
CANADA / JUDGMENT

5551928 Manitoba Ltd. (Re)

2018 BCSC 1482

COURT

Supreme Court of British Columbia

DECIDED

31 August 2018

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2018 BCSC 1482 5551928 Manitoba Ltd. (Re)

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

5551928 Manitoba Ltd. (Re),

2018 BCSC 1482

Date: 20180831

Docket: S1711670

Registry: Vancouver

IN THE MATTER OF 5551928 MANITOBA LTD.

Corrected Judgment: The paragraph numbering and subparagraph numbering of the judgment were corrected throughout on September 10, 2018

Before: The Honourable Mr. Justice Branch

Reasons for Judgment

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Place and Date of Hearing:

Vancouver, B.C.

August 22, 2018

Place and Date of Judgment:

Vancouver B.C.

August 31, 2018

- [1] The petitioner is a corporation under The Corporations Act, C.C.S.M., c. C225.[1] The petitioner seeks to rectify a directors' resolution dated November 20, 2015 (the "Resolution"). The proposed rectification would alter the Resolution such that the declared capital dividend would be reduced from \$298,000 to \$113,212.
- [2] Capital dividends issued by corporations to its shareholders are advantageous in that they can be distributed on a tax-free basis. The impetus for seeking to distribute a capital dividend in this case was the sale by the petitioner of property located in Manitoba on September 15, 2015 (the "Sale"). Subsequent to the Sale, the directors sought to distribute the maximum amount of capital dividends that could be distributed to its shareholders in 2015.
- [3] Before the Sale, the petitioner's capital dividend account was at \$24,119. The question that arose for the directors was the new amount available for distribution following the Sale.
- [4] The calculation of the notional capital dividend account is painfully complex: see (if you dare) the Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.) (the "Act"), ss.14, 83, 89. The petitioner's directors understandably sought advice from third party accountants in relation to the calculation of the proper figure.
- [5] In performing the calculation, the petitioner's accountants first included the non-taxable portion of the capital gains of \$89,093 arising from the disposition of capital property in the Sale. The accountants also included in their calculation an amount of \$184,880 arising from the disposition of "eligible capital property". As such, the accountants advised the directors that:
- a) the petitioner's capital dividend account would be \$298,092 (\$24,119 + \$89,093 + \$184,880) immediately before December 31, 2015;
 - b) a capital dividend payable on December 31, 2015 in the aggregate amount of \$298,000 or \$0.298 per share could be declared; and
 - c) the dividend would not result in any tax payable by the petitioner or its shareholders.
- [6] The accountants admit that they incorrectly calculated the capital dividend amount available at the relevant time. Specifically, the accountants incorrectly included the amount of \$184,880. The inclusion of this amount was contrary to s. 14(1) of the Act (as it then read) and paragraph (c.2) of the definition of "capital dividend account" in subsection 89(1), which provide for such amounts to be added to the capital dividend account only at the end of the corporation's taxation year, which in this case would have been August 31, 2016. There is no

dispute that the figure was correct from a mathematical perspective. Rather, the error was whether it was available to be distributed in 2015. The accountants advised it was available in 2015, but in fact it could only be made available in 2016.

- [7] The accountants also made a mistake in their review of the securities register. Specifically, they mistakenly understood that 1,000,000 Class A Common shares were issued and outstanding at the time, when in fact only 1,000 Class A Common shares were issued and outstanding. This resulted in the erroneous calculation of the dividend payable on a per share basis as \$0.298 per share instead of \$298 per share. However, this error is not of particular moment, as all of the subsequent filings and distributions were made on the basis of the correct \$298 per share.
- [8] Based on the accountants' erroneous advice that \$298,092 was the amount that could be distributed for the 2015 year, the directors agreed to issue the Resolution providing for an aggregate amount of \$298,000 payable December 31, 2015 from the Corporation's capital dividend account.

[9] The wording of the Resolution is key. The material terms are as follows:

WHEREAS the company has a capital dividend account of the amount of \$298,092.00.

NOW THEREFORE BE IT RESOLVED THAT:

1. A dividend of \$0.298 per share on the outstanding Class A common shares in the capital of the Company, namely \$298,000 in the aggregate, be and the same is hereby declared payable from the Company's Capital Dividend Account pursuant to Subsection 83(2) of the Canadian Income Tax Act on the 31th [sic] day of December, 2015.
2. The President of the Company be authorized forthwith to complete and file with the Receiver General of Canada the form and documents prescribed pursuant to Regulation 2101 of the Canadian Income Tax Act in order to have the rules set forth in Subsection 83(2) of the said Act apply to the full amount of the dividend.

