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Tax Planning for Legal Professionals

As a professional, you encounter many wealth management issues on a regular basis. One such issue that is frequently overlooked, however, is tax planning. For most professionals, a strategic tax plan can translate into many opportunities to minimize taxes and maximize wealth.

Tax planning is a process. As with any process, there are steps to be taken. An effective tax planning strategy begins with a comprehensive overview of your financial circumstances and goals. Once implemented, it requires regular review to ensure it continues to meet those goals. Long-term advance planning is essential -- "parachute" planning is simply not good enough.

Your complete tax plan should meet five objectives:

1. **Save Taxes Now**

Maximizing deductions and paying of non-deductible expenses

Obviously, you don't want to pay any more tax than is absolutely necessary. It may be possible to restructure your loans to ensure that they are deductible for tax purposes. Some of your other expenditures may also be deductible from your taxable income, including health expenses, some automobile expenses and a portion of home office expenses. And while some other expenses incurred for business purposes may not be tax-deductible (e.g. life insurance premiums, 50% of meals), it may be much more economical to pay those expenses with corpo-

rate dollars rather than personal dollars.

The Benefits of Incorporating

If you have not yet incorporated, a Professional Corporation may prove to be very useful. Many professionals are turning to Professional Corporations as a means of tax deferral. As a corporation, you can take advantage of the small business deduction allowing net income below \$400,000 that is earned and retained in your Professional Corporation to be taxed at approximately 19%*, rather than the potential 47%* if earned outside a corporation. This deferral can amount to significant tax savings.

A Professional Corporation may also permit the integration of other useful strategies such as:

Individual Pension Plan (IPP)

An IPP is a pension plan that is designed to be a replacement for your RRSP. It may permit annual contributions by a Professional Corporation to the pension plan that are substantially in excess of normal RRSP limits. In turn, a larger pool of funds will be available on retirement.

Retirement Compensation Arrangement (RCA)

An RCA can reduce overall taxation by allowing your corporation to make tax-deductible contributions to a "retirement fund." A refundable 50% tax is paid. With proper planning, the tax that you will pay on

the amounts eventually withdrawn will be less than what you would normally have paid.

Private Health Service Plan (PHSP)

A PHSP is an arrangement that will pay your and your family's medical expenses with deductible pre-tax dollars. A PHSP is meant to be in addition to your regular health insurance. All medical expenses paid by the PHSP will be deductible by your Professional Corporation with no income inclusion to you. As well, with a Professional Corporation, you don't need a third party payer and the associated fee of 10% to 20%.

Income Splitting

Although family members and family trusts may not hold shares in a lawyer's Professional Corporation in Ontario, it remains possible to develop an income splitting strategy through the use of loans to family members by the Professional Corporation. This objective can be accomplished through the use of management service entities and other creative techniques.

2. Ensure an Efficient Disposition or Utilization of Assets

It is important to ensure that any disposition, or sale, of your professional practice is done efficiently. It may be possible to dispose of your practice and take advantage of the \$750,000** capital gains exemption. Generally, a Professional Corporation will meet the necessary requirements for this exemption, if care is taken to ensure they are met.



3. Provide a Useful Structure for a Surviving Spouse

On the death of a spouse, the surviving spouse's income will likely increase, which may cause substantial taxation at the top marginal rates and perhaps reduce one's Old Age Security. Testamentary trusts for the benefit of the surviving spouse and family may allow income to be taxed at lower rates.

4. Reduce Tax on the Death of the Last Spouse

There are many ways to minimize the tax payable on death for company shares and other capital property (i.e. cottage) that have increased in value. This may reduce significantly the ultimate tax liability on these assets for your children or grandchildren.

5. Provide an Efficient Structure for the Ultimate Heirs

The tax situation of your ultimate heirs must be considered. Testamentary trusts may be appropriate to permit the income resulting from an inheritance that has been received as a result of your death to be taxed in an efficient manner. This could result in potential savings of \$10,000 per year, per trust. Furthermore, in situations where one of your heirs is or becomes dependent by reason of physical or mental impairment, special issues must be addressed to ensure that government benefits are not compromised, and other tax advantages are obtained. Finally, consider any future inheritance you expect to receive from your parents or other family members. It may be possible to structure their wills to provide for one or more testamentary trusts, creating an efficient structure to benefit you and your family on an ongoing basis.

