Current Cases

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ONTARIO COURT OF APPEAL AND BRITISH COLUMBIA SUPREME COURT

DOES FAIRMONT HOTELS ELIMINATE *ALL* EQUITABLE REMEDIES IN THE TAX CONTEXT?

Canada Life Insurance Company of Canada v. Canada (Attorney General)
2018 ONCA 562

5551928 Manitoba Ltd. (Re)
2018 BCSC 1482

KEYWORDS: RECTIFICATION ■ RESCISSION ■ TAX LITIGATION ■ CAPITAL DIVIDEND ACCOUNT ■ PARTNERSHIPS ■ EQUITY

Introduction

Since the Supreme Court of Canada restricted the scope of rectification in *Canada (Attorney General) v. Fairmont Hotels Inc.*,[56] tax advisers have been forced to consider other equitable remedies when seeking to fix mistakes that result in unintended tax liability. Two recent decisions, *Canada Life Insurance Company of Canada v. Canada (Attorney General)*[57] and *5551928 Manitoba Ltd. (Re)*,[58] address the interaction of alternative equitable remedies with the policy comments from *Fairmont Hotels*. However, rather than clarifying the boundaries of equitable remedies in the tax context, the dichotomy of these decisions leaves tax practitioners with uncertainty as to the scope and breadth of *Fairmont Hotels*.

Comments in *Canada Life* should be cause for concern because the Ontario Court of Appeal appears to have applied the Supreme Court of Canada's reasoning for restricting the availability of rectification to *all* equitable remedies in the tax context. On the other hand, the British Columbia Supreme Court granted rectification in the tax context in *Manitoba Ltd.*, reconciling the remedy with the policy

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56 2016 SCC 56. See also the companion decision to *Fairmont Hotels*, *Jean Coutu Group (PJC) Inc. v. Canada (Attorney General)*, 2016 SCC 55, which addressed rectification in the civil context. In these decisions, the Supreme Court of Canada reached a similar conclusion in both common law and civil law that a grant of rectification requires more than a general intent to avoid or minimize tax.

57 2018 ONCA 562.

58 2018 BCSC 1482.

concerns identified in *Fairmont Hotels*. It is hoped that tax advisers will receive guidance from the Supreme Court of Canada, since the appellant (by cross-appeal) in *Canada Life* has requested leave to appeal the Ontario court's judgment.[59]

Canada Life

Facts

The following entities were involved in the relevant transactions:

- Canada Life Insurance Company of Canada ("CLICC"), The Canada Life Assurance Company ("CLA"), and Great-West Life Assurance Company ("GWL") each carried on an insurance business.
- CLICC was the limited partner of Mountain Asset Management LP ("MAM LP"), in which it owned a 99 percent interest. The general partner ("CLICC GP"), an Ontario company, owned the remaining 1 percent interest.
- MAM LP and GWL were the shareholders of MAM Holdings Inc. ("MAM Holdings"), which was the sole shareholder of Mountain Asset Management LLC ("MAM LLC"), a Delaware company.

A simplified graphic of the organizational relationships between these entities is presented in figure 1.

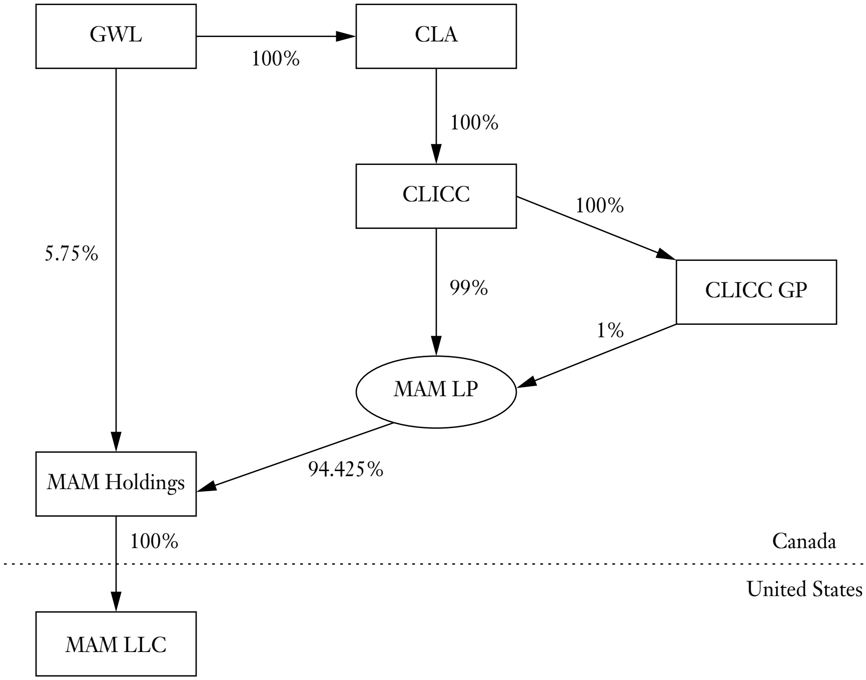
CLICC had entered into separate reinsurance agreements with CLA and GWL, denominated in Canadian dollars. Through its partnership interest in MAM LP, CLICC indirectly held investments denominated in US dollars. As a result, CLICC entered into third-party hedge contracts ("the hedge contracts") with arm's-length financial institutions in order to eliminate any foreign exchange risk. By early December 2017, however, CLICC had accrued and unrealized losses on its interest in MAM LP and accrued and unrealized gains in the hedge contracts, resulting in a mismatch for Canadian tax purposes.[60]

