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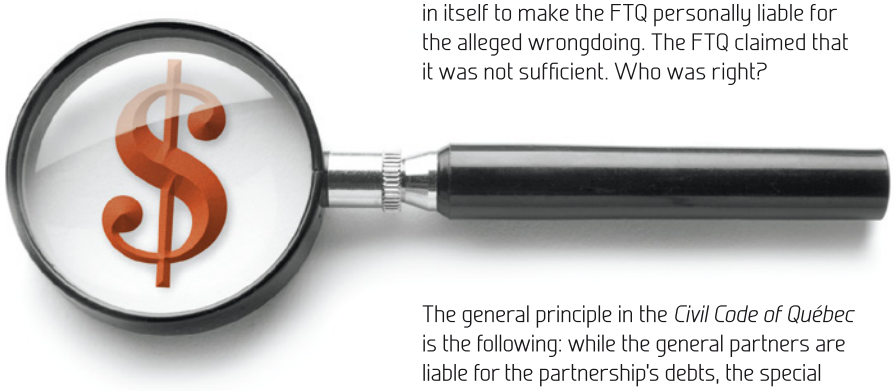
Contents

LIMITED PARTNERS: A CLOSER LOOK AT YOUR LIABILITY

Sarah Talpis-Guillet
stalpisguillet@lavery.ca

A limited partner's participation in the limited partnership is usually confined to one thing: making a financial contribution toward the partnership's development. On the other hand, the general partners manage the partnership's activities and are liable for its debts. This summarizes their respective roles in a nutshell. However, what happens when there seems to be confusion in their roles? Where a limited partner has control over a general partner, does this affect its liability as limited partner?

On July 22, 2010, Justice Jean-François Buffoni of the Superior Court rendered a judgment that considered this issue. In this decision (*Janelle* v. *Fonds de solidarité des travailleurs du Québec [FTQ]*)[1] ("**FTQ**"), the plaintiffs claimed nearly two million dollars in damages from the FTQ, as the limited partner of a limited partnership, for various acts of abuse allegedly committed by the FTQ. According to the plaintiffs, the FTQ's "control" over the general partner should be sufficient in itself to make the FTQ personally liable for the alleged wrongdoing. The FTQ claimed that it was not sufficient. Who was right?



The general principle in the *Civil Code of Québec* is the following: while the general partners are liable for the partnership's debts, the special or limited partners are only bound to the extent of their contribution. Does a limited partner's control over a general partner affect the application of this general principle?

Justice Buffoni noted in his judgment that two authors had already analyzed and expressed their opinions on this issue in the doctrine. According to one theory, where a limited partner exercises control over a general partner (as its *alter ego* for example), this, in and of itself, creates a presumption that it has intruded in the partnership's affairs, which is sufficient to make it liable. Another author, citing article 2244 of the *Civil Code of Québec*, claims that only three actions can make a limited partner personally liable, being when it: 1) negotiates any business on behalf of the partnership, 2) acts as mandatary or agent for the partnership, or 3) allows its name to be used in any act of the partnership.

The court agreed with the second position and held that a limited partner's personal liability can only be incurred in the three specific cases set out in the law, and the mere fact that a limited partner has control over a general partner does not result in its personal liability.

This decision will be reassuring for many limited partners. As there has been relative uncertainty on this issue, many limited partners have attempted to make arrangements to avoid any possible situation of control over a general partner. Such concerns seem less warranted in light of the decision in *Janelle*. Since this case has not been appealed, it remains to be seen whether the Quebec courts will affirm this reasoning in the coming years. ◂

1 J.E. 2010-1445.

VOLUNTARY DISCLOSURE: IS IT STILL A WORTHWHILE OPTION FOR REPENTING TAXPAYERS?

Philip Hazeltine
phazeltine@lavery.ca

For some years now, the voluntary disclosure program ("**VDP**") has been moderately successful with taxpayers. This program gives taxpayers the opportunity to disclose their undeclared income to the Canada Revenue Agency ("**CRA**") rather than risk the imposition of large penalties.

