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Highlights

FIXING TAX MISTAKES AFTER COLLINS FAMILY TRUST

Professor Catherine Brown, *University of Calgary*, and Doug Ewens, K.C., *Moodys Tax Law*

Recent decisions by the Supreme Court of Canada ("SCC"), including *Collins Family Trust*, have severely limited access to the equitable remedies of rescission and rectification that were formerly granted to undo unintended tax consequences. This will have important tax consequences for taxpayers in Canada.

This article discusses the limitations imposed by the SCC in granting equitable relief in tax matters and considers other potential remedies for innocent mistakes, including specific relief provided in the *Income Tax Act* ("ITA"), remission orders, taxpayer relief provisions and the voluntary disclosure program. The article also considers the potential for relief under the common law of mistake and provides practical advice to taxpayers about documenting their transactions in case a mistake is made.

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Overview

The equitable remedies of rectification and rescission have, for the past two decades, formed an important part of the tax landscape in Canada to correct mistakes. Rectification operates to correct a document; rescission operates to unwind it and restore the parties to their original position. These remedies, generally granted by the Superior Court of a province, are important because they affect property rights and are binding on all parties including the Canada Revenue Agency ("CRA").

Recent decisions by the Supreme Court of Canada ("SCC") have severely limited access to these equitable remedies,[1] which were formerly granted to undo unintended tax consequences. This will have important tax consequences for taxpayers in Canada.

This article discusses the limitations imposed by the SCC in granting equitable relief in tax matters and considers other potential remedies for innocent mistakes, including specific relief provided in the *Income Tax Act* (*"ITA"*), remission orders, taxpayer relief provisions and the voluntary disclosure program. The article considers whether provincial relief might provide a more appropriate remedy for innocent mistakes in some circumstances. Finally, the article also considers relief under the common law of mistake and provides practical advice to taxpayers about documenting their transactions in case a mistake is made.

Background

Before those SCC decisions, equitable remedies played an important role in Canada to either correct documents or to unwind transactions. The two most common remedies affecting tax matters are rectification and rescission.

Rectification

The doctrine of rectification traditionally dealt with the equitable jurisdiction of a court to correct mistakes in a document that did not accurately reflect the true intention of its maker(s). Rectification was most commonly sought as an equitable remedy in regard to agreements or contracts. It could also be obtained in regard to other documents, for example, conveyances, deeds, settlements, wills, instruments of appointment, policies of life insurance, bonds, and corporate registers.

In *Fairmont*, the SCC addressed the issue of rectification in the context of an agreement. Unlike in prior tax cases, where the intention of the parties with respect to the tax outcome of the transaction was considered paramount, the SCC stated in *Fairmont* that rectification was restricted to correcting written instruments of the parties that did not reflect their actual prior agreement.[2] In other words, the fact that an agreement did not achieve the tax consequences intended by the parties would no longer be sufficient to grant rectification.

According to *Fairmont*, in order to obtain a rectification order, the parties must demonstrate that:

- there was a prior agreement with definite and ascertainable terms;
- the agreement was still in effect at the time that the instrument was executed;
- the instrument fails to accurately record the agreement; and
- the instrument, if rectified, would carry out the parties' prior agreement.

A good example of a successful application under the SCC's requirements can be found in *Sleep Country*.[3] In that case, Sleep Country Canada and its holding company entered a share-exchange transaction that called for Sleep Country to issue 124 million additional shares to the holding company. Sleep Country's legal counsel mistakenly recorded the issuance of only 12.4 million shares. This mistake appeared in the executed agreement as well as other subsequent "ripple effect" transaction documents including a resolution by Sleep Country's Board of Directors.

When Sleep Country discovered the drafting error(s), it successfully applied to the Ontario Superior Court of Justice for a tax-rectification order. The Court also found that the circumstances in Sleep Country satisfied the 4-part test set out in Fairmont.

Rescission

Equitable rescission has its roots in the law of mistake and is often sought to void a voidable contract. An order of rescission has the effect of canceling or unwinding the transaction and restoring the parties to their pre-contractual positions.[4]

In general terms, the test for equitable rescission in contract requires the party seeking rescission of the contract to establish that:

- the parties were under a common misapprehension as to the facts or their respective rights;
- the misapprehension was fundamental;
- the party seeking to set the contract aside was not itself at fault; and
- one party will be unjustly enriched at the expense of the other if equitable relief is not granted.[5]

It is an all-or-nothing remedy and partial rescission will not be considered by the Court.

The remedy of equitable rescission can also apply to unilateral transactions, for example, a gift, a trust settlement or a resolution to pay dividends, and it operates to unwind the transaction.[6] Because a unilateral transaction involves only one party and not two, the test for equitable rescission is predictably different than for voiding a contract.[7] In a unilateral transaction, only the interest of the mistaken party is involved and a court must consider only that interest in determining if rescission is warranted.