Being unable to match the foreign exchange losses against the accrued foreign exchange gains, CLICC would be subject to tax. In order to offset the gains to avoid taxation, CLICC entered into a reorganization whereby, among other things, CLICC disposed of its limited partnership interest in MAM LP. This disposition generated a loss, which CLICC used to offset the accrued and unrealized gains from the hedge contracts.

59 The application was filed on September 19, 2018. As of the time of writing this case comment, the Supreme Court had not yet determined whether leave would be granted.

60 The unrealized foreign exchange gains accrued in respect of the hedge contracts during CLICC's 2007 taxation year were required to be recognized by CLICC on an accrual basis in 2007. Conversely, the corresponding unrealized foreign exchange loss inherent in CLICC's interest in MAM LP would not be recognized by CLICC in the same taxation year unless it was actually realized in that year.

FIGURE 1 Simplified Organizational Structure



The CRA disallowed the loss on the basis that the limited partnership's dissolution was effected on a tax-deferred basis under subsection 98(5), because CLICC GP was wound up immediately after the dissolution of MAM LP.[61] CLICC objected to the reassessment and subsequently applied for an order *nunc pro tunc* cancelling the various steps taken in the reorganization and replacing them with a new series of steps that would dissolve MAM LP without the application of subsection 98(5).

Ontario Superior Court Decision

CLICC explained that an error was made when the reorganization was designed and implemented. Further, it had relied on the tax advice of its external counsel, who had failed to consider the possibility that subsection 98(5) might apply. Relying on the requirements for rectification as set out in *Attorney General of Canada v.*

61 Subsection 98(5) provides for a rollover of partnership property to a sole proprietorship when the withdrawal or retirement of a partner results in a dissolution of a Canadian partnership (defined in subsection 102(1)) and the business of the partnership is subsequently carried on by one of the former partners as a sole proprietorship. If the conditions for the rollover are met, the rollover is automatic without the need for an election.

Juliar,[62] the Ontario Superior Court of Justice granted the application on the basis that, from the outset, the parties shared a "common and continuing intention" that the reorganization would result in the realization of a deductible tax loss.[63] The attorney general appealed the decision.

Ontario Court of Appeal Decision

Before the appeal was heard, the Supreme Court of Canada's decision in *Fairmont Hotels* specifically overruled *Juliar* and restricted the circumstances in which rectification may be granted. As a result, both parties in *Canada Life* agreed that the application judge had erred in granting rectification. CLICC cross-appealed, asking the court to use its inherent jurisdiction in equity or equitable rescission as alternative bases for relief.

The Ontario Court of Appeal found that seeking the "inherent jurisdiction [of] the court" to "rectify" a corporate transaction in order to retroactively avoid adverse tax consequences was, by a different name, the same type of intervention expressly overruled in *Fairmont Hotels* and *Jean Coutu*.[64]

The court held that the Supreme Court of Canada had signalled that retroactive tax planning by order of the superior court exercising its equitable jurisdiction is impermissible. The Ontario Court of Appeal stated that the Supreme Court of Canada was "concerned not only with the availability of rectification as a remedy, but with the court's doing something under the guise of rectification that is not permitted—altering a corporate transaction *nunc pro tunc* to achieve a particular tax objective."[65]

The Ontario Court of Appeal was of the view that "retroactive tax planning" includes attempts to change one's affairs so that tax consequences that were intended but were prevented by a mistake can be achieved. It held that *any* transaction that is informed by tax considerations can be considered a tax-driven transaction, and that it is impermissible to rewrite history in respect of such a transaction in order to reverse the factual basis of the tax assessment and defeat the resulting tax liability.[66]

Because the Ontario Court of Appeal characterized the relief sought by CLICC as rescission of a contract entered into by mistake, CLICC was required to establish that

62 2000 CanLII 16883 (ONCA). Prior to *Fairmont Hotels*, the decision in *Juliar* stood for the proposition that a common continuing intention to pursue a transaction in a tax-neutral manner satisfied the threshold for granting rectification. However, *Juliar* was not followed in other provinces (see, for example, *Graymar*, infra note 105 and the accompanying text), creating a schism across superior courts prior to *Fairmont Hotels*.

