

CANADA / JUDGMENT

## Zhang v. Canada (Attorney General)

2015 BCSC 1256

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Supreme Court of British Columbia

DECIDED

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2015 BCSC 1256 Zhang v. Canada (Attorney General)

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

Zhang v. Canada (Attorney General),

2015 BCSC 1256

Date: 20150721

Docket: S125044

Registry: Vancouver

Between:

Fang Zhang, Beamtech Optronics Co. Ltd.

and LABest Optronics Co. Ltd.

Petitioners

And

Her Majesty the Queen in Right of Canada

Respondent

Before: The Honourable Mr. Justice Butler

Reasons for Judgment

Counsel for the Petitioners:

Donald W. Smetheram

Counsel for the Respondent:

Zachary Froese

Place and Date of Hearing:

Vancouver, B.C.

February 20, 2015

Place and Date of Judgment:

Vancouver, B.C.

**July 21, 2015**

- [1] The petitioners, Fang Zhang, Beamtech Optronics Co. Ltd. ("Beamtech"), and LABest Optronics Co. Ltd. ("LABest") seek rectification of an agreement made on October 29, 2003 (the "Agreement").
- [2] Pursuant to the Agreement, Mr. Zhang transferred his interest in LABest, a company incorporated in China, to Beamtech, a company incorporated in British Columbia, for US \$150,000. The transfer was to be effective on September 24, 2003. The petitioners seek rectification because in 2007 the Canada Revenue Agency (the "CRA") audited Mr. Zhang and Beamtech and determined that the fair market value of Mr. Zhang's interest in LABest at the time it was transferred to Beamtech, was CAD \$661,164. As a result of that determination and the fact that Mr. Zhang and Beamtech did not make an election under s. 85 of the Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.) ("ITA"), the CRA found that a capital gain of \$443,901 was triggered at the time of the transfer of Mr. Zhang's interest in LABest to Beamtech. Accordingly, the CRA audit determined that Mr. Zhang's income for the 2003 taxation year included a taxable capital gain of \$221,950.
- [3] When Mr. Zhang learned of the tax consequence of the Agreement, he and Beamtech filed a joint election under s. 85 of the ITA in respect of the transfer of Mr. Zhang's interest to Beamtech. Pursuant to that election, the deemed proceeds of disposition on the transfer was \$217,263 (an amount equal to the adjusted cost base of Mr. Zhang's interest in LABest) and Beamtech issued 1,000 common shares to Mr. Zhang in consideration for the transfer of his interest in LABest. The petitioners seek a rectification order to put in place, as of September 24, 2003, the share issue and transfer of Mr. Zhang's interest in LABest in accordance with the s. 85 election. The respondent opposes the relief sought and says that the petitioners are attempting to engage in retroactive tax planning.
- [4] I conclude that the petitioners are not entitled to rectification and I dismiss the petition, for the reasons that follow.