A request for the rescission of a unilateral transaction was the subject of review in the *Collins* case.[8]

The SCC described the issue in *Collins* as being "whether taxpayers are … barred from obtaining … equitable relief – here, rescission of a series of transactions – sought to avoid unanticipated adverse tax consequences arising from the ordinary operation thereon of the *Income Tax Act* …"[9]. The specific request by the taxpayer

was to unwind the payment of dividends made in 2008 to a family trust. The request was made because in 2012 the judicial interpretation of the statutory provisions relied on by the trust had changed, resulting in unexpected adverse tax consequences to the taxpayer.

Before *Collins* was decided, it was unclear whether the principles in *Fairmont* also extended to the remedy of rescission. Brown J, for the Court removed all doubt, stating:

> There is no room for distinguishing Fairmont Hotels or Jean Coutu based upon the particular remedy sought. While a court may exercise its equitable jurisdiction to grant relief against mistakes in appropriate cases, it simply cannot do so to achieve the objective of avoiding unintended tax liability.[10]

The Court clarified that, "Generally speaking, a court of equity may grant relief where it would be unconscionable or unfair to allow the common law to operate in favour of the party seeking enforcement of the transaction." However, the Court added that there is "nothing unconscionable or otherwise unfair about the operation of a tax statute on transactions freely undertaken."[11]

The principles that can be drawn from the SCC's decisions with respect to equitable remedies for mistakes include the following:

(1) tax consequences do not flow from taxpayers' motivations or objectives. They flow from freely chosen legal relationships established by the parties' actual agreement;

(2) tax liabilities should be governed by the ordinary operation of tax statutes; and

(3) transactions and documents cannot be modified merely because they caused adverse tax consequences.

In *Collins*, the taxpayers assumed, based on how subsection 75(2) of the *ITA* had been previously interpreted by the courts and by the CRA (pursuant to a longstanding publicly shared acceptance that subsection 75(2) applied to a transfer (however effected) of property by the settlor to a trust), that the dividends would flow tax-free through the trust. But a Federal Court of Appeal decision in 2012[12] held that assumption was wrong. The unintended tax consequences that resulted did not provide sufficient reason to rescind the dividend payments.

How might the new limitations imposed by the SCC affect a taxpayer in practice?

The Court's clear statement that a taxpayer may not resort to equity to undo or modify a concluded transaction to avoid a tax liability arising from the ordinary operation of a tax statute will clearly require careful and strategic planning especially if one wants to avoid escalating further adverse tax consequences.

Consider the following example.

A taxpayer named Smith with a wife named Lesley and a sister named Leslie instructs his family lawyer to transfer a building that Smith owned to his wife Lesley (by way of gift). The lawyer transfers the building to Leslie (Smith's sister), realizes his mistake some months later, and asks Leslie to convey the property to Lesley, which Leslie does. The CRA takes the position on audit that two non-arm's length[13] transfers of the building have occurred, first from Smith to Leslie and later by Leslie to Lesley and that there is no rollover of the apartment building as intended by Smith to his wife Lesley.

The correct approach in these circumstances would have been for Smith to seek a rectification order to correct the original mistaken and unintended transfer to Leslie and to roll the property to Lesley.[14] However, that 'ship' has arguably sailed. The current reality is that Smith would be deemed to receive proceeds of disposition equal to the fair market value of the building (thus incurring tax on any resulting recapture of CCA and capital gain) and Leslie, who has freely effected a transfer of the building to her sister-in-law Lesley, will also be deemed to receive proceeds of disposition equal to the fair market value of the building at the time of the second transfer (thus incurring tax on any resulting capital gain).[15] Based on the *Collins* decision, this transfer, freely undertaken, may not be eligible for a rescission order.[16] The end result is that no rollover will occur on the transfer by Smith to his wife Lesley and double taxation may occur on the transfers from Smith-Leslie-Lesley. Notwithstanding, relief may still be available under provincial legislation.[17]

Other Potential Remedies

Statutory provisions[18]

Assuming that the remedies of rectification and rescission either are not available or will not provide the required remedy, there may still be recourse to the provisions in the *ITA* that may operate to provide relief from tax mistakes. For example, the desired tax result may require the filing of an election that can no longer be late-filed without Ministerial relief.

The discussion below includes two broad categories of such provisions in the context of estate planning. First, provisions where the Minister can provide relief where it is "just and equitable" to do so. Second, a lengthy list of elections in the *ITA* that may be late-filed or revoked with the permission of the Minister.

