

Supreme Court of Canada upholds rectification in Quebec tax cases

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The Supreme Court of Canada (the “SCC”) recently released its decision in [Quebec v. Services Environnementaux AES inc.](#), 2013 SCC 65, which considered two cases where the Quebec Court of Appeal had allowed rectification as a remedy for taxpayers whose advisors had made an error in executing tax planning documentation. The SCC allowed rectification in both cases.

The first case, Services Environnementaux AES inc. (“AES”) entered into a corporate reorganization where it sought to transfer 25 percent of its shares in its subsidiary on a tax-deferred basis. Due to an error attributed to AES’s advisors in the valuation of the adjusted cost base of the shares, the transaction did not occur on a tax-deferred basis. AES sought a declaratory judgment of rectification before the Quebec Superior Court to amend the numbers in the original agreements to reflect the parties’ intention that the transaction occur without attracting an immediate tax liability. The Quebec Superior Court granted the declaratory order for rectification.

In the second case, Mr. Riopel and Ms. Archambault sold the assets of their corporation to a third party and then, on advice of their accountant, amalgamated their corporation with Mr. Riopel’s holding corporation. The intent of the transaction was that there would be no immediate tax liability to Ms. Archambault. The parties’ advisors made errors in preparing the documents required to carry out the transaction, thus the transaction attracted tax liability. The parties brought a declaratory judgment for rectification to the Quebec Superior Court asking the Court to give effect to the original terms of the transaction by amending or replacing some documents, namely the date of the sale of the shares, changes to the schedules to the articles of amalgamation and changes to filed tax forms. The Agence du Revenu du Quebec (the “ARQ”) and the Canada Revenue Agency (through the Attorney General of Canada (the “AGC”)) intervened in the proceedings and the Court denied the declaratory order for rectification.

The cases were both appealed to the Quebec Court of Appeal, who held that article 1425 of the Civil Code of Quebec (the “Code”), S.Q. 1991, c. 64, allows for the correction of documents similar to the common law remedy of rectification. The AGC and ARQ argued that rectification was not permissible under the Code and the Quebec Rules of Court – or in any event limited to remedying mere clerical errors. The SCC affirmed the Quebec Court of Appeal’s decisions that rectification of contracts in a tax context is permissible under the Code.

In ruling in favour of the taxpayers, the SCC notes that excepting certain situations, “tax law applies to transactions governed by, and the nature and legal consequences of which are determined by reference to, the common law or the civil law.” Therefore a court must decide whether the parties’ actions are consistent with their true intention. If an error in the documentation is proved, the court must note the

error and ensure it is remedied:

In the civil law, the tax authorities do not have an acquired right to benefit from an error made by the parties to a contract after the parties have corrected the error by mutual consent.

This principle should be equally applicable under the common law.

Of interest is the fact that the AGC in oral argument asked the Court to reject the line of common law authority on rectification that stems from the Ontario Court of Appeal's decision in *Canada (Attorney General) v. Juliar*, 50 O.R. (3d) 728, in 2000. The AGC argued that *Juliar* is overbroad and therefore incompatible with the SCC's decisions in *Shafroon v. KRG Insurance Brokers (Western) Inc.*, 2009 SCC 6, and *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*, 2002 SCC 19, which were non-tax rectification cases. The SCC refused to comment on this point, as the Court felt that it was not an appropriate case for such a discussion because AES and Riopel involved the Code, whereas *Juliar* was decided under the common law.

The SCC's decision does not extend or curtail the limits of rectification, as we understand it, from a common law perspective. It should be noted that the AGC sought leave to the SCC in the *Juliar* case and leave was refused. Since the *Juliar* decision, there have been numerous rectification cases heard by the common law courts across the country, giving the AGC ample opportunity to intervene in these rectification applications.

For clients, the status quo remains. While the precise boundaries of rectification remedies are difficult to define, it is clear that there is a boundary where rectification goes beyond fixing errors, becoming essentially retroactive tax planning. Accordingly, the SCC warns taxpayers not to view the decision as "an invitation to engage in bold tax planning on the assumption that it will always be possible to redo their contract retroactively should that planning fail."

It is important for professional advisors to understand the client's instructions and document the intention with any tax planning, especially if the transactions are to occur on a tax-deferred basis. It is best practice to ensure that the recitals in tax planning documentation accord with the parties' intentions.

Finally, one should be aware that if a rectification involves a US person resident in Canada and/or the rectification is in respect of US assets, the Canadian principles of rectification may or may not be compatible with the US legal principles of rectification or rescission. Caution!