what to invest in? Capital gains attract less tax than either interest or dividend income. As the borrower is paying interest to the lender (even at 2%) care should be taken not to convert low-tax capital gains into high-tax interest income, in the hands of the lender. Other than these minor loopholes, which can be calculated, it is true to say that the family is better off with investment income in the hands of the lower-income spouse.

**How much better off?** The following table illustrates the after-tax benefit to the family of a British Columbia investor, in the top tax bracket, who lends various amounts to his/her spouse.

Income Type	Value of loan and Investment Portfolio		
	\$1,000,000	\$500,000	\$250,000
Interest	\$ 9,618	\$ 5,648	\$ 2,943
Dividends	\$ 11,087	\$ 5,128	\$ 1,783
Capital Gains	\$ 3,483	\$ 1,716	\$ 77

The after-tax savings are calculated using a 7% rate of return for the different income types and a 2% prescribed rate. If higher rates of return can be achieved, the fixed loan rate makes for an ever widening spread. This creates increasing after-tax returns for the family.

# One Year Later – The Markets

By John R. Ross, Chairman, Corporate Planning Associates

Do you remember March 2003? We had witnessed a market free fall over the previous year. Check the charts; the market had rebounded from a low in September 2001 and peaked in March 2002. Then, except for a brief surge in the fall of 2002, plummeted until March.

Remember what the pundits were saying: “We are facing a potential disaster”, “Head for the hills because your investments are in serious trouble”, “Never again will we see the types of returns that we enjoyed during the ‘90’s”.

I have been writing articles for this Newsletter over the past few years (“What’s It All About”: Spring 2003, “Capital, What is it, What does it Mean”: Fall, 2002, “Here We Go Again”: Fall 2003) in which I attempted to have you view your

investments in the long-term. It wasn’t easy but I think that most of our clients agreed with this philosophy.

There were exceptions however, and generally they were clients who had recently acquired capital and/or had recently retired. When your entire view of investments is based on a casual observance of the markets, it is very difficult to imagine the gut wrenching felt when it is your money that is being affected. Having worked a lifetime to acquire assets and to then watch them drop in value by twenty-five percent is very disturbing. It’s your money, your hopes and your dreams that appear to be evaporating.

Fast forward to the end of May 2004. The major indexes are up over 20% during the past year. The major funds containing our clients’ assets

are up anywhere from 20% to 35%. The world looks great, paper losses have been recovered and the future looks bright.

Let’s take a moment to reflect on the lesson. There will always be naysayers who will pontificate a world of doom and gloom and if we listen to them we are bound to become discouraged, if not outright distressed. Markets do go up. History has shown that there has been a long and consistent upward trend. Why is it so difficult for us to accept this as a reasonable expectation?

The next time we have a market correction, and there will be a next time, remember 2002 and early 2003. It may reduce the anxiety. I hope so.

## When is Tax Advice Privileged?

By Salvatore Mirandola, Borden Ladner Gervais LLP

Most communications between clients and their lawyers are privileged. In other words, such communications are protected from disclosure to persons outside of the solicitor and client relationship unless the client consents to the disclosure. In recent years, several Canadian cases have dealt with the scope of protection afforded to tax planning documentation. In this article we discuss one case which considers whether communications between clients and their accountants are privileged in the same manner as solicitor-client communications, and two cases which consider whether

legal opinions prepared for one client in the context of a commercial transaction can be disclosed to another party to the transaction without the loss of privilege.

### Kitsch

In *The Minister of National Revenue v. Kitsch* the Federal Court of Appeal had an opportunity to deal with a number of issues relating to forced documentary production by accountants under subsection 231.2(1) of the *Income Tax Act*. One of the issues involved a determination of whether accountant-client privilege

exists as a standalone class of privilege in Canada or as a type of privilege that can be conferred on a case-by-case basis. A large accounting firm was served with requirement letters designed to elicit information regarding the tax motivation behind a series of transactions that allowed the taxpayers in question to deduct certain interest amounts prior to their emigration from Canada.

At trial, Justice Kelen followed prior appellate case law and held that there is no standalone class privilege in respect of communications between accountants and their

clients. He also determined that there is no case-by-case accountant-client privilege because, among other things, tax returns and other tax records that accountants prepare or deal with are materials that can be forced to be provided to the tax authorities. Moreover, reasoned Justice Kelen, the recent negative press that the accounting profession has received has created a “crisis of confidence” that has demonstrated that there is no overriding policy in favour of case-by-case accountant-client privilege:

*Moreover, the ‘community’ of North America is currently experiencing a crisis of confidence in the accounting of financial information with respect to many public companies, and public outrage over accounting misdeeds (eg, with Enron Corporation and Worldcom Inc). Such events, and the resulting outcry, are illustrative of the view of the ‘community’ that a client-accountant privilege is not to be ‘sedulously fostered’.*

In the Federal Court of Appeal, a unanimous panel upheld the principle that there is no class accountant-client privilege in Canada on the basis that, unlike for the legal profession, there is apparently an insufficient link between the accounting profession and the public interest in the administration of justice:

