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In this article, the author discusses the *Atlas Tube* case, in which the Canada Revenue Agency obtained a court order forcing a taxpayer to turn over a tax diligence report prepared by an accounting firm. He focuses on the application of Canada's solicitor-client privilege to documents that non-lawyer third parties provide to legal counsel. After evaluating the case and related jurisprudence, the author considers how taxpayers can use the privilege to protect similar documents from disclosure.

The Federal Court of Canada recently issued a decision allowing the Canada Revenue Agency to compel a taxpayer to hand over a tax diligence report that an accounting firm had prepared in relation to a 2012 acquisition. This case (which is being appealed by the taxpayer) demonstrates that the CRA knows where to find sensitive and confidential tax information prepared by taxpayers for commercial reasons, and that it is more than willing to use its powers to obtain such non-lawyer work product wherever possible.

In *Minister of National Revenue v. Atlas Tube Canada ULC*, 2018 FC 1086, the taxpayer (Atlas) was a Canadian subsidiary of a U.S. private company (JMC) that acquired a Canadian target corporation, Lakeside Steel Inc. (LSI). JMC conducted a due diligence on LSI and its subsidiaries, a process that included retaining an accounting firm to prepare a report detailing (1) the tax profile and attributes of LSI and its Canadian subsidiary (LSC), and (2) LSC's material tax exposures.[1] In 2012, after LSI and LSC had merged and JMC had acquired the combined entity (Lakeside), Atlas obtained the shares of Lakeside in exchange for $90 million of debt.

During an audit of Atlas's 2012 tax year, the CRA asked to see a copy of the accounting firm's report, ostensibly to review valuation issues and interest expense deductions that Atlas had claimed on the debt it issued for the Lakeside shares. The taxpayer refused to turn over the report, prompting the CRA to apply to the Federal Court of Canada for a compliance order under section 231.7 of the Income Tax Act (Canada). The Court agreed with the CRA, and it issued the requested compliance order finding that:

- the report was relevant to the taxpayer's taxes, satisfying the legal standard for CRA examination;
- lawyer-client privilege did not protect the report from disclosure to the CRA;
- compelling Atlas to give the report to the CRA would not offend the principle that the courts established in *BP Canada Energy Co. v. The Queen*, 2017 FCA 61, namely, the rule that the CRA cannot require taxpayers to self-audit; and
- there was no reason for the court to exercise its residual discretion and opt not to order the taxpayer to turn over the report.

[1] Michael McNamara, JMC's executive vice president, corporate secretary and general counsel, described the report as including "an assessment of the probability that the filing positions leading to the tax exposures would be sustained if they were challenged by the [CRA], and an evaluation of whether appropriate reserves had been taken by LSI or LSC in respect of such exposures."

The Court's Decision

Relevance

Section 231.1(1) ITA entitles the CRA to examine any document "that relates or may relate to the information that is or should be in the books and records of the taxpayer or to any amount payable by the taxpayer" under the ITA. In paragraph 23, after reviewing the relevant authorities put forward by both parties, the *Atlas Tube* court opined:

> [b]oth parties acknowledge that there is a low threshold of relevance to be met by the Minister, such that the Minister does not have to establish that the requested documentation is relevant, only that it may be relevant.

It appears that the taxpayer based the thrust of its argument on the relevance issue on specific statements made by Robin Margerison, the CRA auditor responsible for the "aggressive tax planning" portion of the audit. As the court explains in paragraph 25, Margerison gave evidence that the CRA:

> initially requested the Report because it was a document that resulted from JMC commissioning the accounting firm Ernst & Young to perform certain services related to the acquisition, such that it was considered a tax planning document of the sort that CRA routinely requested.

However, the court concluded that the report was not part of the acquisition-related services described by Margerison.

Notwithstanding this conclusion, the court found that the CRA had met the standard of relevance required under the statute. The report was prepared for purposes of the transaction that the CRA was auditing; the jurisprudence did not require the CRA to demonstrate that the report was relevant to a specific issue involved in the audit, but merely that it might be relevant to an amount potentially payable by the taxpayer under the ITA.

