



October 10, 2017

Via email: fn.legislation-taxation-legislation-taxation.fin@canada.ca

Tax Policy Branch
Department of Finance
90 Elgin Street
Ottawa, ON K1A 0G5

Dear Sirs/Madams:

Re: Proposed Changes to Billed-Basis Accounting – Potential Impact on Access to Justice

The Canadian Bar Association (CBA) is pleased to comment on draft legislation released on September 8, 2017 to implement changes to billed-basis accounting (BBA) and the impact it may have on Canadians' ability to seek equal justice.

The CBA is a national association representing over 36,000 jurists, including lawyers, notaries, law teachers, and students across Canada. We promote the rule of law and access to justice, and provide expertise on how the law touches the lives of Canadians every day.

The *Income Tax Act* allows designated professionals (lawyers, accountants, dentists, medical doctors, chiropractors and veterinarians) to elect to use BBA – to exclude the value of work in progress (WIP) from income for that taxation year, and instead to recognize the amounts in income only when the work is billed.

This longstanding principle recognizes the challenges in valuing unbilled time in certain contexts. Given the distinct nature of the lawyer and client relationship, the legal profession has unique challenges in valuing WIP because the amount that might ultimately be billed by a lawyer often depends on future events and multiple factors outside of the lawyer's control.

Budget 2017 and the draft legislation propose to eliminate the ability to use BBA and to require lawyers to include an amount in income in respect of their WIP.

Revised Phase-in Period

The draft legislation revises the coming-into-force period from that proposed in Budget 2017, so the BBA measure would be phased in over a five-year period instead of two years.

The CBA welcomes the longer transition period. We had recommended a longer transition given the amounts of WIP that may be subject to an unanticipated and accelerated tax consequence. A five-year transition period will alleviate significant compliance and administrative costs for law practices and clients.

We thank the Government for taking note of our recommendation.

Remaining Concerns: Access to Justice

While we appreciate the longer transition period, we remain concerned that the BBA proposal may inadvertently reduce access to justice by making it harder for lawyers to take on work for Canadians who cannot afford to pay the lawyer until the matter is resolved.

To ensure that the proposal does not inadvertently hinder access to justice, we recommend that:

- 1) the government clarify that three payment arrangements – classic contingency fees, *de facto* contingency fees and deferred payments – not be impacted by the BBA proposal;
- 2) the *Income Tax Act* clarify the principles relevant to determining the cost of WIP;
- 3) a *de minimis* exception for smaller legal practices be crafted as a practical way to exclude situations where the required compliance and administrative costs are disproportionate to the anticipated tax impact.

I. Impact on Access to Justice

a) Payment Arrangements to Accommodate Client Needs

The proposal to eliminate the option to use BBA is interpreted by many lawyers as requiring them to pay tax on income that will not be realized for several years, if at all, or that is too uncertain to quantify. Lawyers currently accommodate many clients who don't have the means to pay up front through different types of deferred-payment arrangements. This results in a significant amount of work in progress being carried by the lawyer.

The CBA asked its members for examples of how the proposal could affect different types of practices. We received an unprecedented number of responses. A sample is in **Appendix A**.

To understand the potential impact of removing the BBA option, it is instructive to describe three types of deferred-payment arrangements:

1) Classic Contingency Fee Arrangement: an agreement where the lawyer's remuneration for the legal services provided is entirely contingent on the successful disposition or completion of the matter.

Example

Written contingency fee agreement between a personal injury lawyer and a client. Class action for consumer protection, where lawyer for the class is paid a percentage of the settlement.

2) De facto Contingency Fee Arrangements: an agreement where the lawyer's income may not depend entirely on a successful outcome and the client may have some liability to pay even if not successful, although there may be a significant delay between the lawyer commencing the work and any decisions about the amount to be billed. Using the text of the recent CRA guidance (discussed below), like a classic contingency agreement, the lawyer's income only "becomes known and billable at some time after the taxation year in which the

lawyer provided the services” and “no amount is receivable by the lawyer until the right to collect the amount is established”. Moreover, the lawyer’s potential income is widely uncertain and depends on many factors outside the lawyer’s control.

Example

A common law spouse is separating after a 36 year relationship. The husband is playing hardball and controls most of the assets. The client does not have the means to pay up front or on an ongoing basis. The lawyer carries the client’s case until the settlement or court order because she believes it is the right thing to do.

