Docket: 2010-1252(IT)I

BETWEEN:

RICHARD A. KANAN CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeals heard on November 24, 2010, at Calgary, Alberta

Before: The Honourable Justice Diane Campbell

Appearances:

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| Counsel for the Appellant: | Virginia A. Engel, Q.C. |
| Counsel for the Respondent: | Marla Teeling |

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**JUDGMENT**

The appeals from the assessments made under the *Income Tax Act* for the 2006 and 2007 taxation years are allowed, without costs, and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment to allow the Appellant to deduct the fees for services as follows:

1) The fees in Invoices numbered 0504555 and 0606644 are fully deductible.

2) The fees in Invoices numbered 0503135, 0601208, 0601209, 0607089 and 0609074 are deductible to the extent of 73.33 percent of the total amount in each invoice.

The fees in Invoices numbered 0501200 and 0601135 will not be deductible.

All in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 25th day of April 2014.

"Diane Campbell"

Campbell J.

Citation: 2014 TCC 124
Date: 20140425
Docket: 2010-1252(IT)I

BETWEEN:

RICHARD A. KANAN CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

## REASONS FOR JUDGMENT

Campbell J.

[1] The Appellant is appealing reassessments in respect to its 2006 and 2007 taxation years. In both of these taxation years, the Appellant, in calculating its income, deducted legal fees which had been paid to Olson Lemons LLP ("Olson Lemons"), a law firm, and Olson Tax Consultants Inc. ("Olson Tax"), a corporation owned by the law firm and engaged in the business of tax return preparation. The Minister of National Revenue (the "Minister") denied all of the expenses on the basis that they were made or incurred for the benefit of Richard Kanan, the Appellant's major shareholder, the shareholder's spouse and related corporations and that they were not incurred for the purpose of earning income from the business.

[2] To support the deductibility of the expenses, the Appellant provided to the Minister copies of legal invoices and a general description of the legal services. When the Minister advised the Appellant that there was insufficient information to support the deductibility of the claimed expenses and requested greater detail of the legal services and advice provided, the Appellant claimed that the information being required was subject to solicitor-client privilege, which it would not waive.

[3] The only issue is whether there is sufficient evidence, either oral, documentary or both, to support the deductibility of the claimed legal expenses.

[4] Although heard pursuant to the *Tax Court of Canada Rules (Informal Procedure)*, these appeals have a lengthy history associated with them. Prior to hearing the present appeals, similar appeals were heard by Chief Justice Rip in Calgary in March and December of 2010. Although the Appellants in the appeals before Chief Justice Rip were different than the Appellants in the present appeals, they were utilizing the services of the same law firm, Olson Lemons, and the same tax consulting company, Olson Tax. Consequently, the issue in those appeals, concerning deductibility of expenses, was almost identical to the issue before me.

[5] A brief outline of the history in the present appeals follows:

- The Appellant filed a Notice of Appeal on April 23, 2010.
- The Respondent filed a Reply on June 4, 2010.
- The appeals were heard on November 24, 2010 in Calgary.
- Written Submissions were provided by the Appellant and the Respondent on January 21, 2011.
- I issued Interim Reasons on April 15, 2011, directing the parties to meet to reconsider what information could be provided under a limited and partial waiver of solicitor-client privilege and to report back to the Court.
- The Appellant provided some additional information but the parties failed to reach a settlement.
- On September 30, 2011, the Appellant requested that the hearing be reopened to permit the introduction of additional evidence.
- A directive from the Court was issued on October 20, 2011.
- Written Submissions were filed by the Appellant on October 31, 2011 in support of the request to reopen the hearing.
- Written Submissions opposing the Appellant's request to reopen the hearing were filed by the Respondent on November 4, 2011.

- Three appeals, which Chief Justice Rip heard in March, 2010 and December, 2010, were also subject to a similar request by those Appellants to reopen their hearings.

- The Appellants' application in the appeals being heard by Chief Justice Rip was scheduled for a hearing and I directed that the similar application, in the appeals before me, be held in abeyance pending a decision by Chief Justice Rip.

- On December 10, 2012, one day prior to the scheduled hearing of the application by Chief Justice Rip, the Appellants withdrew their application to reopen the hearings.