Solicitor-Client Privilege

The court turned to the next issue: Was the report protected from disclosure under solicitor-client privilege (sometimes referred to as "legal advice privilege")?[2] Because the report was not prepared by lawyers, the solicitor-client privilege would not cover the report on its face. Instead, the taxpayer's counsel argued that this case fell within a line of jurisprudence that extended the privilege to cases in which a lawyer seeks a non-lawyer's input to facilitate the lawyer's delivery of legal advice to her client.[3]

In paragraph 33, the court cited and quoted *Redhead Equipment Ltd. v. Canada (Attorney General)*, 2016 SKCA 115, which reviewed the applicable case law and concluded as follows:

> [41] Based on the foregoing, the privilege extends to all situations in which the third party functions as an interpreter of information provided by the client for the solicitor or serves as a conduit of advice from the solicitor to the client or a conduit of instructions from the client to the solicitor, or employs expertise in assembling information provided by the client and in explaining it to the solicitor.
>
> [45] From the foregoing jurisprudence, some principles regarding communications with and of third parties such as accountants can be extracted:
>
> (a) communications of accountants are not in themselves privileged;
>
> (b) facts and figures are not in themselves privileged but may be if they are part of a communication which is privileged;

[2] For a detailed review of Canada's lawyer-client privilege in a tax context, see Steve Suarez, "Canada Revenue Agency Forces Taxpayer to Disclosure Discussions with Accountant," *Tax Notes Int'l*, May 11, 2015, p. 553. The basic requirements for solicitor-client privilege — a distinct concept from litigation privilege — are a communication made (1) between a lawyer and a client with whom the lawyer has a professional relationship, (2) on a confidential basis, and (3) for the purpose of giving or seeking legal advice.

[3] *See, e.g.*, *Cineplex Odeon Corporation v. The Queen*, 94 DTC 6407, 6409 (Ont. C.J.):

> If the [accounting firm] tax team provided advice to the client or to its solicitor that advice would not be privileged. It is only in the very limited situation where the tax team provides information to the solicitor for the purpose of the client's receiving legal advice that the privilege can be maintained. This is not the creation of an accountant-client privilege but the acknowledgement of an extension of solicitor-client privilege through the principles of agency.

> (c) whether a communication is privileged depends on the function served by the third party in relation to the communication;
>
> (d) the privilege extends only to communications in furtherance of a function essential to the solicitor-client relationship or the continuum of legal advice provided by the solicitor, for example:
>
> (i) a channel of communication between solicitor and client;
>
> (ii) a messenger, translator or transcriber of communications to or from the third party by the solicitor or client;
>
> (iii) employing expertise to assemble information provided by the client and explaining the information to the solicitor; and
>
> (e) no privilege attaches to a communication to an accountant who must consider it and provide his or her own accounting opinion.

The court determined that to decide whether the report was privileged, it had to determine the dominant or principal purpose behind its creation. On this issue of fact, the parties disagreed. The taxpayer's position was that the report's principal purpose was to provide JMC's legal counsel with tax-related information that counsel could use to provide legal advice as to how the parties should structure the transaction. Conversely, the CRA contended that the report's principal purpose was to inform a business decision: Should JMC acquire LSI and, if so, at what price?

In his affidavit, McNamara, who led JMC's due diligence process for the transaction, described the purpose of the accounting firm's Canadian tax review as follows:

> As JMC's objective was to structure the Lakeside Acquisition in the most tax-efficient manner and JMC would be required to assume the risk relating to the historical tax exposure of LSI (and the other entities within the LSI group) if it were to acquire LSI, the purpose of the limited scope Canadian tax review was to describe and explain the tax profile and tax attributes (such as non-capital losses) of LSC and LSI (including their quantum) that could be impacted by or potentially utilized in the structuring of the proposed Lakeside Acquisition, and to determine whether LSC or LSI had any material tax exposures (including contingent tax liabilities) resulting from their Canadian tax filings for the 4 taxation years ended before the acquisition.

He suggested that the report had minimal influence on the decision of whether to proceed with the acquisition, but said it played a much more significant role in the structuring of the transaction.

On the facts, the court concluded that the taxpayer's decision to retain the accounting firm to conduct Canadian tax diligence and, ultimately, generate the report had dual purposes: informing the business decision to purchase; and to assist in structuring legal advice. However, as detailed in paragraph 54, the court found that the report's *dominant purpose* at the time it was commissioned and generated was to inform the business decision of whether to proceed with the acquisition (and, if so, at what price). According to the court, this finding of fact determined the legal conclusion that the privilege did not apply.

