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Recent Updates in Tax Law

Thursday, November 7, 2019

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Legislative Update

Steve Marshall, Associate, McCarthy Tétrault LLP
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Overview

Legislative update:

- Stock option proposals
- Foreign affiliate dumping proposals

International tax developments :

- Multilateral Instrument (MLI) update
- OECD Project: “Addressing the Tax Challenges of the Digitalisation of the Economy” – Pillar One and Pillar Two

Stock Option Changes

- Currently, an employee can claim a deduction equal to 50% of an employment benefit realized by the employee where certain criteria are met.

- Rationale for changes:

  - “A review of employee stock option deduction claims reveals that the tax benefits of the employee stock option deduction disproportionately accrue to a very small number of high-income individuals – resulting in a tax treatment that unfairly benefits the wealthiest Canadians.” (Backgrounder: Proposed Changes to the Tax Treatment of Employee Stock Options)

- The 2019 Federal Budget announced the Government's intention to limit the use of the current employee stock option tax regime, and to move toward aligning it more closely with that of the United States for employees of “large, long-established, mature firms”.

Stock Option Changes

- On June 17, 2019, the Minister of Finance tabled a Notice of Ways and Means Motion that contains the proposed amendments

- Options granted to employees of CCPCs or employees of start-up, emerging or scale-up non-CCPCs after January 1, 2020:

  - No change to taxation of employee stock option benefits or to the availability of the 50% deduction

- Options granted to all other employees on or after January 1, 2020:

  - Each employee will be able to claim the 50% deduction on option grants of up to $200,000 per year (based on the FMV of the shares on the date of grant)
  - Options granted to an employee in excess of $200,000 will not be eligible for the deduction
  - If cap is exceeded in respect of a particular employee for a particular vesting year (such that the deduction is not available to the employee), the employer will generally be entitled to deduct the stock option benefit
  - Issuing corporation may designate all options in a particular grant as “non-qualifying”

Stock Option Changes - Example

	Former Regime	Proposed Amendments
Total FMV of shares on grant	(100,000 × $50) = $5,000,000	(100,000 × $50) = $5,000,000 **this exceeds the $200,000 cap*
Options eligible for the deduction	100,000	$200,000 ÷ $50 = 4,000
Taxable benefit on exercise before the deduction (assumes total FMV of shares on exercise is $7,000,000)	(100,000 × $70) - (100,000 × $50) = $2,000,000	(100,000 × $70) - (100,000 × $50) = $2,000,000
Stock option deduction	$2,000,000 × 50% = $1,000,000	[(4,000 × $70) - (4,000 × $50)] × 50% = $40,000
Tax payable on exercise (using highest Ontario marginal tax rate)	($2,000,000 - $1,000,000) × 53.53% = **$535,300**	($2,000,000 - $40,000) × 53.53% = **$1,049,188**

Stock Option Changes

- Stakeholders were invited to submit comments with respect to the prescribed conditions for the consideration of the Department of Finance by September 16, 2019

- Issues with proposed amendments (Joint Committee submission (September 13, 2019)):

  - No grandfathering for existing options that are exchanged or repriced
  - Employer deduction issues:
    - *Employer that is not the issuer* - problem when the issuer is actually a parent corporation
    - *No successor rules* – if reorganization (e.g., amalgamation, wind-up or sale of a business) occurs
  - Practical issues surrounding the definition of “vesting year”, which is relevant for determining the number of shares that are eligible for the preferential treatment
  - $200,000 annual vesting limit is applied to options in order of grant date (i.e., no ability to choose which options to apply it to for a given year)
  - Notification to the individual regarding non-qualified securities must be given, in writing, on the day the option is granted– impractical and inconsistent with commercial practice

Foreign Affiliate Dumping Changes

- The foreign affiliate dumping ("FAD") rules contained in section 212.3 of the *Income Tax Act* (Canada) were originally intended to discourage foreign multinational corporations from "dumping" foreign affiliates into Canadian subsidiaries in a manner that erodes the Canadian tax base

- Currently, where a non-resident corporation controls a corporation resident in Canada ("CRIC"), and the CRIC makes an "investment" into a foreign affiliate ("FA"), the CRIC is deemed to have made a distribution to its non-resident corporate parent

- 2019 Federal Budget proposed to extend the application of the foreign affiliate dumping rules to Canadian corporations controlled by:

  - a non-resident individual,
  - a non-resident trust, or
  - a group of persons that do not deal with each other at arm's length and that is comprised of any combination of non-resident corporations, non-resident individuals and non-resident trusts