The *Brent Carlson Family Trust* case,[19] a 2021 decision of the Federal Court, provides a useful example of the first type of provision. At issue was whether a section 85 rollover election form could be amended. The *ITA* provides the Minister with the ability to do so "where in the opinion of the Minister it would be just and equitable to do so."[20]

The facts involved two family trusts ("Trusts") that indirectly held all of the outstanding shares of a corporation that carried on the family's business. The Trusts agreed to sell the shares to an arm's length third-party purchaser. The Trusts implemented a series of pre-closing transactions immediately prior to the sale to enable their respective beneficiaries to use their lifetime capital gains deductions ("CGD"s).

Unhappily, the Trusts' professional advisors failed to factor into their advice the fact that a number of the beneficiaries were still minors. This was discovered on audit by the CRA with the result that "kiddie tax" was applied to two share exchange transactions completed in the course of the pre-sale reorganization. The provision at issue[21] deemed the capital gains realized by the minor beneficiaries on completion of the exchange transactions to be taxable dividends with the result that the CGD could not be claimed. The taxpayer requested the Minister to permit the filing with the CRA of amended section 85 rollover election forms as provided under subsection 85(7.1) to address the error.

This was a suitable choice. In Information Circular IC 76-19R3, paragraph 16, the CRA states:

> We will generally accept an amended election under subsection 85(7.1) if its purpose is to revise an agreed amount, and without this revision, there would be unintended tax consequences for the taxpayers involved. We will permit revisions to correct an error, omission, or oversight made at the time

> of the original election. However, we will not permit revisions when, in the Department's view, the main purpose of the amended election is retroactive tax planning.

Unfortunately, the CRA declined to provide the needed relief. The Trusts appealed to the Federal Court for a review of the CRA's decision.

Walker J. for the Court made a number of interesting observations. Among the most significant was that subsection 85(7.1) of the *ITA* addresses the remedy of 'amendment'. Because the taxpayers were not seeking rectification of an executed document or rescission of a transaction, the Minister should not have imported requirements specific to either such equitable remedy in the review of a request to amend an election under subsection 85(7.1). The Court set aside the Minister's decision not to permit an amended election to be filed and remitted that issue to the Minister for redetermination. We understand that the Minister ultimately allowed the taxpayer to file the amended election.

Several other similar provisions in the *ITA* are designed to provide tax relief, including amended elections with respect to eligible dividend designations,[22] tax refunds[23] and to correct over-contributions to tax-free savings accounts.[24]

There is also a lengthy list of elections in the *ITA* that may be late-filed or revoked with the permission of the Minister.[25] For example, the election under subsection 70(6.2) not to have the rollover rules on death apply on a transfer to a spouse, common law partner or a trust for either.

Of particular interest for estate planners are *ITA* subsections 70(9.01), (9.11), (9.21) and (9.31) (which deal with transfers of farm and fishing property), 72(2) (governing the transfer of rights or things on death), 73(1) (relating to *inter vivos* transfers to a spouse), subsection 83(2) (providing for the payment of capital dividends), 104(14) (applicable to preferred beneficiary elections), 107(2.001) (relating to transfers of property from a trust), 164(6) and (6.1) (elections during estate administration,) and 251.2(6) (providing for an election with respect to a loss restriction event by a trust).

The statutory period for making the request for late or revoked elections is up to 10 years after the taxation year in which the election was made. The Minister will grant relief only if a penalty is paid.[26] If the CRA refuses to grant the requested relief, the decision is, of course, subject to judicial review.

Finally, certain designations can be made under *ITA* subsection 220(3.1), also part of the Taxpayer Relief provisions discussed further below.

What tests will be applied by the CRA in providing relief under these provisions is not clear.[27] The decision in *Brent Carlson Family Trust* strongly suggests it should not be tests applied in rectification or rescission cases.[28] Perhaps — ironically — one may now achieve a better result under the ITA's "just and equitable" provisions than under the equitable jurisdiction of a court (unless, contrary to the Federal Court's comments in *Brent Carlson Family Trust*, the decisions in *Fairmont* and *Collins* do become applicable to these statutory provisions).

Taxpayer Relief Provisions

The taxpayer relief provisions also enable a taxpayer to apply for the making, revocation or amendment of elections that may be beyond the ordinary three-year limitation for adjustments. Similarly, a taxpayer can apply

for refunds or reductions of amounts payable that are beyond the statute-barred date, providing there is sufficient documentary evidence to support an unclaimed deduction or refund.

According to the CRA, a taxpayer may qualify for relief from penalties and interest in a broad range of situations including extraordinary circumstances, errors or delays caused by the CRA, inability to pay, financial hardship or other circumstances beyond the taxpayer's control.

