

A non-retroactive rectification order? Anderson rectifies agreement but not agreed transaction

Moodys Private Client
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Taxpayers who erroneously record an agreement in a manner that (per the erroneous documentation) would cause unintended tax consequences to arise may find relief in the equitable remedy of rectification. Rectification is discretionary; when it is awarded, a rectification order is granted by a court on the basis that a document inaccurately reflects the true original agreement of the parties with the order having effect *nunc pro tunc* (i.e. retrospectively or retroactively) as of the date of the original agreement. The retrospective effect of a rectification order is binding for tax purposes. However, in [Anderson v. Benson Trithardt Noren LLP 2015 SKQB 123](#), affirmed by [2016 SKCA 120](#), (*Anderson*)^[1] while the Court rectified documents recording a section 85 rollover, the Court refused to declare that its order was retrospectively binding for tax purposes. Confused? *Anderson* provides both a cautionary tale of the importance of diligently implementing even the most vanilla tax planning and a thought-provoking discussion of rectification in the tax context.

Anderson owned farm equipment and land used in the farming business of his wholly-owned corporation (FarmCo). Anderson had outstanding shareholder loans owing to FarmCo which needed to be repaid to avert being deemed income for his 2011 year [i.e. to meet the 'repaid within one year of year-end' subsection 15(2.6) exception to the subsection 15(2) shareholder loan income inclusion]. On the advice of his accountant, Anderson and FarmCo agreed that in October 2011 Anderson would transfer his farm equipment and land to FarmCo, by section 85 rollover, in exchange for settlement of the shareholder debt and the issuance of shares. The accountant took notes of the tax plan, recorded the agreed upon transactions in FarmCo's financial records, and filed a form T2057 election with the Canada Revenue Agency (CRA). However, instructions were not given to Anderson's lawyer to prepare legal documentation; no transfer agreement was executed, no land titles registrations were made, no share issuance was recorded, etc.

In 2013, CRA advised Anderson and his accountant that it would audit his 2011 taxation year. At this point, Anderson's accountant realized that no legal documentation had been prepared to record the transfer of assets pursuant to section 85. Anderson's lawyer was instructed accordingly and the documentation was drafted and executed in 2013. However, the documentation inadvertently referenced a January 2011 effective date, as opposed to an October 2011 effective date, as intended.

Often, the precise details of a transaction are not yet known or confirmed as of the closing date and such documentation must be backdated as a practical necessity. However, in *Anderson*, the time between closing and the preparation of legal documentation was long enough that CRA challenged whether the transfers of property required for the section 85 rollover and repayment of shareholder debt actually occurred in 2011.

To remedy the situation, Anderson made an application to the Saskatchewan Court of Queen's Bench (the SKQB) to:

- a. rectify the documents to reference October 2011 (as opposed to January 2011), and

b. declare the rectified documents to be valid, binding and effective as of October 2011.

Despite the Courts rectifying the written agreement and related legal documents to *read* October 2011, the SKQB and SKCA in *Anderson* refused to make a declaration that the documents are legally effective as of October 2011, thus leaving unresolved the question of whether the agreed upon transactions actually happened in 2011. The Courts were keenly aware that declaring the rectified documents to be retrospectively binding would effectively predetermine the outcome of any appeal to the Tax Court regarding the effectiveness of the section 85 transaction (of course, this is the objective of any tax-motivated rectification application), but were reluctant to do so because the Tax Court could make its own determination as to whether the section 85 transactions occurred in 2011. The SKCA explained at paragraph 31 of *Anderson*:

The Tax Court has exclusive original jurisdiction to hear appeals relating to federal income tax assessments ([Tax Court of Canada Act, RSC 1985, c T-2, s. 12](#)). It can make any incidental and ancillary findings necessary to fulfill its mandate and, in doing so, may consider the effect of any backdated documents (see *R v. Avotus Corp.*, [2006 TCC 505 \(CanLII\)](#) at paragraphs 13 and 52-55, [2007] 2 CTC 2001).

Anderson can be contrasted with *Dale v. The Queen*, 94 D.T.C. 1100 (TCC); 97 D.T.C. 5252 (FCA) (*Dale*) and *Juliar v. A.G. Canada*, [1999 O.J. No. 3554](#) (ONSCJ); [2000 O.J. No. 3706](#) (ONCA); 2000 S.C.C.A. No. 621 (SCC) (*Juliar*) where section 85 rollover transactions were rectified by retroactively amending a corporation's articles to allow preferred shares to be issued (*Dale*), and by retroactively varying the share and non-share consideration issued to avoid unintended tax consequences (*Juliar*). In *Dale*, the FCA held that the rectification order caused the preferred shares to be authorized and issued retroactively and that the CRA was bound by that order.

So, why is the result in *Anderson* different from *Dale* and *Juliar*? The result in *Anderson* would have been unsurprising if the documents had correctly recorded the agreed upon transaction date from the outset (i.e. if this was not a rectification case), simplifying the relief sought to an application for a declaration by the SKQB that the transactions occurred in 2011. However, these were not the facts of *Anderson*. Instead, the SKQB and SKCA distinguished the agreement of the parties to implement a section 85 rollover in 2011 from whether the agreed upon transactions ever occurred on the agreed upon date. Thus, the courts could rectify the documents recording the agreement without deciding whether the agreed transactions were implemented in 2011. While rectification is a discretionary remedy, we are not aware of any other reported decision that has distinguished rectification of the agreement of the parties from the implementation of the agreed upon transactions in a manner comparable to *Anderson*. This distinction allowed the courts in *Anderson* to reach a different result from *Dale* and *Juliar*.

Consequently, unless reversed by the Supreme Court of Canada, *Anderson* presents a new risk to taxpayers applying for rectification. Even if successful, according to *Anderson*, taxpayers may be left with a remedy that leaves unanswered the fundamental issue of whether the rectified documents are retrospectively binding for tax purposes. Such taxpayers (like *Anderson*) would then face re-litigation of this unanswered question before the Tax Court. This new uncertainty may discourage taxpayers from seeking equitable relief, particularly where the Canada Revenue Agency frame their assumptions of fact to focus on an error or omission in the implementation of a transaction rather than an error in the recording of such transaction.

[1] The authors have been advised that the taxpayer in *Anderson* is applying for leave to appeal the decision of the Court of Appeal for Saskatchewan (SKCA) to the Supreme Court of Canada.