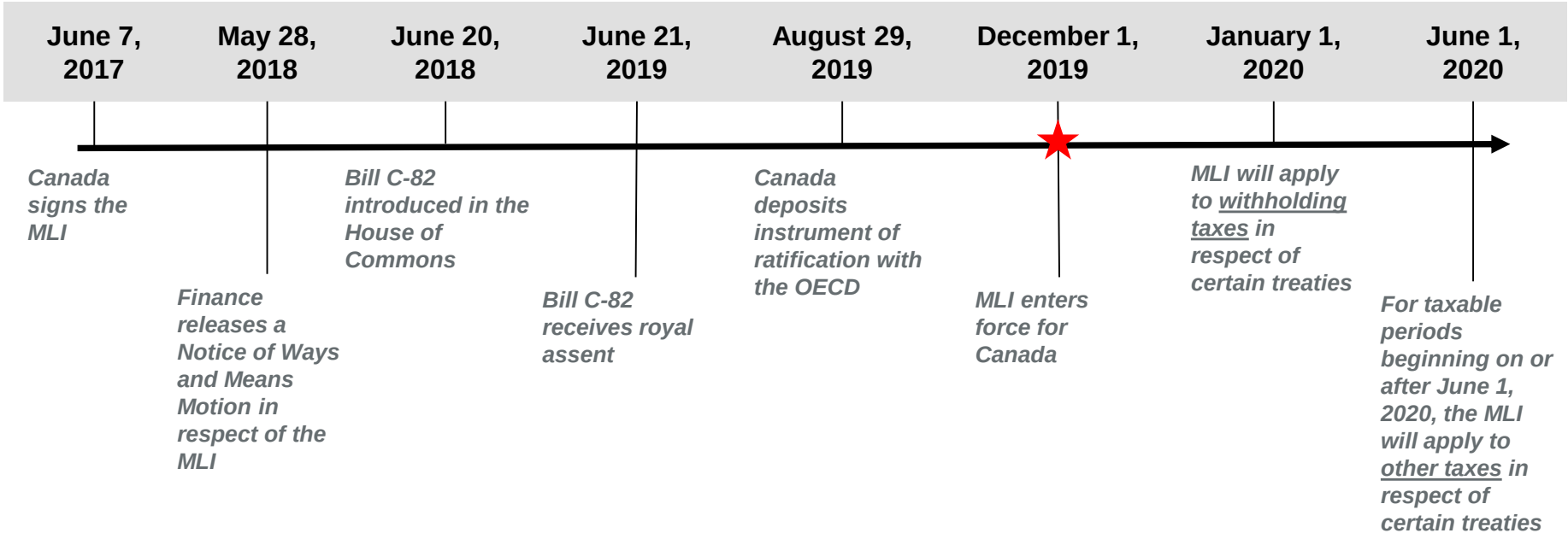
Foreign Affiliate Dumping Changes

- If a trust is a shareholder of the CRIC:
  - the trust is treated as a corporation having a single class of 100 voting shares, and
  - each beneficiary under the trust is deemed to own a pro rata number of the 100 voting shares based upon the proportionate FMV of their beneficial interest as a percentage of the total FMV of the interests of all beneficiaries under the trust
- However, where the trust is discretionary, each beneficiary is deemed to own 100% of the CRIC
- As a result, where a discretionary trust controls a CRIC and has one non-resident beneficiary, the CRIC will be subject to the FAD rules to the extent it makes an “investment” in a FA
- Other issues raised by Joint Committee on May 24, 2019

Foreign Affiliate Dumping Changes

- On July 30, 2019, the Department of the Finance released revised draft legislative proposals which state that a beneficiary under a discretionary trust is deemed to own 100% of the shares of the assumed corporation unless the trust is:
  - resident of Canada; and
  - it cannot reasonably be considered that one of the main reasons for the discretionary power is to avoid or limit the application of the FAD rules
- Canadians were invited to provide comments on these draft income tax legislative proposals by October 7, 2019

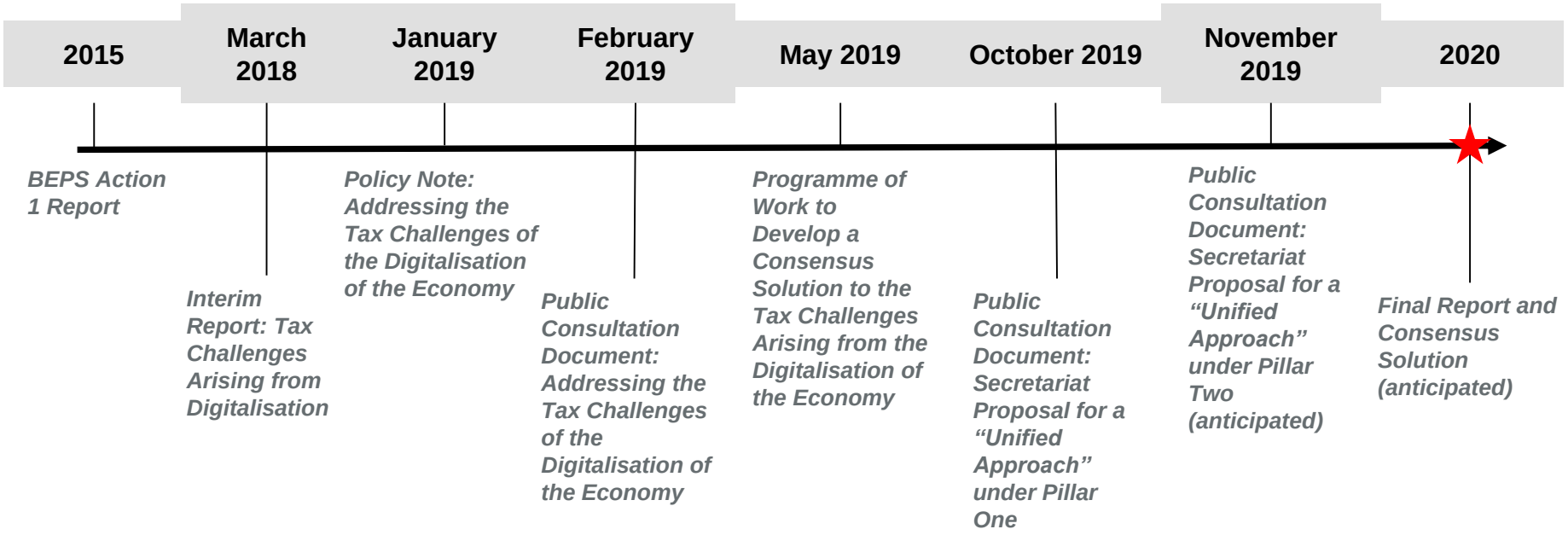
Multilateral Instrument (MLI)