63 *Canada Life v. Attorney General of Canada*, 2015 ONSC 281, at paragraph 36.

64 *Canada Life*, supra note 57, at paragraph 43; *Jean Coutu*, supra note 56. See also *Harvest Operations Corp. v. Attorney General of Canada*, 2017 ABCA 393, at paragraph 75.

65 *Canada Life*, supra note 57, at paragraph 67.

66 Ibid., at paragraphs 68-74.

> (a) the parties were under a common misapprehension as to the facts or their respective rights; (b) the misapprehension was fundamental; (c) the party seeking to set the contract aside was not itself at fault; and (d) one party will be unjustly enriched at the expense of the other if equitable relief is not granted.[67]

The court found that none of these requirements were met.[68]

The court noted that rescission is an "all-or-nothing" remedy, and partial rescission is not a recognized equitable remedy. It found that CLICC was not applying to the court "to rescind the entire Transaction, and to restore it and its affiliates to their original rights, because to do so would not achieve its objective of triggering a loss to set off against its foreign exchange gains."[69]

Additionally, the court found that CLICC had adequate alternative remedies to address the adverse tax consequences resulting from the mistake it had relied on, specifically the following:[70]

- CLICC could, and did, file a notice of objection to appeal its tax assessment.
- CLICC could apply for a remission of tax.[71]
- CLICC had a potential legal action against its professional adviser.

Finally, the court rejected CLICC's argument that equity was required to avoid its own unintended loss and the corresponding unjust enrichment of the CRA. Given that an error was made by CLICC with respect to the effect of the law, there was nothing inequitable about CLICC being taxed on "what it did" rather than on what it intended to achieve. The court pointed out that characterizing the unjust enrichment as a "windfall gain" to the CRA was explicitly rejected as the basis for equitable relief in *Fairmont Hotels*.[72]

Manitoba Ltd.

Facts

Subsequent to a sale of property by 5551928 Manitoba Ltd. in September 2015, the directors sought to distribute the maximum amount of capital dividends that could be distributed to the company's shareholders. The corporation's accountants advised the directors that

67 Ibid., at paragraph 89, citing *Miller Paving Limited v. B. Gottardo Construction Ltd.*, 2007 ONCA 422, at paragraphs 23, 24, 26, and 31.

68 *Canada Life*, supra note 57, at paragraph 89.

69 Ibid., at paragraph 90.

70 Ibid., at paragraph 92.

71 Under section 23 of the federal Financial Administration Act, RSC 1985, c. F-11, as amended.

72 *Canada Life*, supra note 57, at paragraph 93.

- the corresponding capital dividend account (CDA) would, immediately before December 31, 2015, include the amount arising from the disposition of certain eligible capital property (ECP);[73]
- the corporation could declare a capital dividend payable on December 31, 2015 totalling $298,000;[74] and
- the dividend would not result in any tax payable by the corporation or its shareholders.

However, the amount from the disposition of ECP could only be added to the CDA at the end of the taxation year (August 31, 2016). Accordingly, 5551928 Manitoba Ltd. petitioned the Supreme Court of British Columbia to rectify a directors' resolution to reduce a declared capital dividend by the amount erroneously included from the disposition of ECP. In the alternative, 5551928 Manitoba Ltd. sought to rescind the dividend payment ab initio.[75]

Supreme Court Decision

The attorney general did not oppose the alternative order for rescission[76] but opposed the petition for rectification on the basis that 5551928 Manitoba Ltd. had not demonstrated a prior agreement with definite and ascertainable terms supporting the rectification request.

The court granted rectification on the basis that the agreement between the directors to effectively "clean out" the CDA, whatever it may be, was sufficiently precise, definite, and ascertainable. The court found there was no dispute on the following points:

- Following the sale, the directors wished to distribute the maximum proceeds that could be distributed to the shareholders on a tax-free basis.
- The corporation consulted with its accountants for the purpose of determining the balance in the corporation's CDA.
- The corporation sought to make a distribution to its shareholders in the maximum amount that could be distributed without tax.
- The resolution authorizing the capital dividend clearly established that this was the essence of the agreement through a recital clause purporting to set out

73 The ECP regime was repealed effective after December 31, 2016.

74 Being the total of $24,119 (the CDA balance before the sale), $89,093 (the non-taxable portion of capital gains arising from the disposition of capital property), and $184,880 (from the disposition of ECP).