Remission Orders

The taxpayer might also consider an application for a remission order. If granted, the federal Cabinet (technically the "Governor in Council") can "remit" tax or other amounts such as interest and penalties back to a taxpayer or cancel the taxpayer's obligation to pay. These orders are issued "where the Governor in Council considers that the collection of the tax or the enforcement of the penalty is unreasonable or unjust or that it is otherwise in the public interest to remit the tax or penalty."[29] The CRA's internal guidelines state that the director will "generally recommend approval to the Minister in only four circumstances: 1) extreme hardship, 2) incorrect action or advice by the CRA, 3) a financial setback combined with extenuating factors, or 4) an outcome that is the unintended result of legislation." Practitioners have described this option as one that should be pursued only if there is no hope of Judicial relief and the client has very deep pockets. It may therefore be of little practical value in the vast majority of cases.

Voluntary Disclosure

In appropriate circumstances, another potential avenue to seek relief is the Voluntary Disclosure Program ("VDP"). Under the VDP, relief is granted on a case-by-case basis to a taxpayer who voluntarily comes forward to fix errors or omissions in their tax filings before the mistake has been discovered by the CRA. Any taxes owed must be paid, plus interest (in part or in full). However, if the CRA accepts the application, the taxpayer will receive relief from prosecution and in some cases penalty relief and partial interest relief.

As is apparent, each of these potential remedies relies on the discretion of the Minister of National Revenue or the Minister's designate.

As will be discussed further below, provincial legislation may provide a more effective remedy for mistakes.

The Power to Fix Mistakes at the Provincial Level

Legislation

Subsection 92(13) of *The Constitution Act, 1867* gives provincial legislatures the authority to legislate in respect of property and civil rights. Corporate legislation in the Provinces of British Columbia and Ontario and the Civil Code in Québec provide good examples of mechanisms for taxpayers to correct certain mistakes, with potentially beneficial tax consequences.

For example, under the British Columbia *Business Corporations Act*[30] ("*BCBCA"*), any "interested person" may apply to the Supreme Court of British Columbia for an order to correct, negate or modify the consequences in law of a "corporate mistake" or to validate any act or matter that has resulted from a corporate mistake.

For purposes of the *BCBCA*, corporate mistake is defined to include an omission, defect, error, or irregularity that has occurred in the conduct of the business or affairs of a company, that results from one or more triggering events set out in the *BCBCA*.

In other words, the Court has the discretion to alleviate the consequences of the corporate mistake if one of the following has occurred: an omission, defect, error or irregularity in the conduct of a company's affairs that has led to a breach of the *BCBCA* or regulations; a default in compliance with the company's constating documents; the proceedings at a meeting of the shareholders or directors have been rendered ineffective; or a consent resolution has been rendered ineffective. This provides a broad platform to seek relief, albeit only in corporate circumstances.

In *Lau v. Canada (Attorney General)*,[31] the mistake involved a drafting error in a corporation's articles that led to the inclusion of $17.3 million in the taxpayer's income. The error was held to constitute a "corporate mistake" within the meaning of *BCBCA* that could be remedied under that provision. The Court held:

> The BCA, s. 229(2) provides that the court has the ability to correct or negative the consequences of any corporate mistake or validate any matter or thing rendered or alleged to have been rendered invalid as a result of the corporate mistake. I am also satisfied that it is appropriate that this amendment of the Articles be effective nunc pro tunc or retroactively from December 12, 2006. …[32]

Although *Lau* was decided before the *Fairmont* and *Jean Coutu* decisions, there is arguably nothing in those decisions that would prevent the same result in *Lau* today.

Section 275(1) of the *Business Corporations Act* (Ontario)[33] ("*OBCA"*), although not as broad as the *BCBCA*, may also operate to correct a mistake. It provides that "the corporation or its directors or shareholders may apply to the Director for a corrected certificate or other document." According to a document issued by the Government of Ontario, the circumstances that might warrant a corrected certificate include "anything that was clearly intended to be done at the time of the original application (as evidenced by the original resolution)."[34]

The Civil Code of Québec also contains provisions that specifically grant to contracting parties the right to correct documents in order to give effect to the parties' true intention.[35]

Other provincial legislation might also provide appropriate relief for a mistake. For example, the *Land Titles Act* (Alberta) provides that, "In any proceeding respecting land or in respect of any transaction or contract relating to it, or in respect of any instrument, caveat, memorandum or entry affecting land, the judge by decree or order may direct the Registrar to cancel, correct, substitute or issue any certificate of title or make any memorandum or entry on it and otherwise to do every act necessary to give effect to the decree or order."[36] Returning briefly to the example discussed earlier of the ill-fated transfer from Smith to the wrong Leslie — a remedy under the Alberta *Land Titles Act* could provide the needed correction to the first land transfer and thereby provide relief from the CRA 's tax assessments on both transfers.

Other examples of provincial legislation where relief from taxation might be sought by a taxpayer include section 22(1) of the *Employer Health Tax Act* (Ontario), section 14 of the *Mining Tax Act* (Ontario) and section 109 of the *Corporations Tax Act* (Ontario).[37] These provisions provide the appropriate minister with discretion — in circumstances where there is uncertainty as to the liability of a taxpayer to pay any tax imposed under the

statute or where, owing to special circumstances, it is inequitable to demand payment of the whole amount imposed by the statute — to accept such amount as the minister considers proper in satisfaction of any tax, interest and penalties under the statute.