Professionals face many unique tax planning issues. The discussion above is just a starting point for a complete strategy. That strategy may include the use of a Professional Corporation. A Collins Barrow advisor can help you understand these issues and implement the strategies that are right for you.

* Tax rates cited are applicable to Ontario

** Although it is not yet law, the \$500,000 capital gains exemption is slated to go up \$750,000.

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The Management Imperative

A leader can be forgiven for doing the wrong thing on occasion. But what about failing to manage at all? In a corporate setting, this would be perceived as abdication and likely result in dismissal. In many law firms, however, leaders are excused from their management responsibilities. They simply have to mention the important legal work they are doing for a significant client and they can miss meetings and fail to follow through on almost any management initiative. Even in enlightened firms where the managing partner has minimal or no client responsibilities, the practice group leaders and department heads usually continue to carry major client loads and therefore fall prey to the same syndrome.

So the summary goes like this: in most law firms the CEO (Managing Partner) spends too much time on the shop floor making the widgets, not fulfilling a leadership role. In those firms where the CEO actually does lead, the question is, "leading whom?" Even if the CEO isn't consumed with the making of widgets then you can bet the VPs are (VPs in this case being the practice and industry group leaders and perhaps department heads).

A partnership cannot appreciate the cost of the absence of *de facto* management until it understands what effective management can (and should) achieve.

At the highest level of abstraction, management is about getting peak performance from people who are harmoniously striving to achieve personal and firm-enhancing objectives. In a managed firm, individuals are understood so well that their leader finds synergy between personal aspirations and firm success and manages people accordingly. This is no different from what symphony orchestra conductors or sport team coaches do.

Management creates a learning culture where knowledge is not fragmented and lost but organized and harnessed.

Synergistic teams are assembled to attract ever-better work and to enhance the quality and value of the service offerings. Management ensures that the firm is healthy enough to compensate individuals adequately and, beyond that, create an environment that fosters appreciation and respect. Management encourages innovation that yields more effective and efficient practices.

Why, then, do we tolerate the absence of meaningful management in most law firms? Because ...

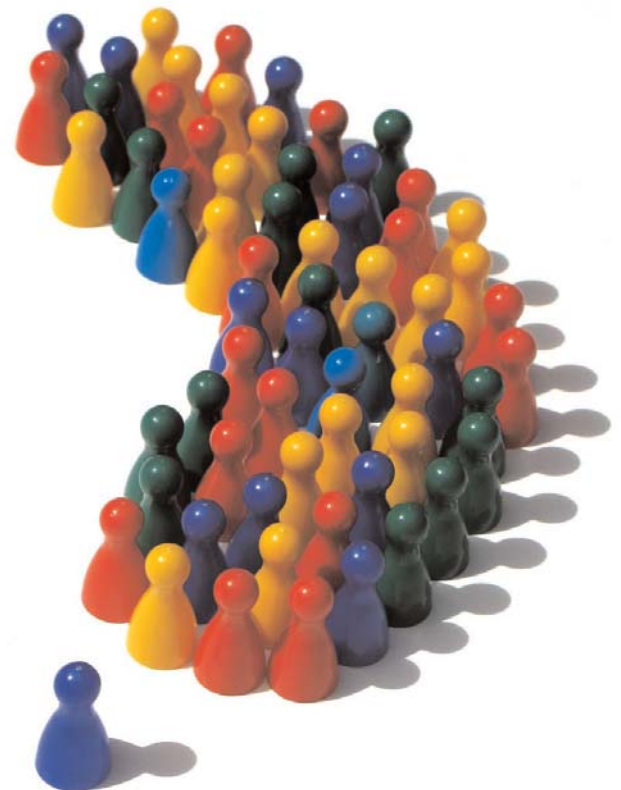
- Legal work is perceived as being more important than management;
- There is a fear that management is an excuse to pro-

duce less;

- Lawyers are ferociously independent and resist being managed;
- Critical and analytical thinking negates most progressive ideas; and
- There is no time to execute the ideas that survive the debates.