75 While the attorney general consented to this alternative relief, we speculate that rectification was advanced because equitable rescission could have resulted in a subsection 15(2) income inclusion as well as imputed interest under section 80.4.

76 Subject to certain revisions in the language of the order: *Manitoba Ltd.*, supra note 58, at paragraph 17.

the full (but unintentionally incorrect) amount of the CDA, specifying that the amount was to be paid from the corporation's CDA pursuant to subsection 83(2).[77]

- As a result of the error, subsection 83(2) simply could not apply to the specifically declared "full amount."[78]

The court rejected the attorney general's argument that the court must treat the actual agreement as being to declare the specific amount of $298,000. The exercise of the court is to find whether there was an agreement, and, if so, the true content of that agreement. Here the court found that the agreement was clear: to empty the entire CDA. The court specifically distinguished *Fairmont Hotels*, where the agreement was "at best an inchoate wish to protect [the corporations], by unspecified means . . . from foreign exchange tax liability."[79]

The only flaw in the resolution was the amount listed as available to be distributed. The directors' resolution declaring the capital dividend contained terms that were necessary, appropriate, and logical only if the true agreement was to empty the CDA. Otherwise, the directors could have simply declared the specific figure provided by the accountants without reference to the CDA, the potential tax consequences of the resolution, or the required filing obligations. Further, the court agreed that the figure (the CDA balance) was ascertainable.[80] The only flaw was in the accountants' calculation.

The court found that none of the policy concerns expressed in *Fairmont Hotels* as to why the ability to seek rectification must be kept within a narrow band were engaged. In so finding, the court cited the following reasons:

- While the Supreme Court of Canada has said that taxpayers attempting to engage in "bold tax planning" should be discouraged,[81] the directors in *Manitoba Ltd.* were only seeking to empty the CDA. The fact that the directors would have been entitled to extract the same total sum by the next taxation year in any event likely contributed to the court's finding that "[t]here was nothing bold about the plan."[82]
- The directors were not seeking to modify the instrument "merely because a party has discovered that its operation generates an adverse and unplanned

77 The Supreme Court of British Columbia commented that the clause was "arguably a nullity in purporting to declare that the [corporation] had something it simply did not have": ibid., at paragraph 31.

78 Ibid., at paragraphs 25-36.

79 Ibid., at paragraph 38, quoting *Fairmont Hotels*, supra note 56, at paragraph 40.

80 The CDA balance was calculated by the CRA—presumably during the course of an audit: *Manitoba Ltd.*, supra note 58, at paragraph 40.

81 *Fairmont Hotels*, supra note 56, at paragraph 33.

82 *Manitoba Ltd.*, supra note 58, at paragraph 42.

tax liability."[83] Rather, the "agreement at the outset was to only issue a planned tax-free capital dividend."[84]

- There was "no suggestion that the corporation was reckless, failed to act with due diligence, or 'should have known better.' "[85] The attorney general conceded that "the directors acted with appropriate due diligence in asking the accountants to advise them of the correct figure, given the complexity of the calculation."[86]
- Recognizing that rectification is not available "to cure a party's error in judgment,"[87] the court found that the directors did not fail to recognize a potential tax exposure. Rather, they "were properly seeking to avoid a tax exposure," which would have been accomplished "if they simply had been provided the proper figure from the accountants. . . . There was a calculation error" not an error that could be attributed to "misunderstanding, risk, or uncertainty about the applicable legal regime."[88]
- The court further distinguished *Fairmont Hotels*, where the taxpayer sought "to wholly rewrite or unwind a complex mechanism or series of business transactions,"[89] finding that the corporation in *Manitoba Ltd.* was not attempting "to adopt a different course of action. Rather, the proposed rectification order simply substitutes the correct figure for the incorrect figure."[90]

Finally, the court dismissed the attorney general's argument that "the availability of alternative remedies should prevent the issuance of a rectification order" on the basis that none "of these alternative remedies outweigh the equities established by the facts described above."[91] Specifically, the court noted:

> a) The ability to apply for remission through an Order in Council is restrictive, uncertain, complex and slow. Furthermore, Canada was unwilling to advise whether the Minister of National Revenue would even support such an application in this case.
>
> b) The ability to pursue a professional negligence suit against the accountants is again expensive, slow and uncertain. The net outcome will depend on both the availability of assets and insurance, and the legal expense necessary to pursue the claim.

83 *Fairmont Hotels*, supra note 56, at paragraph 3.

84 *Manitoba Ltd.*, supra note 58, at paragraph 43.