The lawyer’s potential income will depend on factors such as court delays, case timelines, changes in the client’s personal circumstances and ability to pay and outcome of the case. The lawyer assumes a high degree of risk in spending considerable time on the case with no guarantee of the amount, if any, to be added eventually to the lawyer’s actual income.

3) Deferred Payment Arrangement: an agreement where the lawyer’s ultimate income may or may not be known, but no amount is receivable by the lawyer until the right to collect the amount is established and the client is in a position to pay.

Example

In family law and estate litigation, it is common to enter into arrangements where legal fees are not paid until the clients’ assets are sold and funds become available.

A spouse with a modest income cannot afford to pay for legal representation until a matrimonial home is sold. An individual with a valid claim for support against an estate because the deceased did not make adequate provisions for them will struggle with the cost of legal fees. In these cases, the work accrues significant WIP because the agreement with the client is that the account will not be paid until assets have been realized and claims have been settled.

These payment arrangements allow people who have been wronged – and would otherwise not be able to afford it – to seek justice. In all cases, the lawyer receives no income until the issue has been resolved, and the fees are often not quantifiable until long after the work begins. The lawyer commits to the client’s cause, and essentially finances it until final settlement is achieved. In some cases, fees are never recovered. In others, they are much lower than anticipated.

These payment arrangements are often offered to clients who need them most: in cases of personal injury, family law, wills and estates, employment, medical malpractice, consumer protection and collective First Nation issues.

b) Scope of the Access to Justice Problem and Disproportionate Impact on Vulnerable Individuals

Most law firms in Canada – 90% – count 10 or fewer lawyers. These types of practices are typically more likely to serve clients with lower financial means, so removing the BBA option may have a disproportionate impact on women, Aboriginal peoples and disadvantaged individuals.

For example, in family law matters, women represent a high proportion of clients in compassionate or hardship cases. In separation, child custody and similar cases, women are far more likely to be the spouse with less financial power.

While Budget 2017 was submitted to a gender-based analysis (GBA), the approach taken for this measure is unclear. A GBA tailored to take into account the realities of women clients would reveal that woman may disproportionately experience negative impacts as a result of the BBA proposal.

c) Canada Revenue Agency Guidance Issued on April 28, 2017

For ease of reference, Question and Answer Number Five of the CRA guidance is reproduced:

How will the proposed change impact designated professionals that provide services on a contingency fee basis?

Under the terms of a contingency fee arrangement, all or a portion of a designated professional's fees may only become known and billable at some time after the taxation year in which the professional provided services under the arrangement (e.g., where, under the terms of a written contingency fee agreement between a personal injury lawyer and a client, legal fees are only billable by the lawyer on a periodic basis as amounts are received by the client under a negotiated settlement or a court judgment).

Until such time, there is often no liability on the professional's client to pay any fee; consequently, no amount is receivable by the professional until the right to collect the amount is established. Under these circumstances, for purposes of determining the value of the professional's work in progress at the end of the year, no amount would normally be recognized. As a result, the proposed change to eliminate the ability of designated professionals to elect to use billed-basis accounting is not expected to have any impact on these types of contingency fee arrangements where the terms and conditions of such arrangements are *bona fide*. [Emphasis added]

This guidance helpfully clarifies that the proposed change would not have any impact on a "contingency fee arrangement". However, we seek further clarity on the scope of the CRA guidance and whether it is meant to capture the other types of deferred payment arrangements described above. We discuss how to address this uncertainty in our recommendations below.

d) Crux of the Problem: How to Tax-Account for WIP for Lawyers

In computing income under the proposal to tax work in progress, *Income Tax Act* subsection 10(1) will require property described in inventory (which will include a lawyer's WIP) to be valued at its cost or its fair market value, whichever is lower.

As the examples illustrate, the amount a lawyer will eventually bill in respect of WIP, and the time at which the lawyer is able to bill, often depends on future events and multiple factors outside the lawyer's control (e.g. case timelines, court delays, client's ability to pay, settlement reached, court order, court mandated tariffs). Other professionals affected by the measure—dentists, doctors, veterinarians and chiropractors—have more certainty in their billing practises.

