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Collins Family Trust Case Study [1]

In this case, the taxpayers sought equitable relief from negative tax consequences resulting from transactions entered into that appeared to comply with the then current law to avoid taxation but were later found to lie outside the saving provisions of the law based on subsequent jurisprudence.

In 2008, Todd Collins, principal of Rite-Way Metals Ltd., and Floyd Cochran, principal of Harvard Industries Ltd., each incorporated a holding company and each arranged for the establishment of a family trust which included the holding company as a beneficiary. Funds were loaned by each holding company to the respective trusts to purchase shares in the operating companies.

The operating companies paid dividends to the trusts, which dividends were attributed to the holding companies under subsection 75(2) of the Income Tax Act (Canada) (the "**Act**"). [2] The holding companies, in turn, claimed an offsetting deduction in computing taxable income in respect of those dividends under subsection 112(1). The effect was to move $510,000 from Rite-Way to the Collins family trust, and $2,085,000 from Harvard to the Cochran family trust, without income tax being paid.

In 2011, however, in *Sommerer* v. *The Queen*, [3] the Tax Court of Canada held that the attribution rules in subsection 75(2) are inapplicable where the property in question was sold to a trust, as opposed to gifted or settled. Subsequently, the Canada Revenue Agency ("**CRA**") reassessed the trusts' returns, imposing tax liability in respect of the dividends. The trusts objected, were unsuccessful, then sued for rescission of the transactions including the payment of dividends.

The chambers judge granted equitable relief in the form of rescission, relying on *Re Pallen Trust*, [4] wherein the British Columbia Court of Appeal, applying the English test for equitable rescission stated in *Pitt* v. *Holt*, [5] upheld an order rescinding the same types of transactions on the basis of a mistake about their tax consequences.

The Supreme Court of Canada allowed the CRA's appeal on the basis that the courts below erred in adopting the test for equitable rescission stated in *Pitt v. Holt*.

"[A] limiting principle of equity and, relatedly, principles of tax law stated in *Fairmont Hotels* [6] and *Jean Coutu* [7] are irreconcilable with the conclusion in *Pitt v. Holt*. Equity has no place here, there

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1 *Canada v. Collins Family Trust*, 2022 DTC 5069 (SCC).

2 Where property is transferred to a trust, the resulting income may be attributed to the transferor.

3 2011 DTC 212 (TCC).

4 2015 BCCA 222 (BCA).

5 [2013] 2 A.C. 108 (SC).

6 *Canada v. Fairmont Hotels Inc.* 2016 SCC 56 (SCC). The Supreme Court of Canada limited rectification as a form of equitable relief in tax cases. Rectification is an equitable remedy designed to correct errors in the recording of terms in written legal instruments. It is limited to cases where a written instrument has incorrectly recorded the parties' antecedent agreement. Where the error is said to result from a mistake common to both or all parties to the agreement, rectification of the instrument is available upon the court being satisfied that there was a prior agreement whose terms are definite and ascertainable; that the agreement was still in effect at the time the instrument was executed; that the instrument fails to accurately record the agreement; and that the instrument, if rectified, would carry out the parties' prior agreement. probabilities. Fairmont's application was dismissed, since it could not demonstrate the antecedent agreement.

7 *Jean Coutu Group (PJC) Inc. v. Canada*, 2016 SCC 55 (SCC). This case followed the principles laid out in *Fairmont Hotels.*

being nothing unconscionable or otherwise unfair about the operation of a tax statute on transactions freely undertaken. It follows that the prohibition against retroactive tax planning, as stated in *Fairmont Hotels* and *Jean Coutu*, should be understood broadly, precluding any equitable remedy by which it might be achieved, including rescission." [8]

Equity was developed to alleviate results under "an unyielding common law" that called for the relief as a matter of "conscience" and "greater fairness". Equitable principles "have above all a distinctive ethical quality, reflecting as they do the prevention of unconscionable conduct". [9]

Transactions that do not call for relief as a matter of conscience or fairness are properly outside equity's domain.

"But there is nothing unconscionable or unfair in the ordinary operation of tax statutes to transactions freely agreed upon – "[t]here is nothing inequitable about [a taxpayer] being taxed on 'what it did' rather than on what it intended to achieve." [10]

Tax principles suggest that taxpayers are entitled to arrange their affairs to minimize the amount of tax payable. A court's role is "to apply an unambiguous provision of the Act to a taxpayer's transaction" and not to "recharacterize a taxpayer's *bona fide* legal relationships". [11]

Unless a statute says otherwise, taxpayers are to be taxed in accordance with the applicable tax statute's ordinary operation, based on what they actually agreed to do, and not on what they could have done.

This can operate both in favour of the taxpayer and to their disadvantage. Legal relationships are to be respected even if they appear ill-considered in hindsight.

The CRA has a duty to administer and enforce the Act. The CRA is required to follow the Act absolutely, just as taxpayers are also required to obey it as it stands.

The CRA was bound to apply Parliament's direction in the Act, as interpreted by a court of law, unless and until that interpretation is judged to be incorrect by a higher court – even though the decision in *Sommerer* was made subsequent to the transactions.

Equitable remedies may not be available where taxpayers have freely entered into transactions that have unintended tax consequences.

Taxpayers must be careful in their tax planning; they must try to assess the downside risk if the plan fails, but in any event they must ensure that it conforms with the Act.

Lorne Saltman

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[8] *Collins Family Trust,* paragraph 7.
[9] *Collins Family Trust*, paragraphs 9 and 10.
[10] *Collins Family Trust,* paragraph 11.
[11] *Shell Canada Ltd. v. Canada,* [1999] 3 S.C.R. 622 (SCC), at paragraphs 39-40.