Multilateral Instrument

- Art. 7 : principal purpose test (PPT)
- Art. 8 : 365-day holding period for reduced treaty withholding rate on dividends
- Art. 9 : 365-day look-back period for capital gains exemption on shares

OECD BEPS Project – Addressing the Tax Challenges of the Digitalisation of the Economy



OECD Proposals Addressing Tax Challenges of the Digital Economy

- Pillar One: allocation of taxation rights
  - Scope – large, “consumer-facing” MNEs
  - Nexus – changing the traditional definition of “permanent establishment”
  - Profit allocation – formulaic approach, rather than the “arm’s length principle”

OECD Proposals Addressing Tax Challenges of the Digital Economy

- Pillar One: Scope
  - Large consumer-facing businesses
    - E.g., businesses that generate revenue from supplying consumer products or providing digital services that have a consumer-facing element
  - Proposed exemptions:
    - Extractive industries, commodities, possibly financial services

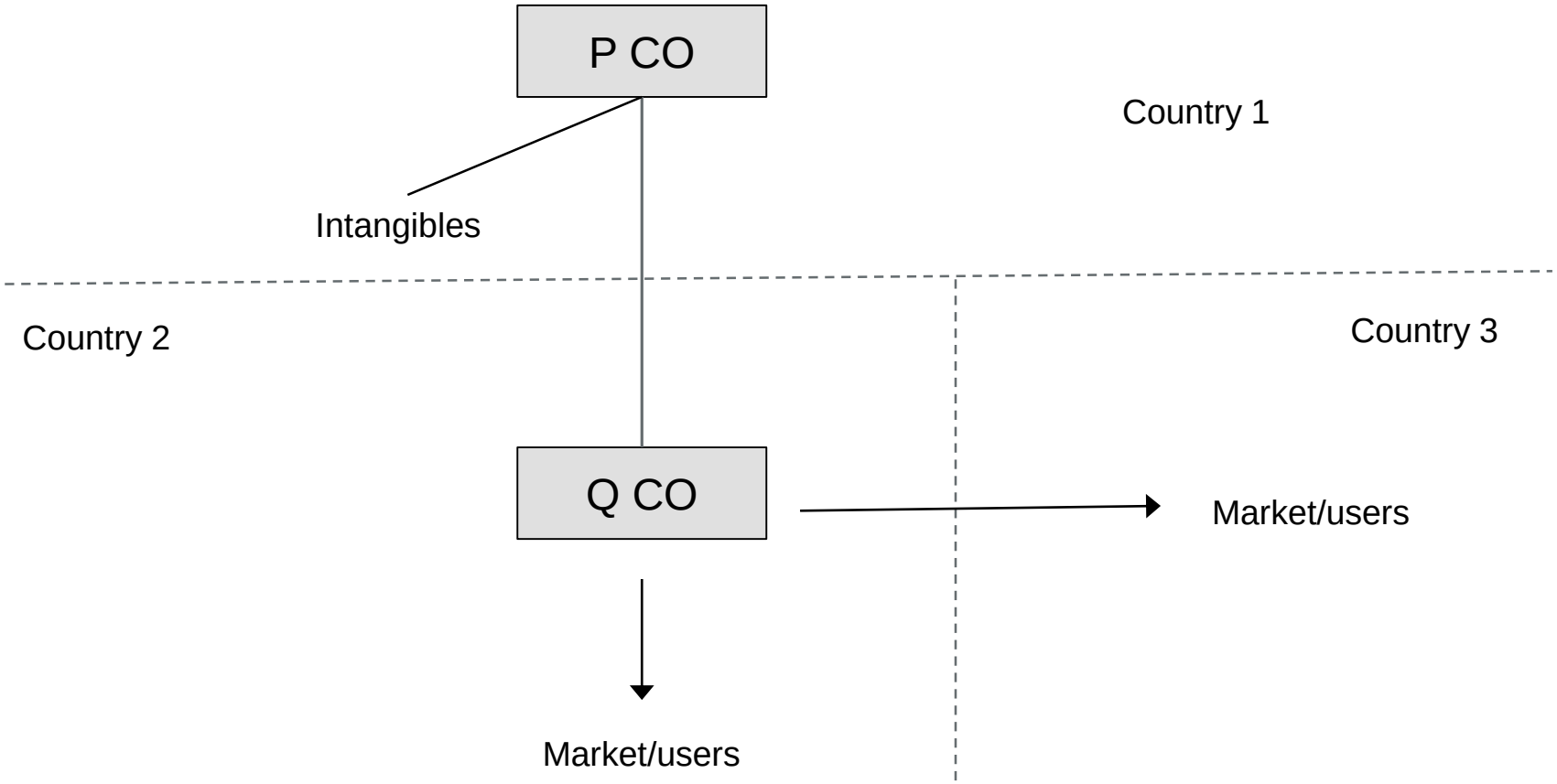
OECD Proposals Addressing Tax Challenges of the Digital Economy