The practice of law is not conducted in a uniform manner. Generally, work in progress commences when the lawyer accepts instructions from a client to undertake a matter on behalf of the client. The "work" consists of the lawyer's personal effort in representing the client to fulfil the client's instructions. It may or may not involve others such as employed lawyers, students and law clerks, and secretarial and clerical assistance. It may or may not involve the preparation of documents or other written material.

The "work" is "in progress" until the task is completed and an account rendered to the client. Only then is the lawyer entitled to any fee. The fee charged to the client is affected by many factors and does not necessarily bear any relation to the time spent by the lawyer or others in the firm on behalf of a client.

In summary, a lawyer's WIP is not an asset that can be transferred for value. It is not comparable to commercial inventory work in progress for which a third party could take the physical goods as they exist and, by adding to the incomplete state, bring the goods to a marketable product. Until a fee can be billed to a client, expenses incurred by a lawyer in rendering services to the client are his or her costs and, in our view, should be treated as such for income tax purposes in the year in which they are incurred.

II. Recommendations

To ensure that the BBA proposal does not inadvertently hinder access to justice and is fairly implemented, we propose the following:

- 1) Confirmation of payment arrangements not caught by the BBA proposal
- 2) Clear definition of the cost of WIP
- 3) Exemption for smaller firms based on a de minimus test

1. Confirmation of Payment Arrangements Not Caught by the BBA Proposal

Recommendation

Given the uncertainty about the scope of the CRA guidance and the importance of maintaining effective access to justice, we recommend that the three types of payment arrangements described above (classic contingency fees, de facto contingency fees and deferred-payments) should not be impacted by the BBA proposal.

To clarify the types of payment arrangements that are not meant to be caught by the BBA proposal, we recommend that a definition of "Exempt Payment Arrangement" be added to the *Income Tax Act*.

2. Clear Definition of the Cost of WIP

Recommendation

We recommend that the Income Tax Act clarify the principles relevant to determining the cost of WIP. In our view, the definition should reflect the direction announced by the Minister of Finance when the issue of valuation of WIP arose in 1981:

The cost of work in progress will not include fixed or indirect overheads, such as rental, secretarial and general office expenses. It will generally be restricted to those costs, such as the salaries paid to professional employees, that are expected to be recovered in future billings. No cost is required to be imputed to partners' or proprietors' time.

3. Exemption for Smaller Firms Based on a De Minimus Test

Recommendation

We recommend crafting a *de minimis* exception for smaller legal practices.

The proposal will impose significant changes and a costly record keeping burden on practitioners, on small firms in particular. Exempting smaller firms would be a practical way to exclude situations where the required changes to administrative practices and updating systems used to record WIP and other costs of making the transition is disproportionate to the anticipated tax impact. We believe this approach would eliminate undue practical burdens without materially affecting the Government's overall budgetary planning.

The CBA applauds the Government's objective of tax fairness and its support of the middle class and vulnerable Canadians.

While measuring all business income on an accrual basis and the perfect "matching" of expenses and revenues may suggest equality on its face, we suggest that the tax system must be flexible enough to reflect differences in the manner in which various businesses are carried on (and the reasons for these differences). For the legal profession, we believe that tax policy must recognize the unique relationship clients have with their lawyers and how it ensures access to justice.

The Government is proposing a major change to a longstanding practice that could have a significant and unintended impact on Canadians seeking to access to legal services and the justice system. We believe that the recommended solutions should be adopted to ensure that access to justice is not adversely impacted and that the measure is fairly implemented.

Yours truly

(original letter signed by Kerry L. Simmons)

Kerry L. Simmons, Q.C./c.r.

**EXAMPLES OF HOW ACCESS TO JUSTICE CAN BE IMPACTED
BY AREA OF PRACTICE AND TYPE OF PAYMENT ARRANGEMENT**

Family Law - Division of property after 36 year common law relationship separation De-facto Contingency Arrangement

My client, a woman in her late 60s in rural Newfoundland, is going through a separation after a 36 year common law relationship. The husband is playing hardball and controls most of the assets. The client does not have the means to pay up front or even on an ongoing basis. I decide to carry the client because it is the right thing to do.

My potential income will depend on future events and multiple factors that are outside of the lawyer's control including court delays, case timelines and changes in the client's personal circumstances and ability to pay, outcome of the case, etc. There is a high degree of risk in taking on this client as the lawyer will spend considerable time working on the case with no guarantee of the amount, if any, to eventually be added to the lawyer's actual income.

