
CANADA / JUDGMENT

Re: Pallen Trust

2014 BCSC 305

COURT

Supreme Court of British Columbia

DECIDED

27 February 2014

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2014 BCSC 305 Re: Pallen Trust

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

Re: Pallen Trust,

2014 BCSC 305

Date: 20140227

Docket: S132545

Registry: Vancouver

Re: Pallen Trust

Before: The Honourable Mr. Justice D.M. Masuhara

Reasons for Judgment

Counsel for Petitioner:

J. A. Nitikman

Counsel for Department of Justice:

S. Sit/Z. Froese

Place and Date of Hearing:

Vancouver, B.C.

November 5, 2013

Place and Date of Judgment:

Vancouver, B.C.

February 27, 2014

Introduction

- [1] The petitioner, the Pallen Trust, (the "Trust") seeks rescission of two dividends it received totalling \$1.75 million which have led to a \$552,678 tax liability identified in a proposed reassessment by Canada Revenue Agency ("CRA").
- [2] The Crown opposes the application arguing that rescission should not be permitted to effect retroactive tax planning to avoid tax liabilities.

Background

- [3] David Pallen is the principal of Integrated Pest Supplies Ltd. ("Integrated"). He is also a retired firefighter. The company is a family business and sells pest control supplies on a wholesale basis. In 2007, Mr. Pallen was approached by accountants at Meyers Norris Penny LLP ("MNP"), as was his lawyer of 25 years, Larry Hagan, with a potential plan to reorganize his company to take advantage of s. 75(2) of the Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.). (the "ITA")
- [4] At the time, section 75(2) read as follows:

Trusts

- 75. (2) Where, by a trust created in any manner whatever since 1934, property is held on condition
 - (a) that it or property substituted therefor may
 - (i) revert to the person from whom the property or property for which it was substituted was directly or indirectly received (in this subsection referred to as "the person"), or
 - (ii) pass to persons to be determined by the person at a time subsequent to the creation of the trust, or
 - (b) that, during the existence of the person, the property shall not be disposed of except with the person's consent or in accordance with the person's direction, any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, shall, during the existence of the person while the person is resident in Canada, be deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person.
- [5] On August 29, 2007, Mr. Hagan and Mr. Pallen met with the MNP accountants, Mr. Cesmystruk and Mr. Robinson, to discuss the plan. As a result, Mr. Hagan retained MNP to outline the plan in detail and to give tax advice on the plan.

- [6] The plan is dated December 14, 2007 and addressed to Mr. Hagan (the "Plan"). The Plan involved various steps, including:
- (a) the creation of two new corporations, D.W. Pallen Holdings Ltd. ("Pallen Holdings") and DWP Holdings Ltd., both of which would be owned by Mr. Pallen.
 - (b) the creation of Tonn Holdings Ltd. to be owned and held by Tammy Tonn, Mr. Pallen's common law spouse.
 - (c) the creation of a discretionary trust that would be called the Pallen Trust. Mr. Pallen and Ms. Tonn would be the trustees. The beneficiaries would be Pallen Holdings and Tonn Holdings. The trust deed would permit the trustees to add other persons as beneficiaries.
 - (d) DWP Holdings would then be amalgamated with Integrated into one company under the name Integrated Pest Supplies Ltd. ("New Integrated").
 - (e) Upon amalgamation, Mr. Pallen would be issued 100 Class A voting common shares of New Integrated, which shares were entitled to dividends at the direction of New Integrated's sole director, Mr. Pallen.
 - (f) The shares of New Integrated would then be sold to Pallen Holdings Ltd. in exchange for 99 shares of Pallen Holdings. This sale would be tax deferred under section 85(1) of the ITA.
 - (g) Pallen Holdings would pay \$100 to New Integrated to subscribe for 100 Class D shares. The amount paid would be fair market value. The Class D shares would be entitled to dividends at the discretion of Mr. Pallen as New Integrated's director.
 - (h) Pallen Holdings would sell its 100 Class D shares to the Trust for \$100. The Trust would pay for those shares with \$100 borrowed from Pallen Holdings.
 - (i) New Integrated would declare a dividend of \$10,000 on its Class D shares and pay the amount in cash to the Trust.
 - (j) The Trust would then use \$101 of the dividend to repay the loan from Pallen Holdings, with interest, invested \$5,000 in a term deposit and loan the remaining \$4,899 to Pallen Holdings, who in turn would re-lend it to New Integrated.
- [7] The Plan was predicated on an understanding that s. 75(2) would apply no matter how property was transferred to the trust, whether it was merely contributed for free or sold to the trust at fair market value. The Trust would not be taxable on the dividends it received on the Class D shares.
- [8] Mr. Pallen deposed that he "retained Hagan to advise Tammy and me on the creation and implantation [sic] of the Plan to allow [Integrated] to protect its assets from potential creditors, while at the same time minimizing or eliminating any income tax payable as a result of implementing the Plan."

