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Corporate Tax Planning

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STATUTORY RATIFICATION

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Mistakes in implementing tax plans are inevitable. From a policy perspective, it is appropriate to allow a taxpayer to fix mistakes in documents that lead to unintended tax consequences provided that the taxpayer does not engage in retroactive tax planning.

Currently, the most common way to fix mistakes in tax planning is to obtain a remedy by court order. While this method can be effective, the court application entails undue process in uncontested cases. This violates the proportionality principle in litigation, the goal of which is timely and affordable access to justice.

Canadian corporate statutes permit an application to an administrator to correct certain corporate slips. The scope of this administrative mechanism is too narrow to provide relief in many tax cases. Where the administrator refuses relief, the taxpayer must apply for a court order to correct the mistake, even if the change is unopposed by the Crown.

Delaware corporate law offers statutory ratification as a way to fix defective corporate acts resulting from a failure of authorization. This process corrects certain corporate slips privately. While this process could be adopted in Canada, it would not go far enough in tax cases because it would not keep all uncontested cases out of court.

Canadian legislatures should consult stakeholders to codify an appropriate legal test that would allow the correction of mistakes in tax planning by statutory ratification. For uncontested cases, statutory ratification would permit the correction of mistakes without a court application or an administrative decision.

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A streamlined process to fix mistakes in tax cases provides a multitude of benefits. The time has come to enact a broader set of tools in Canadian legislation to fix mistakes privately in uncontested tax cases.

KEYWORDS: RECTIFICATION ■ COURTS ■ DISPUTES ■ LITIGATION ■ CORPORATE TAXES ■ STATUTE

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INTRODUCTION

In Canada, tax law applies to the legal form of a transaction under the legal documentation applicable at the time of the transaction.[1] Additionally, in accordance with the *Duke of Westminster* principle, Canadian taxpayers are entitled to arrange their affairs so as to minimize their tax payable.[2]

To achieve a specific tax result, a tax plan must be implemented properly. An amendment of a document by the parties with retrospective effect, while effective as between those parties,[3] cannot change the prior tax consequences of the transaction.[4]

1 *Shell Canada Ltd. v. Canada*, [1999] 3 SCR 622, at paragraph 39.

2 *Inland Revenue Commissioners v. Westminster (Duke)*, [1936] AC 1, at 8 (HL).

3 *Trollope & Colls etc. v. Atomic Power etc.*, [1962] 3 All ER 1035 (QB).

4 *Sussex Square Apartments Limited v. The Queen*, 99 DTC 443, at paragraph 41 (TCC) (aff'd. 2000 DTC 6548 (FCA)), citing *Waddington v. O'Callaghan (HM Inspector of Taxes)* (1931), 16 TC 187 (KB). But see *Twomey v. The Queen*, 2012 TCC 310.

Taxation statutes are complex, and becoming ever more so. It is inevitable that errors or omissions will arise in implementing tax plans. These mistakes may generate unintended tax consequences. Unless documents can be corrected to place the taxpayer in the position originally intended, the taxpayer may bear an unconscionable tax burden that arises solely by virtue of a mistake.

In response to the unfairness of unintended tax consequences that arise from erroneous documents, a taxpayer may apply to a court for relief. Courts have inherent jurisdiction to fix mistakes in implementing tax plans under common-law and equitable remedies, such as rectification, rescission, and the doctrine of common-law mistake.[5]

The equitable remedy of rectification permits the amendment of documents for a transaction effective as of the date of the transaction. To obtain rectification, a taxpayer must prove that legal documentation for a transaction failed to implement the true agreement between the parties from the outset.[6] The bounds of rectification are difficult to delineate, and the case law is mixed. In tax cases, steps may be altered or omitted, or new steps may be added, as required to achieve a definite and ascertainable tax objective at the time of the transaction. Some courts have allowed the correction of mistakes where the taxpayer intended to avoid a particular tax, tax law allowed the tax to be avoided, and the taxpayer would have avoided the tax if the parties had transacted in accordance with their intention from the outset. Rectification puts the parties in the position that they originally intended to occupy, eliminating unintended tax consequences.

Another equitable remedy is rescission. Rescission may be available to render a contract voidable where the parties made a fundamental mistake in assumptions going to the root of the contract,[7] or to make a voluntary disposition of property voidable where the transferor founded the transfer on a causative mistake of sufficient gravity that it would be unconscionable not to correct the mistake.[8] Since rescission does not void the documents, they govern unless and until rescinded by the innocent party. While relatively rare, rescission has been used to eliminate adverse tax results of a dividend[9] and of a conveyance of land.[10]

5 Under civil law, the law of obligations permits the true agreement of wills of the parties to be discerned by interpretation, and errors in legal documents may be corrected by the parties themselves subject to court intervention: *Quebec (Agence du revenu) v. Services Environnementaux AES inc.*, 2013 SCC 65. This article focuses on relevant principles in the common-law jurisdictions of Canada. These remedies are evolving and have been exhaustively canvassed elsewhere: see, for example, Terry S. Gill, “Fixing Mistakes: Rectification & Rescission,” in *2014 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2014), 9:1-12.

6 *Juliar v. Canada (Attorney General)*, 1999 CanLII 15097, at paragraph 33 (ONSC); aff’d. 2000 CanLII 16883 (ONCA); leave to appeal to the Supreme Court of Canada denied, [2000] SCCA no. 621.

7 S.M. Waddams, *The Law of Contracts*, 6th ed. (Aurora, ON: Canada Law Book, 2010), at paragraph 390.

8 *Re: Pallen Trust*, 2014 BCSC 305, at paragraph 57; aff’d. 2015 BCCA 222.

9 Ibid.

10 *Stone’s Jewellery Ltd. v. Arora*, 2009 ABQB 656.

The doctrine of common-law mistake provides yet another avenue for relief. This doctrine voids a contract from the outset. Distinct from rescission, this relief denies valid contract formation on the basis of a common mistake going to the root of the contract or a unilateral mistake that precluded a meeting of the minds. It is available to vitiate a contract only if the mistake relates to the identity of the parties or the identity of the subject matter of the transaction. A mistake as to the quality of the subject matter does not void a contract unless the mistake renders the subject matter fundamentally different from what the parties believed it to be at the time of contract formation.[11] A taxpayer may use this remedy to annul documents and thus eliminate unintended tax consequences. It has been used very sparingly in tax cases, but has been applied to annul a conveyance of land.[12]

While court-ordered remedies can fix mistakes effectively, justice requires both acceptable outcomes and fair processes. A court application is lengthy and expensive, and wastes scarce public resources in uncontested cases. Effective solutions outside the court process should be available.

Under Canadian corporate statutes, certain errors may be corrected by an application to an administrator in limited circumstances. The scope of this mechanism is narrow. As a result, many mistakes that give rise to unintended tax consequences cannot be corrected under this process.

Delaware corporate law offers statutory ratification. It fixes mistakes in defective corporate acts that arise from a failure of authorization. It does not require an application to a court or to an administrator. The process provides an efficient and effective cure for a subset of corporate slips that lead to unintended tax consequences. It is not designed to fix errors in all tax cases. Thus, while Delaware corporate law is better than existing Canadian processes to remedy corporate mistakes, even if it were adopted in Canada, the process does not go far enough.

Canadian legislation should allow a taxpayer to amend documents effective as of the date of the document, or to annul documents, in order to eliminate unintended tax consequences by statutory ratification. The rules should be broad enough to keep all uncontested cases out of court. The Crown should be notified of ratification to prevent abuse. Because the subject matter overlaps federal and provincial jurisdictions, each Canadian jurisdiction should adopt its own regime. Competition for capital may drive convergence to the best model.

Statutory ratification is quick and cheap, and preserves scarce public resources in uncontested cases. Properly bounded, statutory ratification fosters confidence in the just administration of taxation statutes. This is a cornerstone of an effective self-assessment tax system. The time to enact Canadian statutory ratification processes has come.

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11 *Lever Bros. Ltd. v. Bell*, [1931] UKHL 2, cited in *McLeod v. The Queen*, 97 DTC 777, at 779 (TCC).

12 *Stone's Jewellery*, supra note 10.

CORRECTING MISTAKES IN TAX PLANNING IS APPROPRIATE

In 1917, Parliament enacted the Income War Tax Act, 1917;[13] it was eight pages long.[14] The Act has since evolved into "one of the most detailed, complex, and comprehensive statutes in our legislative inventory";[15] the current Income Tax Act and regulations extend to more than 2,400 pages.[16] In this context, it is inevitable that taxpayers will make mistakes in implementing tax plans. These mistakes can give rise to unintended tax consequences.

In our view, it is appropriate from a policy perspective to allow a taxpayer to correct such mistakes. Parliament allocated the income tax burden among taxpayers on the basis of income as computed under principled statutory rules. Mistake-based taxation imposes a burden on a taxpayer that was not intended to be borne, confers a windfall on the Crown, and imposes a higher tax burden on a taxpayer that has made an error in a tax plan than on a taxpayer that undertakes a similar transaction but does not make an error; this burden is inconsistent with the principle of horizontal equity.[17] Tax exigible by mistake may arise unexpectedly, possibly in circumstances where the taxpayer lacks sufficient liquidity to satisfy the burden. The result can be unfair and may prompt a perception of ensnarement of taxpayers by the Crown. Taxpayers should not be held to a standard of perfection. Tax law ought to apply to allocate the overall tax burden on the basis of changes in wealth arising from exercises of autonomy pursuant to the codified rules. Where a mistake vitiates the taxpayer's free choice of action, the taxpayer should be excused from responsibility for the resulting tax exposure.

This position is consistent with a longstanding tradition to administer Canadian tax law benevolently. For example, subsections 220(3.2), 85(7.1), and 93(5.1) confer on the minister of national revenue discretion to allow a taxpayer to late-file, amend, or revoke an election under the Act.[18] The purpose of these rules is to provide relief where the taxpayer demonstrates that its original tax position caused an unintended tax consequence.[19] Under the administrative guidance of the Canada Revenue Agency (CRA), the minister grants relief where there have been tax consequences

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13 SC 1917, c. 28.