- Pillar One: Nexus
  - Grants taxing rights to countries where users are located ("user" or "market" jurisdiction)
    - Businesses that sell to users remotely
    - Businesses that sell through a local distributor (related or unrelated)
  - Based on revenue threshold, and certain online activities
  - Not based on physical presence in the user/market jurisdiction

OECD Proposals Addressing Tax Challenges of the Digital Economy

- Pillar One: Profit Allocation Formula
  - Existing arm's length transfer pricing principles complemented with formulaic approach
  - Introduces a "three tier mechanism"
    - Amount A: deemed residual profit allocated to market jurisdiction under formula
    - Amount B: remuneration for baseline marketing and distribution functions in the market jurisdiction
    - Amount C: binding dispute prevention and resolution mechanisms

Illustration



OECD Proposals Addressing Tax Challenges of the Digital Economy

- Pillar Two:
  - Intended to ensure that all internationally operating business pay a minimum level of global tax
  - Public consultation document expected November 2019

OECD Proposals Addressing Tax Challenges of the Digital Economy

- Pillar Two:
  - Income inclusion rule
  - Tax on base eroding payments
    - "Undertaxed payments rule" – deny a deduction or impose source-based tax (e.g., withholding tax) for related party payments
    - "Subject to tax rule" – deny treaty benefits unless the item of income subject to minimum tax

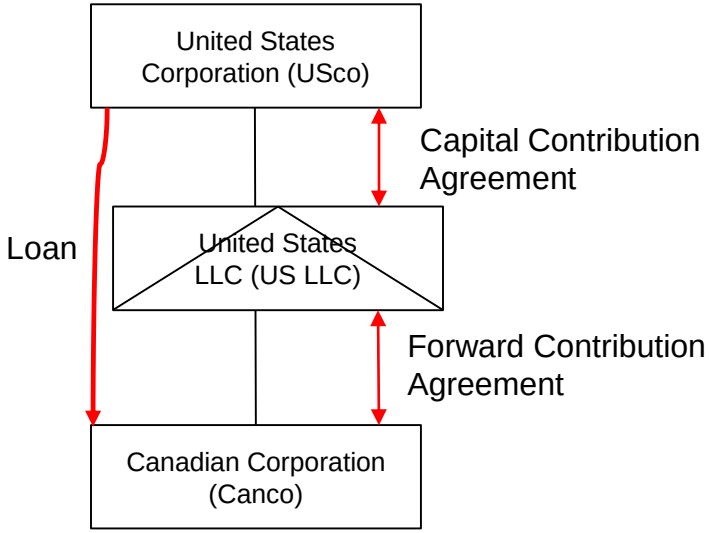
Privileged & Confidential

Cross-Border Financing

Raj Juneja, Partner, McCarthy Tétrault LLP

Inbound Developments

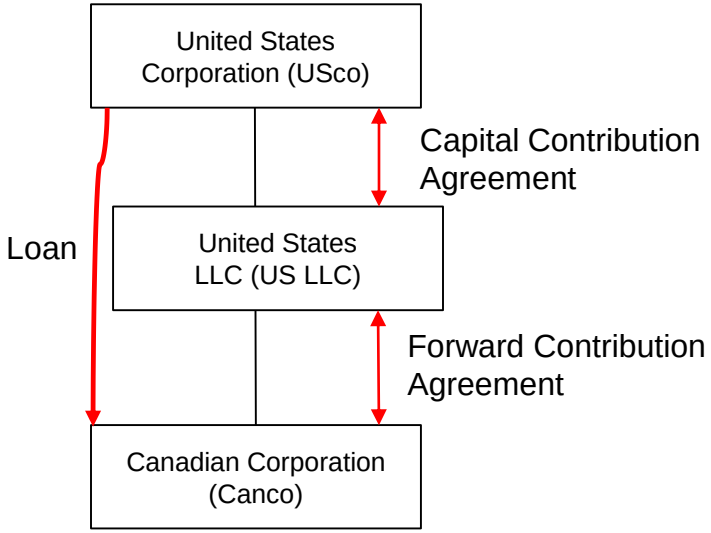
Recent CRA Desk Notice - US into Canada in-bound Forward Subscription



Cash Flows

- Interest or principal paid by Canco to USco is contributed by USco to US LLC as a capital contribution pursuant to a capital contribution agreement entered into on implementation of the structure.
- US LLC uses cash received from USco to acquire shares of Canco pursuant to a forward subscription agreement entered into on implementation of the structure.

