

# Rectification- A Useful but not Universal Tool to Remedy Mistakes

Toolbox Seminar

May 26, 2016

Presented by:  
Lorne Saltman



GARDINER ROBERTS

---

---

---

---

---

---

---

---



## Topics to Discuss

- What is Rectification ?
- Leading Tax Cases
- Objections by the Canada Revenue Agency
- Leading Contract/Trust/Estate Cases
- Others

---

---

---

---

---

---

---

---



## What is Rectification?

- Rectification is one of the equitable remedies available to a superior court of a province to relieve against that which is unfair, unconscionable, or unjust
- Rectification has traditionally been considered an equitable remedy that is available to correct a written agreement when the parties were in agreement on the terms of their contract but, by mistake, wrote them down incorrectly
- It is a remedy, however, that may be used in appropriate circumstances to avoid an adverse tax consequence from a completed transaction

---

---

---

---

---

---

---

---



---

---

---

---

---

---

---

---

**The elements that must be proven to obtain a rectification order are as follows:**

- The parties had a common intention before making the written instrument alleged to be deficient;
- This common intention continued unchanged at the time the written instrument was executed;
- The written instrument mistakenly did not conform to the prior common intention; and
- The party seeking relief can show the precise form in which the written instrument can be made to express the prior common intention.

---

---

---

---

---

---

---

---

***Juliar v. Canada (Attorney General)***

- The leading judicial authority on the remedy of rectification in income tax matters
- The taxpayer/applicants for relief received promissory notes as consideration for shares of their holding company by mistake, and the court substituted shares as the consideration by way of rectification of the transfer documentation

---

---

---

---

---

---

---

---



*Juliar v. Canada (Attorney General)*

...cont'd

- The Juliar family owned a holding company ("867"), which held the shares of a convenience store business. The family sought to divide the business between family members.
- The application judge found as a fact that the Juliars had a common and continuing intention that the transaction occur on a basis which would not attract immediate income tax liability.

---

---

---

---

---

---

---

---

---

---



*Juliar v. Canada (Attorney General)*

...cont'd

- The Juliars transferred their shares in 867 to a newly-incorporated holding company. Due to a mistaken assumption as to the adjusted cost base of the shares, their accountant had advised them to transfer their shares in exchange for promissory notes.
- They assumed that the adjusted cost base of the shares was sufficient so not as to give rise to taxable deemed dividends under the ITA. However, the adjusted cost base of the 867 shares was in fact less than assumed and the Juliars were deemed under the ITA to have received dividends on the excess, resulting in significant tax liabilities.

---

---

---

---

---

---

---

---

---

---



*Juliar v. Canada (Attorney General)*

...cont'd

- In contrast, had the Juliars received shares of the new holding company as consideration for the shares of 867 instead of the notes, the transfer would have qualified for a rollover, deferring the tax liability.
- Given the Juliars' common and continuing intention to avoid immediate tax liability, the Court rectified the corporate documents to substitute shares of the new holding company for the promissory notes as consideration.

---

---

---

---

---

---

---

---

---

---



*Juliar v. Canada (Attorney General)*

...cont'd

- In doing so, the Court commented as follows:
  - "Denial of the application would place on the Juliars a heavy burden which they were entitled to avoid and which they sought to avoid from the inception of the transaction.
  - It would yield to Revenue Canada a premature gain solely because of an error in understanding or communication between [Mr. Juliar] and [the Juliars' accountant]."

---

---

---

---

---

---

---

---



*Juliar v. Canada (Attorney General)*

...cont'd

- The decision was upheld by the Ontario Court of Appeal, which concluded that the true agreement between the parties was that the transfer of shares in 867 to the new holding company would occur in a manner that would not attract immediate liability for income tax.
- It was not necessary to prove a specific intent to issue shares instead of debt.

---

---

---

---

---

---

---

---



**Post-Juliar Decisions**

- Recently, the CRA has objected to certain applications for rectification orders, asserting that the courts have extended the scope of relief too far after *Juliar*:
  - Instead, there should be present a specific intent to use a determinable instrument or structure; and
  - Rectification has gone so far as to permit retroactive tax planning.