85 Ibid., at paragraph 44, citing *Fairmont Hotels*, supra note 56, at paragraphs 13 and 23.

86 *Manitoba Ltd.*, supra note 58, at paragraph 44.

87 *Fairmont Hotels*, supra note 56, at paragraph 19.

88 *Manitoba Ltd.*, supra note 58, at paragraph 45.

89 Ibid., at paragraph 46, citing *Fairmont Hotels*, supra note 56, at paragraph 19.

90 *Manitoba Ltd.*, supra note 58, at paragraph 46.

91 Ibid., at paragraph 47.

c) The ability to elect to treat the excess amount declared as taxable dividends under s.184(3) of the Act would still result in a tax liability for the shareholders, which was precisely what the agreement was seeking to avoid.[92]

Comments

There is no question that following *Fairmont Hotels*, rectification is limited to cases where the parties were in agreement and the written instrument failed to correctly record that agreement. The question that remains unanswered is whether *Fairmont Hotels* also restricts *all* other equitable remedies.

The Supreme Court of Canada held in both *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.* and *Fairmont Hotels* that rectification is to be used "with great caution."[93] However, these comments should not be taken to overrule the wide equitable jurisdiction that superior courts have "to relieve persons from the effect of their mistakes."[94] Further, a court of equity should be entitled to do whatever is "practically just."[95] If a conflict exists between the rules of equity and common law, the rules of equity must prevail.[96]

Form Matters

Both *Fairmont Hotels* and *Canada Life* relied on the proposition from *Shell Canada Ltd. v. Canada*[97] that tax consequences "flow from freely chosen legal arrangements, not from the intended or unintended effects of those arrangements,"[98] and that courts should look into "what the taxpayer agreed to do."[99] This is not in dispute. Tax liability should be based on what happened, not on what, in retrospect, the taxpayer wishes had happened. However, reliance on *Shell Canada* fails to recognize that equity can alter or void freely chosen legal arrangements, thereby changing the underlying facts (that is, what happened). Equity is a flexible tool that provides a superior court with all the power necessary to do justice between the parties.[100]

92 Ibid.

93 *Performance Industries*, 2002 SCC 19, at paragraph 31, and *Fairmont Hotels*, supra note 56, at paragraph 13.

94 See *TCR Holding Corporation v. Ontario*, 2010 ONCA 233, at paragraph 26.

95 See *Stone's Jewellery Ltd. v. Arora*, 2009 ABQB 656, at paragraph 29, citing an excerpt from G.H.L. Fridman, *The Law of Contract*, 5th ed. (Toronto: Thomson Carswell, 2006), at 812. *Fairmont Hotels*, supra note 56, at paragraphs 54 and 67, also recognized that equitable remedies are discretionary.

96 See, for example, the Judicature Act, RSA 2000, c. J-2, as amended, section 15; the Law and Equity Act, RSBC 1996, c. 253, as amended, section 44; and the Courts of Justice Act, RSO 1990, c. C.43, as amended, section 96.

97 [1999] 3 SCR 622.

98 *Fairmont Hotels*, supra note 56, at paragraph 24.

99 *Canada Life*, supra note 57, at paragraph 67.

100 *TCR Holding*, supra note 94, at paragraph 26.

Furthermore, provincial law determines the legal relationships to which tax law applies.[101] Where the requisite legal test has been met, a superior court should be able to cure unfair and unjust results, even in tax cases.[102] Without a court order, 5551928 Manitoba Ltd. would have been required to pay a punitive 60 percent tax on the portion of the dividend that did not qualify as a capital dividend.[103] This is precisely the type of situation in which equity *should* be given the discretion to intervene.

Rescission as a Distinct Equitable Remedy

While some may interpret *Canada Life* and *Harvest Operations*[104] as applying *Fairmont Hotels* beyond rectification to all equitable relief, rescission and rectification are distinct remedies that require separate analysis. The same brush cannot be used to paint all equitable remedies in the tax context. In *Graymar Equipment (2008) Inc. v. Canada (Attorney General)*, Brown J (who subsequently wrote the majority decision in *Fairmont Hotels*) found that a superior court's inherent jurisdiction does not permit it to "grant a remedy where doing so runs afoul of binding authority."[105] However, the court can "use its own intelligence and creativity to . . . breathe new life into causes of action and remedies."[106] It follows that other distinct remedies, such as rescission, remain available following *Fairmont Hotels*.