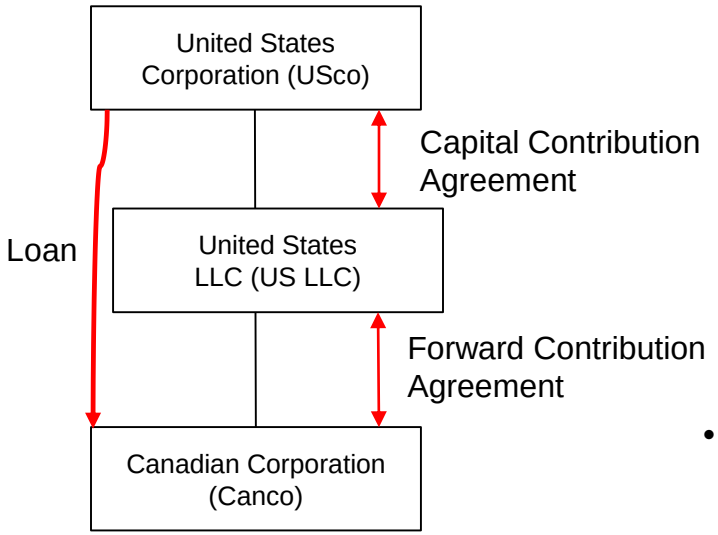
Recent CRA Desk Notice - US into Canada in-bound Forward Subscription



Intended Tax Consequences

- The interest paid by Canco is deductible for Canadian tax purposes.
- No income inclusion for US tax purposes because loan and cash flows are disregarded for US tax purposes (however, some concern when dividends paid by Canco under the new US participation exemption).

US into Canada in-bound – Forward Subscription

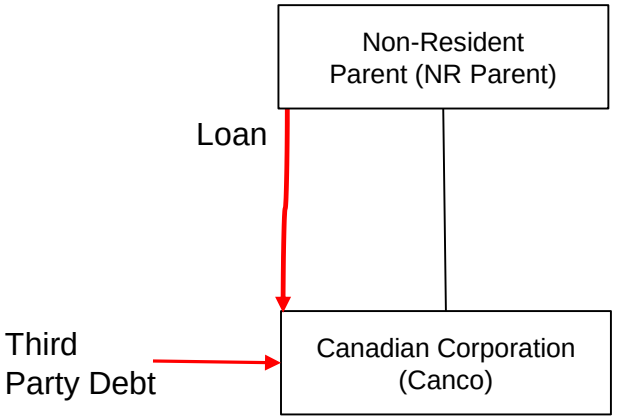


- It is understood that CRA has well over 100 cases under audit where it is proposing to reassess under s. 247(2)(b) and 247(2)(d)
  - the transaction is not a transaction that would be entered into by arm's length parties and not entered into for primarily *bona fide* purposes other than to obtain a tax benefit
  - potentially allows adjustment to both nature and quantum
- CRA issued a Desk Notice on July 9, 2019, advising tax professionals that it reached a settlement with a taxpayer on the basis of s. 247(2)(b) and 247(2)(d) applying
  - understood taxpayer was motivated to settle for other reasons
  - CRA appears to be slow playing other files – believed CRA is awaiting the appeal in the TCC's decision in *Cameco* – only case to address to s. 247(2)(b) and 247(2)(d)

Canadian Hybrid Debt Mismatch Rule?

- In the Liberal government's election platform, it was indicated that they would implement a hybrid debt mismatch rule (as recommended by the OECD)

Possible 30% of EBITDA Interest Limitation



- Under the Canadian thin capitalization rules, interest on debt owed to NR Parent cannot exceed 1.5 times NR Parent's equity investment in Canco, otherwise the deduction of interest on the excess portion of the debt will be denied.
- Currently, no limitation on deduction of interest on debt owed by Canco to third parties (even if guaranteed by NR Parent).
- In the Liberal government's election platform, for corporations with net interest expenses of more than $250,000, the interest expense would be limited to no more than 30% of its EBITDA.
    - Interest would be deductible above 30% if the corporation is part of a corporate group and the worldwide ratio of net third party interest expense to EBITDA of that group exceeds this level.

Financing US Operations

Financing US Operations

US Anti-Hybrid Mismatch Rules

- Applies to tax years beginning after December 31, 2017
- Draft regulations released in December of 2018. Final regulations expected later this year or early next year.
- Deny interest deduction under financings that utilize hybrid instruments or hybrid entities or otherwise provide for a deduction/no-inclusion outcome – Conceptually similar to core principles outlined by the OECD and the EU Anti-Avoidance Directives
- US interest deduction denied for typical structures such as:
  - a “repo financing” (Canco holding preferred shares of a US opco that is characterized as debt for US tax purposes because of a sale and a repurchase obligation by a US holdco)
  - financing through a Luxembourg holding company (offsetting deduction through notional interest deduction or hybrid instrument (hybrid instrument no longer works under the EU anti-avoidance directive))

Financing US Operations

US Ant-Hybrid Mismatch Rules

- Many alternatives have been proposed/implemented
- Final US regulations could have an impact on some of the alternatives
- Various other structures are being considered that don’t involve an interest deduction in the US

Financing US Operations

Other US rules to consider

- Debt/equity characterization (IRC 385) – recently announced that documentation regulations have been removed and US Treasury and the IRS intend to propose more “streamlined and targeted” recast rules

- Interest deductibility limitation (163(j))

- BEAT (US base erosion and anti-abuse tax) – deductible payments to related foreign parties (interest, royalties, etc.) added back to ensure a minimum tax (10% in 2019 through 2025) is paid in the US

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Are Equitable Remedies Like Rectification and Rescission Still Available to Fix Tax Mistakes?

