

In this issue of the *UBC Law Tax Newsletter*, Professor Anthony Sheppard recounts the storied career of the Hon. Justice Leslie M. Little (p. 1) and rolls off the three R's of tax planning, in reverse (p. 6).

The Honourable Justice Leslie M. Little

Interview on his retirement from the Tax Court of Canada

By Tony Sheppard

Introduction

On July 18, 2011, I had the pleasure of interviewing The Honourable Justice Little in anticipation of his retirement as a tax judge. Justice Little enjoyed careers as a tax litigator from 1962 to 2002, and as a tax court judge from 2002 until July 25, 2011.¹ In this interview, Justice Little reminisces on the milestones leading to the current tax system, discusses present and emerging tax issues, and offers advice to aspiring tax practitioners.

Justice Little was born and raised in Moncton, New Brunswick. He graduated from Mt. Allison University with a Bachelor of Arts (BA) degree in Political Science and Economics in 1958. Three years later, Justice Little graduated from Dalhousie Law School with a Bachelor of Laws (LLB). During his studies he was inspired to pursue a tax specialization by classes with Dalhousie Law Professor Edwin C. Harris, in legal accounting and tax.

While in university in the Maritimes, Justice Little decided to live in Vancouver, British Columbia after graduation. For summer jobs, Justice Little worked as a labourer-teacher by day and taught evening classes to his co-workers through Frontier College. On one of these summer postings, Justice Little worked in British Columbia and liked the area. Having relatives already living in British Columbia was another attraction.

The month of May, 1961 was eventful for Justice Little: he graduated from Dalhousie on May 18th, he married Heather on the 20th, and they left for Vancouver on the 24th, driving across Canada for his articles with the Vancouver law firm, Davis & Co. Justice Little started his articling year with a rare opportunity to observe



Members of the Tax Court of Canada

Vancouver's leading counsel of the day in action in a high-profile case: the BC Supreme Court trial of the *BC Electric* case, presided over by Chief Justice Lett. Justice Little also worked on his first tax appeal during his articling year. Because there were so few tax lawyers in Vancouver during that era, Justice Little joined the Legal Branch of National Revenue, for two months in the Vancouver office followed by four years in Ottawa, to gain more experience in tax law.

Justice Little recalls one of his amusing experiences as a lawyer representing National Revenue. He appeared before the Tax Appeal Board alleging taxpayers had made spurious claims of charitable contributions to a church. A minister of a "break-away" church had prepared tax returns for parishioners free of charge, inserting fictitious charitable claims. The alleged donations were unpaid, though the church had issued charitable receipts for them. The self-appointed archbishop attended the

hearing as a witness. As counsel for National Revenue, Justice Little asked the presiding member of the Board to have the archbishop swear an oath or affirm before testifying, as would be required of any witness. The Board member refused the request, saying, “Mr. Little, I would never ask an archbishop to be sworn in my court. If you can’t believe an archbishop, who can you believe?” The archbishop testified unsworn to the Board, straying from the truth in his evidence. After hearing the archbishop’s testimony, the member realized that sometimes you can’t believe an archbishop’s testimony.

Justice Little was a partner in Thorsteinssons, practicing tax law from 1967 to 2002. He feels extremely fortunate to have had the opportunity of working with such intelligent and diligent partners and associates over the years.

Major Changes in Tax Practice

Justice Little says the fields of tax planning and tax litigation really started in Canada after 1967-1971. The era began with the Report of the Carter Royal Commission (1967), followed by the Federal Government’s White Paper and ultimately by the 1971 amendments to the *Income Tax Act*. Whereas before Tax Reform in 1972 taxation was only a minor issue, Tax Reform gave tax a public profile and added complexity, with the introduction of sophisticated new concepts such as capital gains and capital dividend accounts. Beginning with Tax Reform, the *Income Tax Act* has become the most complex federal legislation ever enacted. Justice Little ranks Tax Reform in 1972 as the most important change he experienced during his career.

The whole tax industry began with Tax Reform in 1972. From 1972-1990 there was a phenomenal growth in income tax planning. The economic downturn of 1982-3 added tax losses to tax planning. During this period of time, tax shelters began to be developed and heavily promoted, which continues to this very day.