- [9] He deposed that "I understood that [the Plan] would result in the Dividends being paid to the Trust without any tax being payable on the Dividends. That was a critical part of the Plan; I would not have carried out the Plan if the Trust had had to pay tax at the highest rate on the Dividends."
- [10] He also deposed that he "understood that after the Trust received Dividends from New Integrated, the Trust would either keep them or would lend them to our holding companies, which would keep them or lend them back to Old Integrated under security to be granted by New Integrated. I understood that this would result in the cash from the Dividends being protected from seizure by New Integrated's future creditors."
- [11] The Plan states that it is an Asset Protection Proposal. Further, the Plan states that the key objective sought by Mr. Pallen was:

Asset Protection: To protect the investments and equity of Integrated from future risks through the use of a holding company and a Trust.

- [12] Under the heading Tax Matters in the Plan, MNP states that:

This proposal is based upon our understanding and interpretation of the existing provisions of the ITA, the ITR and the current administrative practices of the CRA.

Our proposal also takes into account proposed amendments and proposals tabled or released by the Minister of Finance as of the date of this proposal. It has been assumed that any proposed changes will become law. No assurance to that effect, however, is given. Similarly, no assurance can be given that legislative changes in future will not affect the tax considerations discussed herein.

The opinions expressed herein represent our views as Chartered Accountants experienced in income tax matters. None of the opinions are or should be construed to be legal opinions.

It should be noted that no application has been made for an advance tax ruling with respect to this proposal nor is it intended that any application be made. Accordingly, no assurance can be given that the tax (or valuation) considerations discussed herein will not differ from the interpretation of the CRA.

- [13] With respect to tax implications for the receipt of dividends by the Trust, the Plan stated the following:

[Mr. Pallen] would receive the dividend in his capacity as trustee of the [Pallen Trust]. Normally the [Pallen Trust] would be subject to Part 1 tax on the income earned from the trust property (the dividend); however, subsection 75(2) of the ITA would have application in this situation. By virtue of subsection 75(2) of the ITA, any income from Class D common shares of Integrated purchased by [Pallen Trust] (or from property substituted therefore) would be deemed to be income of [Pallen Holdings] (during Pallen Holdings existence while it is a resident in Canada).

In light of the above, it follows that Pallen should, by virtue of subsection 112(1) of the ITA, be entitled to a deduction in the amount of the deemed dividend Pallen would be required to include in its income, resulting in Pallen having no net income. For reasons previously discussed, Pallen would only be subject to tax pursuant to Part IV of the ITA to the extent of its pro-rata share of any dividend refund to which Integrated may be entitled as a result of paying the dividend. This tax may only be calculated as at Integrated's year end.

[14] The Plan further states the following under the heading Tax Avoidance:

In preparing this proposal, we have, of course, proposed transactions which are designed to meet with your client's planning objectives while, at the same time, minimizing the income and other tax implications associated with those objectives.

Effective for transactions entered into after September 12, 1988, a broad GAAR [General Anti-Avoidance Rule] can be used to eliminate any form of tax advantage resulting from one transaction or a series of transactions

Arguably, the transactions contained herein do not include an avoidance transaction since there are bona fide purposes for undertaking each transaction which is asset protection (other than to obtain the perceived tax benefit). As well, even if it is found that the primary purpose of one or more transactions was to obtain a tax benefit, the tax consequences associated with each of the transaction we have proposed are derived from specific sections in the ITA, which provide for those results. As such, you are entitled to take the position that the transactions, which we have proposed should not reasonable be considered to result directly or indirectly in a misuse or abuse of the ITA read as a whole. Notwithstanding the above, we wish to emphasize, however, that professional advice cannot remove all the risk inherent in this very subjective rule and we want to ensure you are aware of that risk before proceeding.

