

Legal Invoices: Maintaining Privilege While Supporting Deductibility

A taxpayer's desire to maintain solicitor-client privilege over its legal invoices can create unique evidentiary challenges when the taxpayer is attempting to support the deduction of legal fees. However, Canadian case law provides the taxpayer with a number of alternative techniques to overcome such challenges.

Not all legal fees are deductible as current expenses on income account, or otherwise, for the purposes of the Act. The burden of establishing that legal fees are deductible rests with the taxpayer. At the same time, it is well accepted that a taxpayer's legal invoices, including a description of the services provided, are subject to solicitor-client privilege and therefore are protected from disclosure to third parties (see, for example, *Southern Railway of British Columbia Ltd. v. Canada (Deputy Minister of National Revenue)*, 1991 CanLII 2083 (BCSC)). On occasion, these two concepts can conflict.

Legal invoices often include generic or vague descriptions of services; sometimes they set out overly detailed descriptions of the tasks undertaken. Each situation presents problems if the CRA requires a taxpayer to support the deductibility of legal fees. On the one hand, invoices that lack details may not provide enough information to justify the deduction. On the other hand, although detailed invoices may better support the deduction, they also may motivate a taxpayer to claim solicitor-client privilege: disclosure of detailed descriptions of services may provide the CRA with a roadmap of potential tax audit issues or transactions that otherwise might not come under scrutiny. Luckily, Canadian jurisprudence has provided some helpful guidance to deal with such situations.

In *Richard A. Kanan Corporation v. The Queen* (2011 TCC 211), the taxpayer claimed deductions for legal and accounting fees. In the course of a CRA audit, the taxpayer provided copies of invoices to support the deductions. The invoices simply set out the total fee amount and stated that

the fees were "For Legal Services Rendered"; they contained no further information about exactly what legal services were provided. The CRA denied the deduction on the basis that a more detailed description of the services was necessary. It was not contested that the additional information requested by the CRA would be subject to solicitor-client privilege.

The court discussed the interplay between the burden of proving the deductibility of expenses and the right to confidentiality of communications with legal counsel. The court acknowledged that the Act does not abrogate a taxpayer's right to claim solicitor-client privilege. Notwithstanding this protective view of privilege, the court stated that taxpayers often will be required to reveal some privileged information to support their deductions for legal fees.

Fortunately, the jurisprudence provides a number of options for supporting the deductibility of legal fees while at the same time maintaining solicitor-client privilege over legal invoices. For example, a taxpayer can provide the CRA with the complete legal invoice and rely on the doctrine of limited waiver. This doctrine generally provides that a person that discloses privileged information to a third party for the limited purpose of complying with a statutory requirement (such as section 170 of the Canada Business Corporations Act) waives privilege for that specific purpose only: see *Interprovincial Pipe Line Inc. v. MNR* (1995 CanLII 3542 (FC)). Although there is no statutory requirement to disclose legal invoices to support the deductibility of legal fees, *Kanan* appears to expand the limited-waiver doctrine to include circumstances in which a taxpayer is forced to disclose privileged documents as the only means of contesting the minister's assumptions of fact, which otherwise will be accepted prima facie by the courts. Notably, however, if it is the taxpayer's objective to withhold certain sensitive portions of a legal invoice, this approach may not be satisfactory: it may be difficult to substantiate that the doctrine of limited waiver was breached by the CRA if the CRA conducts a subsequent audit or requests documents related to tax issues mentioned in the invoice.

Alternatively, a taxpayer may choose to provide the CRA with only part of the legal invoice and rely on the doctrine of partial waiver. Under this doctrine, privilege may be waived for only part of a privileged document, provided that it would not be misleading to the court or another party to not disclose the entire document: see *Power Consol. (China) Pulp Inc. v. BC Resources Invst. Corp.* (1988 CanLII 3214 (BCCA)). Provided that a taxpayer is not trying to mislead the CRA into allowing the deduction of legal fees that otherwise would not be deductible, this may be a useful alternative.

Kanan offers a third choice: the taxpayer can provide supplementary documentation that supports the deduction. This approach may avoid a potential concern about whether privilege over legal invoices will be maintained if part of a privileged invoice is disclosed. While the adequacy of documentary support for the deduction of legal fees will depend on the facts of each case, the court in *Kanan* suggested that a detailed invoice, an engagement letter, or a reporting letter with appropriate explanations of the services provided may be sufficient. Offering an opportunity for further protection of confidentiality, the court stated that such documents may be redacted to remove irrelevant detail so long as the remaining information is sufficient to support the deduction.

If the deductibility of legal fees is an issue that appears to be headed to trial, it is important to remember that information provided in the context of court actions is subject to an implied undertaking. The implied-undertaking rule provides that documentary and oral information obtained during discovery is not to be used for any purpose other than securing justice in the proceedings in which the answers were compelled: see *Juman v. Doucette* (2008 SCC 8). Multiple TCC decisions have confirmed that this common-law principle applies to pre-trial discovery under the Tax Court of Canada Rules (General Procedure: see, for example, *Armstrong v. The Queen*, 2013 TCC 59). Notably, however, the implied undertaking is rebuttable in certain situations.

In summary, although the desire to maintain solicitor-client privilege can pose evidentiary difficulties for a taxpayer seeking to support the deductibility of its legal fees, Canadian case law provides a number of approaches for overcoming those difficulties. The most suitable approach will depend on the facts of each case. Additionally, tax advisers should always be mindful of the nature and extent of the information that appears in the invoices they submit to their clients.

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