In Justice Little’s opinion, the second significant developments in tax law were the changes in the courts’ interpretation of tax legislation, and the style of writing reasons for judgment, both of which resulted from the complexity of Tax Reform in 1972. Third in importance is the General Anti-avoidance Rule (GAAR)² which started off with little impact but has gained importance since 2005.³

Justice Little appeared before the Tax Appeal Board, the Tax Review Board, the Exchequer Court, the Federal Court-Trial Division, the Tax Court of Canada, and the

Federal Court of Appeal. The Tax Court of Canada began in 1983, initially sharing original jurisdiction over appeals with the Federal Court-Trial Division. Since 1990, the Tax Court of Canada has had exclusive original jurisdiction over tax appeals.⁴ As a result, taxpayers’ appeals are decided by an independent and experienced judiciary in the Tax Court and the Federal Court of Appeal. It is a matter of concern, however, that the Supreme Court of Canada grants leave so infrequently in tax appeals. Administrative efficiencies have resulted from combining the registries of the Federal and Tax Courts in the Courts Administration Service.

In tax litigation, procedure has evolved over the years from the rudimentary adversary system of the former Tax Review Board, in which the presiding member played a very passive role, to the current General Procedure, in which the tax court justices can actively participate in dispute resolution before trial. The first procedural innovation, introduced in 1993, is the *status hearing*, which enables a judge to inquire into the reasons why a case has not progressed.⁵ The second innovation is *case management*, where a judge is appointed to follow a case as it proceeds through the various stages to trial.⁶ In addition, tax court judges may hold a *settlement conference* with the parties and their counsel to explore the possibilities of settlement or narrowing the issues before trial. To preserve the impartiality of trial judges, judges involved in any of these pre-trial proceedings do not preside at trial, and the proceedings are not disclosed to the trial judge.⁷

The fourth innovation is a *pre-trial or trial management conference*, at which the trial judge presides, usually held a couple of weeks before trial, by conference call, to inquire into issues that might arise during the trial.⁸ Additionally, video-conferencing facilities are available in some locations.

An innovation to expedite tax litigation involving numerous taxpayers and large amounts is the *group appeal or lead case* procedure, where a tax court judge organizes multiple appeals with common issues into a more manageable series of test or ‘lead’ cases, involving representative groups of taxpayers.⁹ Group appeals are useful to prevent multiple separate trials of disputes between promoters of large-scale tax shelters and the Canada Revenue Agency, potentially dragging hundreds or thousands of taxpayers into separate tax litigation totaling millions of tax dollars.

When dubious tax shelters fall apart, the consequences can be ruinous to the taxpayers. Justice Little cautions potential investors in questionable schemes that if

something is too good to be true, it probably won't hold up in court. A tax court judge's primary role is to determine the truth of any allegation, including if necessary, refuting spurious claims of overly aggressive tax shelter promotions. Justice Little has dismissed numerous appeals of abusive tax shelters involving pyramid schemes, RRSP strips, fictitious charitable deductions and bogus medical expenses. Though the Tax Court of Canada does not have jurisdiction over criminal tax evasion, the Court sometimes hears appeals of cases dealing with the indirect civil consequences of these transactions.

Predictions

Justice Little expects the Tax Court of Canada in the next couple of years will have to deal with numerous appeals concerning disallowed claims of leveraged charitable deductions and disputes over tax-motivated valuation in inter-corporate transfer pricing. A leveraged charitable deduction occurs when a taxpayer buys an asset cheap and donates it to a charity claiming an inflated value for the amount of the deduction with supporting appraisal. Transfer pricing is another growing area of tax planning and litigation. Justice Little predicts that taxpayers' emails and other electronic communications will become a sources of evidence that the Canada Revenue Agency will make greater use of, to discredit taxpayers' claims for favourable tax treatment of real estate flips and to disallow deduction of exaggerated expenses. Justice Little also predicts that the Tax Court of Canada might increase access to the informal procedure by raising the current monetary limits.¹⁰

Justice Little suggests that the Tax Court of Canada may become regionalized in the future. Currently, judges must maintain a place of residence in the Ottawa area, and must travel throughout Canada to hear tax appeals.¹¹ To relieve against costs and hardships of long-distance travel, judges would be assigned to hear appeals within distinct regions of Canada.

Advice

Justice Little advises law students or lawyers seeking entry into the field of tax law to consider one or more of the following routes to tax specialization: (1) apply for a position as a judicial law clerk in the Federal Court of Appeal or the Tax Court of Canada; (2) apply for articles or employment with a boutique tax law firm such as Thorsteinssons or Felesky, Flynn; (3) obtain an accounting designation, such as a Chartered Accountant (CA) or a Certified General Accountant (CGA); (4) obtain a Masters of Law (LLM) degree in taxation; and/or (5) apply

for articles or employment with the Department of Justice. A successful career in tax law requires dedication, diligence and a willingness to work with financial figures. Tax practice involves both the legal and accounting professions. Tax litigation is the preserve of lawyers, but lawyers and accountants share the field of tax planning.