## Background

- [5] At all material times, Mr. Zhang and his family were residents of Richmond, British Columbia. For some time prior to 2003, he carried on a business in the People's Republic of China ("PRC"), which manufactured and distributed laser beam quality control equipment. On January 31, 2002, he established LABest under the laws of the PRC for the purpose of conducting that business. He invested capital of US \$150,000 to start up LABest and later invested a further US \$30,000. He was the sole owner of the company. Mr. Zhang had carried on the business in a personal capacity for some time prior to the incorporation of LABest, and the company was profitable from its inception.
- [6] In April 2003, Mr. Zhang and his wife met with their accountant, Bob Zhang, to review their 2002 tax returns. Bob Zhang is not related to Mr. Zhang. To avoid confusion, I will refer to him as "Bob", and in doing so I intend no disrespect. In the course of their discussions, Mr. Zhang asked if it was possible to distribute the income from his business in the PRC to British Columbia so that the earnings would be available to support his family. In response Bob said Mr. Zhang could set up a corporate structure whereby the income from the business would be earned in the PRC by a Chinese company which in turn would be owned by a British Columbia company. Using this structure, income earned and taxed in the PRC could be distributed to the British Columbia company as "exempt surplus dividends". The dividends would not be subject to tax in Canada when received, and would only attract tax when distributed as dividends to the shareholders in Canada. This discussion was cursory and conceptual in nature. Bob made no notes of the discussion and did not charge Mr. Zhang for tax planning advice. The formal retainer was restricted to preparation of the 2002 tax returns.
- [7] The discussions in April 2003 did not extend to the manner by which Mr. Zhang could transfer ownership of the Chinese company to the British Columbia company. Indeed, Bob was not advised of the existence of LABest. He assumed Mr. Zhang had yet to incorporate companies in the PRC and British Columbia. Sometime after that discussion, on August 1, 2003, Mr. Zhang incorporated Beamtech in British Columbia. Mr. Zhang subscribed for 100 shares in Beamtech and was the company's sole shareholder and director.
- [8] Bob became aware of the existence of LABest and Beamtech in August 2003 during a meeting with Mr. Zhang and his wife to follow up on the earlier discussion. At that time, they gave Bob a copy of the Chinese documentation establishing LABest and the British Columbia certificate of incorporation for Beamtech. At that point, Bob realized that Mr. Zhang had not set up a corporate structure which would allow the income from his Chinese company to be received tax-free in British Columbia. In order to "salvage" the structure, he advised Mr. Zhang to transfer ownership of LABest to Beamtech.
- [9] There are material differences in the evidence of Bob and Mr. Zhang as to the nature of the discussion at their meeting in August 2003. Mr. Zhang says that Bob's primary concern was the possibility that the transaction could trigger a capital gain. He said Bob was concerned

that the transaction could trigger an immediate Canadian income tax liability unless a rollover procedure was followed if the fair market value of his shares exceeded the amount he had invested in LABest. Bob advised that the work to accomplish a rollover, pursuant to s. 85, was complicated and would cost \$2,000. Bob also said he was not sure it would be possible to do that rollover. Mr. Zhang also says Bob told him that if the value of the proposed share transfer did not exceed US \$150,000, the amount of his initial capital investment, then a rollover would not be necessary. Mr. Zhang says he instructed Bob not to do any research or work on a rollover until he found out what the value in the PRC would be for the transfer of his interest in LABest. He says he did not ask for or receive any detailed advice about the requirements for a rollover, or any tax planning in relation to the transfer of his interest in LABest to Beamtech.

- [10] Bob's recollection of the sequence of events as set out in his affidavit and cross-examination is different from Mr. Zhang's. Bob says that when he saw that Mr. Zhang owned the shares of Beamtech and of LABest, he advised Mr. Zhang to transfer his interest in LABest to Beamtech. At the time, he was not sure this would be effective to save the structure. He says they had a discussion about what the transfer price might be. It was not possible to establish that because the Chinese government had to be involved and had the ability to determine the transfer value. The determination made by the government could not be questioned. Mr. Zhang recalls a brief discussion about the possibility of a rollover but it was not substantive. Bob recalls that Mr. Zhang was reluctant to pay the fee of \$2,000 that would be required to explore that possibility. Bob's evidence strongly suggests that the discussion was focused on putting in place a corporate structure which would enable income from LABest to be received tax-free in Canada, not on tax issues arising from the possibility of triggering a capital gain on the transfer of LABest to Beamtech.
- [11] The transfer of Mr. Zhang's interest in LABest to Beamtech, a foreign entity, required approval of the Chinese authorities. This includes approval of the price. Mr. Zhang was in China and took the necessary steps to effect the transfer and obtain that approval. He arranged for the transfer to be made by way of the Agreement. He drafted the Agreement while he was in the PRC. It is in Chinese and was signed on October 29, 2003. The Agreement provides that Mr. Zhang's interest in LABest is transferred to Beamtech effective as of September 24, 2003. On November 14, 2003, the PRC officials approved the transfer of Mr. Zhang's interest in LABest to the new foreign owner, Beamtech, at a price of US \$150,000, the amount of the original capital investment in the company by Mr. Zhang.
- [12] Prior to completing the transaction, Bob had a brief telephone discussion about the transfer with Mr. Zhang, while the latter was in the PRC. Mr. Zhang informed Bob that the Chinese government would approve a transfer value which was the same as the initial capital investment: US \$150,000. Mr. Zhang told Bob that was the fair market value. They both understood there was nothing that could be done about that valuation. Bob says they had no discussion about the possibility of Beamtech issuing shares to Mr. Zhang as consideration for the transfer. There was no discussion about a possible s. 85 rollover. Mr. Zhang assured