Then what might a firm do to ensure that it is managed effectively? Here is the beginning of a checklist for your consideration:

- For large firms, ensure that the managing partner has *no client responsibilities*;
- For smaller firms, or where the managing partner is concerned about returning to active practice after serving, legislate that the managing partner's client activities be limited to an appropriate, pre-determined level;
- Create minimum, management-focused, non-billable hour targets for practice group leaders and industry group leaders (absolute minimum 300 hours per year).



The allocation of time for management is necessary but not sufficient. The operative ingredient is the willingness of the managing partner to actually manage and this means setting objectives against which performance can be measured. The managing partner must *manage the managers*. Indicia that the managing partner is actually managing include the following:

- Getting to know the practice group and industry group leaders in terms of their personal aspirations as well as their views about the firm's potential and how their respective groups might contribute;
- Interactively setting customized objectives with practice group and industry group leaders for their respective groups;
- Agreeing on sensible expectations of each practice group and industry group leader in terms of the difference they will make to the group each leads;
- Meeting informally with practice group and industry group leaders to ask how they are progressing, to provide ideas and to offer help;
- Ensure that leaders are delegating to members of their respective groups and/or to support professionals in the firm so that the progress of the group is not limited to the time resources of the leader -- also to ensure that the leaders delegate matters where they lack personal aptitude or desire. For example, some leaders are reluctant to coach their individuals but

have others in their groups who are well suited to the task;

- Replace practice group and industry group leaders who fail to perform (or worse, who passively sabotage firm efforts).

Effective management is highly customized. At a minimum, each group should improve service offerings, create learning environments, become more efficient, attract better work, attract good people and lower turnover. However, true management requires a primary focus on one or two of these. For example, a highly proficient practice group may focus on attracting better clients while a group serving premium clients may focus on enhancing client satisfaction to protect them from competitors.

Managing partners, therefore, need to let go of the idea that management is a symmetrical matrix. Like children in the family, each group is unique and requires appropriate primary objectives and highly customized encouragement.

In an increasingly competitive world, the partnerships that tolerate the absence of effective management will pay the price... maybe a worthy topic for an upcoming partnership meeting.

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Charitable Contributions: Get Some Bang for Your Buck

Some firms make charitable contributions solely because they believe in giving back to the community. If this is the case with your firm, take charitable contributions out of the business development budget. However, if your contributions are intended to generate return -- including visibility in the community, improved client relationships, and new business development -- then you should define some criteria for this budget item.

Determine which charities warrant contributions based on such factors as the number of firm lawyers involved in the cause, the level of lawyer involvement, the level of client involvement, and the amount or type of recognition the firm receives for its contribution.

Define policies for charitable contributions, such as requiring that lawyers requesting funds for charitable contribution explain the value and benefits of the contribution. For events such as purchasing a table at an event, lawyers should be required to identify which clients, prospects, and lawyers will be attending the event, and the benefit of inviting these individuals. Consider selecting a single charitable organization to which the firm could make a major contribution. Use the contribution and the firm's involvement in the organization to increase the firm's visibility in the community.

For more helpful marketing tips from Jay Jaffe, visit the Jaffe Associates Marketing Tip Library at <http://www.jaffeassociates.com/Jaffe/MarketingTips.php>



TECH Central

Are you overwhelmed by the volume of messages in your e-mail inbox? Are you spending more time managing your e-mail than actually working? You're not alone. With many lawyers and professionals receiving 100 or more work-related messages per day, it can be easy to drown in that electronic sea. But there are ways to help manage the e-mail monster. Here are some quick tips for you and your firm:

- Deal aggressively and immediately with your e-mail. Reply quickly while the item is fresh in your mind. Replying later requires you to read and consider the message twice.
- Delete junk mail and messages you have dealt with promptly. Don't use your inbox for long-term storage. Set up appropriately labeled folders for storing messages. This will help reduce that helpless feeling you get when opening a bloated inbox.
- Check your e-mail only at defined times throughout the day. Don't be a slave to the "new message" icon.
- Beware the "reply to all" button! Consider the recipient list *carefully* and ask yourself, "do *all* of those people really want/need to receive my reply?"
- Use up-to-date and customizable spam filters and "block sender" features.
- Make good use of the "message subject" line. Summarize your message topic *clearly* to help the recipient identify and manage your message.
- Keep it short. In most cases, a few concise sentences are all you, and your recipient, need. Few people will actually read an entire message if they have to scroll their screen to do so.
- Establish a clear e-mail policy in your office. And don't be afraid to let a friend or co-worker know (politely) if he or she is contributing to the overload problem with excessive or inappropriate messages.

