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Lawyer not liable for client's tax liability on employment debt forgiveness *(Waters v. Furlong)*

By James R.G. Cook

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In *Waters v Furlong*, [2023 ONSC 3908 (CanLII)](), the plaintiff was a certified public accountant (CPA) who had worked as the Chief Financial Officer for a company for approximately 11 years. In 2012, he was having personal financial difficulties, which he discussed with the company's owner and president, who agreed to loan him $125,000 as a demand loan with a low interest rate.

In January 2016, the plaintiff was called into the owner's office and presented with a termination letter and a "Release and Indemnity" agreement. The termination letter stated due to circumstances that had recently come to its attention, the company had concluded that it was no longer in its best interest to continue the plaintiff's employment relationship.

The letter offered to forgive the plaintiff's outstanding indebtedness and any requirement to reimburse the company for any "improper expenses" put through the company for the plaintiff's personal benefit in exchange for the executed Release and Indemnity.

The Release and Indemnity released the company from all claims that the plaintiff may have against it but stated that it did not apply to the failure or the refusal of the company to comply with the terms of settlement.

The plaintiff arranged to see the defendant lawyer, who had acted for him on several real estate transactions in the past. The lawyer practiced corporate, commercial, land development, real estate, estates and some wrongful dismissal. He did not practice in the areas of tax law or litigation and was not an expert in employment law.

The plaintiff showed the lawyer the termination letter and the Release and Indemnity documents. They had a short meeting of 15 to 20 minutes. There was no written or monetary retainer.

Following the meeting, the plaintiff called the company's owner and requested that he amend the settlement documents to put specific amounts in the letter, both grossed up to include the tax amount and personal expenses.

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He further requested a letter stating that the severance amount would be two months. However, the company refused and there was no discussion about paying taxes on the loan forgiveness. The plaintiff signed the Release and Indemnity.

By April 2016, the plaintiff was able to secure employment at another company, with a higher salary than he had previously received.

In October 2017, the plaintiff received a notice of assessment from the Canada Revenue Agency (CRA) indicating that he had not declared all of his income received from his former employer in 2016. The CRA assessed additional income tax owing of $69,786.61 arising from the loan forgiveness.

He then sued the lawyer for providing negligent advice. At trial, he argued that he went to the meeting with the lawyer concerned about tax liability and that the lawyer never told him about the potential liability with respect to the loan forgiveness. While he conceded that he knew, as a result of his own training as a CPA, that if an employer forgave a debt to an employee, this was a taxable event for the employee, he claimed that he would not have signed the Release and Indemnity had he known that he would be responsible for taxes rather than his former employer.

The lawyer confirmed that he met with the plaintiff for 15 to 20 minutes at his law offices in January 2016. However, he was not able to locate notes or a file and did not believe he opened a file. There was no written or monetary retainer and no account was issued.

The lawyer recalled seeing the termination letter but he was not shown the promissory note or any other loan documentation. The plaintiff's concern was to ensure that he did not have to repay his indebtedness following his termination. He was not interested in a wrongful dismissal suit. The lawyer asked about the cause of the dismissal but received only a vague and evasive response.

While the indebtedness was from a loan, the lawyer said that he could not get any specific information from the plaintiff regarding "improper expenses put through the company for your personal benefit". He felt as though the plaintiff was withholding information from him.

In regards to the indebtedness to the company, he told the plaintiff that forgiveness of indebtedness in an employment situation creates a tax liability. The plaintiff indicated that he was aware of that since he was an accountant. The plaintiff did not come to him for tax advice.

The lawyer advised that there was nothing in the documents given to him that obligated the employer to pay the taxes. He did not indicate that the employer would pay the taxes because it was clear on the face of the documents, clear to any lawyer, clear to any accountant and clear to anybody who read it that there was nothing about the employer paying the taxes in the termination letter.

The lawyer said that he offered to call or contact the employer to try to get the document revised but, to his surprise, the plaintiff said no, that he did not want him to.

The plaintiff alleged, among other things, that the lawyer failed to ensure his advice was correct, properly communicated, and understood by his client. The plaintiff's position was that the lawyer had breached a duty to take reasonable care to avoid and/or minimize all risks of harm to him.

The trial judge noted that while it is undoubtedly good practice to open a file, take notes and send follow-up communication to a client, a failure to

do so does not constitute negligence or breach the standard of care. Rather, the question of whether a lawyer has met the standard of care is a factual determination based on what the lawyer was requested to do and what the lawyer did: *614128 Ontario Ltd. v. Bianchi*, 2016 ONSC 2450, at paragraph 83.

In the case at hand, the court was satisfied that the lawyer was asked whether the termination letter and documentation were sufficient to expunge the plaintiff's indebtedness to his employer, whatever that amount actually was.

In the court's view, the lawyer properly and fully responded to the question asked, namely that the wording in termination letter was sufficient to expunge the indebtedness. The lawyer communicated his advice to the plaintiff such that the plaintiff, his client, properly understood that advice and that he took reasonable care to avoid or minimize all risks of harm to the plaintiff by, *inter alia*, suggesting that he contact the employer to amend the termination letter or write another letter specifying the specific amounts of indebtedness that would be forgiven. The plaintiff did not ask him to do so. There was no evidence that a better deal could have been negotiated.

Further, the lawyer'sreasons for that advice were sufficiently clear so that the plaintiff could make an informed decision, which he did. The trial judge was satisfied that the lawyer went beyond the advice sought to indicate that the loans being forgiven would be treated by the CRA as taxable benefits, payable by the employee. The plaintiff himself indicated that he understood that as a CPA.

The plaintiff did not establish that his former employer would have agreed to pay any taxes arising from the forgiven indebtedness. As a result, he cannot be compensated for any taxes which he had to pay, as there was no agreement or contract with the former employer as to payment of the taxes.

The plaintiff argued that had he been told that he would have to pay taxes on forgiven indebtedness he would never have signed the Release and Indemnity. However, the court noted that in professional negligence actions, a client's assertion that he or she would have acted differently had they received proper advice should be viewed with skepticism. These types of assertions should be assessed warily and with great caution as such hindsight is opinion, not fact: *Pilotte v. Gilbert*, 2016 ONSC 494, at paragraphs 341-343; *Lenz v. Broadhurst Main*, 2004 CanLII 5059 (ON SC), at paragraphs 102-103, 107, affirmed 2005 CanLII 33123 (ON CA).

Lastly, the plaintiff did not establish that he had lost an opportunity to sue his former employer had he chosen to do so since the release did not apply to a failure or refusal of the company to comply with the terms of settlement as agreed upon. Had he been able to prove that the company had agreed to pay the tax, which he did not, then he would not have been barred from suing them. However, he never sued his former employer for breach of the agreement or for wrongful dismissal. He only sued the defendant lawyer.

In the result, the court concluded that the plaintiff failed to prove his allegations of breach of standard of care and breach of contract against the lawyer and the action was dismissed.

Contact us

If you have a litigation matter and are in need of legal advice, please do not hesitate to contact James Cook, at 416.865.6628 or jcook@grllp.com.

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