[15] The Plan was reviewed by Mr. Hagan and it appears that he recommended Mr. Pallen move forward with it. The Plan was initiated and a \$10,000 cash dividend was paid to the Trusts by New Integrated on February 3, 2008.

[16] On December 31, 2008, New Integrated declared a second dividend of \$1,740,000 on its Class D shares and the Trust accepted the dividend by way of a non-interest-bearing promissory note.

[17] In 2010, New Integrated paid \$250,000 in cash to the Trust as partial payment of the promissory note. The balance of the note remains outstanding.

[18] Under the trust deed the shares could revert to Pallen Holdings so that on the surface s. 75(2) would apply to those shares. The only beneficiaries currently are Pallen Holdings and Tonn Holdings, companies which are solely owned respectively by Mr. Pallen and Ms. Tonn. The effect of that would be that if New Integrated paid dividends on the Class D shares to the Trust, those dividends would be treated for tax purposes as if they had been paid to New Integrated by the operation of s. 75(2) of the ITA. That would be an inter-corporate dividend, so the dividends would be tax-free to New Integrated, by the operation of s. 112(1) of the ITA.

In the meantime, the Trust would add the cash from the dividends to its capital without paying tax on the dividends, and could distribute the capital to its beneficiaries tax free.

- [19] For tax year 2008, the Trust did not report the dividends paid to it. Only Pallen Holdings reported the dividends.
- [20] In 2011, the Tax Court of Canada handed down *Sommerer v. Her Majesty the Queen*, 2011 TCC 212, aff'd 2012 FCA 207. It held that s. 75(2) does not apply when property is sold to a trust at fair market value.
- [21] The implication for the Trust was that s. 75(2) would not apply to deem the Trust's dividends to have been paid to New Integrated. This meant that the Trust would be taxed at the highest possible rate on the dividends.
- [22] In May 2012, CRA commenced an audit of the dividends paid in 2008 to the Trust. Mr. Eugenio, Aggressive Tax Planning Auditor, conducted the audit. In his report he stated that the Aggressive Tax Planning Section had "identified this case using screening tools developed as part of a project that was initiated locally."
- [23] In his Executive Summary he wrote:

This is a surplus strip case using the attribution rule in subsection 75(2) of the Income Tax Act (the "Act").

In 2008, the Pallen Trust (PT), a personal trust, entered into a series of transactions that enabled it to extract surplus from an operating corporation, Integrated Pest Supplies Ltd. (IPSL), without paying any tax.

In this series of transactions, David Pallen rolled over his shares of IPSL in exchange for shares of another corporation he also owns, D.W. Pallen Holdings Ltd. (DWPHL). DWPHL then subscribed for 100 Class D shares of IPSL and immediately sold them to PT. DWPHL then subscribed for 100 Class D shares of IPSL and immediately sold them to PT. DWPHL sold the 100 Class D shares of IPSL to PT subject to an agreement granting DWPHL the right to reacquire the shares from PT under certain conditions. In 2008, IPSL paid dividends of \$1,750,000 to PT.

In accordance with subsections 75(2) and 82(2), DWPHL, a capital beneficiary of PT, reported the \$1,750,000 dividends that IPSL paid to PT and applied an equivalent amount as a deduction against the dividend income pursuant to subsection 112(1). As a result, \$1,750,000 was stripped from IPSL tax-free and now forms part of PT's capital that can be allocated at the discretion of the trustee to the beneficiaries without being subject to tax.

Based on our review of the transactions, we determined that:

- Paragraphs 12(1)(j) and 82(1)(a) can be applied to tax the dividends received by PT from IPSL in the hands of PT. We determined that subsection 75(2) is not applicable to DWPHL as it sold the shares from which the dividends were derived to PT at the fair market value of the shares. As the income is not attributed to DWPHL, it is taxed in the hands of the recipient, in this case, PT.