Interestingly, the court went on to state that, irrespective of the dominant purpose of the report, McNamara's evidence regarding the report's contents suggested that it might not meet the requirements for the solicitor-client privilege to extend to the accountant's work product. In paragraph 55, the court explains:

> Atlas argues that the Report represents the product of [the accounting firm] employing its expertise to assemble information to be communicated to legal counsel, for the purpose of obtaining legal advice on the structuring of the transaction, consistent with the circumstances in which *Redhead* explains an accountant's work can be privileged. However, Mr. McNamara's affidavit describes the Report not only as

> explaining the tax profile and tax attributes of LSC and LSI but also as explaining material tax exposures resulting from the last four years of Canadian tax filings, including an assessment of the probability that the filing positions leading to the tax exposures would be sustained if challenged by CRA, and an evaluation of whether appropriate reserves had been taken in respect of such exposures. Such assessment and evaluation represent accounting opinions by [the accounting firm], which do not appear to me to be capable of being characterized as prepared for the purpose of obtaining legal advice on the structuring of the transaction.

In any event, the court determined that the solicitor-client privilege did not protect the report from disclosure.

Other Bases for Nondisclosure

The taxpayer also asserted that, by seeking the report, the CRA was effectively requiring the taxpayer to disclose a document whose primary substance was the identification and quantification of potential tax exposures, not unlike tax accrual working papers (TAWPs). On this issue, the facts bore some similarity to those of *BP Canada Energy Co.*, in which the CRA sought to compel the taxpayer to turn over the list of uncertain tax positions it had generated as part of the financial statement preparation process.[4] In that case, the Federal Court of Appeal rejected the CRA's demand for a variety of reasons. While acknowledging that the scope of the CRA's powers to demand information from taxpayers is broad, the Court of Appeal held that these powers are not without limit and, specifically, cannot be used to "obtain general and unrestricted access to" TAWPs. In language quoted by the *Atlas Tube* court at paragraph 59, the court stated:

> To be clear, although auditors are entitled to be provided with "all reasonable assistance" in performing their audits (paragraph 231.1(1)(d) of the Act), they cannot compel taxpayers to reveal their "soft spots" . . . . While this is an unwritten rule without clearly defined boundaries, it certainly stands against any construction of the Act that would allow the Minister to compel a taxpayer to self-audit on an ongoing basis.

The *Atlas Tube* court agreed that the accounting firm's report bore some similarities to TAWPs. However, in paragraph 63, the court distinguished *BP Canada* because, in that case, the CRA was demanding the list of uncertain tax positions after the completion of the audit that gave rise to the initial dispute, seeking to use it as a "roadmap" for future audits. In contrast, the CRA's demand for the Atlas report involved a specific inquiry made in the context of an active audit of the year to which the information being sought related. The court found that this was enough of a difference to allow it to conclude that compelling disclosure of the Atlas report would not offend the principle against self-audit that the Federal Court of Appeal described in the *BP Canada* case.

Finally, the taxpayer asked the court to exercise its residual discretion and choose not to order disclosure of the report because the production would be unfair and prejudicial to Atlas on the facts. The court found no justification for this request on the facts at hand and ordered the taxpayer to deliver the report to the CRA.

Discussion

The most interesting element of the *Atlas Tube* case is the court's discussion of — and its conclusions regarding — the scope of solicitor-client privilege as it applies to the work product of non-lawyer third parties, such as accountants.

Clearly, the decision turns on the specific findings of fact that the court made based on the evidence before it. It is difficult to know whether the evidence recounted in the judgment is a complete summary of everything that may have been relevant to the privilege determination. As such, this discussion focuses on the court's legal reasoning and its relevance generally, rather than its application to the specific facts of *Atlas Tube* (as

[4] For prior coverage, see Suarez, "Canadian Appeals Court Denies CRA Demand for Taxpayer's UTP List," *Tax Notes Int'l*, Apr. 24, 2017, p. 288.

important as those may be to the parties litigating the case).

The Supreme Court of Canada has often reiterated the importance of solicitor-client privilege. For example, in *Blank v. Canada (Minister of Justice)*, 2006 SCC 39, the Court states:

> The solicitor-client privilege has been firmly entrenched for centuries. It recognizes that the justice system depends for its vitality on full, free and frank communication between those who need legal advice and those who are best able to provide it. Society has entrusted to lawyers the task of advancing their clients' cases with the skill and expertise available only to those who are trained in the law. They alone can discharge these duties effectively, but only if those who depend on them for counsel may consult with them in confidence. The resulting confidential relationship between solicitor and client is a necessary and essential condition of the effective administration of justice.[5]

Atlas Tube requires us to consider the involvement of third-party non-lawyers in the provision of privileged legal advice — an area of law that Canada has not developed fully — against this general backdrop.