- On April 24, 2013, Chief Justice Rip issued his reasons in all 3 appeals (*Dr. Mike Orth Inc v The Queen*, 2013 TCC 123, *371501 B.C. Ltd.* and *440214 B.C. Ltd.*, 2013 TCC 124).

- On May 24, 2013, the Appellants appealed the decisions to the Federal Court of Appeal.

- On July 24, 2013, the parties were advised that I intended to hold my decision in abeyance pending the outcome of the decision of the Federal Court of Appeal.

- On February 5, 2014, the FCA upheld the decision of Chief Justice Rip.

The Facts

[6] The facts in these appeals were described in detail in my Interim Reasons but, briefly, the Appellant, a British Columbia corporation, operates a dental practice in Invermere, British Columbia. The Appellant receives legal counsel from Olson Lemons and tax consulting advice from Olson Tax, which are based in Calgary, Alberta.

[7] Thomas Olson, a partner at Olson Lemons, was the only witness testifying on behalf of the Appellant. He testified that the contents of the legal files, relating to the expenses, were protected by solicitor-client privilege. Since his client had not waived that privilege, he limited his testimony to unprivileged information, claiming that the

onus on the Appellant did not require it to disclose any information over which privilege was claimed.

[8] The Respondent claimed that the Appellant provided insufficient information of the work completed. Since this would not satisfy the Appellant's onus in this Court, then the expenses should not be deductible.

[9] Although the Appellant's minute book and general ledger had been provided during the audit process, only the T2 corporate tax returns and the invoices for the expenses were introduced into evidence at the hearing. There are nine invoices in issue during this period. They contain no description of the work completed for which fees were charged. Except for charges for disbursements, all invoices simply referenced the work generally as "Fees for Services".

[10] During the period under appeal, there were essentially three categories of expenses for which invoices were issued:

(a) General Retainer Expenses – described as fees for day-to-day general advice to the Appellant in areas such as tax-related and corporate matters (Transcript, pp. 17-18, 59 and 61);

(b) Preparation of Returns – described as those invoices relating to tax and corporate compliance, accounting and bookkeeping and preparation of returns (Transcript, pp. 105 and 130); and

(c) Projects – described as the identification, analysis and advice given to the Appellant and Olson Tax respecting specific legal issues and transactions, the consequent reporting of these and preparation of the supporting documentation (Transcript, pp. 63-64).

[11] Mr. Olson testified that his firm would enter into a "retainer engagement arrangement" with the Appellant at the commencement of each year. Pursuant to this engagement, the Appellant would pay "set fixed costs", in advance, for anticipated services that Olson Lemons would be providing throughout the year. Clients were not billed at an hourly rate. According to Mr. Olson, time recordings that were maintained were not always accurate because they did not affect the quantum of the fee, which was agreed to in advance. Mr. Olson stated that the fees were "… not based on time records, it's based [on] my experience doing these files." (Transcript, p. 116).

[12] In respect to the invoices relating to "projects", Mr. Olson stated that, in both 2006 and 2007, he dealt with compensation to employee shareholders, dividend issues and the payment of bonuses. For example, in respect to dividend issues, the business and taxation issues, relating to such payments, would be identified, resolutions and other documents would be prepared to ensure compliance and advice would be provided to Olson Tax, the tax preparers, on behalf of the Appellant. In 2006, shares were issued and advice and documentation were provided for the Appellant and the tax preparers relating to compensation and dividends as well as the share issuance. Mr. Olson testified that information respecting the share issuance was contained in the corporate minute book which had been provided to Canada Revenue Agency ("CRA") but which Mr. Olson did not provide to the Court. In 2007, the "project" fees related to compensation, dividends and changes to the stated capital accounts.

[13] According to Mr. Olson, the fees attributable to the "projects" could be broken down as follows:

(a) 20 percent for providing advice on preparation and filing of returns;

(b) two-thirds of the remaining 80 percent for advising the Appellant on specific transactions relating to payment of bonuses, dividends or issuance of shares, together with all related documentation; and

(c) one-third of the 80 percent for compliance advice on tax and corporate compliance, including the timing of bonuses and remitting of corporate withholdings and general reporting obligations.

There seemed to be apparent overlapping between this latter category (the one-third of the 80 percent division) and the projects category assigned the 20 percent. The evidence did not clarify this.