14 Pierre Cossette, "Tax Law Practice, from Yesterday to Tomorrow" (2013) 61, special supp. *Canadian Tax Journal* 45-57.

15 *65302 British Columbia Ltd. v. Canada*, [1999] 3 SCR 804, at paragraph 51.

16 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act.

17 *Symes v. Canada*, [1993] 4 SCR 695, at 738.

18 Many other provisions allow the minister or a court to provide relief where it would be just and equitable to do so: see Carla Hanneman, "What Is 'Just and Equitable'?" (2013) 3:4 *Canadian Tax Focus* 8.

19 David M. Sherman, ed., *2015 Department of Finance Technical Notes: Income Tax*, 27th ed. (Toronto: Carswell, 2015), at subsections 220(3.2), 85(7.1), and 93(5.1).

not intended by the taxpayer, the taxpayer took reasonable steps to comply with the law, and the taxpayer acted diligently to take remedial action.[20] The minister refuses relief where the taxpayer seeks to engage in retroactive tax planning, adequate records do not exist, or the taxpayer was negligent or careless in complying with the law.[21]

These principles are fair and understood by the tax community. Allowing a taxpayer to fix a mistake in implementing a transaction invokes the same policy considerations as statutory rules that confer discretion on the minister to fix a mistake in an election. In each type of case, it is proper to correct mistakes in appropriate circumstances.

THE CRA'S ADMINISTRATIVE POSITIONS

The CRA accepts that correcting mistakes to eliminate unintended tax consequences by court order is appropriate in some cases.[22]

The CRA does not oppose an application for rectification to fix a corporate slip, as in *Dale v. Canada*.[23] In *Dale*, a taxpayer transferred property to a corporation purportedly in consideration for preferred shares. The parties intended the transaction to occur on a tax-deferred basis under subsection 85(1). At the time, however, the corporation's constating documents did not authorize the issuance of preferred shares. As a result, the transfer occurred but the purported issuance of shares failed; the taxpayer did not receive preferred shares in consideration for the transferred property, and the rollover did not apply as intended. The taxpayer subsequently obtained a court order that deemed the preferred shares to have been validly issued effective as of the date of the transaction. The Federal Court of Appeal held that the court order bound the Crown in tax law, eliminating the unintended tax consequences.

There are many types of corporate slips. Corporate-law formalities must be met, and must be undertaken in the proper order, to perfect a corporate act. Examples of irregularities include a failure of directors' resolutions to authorize a stock issuance, a failure to obtain a shareholder vote on a fundamental change, and an issuance of a class of shares beyond the authorized share capital set out in the articles. The CRA does not oppose fixing corporate slips because, typically, contemporaneous documentary evidence demonstrates a common and continuing original intention of the

20 *Information Circular* 07-1, "Taxpayer Relief Provisions," May 31, 2007, at paragraph 56. Relief also may be provided where the taxpayer's request arises from circumstances that were beyond the taxpayer's control; the taxpayer acted on incorrect information given by the CRA; the request results from a mechanical error; the later accounting of the transactions by all parties is as if the election in question had been made (or had been made in a particular manner); or the taxpayer can demonstrate that it was not aware of the election provision, even though it took a reasonable amount of care to comply with the law, and that it took remedial action as quickly as possible.

21 Ibid., at paragraph 57.

22 *Income Tax Technical News* no. 22, January 11, 2002.

23 [1997] 3 FC 235 (CA).

parties to undertake the proper transaction from the outset. The parties strive only to validate the defective corporate act, not to undertake a different transaction.

The CRA also does not oppose an application to rectify documents where the amendments are integral to achieving the original intentions of the parties.[24] This category covers a wide variety of cases. As an example, a taxpayer may request a change to the amount of a capital dividend that exceeded the corporation's capital dividend account (CDA), as occurred in *Winclare Management Services Ltd. v. Canada (Attorney General)*.[25]

In *Winclare*, a taxpayer applied to a provincial superior court to rectify a directors' resolution. The directors mistakenly declared a dividend of an amount exceeding the corporation's CDA, and the corporation elected under subsection 83(2) to treat it as capital dividend. The CRA identified the taxpayer's error on audit. The rectification application sought to reduce the amount of the dividend to the CDA balance at the time of the directors' resolution. The Crown did not oppose the application. Ultimately, the Ontario Superior Court of Justice granted rectification to eliminate the unintended tax consequences.

On the other hand, the CRA opposes fixing a mistake to eliminate an unintended tax consequence by court order in two types of cases. Under the first type, the taxpayer cannot prove its original and continuing intention to transact on a particular tax basis. Under the second type, the taxpayer "is asking the court not to rectify the transaction back to its intended form, but to undo the intended transaction and put in place a new one formed after the original transaction."[26]

The CRA's position strives to block retroactive tax planning. In retroactive tax planning, a taxpayer eliminates unintended tax consequences, or creates tax benefits, by deviating from its originally intended exercise of autonomy. If permitted, retroactive tax planning would allow a taxpayer to shirk its duty to exercise due diligence at the time of the transaction, permit a taxpayer to play the audit lottery with impunity, and encourage aggressive tax planning.[27] This would undermine public confidence in our self-assessment system of taxation.

In our view, there are two distinct types of retroactive tax planning. The first type involves amending or annulling documents to implement a tax plan or to avoid an unanticipated tax consequence that was not contemplated at the time of the original transaction. The second type involves an attempt by the taxpayer to resile from an uncertain tax position that was undertaken deliberately but that ultimately produced adverse tax consequences. While the taxpayer incorrectly guessed the

24 ITTN no. 22, supra note 22.

25 2009 CanLII 18234 (ONSC).

26 ITTN no. 22, supra note 22.

27 In *AES*, supra note 5, at paragraph 54, the court held that "[t]axpayers should not view this recognition of the primacy of the parties' internal will—or common intention—as an invitation to engage in bold tax planning on the assumption that it will always be possible for them to redo their contracts retroactively should that planning fail."

outcome of the uncertain tax position, this type of mistake does not vitiate responsibility for the tax burden that results. The taxpayer should not be entitled to undo the transaction because the taxpayer voluntarily ran the risk of being wrong.[28] A court order should not become a tool for "fixing" aggressive tax plans discovered on audit.[29] Consistent with the tradition of Canadian tax law in other contexts,[30] a court order must not become a means to facilitate retroactive tax planning.

The CRA's position, however, also prohibits correcting mistakes similar to the one in *Juliar v. Canada (Attorney General)*,[31] discussed below. The CRA deliberately formulated its position to limit *Juliar* to its facts. While the CRA will not challenge a case that fits squarely within the facts of the *Juliar* decision,[32] the Crown does not accept the principle that an equitable remedy may reformulate the substance of a transaction to eliminate unintended tax consequences. This prompts the Crown to relitigate the same point. Duplicative litigation produces conflicting jurisprudence because some cases follow *Juliar* but others refute it.

JUDICIAL TREATMENT

In *Juliar*, a father and mother owned shares of an operating corporation that carried on a variety store business. The parents turned over the business to their two daughters together with their respective spouses through the creation of a holding corporation. The parents transferred shares of the operating corporation to the holding corporation in consideration for shares of the holding corporation, and gifted such shares of the holding corporation to each couple. The parents did not pay tax on the disposition. Thereafter, the couples divided ownership of the holding corporation to operate separate businesses independently. Each couple incorporated a separate family holding company, and transferred their respective shares of the holding corporation to the family holding company. The parties intended that these transactions would not trigger an obligation to pay income tax immediately. One couple effected the transfer as a share-for-share exchange under subsection 85(1). The second couple, however, received promissory notes from the family holding company as consideration for the transfer. After an audit, the second couple was reassessed for deemed dividends under section 84.1 arising on the share transfer. Following the reassessments, the parties learned that the cost base of the shares was lower than they had thought.[33] The taxpayers applied for rectification to implement a share-for-share exchange.

28 *Futter & Anor. v. Revenue and Customs*, 2013 UKSC 26, at paragraph 114.

29 ITTN no. 22, supra note 22.

30 Subsections 220(3.2), 85(7.1), and 93(5.1), and IC 07-1, supra note 20.

31 Supra note 6.

32 ITTN no. 22, supra note 22.

33 The judgments in *Juliar*, supra note 6, do not describe the technical tax analysis of the transactions.

The Ontario Superior Court of Justice granted rectification, and the Ontario Court of Appeal upheld the lower court's decision. The Ontario Court of Appeal found that the true agreement between the parties was to transfer their interest in the operating business in a manner that would not attract immediate tax liability. In the circumstances, the court inferred that the sole transaction intended must have been a share exchange, not a transfer of shares for boot that gave rise to a deemed dividend. Thus, the court rectified the documents to implement that transaction as originally intended.

In the cases that follow *Juliar*, courts reformulate the substance of the taxpayer's arrangements to eliminate unintended tax consequences arising by virtue of mistake. These cases include *Fairmont Hotels Inc. et al. v. AG Canada*[34] and *Telus Communications Inc. v. The Queen*.[35] *Fairmont* provides an example of a mistaken action, while *Telus* provides an example of a mistaken omission.

In *Fairmont*, the taxpayer and its affiliates entered into reciprocal loan arrangements to provide US dollar denominated financing to a Canadian real estate investment trust. The arrangement was structured so that no entity would realize a net foreign exchange gain or loss. Subsequently, control of the taxpayer was acquired. As a result, the foreign exchange exposure on some of the taxpayer's investments in US dollar denominated preferred shares was no longer hedged. The taxpayer knew that these investments were unhedged, and did not have a specific plan for ensuring that the structure would remain tax-neutral. At a later date, however, the taxpayer unwound the reciprocal loan arrangements on an urgent basis. The taxpayer caused its affiliates to redeem their preference shares held by the taxpayer, triggering foreign exchange gains. The taxpayer learned of its mistake when the CRA audited the affiliates' tax returns.