Taxpayers who have taken advantage of the VDP in the past few years have in some cases benefited from a reduction in the tax otherwise payable. Following certain highly publicized events which focused attention on the advantages afforded by the VDP, the CRA decided to make amendments to the program. These amendments resulted in the uniformization of certain administrative policies applicable to the settlements negotiated with taxpayers under the VDP.

One such administrative policy of the CRA and the provincial tax authorities was to apply a combined federal-provincial tax rate of 38% to the amounts repatriated from abroad by a taxpayer. For example, a taxpayer might repatriate the amount of one million dollars from abroad and pay a combined tax of $380,000 on that amount instead of $480,000 (at the maximum marginal tax rate). This policy therefore encouraged taxpayers to declare their offshore income before a tax audit was undertaken.

Since January 1, 2009, this administrative policy has been eliminated for all voluntary disclosure files opened after that date. Since then, the CRA was not following just one generally applicable guideline for the repatriation of offshore funds, and was handling these situations on a case-by-case basis.

At the 2010 conference of the Association de planification fiscale et financière, Mr. Kevin Pratt, Director, Policy, Planning and Disclosure Division of the CRA, discussed the highlights of the policy now applicable to taxpayers wishing to repatriate amounts from abroad.

Mr. Pratt confirmed that the administrative policy of "38%" has been shelved. Henceforth, taxpayers must inform the CRA of the nature of the income earned abroad, the years during which the income was earned, and the country where it was earned. Taxpayers must also provide all the available information and documents relating thereto. In addition, they will no longer be able to include income earned during a so-called statute-barred year in a non-statute-barred year in order to reduce the interest payable on the tax owed to the CRA, although some relief may be obtained in certain situations.

We are waiting for an official document from the CRA and the reaction of Revenue Quebec's representatives to these amendments to the VDP.

As a favourite slogan of the CRA goes: "Come to us, before we go to you!!!" ◂

THE COURT OF APPEAL RECOGNIZES THE RIGHT TO CLAIM LEGAL FEES FROM A DEFAULTING DEBTOR

André Paquette
apaquette@lavery.ca

Many commercial agreements contain clauses stipulating that if a party to the agreement is in breach of its contractual obligations, reasonable professional fees incurred by the other party to enforce the agreement are payable by the defaulting party. Such clauses are found in commercial leases, sales agreements and licences, among others.

In two recent decisions rendered by the Honourable Justice Danièle Mayrand,[1] the Superior Court ruled on the validity of this type of clause in a commercial lease.

In both decisions, the judge dismissed the portion of the claims for professional fees that were borne by the plaintiffs on the ground that the clauses providing for the payment of the fees contravened article 1374 of the *Civil Code of Québec*. This article states that the "prestation" or the party's obligation provided for under the contract must be **determinate or determinable**. The Superior Court, applying the reasoning of the Court of Appeal in *Laferrière* v. *Entretiens Servi-pro inc.*,[2] concluded that a clause of the kind described above is unenforceable because the amount of the object of the clause, i.e. the professional fees, is vague and unascertainable. Indeed, the court concluded that the clause did not provide for a specified penalty, and that the calculation thereof depended entirely on a third party, namely the plaintiff's lawyer.

According to these two decisions, a clause providing for the payment of professional fees in addition to other amounts payable under the agreement, was not available to protect a party against the financial risk represented by the cost of professional fees generated by a lawsuit unless the amount of such fees is determined in the agreement, or the agreement provides for a sufficiently accurate means of calculation thereof.

On the basis of these decisions, it would have appeared advisable, particularly for businesses that regularly enter into agreements in the ordinary course, to review the clauses providing for the recovery of professional fees so as to ensure they had an effective contractual strategy for alleviating the burden that constitutes the costs of a lawsuit based on the agreement.

This won't be necessary! In a decision rendered last November 2,[3] the Court of Appeal, after reviewing the case law and doctrine on the issue (except for the two decisions of the Superior Court referred to above, which were rendered after the hearing of the case before the Court of Appeal), clearly recognized the legality of a clause stipulating that a tenant is bound to pay the legal costs incurred by the landlord to enforce the provisions, conditions and obligations of the lease.

Indeed, according to the appeal court's judgment, the general validity of these clauses shall now be recognized, at least in the case of a contract by mutual agreement.