Analysis

[14] By basing income on profits as opposed to revenue, subsection 9(1) of the *Income Tax Act* (the "*Act*") permits taxpayers to deduct expenses, such as legal expenses, in calculating their income. Permissible deductions are limited, however, by paragraph 18(1)(*a*). In the Federal Court of Appeal decision in *Dr. Mike Orth Inc v Canada*, 2014 FCA 34, one of the three appeals originally heard by Chief Justice Rip and referenced earlier in these reasons, Justice Sharlow referred to the applicable test as the "statutory purpose test", that is, whether the legal expenses were incurred for the purpose of earning income from a business or property and were not outlays on account of capital or personal expenses.

[15] In my Interim Reasons, at paragraph 29, I came to the following conclusion as to how an appellant will be expected to justify the deductibility of legal expenses:

> [29] When a taxpayer deducts an expense from his or her income, he or she may be called upon to justify that deduction – to convince the Minister, or failing that, the Court, that it is a properly deductible expense. Where the expense is a lawyer's fee, the proof that is required will often be covered by solicitor-client privilege. While these Interim Reasons are not intended to provide the CRA with a licence to access privileged information, it is clear that a taxpayer who presents a claim for deductions in a return must also accept that at least some disclosure will be necessary to properly dispose of that claim.

[16] In *Dr. Mike Orth Inc. v The Queen* and the related appeals, Chief Justice Rip reviewed in detail the jurisprudence respecting the onus, which an appellant has in this Court, to establish a *prima facie* case that "demolishes" the Minister's assumptions of fact that form the basis of the assessment. If an appellant successfully demolishes those assumptions of fact, the onus shifts to the Minister to rebut the appellant's *prima facie* case and prove the assumptions. Chief Justice Rip, at paragraph 20, concluded:

> [20] A taxpayer wishing to establish a *prima facie* case to demolish all or any of the Minister's assumptions must not only present evidence of a high degree of probability that must be accepted by the Court but must allow for a fair and open cross−examination of the evidence by Minister's counsel. Counsel is entitled to vigorously challenge the evidence of the taxpayer by cross-examination. A taxpayer claiming privilege in cross−examination on matters he or she leads in examination−in−chief, thus limiting the cross−examination, must consider possible consequences. A taxpayer claiming privilege who wishes to shift the onus must still make a case that will survive cross−examination.

[17] Chief Justice Rip, at paragraph 21 of his reasons, noted that one of the issues before him was a determination as to "… whether the appellant while maintaining his right to solicitor-client privilege has presented evidence reversing the onus placed on the appellant by the Minister's assumptions." I have that same determination to make in the present appeals.

[18] The Respondent does not challenge the Appellant's argument that it had a right to maintain solicitor-client privilege over the advice provided to it by Olson Lemons. However, the Respondent contends that, by invoking privilege, the Appellant has failed to meet its onus of demolishing the assumptions. Justice Sharlow in *Dr. Mike Orth Inc. v Canada*, at paragraph 13, in assuming that the claims of solicitor-client privilege were valid claims for the purpose of those appeals, went on to state:

> [13] … However, neither the Minister nor the Court is obliged to determine a factual dispute in the taxpayer's favour merely because the taxpayer asserts and refuses to waive a claim of solicitor and client privilege with respect to evidence that could resolve the dispute.

[19] While I recognize the Appellant's right to claim solicitor-client privilege, I came to much the same conclusion that Chief Justice Rip did in the three similar appeals concerning the testimony of Mr. Olson. At paragraph 49 of the reasons in *Dr. Mike Orth Inc. v The Queen*, Chief Justice Rip stated the following:

> [49] … However, most of Mr. Olson's testimony describing the various invoices in question which, while interesting, is not illuminating to the extent that I actually learned the purpose for which the legal fees were incurred and be able to come to a reasonable conclusion as to whether the fees were incurred for business or other reasons. …

Mr. Olson responded with generalities to much of the questioning. In many instances, he claimed that he either did not recollect or was not sure. Some of his responses contained estimations. Some of his evidence could have been supported by the documentation, such as the minute book records, that he had provided to CRA but not the Court, leaving one with the impression that he felt that was sufficient to satisfy this Court. When asked on cross-examination which items were reconciled with the general ledger, his response meandered as follows:

> A. I - - I don't recall. Sometimes we reconcile inter-companies, sometimes we reconcile bank loans, but not always, and often not, but sometimes at the request of a client you do, but I don't recall what reconciliations were requested of us.
>
> (Transcript, pp. 83-84)

This response was in respect to a document (the general ledger) that had been freely handed over to CRA. I would expect any taxpayer, and particularly a lawyer, to have reasonably anticipated such questions and to be prepared and forthcoming in their response. When asked to confirm the accuracy of the authorized share structure and changes to the corporate structure and the stated capital, he could not do so without supporting documents, one being the minute book which was not produced in evidence. It was obvious that it had not been reviewed by Mr. Olson, as one would expect, prior to coming to Court to testify.

[20] In response to how many employees the dental practice employed, Mr. Olson testified that Mr. Kanan's wife was "involved in the business" and that there were other staff but that he was not aware whether they were employees or contractors (Transcript, p. 117). When he was re-directed back to the original question of how many employees were working, his response again showed how little effort he put into his preparation for giving evidence on behalf of the Appellant: "… I'm sure they're in my records somewhere, but I don't remember now." (Transcript, p. 118). When questioned about bonuses paid in the 2006 taxation year, he could not recall the specifics, or whether, in fact, they were actually accrued and paid in that year. To this response, he added: "… but that would be information that's readily available in the financial statements. If I had a copy, I could tell you." (Transcript, p. 141).

[21] I was not impressed with Mr. Olson's lack of preparation or his flippant responses. While a solicitor has a duty to respect a client's refusal to waive otherwise privileged information, there were many instances where Mr. Olson could have provided specifics. Those specifics were detailed in the ledger, financial statements and minute book, but Mr. Olson apparently did not think it was essential to bring these documents to Court or to review them in advance of the hearing. While credibility was not an issue, Mr. Olson was less than an ideal witness.

[22] Following the Federal Court of Appeal's comments in *Dr. Mike Orth Inc. v Canada*, notwithstanding the Appellant's right to claim solicitor-client privilege and the duty of CRA not to violate that privilege when claimed, the Appellant nevertheless bears the burden of proof to demolish the Minister's assumptions of fact in these appeals. With this in mind, I turn now to a review of the 9 invoices and a determination of whether the amounts contained in those invoices are deductible by the Appellant in calculating its income in the 2006 and 2007 taxation years.

<u>The Invoices</u>

*General Retainer*

| Tax Year | Date | Invoice No. | Amount for Fees | Total with Disbursements and Taxes |
|---|---|---|---|---|
| 2006 | February 1, 2005 | 0501200 | $2,675.00 | $2,863.05 |
| | January 6, 2006 | 0601135 | $2,675.00 | $2,864.88 |

[23] Mr. Olson described the fees charged in these two invoices as relating to a "general retainer". He stated that the retainer involved answering day-to-day questions but he did not elaborate further on the nature of those questions. Consequently, I have almost no evidence before me to assess what types of questions were asked, what advice was provided and to whom or what work would be covered by these fees.

[24] In *Dr. Mike Orth Inc v The Queen*, at paragraph 55(i), Chief Justice Rip disallowed similar invoices that were given for general advice because he could not "determine any allocation or even if these fees were deductible in computing income because there is no evidence before me…". Since I have no evidence relating to the nature of the questions or the resulting services, the Appellant has not established a *prima facie* case that the expenses, relating to Invoices numbered 0501200 and 0601135, should be deductible.

*Tax Return Preparation*

| Tax Year | Date | Invoice No. | Amount for Fees | Total with Disbursements and Taxes |
|---|---|---|---|---|
| 2006 | April 19, 2005 | 0504555 | $4,000.00 | $4,280.00 |
| 2007 | June 6, 2006 | 0606644 | $5,000.00 | $5,448.31 |

[25] Mr. Olson testified that these expenses related essentially to tax return preparation. "It was solely for the preparation of income tax returns, we call that tax compliance." (Transcript, p. 105). In addition, accounting services, including bookkeeping and account reconciliations, would have been provided. Legal advice, that may have been given with respect to the tax returns, would be invoiced separately (Transcript, p. 130).