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Rectification: Introduction

Rectification is an equitable remedy **to restore parties to a bargain that was incorrectly recorded in an instrument**.

Traditionally, rectification was applied as a method to correct mainly transcription errors, and not intended to change the bargain between the parties.

A common articulation of the test was as follows: there must be a prior agreement, a common intention, a finding that the documents don't properly record the intention, and a mistake.

Rectification: Classic Definition

There will be cases where the terms of the instrument do not accord with the true agreement between the parties: a term may have been omitted, or an unwanted term included, or a term may be expressed in the wrong way. In such cases, equity has power to reform, or rectify, that instrument so as to make it accord with the true agreement. What is rectified is not a mistake in the transaction itself, but a mistake in the way in which that transaction has been expressed in writing. **"Courts of Equity do not rectify contracts; they may and do rectify instruments purporting to have been made in pursuance of the terms of contracts."**

J. McGhee, ed., Snell's *Equity*, 31st ed. (London: Sweet & Maxwell, 2005)

Rectification: Expansion

In the late 1990s/early 2000s, rectification became available in many more circumstances.

Courts often permitted changes to **transactions** (or even the creation of transactions) if the changes achieved a demonstrated tax intention, if the evidence was strong and the tax intention was the operating motivation for the transaction/document gone bad.

Rectification was expanded to include not just situations in which the mistake was in not properly transcribing the agreement, but also situations **in which the agreement does exactly what the parties intended but the parties chose the wrong mechanism to achieve their tax intention**.

Rectification: Expansion

Until December 2016, this was generally considered the leading case for rectification in tax cases: ***Juliar v. Canada (Attorney General)***, 99 DTC 5743 (Ont. S.C.J.), aff'd at 2000 DTC 6589 (Ont. C.A.), leave to S.C.C. refused at [2000] S.C.C.A. No. 621

- Taxpayer sold shares of Opco to Holdco in return for promissory note thought to be equal to the ACB of the transferred Opco shares.
- It turned out that the ACB was less than FMV (and less than the amount of the promissory note), with the result that the transfer became taxable.
- The Court permitted the consideration to be changed to shares of Holdco to enable a tax-free section 85 rollover.
- The Court found (inferred, actually, because the parties did not actually discuss income tax matters) that the taxpayer intended that the transaction not trigger tax.
- Arguably, the Court rewrote the bargain – corrected the manner in which the transaction was structured in order to achieve the tax result the taxpayer (apparently) intended.

Rectification: Expansion

In *Juliar*, the Ontario Court of Appeal acknowledged that (i) rectification was being granted based on the taxpayer's general intention to transfer shares on a tax-free basis, and (ii) that this general intention was based on inference rather than direct evidence of intention.

> [26] The appellant quarrels with the finding of fact that "it was the intention of the Juliars that the transactions would not trigger an immediate obligation to pay income tax." The appellant argues that this finding "was based more on an inference than on clear, direct, and admissible evidence."
>
> [27] This latter is a fair comment. It is possible, even probable, that no one mentioned income tax throughout the nine or ten months in issue. The plain and obvious fact, however, is that the proposed division had to be carried out on a no immediate tax basis or not at all.

Rectification: Expansion

Examples of circumstances in which rectification was granted:

- Changing form of **consideration** so a section 85 rollover can occur (*Juliar* – above)
- Changing an invalid short-form **amalgamation** to a permitted long-form amalgamation (*Re Aylwards (1975) Ltd.*, [2001] N.J. No. 195 (Nfld. S.C. – T.D.))
- Changing an agreement to set out, as a party, the **correct name** of the owner of the copyright in a film production so that a film tax credit would be available (*Snow White Productions Inc. v. PMP Entertainment Inc.*, 2005 DTC 5150 (B.C.S.C.)

Rectification: Expansion

Examples of circumstances in which rectification was granted:

- Changing a **merger** by windup into a merger by amalgamation to preserve tax losses and other tax attributes of the target company (*Re GT Group Telecom Inc.*, [2004] O.J. No. 4289 (Ont. S.C.J.))
- Changing the **terms of a trust deed** so as to prevent the application of the revocable trust rules in subsection 75(2) of the *Income Tax Act* (*McPeake v. Her Majesty the Queen*, 2012 BCSC 132)
- Changing a corporate resolution to **reduce the amount of a dividend** so as not to exceed the balance of the taxpayer's capital dividend account (*Winclare Management Services Ltd. v. Canada (Attorney* General), [2009] 5 CTC 278 (Ont S.C.J.))

Rectification: Contraction

Graymar Equipment (2008) v. Canada (AG), 2014 QBQB 154

An LP acquired a business through various entities, including its subsidiary Graymar Equipment. The financing was funded with bank debt. The acquired business did not do well. A complex restructuring occurred, at the conclusion of which the LP subscribed for more shares in Graymar in consideration of debt owed by the LP to Graymar. The debt was not repaid within 1 year, so CRA reassessed the LP's partners under subsection 15(2) ITA. The parties sought rectification to approve a retroactive resolution to settle the loan through a return of capital from Graymar to the LP and to set off the return of capital with the loan owing by the LP to Graymar.