The Ontario Superior Court of Justice allowed the parties to rectify the transactions. The court ordered the share redemptions to be replaced with loans from the affiliates to the taxpayer in a principal amount equal to the redemption price of the preference shares. The court found that the parties had a continuing intention from the initial structuring of the reciprocal loan arrangements to carry out the arrangement on a tax-neutral basis whereby any foreign exchange gains would be offset by corresponding foreign exchange losses. The applicants also had a continuing intention from the time of the acquisition of control not to redeem the preference shares. On unwinding the arrangement, the taxpayer's purpose was not to redeem preference shares but to unwind the loans on a tax-free basis. The Ontario Court of Appeal applied *Juliar* and did not interfere with the application judge's decision.

In *Telus*, a corporation was a member of partnerships in a tiered structure. The taxpayer elected under subsection 249.1(9) to choose an aligned, off-calendar fiscal period for two of its subsidiary partnerships that the taxpayer believed to constitute

34 2014 ONSC 7302; aff'd. 2015 ONCA 441; leave to appeal to the Supreme Court of Canada granted, [2015] SCCA no. 358.

35 2015 ONSC 6245.

the complete structure. After filing the election, the parties discovered that one of the partnerships held a minority interest in a third partnership, which did not appear on the organizational chart attached to the election. If the parties had known about that minority interest, they would have transferred it out of the structure before making the election. Their omission to do so invalidated the election, resulting in adverse tax consequences.

The Ontario Superior Court of Justice allowed rectification to validate the election. The court found that the applicants had intended to make a multi-tier alignment election to align the fiscal periods of the two partnerships and had made an honest mistake that frustrated their intention; moreover, they had disclosed the mistake to the CRA within one month of discovering it. The court concluded that the applicants met the requirements for rectification set out in *Juliar* and *Fairmont*; that is, they had a continuing specific intention to file a valid election to achieve a particular tax result.

Under *Juliar*, *Fairmont*, and *Telus*, rectification applies where the taxpayer shows a continuing specific intention to undertake a transaction to accomplish a particular tax result but a mistake caused the instrument not to accord with the intention of the parties. The breadth of the legal test is explained in *Fairmont* as follows:

> *Juliar* is a binding decision of this court. It does not require that the party seeking rectification must have determined the precise mechanics or means by which the party's settled intention to achieve a specific tax outcome would be realized. *Juliar* holds, in effect, that the critical requirement for rectification is proof of a continuing specific intention to undertake a transaction or transactions on a particular tax basis.[36]

The Supreme Court of Canada has not, to date, either approved or rejected the *Juliar* principle. In *Quebec (Agence du revenu) v. Services Environnementaux AES inc.*,[37] however, under the civil law of obligations, the court allowed a mistake to be corrected in circumstances similar to those in *Juliar*. In *AES*, a corporation owned shares of its corporate subsidiary. The corporation undertook an exchange of shares of the subsidiary for a promissory note and other shares. The parties intended to effect the reorganization on a tax-deferred basis under section 86. Tax advisers erroneously calculated the cost basis of the exchanged shares; consequently, the corporation realized a capital gain on its disposition of the shares. The subsidiary repaid the promissory note over time. After reassessments of tax, by subsequent agreement, the parties cancelled the prior promissory note, and the subsidiary issued to the corporation fixed-value preferred shares and a new debt in a smaller principal amount equal to the proper tax cost of the exchanged shares.

The Supreme Court of Canada held that a contract belongs to the parties and they may, as between themselves, subject to any rights acquired by third parties,

36 *Fairmont*, supra note 34 (ONCA), at paragraph 10.

37 Supra note 5.

amend or annul the contract and the documents recording it. The parties' agreement was intended to defer tax payable, but this result was vitiated by an error in implementation that would have justified annulment of the contract. Instead, the parties corrected the error by amending the legal documentation to restore the integrity of the original agreement, which eliminated inconsistency between the true agreement and the expression of that agreement in the contract. The court held that the common intention of the parties may be shown in a private writing, but if such a writing is proven to contain an error, a court must ensure that the error is remedied. Thus, at civil law, the amended agreements were binding, subject only to third-party rights such as those of the Crown. The court held that the Crown did not have vested rights under the erroneous legal documentation that defeated the parties' amendment to reflect the true agreement. Thus, since the legal documentation did not reflect the true agreement of the parties, properly interpreted, the court noted the error and remedied it.

On the other hand, in some cases the courts have rejected the *Juliar* principle. These cases include *Graymar Equipment (2008) Inc. v. Canada (Attorney General)*[38] and *Canada (Attorney General) c. Groupe Jean Coutu (PJC) inc.*[39] The facts and conclusions of these cases are set out below, followed by a discussion of the criticisms of the *Juliar* principle.

In *Graymar*, a partnership subscribed for shares of a corporation, and the partnership owed a debt to the corporation, as part of a 141-step debt restructuring. In that sophisticated transaction, certain non-resident partners realized a deemed dividend under subsection 15(2), paragraph 214(3)(a), and subsection 212(2), but the corporation did not withhold or remit Canadian withholding tax. The parties sought to avoid the tax after the CRA's audit detected the partnership's omission to repay the shareholder loan within the time prescribed by subsection 15(2.6) to avoid a deemed dividend.

The Alberta Court of Queen's Bench denied the parties' application for rectification. The court did not find an original intention of the partnership to repay its shareholder loan. The court found that the restructuring conformed to the parties' original intention for the restructuring, which was to reduce the external debt of the partnership.

In *Jean Coutu*, a civil-law case, a corporation effected a series of transactions to neutralize foreign exchange fluctuations on its investments in a subsidiary formed in the United States. Tax advisers devised two alternative approaches. Ultimately, the first approach was adopted and the second rejected. The first approach gave rise to unforeseen exposure to foreign accrual property income (FAPI) that was detected by the CRA on audit, whereas the second one would not have done so. The taxpayer sought to substitute the second approach for the first to avoid that FAPI.

38 2014 ABQB 154.

39 2015 QCCA 838; leave to appeal to the Supreme Court of Canada granted, [2015] SCCA no. 263.

The Quebec Court of Appeal denied the application. The court held that the taxpayer's general intent that the transactions be tax-neutral was not sufficiently determinate to provide a basis for correcting the transactions so as to eliminate the unforeseen tax consequences. The taxpayer did not show a specific intention to avoid FAPI from the outset. The court found that the transactions were intended to neutralize foreign exchange fluctuations, and they achieved that objective. As a result, the court declined to allow revision of the transactions to avoid tax from FAPI that was not contemplated at the time of the transactions.

Cases that refute *Juliar* typically advance one or more of four arguments. First, *Juliar* violates stare decisis (the doctrine of precedent) because the judgment departs from binding, higher-court jurisprudence in non-tax cases. Second, *Juliar* effectively renders the Crown an insurer of tax advisers. Third, *Juliar* violates the principle in *Shell Canada Ltd. v. Canada*[40] that a taxpayer is entitled to be taxed on the basis of what it actually did, not what it could have done. Fourth, *Juliar* is too flexible because it provides relief on the basis of a general intention to reduce tax by modifying or replacing a transaction, which facilitates retroactive tax planning in some cases. Each of these four arguments is questionable, for the reasons set out below.

Juliar Does Not Violate Stare Decisis

The Crown has argued that *Juliar* departs from binding jurisprudence in *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*[41] and *Shafron v. KRG Insurance Brokers (Western) Inc.*,[42] on the basis that, traditionally, rectification corrects only transcription errors.

In *Performance Industries*, the plaintiff and the defendant concluded an agreement to develop a golf course. Under the agreement, the plaintiff would operate the golf course for five years. On expiration of the term, the defendant would buy out the plaintiff. The parties agreed in their oral discussions that the plaintiff had an option to develop residential property on a strip of land along the 18th hole. The oral agreement contemplated that the strip would have a width of 110 yards to accommodate two rows of houses. The defendant drafted the written agreement, which provided for a strip of 110 feet, sufficient for only a single row of houses. The defendant knew that the written terms did not reflect the oral agreement. The plaintiff signed the written agreement without reading the relevant provision. When the five-year term expired, the defendant tendered the purchase price to buy out the plaintiff. The plaintiff refused to vacate the land, and the defendant successfully sued for specific performance. The plaintiff subsequently sought rectification of the agreement or, alternatively, compensatory and punitive damages from the defendant.

The Supreme Court of Canada concluded that the plaintiff was entitled to rectification but, in lieu of rectifying the agreement, upheld the trial judge's award of

40 Supra note 1.

41 2002 SCC 19.

42 2009 SCC 6.

compensatory damages. The court held that where a unilateral mistake occurred, demanding conditions must be met to obtain rectification. Specifically,

1. there must be a prior oral contract with definite and ascertainable terms that were not written down properly;
2. the party seeking to uphold the terms of the written agreement knew or ought to have known of the error, in circumstances amounting to fraud or the equivalent of fraud; and
3. there must be a precise form in which the prior oral agreement can be reduced to writing.[43]

In *Shafron*, the parties entered into an employment contract that included a restrictive covenant. The covenant provided that the defendant would not be employed in the business of insurance brokerage within the "Metropolitan City of Vancouver" for three years after leaving employment with the plaintiff. One month after the defendant's termination of employment, the defendant took a position as an insurance salesman in Richmond, a suburb of Vancouver. The plaintiff sued to enforce the restrictive covenant.

The Supreme Court of Canada held that a restrictive covenant is valid only if the geographic coverage of the covenant, the duration of enforcement, and the scope of prohibited activity is reasonable. On finding that the meaning of the term "Metropolitan City of Vancouver" was ambiguous and uncertain, the court held that the provision was prima facie unenforceable for unreasonableness. The court considered whether the covenant could be rectified on the basis that the term "Metropolitan City of Vancouver" mistakenly described the geographic scope of the covenant. The court outlined the elements for rectification by summarizing the legal test in *Performance Industries*.[44] The court denied rectification because the parties did not have a prior oral agreement regarding the geographic scope of the covenant and the parties did not mistakenly describe something else in the written contract.