- Even if subsection 75(2) were to apply, its application does not preclude an equivalent inclusions of the dividends in the income of PT pursuant to paragraphs 12(1)(j) and 82(1)(a) given that the series of transactions undertaken were contrary to the clear intent of subsection 75(2).
- Alternatively, GAAR can be applied to deny a tax benefit, and to tax this income in the hands of PT that received the income. The series of transactions implemented in this arrangement include an avoidance transaction that resulted in a tax benefit to PT and represents a misuse and abuse of subsection 75(2) and 112(1) of the Act read as a whole. The transactions enabled PT to withdraw surplus from IPSL without paying any tax and are contrary to the overall scheme of the Act. The reasonable tax consequences to deny a tax benefit are to tax this income in the hands of PT that received the income.
- PT may not deduct any amount against its income under subsection 104(6) because no amount was paid or became payable to DWPHL in the year. If, for whatever reasons, PT was allowed a deduction under subsection 104(6) as income allocated to DWPHL, it is our position that DWPHL must include into income, under subsection 104(13), the amount allocated by PT.

[24] As a result of the Sommerer decision Mr. Eugenio wrote that s. 75(2) did not apply to the Class D shares because Pallen Holdings sold the Class D shares to the Trust at fair market value. Accordingly, the dividends would be included as taxable income for the Trust. This amount was determined to be \$2,187,500 for 2008. CRA's proposed reassessment would lead to a tax liability for the Trust of \$552,678 plus interest at prime plus 4% compounded daily, from April 1, 2009 to the date of payment.

[25] As a result, this application to rescind was filed.

Discussion

What is the law governing rescission for mistake?

[26] Rescission is an equitable remedy. The remedy is available in circumstances that include a unilateral mistake. It is immaterial that a beneficiary did not induce the mistake or know of it or share it. The law of rescission includes mistakes of fact and mistakes of law.

[27] The petitioner seeks rescission of the dividends, which, for the purpose of this case, are being treated as a voluntary disposition on the part of New Integrated to the Trust as a shareholder. The petitioner relies upon the argument that the entire plan was based on a mistake of law.

[28] Central to this case, then, is discerning when the court will find that a mistake made meets the conditions for the court to exercise its equitable jurisdiction to rescind a voluntary disposition. I note that the Crown has not disputed the court's jurisdiction to grant the relief sought nor raised issues in respect to the applicant being the Trust (the donee) rather than New Integrated (the donor).

- [29] The United Kingdom's highest court recently addressed the issue of when equity operates to rescind a voluntary disposition. In *Pitt v. Commissioners for Her Majesty's Revenue and Customs*, [2013] UKSC 26, ["Pitt"] the Court undertakes a careful examination of the development of the equitable jurisdiction of the English courts to set aside a voluntary disposition on the basis of mistake.
- [30] In an earlier case, *Gibbon v. Mitchell* [1990] 1 W.L.R. 1304, ["Gibbon"] the test had been stated that rescission of a voluntary disposition would be granted for mistake where "the mistake is as to the effect of the transaction itself and not merely as to its consequences or the advantages to be gained by entering into it."
- [31] As outlined in *Pitt* at paras. 118 and 123, the dichotomy in *Gibbon* between a transaction's effect and its consequences led to confusion as to when a mistake could truly give rise to the ability to rescind a voluntary transaction. The court noted that *Gibbon* has been "very influential" and has been "cited as one of the key authorities in most of the standard works on equity and trusts". However, the court also noted that the decision had been given *ex tempore* and was "not based on much adversarial argument". Further, the court questioned the source from which the principle stated in *Gibbon* was derived and observed that the case has "been criticized" both from legal scholars and in more recent decisions of the court.
- [32] In *Pitt*, the court rejected the distinction between effect and consequences. The court held that the true test of granting rescission of a voluntary disposition was set out in *Ogilvie v. Littleboy* (1897) 13 T.L.R. 399, 400, as quoted in *Pitt* at para. 101:

Gifts cannot be revoked, nor can deeds of gift be set aside, simply because the donors wish that they had not made them and would like to have back the property given. Where there is no fraud, no undue influence, no fiduciary relation between donor and donee, no mistake induced by those who derive any benefit by it, a gift, whether by mere delivery or by deed, is binding on the donor . . . In the absence of all circumstances of suspicion a donor can only obtain back property which he has given away by showing that he was under some mistake of so serious a character as to render it unjust on the part of the donee to retain the property given to him.