These examples of available relief under provincial legislation give rise to a broader question.

If provincial legislation can be used to provide statutory relief for taxpayers (and their professional advisors) to correct innocent mistakes in the implementation of their plans, shouldn't all provinces be encouraged to enact legislative provisions similar to that in British Columbia under the *BCBCA* or under the Civil Code of Quebec, to provide similar remedies in appropriate circumstances?

A broader approach could be for each province to reinstate or further clarify when access to the equitable remedies of rectification and rescission will be available under provincial law. In Alberta, for example, a detailed submission has been made[38] to the Minister of Justice of the Government of Alberta in order to accomplish precisely that result. That submission seeks an amendment to an existing Alberta statute, the *Judicature Act* (Alberta),[39] section 16 which empowers the Court of King's Bench of Alberta to grant, among other remedies, equitable relief to claimants.[40]

Common Law

Provincial courts may also provide relief to a taxpayer based on the common law of mistake. Relief for common law mistake is not an equitable remedy and was not addressed by the SSC in *Fairmont, Jean Coutu* or *Collins.*

The difference between common law mistake and rescission in equity for contracts is set out by Strekof J. in *Re Stone's Jewellery ("Stone's")*:[41]

> 26 Both the common law and equity provide remedies in certain circumstances for contracts that were entered into as a result of a common mistake shared by the parties to a contract.
>
> 27 At common law, a distinction was drawn between a mistake that constituted an error which went to the identity of the contract and caused the contracting party to obtain something other than what they had intended and a lesser error where the contracting party obtained what they had intended but it turned out to be less valuable. Only the former was considered to be a fundamental mistake which went to the root of the contract, or the intention to contract, so as to render the contract *void ab initio*. Any lesser mistake that went only to the motivation to contract or to questions of quality would only give rise to damages.

The doctrine of mistake at common law may operate to solve a tax problem if a taxpayer, for example, enters into a contract[42] with the primary intention and agreement to obtain a particular tax result but, due to a mistake, the particular tax result bargained for is not obtained. This was the result in *Stone's*.[43]

In *Stone's,* two transfers of land occurred; first, a transfer by the Vendor to the Arora brothers instead of to Stone's Jewellery — a corporation they controlled — and later a transfer by the brothers to another holding company. The CRA assessed the siblings for tax, interest and penalties in an amount that exceeded the value of the land.

The second transfer to the holding company provides a useful example of the common law mistake in a tax context and the remedy it provides. This transfer was undertaken under the mistaken belief held by all of the parties to the transaction that it could be done on a tax-free basis pursuant to 85 of the *ITA*. This understanding was confirmed by the express language in the preamble to the May 8, 2006 Transfer Agreement which stated:

> The Vendor and Purchaser intend that subsection 85(1) of the *(Income Tax) Act* and any comparable provision of the laws of the province shall apply to the aforementioned exchange of the Property.

The CRA took the position that the lands were land inventory, and therefore not “eligible property" for the purposes of the 85 election.

The Court held that even if available, rectification was not an appropriate remedy in the circumstances as the Court did not have the power to direct that the 2006 transfer proceed on a tax-free basis pursuant to section 85. Instead, the Court held that taxpayers were entitled to a declaration the transaction was *void ab initio* at common law as a result of the common mistake made by them in respect of the transaction.

In reaching this conclusion the Court stated:

> 46 The essence of a section 85 rollover is a transaction by which an individual transfers eligible property to a corporation on a tax-deferred basis without triggering any immediate tax consequences, provided all of the statutory requirements are met. In this case, the Lands which were being transferred did not constitute eligible property and, therefore, no section 85 rollover occurred. This constituted a fundamental mistake that went to the root of the contract and, therefore, at common law the Transfer Agreement was *void ab initio*. As a result, title to the Lands should be returned to the names of the Arora siblings.

The 2004 transfer by the Vendor to the brothers instead of to Stone’s Jewellery was also void *ab initio* for common mistake. The Court held:

> 69 The mistake … was that the Aroras could have title registered in their names directly and effectively bypass Stone's participation in the transaction. This constituted a fundamental mistake that went to identity of the parties to the contract and the essence of the agreement and, therefore, at common law the transaction was *void ab initio*. As a result, title to the Lands should registered in the name of Stone's as the named purchaser under the Real Estate Purchase contract with the vendor.

The result in *Stone’s* was no doubt well received by the taxpayers. Regrettably, the remedy available for common law mistake is not well-developed in Canada. However, in our view, it should remain unimpacted by the SCC cases with respect to equitable remedies and is replete with possibilities.