Conclusion

During Justice Little's nine and a half years as a Justice of the Tax Court of Canada, he delivered 308 written reasons for judgment and over 25 oral judgments. Justice Little said that he thoroughly enjoyed his experience while serving as a Judge on the Tax Court. He was especially pleased with the support he received from the other judges and the staff of the Court.

Reversals on appeal can befall decisions of any trial judge. Coincidentally with Justice Little's retirement, the Supreme Court of Canada (4:3) has just reversed one of his decisions, even though a unanimous Federal Court of Appeal had affirmed it.¹²

Justice Little has earned our thanks for his service to Canada, for this most informative interview, and our best wishes for a long and happy retirement.

Endnotes

- 1 *Tax Court of Canada Act*, RSC 1985, c T-2, s 7(2).
- 2 *Income Tax Act*, s 245.
- 3 *Canada Trustco Mortgage Co v Canada*, 2005 SCC 54, [2005] 2 SCR 1.
- 4 *Tax Court of Canada Act*, s 12.
- 5 *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a, Rule 125; Practice Note No 7: *Status Hearing Amended* (September 23, 2005).
- 6 Practice Note No 17, *Proposed rules and amendments with respect to Settlement Offers, Lead Cases and Litigation Process Conferences* (effective January 18, 2010), Rule 126.1.
- 7 *Ibid*, Rule 126.3.
- 8 *Ibid*, Rule 126. 2.
- 9 *Ibid*, Rule 146.
- 10 *Tax Court of Canada Rules (Informal Procedure)*, SOR 90-688b (the amount in issue must not exceed \$12,000 and a loss must not exceed \$24,000 though the excess may be waived).
- 11 *Tax Court of Canada Act*, s 6(1).
- 12 *Canada Trustco Mortgage Co v Canada*, 2011 SCC 36 reversing 2009 FCA 267 affirming 2008 TCC 482, [2009] 1 CTC 2264.

Where are they now?

Updates on the careers of two recent graduates from UBC Law's LL.M. program in taxation.



Bonnie Jin, LL.M. ('07)

Q: What considerations led you to enter the LL.M. program in taxation at UBC

BJ: I was quite interested in taxation during my LL.B. studying in China and planned to be a tax advisor in the future. I understand that entering the LL.M. program in taxation can be helpful for my career planning.

Q: How has what you learned during the LL.M. program in taxation helped your professional career?"

BJ: I finally decided to be a lawyer, mainly focusing on the PE/VC, M&A projects. However, what I have learned provides me with a much wider perspective on the international taxation and further makes me

detail-oriented.

Q: Would you have any advice for students considering or currently taking the LL.M. program in taxation?

BJ: If you are considering the LL.M. program in taxation, any working experience you have in relation to taxation would be helpful.

If you are currently taking the LL.M. program in taxation, consider an internship at one of the 'Big Four' or law firms. Practice is always the best way to learn more.

Q: What are your fondest memories from your time at UBC?

BJ: The courses I have taken and the classmates I have met. Among others, of course the weekly discussion with my supervisor!

Bonnie's thesis: *The Legal Environment of Corporate Income Taxation for FDI in China: Policy, Changes, Risks.*

Abstract: Foreign direct investment (FDI) was unknown to Chinese people before the opening policy in 1979, but since then China's economy has been surging ahead in the past twenty eight years. As one aspect of the FDI policy, I focused on the corporate taxation field to be my research interest, and the topic of my thesis. In the thesis, the reader will learn how FDI developed in

China and degree of FDI development. Also, I provide the reader with China's tax system and policy-oriented in as much detail as possible, most of which is the tax incentive policy towards the FDI in China. However, the policies and incentives raise some issues. As the result of offering FDI tax preference, Chinese government tax revenue as a percentage of GDP has been declining steadily. Problems such as tax avoidance and evasion, and local "fake" FDI entities are getting serious. The new Corporate Income Tax Law of the People's Republic of China (CIT Law) was passed by the PRC National People's Congress on March 16 2007 and will take effect on January 2008. When China entered into the World Trade Organization (WTO) in 2001, compliance with the general rules required China improve its tax system as soon as possible. The CIT law section in the thesis includes the policy-changing behind the legislation and expected influence on the FDI in China in the future. As a result of the changes to be brought about by the CIT Law, foreign and domestic business in China must adapt to the new tax regime, and offer some recommendations in that regard.