- [33] The court in *Pitt* stated at para. 122:

I can see no reason why a mistake of law which is basic to the transaction (but is not a mistake as to the transaction's legal character or nature) should not also be included, even though such cases would probably be rare. If the *Gibbon v Mitchell* test is further widened in that way it is questionable whether it adds anything significant to the *Ogilvie v Littleboy* test. I would provisionally conclude that the true requirement is simply for there to be a causative mistake of sufficient gravity; and, as additional guidance to judges in finding and evaluating the facts of any particular case, that the test will normally be satisfied only when there is a mistake either as to the legal character or nature of a transaction, or as to some matter of fact or law which is basic to the transaction. [emphasis added]

- [34] In summary, the test as set out in *Pitt* is that a court may rescind a voluntary disposition where it is found that it a mistake of sufficient causative gravity was made that would make it unconscionable, unjust or unfair to leave the mistake uncorrected.
- [35] The parties in the case at bar take different positions on the applicability of *Pitt* to this case. The Crown argues that the current applicable law on rescission of a voluntary disposition for mistake is the law from *Gibbon*, and that the alleged mistake in this case must be assessed to determine whether it was a mistake as to the transaction's effect (for which rescission could be granted) or the transaction's consequences (in which case there could be no rescission). The Crown argues that, on the basis of this law, rescission should not be granted in this case as any alleged misunderstanding by those who participated in the design and implementation of the plan was merely as to consequences or the advantages to be gained by entering the transactions and not to the effect of the transactions themselves.
- [36] The Crown submits that the parties entered into the transactions in accordance with the plan proposed by MNP and that the creation of the Trust and related parties, and the payment of the dividends, are the legal effects of the transactions themselves. The taxability of the dividend in the Trust's income is only a consequence of the Plan. It is further argued that a taxpayer should not be permitted to go back and forth in arranging their affairs when a taxpayer is faced with a bill that they do not want to pay.
- [37] In order to determine whether I should accede to this submission, it is first necessary to determine which law guides this decision.
- [38] The law from *Gibbon* has been followed by Canadian courts. For example, in *Stone's Jewellery Ltd. v. Arora*, 2009 ABQB 656, 314 D.L.R. (4th) 166, a tax case, at para. 50, the court in granting rescission held that the circumstances therein fell:
- within the strict confines of the rule for granting relief outlined in *Gibbon*, that is, that the transaction "will be set aside for mistake whether the mistake is a mistake of law or fact, so long as the mistake is as to the effect of the transaction itself and not merely as to its consequences or the advantages to be gained by entering into it.
- [39] The law from *Gibbon* has been adopted by this court at the law in this province: See *In the Matter of John Horvath*, 2000 BCSC 117 at para. 31. It also appears to have been implicitly adopted by the Ontario Court of Appeal in *771225 Ontario Inc. v. Bramco Holdings Co.* (1995), O.R. (3d) 739 (C.A.), leave to appeal ref'd [1995] SCCA No. 147
- [40] Courts in this jurisdiction have not yet considered the analysis and perspective set out in *Pitt*. In *Bergen v. Bergen*, 2013 BCCA 492, the Court of Appeal had the case brought to its attention but declined to examine whether *Pitt* represents the law in this province as the mistake was neither pleaded nor argued at trial and the requisite facts could therefore not be found.

- [41] I am, of course, not bound by the decision in *Pitt* as a matter of stare decisis, though I note that English decision are persuasive in this jurisdiction and entitled to careful consideration: *R. v. Hing*, 53 D.L.R. 356, [1920] 3 W.W.R. 314 (B.C.C.A.) at para. 26. That case makes it clear that where recent English case law is out of variance with the established practice in a province, that English authority should be considered but is not binding on the courts.
- [42] I also note the case of *In the matter of S Trust*, [2011] JRC 117, a decision of the Jersey Royal Court issued prior to the U.K. Supreme Court decision in *Pitt v. Holt*, where after a detailed analysis the court rejected the dichotomy identified in *Gibbon*.
- [43] The analysis in *Pitt* is persuasive. In my view, the approach set out in *Pitt* for determining whether a mistake was made that can give rise to rescission warrants adoption and is applicable to this case.

Was there a mistake of sufficient causative gravity such that it would be unjust not to grant rescission?