Performance Industries and *Shafron* are non-tax, contract cases. The principal concern in such cases is unjust enrichment as between the parties to the instrument. In these cases, rectification is designed to prevent a written instrument from being used as an engine of fraud or of misconduct equivalent to fraud. The remedy restores the parties to an original oral bargain so that one party cannot rely on the strict terms of a written instrument that contravenes the true arrangement between the parties.

43 *Performance Industries*, supra note 41, at paragraphs 37, 38, and 40.

44 *Shafron*, supra note 42, at paragraph 53. Some have questioned whether it was appropriate for the court to apply the test from *Performance Industries*, a case of unilateral mistake, in *Shafron*, a case of mutual mistake: see Patrick Hartford, "Clarifying the Doctrine of Rectification in Canada: A Comment on Shafron v. KRG Insurance Brokers (Western) Inc." (2013) 54:1 *Canadian Business Law Journal* 87-98, at 94-96. Jurisprudence prior to *Shafron* had applied a more lenient standard in cases of mutual mistake: see *Royal Bank of Canada v. El-Bris Limited*, 2008 ONCA 601.

From a policy perspective, this limited scope for rectification in non-tax, contract cases is sound. Rectification cannot be granted as a substitute for due diligence at the time an instrument is signed. The cautionary function of the element of consideration in contract formation recognizes that the solemnity of the formal act of exchange prompts sober thought about the merits of the bargain and acts as a check against inconsiderate action.[45] To grant rectification as a substitute for due diligence at the time of signing a contract would undermine the very reason why consideration is required to enforce a bargain.

Further, rectification should not provide a means to relieve a party from a bad bargain. It is important not to reshape a deal, because a contract confers on the parties legitimate expectations of enforcing mutual benefits earned through exchange. A restrained approach to rectification preserves the confidence of the commercial world in written contracts.[46] It also relieves a court from having to draft terms of an instrument affecting parties with divergent interests.[47] Therefore, the remedy is limited to correcting transcription errors.

In tax cases, the injustice of mistake-based taxation trumps the policy that underlies the sanctity of contracts. The Crown, which lacks privity of contract, reaps an undeserved windfall, yet strives to rely on the strict terms of the instrument to justify its enrichment. There is no suspicion that the taxpayer seeks relief from a bad bargain with the Crown. The Crown did not earn entitlement to tax receivable through a contractual exchange with the taxpayer. Thus, the sanctity of contracts does not justify the Crown's retention of a windfall at the expense of a taxpayer. Further, rectification in tax cases may require amendment of instruments other than contracts, such as legal documentation for voluntary dispositions and other corporate records. Respect for the sanctity of contracts should not fetter the discretion of the courts to grant rectification of written instruments in tax cases.

In addition, the element of fraud or misconduct equivalent to fraud is not relevant in tax cases. The unconscionable tax result arises from a mistake in legal documentation or the application of tax law to an erroneous transaction, not from the conduct of the Crown. The Crown is akin to a finder who has done nothing wrong. Case law acknowledges the irrelevance of fraud in tax-motivated rectification.[48]

Thus, the criticism that *Juliar* does not respect stare decisis is misplaced. *Performance Industries* and *Shafron* are distinguishable because tax-motivated rectification involves a different, material consideration: the dispute involves the taxpayer and the Crown as a third party to the taxpayer's arrangement. The law of equity should be flexible enough to fashion a remedy to provide justice in non-tax and tax cases while respecting the relevant policy considerations arising in the particular type of case.

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45 Lon L. Fuller, "Consideration and Form" (1941) 41:5 *Columbia Law Review* 799-824, at 800.

46 *Performance Industries*, supra note 41, at paragraph 31.

47 *H.F. Clarke Limited v. Thermidaire Corp. Ltd.*, 1973 CanLII 41 (ONCA).

48 *Harvest Operations Corp. v. Canada (Attorney General)*, 2015 ABQB 327, at note 5.

In tax cases, rectification should be available to revise the mechanics of a transaction to achieve the taxpayer's continuing and specific intention to avoid a particular tax. The remedy cannot be limited to fixing transcription errors, since that approach may not eliminate unintended tax consequences where it is just and equitable to do so. Equity is flexible enough to fix mistakes in tax cases, whether under rectification or, if necessary, under the inherent equitable jurisdiction of a superior court to relieve a person from the effect of a mistake.[49]

The Crown Is Not an Insurer of Tax Advisers

Some courts refuse rectification in tax cases because the Crown should not be rendered an insurer of tax advisers. There is no dispute that if a court order to fix a mistake that leads to unintended tax consequences is denied, a loss persists from the resulting tax burden. This loss must be allocated as between the taxpayer and its advisers who are at fault. The Crown keeps the tax receivable and does not insure that loss. However, this position assumes the outcome as the basis for justifying the argument. Consequently, this argument is unpersuasive in determining whether the court order should be granted.

The issue on the court application is the very existence of the loss in question. If the order is granted, there is no loss for the Crown to underwrite. The tax authorities do not have an acquired right to benefit from an error by the parties in legal documentation for a transaction.[50] The Crown does not suffer any prejudice because it "forfeits" a windfall.[51] Thus, the Crown does not insure tax advisers where the court fixes a mistake to eliminate unintended tax consequences, because in that case there is no loss.

Further, refusing relief on the basis that the Crown should not insure providers of tax advice fosters injustice. The best solution is to eliminate entirely the loss from an unintended tax burden, not to shift the burden to a tax adviser who is at fault. Tax should not be levied on the basis of mistake, but rather pursuant to a change in economic position realized on an exercise of autonomy under principled statutory rules. Consequently, whether the taxpayer bears the burden of unintended tax consequences, or recovers damages from its adviser (or its insurer) who then must bear the loss, the tax burden itself is not justified on that basis. Eliminating mistake-based taxation, which misallocates the overall tax burden contrary to the principle of horizontal equity, is preferable to reallocating it.

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49 *TCR Holding Corporation v. Ontario*, 2010 ONCA 233; leave to appeal to the Supreme Court of Canada denied, [2010] SCCA no. 206; and *Telus*, supra note 35.

50 *AES*, supra note 5, at paragraph 52. This jurisprudential principle developed in litigation under the civil law, such that an amendment of a document is not blocked on the basis that the change affects acquired rights by third parties. However, the point is persuasive in the common-law tradition as well.

51 *Baytex Energy Ltd. v. Canada (Attorney General)*, 2015 ABQB 278, at paragraph 54; and *Nizar Kanji v. Attorney General of Canada*, 2013 ONSC 781, at paragraph 21.

In any event, a taxpayer's claim against a tax adviser may not provide adequate recourse. A taxpayer may recover damages only if the taxpayer establishes negligence or breach of contract on the part of the tax adviser. This is not an easy feat in the technical field of tax law.[52] Further, a lawsuit entails significant costs in time, money, and delay. Even a successful suit may be frustrated by a limited measure of damages[53] or a contractual limitation on liability.[54] Therefore, relying on a suit for negligence or breach of contract may not suffice to achieve justice in a particular case.

Shell Canada Does Not Hold a Taxpayer to Erroneous Legal Documentation

Some cases hold that the taxpayer should be held to its erroneous legal documentation to comply with *Shell Canada*. This position posits that a taxpayer must pay tax on a transaction actually effected, not on another transaction that it would have effected given the benefit of hindsight.[55] This argument is presented as a corollary of the principle in *Shell Canada* that "[u]nless the Act provides otherwise, a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not based on what a less sophisticated taxpayer might have done."[56]

Shell Canada does not mandate that a taxpayer must be held to erroneous legal documentation. Properly understood, *Shell Canada* sets out rules to govern statutory interpretation applicable to the Act as enacted by Parliament, and deters the judiciary from legislating from the bench. It holds that tax law applies to the legal form rather than the economic realities of a transaction. The court did not consider the issue of whether it is appropriate to correct mistakes giving rise to unintended tax consequences.

The object of an application for a court order to correct a mistake is to determine the legal form of the transaction to which the principle in *Shell Canada* applies. Far from determining the outcome of the application, it is only after the court order is granted or refused that the principles of statutory interpretation in *Shell Canada*

52 For example, in dismissing a negligence action in *J.F. Newton Limited et al. v. Thorne Riddell et al.*, 91 DTC 5276, at 5282 (BCSC), the trial judge stated, "It surpasses my imagination that anyone considers language such as this [in section 55] to be capable of an intelligent understanding, or that such language is thought to be capable of application to the events of real life, such as the sale of a business."

53 For example, where a mistake accelerates tax payable, damages may be limited to the time value of money rather than the full amount of tax payable.

54 *Felty v. Ernst & Young LLP*, 2013 BCSC 815, at paragraph 259; aff'd. 2015 BCCA 445.

55 *Jean Coutu*, supra note 39, at paragraph 36; *Mac's Convenience Stores Inc. c. Canada (Procureur général)*, 2015 QCCA 837, at paragraph 41; and *Graymar*, supra note 38, at paragraphs 54 and 68-69.

56 *Shell Canada*, supra note 1, at paragraph 45.

apply to discern the tax consequences of the legal form of the transaction determined on the application.

The legal form of the transaction to which tax law applies ought to reflect the taxpayer's free will to act. A mistake vitiates the taxpayer's autonomy. This should excuse its responsibility for unintended tax consequences that result from the mistake where the taxpayer does not engage in retroactive tax planning. On that understanding, there is no inconsistency between *Shell Canada* and allowing a taxpayer to correct mistakes to eliminate unintended tax consequences.