Full text: <http://hdl.handle.net/2429/32138>

Rajbir S. Grewal, LL.M. ('08)

Q: What considerations led you to enter the LL.M. program in taxation at UBC?

RG: The quality of the tax law professors and course offerings at UBC made a UBC LL.M. the perfect option for me. I was also attracted by the flexible nature of the thesis based LL.M. program, which allowed me to

focus my learning on the issues that interested me the most, supplemented by course work in areas in which I wanted a more organized presentation of knowledge.

Q: How has what you learned during the LL.M. program in taxation helped your professional career?

RG: The LL.M. allowed me to deepen my understanding of the law in my

area of practice. It has been helpful in allowing me to frame legal issues more effectively and more persuasively, as well as look at legal problems from more varied perspectives and thus allow me to better gauge a case's chances of success at trial or the degree to which a judge will find a legal position persuasive.



Q: *Would you have any advice for students considering or currently taking the LL M program in taxation?*

RG: Take the opportunity to read and think widely and deeply in your area of interest. Such an opportunity will rarely come again.

Q: *What are your fondest memories from your time at UBC?*

RG: The intellectual stimulation and the pleasure of encountering new ideas.

Q: *What is a highlight of your career so far?*

RG: Appearing and winning in the Federal Court of Appeal.

Q: *What is your current position?*

RG: I am counsel with the Tax Law Services section of the federal Department of Justice.

Rajbir's thesis : *Towards Integrity in Tax Law : The Problem of Form and Substance in Canadian Tax Jurisprudence*

Abstract: This study examines the problem of form and substance in Canadian tax jurisprudence, which has been characterized by a troubling equivocation between formalistic and substantive approaches in cases involving tax avoidance transactions with the current period of jurisprudence dominated by formalism. The vacillation of Canadian jurisprudence contrasts with the consistently substantive tax jurisprudence of the United States. The latter situation discloses an unresolved doctrinal tension in Canadian tax jurisprudence between two viable

doctrinal alternatives. This study seeks to resolve the problem of form and substance by finding the right answer to the problem by examining the tax policy, political, and legal philosophical implications of formalistic jurisprudence along with the manner in which the legal system as a whole (i.e. jurisprudence outside of tax law) rationally employs both form and substance for distinct purposes to solve distinct kinds of legal problems. Using the principles that are implied in the practices of the legal system as a whole, a right answer to the form and substance problem — one that is horizontally consistent or integral with the whole — suggest itself, namely that substantive, judge-made standards are the right solution to the problem of form and substance in Canadian tax jurisprudence and that formalism in tax jurisprudence is a legal aberration in the Canadian legal system.

Full text: <http://hdl.handle.net/2429/4076>

UBC Law Student Tax Research

In the third Year of the J.D. program, **Daniel Palmer, J.D. (class of 2011)** completed a directed research under Professor David Duff's supervision on Transfer Pricing. Dan is now articling with Borden Ladner Gervais (Vancouver office). He has had various tax issues to work on but nothing yet on transfer pricing. Here's summary of Dan's paper.

Future Directions in Transfer Pricing
Daniel Palmer, J.D. ('11)

Abstract: Transfer pricing is increasingly manipulated by multinational corporations, resulting in an eroded tax base in Canada and an uneven tax treatment for companies that do not operate across borders. This paper argues that Canada must think of new approaches to dealing with the transfer pricing problem.

First, Canada's Advanced Pricing Program should be better utilized. A

stream-lined approach for smaller companies, similar to that in the United States, could encourage participation in the program, resulting in more certainty for both taxpayers and the government. Also, while publication of the agreements themselves may compromise the privacy of corporations, the CRA should publish industry-specific guidelines when enough APAs have been concluded in order to provide taxpayers with more insight on the application of the transfer pricing rules.

Second, Canada should consider adoption of a hybrid formulary apportionment method. This approach would retain the current transfer pricing regime when appropriate comparable transactions are available, but apply a formula when they are not. Bi-lateral agreements between countries could be used to avoid double-taxation in situations where countries choose different formulae. While this is not something Canada can implement unilaterally, it should be open to negotiation on this topic.

Back to the Future: The Three “R’s” of Tax Planning-in-Reverse: Reorganization, Rectification and Rescission

By Tony Sheppard

Introduction

Plans look to the future for their implementation. Tax planning usually involves arranging one’s affairs to reduce future taxes. No one can know the future with certainty. Even the best-laid plans risk failure to achieve their objective: the plan may be misconceived or its execution may be faulty. After planning transactions to reduce taxes and going through with them, the taxpayer might find the intended reduction has not been achieved after all. To the taxpayer’s regret, the upshot can be a failure: the transaction does not reduce taxes, or even worse, it boomerangs and increases them. When the tax plan goes wrong, what, if anything, can the taxpayer do to salvage the situation, after the fact?

