Tax Topics

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THE BC TRUST CASE: RECTIFICATION IN THE POST-FAIRMONT WORLD

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The recent case of *BC Trust v. Canada (Attorney General)*, 2017 DTC 5017, concerned an application by the petitioner BC Trust seeking a declaration which would give retroactive effect to a trust minute to be dated December 31, 2012. This minute would allocate the income of BC Trust to its income beneficiary, the Alta Trust, in respect of BC Trust's 2012 taxation year.

The facts in the case are relatively simple. BC Trust was established on May 1, 2002. Pursuant to the trust settlement, the trustees of BC Trust are empowered to make amounts payable to one or more beneficiaries by means of signed trust minutes declaring an amount payable to a beneficiary.

The sole income and capital beneficiary of BC Trust is the Alta Trust. This set-up was designed to create an efficient tax structure for the ownership and distribution of assets.

Pursuant to subsection 104(6) of the *Income Tax Act* (Canada) (the "ITA") the trustees of BC Trust allocated 100% of the net income of BC Trust to the Alta Trust for BC Trust's 2002 to 2011 taxation years.

However, in a letter dated November 7, 2011, the Canada Revenue Agency (the "CRA") advised BC Trust it had initiated a review of its 2008 through 2010 taxation years. In a second letter, dated April 5, 2012, the CRA advised that it had made a designation under subsection 104(2) of the ITA to treat BC Trust and the Alta Trust as one trust. Notices of reassessment were issued in respect of BC Trust's 2008, 2009, and 2010 taxation years. BC Trust filed notices of objection on August 10, 2012.

As a consequence of these events, the trustees considered whether to make an allocation of income from BC Trust to the Alta Trust pursuant to subsection 104(6) of the ITA in respect of the income of BC Trust for its 2012 taxation year. The trustees of BC Trust concluded that making this allocation might be contrary to the provisions of the ITA and, therefore, a breach of their fiduciary duties. The trustees declined to make an allocation that year.

By December 2013, the reassessment process had advanced sufficiently so that, on the basis of professional advice, the trustees of BC Trust became confident that an allocation of income from BC Trust to Alta Trust could be made as had been done in prior years. Accordingly, allocations were made for 2013 and 2014.

In 2015, the dispute was settled with the CRA. As part of the settlement the CRA agreed to reverse the designation it had made pursuant to subsection 104(2). It was also agreed that both BC Trust and Alta Trust would be taxed as British Columbia residents for all years after and including 2015. Since there had never been an allocation of income for 2012, the parties agreed that BC Trust could make an application to court to determine whether BC Trust would be permitted to retroactively allocate its income in 2012 to Alta Trust.

BC Trust specifically sought an order allowing the trustees to execute a trust minute dated December 31, 2012, and having effect on that date, allocating the income of BC Trust for 2012 to the Alta Trust. BC Trust also sought an order permitting it to amend its T3 Trust Income Tax and Information Return for 2012.

The BC Supreme Court considered whether such a declaration could be granted, either because the failure to make the allocation in 2012 was a mistake which could be addressed by rectification or by the inherent jurisdiction of the Court.

Justice Weatherill cited *Juliar v. Canada (Attorney General)*, 2015 ONSC 6245, for the proposition that in the tax context rectification can be granted in order to carry out the "primary and continuing [tax] objective of the [parties]". However, Justice Weatherill also cited the cases of *Sylvan Lake Golf & Tennis Club Ltd. v. Performance Industries*, 2002 DTC 7599, and *KRG Insurance Broker (Western) Inc. v. Shafron*, 2009 DTC 5194, for the proposition that rectification is granted to restore a transaction to its original purpose and not to avoid an unintended effect.

Justice Weatherill held that this "dichotomy" in the case law concerning rectification in the tax context had been resolved by the Supreme Court of Canada in *Canada (Attorney General) v. Fairmont Hotels*, 2016 DTC 5135, which held that a common continuing intention of tax efficiency is insufficient to establish an entitlement to rectification. Justice Weatherill also held that the *Fairmont Hotels* case made clear that rectification is limited to cases where a written instrument has incorrectly recorded the parties' antecedent agreement. Therefore, the Court stated that rectification is not available where the basis for seeking it is a party's wish to amend, not the instrument that records the agreement, but the agreement itself.

The Court then held that as there was no written agreement or other document, including BC Trust's 2012 T3 income tax return, which incorrectly recorded BC Trust's intentions at the time, the doctrine of rectification was not available.

The Court then turned to the question of its inherent jurisdiction to grant the declaration pursuant to section 41 of the *Trustee Act*, R.S.B.C. 1996, c. 464.

The Court noted that while at all times the trustees wanted to minimize the tax liability of BC Trust, it was equally clear the trustees had decided not to allocate the 2012 income of BC Trust. The Court held that this decision was made by sophisticated people and based upon professional advice. The Court further held that there was no evidence that the trustees acted other than honestly, in good faith, and in accordance with the standard of care expected of them in the circumstances, and that there was no evidence that the judgment of the trustees was flawed or was factually or legally incorrect. Consequently, the Court declined to exercise its inherent jurisdiction to grant the declaration.

BC Trust had also advanced the argument that the inherent jurisdiction of the Court permitted it to intervene because the decision of the trustees of BC Trust had been made based on a mistake by the CRA, namely to make the subsection 104(2) designation. BC Trust argued that the mere fact of the settlement agreed to by BC Trust and the CRA was evidence the designation made by the CRA had been a mistake on the basis of *CIBC World Markets v. Canada,* 2012 GTC 1011. BC Trust argued the *CIBC World Markets* case stood for the proposition that the CRA was prohibited from entering into settlements unless based on the facts and the law. The Court rejected this argument, noting that *CIBC World Markets* simply stated that the Minister cannot compromise when it is correct on the facts and the law. Where the facts and/or law are unclear there is nothing improper about arriving at a settlement.

BC Trust v. Canada (Attorney General) is an important reminder that the circumstances in which rectification will be available to taxpayers have been significantly circumscribed as a result of the decisions in *Fairmont Hotels* and *Jean Coutu Group (PJC) Inc. v. Canada (Attorney General)*, 2016 DTC 5134. Consequently, taxpayers may have to look for alternative remedies to address situations formerly dealt with through rectification.

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