[Emphasis added.]

- [10] On December 2, 2015, the petitioner's accountants sent to the Canada Revenue Agency a Form T2054 "Election for a Capital Dividend Under Subsection 83(2)" together with a copy of the Resolution and schedules with the calculation of the petitioner's capital dividend account immediately before December 31, 2015.
- [11] Actual payment of the declared capital dividend was then made in two installments:
- a) cash payments in the aggregate amount of \$50,000 were made on May 19, 2016 and May 25, 2016; and
 - b) a notional payment in the aggregate amount of the balance of \$248,000 was made on August 31, 2016, through a debiting adjusting journal entry to the shareholder loan account.

- [12] When the Canada Revenue Agency identified the error outlined above, a notice of assessment dated June 28, 2017 was issued for further tax payable under Part III of the Act in an amount equal to 60% of the amount by which the dividend declared by the Resolution exceeded the Corporation's actual capital dividend account immediately before the time of the dividend (i.e. 60% of \$184,789, or \$110,873.10).
- [13] There is no dispute that the directors did not appreciate that the maximum amount of capital dividend account as at December 31, 2015 was only \$113,212 until they were so informed by the Canada Revenue Agency.

ORDERS REQUESTED

- [14] The petitioner seeks the following orders:
- a) An order pursuant to Rule 20-3(2) appointing Jin Seop Kim to represent the personal representative of the shareholder Hyo Sook Lee in this proceeding.
 - b) An order nunc pro tune rectifying the resolution of the directors of 5551928 Manitoba Ltd. dated November 20, 2015.
 - c) In the alternative, an order that the dividends totalling \$298,000, declared by resolution of the directors of 5551928 Manitoba Ltd. dated November 20, 2015 and paid by the Corporation to its shareholders in two installments on May 19 and 25, 2016 and August 31, 2016, be rescinded ab initio.
- [15] There is no opposition to the first order. Mr. Kim was Ms. Lee's spouse. She is now deceased.
- [16] The Attorney General of Canada ("Canada") opposes the order for rectification.
- [17] Canada does not oppose the alternative order for equitable rescission, so long as the language of the order is modified as follows:
- c) an order that the dividends resolution totalling \$298,000, declared by resolution of the directors of 5551928 Manitoba Ltd. dated November 20, 2015 and paid by the Corporation to its shareholders in two installments on May 19 and 25, 2016 and August 31, 2016, be rescinded ab initio.
- [18] However, the petitioner still seeks rectification as its preferred remedy, since equitable rescission leaves open various potential tax liabilities for the shareholders that rectification does not. Canada does not dispute that this is the practical difference between the remedies. The petitioner says that if rectification is refused, they would agree to an equitable rescission order in the form proposed by Canada.
- [19] As such, the only material issue is whether rectification is appropriate in these circumstances. For the reasons expressed below, I find that it is.

RECTIFICATION

- [20] The governing case on rectification is *Canada (Attorney General) v. Fairmont Hotels Inc.*, 2016 SCC 56. In that case, in rejecting rectification the court stated:
- [38] To summarize, rectification is an equitable remedy designed to correct errors in the recording of terms in written legal instruments. Where the error is said to result from a mistake common to both or all parties to the agreement, rectification is available upon the court being satisfied that, on a balance of probabilities, 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 .
- [21] The Supreme Court clarified that rectification only "aligns the instrument with what the parties agreed to do, and not what, with the benefit of hindsight, they should have agreed to do" (para. 19).
- [22] The Supreme Court cautioned:
- [39] Rectification is not equity's version of a mulligan. Courts rectify instruments which do not correctly record agreements. Courts do not "rectify" agreements where their faithful recording in an instrument has led to an undesirable or otherwise unexpected outcome.
- [23] It is important to note that in *Fairmont*, the court expressly overruled the Ontario Court of Appeal's earlier decision in *Canada (Attorney General) v. Juliar* (2000), 50 O.R. (3d) 728 (C.A.), which had established a more relaxed test. The Supreme Court stated:
- [17] In *Juliar*, the parties had, by a written agreement and in the course of the restructuring of a family business, transferred shares to a corporation in exchange for promissory notes for an amount equal to what the parties believed to be the value of the shares. Upon discovering that the promissory notes were worth more than the shares' value (resulting in the taxpaying party being assessed as having received a taxable deemed dividend), the parties sought rectification in order to convert what had originally been structured as a shares-for-promissory notes transfer into a shares-for-shares transfer (which would have been tax-deferred). For the Court of Appeal, and citing the decision of *Re Slocock's Will Trusts*, [1979] 1 All E.R. 358 (Ch. D.), Austin J.A. held that the written agreement could be rectified as sought, citing the trial judge's finding that the parties had "a common . . . continuing intention" to transfer shares in a way that would avoid immediate tax liability (para. 19). In order to achieve that objective, Austin J.A. said, the deal "had to be . . . a shares for shares transaction" (para. 25).
- [18] This reasoning presents several difficulties. First, as many commentators have observed, it is indisputable that *Juliar* has relaxed the requirements for obtaining rectification, and correspondingly expanded the scope of cases in which rectification may be sought and granted beyond that which the governing principles allow [citations omitted].