After the fact, a taxpayer may suffer pangs of remorse because of the untoward tax consequences, but regrets are insufficient to alter the tax outcome of a transaction. In *Friedberg v Canada*,¹ Linden JA said:

In tax law, form matters. A mere subjective intention, ...is not by itself sufficient to alter the characterization of a transaction for tax purposes. If a taxpayer arranges his affairs in certain formal ways, enormous tax advantages can be obtained, even though the main reason for these arrangements may be to save tax (see *The Queen v. Irving Oil*, 91 DTC 5106, Per Mahoney, J.A.). If a taxpayer fails to take the correct formal steps, however, tax may have to be paid. If this were not so, Revenue Canada and the courts would be engaged in endless exercises to determine the true intentions behind certain transactions. Taxpayers and the Crown would seek to restructure dealings after the fact so as to take advantage of the tax law or to make taxpayers pay tax that they might otherwise not have to pay. While evidence of intention may be used by the Courts on occasion to clarify dealings, it is rarely determinative. In sum, evidence of subjective intention cannot be used to ‘correct’ documents which clearly point in a particular direction.

For similar reasons, tax courts reject a taxpayer’s plea for assessment of the tax consequences of a done deal on the assumption that it might have been done more

astutely. In *The Queen v Bronfman*,² Dickson CJ said:

the courts must deal with what the taxpayer actually did, and not what he might have done: *Matheson v. The Queen*, [1974] CTC 186 at 189, 74 DTC 6176 at 6179 (F.C.T.D.) per Mahoney J.

Form prevails over substance as a general rule of taxation. A gift for legal and tax purposes requires the formal elements of a donative intention by the donor, delivery to and acceptance by the donee: the mere intention of the donor to make a gift is insufficient without the formal steps.³ A death benefit from a pension plan is the functional equivalent of exempt life insurance, but for tax purposes its form prevails over its economic substance, and it is taxable as a pension benefit in the hands of the recipient.⁴

In *The Queen v 1524994 Ontario Ltd*,⁵ the taxpayer was a professional corporation whose controlling shareholder practiced audiology though it. The audiologist wanted to bill the provincial medical plan but, as an incorporated audiologist with office and equipment, he was ineligible to obtain billing privileges. However, the audiologist entered into a relationship with medical doctors, who had the desired billing rights, to comply with the requirements of the plan. The plan conferred billing rights on physicians if the audiology services performed were provided by an audiologist who was in their employment, used their equipment and practiced audiology under their supervision. To satisfy the plan’s requirements for billing purposes, the taxpayer purported to enter into an employment contract for his services and a rental agreement of his equipment with physicians in an office across the hall so that he could practice audiology on their patients nominally through them and they could bill the plan. Under the agreements, the physicians billed the plan for audiology and paid the taxpayer a “salary” for his services and “rent” for the equipment, but the audiologist provided the services to the physician’s patients on referral, in his own office. The provincial medical plan accepted the arrangement and the physicians successfully billed the plan for the services. The taxpayer was assessed for GST on payments of “rent” received under the agreement, but it objected that the form of the agreements was only to circumvent

the requirements of the medical plan and did not reflect the reality of the audiologist's true legal relationship with the physicians for tax purposes. The Tax Court Judge accepted the objection, but the Federal Court of Appeal reversed and upheld the assessment, dismissing the audiologist's argument, on the ground that since form had succeeded with the medical plan, form should apply for tax purposes, stating as follows:⁶

the Tax Court judge erred in law in basing his decision on after-the-fact evidence of the taxpayer's intention to re-characterize an agreement, which was clear, complete, and so effective as between the parties...Where a taxpayer has created a fiction and lived by it, his fiction has become its real economic world, for better and for worse, plus GST.

Since tax courts regard "the form" of a transaction as largely determinative of its tax consequences, after a transaction has gone to completion with untoward tax results, the taxpayer who wishes to improve upon the tax outcome must revise the form of the transaction back to the beginning of the deal. The change of form must relate back to the outset. Chronologically, this is tax planning in reverse or retroactive tax avoidance.

