The End of Rectification & Rescission in Tax Matters?

By Robert G. Kreklewetz & Rebecca D. Loo

The Ontario Court of Appeal’s recent decision in Canada Life Insurance Company of Canada v. Canada (Attorney General) (2018 ONCA 562) seems to have put a final stake in the heart of equitable remedies in tax matters. The case dealt with rescission, and has the effect – along with prior Supreme Court jurisprudence – of clarifying that the equitable remedies of rescission and rectification will not generally be available to taxpayers seeking to correct drafting or planning mistakes.

Canada Life Insurance Company of Canada (“CLICC”) entered into a series of 2007 transactions attempting to realize a capital loss in that year. The goal of these transactions was to offset accrued capital gains, such that CLICC could avoid significant taxation in 2007. The CRA disallowed CLICC’s claim for the loss based on a provision of the Income Tax Act, which resulted in the key transaction being treated on a “tax-deferred” basis rather than generating the intended capital loss in 2007.

CLICC contended that an error was made in structuring the transactions. It first applied to the Ontario Superior Court for a rectification order – seeking to set aside the transactions and replace the original steps with alternative steps that would generate the desired tax result. CLICC was successful before the application judge, but the decision was appealed, and then effectively overturned by the results of similar litigation before the Supreme Court of Canada in Canada (Attorney General) v. Fairmont Hotels Inc. (2016 SCC 56). Fairmont clarified the law on rectification, and restricted it to the correction of written agreements that were improperly recorded, so CLICC was forced to concede that it was not entitled to rectification. CLICC then cross-appealed, seeking relief either through the court’s inherent jurisdiction to relieve against a mistake, or through the similar but different equitable remedy of rescission.

On appeal, the Ontario Court of Appeal (ONCA) dismissed the cross-appeal, and held that the rationale underlying Fairmont applied similarly to prevent the court from granting equitable relief on either basis argued by CLICC.

More on the Equitable Remedies of Rectification & Rescission: Broadly, rectification involves changing the written agreements that were entered into so as to implement the parties’ true intentions. Prior to Fairmont, Canadian courts had been trending toward a more flexible approach to rectification. A line of cases, beginning with Julian v. Canada (Attorney General) (2000 CanLII 16883), allowed rectification where the parties’ agreement was accurately recorded, but where this agreement led to a different result than the parties had intended. As long as the parties had demonstrated a “common continuing intention” to achieve a specific result, rectification was available to fix transactions that the parties had mistakenly believed would lead to that result.

This all changed with Fairmont, where the SCC rejected this approach, and held that rectification is only available to correct an agreement that was incorrectly recorded in a written instrument: “rectification aligns the instrument with what the parties agreed to do, and not what, with the benefit of hindsight, they should have agreed to do.” The latter would constitute impermissible retroactive tax planning.

Other remedies relying on the court’s equitable jurisdiction may still be available where rectification is not. One alternative is the remedy of equitable rescission, which involves cancelling and unwinding a transaction to restore the parties to their original rights. A further alternative is to rely on the court’s inherent jurisdiction to relieve against mistakes. However, the ONCA in Canada Life rejected both of these arguments, holding that CLICC was seeking the same type of intervention, by a different name, that was rejected in the Fairmont case. Further, the ONCA interpreted the Fairmont case to mean that the court’s equitable jurisdiction to relieve against mistakes cannot be used for the purposes of retroactive tax planning (including attempts to change transactions to achieve a taxpayer’s intended tax consequences).

Ultimately, the takeaway from the Canada Life and Fairmont cases is that rectification, rescission, and other equitable remedies are likely going to be unavailable to fix most tax mistakes. Taxpayers should ensure that they have properly considered all of the tax consequences when structuring their affairs. Otherwise, they may be stuck with an unexpected tax bill and unsatisfactory avenues of recourse.

Rectification and rescission, and other equitable remedies are likely going to be unavailable to fix most tax mistakes. Prevailing case law puts a premium on getting tax planning right the first time!

Do you require assistance in this area? Please contact us by clicking here.

Millar Kreklewetz LLP is a Canadian super-boutique law firm, focused on indirect taxes, including GST/HST and customs and trade matters. Our client base is comprised of national and international leaders in almost every industry sector.