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Rectification in Canada post-*Fairmont*

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Rectification has an uneven history as a means to avoid unintended tax consequences. Prior to the Ontario courts' decision in *Juliar*, there was generally thought to be little room for equitable remedies in tax disputes. *Juliar* expanded rectification's utility in tax matters by allowing a taxpayer to retroactively convert a share-for-promissory note transaction into a share-for-share transaction to avoid an unintended tax consequence. The Supreme Court of Canada denied the Crown's application for leave to appeal *Juliar* in 2001, and *Juliar's* reasoning was adopted by courts across the country. It took nearly fifteen years for a common-law rectification case to reach the Supreme Court again.

In its 2016 decisions in *Canada (Attorney General) v Fairmont Hotels Inc.*, and *Jean Coutu Group (PJC) Inc. v Canada (Attorney General)*, the Supreme Court of Canada overruled *Juliar* and limited the availability of rectification. The Court confirmed that rectification only corrects errors in transcribing an agreement to writing - it does not correct or remake agreements that produce unintended consequences. The Court also expanded on the policy concerns surrounding the use of equitable remedies to rewrite fiscal history. Many first thought that *Fairmont* and *Jean Coutu*, by restricting the scope of the remedy, had effectively neutered rectification as a means of avoiding unintended tax consequences across Canada. Have these views proved prescient? Let us review some of decisions and take an early glimpse at the post-*Fairmont* landscape across Canada:

Alberta

In *Harvest Operations Corp. v Attorney General of Canada*, a predecessor corporation of the applicant (Viking) had incorporated a new subsidiary (Acquireco) to purchase the shares of a target company (Targetco) in a tax- neutral manner, relying on the bump rules in paragraph 88(1)(d) of the *Income Tax Act*. As the closing approached, a Targetco creditor demanded that Targetco clear its indebtedness before it would consent to the change of control. Viking immediately caused an affiliated trust to loan $35,000,000 to Targetco for this purpose, but this loan impacted the applicability of the bump rules and produced adverse tax consequences.

An originating application was filed at the Court of Queen's Bench of Alberta (ABQB) to rectify several instruments so that the affiliated trust would loan $35,000,000 to Acquireco, which would then subscribe for $35,000,000 of newly issued Targetco shares. Relying on a pre-*Fairmont* ABQB decision that questioned the correctness of *Juliar*, the ABQB dismissed the application. The ABQB held that there was no evidence that parties intended Acquireco to subscribe for $35,000,000 of Targetco shares and that, in any event, an intention for "tax neutrality" on its own was insufficient to obtain relief.

The applicant's appeal reached the Alberta Court of Appeal (ABCA) after the Supreme Court released its judgement in *Fairmont*. The ABCA recognized *Fairmont* as the leading authority, and dismissed the appeal on the basis that the instruments the applicant sought to rectify actually reflected the true agreement of the parties. The Court confirmed that the primary focus of a rectification application is the method(s) by which the parties sought to achieve tax neutrality, not the goal of tax neutrality itself. The ABCA also rejected what it called the applicant's "Hail Mary" request that it simply exercise its equitable jurisdiction to relieve against mistake. In this regard, the Court held that to do so would "pump theoretical steroids" into the rectification doctrine and run afoul of the Supreme Court's decision in *Fairmont*.

Ontario

There have been two significant decisions from Ontario courts post-*Fairmont*, *Canada Life Insurance Company of Canada v Canada (Attorney General)* and *TechnoComm Solutions Inc. v Canada (Attorney General)*.

In *Canada Life*, the taxpayer carried out a series of transactions in December 2007 in order to realize a tax loss to offset unrealized foreign exchange gains. Due to erroneous advice from its tax advisor, the series of transactions failed to produce the loss, which the CRA denied after an audit. Canada Life sought rectification to cancel the transactions it undertook and replace them with new transactions that, it argued, would create the tax loss it always intended to create. Before the Supreme Court released its decision in *Fairmont*, the Ontario Superior Court of Justice (ONSC) allowed the application based on *Juliar*, noting that Canada Life's intention to create a tax loss was undisputed.

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The Crown's appeal reached the Ontario Court of Appeal (OCA) after the Supreme Court's judgment in *Fairmont* was released. At the OCA, Canada Life conceded it was no longer entitled to rectification, but argued instead that it could substitute new transactions for the original transactions based on the OCA's equitable jurisdiction to relieve against mistakes, or based on the equitable remedy of rescission.

The OCA rejected both positions based on *Fairmont*. The OCA held that the Supreme Court had done two things in *Fairmont:* (i) it overruled *Juliar's* approach to rectification, whereby taxpayers could retroactively unwind and replace corporate transactions, rather than simply correct errors in written instruments; and, (ii) it affirmed the policy concerns identified by the OCA in its earlier decision in *Bramco* - that altering corporate transactions retroactively to achieve more favourable tax treatment was impermissible. The OCA interpreted "retroactive tax planning" broadly, finding that it includes attempts to retroactively change transactions to produce the intended tax consequences, along with attempts to obtain more favourable tax treatment than originally intended. The OCA also rejected Canada Life's argument that regardless of whether it called the remedy it sought "rectification", the Court retained its ability to grant relief based on its equitable jurisdiction to relieve against mistakes. The OCA recognized this argument for what it was - an attempt to obtain the same relief by another name, thus avoiding *Fairmont* - and rejected it.