Rectification: Contraction

Graymar Equipment (2008) v. Canada (AG), 2014 QBQB 154

Some interesting facts:

- The purpose of the debt restructuring was to repay the bank debt and to reduce interest costs.
- The accountants had prepared a memo outlining the 15(2) risk, but the advice never reached the client.
- The judge assumed that had the clients received the advice, the loan would have been repaid within one year and 15(2) avoided.

Rectification: Contraction

Graymar Equipment (2008) v. Canada (AG), 2014 QBQB 154

Rectification was refused.

Rectification should be exercised cautiously, especially when we're dealing with sophisticated businesspeople who/that reduce their agreements to writing. Rectification is available when the terms of an instrument do not accord with the parties' true intention driving its formation, and not to rewrite fiscal history when unforeseen tax consequences happen.

It is irrelevant that the parties would have done things differently had they adverted to the tax problem.

In this case, the failure to repay the loan within one year did not frustrate the purpose of the transactions (repaying bank debt and reducing interest costs).

Courts will be wary to infer a tax intention based on a taxpayer's self-serving evidence..

Rectification: Contraction

Graymar Equipment (2008) v. Canada (AG), 2014 QBQB 154

[66] … *Juliar* sits uneasily with Supreme Court's direction in *Performance Industries* and *Shafron* that rectification is granted to restore a transaction *to its original purpose*, and *not to avoid an unintended effect*….

[68] I acknowledge that, as Cameron J said at the Superior Court in *Juliar* at para 45, it is a fact of modern commercial life that tax consequences are an essential consideration in most commercial transactions, and that adverse tax consequences are often a "deal breaker". At the same time, the proposition that every commercial transaction has as its intention tax avoidance is not an appropriate subject of judicial notice. **If taxpayers may structure their affairs so as to reduce tax…, they may also be taken as having structured their affairs in such a way as to increase tax where they do so for other reasons.**

Rectification: Contraction

In December 2016, the Supreme Court of Canada decided two cases that have restricted the circumstances in which a rectification order will be granted.

Canada (Attorney General) v. Fairmont Hotels Inc., 2016 SCC 56

Jean Coutu Group (PCJ) Inc. v. Canada (Attorney General)**,** 2016 SCC 55

The SCC held that:

- a general intention to avoid or mitigate tax is not sufficient to obtain rectification; rectification is only available where there has been a **prior agreement with definite and ascertainable terms**
- rectification cannot be used to change the intended bargain; rectification is available where a prior agreement was incorrectly recorded in an instrument

Rectification: Contraction

Fairmont Hotels Inc.

In 2002-2003, Fairmont Hotels and various related companies set up a USD reciprocal loan arrangement as a hedge against foreign exchange rate fluctuations and tax thereon. The arrangement was modified a few years later, but not completely, so certain subsidiaries of Fairmont Hotels were potentially exposed to foreign exchange fluctuations and tax.

In 2006, the reciprocal loan arrangement had to be unwound urgently for business reasons. The unwind transactions included the redemption of preference shares held by Fairmont Hotels in certain subsidiaries. The redemptions were a mistake, and resulted in a tax liability on foreign exchange gains with no offsetting losses.

Fairmont Hotels brought an application to replace the share redemptions with loans, in order to eliminate the tax liability.

Rectification: Contraction

Fairmont Hotels Inc. v. AG Can

The Supreme Court refused rectification:

> [39] … It is therefore clear that Fairmont intended to limit, if not avoid altogether, its tax liability in unwinding the Legacy transactions. And, by redeeming the shares in 2007, this intention was frustrated. Without more, however, these facts do not support a grant of rectification. The error in the courts below is of a piece with the principal flaw I have identified in the Court of Appeal's earlier reasoning in *Juliar*. **Rectification is not equity's version of a mulligan. Courts rectify instruments which do not correctly record agreements. Courts do not "rectify" agreements where their faithful recording in an instrument has led to an undesirable or otherwise unexpected outcome.**

Rectification: The Tests

Where there is a **common mistake**, the applicant must show:

- ¬ the existence of a **prior agreement whose terms are definite and ascertainable**
- ¬ that the prior agreement was **still effective** when the instrument was executed
- ¬ that the instrument **fails to record accurately** the prior agreement
- ¬ that if rectified as proposed, the instrument would **carry out** the prior agreement

Where there is a **unilateral mistake**, the applicant must show:

- ¬ the four conditions set out above, PLUS the following
- ¬ that the party resisting rectification knew or ought to have known about the mistake
- ¬ that permitting the resisting party to take advantage of the mistake would amount to a “fraud or the equivalent of fraud”

Other Potential Judicial or Statutory Remedies

- ¬ Rescission
- ¬ Relief from mistakes
- ¬ Corporate statutory ‘rectification’

Rescission: Example
Pallen Trust

Pallen Trust, 2015 BCCA 222 (pre-*Fairmont Hotels*)

- Dividends were paid to a trust. Everyone believed 75(2) would apply to cause the dividends not to be taxable to the trust. The FCA decided another case that held that 75(2) would not apply in these circumstances, so the trust unexpectedly became liable for the tax on the dividends.

