2018 Issue No. 11
19 March 2018

# Tax Alert – Canada

## Federal Court of Appeal reaffirms the existence of common interest privilege outside a litigation context

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 6 March 2018, the Federal Court of Appeal (the FCA) rendered its decision in *Iggillis Holdings Inc. v. The Queen* (2018 FCA 51), reversing the Federal Court (the FC) decision (2016 FC 1352).

The issue in this case relates to solicitor-client privilege. The Minister of National Revenue (the Minister) required that Iggillis Holdings Inc. and Ian Gillis (the Taxpayers) provide the legal memorandum explaining the tax consequences of the series of transactions in an arm's length sale by the Taxpayers to a third party. The memorandum was on the letterhead of purchaser's counsel and was prepared predominantly by that counsel, although counsel for the Taxpayers also provided some input into the memo, which was then shared by the lawyers of each party to the transaction with their respective client. The FC concluded that the memorandum had to be provided to the Minister and that common interest privilege (CIP) did not protect the memorandum. The FCA overturned the FC decision and concluded that the memorandum was protected from disclosure to the Minister by solicitor-client privilege, acknowledging CIP in a transactional context.

Building a better working world

## Facts

Abacus Capital Corporations Mergers and Acquisitions (Abacus) wanted to acquire the shares of the corporations previously held by the Taxpayers. The two corporations concluded a transaction to this extent.

Each party was represented by a law firm that provided tax advice to its respective client. After various discussions between counsel, the proposed transactions were summarized in a series of charts and a legal memorandum was drafted to indicate the tax consequences of the various steps undertaken in the series of transactions. The memorandum was prepared by Abacus's law firm, with some input from the Taxpayers' law firm, and it was then shared by each law firm with their respective client.

After the completion of the transactions, the Minister asked the Taxpayers to provide a copy of the memorandum. The Taxpayers refused, arguing that it was protected by solicitor-client privilege. Therefore, the Minister served requirements to the Taxpayers pursuant to subsection 231.2(1) of the *Income Tax Act* (Canada) (the Act) requesting the production of the memorandum. The memorandum was not provided to the Minister, and the Minister sought a compliance order from the FC under subsection 231.7(1).

## Position of the parties

The Taxpayers refused to provide the memorandum to the Minister, arguing that it was protected by CIP. Abacus intervened in the litigation under the same argument.

The Minister argued that she was entitled to the communication of the memorandum, saying it was not protected by CIP, because it was a business document and not a legal document. The Minister argued that the legal advice was incidental to the nature of the transaction and that the lawyers implicated in the transaction were not providing legal advice or were not acting as lawyers. The Minister argued that the lawyers were negotiating a business transaction and were acting as business advisors. Finally, the Minister argued that Abacus lost or waived its privilege over the memorandum when the document was shared with the other law firm.

## The FC decision

The FC rejected the Minister's argument that there was no common interest, because the two parties to the transactions were on opposite sides of the proposed transaction. The FC judge opined that the two parties had a common interest regarding the tax legal issues because they were working together to reduce taxes payable on the transaction. The FC also rejected the Minister's argument that the memorandum did not contain legal advice for the parties to which the document was communicated. After reviewing the memorandum provided to the FC in a sealed envelope, the FC opined that the nature of the memorandum was legal, because it outlined the tax consequences following an analysis of the law applicable to the case.

While the FC judge recognized that CIP was well established in Canadian law, he opined that it was not a valid component of the solicitor-client privilege and therefore rejected the Taxpayers' argument that Canadian law was favourable to a liberal interpretation of the privilege that would include the legal advisory CIP.

The FC made a distinction between litigation CIP and advisory CIP. While the FC recognized litigation CIP, it rejected advisory CIP. The FC opined that advisory CIP is only a part of litigation solicitor-client privilege and would be applicable to different persons where their legal position would at least be similar.

The FC judge distinguished the facts of this case from the FC decision in *Pitney Bowes of Canada Ltd. v. Canada*, 2003 FCT 214 (*Pitney Bowes)* where the FC recognized the existence of advisory CIP. To support its opinion, the FC judge stated that each of the two parties to the transaction in the present case hired a different law firm, while in *Pitney Bowes,* the two clients had hired the same law firm.

Therefore, the FC concluded that the memorandum had to be communicated to the Minister.

## The FCA decision

The issue to this appeal was whether the FC judge was correct in finding that the CIP is not a valid principle of law that could be applied to the memorandum in this case. This case attracted a lot of interest and provoked uncertainty in the tax community, as can be seen by the intervention of the Canadian Bar Association and the Federation of Law Societies of Canada before the FCA.

The FCA reversed the judgment of the FC and allowed the appeal of the Taxpayers.