Documentation and The Prudence of Expressing Parties’ Intended Tax Consequences

Both *Brent Carlson Family Trust* and *Stone’s* highlight the continued importance of expressing the parties’ intentions in a written agreement in case relief is to be sought at either the federal or provincial level for a mistake and pursuant to the common law of mistake.

This reality should spur a new era of "best practices" in documenting agreements, resolutions of directors and shareholders and other instruments, encouraging inclusion of a description in the documentation to establish what tax results the parties intend will follow from the agreement, resolution or other instrument they are executing. This should include setting forth — explicitly in the appropriate documentation — the tax consequences expected to result from completing the transaction or event effected by that agreement, resolution or other instrument.

Why?

Because documenting the intended tax consequences should help achieve some forms of tax relief. As discussed above, in *Brent Carlson Family Trust* the Federal Court set aside the Minister's decision not to permit an amended subsection 85(1) joint election to be filed and remitted that issue to the Minister for redetermination. The Court noted (and in our view, the Court's decision was assisted by) the fact that the transaction step memo included "consistent references" to the objective of permitting the family members of the trust to benefit from the use of their capital gains exemptions.[44]

In the Court's view:

> The discretion granted to the Minister in subsection 85(7.1) suggests an acceptable ambit for retroactive tax planning and the correction of unintended tax consequences. In other words, not every case in which a party seeks to amend a subsection 85(1) or (2) election involves impermissible retroactive tax planning.[45]

The Court also commented on the reliance by the taxpayer on the CRA's Information Circular IC76-19R3 to demonstrate that the Minister has a history of accepting an amended election when it is clear that the parties wanted the rollover "without immediate tax consequences".

So exactly what should an agreement include?

Consider an agreement by an individual transferring marketable securities to his or her holding corporation. The document should state that the parties will file a joint election under subsection 85(1) and that the expected tax result will be that the transferor will realize no net taxable capital gain on the transfer. If the adjusted cost base of the securities turns out to be less than the parties had believed and had set forth in their joint election, expressing the expected tax result will at least facilitate the parties' request to the Minister to permit an amended joint election to be made pursuant to *ITA* paragraph 85(7.1)(b).

The Circular also provides that Revenue Canada will generally accept an amended election when "it corrects other situations which resulted in unintended tax consequences, e.g., the application of section 84.1, subsections 15(1), 84(1), and 85(2.1), or paragraph 85(1)(e.2), **when it is clear that the parties wanted the rollover without any immediate tax consequences.**" (emphasis added).

Further, in circumstances where an individual transfers property to a corporation of which that individual and other family members are shareholders, we think that it would be prudent for the vendor and purchasing corporation to set forth in their agreement of purchase and sale their intended tax consequences with a view to minimizing the risk of the transfer resulting in the conferral of an unintended "benefit" on a different family member shareholder arising, with the result that paragraph 85(1)(e.2) is invoked by the CRA. Sample wording is set out below:

> The Parties intend that the fair market value of the consideration, immediately after the time of transfer, received by the Transferor from the Transferee Corporation will equal the fair market value of the Transferred Property immediately before the time of transfer, in order that no amount of benefit shall have been conferred on any person related to the Transferor, and that the provisions of paragraph 85(1)(e.2) of the *Income Tax Act* will not apply to deem the elected amount for purposes of paragraph 85(1)(a) of the *Income Tax Act* to be increased by any amount.

Another example where clear language about intention should be included in the documentation is on the winding-up of a Canadian partnership. *ITA* subsection 98(3) provides a tax-deferred rollover only if each partner receives an undivided interest in any one partnership property that is the same as that partner's proportionate interest in every other partnership property. The documentation conveying to each partner its interest in the partnership property could include the following provision:

> The Parties intend that the transfer and conveyance by the Partnership to each Partner will result in the receipt by each Partner of a proportionate undivided interest in all Partnership property immediately before the effective time of winding-up that is the same as that Partner's proportionate undivided interest in every other Partnership property in the manner contemplated by subsection 98(3) of the *Income Tax Act*.

The Road Forward

The SCC has made clear that the halcyon days of court-ordered equitable relief to correct unintended tax consequences are behind us. This invites a closer examination by taxpayers and their advisors of other methods of seeking relief for tax mistakes, including provisions in the *ITA* and — where available — provincial legislation as well as considering the availability of the common law of mistake. It also invites the provinces to consider whether they should enact further measures to provide relief from mistakes made by their residents (or the professional advisors of their residents) under provincial legislation in appropriate circumstances.

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[1] *Canada (Attorney General) v. Fairmont Hotels Inc.*, [2016] 2 S.C.R. 720 (S.C.C.) ("*Fairmont*"); *Jean Coutu Group (PJC) Inc. v. Canada (Attorney General)*, 2016 SCC 55 (S.C.C.), ("*Jean Coutu*"); and *Canada (Attorney General) v. Collins Family Trust*, 2022 SCC 26 (S.C.C.) ("*Collins*").