In *TechnoComm*, the applicant claimed it erroneously recorded payments made to its sole shareholder as loans, rather than as tax-free returns of capital. The applicant sought to rectify its records by retroactively declaring a dividend, grinding the paid-up capital of the shareholder's shares, and crediting the difference to the shareholder loan account. The ONSC strictly applied *Fairmont's* conclusion that rectification was predicated on the existence of a prior agreement that was erroneously reduced to writing. The Court held that while an agreement between the shareholder and the applicant corporation evidenced an intention to create the preconditions to declare a tax-free dividend, the agreement did not prove there was a specific intention on the part of the company to declare a tax-free dividend. On that basis, the application was dismissed.

British Columbia

As in Ontario, there have been two noteworthy decisions from BC courts post-*Fairmont*, *5551928 Manitoba Ltd. (Re)* and *Crean v Canada (Attorney General)*.

In *5551928 Manitoba Ltd.*, the petitioner declared an excessive capital dividend after its accountants incorrectly calculated the balance of its capital dividend account. The petitioner sought to rectify the resolution declaring the dividend to reduce the dividend to the actual balance of its capital dividend account. The Crown opposed the petition for rectification (but would have consented had the petition sought to simply rescind the resolution) on the basis that the corporation's directors had agreed to declare a dividend of the specific figure their accountants had advised. The BC Supreme Court (BCSC) rejected the Crown's position. It found, based on the language of the resolution and the affidavit evidence of the directors and the accountants, that the true agreement was to declare a capital dividend up to the balance of the capital dividend account and that this agreement was definite and ascertainable. The Court noted that it was not being asked to wholly rewrite or unwind a complex series of corporate transactions and thus none of the policy considerations raised by the Supreme Court in *Fairmont* applied. I understand the Crown has appealed this decision to the BC Court of Appeal.

In *Crean v Canada (Attorney General)*, two brothers each owned half the shares of a holding company (Holdco). When one of the brothers (Tom) wished to retire, the brothers entered into an Agreement in Principle, which provided that the other brother (Mike) would purchase Tom's interests, and that the transaction would be structured so that Tom received capital gains treatment for tax purposes. The brothers sought external advice on how to accomplish this. Their advisor's plan, which the brothers implemented, was for Mike to roll his interest in Holdco into a Newco, which would then purchase Tom's Holdco

shares for a promissory note. This resulted in a deemed dividend for Tom pursuant to subsection 84.1(1) of the *Income Tax Act*, rather than the intended capital gains treatment. The petitioners asked the BC Supreme Court to rectify their Share Purchase Agreement to reflect a direct sale from Tom to Mike, and to rectify the promissory note so it identified Mike, rather than Newco, as the issuer. The Crown opposed the petition based on *Fairmont*.

The BCSC granted the petition. It found that the true agreement between the brothers was for a direct sale between Tom and Mike such that Tom would receive capital gains treatment, as described in the Agreement in Principle. The Court accepted the advisor's evidence that the brothers wanted a direct sale, and that he made mistakes in reducing that agreement to writing. The Court also accepted that this prior agreement remained in effect, notwithstanding that the brothers executed legal instruments that implemented a different plan, because Tom and Mike were not legally experienced and simply assumed their advisors had drafted the instruments directly. The Court briefly touched on the policy concerns identified by the Supreme Court (though it referred repeatedly to *Jean Coutu*, rather than *Fairmont*), but held they were not engaged in this case because, in the Court's view, "rectifying" the transactions would not offend the intention behind subsection 84.1(1) of the *Income Tax Act*.

Early conclusions from post-Fairmont decisions

Taken cumulatively, the decisions confirm that *Fairmont* has changed the game. The search for prior agreements with definite and ascertainable terms has replaced the hand wringing about how specific a tax intention is required. The focus in each of the decisions has been on what the taxpayer/applicant/petitioner actually agreed to do, rather than on what they "would have done", had they been better informed.

However, taken individually, the decisions suggest a divergence in approach across different jurisdictions. It was already difficult to obtain rectification in Alberta, where even pre-*Fairmont* the Court of Queen's Bench was questioning the correctness of *Juliar*. In Ontario, the *Canada Life* decision's emphasis on the Supreme Court's policy concerns suggests that a restrictive approach may take hold. Additionally, both the Alberta and Ontario Courts of Appeal quickly rejected the idea that they may continue to grant relief based on a broad equitable jurisdiction to relieve against mistake.

In contrast, the early returns from the BC courts are more encouraging for taxpayers. There, the courts have grappled with what a prior agreement with definite and ascertainable terms means. In my view, the BCSC reached the correct result in *5551928 Manitoba*, where it seemed obvious that the true agreement was to declare the maximum possible tax-free capital dividend. I will be interested to read the BCCA's decision on the appeal. So far, *Crean* appears to be the outlier. The facts in *Crean* and the remedy obtained are very similar to those in *Juliar*. I find the result in *Crean* very difficult to reconcile with the policy statements made by the Supreme Court in *Fairmont* and adopted by the OCA in *Canada Life*. I understand that the Crown has not appealed *Crean*. I will be monitoring whether the BCCA considers *Crean* when it decides *5551928 Manitoba*, and what, if anything, courts in other jurisdictions considering rectification applications have to say about *Crean*. We may yet be in for another fifteen years of rectification being applied inconsistently across the country for tax purposes. ■