Bob that with that value there was no gain or loss on the transfer. Mr. Zhang understood from his brief discussions with Bob that there would be no tax issue on the transfer of his interest in LABest.

#### Provisions of the ITA

[13] Section 69(1) of the ITA is the deeming provision which is relevant to the determination made by the CRA:

69(1) Except as expressly otherwise provided in this Act,

- (b) where a taxpayer has disposed of anything
- (i) to a person with whom the taxpayer was not dealing at arm's length for no proceeds or for proceeds less than the fair market value thereof at the time the taxpayer so disposed of it,

the taxpayer shall be deemed to have received proceeds of disposition therefor equal to that fair market value

[14] Section 85(1) of the ITA permits a shareholder of a corporation to transfer property owned by the shareholder to the corporation for consideration that includes shares of the capital stock of the corporation, if the shareholder and the corporation have made a joint election in the prescribed form as to the value of the property. It allows the shareholder and the corporation to agree to a value (as to the shareholder's proceeds and the corporation's cost) of the property to be transferred which is less than the fair market value, and that value will be deemed to be equal to the fair market value. This permits a deferral of capital gains tax.

[15] Mr. Zhang and Beamtech did not deal at arm's length. Therefore, under s. 69(1), Mr. Zhang is deemed to have received proceeds of disposition equal to the fair market value of his interest in LABest at the time of disposition of that interest to Beamtech. As Mr. Zhang and Beamtech did not make an election under s. 85(1), unless the rectification is granted, Mr. Zhang is unable to take advantage of the deferral of the capital gain.

[16] In the absence of an election under s. 85, to the extent that the fair market value of Mr. Zhang's interest exceeded the adjusted cost base of that interest, the ITA requires Mr. Zhang to recognize a capital gain on the disposition, 50% of which is taxable as income. In the absence of a formal election under s. 85, the deeming rule in s. 69(1) applies, notwithstanding the value that Mr. Zhang and Beamtech attributed to LABest in the Agreement at the time of the transfer.

[17] After the audit of Mr. Zhang and Beamtech in 2007, the CRA determined that the fair market value of his interest in LABest, at the time of transfer, was CAD \$661,164. This determination was based on the profitable history of the business and LABest. That assessment is not at issue on this application. The sole question is whether Mr. Zhang and Beamtech are entitled to rectification of the Agreement.

## Law

[18] The law which governs rectification of commercial contracts is not controversial. In *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*, 2002 SCC 19, the Court set out the preconditions to obtain the equitable remedy: 1) the applicant must show the existence and content of the prior oral agreement; 2) the prior agreement was mistakenly (or fraudulently) misrepresented in the written instrument; 3) the precise terms of the rectification are readily ascertainable; and 4) there is convincing proof of the mistake. The Court noted that rectification is available for both mutual and unilateral mistakes providing that the preconditions are met. As Binnie J. noted at para. 31:

The court's task in a rectification case is corrective, not speculative. It is to restore the parties to their original bargain, not to rectify a belatedly recognized error of judgment by one party or the other

[19] In this province, the preconditions for rectification as set out in *Bank of Montreal v. Vancouver Professional Soccer Ltd.* (1987), 15 B.C.L.R. (2d) 34 (C.A.) at 36, are frequently cited as follows:

Before rectification can be obtained, the applicant must establish:

1. that the written instrument does not reflect the true agreement of the parties;
2. that the parties shared a common continuing intention up to the time of signature that the provision in question stand as agreed rather than as reflected in the instrument.

