

## Capital Dividends Allocated through a Trust to a Corporate Beneficiary

In two recent technical interpretations, the CRA confirmed that when taxable dividends are received by a trust and the trustee allocates the dividend to a beneficiary and makes the designation under subsection 104(19) of the Act, the dividend is deemed to have been received by the beneficiary at the end of the trust's taxation year in which the trust received the dividend.

Every *inter vivos* trust has a December 31 year end. If one of the beneficiaries of the trust is a corporation there could be unexpected consequences. If the corporate beneficiary's year end is July, for example, it would be deemed to have received the dividends in its taxation year ending July following the allocation and designation under subsection 104(19) by the trust. Therefore, if the dividend in question is a dividend payable out of the general rate income pool of the underlying Opco, the corporate beneficiary must wait until after its July year-end to declare a general rate income pool ("GRIP") dividend to its shareholders.

## QSBC Deduction and Minority Shareholder

A minority shareholder of a company that owns less than 10.1% of Opco through his or her wholly owned Holdco doesn't qualify for the deduction in respect of QSBC shares if he sells his Holdco shares. Holdco and Opco would not be connected and therefore the shares of Holdco would not qualify. Part IV tax is also a problem under these circumstances.

# CORRECTION (RECTIFICATION) OF CONTRACTS: THE QUEBEC COURT OF APPEAL AND THE SUPREME COURT OF CANADA SPEAK

— Daniel Frajman Spiegel Sohmer Inc., Montreal, Canada

Several recent court decisions, arising in relation to both private law and tax matters, underline the importance of correctly drafting contracts so as to reflect the intention of the parties. This is because, although these decisions indicate that the courts may try to establish actual intention so as to correct errors in the text of a written contract (known as the "rectification" of an error), it may be difficult to prove intention that is contrary to a written text, and, in tax matters, what can perhaps be described as overly bold tax planning, likely will not be corrected under the courts' power to correct errors.

A court decision, rendered in 2011 by the Quebec Court of Appeal in a private law matter, is *Ihag-Holding, a.g. v. Corporation Intrawest*, 2011 QCCA 1986 ("*Intrawest*"), dealing with the purchase by Intrawest of a ski resort in the Gatineau, Quebec region, and where the Court corrected a written contractual error based on a rule of contractual interpretation found at article 1425 of the *Civil Code of Quebec* ("CCQ"), which reads as follows:

The common intention of the parties rather than adherence to the literal meaning of the words shall be sought in interpreting a contract.

Intrawest was certainly happy with the decision. The error in question arose when one of Intrawest's lawyers made a mistake when copying an earnout formula contained in a preliminary offer document, resulting, by mistake, in a much larger earnout (several million dollars!) being payable by Intrawest under the earnout formula that was placed (mistakenly) in the closing documents.

The mistake in *Intrawest* was not noticed until after closing, and even though the closing documents contained the standard “complete agreement” clause to the effect that there are no agreements between the parties other than those contained in the closing documents, the Court applied article 1425 of the CCQ so as to uphold the common intention (the original lower earnout formula) that the Court determined was in the offer documents, and not in the post-mistake closing documents. Significantly, the Court did not apply article 1407 of the CCQ, a provision concerning vitiation of consent that allows for the nullity of contracts that are subject to material errors when formed. This is important because parties often will not want a written contract containing a mistake to be declared null, but rather often want to correct an error, resulting essentially in an amendment to the written text that reflects their true intention.

The more recent decision of *Agence du Revenu du Québec v. Services Environnementaux AES Inc.*, 2013 SCC 65 (“AES”), decided late in 2013 by the Supreme Court of Canada (“SCC”) on an appeal from Quebec, dealt with the correction of mistakes in contracts used to implement tax plans. This decision actually corrected contracts in two separate cases, one in which the adjusted cost base (“ACB”) provided for the written contract by the corporation’s accountants was incorrect and was corrected by the Court, and another one in which the steps of a corporate amalgamation were mistakenly carried out in the wrong order, which was corrected by the Court. In both cases, the correction saved significant tax for the taxpayers (to the chagrin of the tax departments).

The SCC in *AES Inc.*, just as was done by the Quebec Court of Appeal in *Intrawest*, applied article 1425 (and not article 1407 of the CCQ) so as to correct (or, essentially amend) contracts, rather than nullify them, in the face of errors included in the written contracts when they were signed.

Nevertheless, the SCC certainly left us with uncertainty as to whether rectification would be applied in all cases of error. For example, the SCC noted that third parties should not be unduly prejudiced by rectification, but it may not always be clear when third parties (including the tax departments) are unduly prejudiced. (In *AES Inc.*, at least, the tax departments were not seen as unduly prejudiced. (To quote the SCC, “[t]he tax authorities do not have an acquired right to benefit from an error”.) Furthermore, the SCC seems to have stated that rectification cannot lead to a kind of retroactive tax-planning that was not originally intended, and/or correct tax plans that are overturned under the general anti-avoidance rule (“GAAR”). This latter point would seem to stem from the following statement by the SCC in *AES Inc.*:

Taxpayers should not view [the recognition in this case] 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.

Additional uncertainty regarding the availability of rectification relates to whether the parties to a written contract containing an alleged error can prove an original contrary intent. The courts seem consistent in requiring a real indication (referred to as “commencement proof”) that the contrary intention existed, and that can be hard to show if one of the parties to the contract is not consenting to the rectification.

Although *Intrawest* and *AES Inc.* were cases governed from a private law perspective by Quebec civil law, the *AES Inc.* decision of the SCC, in particular, must at least inform the private law throughout Canada. Nevertheless, it should be noted that the SCC in *AES Inc.* appeared to indicate that it was applying rectification as understood in Quebec civil law, and that it was not applying the “common law remedy of rectification” stated, perhaps along differing lines of authority, in such cases as *Canada (Attorney General) v. Juliar* (2000), 50 O.R. (3d)728, and *Shafroon v. KRG Insurance Brokers (Western) Inc.*, 2009 SCC 6.

As seen above, even though the courts often are open to correcting errors in written contracts, including in tax matters, care must be taken to plan and draft correctly at the outset so as to avoid a lengthy court rectification

process which is not guaranteed to succeed.

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#### TAX PROFILE

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