I would not be able to take on a client like this if I was expected to pay tax on my work in progress.

Family Law – Separation, Generally

De-facto Contingency Arrangement, Deferred Payment Arrangement

Frequently in family separation there is one spouse, most often still the woman, who has less access to resources on separation. In assisting women, lawyers may choose to defer payment of legal bills until some further steps in the legal process – after initial orders or agreements for spousal support or interim property distribution are obtained, for example. At times, legal bills are deferred until the matrimonial property settlement or final order is reached, at which time fees are paid out of the settlement funds. Some parties with few accessible assets may need to liquidate assets before being able to pay for legal assistance, even though they have a need for legal assistance at the outset to make those determinations and to get to a final arrangement.

Family clients have a tremendous unmet legal need. In many communities, family lawyers can take paying clients and decline those who require some deferment or alternative pay arrangement. Many lawyers try to meet those needs with flexible payment arrangements to ensure all parties get the service they need.

Having to pay tax on work in progress prior to the collection of the bill, when there is no assurance that the bill will be collected, would deter family lawyers from being willing or able to assist those clients who cannot afford up front retainers.

Family Law – Custody- A mother fights to get her children back from estranged husband

De-facto Contingency Arrangement

A husband, separated from his wife and who has left New Brunswick to work in Alberta, comes home one weekend to visit his children. He returns to Alberta with the children. Their mother is desperate to get the children back and now has to sue her husband for custody. On average, a child custody case will take up to four years to resolve and legal fees only get paid on what equity may exist in a matrimonial home. With no income of her own, and facing a lengthy legal process given the two jurisdictions, the client did not have the means to pay any legal fees up front or pay full freight rates. The lawyer takes on the case and tells the client “we’ll figure out the money later”.

Family Law, Wills and Estates**Deferred Payment Arrangement**

As a lawyer in private practice with a focus on family law and estate litigation, it is common for me to enter into arrangements where the legal fees are not paid until the clients' assets are sold and funds become available.

A spouse who has a modest income and cannot afford to pay for legal representation until a matrimonial home is sold, or an individual who has a valid claim against an estate for their support because the deceased did not make adequate provisions for them will struggle with the cost of legal fees. In such cases, the lawyer's work accrues significant WIP which cannot reasonably be billed because the agreement with the client is that the account will not be paid until assets have been realized and claims have been settled.

Compelling me to include WIP as income would very likely result in my not being able to take on these types of clients and would force people, with limited means seeking justice, into making settlements that are unfair.

Family Law, Civil Litigation**Contingency Fee Arrangement, De-facto Contingency Arrangement, Deferred Payment Arrangement**

As a lawyer in a mid-sized law firm, I was assigned many cases where leniency was required when representing people of limited financial means and for clients who couldn't pay up front nor hire a lawyer at full freight. For example, a female client was denied coverage by an insurance company. She was unable to pay up front, and it was agreed that she would not have to pay any fees, including disbursements, until a settlement was reached. Her case spanned five years before it was settled.

I now practice family law at a small firm and a significant percentage of my clients, most often women, cannot afford to pay my legal fees until, for example, the matrimonial home has been sold and assets divided.

Aboriginal Law**De-facto Contingency Arrangement, Deferred Payment Arrangement**

I work exclusively for First Nation and Métis organizations. Their Aboriginal and treaty rights are continually challenged by Crown actions, decisions, by off-reserve development in the traditional territory and by the exigencies of modern governance. Aboriginal peoples already face systemic barriers to justice for their historic and modern grievances against the state.

Given that most of my clients must respond to Crown referrals and actions frequently, they never have the opportunity to amass the funds needed to pay for the legal services required in advance. Most of my work is funded through my clients' own-source revenues, none of which is stable and often follows the fluctuations in commodity markets. They are unable to pay retainers in advance and contingency fee arrangements are not viable solutions because much of the legal relief being sought against the Crown tends to be declaratory. Many of my Aboriginal clients could not obtain my legal services unless they already had money set aside for those services.