---

---

---

---

---

---

---

---

### Post-Juliar Decisions ...cont'd

- A number of court decisions outside of Ontario have accepted the CRA's position
- In *Groupe Jean Coutu (PJC) Inc. v. Attorney General for Canada*, the Québec Court of Appeal held that a plan for a Canadian parent company to reduce exposure to currency risk in respect of its investment in a US subsidiary unexpectedly resulted in *FAPI* to the Canadian parent

---

---

---

---

---

---

---

---

### Jean Coutu ...cont'd

- The Canadian parent sought to substitute for the faulty plan an alternative that would not have given rise to *FAPI*
- The CRA objected on the basis that the Canadian parent sought to “rewrite tax history” because of unintended tax consequences from the original plan:
  - what the parties intended (to insulate the parent against FX risks) was achieved, and the documentation was consistent with that intent;
  - to substitute the alternative plan would be tantamount to retroactive tax planning; and they argued that rectification required a specific intent to be shown, not just a general intent to have a tax-neutral transaction

---

---

---

---

---

---

---

---

### Jean Coutu ...cont'd

- The judge in the first instance agreed with the parent but the Court of Appeal disagreed and found in favour of the CRA:
  - Tax liability, the Court said, is based on what happened and not on what a party in retrospect would have rather done
  - Rectification is granted to restore a transaction to its original purpose and not to avoid an unintended effect;
- The Supreme Court of Canada is scheduled to hear appeals from this *Jean Coutu* case where rectification was denied and another Ontario case, *Fairmont Hotels v. Attorney General for Canada*, where it was granted in another failed Canada/US FX structure

---

---

---

---

---

---

---

---

### Foreign Rectification Order

- Will a Canadian court recognize a rectification order granted by a foreign court to correct a mistake in a transaction affecting the foreign jurisdiction and Canada?
- That question recently arose in the case of *Canadian Forest Navigation Co. Ltd. v. The Queen*
- A Canadian parent company with subsidiaries in Cyprus and Barbados received distributions which became taxable as dividends, and wished to have them rectified by the respective courts and treated as non-taxable loans

---

---

---

---

---

---

---

---

### *Canadian Forest Navigation Co. Ltd. v. The Queen* ...cont'd

- When the CRA assessed the Canadian parent on the basis that it had received taxable dividends, it applied to the Cyprus and Barbados courts for rectifying orders that the distributions be treated as loans, but without any notice to, or input from, the CRA
- After the assessment and objection process, the parent moved in the Tax Court to require the CRA to recognize the foreign orders and treat the receipts as loans not as dividends
- The Tax Court of Canada refused to make the requested order

---

---

---

---

---

---

---

---

### *Canadian Forest Navigation Co. Ltd. v. The Queen* ...cont'd

- The Court ruled that the domestic Canadian court (whether a Québec civil court if the foreign affiliate were to seek enforcement of the debt against the Canadian parent, or the Tax Court if the Canadian parent sought to have the CRA's assessment overturned) would have to consider certain relevant factors in deciding whether to enforce the foreign orders

---

---

---

---

---

---

---

---

### *Canadian Forest Navigation Co. Ltd. v. The Queen ...cont'd*

- The Court should consider the following factors:
  - Will the foreign judgment disturb the structure and integrity of the Canadian legal system ?
  - Does the foreign judgment conflict with domestic law?
  - Will enforcing the foreign judgment result in judicial assistance being given by a Canadian court that would be used in a manner that would not have been available in a strictly domestic litigation?
- In any subsequent Tax Court trial, the Canadian parent would be able to introduce the foreign judgment as evidence, the CRA could object, and the presiding judge would decide what weight to give to the foreign orders

---

---

---

---

---

---

---

---

### **Non-Tax Cases for Rectification**

- The Supreme Court of Canada in cases relating to rectification of contracts that produced unintended (non-tax) results have held that the court's task is corrective, not speculative.
- "It is to restore the parties to their original bargain, not to rectify a belatedly recognized error of judgment by one party or the other."

---

---

---

---

---

---

---

---

### **Rectification and Trusts**

- When a tax-related error is made in relation to a trust, it may be possible to apply for an order from the civil courts to rectify the relevant documents to be consistent with the original intention of using the trust, and thus avoid the adverse tax consequences

---

---

---

---

---

---

---

---

*Canada (Attorney General) v. Brogan Family Trust*

- The CRA and the Department of Justice have expressed dissatisfaction and concern with the result in this case
- The Ontario Superior Court of Justice held that CRA need not be served with notice of a rectification application to add minor beneficiaries inadvertently omitted from a family trust deed. Subsequently, tax on the capital gain on the sale of trust property was allocated to the added minor beneficiaries:
  - “ the CRA is only required to be given notice of a proposed rectification proceeding when the CRA’s legal interests might be directly affected by the outcome of the rectification proceeding, such as where the CRA is a creditor and the rectification would affect its rights

---

---

---

---

---

---

---

---

This information has been presented to you courtesy of **Gardiner Roberts LLP** as a service for our clients and other persons dealing with tax and estates issues. It is not intended to be a complete statement of the law or an opinion on any subject. Although we endeavour to ensure its accuracy, no one should act upon it without obtaining proper legal advice, following a thorough examination of the facts of a specific situation and the applicable law.

---

---

---

---

---

---

---

---