The primary authority that the *Atlas Tube* court relied upon when deciding this issue was the *Redhead Equipment* case. Whether or not the *Redhead Equipment* court correctly applied the law to the facts before it,[6] for the most part, in that case the provincial appeals court stated the law accurately. Specifically, in paragraphs 40 through 49, the court concluded that:

- Privilege extends to "communications and circumstances where a third party employs an expertise in assembling information provided by the client and in explaining that information to the solicitor. In doing so, the third party makes the information relevant to the legal issues on which the solicitor's advice is sought." Thus, paragraph 40 states that privilege applies when the third party essentially served as a translator.
- "There is no such thing as accountant-client privilege."
- Properly interpreted, the jurisprudence does not support the contention that "most communications between solicitor and third party, and client and third party, [are] privileged because the lawyer is 'driving the bus' and everyone is on board and travelling toward the same transactional destination." The court concluded that this view stretched the privilege "beyond the breaking point."
- "In situations where the accountant gives original and independent tax advice to either the lawyer or the client, this will not be privileged just because the lawyer has overall responsibility."
- "There is no transactional solicitor-client privilege for third parties in a multi-disciplinary transaction just because a lawyer is giving legal advice on the transaction."

However, none of the foregoing statements address or are inconsistent with a non-lawyer gathering factual information about a target company (as an accountant might do during a buyer's due diligence process) to assemble it for and provide it to the buyer's tax lawyer, so that the lawyer can analyze it and provide bona fide legal advice to the buyer (the lawyer's client) regarding potential exposures and planning opportunities under applicable tax laws.

Indeed, it is quite common for a buyer's tax lawyer to use tax diligence information assembled during a transaction to, *inter alia*:

- look for ways to structure the transaction to maximize the target corporation's tax attributes or design a post-closing reorganization to achieve specific objectives under relevant tax laws;
- identify matters that should be the subject of specific representations, warranties, covenants, closing conditions, or indemnities in the transaction documentation; or

[5] Para. 26. *See also R. v. McClure*, [2001] 1 S.C.R. 445, 2001 SCC 14, at para. 35 ("Solicitor-client privilege must be as close to absolute as possible to ensure public confidence and retain relevance.").

[6] In terms of how it applied the law to the specific facts of the case, the *Redhead Equipment* decision effectively represents the low-water mark of permissible third-party involvement in solicitor-client privilege in the Canadian jurisprudence.

- deliver a closing opinion to the buyer as to the anticipated consequences of the transaction under applicable tax laws.

All of these clearly constitute the bona fide rendering of legal advice. Privilege generally will not apply to information that is merely provided to a lawyer but not actually used by him in formulating and delivering legal advice. However, separate and apart from the facts in *Atlas Tube*, there is clearly support in Canadian jurisprudence for extending solicitor-client privilege to non-lawyers who use their expertise to gather information and explain it to a lawyer when that lawyer actually uses that work product to render legal advice.

The court in *Atlas Tube* purported to make the privilege determination based on its assessment of "the principal or dominant purpose behind the creation of the particular document for which privilege is claimed" (paragraph 36). However, it is not clear that this is the correct standard. In *Gower v. Tolko Manitoba Inc.*, 2001 MBCA 11, another provincial appeals court considering a case in which a client retained a lawyer to conduct an investigation specifically rejected the argument that a "dominant purpose" was necessary to support the creation of solicitor-client privilege. As that court explained in paragraphs 34 through 39:

> It is not helpful to use the phrase "dominant purpose" when discussing legal advice privilege. That phrase is commonly found in connection with litigation privilege. . . . Nowhere in the definition of legal advice privilege is there any requirement that the communications between the lawyer and his/her client be for the dominant purpose of litigation. Rather, what must be present is the provision of legal advice as one of the purposes of the document, but that legal advice is not confined to a situation where litigation is contemplated.
>
> In the situation at hand, it is clear from the evidence that Janzen [the lawyer] was asked to investigate and perform a fact-finding function. If that is all she was asked to do then, regardless of the fact that she is a lawyer, she would not have been providing legal advice and would have been acting as an investigator, not as a lawyer. Consequently, legal advice privilege would not have been available.
>
> However, there is strong evidence that she was asked to do more. The investigation to determine the veracity of the allegations made against the plaintiff was only one part of her tasks. It is clear that the client requested Janzen make recommendations based on the facts that she gathered and provided advice with respect to the legal implications of those recommendations. Thus, the fact gathering was inextricably linked to the second part of the tasks, the provision of legal advice.
>
> The appropriate test is not whether the investigative function performed by Janzen could have been performed by a non-lawyer. It clearly could have, but as the motions judge held, relying on *Wigmore on Evidence*, 1999 supplement (New York: Aspen Law & Business, 1999) at para. 2296, and *In Re Allen*, 106 F.3d 582 (4th Cir. 1997) at para. 26:
>
> > The relevant question is not whether Allen was retained to conduct an investigation, but rather, whether this investigation was "related to the rendition of legal services.