[20] While the law regarding rectification is not controversial, the preconditions necessary for its application are more difficult to consider and apply where the parties to the contract are not at arm's length and rectification is sought to avoid tax consequences of a transaction. A number of decisions in this province and elsewhere in the country have considered this situation.

[21] The leading decision dealing with rectification in these circumstances is *Canada (Attorney General) v. Juliar* (2000), 50 O.R. (3d) 728 (C.A.). The decision in *Juliar* concerned one of two siblings and their spouses who decided to transfer their interests in a numbered company which operated a family variety store business to two new family companies. The object of the transaction was to divide the business between the two families. The siblings and their spouses had received their shares in the family business from their parents by way of a rollover under the ITA. One couple, the Roffs, transferred their shares in the numbered company for shares in a new family company and made an election under s. 85 of the ITA. The Juliars received promissory notes, and not shares, from their new family company in exchange for their shares in the numbered company. This was done pursuant to the recommendations of their accountant who was misinformed about the earlier transfer of shares from the parents to the children. The CRA took the position that the Juliars owed tax based on the capital gain which resulted from the application of s. 69 of the ITA. In other words, the Juliars were deemed to have received proceeds of disposition equal to the fair

market value of their shares in the numbered company.

- [22] On the other hand, the Roffs, who received shares in the new family company and made an election under s. 85, were able to defer any tax liability arising from the new corporate structure.
- [23] The trial judge permitted rectification of the Juliars' transaction in such a manner as to avoid liability for the immediate payment of capital gains tax: *Juliar v. Canada (Attorney General)* (1999), 46 O.R. (3d) 104 (S.C.J.). In doing so, he found that their accountant mistakenly believed that taxes had been paid when shares in the numbered company were transferred to the Juliars. In those circumstances the accountant advised the couple that the transaction to transfer ownership to the new family company could proceed without tax consequences whether it was structured using shares, promissory notes, or cash. The accountant recommended the use of promissory notes as they would be easier to redeem. The Court of Appeal noted that the trial judge found "that the Juliars had a common and continuing intention from the outset to transfer their half interest in the business of Juliar Holdings and to do so 'on a basis which would not attract immediate liability for income tax on the transaction.'": para. 19. The trial judge concluded that the structure of the transaction would have been in accordance with s. 85 of the ITA had the mistake in determining the cost of the numbered company shares not been made. The trial judge concluded his reasons by stating, at para. 54:

Denial of the application would place on the Juliars a heavy burden which they were entitled to avoid and which they sought to avoid from the inception of the transaction. It would yield to [the CRA] a premature gain solely because of an error in understanding or communication between [Mr. Juliar and the accountant].

- [24] The Court of Appeal upheld the decision of the trial judge and in the course of doing so explained the "true agreement" between the parties at para. 25:

The trial judge effectively found that the true agreement between the parties here was the acquisition of the half interest in the business by transfer of shares in [the numbered company] to Juliar Holdings in a manner that would not attract immediate liability for income tax. In these circumstances, that had to be, not a transaction pursuant to s. 84.1 of the Income Tax Act, but a shares for shares transaction. Hence, it was appropriate for the trial judge to permit rectification to reflect that transaction.

- [25] The Court of Appeal found that it was possible for the trial judge to infer on all of the evidence that it was "plain and obvious" that the proposed division "had to be carried out on a no immediate tax basis or not at all."
- [26] In *Juliar*, the trial judge distinguished *771225 Ontario Inc. v. Bramco Holdings Co.* (1995), 21 O.R. (3d) 739 (C.A.). In *Bramco*, the Court of Appeal upheld the trial court's refusal to rectify the register of land title and a contract for purchase of lands to reflect a different purchaser than the numbered company which acquired a property. By mistake, the purchase was

made by a non-resident company rather than a resident company and this resulted in a significant land transfer tax liability. The purchase had been structured in order to avoid income tax liability, not liability for land transfer tax. The Court of Appeal explained the refusal to exercise its equitable jurisdiction, in *Bramco* at 742:

The second reason why I would not exercise equitable discretion in the appellant's favour in this case is because it would seem to me that to do so would run contrary to a well-established rule in tax cases that the courts do not look with favour upon attempts to rewrite history in order to obtain more favourable tax treatment. In this case, Ms. Ho took title in the name of 002 rather than in the name of 225 because there was an income tax advantage for her if she did so. She did not know that by doing so she would suffer a very significant land transfer tax disadvantage. The cases seem to hold consistently that tax liability is based upon what happened, not upon what, in retrospect, the taxpayer wished had happened.