An agreement by the parties to change the form of, or to revoke an executed transaction for the purpose of changing the tax consequences of the previous transaction does not work retroactively, because it takes effect prospectively from the moment of their new agreement. The attempt to reverse or change the previous transaction only binds the parties themselves and does not affect third parties, such as the Canada Revenue Agency. The parties cannot by their own agreement retroactively undo for tax purposes what they have previously done. Despite the purported change, the Canada Revenue Agency can assess on the basis of the original transaction. A retroactive change of form requires an order of a court of competent jurisdiction.⁷

For example, in a Quebec civil law case,⁸ back in 2002, the parties exchanged parcels of real estate in the mistaken belief that it would be a tax-free exchange. Contrary to their understanding of the tax consequences, an assessment of GST and QST took place in 2004. Immediately thereupon, the parties attempted to invalidate the assessment by executing a "deed of annulment" to reverse the 2002 transaction and return the properties back to their original ownership. The Tax Court held their attempted nullification ineffective under civil law to undo the assessment because ignorance of

tax law is no excuse, and the deed could not operate retroactively or affect the Canada Revenue Agency as a third party. In an *obiter dictum*, the Tax Court suggested the taxpayer might have succeeded in reversing the assessment with a court-ordered retroactive annulment of 2002 transaction.⁹

The Tax Court of Canada has only limited jurisdiction, which is confined to overturning, modifying or upholding an assessment by the Canada Revenue Agency. The Tax Court does not have a statutory or equitable jurisdiction to alter the form of a taxpayer's transaction.¹⁰

For a legally effective retroactive alteration of the form of a consummated transaction, the taxpayer must apply to a court of competent equity jurisdiction i.e., the superior court of a province or territory, for an order retroactively changing the form for all purposes, including tax. The superior court derives its jurisdiction to undo transactions either by statute or from its inherent capacity as a court of equity. The rule prohibiting collateral attack on a court order requires the Tax Court of Canada and the Canada Revenue Agency to abide by such an order.¹¹

Taxpayers have attempted to overturn assessments of federal taxes and bypass the cumbersome step of application to the superior court of the province, by arguing that even in the absence of a superior court order actually changing the transaction's form retroactively, the Tax Court can make assumptions about the likely outcome of such an application as though the taxpayer had made it, and determine the tax consequences on the basis of an assumed order that the superior court would likely have made. While result is attractive, it is beyond the jurisdiction of the Tax Court. The Tax Court has correctly (it is submitted with respect) rejected this line of argument as exceeding its jurisdiction. The Tax Court cannot determine taxation on a form of transaction assumed to have been changed by order of a superior court, without the authority of the actual order. The argument fails because it would require the Tax Court to apply a line of equitable reasoning as though it were a court of equitable jurisdiction. Only the superior court has such power. The Tax Court does not have a jurisdiction to assess tax on assumptions about what a superior court with statutory or equitable jurisdiction might have done to change the form of the transaction, had it been asked to do so.¹²

Appeal of a provincial or territorial tax assessment to a superior court does not face the same jurisdictional

limitation imposed on the Tax Court of Canada, with the result that the same judge of the superior court can, in one proceeding, approve the application for retroactive change of form and allow the appeal of the provincial tax assessment. The superior court has the necessary statutory or equitable jurisdiction and may, in its discretion, permit joinder of an appeal of the assessment on the basis of retroactive reform of the problematic transaction with the application to approve the change of form. For this reason, tax-planning in reverse at the provincial level is more efficient than at the federal equivalent, as the provincial taxpayer can combine the two remedies in one proceeding, with the court's permission.

For example, the taxpayer was assessed to provincial sales tax on a transfer of tangible property to another company in exchange for the recipient's shares. The taxpayer had intended to make the transfer tax-exempt as to a wholly-owned subsidiary which would have qualified for the exemption, but overlooked the problem of form in that it would acquire its shares in the transferee only after completion of the transaction. Technically, the taxpayer did not own any shares in the recipient at the time of the transfer. The shares of the recipient were issued to the taxpayer as consideration for the transfer on completion. The provincial taxing authority caught the taxpayer's error of form and assessed accordingly, but the superior court permitted the taxpayer simultaneously to obtain an order for rectification of the transaction and a second order allowing the appeal from the tax assessment.¹³ If the only parties to both proceedings are the taxpayer and the taxing authority, joinder is usually preferable to resolve all the issues in one proceeding before a single judge, but it is up to the judge to decide whether to hold a single hearing or separate hearings, after consulting with the parties.¹⁴ A separate hearing would be necessary if third persons oppose the application for, or might be adversely affected by a retroactive change to the form of the transaction.