- The Court agreed that the dividends could be rescinded because there was a "causative mistake of sufficient gravity…as to the legal character or nature of the transaction or as to some matter of fact or law which is basic to the transaction".

- The Court felt that it would be unfair to refuse to rescind the dividends because the taxpayer's understanding of the applicability of 75(2) was a common understanding in the tax community and of CRA itself.

Equitable Remedies Under Fire? *Canada Life Insurance Company*

Canada Life Insurance Company of Canada v. Canada (AG), 2018 ONCA

Canada Life was exposed to FX risk because it indirectly held USD investments. It entered into various hedge contracts to eliminate the FX risk. There was a timing mismatch between when gains/losses could be recognized, so a series of transactions was implemented. A mistake was made in designing these transaction. The taxpayer tried to obtain relief from mistake or rescission by replacing the bad transactions with fixed transactions. The Ontario Superior Court allowed the changes; the Ontario Court of Appeal reversed.

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Equitable Remedies Under Fire? *Canada Life Insurance Company*

Canada Life Insurance Company of Canada v. Canada (AG), 2018 ONCA

The Ontario Court of Appeal suggested that rescission and relief from mistake will not be granted in situations where there is retroactive tax planning.

The Court drew on *Fairmont Hotels* as support for its analysis, even though *Fairmont Hotels* was a rectification case, not a rescission case.

Leave to the SCC was denied.

Equitable Remedies Under Fire? *Canada Life Insurance Company*

Canada Life Insurance Company of Canada v. Canada (AG), 2018 ONCA

> [63] As already noted, in 2016 the Supreme Court allowed the appeal from this court's decision in *Fairmont Hotels*. In my view, the companion decisions in *Fairmont Hotels* and *Jean Coutu*, do two things: (1) they specifically overrule the broad approach to rectification in the tax context that had been taken in *Juliar*, and (2) they recognize and give effect to the same policy concerns that form the basis for the second prong of the *Bramco* decision. ***Fairmont Hotels* and *Jean Coutu* effectively preclude the use of this court's equitable jurisdiction to refashion a corporate transaction to achieve a specific tax objective, whether or not that was the original intention of the parties to the transaction.**

Equitable Remedies Under Fire? *Collins Family Trust*

***Collins Family Trust v. Canada (Attorney General*), 2019 BCSC 1030**

The facts were virtually identical to *Pallen Trust*. Rescission was granted, but with reservations:

> [5] I agree with the submissions of the respondent that the decisions of the Supreme Court of Canada in *Fairmont* and *Jean Coutu* have seriously undermined *Pallen*. However, *Pallen* has not been expressly overruled and I am bound to follow it. In my view, it is for the British Columbia Court of Appeal to determine whether *Pallen* remains good law in light of the legal developments since it was rendered.

Statutory "Rectification" *Greither Estate*

***Greither Estate v. Canada (Attorney General)*, 2017 BCSC 994**

Changing consideration for sale of shares from promissory note to a share—to avoid the application of section 212.1 of the *Income Tax Act*—was not the sort of "corporate mistake" that can be fixed using the B.C. corporate statute:

> [37] **In this case, the mistake of not completing the Transaction in the most tax effective manner does not in my view, fall within these subsections.** As a result I find that a corporate mistake engaging my discretionary power pursuant to s. 229(2) of the *BCA* has not occurred.
>
> [38] The Greither Estate did what it planned to do - it sold Karoline's Greither's share in 627291 B.C. Ltd. in exchange for a note in the amount of approximately $1.95 million and one preferred share of Old Flora. There was no omission, defect, error or irregularity resulting in one of the prescribed events. The Transaction simply did not have the desired tax effect.

There is Still Hope
Crean

***Crean v. Canada (Attorney General)*, 2019 BCSC 146**

Two brothers each owned 50% of the shares of Holdco. Brother A decided to sell his 50% to Brother B. The brothers entered into an Agreement in Principle which provided that Brother B would purchase all of Brother A's interest "direct or indirect, for the sum of $3,200,000 CDN" and that the transaction would be structured "to the extent possible, so that [Brother A] receives capital gains treatment for tax purposes."

Brother A's shares were sold to Brother B's new wholly owned corporation for a promissory note. This led to unintended tax consequences to Brother A. The brothers sought to rectify the transaction to have the sale of Brother A's shares directly to Brother B.

There is Still Hope
Crean

***Crean v. Canada (Attorney General)*, 2019 BCSC 146**

Rectification was granted. The Agreement in Principle was interpreted to be a definite and ascertainable prior agreement that contemplated a direct sale from Brother A to Brother B.

The “direct and indirect” language in the Agreement in Principle was a reference to Brother A’s interests and not to the manner in which the sale was to occur.

Accordingly, this was not a tax planning mistake, but a mistake of implementation of a definite and ascertainable prior agreement.

Conclusions

Rectification is still available, but in a much narrower range of circumstances. Rectification is not available to change the bargain between the parties, but is available if the legal instruments do not properly implement a prior agreement with definite and ascertainable terms.

We can expect that courts will grapple with how “definite” and “ascertainable” a prior tax plan must be before rectification will be considered.

Some judges are extending *Fairmont Hotels* to remedies other than rectification.

Questions? Comments?

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