In reviewing the analysis of the FC judge, the FCA disagreed with his use of a decision from the New York Court of Appeals on which to base his ruling. The FCA opined that the FC judge should have focused his analysis on the applicable provincial law as required in the definition of "solicitor-client privilege" in subsection 232(1) of the Act, rather than based on the judge's view of general principles for CIP. As a result, the FCA found that, in this case, it was appropriate to rely on decisions from the courts of Alberta and British Columbia, the jurisdictions in which the parties to the transaction were located.

The FCA cited the decisions *Maximum Ventures Inc. v. De Graaf*, 2007 BCCA 510 (*Maximum Ventures*), and *Fraser Milner Casgrain LLP v. Minister of National Revenue*, 2002 BCSC 1344 (*Fraser Milner Casgrain LLP*) to support the existence of advisory CIP in British Columbia. In *Maximum Ventures*, the British Columbia Court of Appeal concluded there was sufficient common interest to apply solicitor-client privilege to an opinion prepared by a lawyer and communicated to third parties with mutual interests in commercial transactions. Although the facts of *Maximum Ventures* are slightly different than the present case in that the memorandum in the present case was prepared by both of the parties' lawyers and shared to both parties, the FCA found those distinctions not enough to distinguish both cases: the opinion of a client's lawyer was still shared with the other party with common interests in the transactions. In addition, in *Fraser Milner Casgrain LLP*, documents were disclosed by Fraser Milner Casgrain LLP to persons that were not their clients but had common interests in certain transactions that also involved their clients. In *Fraser Milner Casgrain LLP*, the British Columbia Supreme Court also found that the solicitor-client privilege attached to the documents had not been waived by the disclosure to the other parties with common interest in the transactions.

On that basis, the FCA found that the "solicitor-client privilege is not waived when an opinion provided by a lawyer to one party is disclosed, on a confidential basis, to other parties with

sufficient common interest in the same transactions" (in para. 41). Moreover, the FCA arrived at this conclusion notwithstanding the sequence of disclosure of the opinion, meaning whether it is first disclosed to the client of the lawyer and then to the other parties, or if such disclosure is made simultaneously by the lawyer to his client and the other parties. Indeed, the FCA went so far as to suggest (at para. 19) that "[w]hen dealing with a statute as complex as the *Income Tax Act*, it may well be more efficient and the interests of the respective clients may well be better served if the lawyers collaborate on the opinion that is to be provided in relation to the application of that statute to the series of transactions to be completed by the parties".

The FCA also opined that the non-disclosure of the memorandum would not result in a loss of evidence, considering a document containing legal opinions would be inadmissible in evidence. It is rather the responsibility of the Court to determine the legal implications of a transaction. The FCA stated that each party would have a chance to argue at a potential trial how the provisions of the Act should apply in the particular situation.

Accordingly, the FCA concluded that the parties had sufficient common interest in the transactions and found that the memorandum was protected from disclosure by solicitor-client privilege.

## Lessons learned

This FCA decision is good news for taxpayers, because the FCA rejected the narrow scope of CIP as found by the FC, and reaffirmed its existence as a valid exception to the waiver of solicitor-client privilege, which is vital in commercial dealings. This decision also confirms that disclosures between counsels of different parties with common interests will not automatically provoke a waiver of the solicitor-client privilege. Moreover, this decision emphasizes that it is important for taxpayers to benefit from proper advice and to ensure efficiency during the undertaking of transactions while being represented by different law firms.

While the decision affirms the existence of advisory CIP, taxpayers still need to remain cautious when they are communicating a legal opinion to another party, in order to ensure that the solicitor-client privilege will not be lost or waived.

The Minister has until 7 May 2018 to seek leave to appeal the FCA decision to the Supreme Court of Canada.

## Learn more

For more information, please contact your EY or EY Law advisor or one of the following professionals:

**Daniel Sandler**
+1 416 943 4434 |
daniel.sandler@ca.ey.com

**David Robertson**
+1 403 206 5474 |
david.d.robertson@ca.ey.com

**Louis Tassé**
+1 514 879 8070 |
louis.tasse@ca.ey.com

**Roger Taylor**
+1 613 598 4315 |
roger.taylor@ca.ey.com

**EY** | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About EY's Tax Services
EY's tax professionals across Canada provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. We offer a range of tax-saving services backed by in-depth industry knowledge. Our talented people, consistent methodologies and unwavering commitment to quality service help you build the strong compliance and reporting foundations and sustainable tax strategies that help your business achieve its potential. It's how we make a difference.

For more information, visit ey.com/ca/tax.

About EY Law LLP
EY Law LLP is a national law firm affiliated with EY in Canada, specializing in tax law services, business immigration services and business law services.

For more information, visit eylaw.ca.

About EY Law's Tax Law Services
EY Law has one of the largest practices dedicated to tax planning and tax controversy in the country. EY Law has experience in all areas of tax, including corporate tax, human capital, international tax, transaction tax, sales tax, customs and excise.

For more information, visit http://www.eylaw.ca/taxlaw



A member firm of Ernst & Young Global Limited.



ey.com/ca