*I see nothing in the submissions of the taxpayers that militates against the earlier ruling rendered by this court in *Baron v. Canada*, supra. Solicitor-client privilege is rooted in the proper administration of justice, made necessary by the need for confidential advice in prosecuting one’s rights and preparing defences against improper claims. Lawyers are legally and ethically required to uphold and protect the public*

*interest in the administration of justice. In contrast, accountants are not so bound. Nor do they provide legal advice, as to do so would constitute a breach of provincial and territorial laws governing the legal professions. In my analysis, no overriding policy consideration exists so as to elevate the advice given by tax accountants to the level of solicitor-client privilege.*

As for so-called ‘case-by-case’ accountant-client privilege, none of the established criteria for case-by-case privilege were met. In particular:

- although accountants are expected, as a matter of professional ethics, to maintain client confidentiality, this confidentiality is trumped by the power of the Canada Revenue Agency to require disclosure;
- confidentiality was not shown to be “essential to the full and satisfactory maintenance” of the relationship between the accountants and their clients;
- the accountant-client relationship is not as fundamental to society and the administration of justice as the solicitor-client relationship; and
- case-by-case privilege has been conferred in certain cases involving clients and their doctors, sexual assault therapists and clergy. Society places a much higher value on the physical, mental and spiritual integrity of a person than on personal wealth. Accountants’ work, presumably, is relevant to personal wealth.

Kitsch confirms that accountant-client privilege per se does not exist in Canada. Accordingly, in order for communications to or by accountants to attract privilege, there must be a strong link to legal advice.

## **Pitney Bowes and Other Recent Cases**

*Fraser Milner Casgrain LLP v. MNR and Pitney Bowes of Canada Ltd v. The Queen* each deal with whether so-called ‘common interest privilege’ can exist in respect of tax advice provided to both or all opposing parties in commercial transactions. In essence, the facts of both cases are similar and simple. Law firms provided or disclosed tax advice to the opposing parties of a commercial transaction, and the Canada Revenue Agency sought production of the advice on the basis that any solicitor-client privilege that may have existed had been waived. The applicants argued that privilege had not been waived, and that the documents in question were protected from disclosure by common interest privilege. In both cases the applicants argued that the legal advice had been prepared in confidence, for the benefit of both (or all) sides to the commercial transactions, in order to facilitate the common interests of the participants in having the transactions completed successfully.

The difficulty was that common interest privilege has its origins as a branch of litigation privilege, and there was no anticipated litigation in either *Fraser Milner Casgrain* or *Pitney Bowes*. However, both courts found little point in confining common interest privilege to the litigation context. For example, in *Pitney Bowes*, Justice O’Reilly recognized that:

*In many commercial transactions, the parties will want to negotiate on the footing of a shared understanding of each other’s legal position. They will seek legal advice from reputable solicitors whose opinions will be respected by the other parties. Indeed, the solicitors may represent more than one party to the deal.*

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## When is Tax Advice Privileged ?

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*The sharing of legal opinions will ensure that each party has an appreciation of the legal position of the others and negotiations can proceed in an informed and open way. The advice may be provided for one or more party on the understanding that others should be provided copies. The expectation, whether express or implied, will be that the opinions are in aid of the completion of the transaction and, in that sense, are for the benefit of all parties to it. Such circumstances, in my view, create a presumption that the privilege attaching to the solicitor-client communications remains intact notwithstanding that they have been disclosed to other parties.*

Justice O'Reilly was also careful to point out that the existence of a commercial transaction will not always protect solicitor-client communications disclosed to all parties to the

transaction. The parties must also behave in a manner that is consistent with the maintenance of privilege. Accordingly, parties to a commercial transaction who wish to share legal advice would do well to document their intentions clearly in a retainer agreement with the relevant legal advisers and/or a confidentiality agreement or other document retained by all the relevant parties, and to ensure that the legal advice is not disclosed to persons outside the client and lawyer team.

### Conclusion

The cases described above will help our clients and their tax advisors understand when tax advice is privileged and when it is not. This is an interesting area of the law which continues to develop in Canada and abroad.

*This article reprinted with permission of Borden Ladner Gervais LLP.*

## CPA's Marketing Update

*By P. Lee Fisher, President and Chief Executive Officer, Corporate Planning Associates*

Here we are in the middle of the summer which, traditionally, brings a less hurried pace to the office. In the three months leading up to summer, eleven new clients have started working with us; three with our Vancouver office, three in Calgary, and five in Toronto.

Five of the new clients are "Individual clients", in other words, they have come to us at the recommendation of a friend or relative, not through a corporate referral program. Five have been referred to us through an existing corporate program. One new client represents the beginning of a new corporate relationship.

The objective of our advertising campaign is to raise the awareness of corporate executives to the service that is available through CPA so that when our Senior Vice Presidents approach a corporation, there is already an interest in hearing more about us. The next advertising insert is scheduled for the August issue of Golf Canada.

In our next Newsletter, I'll tell you about our exciting plans for the Fall. In the meantime, enjoy your summer!

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