- [44] The petitioner submits that the circumstances in the present case meet the conditions for rescission. Specifically it argues that the Plan was undertaken based on a mistake of law, the causative mistake.
- [45] In furtherance of its position, the petitioner submits that CRA's proposal to assess the Trust in respect of the dividends on the basis of s. 75(2) was contrary to its published position on the meaning and application of subsection 75(2) as it stood at the time the Plan was created.
- [46] The Crown argues that rescission should not be used as a means to effect retroactive tax planning. The Crown submits that a taxpayer's liability for taxes is based upon what the taxpayer actually did, and not upon what, in retrospect, the taxpayer wishes he or she might have done. See for example: *771225 Ontario Inc. v. Bramco Holdings Co.* (1995), 21 O.R. (3d) 739 (C.A.); *Perrault v. The Queen* (1978), 78 D.T.C. 6272 (F.C.A.); and *Bronfman Trust v. The Queen*, [1987] 1 S.C.R. 32. The Crown acknowledges that equitable rescission is available to protect a contracting party from a mistake made, even where that mistake is insufficient to invalidate a contract at common law. However, it is submitted that the applicants were not mistaken nor misled by the CRA with respect to the applicability of s. 75(2); rather, the applicants knowingly took the risk that s. 75(2) might not apply when the subject transactions were entered into. In this regard, the Crown refers to Mr. Cesmystruck's affidavit in which he deposed that he advised Mr. Hagan that the dividends would "likely not be taxable" to the Trust but would be deductible by the Holding company under subsection 112(1) of the Act. It is pointed out by Mr. Nitikman that the written plan did not use the term "likely". I prefer the written words in the Plan as earlier set out above. I find that the term "likely" was not used at the time the accountants provided their Plan.

[47] The Crown argues that the CRA did not rely only on the Sommerer decision when it proposed to include the dividends as the Trust's income. CRA determined that even if s. 75(2) applied, s. 82(1)(a) and s. 12(1)(j) and the GAAR provisions under s. 245 of the Act would still permit CRA to include the dividends in the Trust's income.

[48] In this analysis, I am cognizant of a reservation set out in Pitt, the court at para. 135 expressed as unresolved the question of:

Whether the court should assist in extricating the claimants from a tax-avoidance scheme which had gone wrong. The scheme adopted by Mr. Futter was by no means at the extreme of artificiality but it was hardly an exercise in good citizenship. In some cases of artificial tax avoidance the court might think it right to refuse relief, either on the ground that such claimants acting on supposedly expert advice, must be taken to have accepted the risk that the scheme would prove ineffective, or on the ground that discretionary relief should be refused on grounds of public policy. Since the seminal decision of the House of Lords in *WT Ramsay Ltd v Inland Revenue Comrs* [1982] AC 300 there has been an increasingly strong and general recognition that artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures. But it is unnecessary to consider that further on these appeals.

[49] It is pointed out by the Crown that in Pitt the court noted, at paras. 134-135, that the primary purpose of the disposition at issue was Mr. Pitt's health and welfare, not tax avoidance. It is pointed out that in contrast, in the instant case, the petitioner has engaged in an artificial tax avoidance scheme and as such the court ought not to provide the relief sought.

[50] While the plan as set out by MNP identifies asset protection as the key objective, the submissions in this hearing by Mr. Nitikman emphasized that the subject transactions were tax driven. In my view, the tax aspect was a basic feature of the Plan. Significantly, there is considerable discussion in the Plan regarding tax implications. Moreover, as Mr. Nitikman points out, the significant dividend of \$1.84 million in 2008 evidences the tax-driven motivation behind the transactions. The evidence demonstrates that the tax implications were basic to the Plan.

[51] As mentioned earlier, the Crown argues that the difficulty in which the petitioner finds itself arises not so much as a mistake of law but rather the assumption of risk where the risk plan "may prove to be ineffective". In this case, the Plan as I have noted above identifies reservations as to the tax aspects in MNP's Plan, including the statement that "no assurance can be given that the tax (or valuation) considerations discussed herein will not differ from the opinion of the CRA. MNP's view as to the applicability of s. 75(2) proved to be wrong.