[2] In *Fairmont*, the SCC also confirmed that rectification may be available in other circumstances such as fraud, undue influence or misrepresentation under a Superior Court's equitable jurisdiction.

[3] *Sleep Country Canada Holdings Inc. and Sleep Country Canada Inc. v. Attorney General of Canad*, 2022 ONSC 6103 (ONT. S.C.J. [COMMERCIAL LIST]).

[4] See Charles Mitchell "Rescission of Voluntary Settlements and Dispositions of Trust Property on the Ground of Mistake", https://discovery.ucl.ac.uk/id/eprint/1543043/1/Mitchell_Rescission.pdf; and Nitikman, Joel, Equitable Rescission of Contracts for Mistake in Canada After Great Peace: Whither Solle v. Butcher? (February 2022), Canadian Tax Journal, volume 69, no. 4, 2021, pp. 1027-1097, https://www.ey.com/en_gl/tax-alerts/supreme-court-of-canada-holds-equitable-remedy-of-rescission-is-not-available-to-remedy-adverse-tax-consequences.

[5] As set out in *Canada Life Insurance Company of Canada v. Canada (Attorney General)*, 2018 ONCA 562 (Ont. C.A.) at para. 89.

[6] See Charles Mitchell. "Rescission of Voluntary Settlements and Dispositions of Trust Property on the Ground of Mistake", https://discovery.ucl.ac.uk/id/eprint/1543043/1/Mitchell_Rescission.pdf and Nitikman, Joel, Equitable Rescission of Contracts for Mistake in Canada After *Great Peace*: Whither *Solle v Butcher*? (February 2022). *Canadian Tax Journal*, Volume 69, No 4, 2021, pp. 1027-1097.

[7] In a contractual setting, the two parties involved and each of their interests must be considered. The mere fact that one party to a contract entered into it under a mistake does not mean that the other party made a mistake and, therefore, absent special circumstances, there may be no basis to rescind the contract.

[8] *Canada (Attorney General) v. Collins Family Trust*, 2022 SCC 26 (S.C.C.).

[9] *Collins*, note 1 at para. 1.

[10] *Ibid*., at para. 22.

[11] *Ibid*., at para. 7.

[12] *R. v. Sommerer*, 2012 FCA 207 (F.C.A.), which held that subsection 75(2) does not apply to property transferred to a trust by a settlor pursuant to a sale at fair market value.

[13] See *ITA* paragraph 252(2)(c).

[14] Whether or not a rectification order would be granted is uncertain. Leslie has already transferred the property to Lesley, thereby resolving the problem created by the error in the document. The only reason for the rectification order would be to eliminate the unintended tax consequences on the transfers — firstly from Smith to Leslie and secondly from Leslie to Lesley. To compound the problem, Leslie's cost base may be zero. If applicable, *ITA* paragraph 69(1)(c) would deem Leslie to have acquired the building at its FMV, in which case there may be only a nominal gain on Leslie's transfer of the building to Lesley. HOWEVER, that assumes that Leslie had acquired the building as a gift from Smith, and in order to constitute a "gift" in law, the donor must have intended to make the gift — which intention the example assumes that Smith lacked.

[15] *ITA* subsection 248(28), the purpose of which is to ensure that a taxpayer is not required to include in income the same amount twice, would appear not to apply, since the gains are deemed to be realized by separate taxpayers.

[16] If the transfer of property from Smith to his wife Lesley was preceded by an agreement concluded by them, the Court would no doubt grant a rectification order. The criteria in *Fairmont* would have been met. The Court might also allow the parties to rescind the agreement. But these are not our facts. Leslie attempted to undo the error herself by transferring the property to her sister-in-law, Lesley.

[17] See the discussion *infra* at notes 29 - 34 as well as the discussion *infra* pertaining to a potential remedy under the *Land Titles Act* (Alberta).

[18] This section relies in large part upon an article by Catherine Brown, "Rescission: Where are We Now," ETPJ December 2022.

[19] *Brent Carlson Family Trust v. Canada (National Revenue)*, 2021 CarswellNat 3601, 2021 D.T.C. 5058, 2021 FC 506, 2021 CF 506 (F.C.).

[20] *ITA* subsection 85(7.1). For CRA guidelines on "just and equitable" (including cases where no amended election is required), see Information Circular 76-19R3 (Transfer of Property to a Corporation under Section 85), paras. 16-19. See also Carla Hanneman, "What is 'Just and Equitable'?", 3(4) Canadian Tax Focus (ctf.ca) 8 (Nov. 2013); McDonald & Kroft, "Filing a Tax Election After the Statutory Deadline", Bennett Jones on Tax Disputes (Taxnet Pro Tax Disputes Centre), June 2022, pp. 2-7; and *Patterson Dental Canada Inc. v. R.*, 2014 TCC 62 (T.C.C.) at para. 31 as cited in David Sherman's tax notes under subsection 85(7.1).