Juliar Is Not Too Flexible

Juliar has also been criticized on the basis that the principle is overbroad. First, one might read the judgment to hold that a mere general intention to reduce tax liability by modifying or replacing a transaction is sufficient for relief. *Juliar* did not hold that a general intent to minimize tax is sufficient to justify correction of a mistake resulting in adverse tax consequences. Rather, the court inferred a specific intention of the parties to effect a share-for-share exchange on the basis that such form of transaction could be the only one that would have achieved their intention to transact on a tax-deferred basis. The court granted the remedy required to achieve a just outcome. The specificity of the intention to avoid a tax that is required depends on the nature of the case. A useful touchstone may be the flexible test in *McPeake v. Canada (Attorney General)*: "The intention underlying the document must be more than a general intention. Exactly what constitutes sufficient specificity of intention varies by context."[57]

Second, *Graymar* posits that rectification is available only to restore a transaction to its originally intended purpose, and not to avoid an unintended effect such as a tax disadvantage.[58] Accordingly, tax savings must be the driving force of the transaction for the taxpayer to obtain relief.

Under this logic, oddly, only primarily tax-driven transactions would satisfy the test for rectification in tax cases. Aggressive tax planning designed to achieve tax benefits could qualify for rectification because such transactions are primarily motivated by an intention to minimize tax. Innocent errors that create an unexpected tax burden, as in *Juliar*, would not qualify. In our view, this proposition is unworkable under the law of equity in the tax context. From a policy perspective, this criticism of *Juliar* should be rejected. It encourages aggressive tax planning, which may be entitled to relief on the *Graymar* standard since tax saving is the driving force of the transaction, but it disqualifies deserving and more sympathetic cases from relief.[59]

57 2012 BCSC 132, at paragraph 18.

58 *Graymar*, supra note 38, at paragraph 66.

59 An example of a case denied relief under the *Graymar* standard is *Harvest Operations*, supra note 48. In *Harvest Operations*, a corporate purchaser acquired a target, amalgamated with the target, bumped the target assets, and transferred those assets. On the closing date, a creditor of

Third, one might criticize *Juliar* as being so flexible that a taxpayer may seek to engage in retroactive tax planning by way of a court order. It comes as no surprise to litigators that how the issue is framed critically affects the outcome. One commentator noted:

> In the Ontario decision of *Binder v. Saffron Rouge Inc.* a Canadian company seeking additional financing issued shares to US investors, causing it to cease to qualify as a Canadian Controlled Private Corporation ("CCPC"). The number of shares issued were [sic] premised on the company being valued at $225,000. The parties were all aware that the transaction would compromise the company's CCPC status and thus the tax rate payable by the company. They were not aware that the change in status would also compromise the Canadian shareholders' ability to claim the lifetime capital gains exemption on their shares. Approximately two years later, a third party offered about $2 million for the company. Based on this offer, the US investors acknowledged that the 2005 valuation of $225,000 was too low and agreed to take a lower number of shares based on a company valuation of $500,000. If permitted to occur on a retroactive basis, this would also reinstate the company's CCPC status and the Canadian shareholders' ability to claim the capital gains exemption. With the consent of the US shareholders, the Canadian shareholders applied for rectification of the 2005 transaction to retroactively reduce the number of shares issued to the US investors. The application was dismissed on the basis that the parties lacked the requisite common, continuing intention that the transaction be implemented in a manner that would preserve the Canadian shareholders' capital gains exemption. . . . [T]he shareholders were not aware of the capital gains issue and thus could not have formed an intention in respect of it.
>
> The *Binder* case demonstrates how subtle the line between success and failure can be in such a case. *Query whether the result might have been different if the facts and issues were instead framed such that the parties at all times intended to complete the transaction at fair market value, but due to an error in valuation failed to fulfill that intention.*[60]

Despite this observation, the role of an impartial trier of fact is to assess credibility and to find the facts of each case based on the evidence. The trier of fact prevents a court order from becoming a tool to engage in retroactive tax planning. Where the trier of fact finds that the taxpayer does not engage in retroactive tax planning, tax-motivated rectification should be granted, on the basis of the *Juliar* standard.

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the target unexpectedly demanded repayment of a facility. An affiliate of the purchaser lent the target an amount to fund the repayment. As a result, the quantum of the bump was reduced and the amalgamated corporation realized a gain on the transfer of the target's assets. The purchaser sought rectification to replace the loan to the target with a two-step transaction whereby the affiliate would make a loan to the purchaser and the purchaser would subscribe for shares of the target, thus preserving bump room. The court denied rectification because the parties did not intend that revised form of transaction from the outset. The amalgamated corporation realized a capital gain despite the fact that the purchaser had paid fair market value consideration for the assets of the target. While the purchaser intended to avoid the capital gain from the outset, this intention was not the driving force of the acquisition.

60 Gill, supra note 5, at 9:5 (emphasis added).

In any event, a refusal to sanction retroactive tax planning does not warrant a blanket prohibition on correcting mistakes pursuant to an equitable remedy. We do not diminish the importance of the observation that the *Juliar* standard may be susceptible to manipulation by clever advocacy. However, the *Juliar* principle does not permit retroactive tax planning, because in cases of retroactive tax planning the taxpayer does not have a continuing specific intention to avoid a particular tax. The concern that the *Juliar* principle may be susceptible to manipulation highlights the importance of the role of the trier of fact to determine the facts of each case in order to foreclose abuse. Correcting mistakes to eliminate unintended tax consequences must be limited to implementing the taxpayer's originally intended exercise of its free will at the time of the transaction.

The Case Law Is Mixed and Evolving

Juliar developed the law of rectification to provide justice in tax cases.

The case law is mixed. In rendering judgment, courts appear to be making conflicting comments on the appropriate scope of rectification in tax cases, as a consequence of which the validity of the *Juliar* standard remains unsettled. In *AES*, the Supreme Court of Canada declined to criticize, approve, or comment on *Juliar* because the governing civil law differed from the law of rectification. The court has granted leave to hear the appeal of *Jean Coutu*, another civil-law case, and of *Fairmont*. The Supreme Court of Canada's decision in each of these cases will provide guidance across the provinces.

In our view, *Juliar* should be good law. The precise limits of rectification to correct mistakes leading to unintended tax consequences are not fixed. Each case turns on the balance of the equities that arise on the evidence and a court's discretion to fashion an outcome to serve the interests of justice.

Appropriate To Correct Mistakes from a Policy Perspective

In our view, appropriate tax policy requires taxation based on changes in economic position arising on an exercise of free will by a taxpayer under codified rules, and does not sanction mistake-based taxation. This conclusion is consistent with the policy underlying a number of relieving provisions in the Act and with the principle of horizontal equity. A mistake vitiates a taxpayer's autonomy and excuses its responsibility for the resulting tax exposure. *Performance Industries* and *Shafron* are distinguishable because different policy considerations predominate in tax cases. The counterargument that the Crown should not insure tax advisers is not compelling. Further, *Shell Canada* does not require a taxpayer to be held to erroneous legal documentation. Even the CRA agrees that mistakes that lead to unintended tax consequences ought to be corrected in appropriate cases.

Thus, from a policy perspective, it is appropriate to fix mistakes in documents that lead to unintended tax consequences provided that the taxpayer does not engage in retroactive tax planning. The law of equity should be flexible enough to provide relief in appropriate cases, and if it is not, it must evolve to do so. If the judiciary cannot provide adequate relief, a legislative response is required.

COURT-ORDERED REMEDIES EFFECTIVE BUT REQUIRE UNDUE PROCESS IN UNCONTESTED CASES

On the basis that it is appropriate to fix mistakes that lead to unintended tax consequences, the issue becomes how to fix these mistakes efficiently and effectively. The most common method to fix mistakes in tax planning is a court order. While court-ordered remedies can be effective to fix a mistake to relieve unintended tax consequences, the taxpayer must apply for a court order to achieve that result. The case law is mixed, and so the prospect of success for the application is uncertain. Further, each court-ordered remedy requires a formal application to provincial superior court to achieve a favourable outcome.

This process is disproportionate and unsatisfactory in uncontested cases. Justice requires not only adequate outcomes but also fair processes. Undue process, disproportionate to the nature of the dispute and the interests at stake, and involving unnecessary expense and delay, frustrates the fair and just resolution of legal problems.[61]

A court application often entails hardship. The process, at its fastest, takes months to complete. In the interim, the taxpayer may be required to recognize tax exposure in its financial statements.[62] Further, the taxpayer must incur legal expenses and filing fees associated with litigation. Where a reassessment levies tax payable that is voluntarily paid to avoid interest charges or that is enforced by collection action, the resulting litigation costs aggravate the tax burden for which relief is sought. In addition, the application creates a public record, causing embarrassment for all concerned. More importantly, the taxpayer may be forced to disclose information that otherwise would remain confidential.

In some jurisdictions, the taxpayer must notify the Crown of the application.[63] The federal Department of Justice imposes its own administrative procedure that the applicant must navigate.[64] Any taxpayer seeking relief must obtain a court order, irrespective of whether the Crown contests the application. A court must consider the relevant law and the facts of the case to render judgment. This approach in uncontested cases wastes scarce judicial resources, as well as the time of court staff involved in the application process.

61 *Hryniak v. Mauldin*, 2014 SCC 7, at paragraphs 24-25 and 29.

62 International Accounting Standards Board, *International Accounting Standard* IAS 12, "Income Taxes."

63 *Snow White Productions Inc. v. PMP Entertainment, Inc. et al.*, 2004 BCSC 604, at paragraph 2; and *McPeake*, supra note 57, at paragraph 2. But see *Canada (Attorney-General) v. Brogan Family Trust*, 2014 ONSC 6354, in which the court held that the Crown must be notified only where the CRA is a creditor.

64 Joel Nitikman, "Many Questions (and a Few Possible Answers) About the Application of Rectification in Tax Law" (2005) 53:4 *Canadian Tax Journal* 941-73, at 970.