Beyond clarifying that a superior court cannot grant an equitable remedy in a manner that would undermine the rectification doctrine, *Fairmont Hotels* did not otherwise limit the equitable jurisdiction of superior courts or the availability of other distinct equitable remedies, such as rescission. Rescission for mistake may be available in equity in circumstances that do not meet the narrower common-law test for rescission if the parties were under a common misapprehension as to the facts or their respective rights that were fundamental to the contract, and the mistake renders enforcement of the contract unconscionable.[107]

The purpose of equitable rescission is to eliminate a benefit that one party received as a result of, inter alia, duress, deception, misrepresentation, or unilateral

101 See *Quebec (Agence du revenu) v. Services Environnementaux AES inc.*, 2013 SCC 65, at paragraph 45, and the Interpretation Act, RSC 1985, c. I-21, as amended, section 8.1.

102 Salvatore Mirandola, "No Equity for Unintended Tax Consequences?" *Tax Topics* no. 2421, August 2, 2018, 1-4.

103 In this situation, subject to making an election under subsection 184(3), the corporation will be subject to part III tax under subsection 184(2), equal to 60 percent of the portion of the dividend that does not qualify as a capital dividend. Further, under subsection 185(4), the shareholders are jointly and severally liable with the corporation for their proportionate share of the part III tax that becomes payable by the corporation (*Income Tax Folio* S3-F2-C1, "Capital Dividends," at paragraphs 1.86 to 1.93).

104 Supra note 64.

105 2014 ABQB 154, at paragraph 30.

106 Ibid.

107 *Beazer v. Tollestrup Estate*, 2017 ABCA 429, at paragraphs 26-28.

or common mistake. Rescission may provide appropriate relief where rectification will not[108] (and vice versa). Rescission can be used to set aside agreements[109] or voluntary or gratuitous transfers of property, such as dividends.[110] The effect is retroactive. A court effects rescission by cancelling and unwinding a contract and issuing whatever ancillary orders are necessary to restore the parties to their original positions. In the tax context, equitable rescission may be granted where one can point to a mistake of "sufficient gravity" that it would be unconscionable, unjust, or unfair to not correct that mistake.[111]

Prior to *Canada Life*, two decisions discussed rescission in the tax context. In *Stone's Jewellery* the Alberta Court of Queen's Bench found that two sets of transactions were void ab initio at common law because they were based on fundamental mistakes that went to the root of the contracts in issue.[112] However, the court held that even if it had not found that the transactions were void at common law, it would have exercised its equitable jurisdiction to rescind the transfer agreements. In *Pallen Trust*, the British Columbia Court of Appeal held that rescission may be granted if the error was a "causative mistake of sufficient gravity" that went either to "the legal character or nature of a transaction, or . . . to some matter of fact or law which is basic to the transaction."[113]

In *Canada Life*, the Ontario Court of Appeal found it unnecessary to determine whether the test for equitable rescission of a voluntary disposition in the tax context, as set out in *Pallen Trust*, was good law following *Fairmont Hotels*, because the reorganization in *Canada Life* did not involve a gratuitous transfer but rather a transaction between related entities. Consequently, the court found that the relief sought was more accurately described as rescission of a contract entered into by mistake.[114]

This distinction between a voluntary distribution that is subject to a corporate director's exercise of discretion and a transfer of assets as part of a transaction between related entities could result in *Canada Life* being distinguished on the facts in future applications. Perhaps the "narrow" approach to equitable relief found in *Canada Life* can be limited to instances involving complex corporate reorganizations where the applicant is asking the court to alter the character of the transaction.

However, this distinction may not allow for rescission to insert or delete intermediary steps and transactions, and is consequently difficult to reconcile with the

108 See, for example, *Stone's Jewellery*, supra note 95.

109 Ibid.

110 *Re Pallen Trust*, 2015 BCCA 222, which followed and applied *Pitt v. Holt* (sub nom. *Futter & Anor v. Revenue and Customs*), [2013] UKSC 26.

111 *Pallen Trust*, supra note 110, at paragraph 61.

112 *Stone's Jewellery*, supra note 95, at paragraphs 45-46 and 69.

113 *Pallen Trust*, supra note 110, at paragraph 2.

114 *Canada Life*, supra note 57, at paragraphs 88-89.

broad and elastic approach taken by equitable rescission. Limits on the availability of equitable rescission have not been fixed.[115]

An additional impediment to the relief sought by CLICC is that rescission is "all or nothing"—partial rescission is not a recognized equitable remedy. The Ontario Court of Appeal seemed to draw a negative inference based on the fact that CLICC sought to have only part of the reorganization rescinded in order to generate a particular tax outcome. Denying rescission on these grounds, however, ignores the fact that each step of the reorganization was a distinct transaction.

Retroactive Tax Planning—One Size Fits All?