[21] *ITA* subsection 120.4(5).

[22] *ITA* subsections 89(14) and (14.1).

[23] *ITA* subsection 164(4).

[24] *ITA* subsection 207.06(1).

[25] See Regulation 600. The prescribed provisions include subsections 13(4), (7.4) and (29), 20(24), 44(1) and (6), 45(2) and 45(3), 50(1), 53(2.1), 56.4(13), 70(6.2), (9.01), (9.11), (9.21) and (9.31), 72(2), 73(1), 80.1(1), 82(3), 83(2), 91(1.4), 104(14), 107(2.001), 143(2), 146.01(7), 146.02(7), 164(6) and (6.1), 184(3), 251.2(6) and 256(9) of the *ITA*.

[26] See *ITA* subsection 220(3.5). The penalty is calculated as "the product obtained when $100 is multiplied by the number of complete months from the day on or before which the election was required to be made to the day the application was made in a form satisfactory to the Minister." The maximum penalty is $8,000.

[27] Some guidance may be found in CRA Appeals Manual 2018 under the heading 6.3.2.4 — Just and Equitable. (taxnet.pro). According to the manual "The general concept of "just and equitable" allows a common-sense evaluation of a situation based on objective evidence. This approach permits the Minister to help objectors resolve problems that arise through no fault of their own and that cause them to be unable to comply with a statutory requirement. The concept is used to indicate conformity to the principles of justice and fairness."

[28] *Brent Carlson Family Trust* note 18, at para. 54.

[29] The orders are issued under the authority of *Financial Administration Act*, R.S.C. 1985, c. F-11, s. 23(2).

[30] S.B.C. 2002, c.57, s. 229(1). This provision was originally included in British Columbia's *Company Act*, R.S.B.C. c. 59.

[31] 2014 BCSC 2384 (B.C. S.C.).

[32] *Ibid*., at para. 124.

[33] R.S.O. 1990, c. B.16.

[34] Companies and Personal Property Security Branch Requirements. Ministry of Public and Business Service Delivery. Service Ontario. See https://www.forms.ssb.gov.on.ca>GetFileAttach

[35] See generally Natalie Goulard and Frédérique Duchesne, "Correcting Taxpayer Mistakes in Quebec Post-Collins" (2022) 3:4 *Perspectives on Tax Law & Policy* 9-11.

[36] *Land Titles Act*, R.S.A. 2000, c L-4, s. 190.

[37] R.S.O. 1990, c. M. 15.

[38] Specifically, on August 17, 2022, Doug Ewens, K.C. sent a submission to the Honourable Tyler Shandro, Alberta's then Minister of Justice, Solicitor General and Deputy House Leader, seeking this amendment. Responses by the Minister's representatives to date, however, have indicated that "the *Judicature Act* is not being considered for review at this time".

[39] R.S.A. 2000, c. J-2.

[40] The logic underlying the proposal is that denying taxpayers relief for inadvertent tax errors should not be tolerated by a provincial government in situations where a taxpayer resident in that province has expressed the intention to complete a particular transaction the essential terms of which have been settled and the explicitly sought tax consequences that are consistent with provisions of the applicable tax legislation have been identified. A common argument against such relief measures is the potential for retroactive tax planning. Of course, retroactive tax planning generally should not be sanctioned because of the importance of protecting the fisc. However, an important distinction exists between retroactive tax planning and seeking a superior court judge's order to permit the amendment of the terms of a plan intended to be completed by the parties with tax consequences contemplated by the *ITA* that have been clearly identified (but which plan was documented incorrectly owing to a mistake). The scope of any potential provincial relief would presumably be subject to the rule of law, but there appears ample scope for equitable relief under provincial law in appropriate circumstances.

[41] *Stone's Jewellery Ltd. v. Arora,* 2009 ABQB 656 (Alta. Q.B.). Paragraphs 28 and 29 of the reasons for judgment in *Stone's* are also instructive regarding contracts that are void at common law. See also the comments of Justice Chipman of the Nova Scotia Court of Appeal in *MacInnes v. Inverness (County)* (1995), 141 N.S.R. (2d) 212 (N.S. C.A.).

[42] Three types of mistakes are found under the common law: unilateral mistake, mutual mistake and common mistake.

[43] This decision pre-dated *Fairmont* and *Jean Coutu* but deals with common law mistake not equitable remedies.

[44] See paragraph 15 of the Federal Court's reasons for judgment.

[45] *Brent Carlson Family Trust* note 18, at para. 52.

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