The court process to fix mistakes in tax cases unopposed by the Crown is unreasonable. Over a decade ago, a commentator questioned the need for a court order to fix a mistake that results in unintended tax consequences:

> Why apply to a court for rectification? After all, if rectification is the correction of an error in a document that does not reflect what the parties agreed, who better than the parties themselves to simply amend the document so that it does say exactly what they agreed? Why involve the courts at all?[65]

The judiciary has echoed the sentiment that the procedure for rectifying mistakes is excessive. In *Winclare*,[66] the taxpayer applied for rectification to reduce the amount of a dividend to the balance of its CDA in order to eliminate unintended tax consequences. At the hearing, counsel for the taxpayer advised the court that the Crown did not oppose the application. The court declined to issue judgment because the judge did not understand why the application was required. The court adjourned to hear from the Crown.

At the subsequent hearing, the Crown advised that, while the taxpayer deserved relief, its sole recourse was a court order. The court "could not help but wonder why it should be necessary for the applicants to bring this application for rectification and incur substantial legal costs in order to do so."[67] The court contemplated that the taxpayer ought to have been able to secure a further directors' resolution amending the erroneous prior resolution without any court intervention. The Crown submitted that this solution did not suffice because a formal judgment for rectification was mandatory in tax cases; the Crown could not rely solely on the subsequent actions of taxpayers to alter a prior transaction. The court found that, whether or not that principle applied, rectification should be granted. In closing, the court stated, "It is unfortunate that no statutory authority presently exists that would have enabled the CRA or its Minister to intervene in this case in the interests of justice without first requiring this merely formal but costly application to be made."[68]

Although court-ordered remedies effectively fix mistakes that generate unintended tax consequences, the court application required is unjustifiable in uncontested cases. A streamlined process ought to be available to fix mistakes.

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65 Ibid., at 966. Nitikman acknowledged that *Sussex Square*, supra note 4, prompted a need for court-ordered rectification to fix mistakes. He disagreed, however, with the logic that no instrument executed in private by the parties can alter the past and rewrite fiscal history. He argued that, because rectification is restorative, not retroactive, the parties' amendment of the defective instrument restored them to the position that they had intended from the outset, and this did not constitute fiscal revisionism. In our view, a purely private process goes too far because, without any oversight, it is susceptible to abuse.

66 Supra note 25.

67 Ibid., at paragraph 11.

68 Ibid., at paragraph 13.

CANADIAN LEGISLATIVE PROCESSES

To varying degrees, Canadian corporate statutes contain mechanisms by which the administrator can fix errors in certain corporate documents effective as of the date of the document. A decision of the administrator may be subject to judicial review. Generally, every Canadian corporate statute provides for this process. As an example, consider section 265 of the Canada Business Corporations Act (CBCA).[69]

Section 265 of the CBCA

Section 265 of the CBCA confers authority on "the Director"[70] to direct shareholders or directors of a corporation to fix errors in specific types of documents—"articles, a notice, a certificate or other document" (individually, a "subject document").[71] A subject document connotes a public document issued to the corporation by the Director or kept on file with the corporate registry.[72] Case law suggests that the ambit of the rule may be limited to errors that require correction in order to comply with the corporate-law statute.[73] On this basis, strictly private legal documents, such as directors' or shareholders' resolutions, agreements, or deeds that are not attached to filings with the corporate registry, fall outside the scope of the rule.

69 RSC 1985, c. C-44, as amended. Canadian corporate-law statutes also provide that a corporation, a security holder, or any other aggrieved person may apply to a court to rectify the corporate register or records where a person's name has been wrongly entered or retained in, or wrongly deleted or omitted from, the registers or other records of a corporation: see, for example, CBCA section 243. Likewise, an application for approval of a plan of arrangement may allow a court to vary legal documents: CBCA section 192(3). Certain statutes have more detailed rules. For example, section 229 of the Business Corporations Act (British Columbia), SBC 2002, c. 57, as amended, allows a court, on its own motion or on application of an interested person, to correct a "corporate mistake" as defined in section 229(1), or to validate any action rendered invalid by the corporate mistake. In each case, the process involves a court application. On that basis, these procedures are not administrative remedies as contemplated herein.

70 CBCA section 2 defines the "Director" as the person appointed to administer the CBCA.

71 CBCA section 265(1). In 2001, Parliament amended the provision to, among other things, confer authority on the Director to request changes to a broader range of documents that contain errors, not merely "certificates": SC 2001, c. 14, section 130; and Industry Canada, *Clause-by-Clause Briefing Book: Bill S-11* (Ottawa: Industry Canada, 2001).

72 CBCA section 265(6) contemplates that the Director "may issue a corrected certificate or file the corrected articles, notice or other document" if the application is accepted. This rule implies that a subject document must be capable of issuance or filing by the Director.

73 In *Allsco Building Supplies Ltd. v. McAllister* (1990), 44 BLR 201, at 205 (NBQB), Landry J held that the authority conferred on the Director under section 189(1) of the Business Corporations Act (New Brunswick), SNB 1981, c. B-9.1, as amended, a parallel provision, "seems to contemplate an error which requires correction in order to ensure compliance with the Act."

Under the provision, the Director may accept a correction to a subject document at the request of the corporation or an interested person (individually, a "subject person")[74] if

> (a) the correction is approved by the directors of the corporation, unless the error is obvious or was made by the Director; and
>
> (b) the Director is satisfied that the correction would not prejudice any of the shareholders or creditors of the corporation and that the correction reflects the original intention of the corporation or the incorporators, as the case may be.[75]

The Director maintains an administrative policy ("the policy") that governs statutory correction of "articles or certificates."[76] The policy defines a "correction" as "a request to fix an error in a corporation's articles or certificate that occurred during the preparation of the articles or issuance of the certificate."[77] The policy states that a subject person can request a correction where

- the error is attributable only to the Director;
- the error is obvious; or
- the error is not obvious and occurred during the preparation of the articles or the certificate.[78]

The policy advises that the Director will refuse to correct errors in judgment.

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74 Before the amendment of the CBCA in 2001, only the Director could request a corporation to correct "certificates" containing errors. The 2001 amendments introduced "flexibility by allowing corporations to request changes" and clarified that the process extended beyond errors committed by the Director: *Clause-by-Clause Briefing Book*, supra note 71.

75 CBCA section 265(3). Under CBCA section 265(6), the Director may demand the surrender of the original subject document and may issue a corrected certificate or file the corrected articles, notice, or other document. Under CBCA section 265(7), the corrected subject document generally must bear the date of the document that it replaces unless the correction fixes the date of the original document. Under CBCA section 265(8), if a corrected certificate materially amends the terms of the original certificate, the Director must, without delay, give notice of the correction in a publication generally available to the public.

76 Industry Canada, *Policy Statement* 2.7, "Correction of Articles or Certificates of a Business Corporation," October 13, 2015 (https://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs01344.html). The policy does not apply to errors contained in routine forms filed with the Director or the annual return. A different policy applies to correction of these documents: see Industry Canada, *Policy Statement* 2.7.1, "Requests for Correction of CBCA Forms 2, 3, 6 and 22," January 26, 2006 (https://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs02318.html).

77 *Policy Statement* 2.7, supra note 76.

78 For example, under *Policy Statement* 2.7, ibid., a subject document that contains a typographical error may be corrected under the provision. Further, articles of incorporation that authorize four classes of shares but describe only three may be corrected but the application to do so is more onerous.

Administrative Remedy Inadequate To Fix Mistakes in Tax Cases

Under the policy, the refusal to correct an error in judgment forecloses the correction of certain mistakes in tax planning, as illustrated by the following example:

> A corporation wants a tax credit and amends its articles to meet the Canada Revenue Agency (CRA)'s criteria. CRA determines that the corporation does not meet the criteria for the tax credit. A request to correct the articles to meet CRA's criteria for the tax credit will not be approved, even though the original intent was to amend the articles to access the tax credit. The error in judgment was produced by means of how the articles were amended.[79]

Section 265 of the CBCA also does not fix many corporate slips that lead to tax exposures. Consider articles of amalgamation issued by the Director that effect a tri-partite amalgamation of a corporation, its sister corporation, and the sister's subsidiary corporation. The amalgamation does not qualify as a vertical amalgamation under subsection 87(11) of the Income Tax Act because neither the corporation nor its sister corporation is a wholly owned subsidiary of the other. Thus, losses of the amalgamated corporation cannot be carried back to be deducted against taxable income of the corporation or its sister corporation pursuant to subsection 87(2.11). The Director refuses to fix this type of mistake to allow an amalgamation of the sister corporation and its subsidiary alone. Under the policy, the mistake constitutes an error in judgment. The error may only be corrected, if at all, by a court order.

It is doubtful that the rule fixes the type of corporate slip found in *Dale*.[80] If articles of amendment of a corporation were filed that authorized the issuance of a new class of shares after a transaction, a taxpayer might apply to the Director to correct the date of the document to effect the filing before the transaction. Under the policy, the Director accepts a request to fix an error that occurs during the preparation of the articles. A late filing, however, appears to involve an erroneous failure to file the articles before the transaction, not any defect in the preparation of the articles that concerns the administrator of the statute. The Director might therefore refuse the request to fix such a mistake. Thus, the regime neuters the discretion of the Director to fix mistakes involving his or her own registry, let alone documents handled privately beyond the reach of the Director.

The rule also cannot be used to fix a mistake involving an improper quantum of a capital dividend, as in *Winclare*. The resolutions of the board of directors to declare the dividend are strictly private documents. They are not subject documents because they are neither a public document issued to the corporation by the Director nor kept on file with the corporate registry.

79 Ibid.

80 See supra note 23 and the accompanying text.

Further, the rule cannot fix mistakes such as those in *Juliar*, *Fairmont*, or *Telus*.[81] In each case, the error involved a private document rather than a subject document issued by the Director or lodged with the corporate registry.

Thus, Canadian administrative remedies are too narrow to fix mistakes in tax cases. We need a broader rule to achieve that objective.