[27] These Ontario decisions have been considered in British Columbia and the *Juliar* decision has been applied in a number of cases including, *McPeake v. Canada* (Attorney General), 2012 BCSC 132. In *McPeake*, Dorgan J. granted rectification of a trust deed. In doing so, she described *Juliar* and *Bramco* as representing the positive and negative approaches, respectively, on petitions for rectification. Her reasons for judgment thoughtfully explain how those two courts came to different decisions. The distinguishing factor is whether the parties were able to establish that they had a specific continuing intention to avoid the particular tax in question. Rectification will not be granted where there is only a general intention to avoid taxes. Dorgan J. commented on this point as follows, at para. 18:

The intention underlying the document must be more than a general intention. Exactly what constitutes sufficient specificity of intention varies by context.

[28] Madam Justice Dorgan noted at para. 26 that the negative decision in *Bramco* turned on the fact that Ms. Ho, the purchaser, "requested rectification to avoid a kind of tax, namely, a land transfer tax, which the court found she had not even contemplated. [Ms. Ho's] focus at the time of purchase was on the avoidance of income tax and not land transfer tax." The fact that a petitioner intends to avoid tax is not fatal to a rectification claim, at para. 28:

Again, it is not tax avoidance itself for which a court will refuse rectification, but a wholly distinct kind of tax avoidance that was not contemplated at the time of formation (of the transaction or deed as the case may be) and that was arguably sacrificed in favour of another, clearly intended, kind of tax avoidance.

[29] Madam Justice Dorgan explained the decision of the trial judge in *Juliar* as follows, at para. 31:

... the court found enough specific intention to avoid income tax in the fact that the Juliars intended that their exchange of shares from the former numbered company to a new corporation would not involve cash consideration, no matter whether the exchange would be for shares or for promissory notes. The Juliars chose a form of transaction not in and of itself but for its potential benefit of not triggering an immediate capital gains tax assessment.

[30] In McPeake, Dorgan J. noted that the affidavit evidence of all of the parties, including the settlor of the trust and several trustees, as to the trust instruments were in agreement as to their intentions. There was no evidence to suggest that their intention was somehow different from what they alleged. She found that the evidence showed "a common specific intention -- one which existed before the deed's formation and which has continued -- to avoid tax payable on capital gains from the sale of the shares to Microsoft by maximizing tax exemptions that could be multiplied across the trust's many beneficiaries": McPeake, at para. 43.

[31] Another case which is of assistance is *Re Pallen Trust*, 2015 BCCA 222. In Pallen, the court upheld the chambers judge's decision to rescind a dividend on the basis of mistake. While the facts are somewhat different from those at hand and the court was considering rescission rather than rectification, the principles are similar and instructive. The court considered what was required to establish an intention which was sufficiently "precise" and a "clearly defined object" such that rectification could be granted. The court expressed the issue in these terms, at para. 50:

As I read the warning, however, its focus was on the need for a "precise" and "clearly defined object" before rectification will be granted -- a simple intention on the part of the taxpayer to reduce his or her tax liability will not suffice. In both instances in *AES* [2013 SCC 65], the intentions of the parties to carry out tax-neutral transactions were clearly established. As Lebel J. stated for the Court, all the amendments did was "give effect to the common intention, an intention that had been clearly defined and that related to obligations whose objects were determinate or determinable."