Human Rights**De-Facto Contingency Fee Arrangement**

My practice is in the area of human rights representing families with children with disabilities, fighting for their legal rights to obtain fundamental access and accommodation in Ontario's educational system. Recently I represented a family with an autistic child who required special accommodations at school. The parents had no luck with direct mediation with the school authorities, nor with the school board. To ensure their child's fundamental right to access education was upheld, they required legal representation to have the matter heard by the Human Rights Tribunal of Ontario. Most of my work in progress ended up being written off and never billed. Without this leniency and deferring my fees until this matter was resolved, which on average can take over a year, this family would not have been able to access justice and defend the legal rights of their autistic child. Compensation in this case was ensuring the child was able to access the education system and did not include a significant monetary settlement. If I have to charge my clients with fees up front, it would be a huge disincentive for families to pursue their legitimate human right cases on behalf of their children.

Employment - Sexual Harassment in Workplace**De-Facto Contingency Fee Arrangement**

My client was a young woman who had been sexually harassed by her supervisor, and when she complained, she was fired. I investigated and confirmed the story through a credible independent witness. I decided to take on the case and deferred payment until a settlement or a court decision was reached. I accumulated a lot of work in progress.

The young woman started receiving intimidating anonymous emails that couldn't be traced. Then the independent witness moved to China and couldn't be located. The client decided to settle her claim for less than it was likely worth, because she couldn't handle the stress. My eventual income was drastically different than the actual work in progress would have indicated and (been subject to tax).

Civil Litigation - Elderly Immigrant Woman Fighting a Difficult Tenant**De-Facto Contingency Fee Arrangement**

My client is an unsophisticated elderly immigrant grandmother who cannot communicate in English. She collects her old age pension and earns money by renting a suite in her home. Her long-time tenant is waging a litigious war against her including a defamation claim, two residential tenancy complaints, a human rights complaint before the BC Human Rights Tribunal and an application before the Court of Appeal.

This senior, of little means – her only real asset being her home – cannot afford to pay me up front or to engage me at my full rate. In representing her through this litigious morass, leniency and flexibility on my part is required and judgment calls must be made throughout on what to bill, when to bill, how much to bill and whether to bill, despite the real costs to my practice. Ultimately, the amount I decide to bill this client will be determined at the end of the process based on the estimated value of the work and not on my actual hourly rate, fees and disbursements. In this case, it's the right thing to do.

As a sole practitioner, if I were required to pay taxes on the work in progress in this matter, it would have a crippling impact on my practice.

Criminal Law**Deferred Payment Arrangement**

The elimination of Billed Based Accounting may have a detrimental impact on access to justice for marginalized individuals charged with criminal offences who rely on legal aid to fund counsel. Currently, a low income individual charged with a criminal offence applies to the provincially funded Legal Aid Plan to issue a certificate. Counsel who accept certificates perform legal defence work for the individuals. This give marginalized individuals access to some of the best defence lawyers in the country, regardless of their ability to pay. Legal Aid pays counsel once all the costs are in, typically at the end of the file, after trial. As trials may take between 12 – 30 months, depending on the matter, counsel may be sitting on work in progress for one to two years. If tax liability were calculated on work in progress, counsel would be forced to pay taxes on funds they might not realize for over a year. This will cause them to stop taking Legal Aid Certificates and low income individuals, whose liberty is at stake, will no longer have access to high quality legal defence.

Criminal Law**Deferred Payment Arrangement, De-Facto Contingency Fee Arrangement**

I do almost all criminal appeals and these are almost all Legal Aid. As a result, I have to wait for most of my accounts to be settled. It is not uncommon for Legal Aid to cut the hours of time allowed for a case and thus cut my bill. You then have to seek discretion. Legal Aid may or may not allow the hours. You cannot tell in advance. Then you have to appeal that decision and it can take more months.

Even if there is the occasional private client, the Court may reserve judgment in a case and it is difficult in practical terms to bill a file when you do not know what the result will be. It may be the result is great and the client will accept the account, or if the result is bad, a discount may need to be given to the client. Either way, you do not know how much your final bill will be, and it is an exercise in theory to evaluate the work in progress as if it was real billable time much less actual money coming in.

My clients include people who are mostly disadvantaged. They are people with mental health issues, people in jail, and those who have had deprived situations. They are often vulnerable members of society.

I am a sole practitioner and as a result have to do everything myself. I am not able to take the wildest guess at how to evaluate my work in progress.