STATUTORY RATIFICATION IN DELAWARE

In the United States, Delaware has a statutory ratification procedure in its General Corporation Law (DGCL).[82] This process enables corporations to engage in self-help to correct a myriad of irregularities in documents under corporate law. It complements equitable reformation in American law[83] and does not block court-ordered relief or ratification of corporate acts that are voidable.[84] It is quick, cheap, and decisive, and efficiently allocates public resources. It promotes Delaware's reputation as a favoured jurisdiction for business investment.[85]

Adverse case-law developments in Delaware prompted enactment of the procedure. Where a share issuance or other corporate act suffered from defective authorization, as a result of failure to comply with statutory formalities, constating documents, or corporate instruments, the share issuance or other impugned act was void, rather than voidable.[86] Consequently, the putative stock or impugned corporate act could not be fixed at law or in equity.[87] Delaware enacted section 204 of the DGCL to override these rigid precedents.

The rule provides that no "defective corporate act" is void or voidable solely as a result of a "failure of authorization" if it is ratified in accordance with the procedures in section 204 of the DGCL or is validated by the Delaware Court of Chancery under section 205 of the DGCL.[88] Section 205 of the DGCL confers jurisdiction on the Delaware Court of Chancery to validate a defective corporate act, any corporate

81 See the discussion above under the heading "Judicial Treatment" (notes 32-35 and the accompanying text).

82 Delaware Code, title 8, chapter 1, sections 204 and 205. The rules were proposed in mid-2013, became law effective April 1, 2014, and were amended to clarify and streamline the procedure effective August 1, 2015.

83 Reformation in American law is an equitable remedy similar to rectification in Canada.

84 DGCL section 204(i).

85 Katherine R. Lofft and Daniel C. Fundakowski, "Validating the Voidable—A Guide to the New Procedures To Ratify Corporate Acts Under Delaware Law," *Corporate Services: Client Alert*, September 2013 (www.ebglaw.com/content/uploads/2014/06/57673_Client-Alert-New-Procedures-to-Ratify-Defective-Corporate-Acts-Under-Delaware-Law.pdf).

86 *STAAR Surgical Co. v. Waggoner*, 588 A. 2d 1130 (Del. SC 1991); *Blades v. Wisehart*, 2010 WL 4638603 (Del. Ch.); and *Olsen v. ev3*, 2011 WL 704409 (Del. Ch.).

87 *STAAR Surgical*, supra note 86; and *Blades*, ibid.

88 DGCL section 204(a).

act or transaction, or share issuance, whether or not ratified under section 204 of the DGCL.

Section 204 of the DGCL

Section 204 of the DGCL enables a corporation to ratify a "defective corporate act"[89] that arose as a result of a "failure of authorization"[90] without court assistance. This rule allows ratification of an "overissue" of "putative stock,"[91] an invalid appointment of directors, and an act or a transaction within the corporation's powers that did not comply with the statute, the corporation's constating documents, or any corporate instrument. A corporation must have a validly elected board in order to ratify defective corporate acts under the provision. If the board's validity is not settled, section 204 of the DGCL does not apply, but the corporation may seek relief from the Delaware Court of Chancery under section 205 of the DGCL.[92] Further, a corporation is precluded from ratifying an act that never occurred (but that the corporation wishes had occurred) or from backdating an act that did occur (but that the corporation wishes had occurred earlier).[93]

Delaware's statutory ratification process generally consists of the following elements:

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89 DGCL section 204(h) defines "defective corporate act" as follows: "an overissue, an election or appointment of directors that is void or voidable due to a failure of authorization, or any act or transaction purportedly taken by or on behalf of the corporation that is, and at the time such act or transaction was purportedly taken would have been, within the power of a corporation . . . but is void or voidable due to a failure of authorization." An overissue is further defined in DGCL section 204(h) (see infra note 91).

90 DGCL section 204(h) defines "failure of authorization" as follows: "(i) the failure to authorize or effect an act or transaction in compliance with the provisions of [the DGCL], the certificate of incorporation or bylaws of the corporation, or any plan or agreement to which the corporation is a party, if and to the extent such failure would render such act or transaction void or voidable; or (ii) the failure of the board of directors or any officer of the corporation to authorize or approve any act or transaction taken by or on behalf of the corporation that would have required for its due authorization the approval of the board of directors or such officer."

91 DGCL section 204(h) defines an "overissue" as an issuance of shares of a class or series in excess of the number authorized, or an issuance of shares of any class or series of capital stock that is not authorized, in the corporation's constating documents. "Putative stock" is defined, ibid., generally as shares of the corporation that, but for any failure of authorization, would constitute valid stock or that cannot be determined by the directors to be valid stock. In turn, "valid stock" is defined, ibid., as shares that have been duly authorized and validly issued in accordance with applicable law.

92 A corporation may also cure an invalid board by filing a certificate of correction: DGCL section 103(f). See C. Stephen Bigler and John Mark Zeberkiewicz, "Restoring Equity: Delaware's Legislative Cure for Defects in Stock Issuances and Other Corporate Acts" (2014) 69:2 *Business Lawyer* 393-427, at 405.

93 Bigler and Zeberkiewicz, supra note 92, at 403.

1. The directors must resolve to ratify the defective corporate act.[94]
2. If the defective corporate act either required shareholder approval at the time of the act or requires such approval at the time the ratifying resolution is adopted, the directors must submit the defective corporate act to shareholders for approval.[95] At least 20 days before the meeting of the shareholders, the corporation must notify
   a. current holders of valid stock and putative stock, voting and non-voting ("the current shareholders"), and
   b. prior holders of such stock as of the time of the defective corporate act, other than holders whose identities or addresses cannot be determined from corporate records ("the prior shareholders").[96]
3. Even where no shareholder approval is needed, the corporation must notify the current shareholders and the prior shareholders of the ratification promptly upon adopting the ratifying resolution.[97]
4. In either case, the notice to the current shareholders and the prior shareholders must include a statement that any claim that the defective corporate act is void or voidable owing to the failure of authorization must be brought to the Delaware Court of Chancery under section 205 of the DGCL generally within 120 days of the "validation effective time."[98]
5. If the defective corporate act required filing a certificate with the Delaware Secretary of State, the corporation must file a certificate of validation.[99]

94 DGCL section 204(b)(1). Generally, the quorum and vote requirements applicable to the board of directors to ratify a defective corporate act are those that apply at the time of ratification, unless the constating documents or any corporate instrument at the time of the defective corporate act required a different arrangement (for example, where approval at the prior time required a larger number or portion of such directors or specified directors), in which case those prior requirements apply. Different quorum requirements apply to the ratification of an election of the initial board of directors of a corporation: DGCL section 204(b)(2).

95 DGCL section 204(c). Generally, the quorum and vote requirements applicable to the shareholders to ratify a defective corporate act are those that apply at the time of ratification approval, unless the constating documents or any corporate instrument at the time of the defective corporate act required a different arrangement (for example, where approval at the prior time required a larger number or portion of such shareholders or specified shareholders), in which case those prior requirements apply: see DGCL section 204(d).

96 DGCL section 204(d).

97 DGCL section 204(g).

98 DGCL sections 204(d) and (g). DGCL section 204(h) defines "validation effective time" generally as the latest of (1) the date of ratification by the shareholders; (2) if shareholder approval is not required, the effective date of ratification by the directors; and (3) the time at which a certificate of validation filed with the Delaware Secretary of State becomes effective.

99 DGCL section 204(e). The certificate of validation must include specified information regarding the defect and may require certain exhibits to be attached, depending on whether a certificate in respect of the defective corporate act had been previously filed and whether any changes to the defective corporate act are required.

Ratification of a defective corporate act under the procedure takes effect from the time the defective act originally occurred.[100] On expiration of the 120-day limitation period, any claim that the defective corporate act so ratified under section 204 of the DGCL is void or voidable owing to a failure of authorization, or that the ratification process was defective, becomes statute-barred.[101] The limitation period does not apply, however, to any persons who were required to be notified of the ratification but who did not receive notice.[102] From a tax perspective, the US Internal Revenue Service (IRS) is not required to be notified of the ratification or of the use of the ratification process.

Section 205 of the DGCL

Section 205 of the DGCL complements section 204. The rule confers on the Delaware Court of Chancery exclusive jurisdiction[103] to

1. validate a defective corporate act ratified under section 204 of the DGCL;
2. determine the validity of a ratification procedure under section 204 of the DGCL;
3. determine the validity of any defective corporate act not ratified or ratified defectively under section 204 of the DGCL;
4. determine the validity of any corporate act or transaction and any stock, rights, or stock options; and
5. modify or waive any ratification procedure.[104]

The section also gives the court discretionary authority to, among other things, impose any conditions to validation and provide remedies for those harmed by ratification.[105] Each of the corporation,[106] any director, any current holder of valid stock or putative stock, any prior holder of valid stock or putative stock as of the time of the defective corporate act, and "any other person claiming to be substantially and adversely affected by a ratification" under section 204 of the DGCL has standing to bring a claim under section 205 of the DGCL.[107] This rule was designed to restore the court's equitable jurisdiction by overriding the adverse jurisprudence.[108]

100 DGCL section 204(f)(1).

101 DGCL section 205(f).

102 Ibid.

103 DGCL section 205(e).

104 DGCL section 205(a).

105 DGCL section 205(b).

106 Including a successor entity to the corporation.

107 DGCL section 205(a).

108 Bigler and Zeberkiewicz, supra note 92, at 417.

Statutory Ratification Under the DGCL Fixes Subset of Corporate Slips Only

The Delaware process fixes a subset of corporate slips consisting of defective corporate acts that arise from a failure of authorization, including those found in both public records and private instruments. The rule fixes errors, omissions, or procedural defects in share issuances, constating documents, and corporate instruments. A court proceeding is not required at first instance. Permission of the administrator of the statute is not required. Rather, the corporation must notify a number of persons who may be affected by ratification. An interested party may sue to challenge the ratification within a short limitation period. This process keeps uncontested cases out of courts and administrative tribunals, thereby preserving public resources for genuine disputes. Delaware's statutory ratification framework could be adopted wholesale into the CBCA and provincial corporate statutes, with such necessary modifications as the circumstances require.