Thus, the *Atlas Tube* court's position that the report must have a dominant purpose of rendering legal advice — that is, as opposed to merely requiring that the rendering of legal advice be one of the purposes behind its creation — is far from settled law, even when a non-lawyer prepared the relevant work product, as long as it constitutes genuine, bona fide input that the lawyer uses to render legal advice. Hopefully, the Federal Court of Appeal will specifically address this critical issue of law when it hears the *Atlas Tube* appeal.

When contemplating privilege issues, it is important to appreciate that lawyers do not render legal advice in a vacuum: Clients seek legal counsel for a specific purpose. In the case of a business transaction, the legal advice invariably informs the client's decision regarding whether to proceed with the transaction and, if so, on what

terms. That clients use legal advice for a business purpose in no way detracts from the fact that it is legal advice being sought and provided; lawyers are expensive, and clients will rarely incur the high cost of legal counsel for generic business advice. When considering whether privilege attaches to inputs that lawyers use in the formulation of legal advice, it is important not to confuse the lawyer's use of the inputs (that is, to provide legal advice) with the client's use of the legal advice in support of which they are generated.

Hopefully, whether on an appeal of this case or in later cases, the Canadian courts will provide further guidance to clarify when solicitor-client privilege can attach to the work of and communications from non-lawyers who are directly providing relevant inputs to a lawyer who, in turn, is providing bona fide legal advice to a client. Until then, taxpayers relying on non-lawyers to perform specific tasks in furtherance of obtaining legal advice — and unwilling to bear the cost of directly engaging lawyers to do that work — should take steps to ensure they stay as clearly as possible within the boundaries of privilege. These steps include:

- clearly evidencing the purpose of the non-lawyer's work (that is, to serve as an input to the lawyer);
- ensuring that the non-lawyer's work focuses primarily on the assembly and presentation of information for use by the lawyer;
- ensuring that the non-lawyer refrains from expressing professional opinions — especially on the interpretation of tax laws, which effectively constitutes legal advice within the domain of lawyers — except to the extent that it is necessary or helpful to allow the lawyer to formulate his own legal advice to the client;
- carefully document why the lawyer needs that work product to render the lawyer's own legal advice to the client; and
- delivering the non-lawyer's work product directly to the lawyer (and not the client).

Ideally, this should involve some form of agreement in which all three parties articulate who is doing what and why. As an evidentiary matter, Canadian courts generally find contemporaneous documentation more persuasive than other forms of evidence (for example, testimony delivered some years later as part of the tax litigation process).[7] While these formalities do require some degree of rigor, carrying them out correctly puts the taxpayer in the best possible position to successfully establish solicitor-client privilege over the resulting sensitive confidential information. As the jurisprudence states, the party asserting solicitor-client privilege bears the burden of establishing it.

The *Atlas Tube* case demonstrates that the CRA is keenly aware that analyses like tax diligence reports contain sensitive and potentially valuable information — and that the CRA will routinely demand these analyses during tax audits. When properly established, solicitor-client privilege remains the only reliable tool that taxpayers can invoke to protect sensitive tax analysis from the tax authorities' disclosure demands. ■

[7] *See, e.g.*, *Canadian Imperial Bank of Commerce v. The Queen*, 2015 TCC 280, at para. 38:

> In *Gower*, however, the Court of Appeal was speaking of fact-gathering that is done *as part of a lawyer's legal services*; in other words, there is still a lawyer who is conducting or supervising the fact-gathering. As already discussed, there is insufficient evidence that counsel for [Canadian Imperial Bank of Commerce] was conducting or directing the internal investigations referenced in the productions. [Emphasis in original.]

In this regard, see also *Imperial Tobacco Canada Limited v. The Queen*, 2013 TCC 144, at paras. 72-77.