- [19] I agree with this observation. As I have stressed, rectification is available not to cure a party's error in judgment in entering into a particular agreement, but an error in the recording of that agreement in a legal instrument. Alternatively put, 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 parties' mistake in Juliar, however, was not in the recording of their intended agreement to transfer shares for a promissory note, but in selecting that mechanism instead of a shares-for-shares transfer. By granting the sought-after change of mechanism, the Court of Appeal in Juliar purported to "rectify" not merely the instrument recording the parties' antecedent agreement, but that agreement itself where it failed to achieve the desired result or produced an unanticipated adverse consequence -- that is, where it was the product of an error in judgment .
- [24] Here, Canada says that the petitioner has not demonstrated a prior agreement with definite and ascertainable terms supporting the request for rectification. Specifically, Canada argues that the direction to the accountants to distribute the "maximum amount of the proceeds from the Sale that could be distributed to the shareholders on a tax-free basis" does not establish a prior agreement with definite and ascertainable terms.
- [25] I disagree. I find that there was a definite and ascertainable agreement between the directors to effectively "clean out" the petitioner's capital dividend account. There is no dispute that this was what the directors intended to do, both when seeking the advice of the accountants, and when subsequently passing the Resolution.
- [26] As to the genesis of the agreement, there was no dispute or attack on the director Duck-Sin Jong's evidence that:

Following the Sale, the directors of the Corporation wished to distribute the maximum amount of the proceeds from the Sale that could be distributed to the shareholders on a tax-free basis.

- [27] Further, there was no dispute or attack on Mr. Jong's evidence as to the direction given to the accountants:

The directors of the Corporation consulted the Corporation's accountants for the purpose of determining the balance of the Corporation's capital dividend account .

- [28] The accountants assumed their direction on the same basis, deposing as follows:

In November 2015, the Corporation sought to make a distribution to its shareholders in the maximum amount that could be distributed without tax.

- [29] Finally, the Resolution clearly establishes that this was in fact the essence of the agreement. It accomplishes this in no less than three ways.

- [30] First, the resolution begins with a "whereas" clause purporting to set out the full (but unknowingly incorrect) amount of the capital dividend account.

- [31] Second, the resolution provides that that amount was to be paid "from the Company's Capital Dividend Account pursuant to Subsection 83(2) of the Canadian Income Tax Act". In fact, due to the error, the Capital Dividend Account was not what was noted in this clause. Indeed, the clause is arguably a nullity in purporting to declare that the petitioner had something it simply did not have.
- [32] Third, the resolution directs that the paperwork be completed "in order to have the rules set forth in Subsection 83(2) of the said Act apply to the full amount of the dividend." Again, due to the error, s. 83(2) simply could not apply to the specifically declared "full amount".
- [33] Collectively, disregarding the error, these are all terms that were only necessary, appropriate, and logical if the true agreement was to empty the capital dividend account. Otherwise, the directors could have simply declared the specific figure provided by the accountants without reference to the capital dividend account, its potential tax consequences, or the required filing obligations.
- [34] As such, the directors' agreement was clear and definite throughout - to fully exhaust the tax-free capital dividend account, whatever it may be. The only flaw was in the figure, a figure that was provided by an expert third party. Collectively, this evidence is sufficiently clear convincing and cogent as to the true terms of the agreement: Fairmont, para. 36.
- [35] Canada argued that the directors had resolved to the specific figure intentionally, and consistent with the advice given. Canada suggested that, as such, the court must treat the actual agreement as being to declare the specific amount of \$298,000.
- [36] However, this formulation of the agreement is inconsistent with the evidence of the directors, the evidence from the accountants, and the language of the Resolution.
- [37] It is not enough to say that the \$298,000 figure was clearly set out in the Resolution. By definition an application for rectification requires that something needs to be rectified. There is always going to have to be something in the contract or agreement that needs to be changed. The exercise is in finding whether there was an agreement, and the true content of the agreement. It is not enough to say that the formal document at issue "says what it says".
- [38] Here I find that the agreement was to empty the capital dividend account, at whatever level it might be. This agreement was clear. It was not in the nature of that in Fairmont, which was described by the court as "at best an inchoate wish to protect, by unspecified means, FHIW and FHIS from foreign exchange tax liability" (para. 40).
- [39] I find that the agreement to empty the capital dividend account was sufficiently precise, definite, and ascertainable. During oral argument, I put the following example to counsel: An individual hires a contractor to remove all the goods in a storage locker for \$100. This would be a valid, clear and enforceable agreement, even if the owner is not aware of exactly how much material is in the locker. The owner simply knows that they want their locker emptied.