Corporate Reorganization

A corporation in financial difficulty may embark upon transactions with the expectation of tax advantages, but an error in planning or execution changes the form and threatens ineligibility for the intended tax break. An out-of-court private restructuring will not have retroactive effect, but a court-approved proceeding can preserve the expected tax advantages. A statutory restructuring approved by the superior court of a province or territory

can make a retroactive order correcting the error in the form and perpetuating the advantages. The jurisdiction is inherently equitable as ancillary to a statutory restructuring. Prior to applying to the superior court, the corporate taxpayer should ascertain that the appropriate regulatory and taxing authorities would not oppose the order. For example, the Canada Revenue Agency may decline to take unfair advantage of a tax windfall resulting from a taxpayer's innocent mistake, when the taxpayer is already in financial distress. Other parties might oppose the application, hoping to gain from the mistake, however. If the order is unopposed by government, and the court is satisfied that it is necessary to do justice, or it will relieve the taxpayer from the adverse legal and tax effects of an inadvertent mistake, the court can, in its discretion, make the order retroactively fulfilling the parties' *bona fide* intention. This order changes the form of prior transactions for legal and tax purposes. As a discretionary order, it is difficult to overturn on appeal.

For example, corporate parties had entered into an amalgamation intending to preserve tax losses and other tax attributes of the original companies for the benefit of the restructured entity, but an inadvertent error in sequencing of the steps imperiled the tax benefits. To recover the tax advantages, the parties undid the faulty amalgamation and entered into a statutory arrangement, with court approval. The Canada Revenue Agency and the Director appointed under the *Canada Business Corporations Act* did not oppose the application to the Ontario Superior Court for approval.¹⁵

Rectification

A superior court or court of general jurisdiction has an inherent advantage over a court of limited jurisdiction such as the Tax Court of Canada, because it can grant equitable remedies such as rectification or rescission. Because these judicial remedies are retroactive, taxpayers are attracted to them to avoid the adverse tax consequences of transactions by redoing or undoing their form.

Rectification permits a court of equity to order changes in contractual or trust documents so that they accurately reflect the intention of the parties. By granting rectification, the court can retroactively undo and correct the documentation of a transaction for tax purposes, but the parties by agreement among themselves cannot achieve retroactive alterations.

The courts generally approve of rectification for tax purposes, as long as the application satisfies the requirements for the remedy:¹⁶

The true principles governing these matters I conceive to be as follows. (1) The court has a discretion to rectify where it is satisfied that the document does not carry out the intention of the parties. This is the basic principle. (2) Parties are entitled to enter into any transaction which is legal, and, in particular, are entitled to arrange their affairs to avoid payment of tax if they legitimately can... (3) If a mistake is made in a document legitimately designed to avoid the payment of tax there is no reason why it should not be corrected. The Crown is in no privileged position qua such a document. It would not be a correct exercise of the discretion in such circumstances to refuse rectification merely because the Crown would thereby be deprived of an accidental and unexpected windfall....

Rectification is limited to correcting a mistake in the wording of documents to reflect the true intentions of the parties to the transaction. The remedy does not extend to redoing the form of a misconceived transaction to achieve expected legal effects or hoped-for tax consequences.¹⁷ Thus, where an English settlor mistakenly created a trust which was taxable, when he should have made an outright gift to exempt the transaction from tax, the court of equity could not order rectification substituting a different form of transaction from that which the settlor intended and accurately worded.¹⁸

Rescission

Where the taxpayer misconceived the legal effect of a transaction, a superior court may grant another equitable remedy, rescission, to cancel or undo the transaction entirely, and incidentally allow the taxpayer to avoid its adverse tax implications. Rescission permits a superior court to cancel or set aside a transaction entirely, where the parties have made a mistake either as to the legal effect of the transaction or as to an existing fact which is basic to the transaction. A mistake as to the tax implications is merely as to the consequences or advantages of the transaction and as such, does not justify rescission.¹⁹ If there is a mistake as to the legal effect of the transaction, the superior court can grant rescission to undo or reverse unintended tax consequences.²⁰

Conclusion

Retroactive tax planning for federal or provincial taxes is possible as ancillary to a corporate reorganization, or with a court-ordered rectification or rescission.