If adopted in Canadian corporate legislation, the process could fix the mistake in *Dale*, where the taxpayer failed to file articles of amendment to authorize the issuance of a new class of shares before a purported rollover transaction. Since the Crown does not oppose that type of correction, the solution could proceed privately.

But the Delaware process does not fix other unopposed cases. The process does not fix the mistake in *Winclare*, where the taxpayer declared a capital dividend in excess of its CDA. The board resolutions should not be a defective corporate act because they did not suffer from any failure of authorization. This case would proceed to court unnecessarily.

The process also does not fix a mistake where an erroneous transaction is not defective owing to a failure of authorization or where the taxpayer reformulates the transaction to achieve its original and continuing intention. The taxpayer would still be required to apply for a court order for relief in those cases.

CANADIAN LEGISLATION SHOULD ADOPT BROADER STATUTORY RATIFICATION

Canadian corporate legislation should be amended to allow the correction of documents that eliminate unintended tax consequences. The rules should be broad enough to keep all uncontested cases out of court. Each jurisdiction in Canada would be required to adopt its own regime.

Legislatures are sovereign and may pass laws to overturn jurisprudence. They may codify an appropriate test for statutory ratification in the interests of justice. Legislatures may consult stakeholders to devise an appropriate legal test and to determine whether the rule should be codified in corporate, partnership, and trust statutes or in a new statute altogether.

One approach is to codify the *Juliar* standard. However, the Crown may not support that approach. Therefore, we recommend that the legal standard for tax-motivated statutory ratification in Canada ought to match the test that governs whether the minister will accept a late-filed, amended, or revoked election. The principles are fair and familiar to the tax community.

Thus, the substantive legal test for statutory ratification ought to be whether the circumstances of a case are such that it would be just and equitable to permit the correction adopted by ratification. This test may be informed by codified factors that are relevant in making the determination. Factors supporting ratification include that the original transaction caused an unintended tax consequence, that the taxpayer took reasonable steps to comply with the law, and that the taxpayer took remedial action quickly. Factors opposing ratification include that the taxpayer was negligent or careless in complying with the law, that the taxpayer engaged in retroactive tax planning, and that the taxpayer cannot provide adequate records or other evidence of its stated original intention.

From a procedural prospective, Canadian statutory ratification may be patterned on the Delaware model. In the corporate context, the directors should resolve to ratify the amendment or annulment of the legal documentation. If the impugned transaction either required shareholder approval at the time of the act or requires such approval at the time the ratifying resolution is adopted, the directors should submit the ratification to current shareholders and prior shareholders at the time of the original transaction (other than those who cannot be identified from corporate records) for approval. Irrespective of whether shareholder approval is needed, the corporation should promptly notify the current shareholders and the prior shareholders of the ratification, stating that any claim to oppose ratification must be brought to a provincial superior court within a 120-day limitation period, upon the expiration of which the ratified transaction is unassailable. If applicable, copies of the revised legal documentation would be filed with the administrator of the relevant corporate statute.

Canadian legislation, as in Delaware, ought to ensure that statutory ratification does not disentitle a corporation from pursuing other avenues of relief. The reason is that, in Canadian law, an adequate legal remedy bars the exercise of equitable discretion by a court to preclude the taxpayer from another chance at the same relief by a different route.[109] Statutory ratification should not create a barrier to equitable relief, which should remain a separate option.

Canadian statutory ratification should depart from the Delaware model, however, in one important respect. The Crown should be notified of use of the process in all tax cases as a safeguard against abuse.[110] The Crown deserves an opportunity to contest cases in order to guard against retroactive tax planning. This approach does no violence to the streamlined process, since litigation would ensue only if the Crown contested the ratification within the applicable 120-day limitation period. In such cases, the process of statutory ratification would be no worse than seeking relief from a court, which requires a hearing in any event.

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109 *771225 Ontario Inc. v. Bramco Holdings Co. Ltd.*, 1995 CanLII 745, at paragraph 8 (ONCA).

110 As noted above, the DGCL does not require the IRS to be notified of use of the process. The regime does not strive to provide a means to fix mistakes in tax cases but rather is designed to overturn adverse jurisprudence in Delaware corporate law.

While some case law holds that a taxpayer is not required to notify the Crown of an application for court-ordered relief,[111] different considerations apply in a statutory ratification process. In particular, a statutory ratification lacks safeguards inherent in a court application. A court application is a public proceeding; the taxpayer owes a duty to make full and frank disclosure[112] (failing which the court order may be re-opened); and an impartial arbiter assesses the quality of the taxpayer's evidence. In the context of statutory ratification, notifying the Crown protects the credibility of the private process. Notice ensures that, where the Crown contests the taxpayer's position, a court of law adjudicates the dispute.

Under our recommended approach, corporate slips, as in *Dale*, and other typical mistakes, as in *Winclare*, could be fixed in private without a formal court application or an application to an administrator. These cases would cease to waste public resources since the Crown would be unlikely to contest them. Where a taxpayer seeks to modify the form of a transaction, as in *Juliar*, *Fairmont*, and *Telus*, statutory ratification could be available to eliminate the unintended tax consequences, subject to the right of the Crown to contest the ratification within a 120-day limitation period. If the Crown contested, a genuine dispute would exist that warranted the attention of a judge. Even then, however, statutory ratification would provide certainty of a consistent legal standard, and the procedure would be no worse than litigation that is required under existing law. Further, in cases of retroactive tax planning, the Crown would oppose the use of statutory ratification to protect the interests of the public.

As an alternative, a more cautious legislature might revise corporate statutes only to adopt the Delaware model, with such modifications as the circumstances require. That approach would be a good place to start, since the Delaware process fixes defective corporate acts arising from a failure of authorization. At a minimum, while not all corporate slips could be corrected, it would provide for the correction of a subset of corporate slips that the Crown does not oppose, such as the one in *Dale*, keeping those undisputed cases out of the courts.

BENEFITS TO CANADA

The opportunity is ripe. Introducing a statutory ratification process in Canada, modelled on the Delaware experience, would provide many benefits.

First, a statutory ratification process promotes the proportionality principle emphasized in civil litigation, which ensures timely and affordable access to justice by taking a restrained approach to court adjudication. In *Hryniak v. Mauldin*, the Supreme Court of Canada held:

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111 *Brogan Family Trust*, supra note 63.

112 Nitikman, supra note 64, at 971, takes the position that a duty of full and frank disclosure that arises on an ex parte application to a court adequately protects the Crown's interests. A conflict of interest and duty, however, can arise as a matter of human nature that can compromise the quality of submissions. Notifying the Crown in tax cases resolves this dilemma.

> Increasingly, there is recognition that a culture shift is required in order to create an environment promoting timely and affordable access to the civil justice system. *This shift entails simplifying pre-trial procedures and moving the emphasis away from the conventional trial in favour of proportional procedures tailored to the needs of the particular case.* The balance between procedure and access struck by our justice system must come to reflect modern reality and recognize that new models of adjudication can be fair and just.[113]

This principle logically extends to enactment of statutory procedures to keep uncontested matters out of the courts. This achieves an adequate outcome *and* a fair process.

Second, statutory ratification can reduce costs. While the process involves intricate corporate law, which may require the advice of solicitors, a taxpayer does not need a barrister to appear in court in uncontested cases. The process avoids litigation that is expensive in terms of time and money.

Third, statutory ratification can accelerate the timeline to fix a mistake. In uncontested cases, the delay to prepare a detailed court application, and an unnecessary wait for a hearing in court, lasting for months if not years, can be avoided.

Fourth, statutory ratification can provide certainty. By codifying a consistent legal standard, the process eliminates the intrinsic uncertainty associated with a court's inherent discretion to grant relief. The ratification is fixed on expiration of the 120-day limitation period.

Fifth, statutory ratification keeps mistakes out of the public record at first instance. A court becomes involved to adjudicate a dispute in the public sphere only where a purported ratification is contested.

Sixth, enactment of a statutory ratification procedure keeps pace with the evolution of corporate law elsewhere. Early adoption of the mechanism improves the climate for business investment. It keeps Canadian jurisdictions competitive internationally. The Canadian jurisdictions that enact such processes may realize tangible benefits from increased revenues associated with a higher number of business incorporations. Competition for capital may drive convergence to the best model.

CONCLUSION

Given the highly technical and complex tax environment, mistakes in tax plans inevitably arise. It is appropriate from a policy perspective to allow a taxpayer to correct mistakes that give rise to unintended tax consequences provided that the taxpayer does not engage in retroactive tax planning. Currently, the most common way to fix such mistakes is to obtain a remedy by court order. While court-ordered remedies generally achieve acceptable outcomes, the court application process required to achieve that result is disproportionate in uncontested cases. Further, existing Canadian administrative correction processes, such as section 265 of the CBCA, are inadequate to cure unintended tax consequences that arise by virtue of a mistake in most cases.

113 *Hryniak*, supra note 61, at paragraph 2 (emphasis added).

Delaware offers a statutory ratification process. The Delaware model encourages self-help for a subset of corporate slips, as in *Dale*, without court intervention. The Delaware process could be adopted in Canadian corporate law. However, because it is not designed for tax cases, it could be improved.

We recommend that legislatures in Canada codify a statutory ratification process to cure mistakes that arise in tax planning. The process can be designed to ensure that uncontested cases involving a corporate slip, as in *Dale*, or other unopposed cases, such as *Winclare*, stay out of the courts. Provided that the rules require the taxpayer to notify the Crown, retroactive tax planning can be policed and contested cases can proceed to court. Where the taxpayer uses statutory ratification to reformulate the substance of a transaction so as to eliminate unintended tax consequences, litigation may ensue where the Crown contests the ratification. But that outcome still benefits from the certainty of a codified legal test, and the procedure is no worse than that prevailing under existing law.

There are a multitude of benefits from adopting a streamlined statutory process for tax-motivated ratification, especially in uncontested cases. A statutory ratification procedure for non-adversarial situations ultimately serves the interests of justice.