However, the Court of Appeal made a point to specify that contractual clauses of this kind must be applied in a reasonable manner, subject to the court's control and taking the circumstances of the case into account, and went as far as adding that only reasonable fees and disbursements that are not excessive or improper may be claimed. ◂

1 *Trac Lease Inc. v. Borex inc.*, 2010 QCCS 1276; *Granrive Development Inc.* v. *Chocolate Gourmet Treats Ltd.*, 2010 QCCS 3366.

2 2005 QCCA 1218.

3 *Groupe Van Houtte inc. (A.L. Van Houtte ltée)* v. *Développements industriels et commerciaux de Montréal inc.*, 2010 QCCA 1970.

THE SUPERIOR COURT'S DECISION IN *CHAMBRE DES NOTAIRES DU QUÉBEC v. CANADA (PROCUREUR GÉNÉRAL)*

Loïc Berdnikoff
lberdnikoff@lavery.ca

On September 8, 2010, the Superior Court decided that the provisions used by the Canada Revenue Agency ("**CRA**") under sections 231.2, 231.7 and subsection 232 (1), paragraph 5 of the *Income Tax Act*, R.S.C 1985, c. 1 (5th Supp.) ("**ITA**") to force lawyers and notaries to disclose documents of information, were unconstitutional.

Justice Marc-André Blanchard first confirmed that a notary, as a legal adviser, has the same duties and obligations to uphold professional secrecy as a lawyer.

Regarding the scope of professional secrecy, he concluded that:

- the right to professional secrecy exists in civil law and in criminal law;
- no distinction exists between a fact and a communication;
- the burden of proving whether or not documents or information sought are protected by professional secrecy belongs to the person challenging its application;
- it is solely in exceptional cases and as a last recourse that a breach of professional secrecy will be permitted;
- legislative frameworks must ensure that professional secrecy is respected;
- any legislation likely to authorize a breach of professional secrecy must be interpreted restrictively;
- professional secrecy applies to all the facts brought to the attention of the legal advisor and to all documents and information held by him, such as wills, offers to purchase, marriage contracts, statements of account for fees and costs and all trust accounting documents of the legal advisor.

Furthermore, relying mainly on the teachings of the Supreme Court in the *Lavallée* case, Justice Blanchard concluded that the implementation of sections 231.2 and 231.7, and the exception contained in subsection 232(1), paragraph 5 of the ITA, reaches beyond what is absolutely necessary and does not guarantee that the holder of the right to professional secrecy will have a reasonable opportunity to object to preserve the confidentiality of the documents or information sought.

Consequently, the Superior Court granted the motion of the Chambre des notaires and declared sections 231.2, 231.7 and subsection 232(1), paragraph 5 of the ITA to be unconstitutional and of no force and effect, adding that his conclusions must extend to all notaries and lawyers in the Province of Québec.

What are the consequences of this judgment?

Since it was rendered last September 8, this decision would normally have prevented the CRA from requiring a notary or lawyer to produce documents or information in his or her possession if protected by professional secrecy. If the CRA required access to such documents or information, it would have to enact a new legislative framework.

However, on October 7, 2010, the Attorney General of Canada and the CRA filed a motion to appeal this decision before the Québec Court of Appeal, which had the practical effect of staying the execution of the judgment. We can therefore expect further developments in this file.

This said, it is of interest to note that similar proceedings were also brought against the Attorney General of Québec and the ministère du Revenu du Québec ("**Revenu Québec**") regarding analogous provisions in the *Act respecting the ministère du Revenu*, R.S.Q. c. M-31, and the *Act to facilitate the payment of support*, L.R.Q. c. P-2.2. This motion, however, was settled and an agreement between both parties was ratified by the Superior Court setting out a specific procedure that must be followed when Revenu Québec wishes to obtain documents or information from a lawyer or notary that may be protected by professional secrecy. ◄

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CONTACTS

MONTREAL – 1 Place Ville Marie
514 871-1522

QUEBEC CITY – 925 Grande Allée Ouest
418 688-5000

OTTAWA – 360 Albert Street
613 594-4936

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