The most apparent contrast between the decisions in *Canada Life* and *Manitoba Ltd.* is seen in their treatment of retroactive tax planning. 5551928 Manitoba Ltd. was not found to have engaged in retroactive tax planning by seeking to substitute the correct figure for the incorrect one. On the other hand, *Canada Life* could be interpreted to mean that *anything* that would reverse the factual basis of a tax assessment, whether bold or bland, is considered impermissible retroactive tax planning. The Ontario Court of Appeal stated that "[r]etroactive tax planning is not limited to attempts to secure a more favourable tax consequence than one had originally hoped to generate."[116] Rather, "it includes attempts to change one's affairs so that tax consequences that were intended, but which were prevented by a mistake, can be achieved."[117] This analysis may differ if no assessment has been issued. The issuance of an assessment generally creates rights for the CRA to participate in an equitable relief proceeding as a creditor.[118]

Further, the Ontario Court of Appeal found that *Fairmont Hotels* affirmed the underlying policy rationale of the decision in *771225 Ontario Inc. v. Bramco Holdings Co. Ltd.*,[119] and held that a superior court exercising its equitable jurisdiction to relieve unintended tax consequences is retroactive tax planning and thus impermissible. The court reconciled this finding with *TCR Holding*[120] on the basis that, while other equitable remedies remain generally available even when rectification is not, such remedies are not authorized for the purpose of impermissible retroactive tax planning. However, these concerns have always been present and were reconciled in *Stone's Jewellery*, where the court acknowledged the undesirability of permitting parties "to engage in retroactive tax planning under the guise of seeking equitable relief,"[121]

115 Fridman, supra note 95, at 812.

116 *Canada Life*, supra note 57, at paragraph 69.

117 Ibid.

118 *Canada (Attorney-General) v. Brogan Family Trust*, 2014 ONSC 6354.

119 *771225 Ontario Inc. v. Bramco Holdings Co. Ltd.*, 1995 CanLII 745 (ONCA).

120 Supra note 94.

121 *Stone's Jewellery*, supra note 95, at paragraph 54.

but found that courts can exercise caution and decline to use discretionary power when an equitable remedy would prejudice third parties.[122]

TCR Holding was further distinguished in *Canada Life* on the basis that in the former case, the application was not motivated by tax considerations but rather sought to avoid an unintended windfall to a third party. It was the avoidance of unjust enrichment, and not unintended tax consequences, that formed the foundation of the court's intervention in equity.[123] We question this view since it ignores the fact that the CRA, a third party, can benefit from unjust enrichment when equitable relief applications are denied.[124]

In *Canada Life*, the court stated that the fact that CLICC's primary objective was to achieve a particular tax outcome did not remove it from the scope of impermissible retroactive tax planning that was precluded by *Fairmont Hotels*. Both of these cases involved "tax-driven" transactions (in the sense that the choice of structure was informed by tax considerations), as did *Juliar* (where the Ontario Court of Appeal found that the transaction "had to be carried out on a no immediate tax basis or not at all").[125] In *Canada Life*, the court was being asked to reverse the factual basis of the tax assessment in order to defeat the tax liability that resulted from the original transaction. The court held that while *Fairmont Hotels* did not preclude the exercise of the court's general equitable jurisdiction to grant relief against mistakes in appropriate cases, the Supreme Court of Canada jurisprudence prevented CLICC from invoking the court's general equitable jurisdiction to achieve the objective of avoiding an unintended tax consequence.

Perhaps a better approach by the courts is to delineate between "bold" tax plans gone wrong that result in tax liability, and tax liability that arose through a genuine error. While overruled by the majority in *Fairmont Hotels*, Abella J found that courts have previously been able to distinguish between legitimate mistakes and attempts at retroactive tax planning.[126]

Alternative Remedies

We query whether the alternative remedies offered by the Ontario Court of Appeal should be considered adequate alternative remedies:

- Seeking discretionary relief from the minister or under the Financial Administration Act is akin to throwing a Hail Mary: time has likely run out, and the probability of success is rather low. The minister's discretion to waive penalties

122 This concern was also addressed in *S & D International Group Inc. v. Canada (Attorney General)*, 2011 ABQB 230, at paragraphs 85-86.

123 *Canada Life*, supra note 57, at paragraphs 76-82.

124 See Abella J's dissenting comments in *Fairmont Hotels*, supra note 56, at paragraph 70.

125 *Juliar*, supra note 62, at paragraph 27.

126 *Fairmont Hotels*, supra note 56, at paragraph 78.

and interest[127] is limited to providing exceptional relief from the application of the Income Tax Act when the minister determines such relief to be warranted.[128] Additionally, as mentioned in *Manitoba Ltd.*, an order in council is restrictive, uncertain, complex, and slow.