Endnotes

- 1 (1991), 92 DTC 6031 at 6032 (FCA), affirmed [1993] 4 SCR 285.
- 2 [1987] 1 CTC 117, 87 DTC 5059.
- 3 *Fallis v The Queen* (2001), 56 DTC 1242, [2002] 1 CTC 2661 (TCC); see also *Langille v The Queen*, 2009 TCC 398, para 31.
- 4 *Woods v The Queen*, 2011 FCA 90.
- 5 2007 FCA 74.
- 6 *Ibid*, paras 11 and 20.
- 7 *Allnutt v Wilding*, [2007] EWCA Civ 412, [2007] WTLR 941, paras 7-9.
- 8 *Ville de Richmond v The Queen*, 2007 TCC 336.
- 9 *Ibid*, paras 87-93.
- 10 See *Huppe v The Queen*, 2010 TCC 644, paras 15-17.
- 11 *Sussex Square Apartments Limited v The Queen*, 1998 CanLII 154, 99 DTC 443 (TCC), affirmed 2000 CanLII 16119, 54 DTC 6548, [2000] 4 CTC 203 (FCA); *Dunfield v. The Queen*, 2001 CanLII 940, 20 RFL (5th) 348, 55 DTC 3774, [2001] 4 CTC 2518 (TCC), paras 19-25 (retroactive order of superior court has binding effect); see also *Donato v The Queen*, 2009 TCC 590.
- 12 *McLaughlin v The Queen*, 2007 TCC 209; *Stern v The Queen*, 2004 TCC 561, 58 DTC 3260, [2006] 2 CTC 2062, para 30; *Kovarik v The Queen*, 2001 CanLII 513, 14 RFL (5th) 110, [2001] 2 CTC 2503 (TCC) (Tax Court should not reserve judgment until taxpayer applies to a superior court for rectification).
- 13 *QL Hotel Service Limited v. Ontario (Finance)* (2008), 90 OR (3d) 760, 2008 CanLII 15226 (ON SC).
- 14 *Fraser Valley Refrigeration (Re)*, 2009 BCSC 848, para 3.
- 15 *GT Group Telecom Services Inc (Re)*, 2004 CanLII 52533, 5 CBR (5th) 230 (ON SC) (court-approved arrangement under the *Canada Business Corporations Act*, RSC 1985, c C-36, s 192; see also *TCR Holding Corporation v Ontario*, 2009 CanLII 43432 (ON SC), affirmed 2010 ONCA 233; *Fairmont Hotels & Resort Inc. (Re)*, 2006 CanLII 57092 (ONSC).]
- 16 *Re Sloccock's Will Trusts*, [1979] 1 All ER 358 at 363 (Ch D); see also *S & D International Group Inc v Canada (Attorney General)*, 2011 ABQB 230.
- 17 *Ashcroft v Barnsdale*, [2010] EWHC 1948 (Ch), para 15 (difficulty of distinguishing between mistakes as to meaning and as to legal consequences).
- 18 *Allnutt*, *supra* note 7.
- 19 *Pitt v Holt*, [2011] EWCA Civ 197.
- 20 *Stone's Jewellery Ltd v Arora*, 2009 ABQB 656, paras 48-54.

UBC Law Faculty Tax Research

Professor and Associate Dean David Duff:

“Canada: Tax Treaty Interpretation and the Residence of a Hybrid Entity” in *Tax Treaty Case Law Around the Globe, 2011* (Michael Lang, et al, eds) (Vienna: Linde Verlag, 2011).

“SCC gets opportunity to clarify GAAR,” 30:42 *Lawyers Weekly* (March 18, 2011) 13.

“Charities and Terrorist Financing” (2011) 61 *UTLJ* 73-117

Professor Claire Young:

“Pensions, Privatization and Poverty: The Gendered Impact” 23:1 *Canadian Journal of Women and the Law* (forthcoming)

Tax Court of Canada Clerkship Program Presentation

By Jennifer Lau, Acting Director of Career Services

Associate Chief Justice Eugene Rossiter of the Tax Court of Canada spoke at the Faculty of Law at Allard Hall on November 15th to law students interested in the Tax Court’s clerkship program. Justice Rossiter described the many benefits of clerking at the Tax Court and encouraged students to consider practicing in smaller centres across Canada. Ian Wiebe, UBC Law ’11, is currently clerking at the Tax Court in Ottawa. Seventeen students in the UBC Law Class of 2011 are clerking at courts across Canada. The UBC Law Career Services Office would like to thank Justice Rossiter for his engaging and enthusiastic presentation.

Thank You!

Grateful thanks from law students and faculty are due to **Thorsteinssons LLP: Tax Lawyers** (thor.ca) for their generosity in providing a copy of the current edition of the *CCH, Canadian Income Tax Act with Regulations, Annotated*, free of charge to every student taking tax at the UBC Faculty of Law.

UBC Law Tax Newsletter

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