[26] In *Dr. Mike Orth Inc v The Queen*, Chief Justice Rip allowed the Appellant to deduct its fees to Olson Tax, where those fees related to tax-related and compliance services. Similarly, in the appeals before me, Mr. Olson stated that the services included attendance on the Appellant's T2 and the ancillary returns together with bookkeeping and reconciliation. This establishes a *prima facie* case to support these expenses being deductible. Although Mr. Olson admitted that the firm may have prepared Dr. Kanan's personal tax returns and those of his family members, he stated, and I have no evidence to the contrary, that they were completed free of charge (Transcript, pp. 112-113).

*Projects*

| Tax Year | Date | Invoice No. | Amount for Fees | Total with Disbursements and Taxes |
|---|---|---|---|---|
| 2006 | March 11, 2005 | 0503135 | $2,200.00 | $2,354.00 |
| 2006 | January 20, 2006 | 0601208 | $2,675.00 | $2,895.30 |
| 2006 | January 20, 2006 | 0601209 | $2,500.00 | $2,675.00 |
| 2007 | August 2, 2006 | 0607089 | $2,950.00 | $3,127.00 |
| 2007 | September 27, 2006 | 0609074 | $3,300.00 | $3,498.00 |

[27] According to Mr. Olson's testimony, any task, that requires more work than simply picking up the phone and answering a quick question, moves out of the "General Retainer" category and falls instead within the category of so-called "Projects". Approximately 20 percent of the fees, under this category, related to providing legal advice and analysis in respect to specific transactions during a particular year, including documentation required and necessary reporting. Mr. Olson divided the remaining 80 percent into two sub-categories:

(a) 2/3 (53.33 percent of the 80 percent total) which related to advice on business and tax issues respecting specific transactions together with the preparation of related documents; and

(b) 1/3 (26.67 percent of the 80 percent total) which related to advice on corporate and tax compliance and reporting obligations.

[28] It appears that both the first 20 percent estimate of the fees and the 26.67 percent of the 80 percent relate to legal advice and analysis. The distinction between the categories, however, was unclear and, from the evidence before me, they appear to cover the same items. Mr. Olson attempted to explain the 26.67 percent as relating to the advice that might be required in respect to payment of bonuses, remittance of tax and other reporting obligations. While communication relating to providing such advice is privileged, since I have no evidence to distinguish between these two categories or to confirm these categories represent expenses incurred for the purpose of earning income from business or property and where it appears they duplicate each other, I am allowing only the initial 20 percent of the total amount of fees listed in these "Project" invoices, but not the 26.67 percent of the 80 percent estimate. Of the remaining 53.33 percent of the 80 percent, Mr. Olson's evidence is that it included some business and legal advice together with drafting documents for specific transactions, such as compensation issues, payment of dividends and adjustments to stated capital. The portion of this 53.33 percent relating to advice or communications, of course, would be privileged. Although there was no attempt to differentiate between the portion attributable to advice and the portion attributable to documentation, the result of the firm's analysis would be available to CRA in the Appellant's tax returns and minute book. Therefore, I am allowing 53.33 percent of the invoice amounts as well as the initial 20 percent.

[29] In summary, the appeals for the Appellant's 2006 and 2007 taxation years are allowed, without costs, and the reassessments are referred back to the Minister for reconsideration and reassessment to allow the Appellant to deduct the fees for services as follows:

1) The fees in Invoices numbered 0504555 and 0606644 are fully deductible.

2) The fees in Invoices numbered 0503135, 0601208, 0601209, 0607089 and 0609074 are deductible to the extent of 73.33 percent of the total amount in each invoice.

The fees in Invoices numbered 0501200 and 0601135 will not be deductible.

Signed at Ottawa, Canada, this 25th day of April 2014.

"Diane Campbell"

Campbell J.

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| CITATION: | 2014 TCC 124 |
| COURT FILE NO.: | 2010-1252(IT)I |
| STYLE OF CAUSE: | RICHARD A. KANAN CORPORATION and HER MAJESTY THE QUEEN |
| PLACE OF HEARING: | Calgary, Alberta |
| DATE OF HEARING: | November 24, 2010 |
| REASONS FOR JUDGMENT BY: | The Honourable Justice Diane Campbell |
| DATE OF JUDGMENT: | April 25, 2014 |

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