[52] However, the uncontroverted evidence is that prior to the Sommerer decision, the general understanding of tax professionals in Canada was contrary to the position that if the condition of s. 75(2) were met, then the fact that property was sold to the trust at fair market value rather than merely donated to the trust was irrelevant to its operation did not apply to the dividends paid to the Trust. This general understanding was also in line with that of CRA. The various interpretation bulletins issued by CRA, which I recognize are non-binding

and certainly are not law, and the cross-examination of Mr. Eugenio on his affidavit demonstrates that this was so:

Q From at least 1994 to November of 2010, the CRA's consistent position and the general understanding of the tax community as a whole was that 75(2) continues to apply, assuming its other conditions are met, even if the property is transferred to the trust under a sale at fair market value; is that a fair statement?

A Yes, it is.

Q All right. But notwithstanding that there was a sale in this case of fair market value, you took the position that 75(2) didn't apply notwithstanding what we've just said; is that correct?

A I'm relying on the Sommerer case.

Q Right. And I was just going to get to that.

In your paper you refer to a fairly recent decision called Sommerer. I never know how to pronounce it. S-o-m-m-e-r-e-r. And I'll just show you the first page of the two -- of the decisions just so we can get the dates straight. I'll show you a copy of the Tax Court judgment, which is dated June 14th, 2011. Do you -- or, I'm sorry, April 14th, 2011. Do you see that?

A Yes.

Q And that decision was upheld by the Federal Court of Appeal and its decision dated June 13th, 2012; is that correct -- or July 13th, 2012; is that correct?

A That's correct.

Mr. NITIKMAN: If I could just have those back. I'll have the Tax Court first page marked as the net exhibit, please.

EXHIBIT 9: Tax Court judgment dated April 14, 2011

Mr. NITIKMAN: And the Federal Court of Appeal first page as the next exhibit, please.

EXHIBIT 10: Federal Court of Appeal decision dated July 13, 2013

Mr. NITIKMAN:

Q And I'm just going to paraphrase your position on the Sommerer case, and you tell me if I've got it right or not. You correct me if I'm wrong, and I'm paraphrasing slightly here.

You relied on the Sommerer case to say to the Pallen Trust, you know, Gee, sorry; even though you did your sale in 2008, before the Sommerer case was a glimpse on anybody's mind, and even though you did a sale at fair market value that everybody was wrong. 75(2) doesn't apply on a sale at fair market value, and therefore you the trust are taxable on the dividend; is that a fair summary of your position?

A Yes, it is.

- [53] In terms of the "aggressive" tax planning, the petitioner countered this characterization by pointing out that the CRA has issued numerous Advance Rulings allowing tax-exempt First Nations Bands to transfer property to a trust and deliberately rely on s. 75(2) to divert income from the trust to the Band to eliminate completely the tax that the trust would otherwise pay. The Crown did not contest this argument. Further, the parties did not argue with any specificity the applicability of GAAR or the other provisions it cited. It is fair to say that the rule is broad and can encompass an extremely wide range of transactions. The decided cases dealing with complex and high structured plans, of which there are many, go both ways, and include surplus strip plans.
- [54] I also note that the CRA audit occurred subsequent to the release of the Sommerer decision. The screening tools used to identify the subject transactions may have been developed subsequently to the decision. My view of the evidence is the s. 75(2) was at the center of CRA's review of the subject transactions.
- [55] I infer from all of the above, that CRA would likely have not contested tax position of the petitioner prior to the Sommerer decision.
- [56] It was further agreed by Mr. Eugenio that should the dividends be rescinded and the monies returned to New Integrated that a future payout would come out on a taxable basis.
- [57] In my view, the circumstances warrant the relief sought by the petitioners. The tax implications were basic to the transaction, there was clearly a causative mistake, the gravity of the mistake was significant and there is no prejudice to a third party affected by the Plan. The monies remain within the entities and remain subject to taxation. A key determinant in this case is the common general understanding as to the operation of s. 75(2) by income tax professionals and CRA as well as my finding that CRA would not have sought to reassess the Trust prior to Sommerer. This aspect of the case in my view is what takes the case into the zone of unfairness. While there was an aspect of risk in the Plan, given the common understanding as to the operation of s. 75(2), I do not see the assumption of risk in this case as a sufficient factor to refuse the relief sought. Had the understanding been less certain, the assumption of risk taking would have negatively affected the question of fairness.

Conclusion

- [58] The dividend declarations are rescinded.

"The Honourable Mr. Justice Masuhara"

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