These are just some preliminary tips. Look for a more detailed article dealing with e-mail etiquette and management in a future issue of *Lawyers Alert*.

The Value of an Apology

Making an apology has never been an easy thing to do, whether it is in business, politics, a courtroom, or in our personal lives. But recently, the government of British Columbia joined a growing list of jurisdictions worldwide in making it a little easier to apologize. In 2006, the B.C. *Apology Act* (S.B.C. 2006, c.19) was enacted, effectively removing the legal consequences for apologizing, or saying "I'm sorry," in connection with an event.

Specifically, the Act provides that an apology or other expression of sympathy or regret does not constitute an admission of fault or liability, and is not admissible in any court as evidence

of fault or liability. It further provides that such an apology will not void or otherwise affect negatively any insurance coverage.

The Act arose in response to a growing trend in Canada, the United States and other nations to encourage businesses and individuals to acknowledge when they have done harm to others, and thereby to promote the resolution of disputes. The hope is that apology laws will help reduce the number and duration of lawsuits, thereby easing court backlogs and saving time and money for businesses and individuals.



Historically, our responses to business, tort or criminal conflicts have most often been adversarial, driven by the desire to protect ourselves from liability. Lawyers counsel their clients to refrain from making any acknowledgment of fault or liability, often going so far as to restrict even expressions of regret or sympathy. The insurance context is no different, with insurers advising motorists never to admit fault after an accident. Some policies even purport to deny coverage outright where the insured makes any acknowledgment of fault or liability. Businesses often throw up a wall of red tape in front of customers trying to complain of faulty products or poor service. The fear has always been that an apology in these circumstances would be used against the apology-maker.

The result of this philosophy towards fault is that many disputes end up in litigation where an honest and open apology might otherwise have resolved the issue much more quickly and economically. In many cases, people who feel they have been wronged by someone else simply want an acknowledgment of the wrong and an expression of apology or regret from that other person. Every lawyer has had at least one case in which the client refused an otherwise fair financial settlement because "it's not about the money - it's the principle!" In most cases, such clients are simply looking for an acknowledgment of the wrong, either from the other party or from a court. Often a simple, yet sincere, apology at any time in the process will provide the satisfaction sought.

Apology legislation holds the hope that apologies will be more readily available by eliminating the fear that an apology will be used against the apology-maker in future legal proceedings. Studies and anecdotal evidence from jurisdictions that have implemented apology legislation show positive results, with reduced litigation, reduced court backlogs, and higher consumer satisfaction in the commercial context.

The trend is growing. The Saskatchewan Legislature is considering similar legislation that would take the form of an amend-

ment to its *Evidence Act*. Nearly half of the U.S. states have some form of apology legislation in effect. Governments, corporations and institutions across North America have begun taking a more pro-active stance toward acknowledging fault and issuing apologies.

Consider the Canadian Government's recent public apology to Maher Arar, with the accompanying multi-million dollar settlement of his claim. Arar himself made it clear that the apology, not the money, was his primary motivation. And many legal analysts speculate that, without the apology, Arar might have pursued -- and would likely have obtained -- a much higher settlement. Many U.S.-based airlines have begun issuing personal, written apologies to customers inconvenienced by delays, poor service and other contingencies. Even A-list celebrities like Mel Gibson have begun making public admissions and apologies for improper behaviour as part of their personal and public-image rehabilitations.

One criticism of apology legislation is the concern that making an apology might become *too easy*, resulting in standardized, form-letter apologies issued as a matter of course. Such insincere apologies would lose the positive impacts discussed above, and might ultimately result in greater irritation to the recipient. The long-term effects cannot yet be determined. Further, the B.C. *Apology Act* has yet to be examined or tested by the courts. Future judicial analysis might provide some more interesting fodder for discussion.

An apology alone won't necessarily resolve every problem. But it can be a critical step in reducing animosity between parties in conflict. Can an apology help most disputes? Yes. And now, in British Columbia at least, it can't hurt.

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