- Without a court order,[129] the Tax Court of Canada will be unable to overturn any factual basis of any reassessment, given that its jurisdiction is limited to the correctness of an assessment.[130] For CLICC, absent a court order, the CRA will assess on the basis that subsection 98(5) applies to the transaction, and the Tax Court will not be able to overturn this finding.
- A professional adviser is not negligent if he or she acts with ordinary prudence, and reliance on liability insurance imposes a burden on insurers.[131]

Further, none of the suggested alternatives offers the same result as rescission: the suggested remedies could potentially reduce an unintended negative consequence, but none can unwind a contract, such that, at law, the transaction never took place.[132]

Conclusion

Comparing the above decisions, *Canada Life* took a very narrow view of *Fairmont Hotels*, severely restricting the availability of other equitable remedies in the tax context. Fortunately, *Manitoba Ltd.* offers flexibility and enables a superior court the discretion to intervene where the requisite legal test is met. We submit that *Fairmont Hotels* did not fetter the discretion of superior courts beyond clarifying that the test for rectification in the tax context is narrow. The distinct equitable remedies of rectification and rescission should remain available to provide relief to taxpayers

127 Under subsection 220(3.1). See also the administrative guidelines that the CRA will generally follow in making a decision whether to grant or deny relief based on a taxpayer's situation: *Information Circular* IC07-1R1, "Taxpayer Relief Provisions," August 18, 2017. Administrative guidelines published by the CRA do not have the force of law.

128 *Jenkins v. Canada (Revenue)*, 2007 FC 295, at paragraph 13.

129 See *Sussex Square Apartments Limited v. The Queen*, 99 DTC 443 (TCC); aff'd. 2000 DTC 6548 (FCA), which provides that the CRA is not bound by transactions that are modified contractually but are not subject to a retroactive court rectification order.

130 Tax Court of Canada Act, RSC 1985, c. T-2, as amended, section 12.

131 Alan M. Schwartz, "Rescission Denied: Troubling for Taxpayers and Advisers" (2018) 26:9 *Canadian Tax Highlights* 1-2.

132 We are mindful that the important consideration is not whether the alternative remedies available in the Tax Court are the same as rescission, but rather whether they are adequate (*Froom v. Canada (Minister of Justice)*, 2004 FCA 352, at paragraph 12). In *JAFT Corp. v. Jones et al.*, 2015 MBCA 77, at paragraph 51, appeal to the Tax Court was considered to be an adequate alternative remedy because the heart of the matter (the CRA's denial of claims for the scientific research and experimental development tax credit) was whether the tax assessment was correct. This is not always the case.

from liabilities resulting from inadvertent mistakes where the relevant test is met and the court finds it necessary to intervene.[133] Superior courts have wide equitable jurisdiction to relieve persons from the effect of their mistakes, and all the powers necessary to do justice between the parties.[134]

Following *Fairmont Hotels*, it was feared that rectification in the tax context was all but eliminated. *Canada Life* seems to have further extended the Supreme Court's restriction to say that

- rectification cannot be used, ever, in the tax context;
- any change to implement intended tax consequences is retroactive tax planning; and
- the restriction applies to all equitable remedies (even rescission, which unwinds contracts rather than modifying them).

However, *Manitoba Ltd.* illustrates that rectification remains available in circumstances where it can be shown that the narrowed *Fairmont Hotels* test is met.

We submit that superior courts should still be entitled to use discretion to grant equitable remedies when appropriate—that is, when the relevant test is met and when granting relief is just. Particularly, when the test for rescission is met, a court should be entitled to use its discretion to grant rescission. In *Fairmont Hotels*, the Supreme Court specified that "a court may not *modify* an instrument merely because a party has discovered that its operation generates an adverse and unplanned tax liability,"[135] but also stated that "imprecision may justify *setting aside* an instrument."[136] "Modifying an instrument" and "setting aside an instrument" are separate, distinct concepts. In our opinion, if the Supreme Court had intended to prevent superior courts from setting aside agreements in a tax context, it would have explicitly said so. The tax community will watch with great interest to see whether the application for leave to appeal the decision in *Canada Life* is granted and whether the Supreme Court elects to clarify its comments in *Fairmont Hotels*.

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133 The distinction between equitable remedies was recognized by Brown J in *Graymar*, supra note 105, at paragraph 50.

134 *Douez v. Facebook, Inc.*, 2017 SCC 33, at paragraph 37; *Bramco*, supra note 119; and *TCR Holding*, supra note 94, at paragraph 26.

135 *Fairmont Hotels*, supra note 56, at paragraph 3 (emphasis added).

136 Ibid., at paragraph 32 (emphasis added).