- [40] As to ascertainability, Canada agreed that the figure was ascertainable (indeed the Canada Revenue Agency calculated it itself). The only flaw was in the accountants' calculation.
- [41] There is no doubt that the court in Fairmont and related cases such as Quebec (Agence du Revenu v. Services Environnementaux AES inc., 2013 SCC 65, and Jean Coutu Group (PJC) Inc. v. Canada (Attorney General), 2016 SCC 55 raise legitimate policy reasons why the ability to seek rectification must be kept within a narrow band. But none of those policy concerns expressed in those cases are engaged here.
- [42] First, there is no concern that the petitioner was attempting to engage in "bold tax planning", which the Supreme Court has said should be discouraged (Fairmont, para. 33). The directors were only seeking to empty the capital account, which they were perfectly entitled to do. Indeed, the petitioner would have been able to extract the same total sum by the next fiscal year in any event. There was nothing bold about the plan.
- [43] Second, the petitioner is not seeking to modify the instrument "merely because a party has discovered that its operation generates an unplanned tax liability": Fairmont, para. 3. Rather, their agreement at the outset was to only issue a planned tax-free capital dividend.
- [44] Third, there is no suggestion that the petitioner was reckless, failed to act with due diligence, or "should have known better": Fairmont, paras.13, 23. Canada conceded that the directors acted with appropriate due diligence in asking the accountants to advise them of the correct figure, given the complexity of the calculation.
- [45] Fourth, this situation cannot be described as an "error in judgment": Fairmont, para. 19. The directors did not fail to recognize a potential tax exposure. They were properly seeking to avoid a tax exposure. The structure would have accomplished their objective if they simply had been provided the proper figure from the accountants. There was no misunderstanding, risk, or uncertainty about the applicable legal regime. There was a calculation error.
- [46] Fifth, there is no concern that the request for rectification requires the court to wholly rewrite or unwind a complex mechanism or series of business transactions: Fairmont, para. 19. Nor is it an attempt to adopt a different course of action. Rather, the proposed rectification order simply substitutes the correct figure for the incorrect figure.
- [47] Canada also suggested that the availability of alternative remedies should prevent the issuance of a rectification order. However, I do not find that any of these alternative remedies outweigh the equities established by the facts described above. Specifically:
- a) The ability to apply for remission through an Order in Council is restrictive, uncertain, complex and slow. Furthermore, Canada was unwilling to advise whether the Minister of National Revenue would even support such an application in this case.
 - b) The ability to pursue a professional negligence suit against the accountants is again expensive, slow and uncertain. The net outcome will depend on both the availability of assets and insurance, and the legal expense necessary to pursue the claim.

- c) The ability to elect to treat the excess amount declared as taxable dividends under s.184(3) of the Act would still result in a tax liability for the shareholders, which was precisely what the agreement was seeking to avoid.

[48] I accept that these alternatives are factors weighing in the discretionary analysis as to whether to issue the equitable remedy of rectification, but their limitations reduce their weight such that they do not change the appropriate result.

CONCLUSION

[49] I grant the order for rectification as requested by the petitioner.

[50] Given my conclusion on rectification, it is unnecessary to consider the claim for equitable rescission, which would have proceeded by consent in any event.

[51] If the parties are unable to agree on costs, they may provide written submissions of no more than 10 pages each within 30 days of the judgment.

"Branch J."

The Honourable Mr. Justice Branch

[1] No issue was taken with respect to jurisdiction as five of seven directors of the petitioners reside in British Columbia, as do 19 of 24 shareholders and the petitioner's accountants.

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