[32] The court in Pallen, at para. 53, referred with approval to the following statement of principle from *Kennedy & Ors v. Kennedy & Ors*, [2014] EWHC 4129 (Ch), which sets out the proper way to evaluate the fairness of leaving a mistake in a document dealing with a disposition:

The injustice (or unfairness or unconscionableness) of leaving a mistake in a disposition uncorrected must be evaluated objectively but with an intense focus on the facts of a particular case. The court must consider in the round the existence of a distinct mistake, its degree of centrality to the transaction in question and the seriousness of its consequences, and make an evaluative judgment whether it would be unconscionable, or unjust, to leave the mistake uncorrected.

[33] In summary, the authorities establish that the task faced by the court on an application for rectification is to identify the intention of the taxpayer when he or she entered into the transaction in question. The proper approach to the issue before the court, extracted from the jurisprudence can be summarized as follows:

- 1) The principles regarding rectification in a commercial context are to be applied where the parties to the contract are not at arm's length and rectification is sought to avoid tax consequences of a transaction. The purpose of rectification remains to rectify the agreement where the written instrument does not accurately represent the true agreement between the parties. However, the focus of the analysis in tax cases is on the intention of the related parties when they entered into the transaction. This is because the 'mistake' in the written instrument is usually a mistake as to the tax consequences of the transaction. It matters not if the mistake was caused by misinformation from the taxpayer to his advisors, or mistaken advice provided by a professional advisor to the taxpayer.
- 2) It is an overstatement to suggest, as in *Bramco*, that there is a "well-established rule in tax cases that the courts do not look with favour upon attempts to rewrite history in order to obtain more favourable tax treatment". There is nothing objectionable about taxpayers attempting to avoid tax.
- 3) The real question which must be considered is whether the taxpayer is able to establish a specific continuing intention to avoid the particular tax in question. A general intention to avoid taxes is not sufficient. The determination of what constitutes sufficient specificity of intention will depend on the context and the circumstances of each case.
- 4) Where the rectification is aimed at a wholly distinct kind of tax avoidance, which was not specifically contemplated at the time the written instrument was formed, rectification will not be granted.
- 5) A common specific intention is one which existed before the formation of the instrument in question and has continued since that time. It must be a "precise" and "clearly defined object" before rectification will be granted.

## Analysis

[34] The difficult question to be resolved in this proceeding is the intention of Mr. Zhang and Beamtech when the former's interest in LABest was transferred to the latter. When I consider all of the evidence, I conclude that the parties did not have a specific or precise intention to avoid capital gains tax on the transaction. The specific intention was to set up a corporate structure which would permit the profits from LABest to be distributed to Beamtech in Canada on a tax-free basis. While Mr. Zhang and Beamtech had a general intent to transfer the interest in LABest to Beamtech in a tax-efficient way, their focus was on establishing the proper corporate structure to permit the revenue to be received tax-free in British Columbia. The intention of the Agreement was to set up the required corporate structure and to do so in a way that was acceptable to the Chinese authorities. In other

words, the focus was on crafting the optimal tax structure in relation to income, and not on capital gains. I will explain how I have arrived at this conclusion.

- [35] I cannot accept Mr. Zhang's version of the meeting with Bob in August 2003. Bob's version of the discussions is much more likely to be accurate and accords with the inherent probabilities of the case. This is so primarily because of the circumstances leading up to the meeting. Prior to the August meeting, Mr. Zhang had asked about a single tax issue: how to receive the revenue from his business in the PRC in British Columbia in a tax-efficient way. Bob described the necessary corporate structure, which would allow income earned and taxed in the PRC to be distributed in British Columbia as exempt surplus dividends. There was no discussion about transferring any interest in a Chinese company in a way that would minimize capital gains tax. Bob was not advised of the existence of LABest. Bob was not asked to provide information about capital gains tax issues; the brief discussion focused solely on a tax-efficient corporate structure for distribution of income.
- [36] When the parties met in August 2003, Bob was surprised by the steps Mr. Zhang had taken. He had set up a corporate structure which would not accomplish the intended object. The focus of their discussion must have been on salvaging the structure. As both men stated, Bob was skeptical this could be done. The discussion did not focus on the tax-efficient transfer of Mr. Zhang's interest in LABest; it focused on correcting the corporate structure to enable revenue to be received tax-free in this country. Bob did raise the possibility that Mr. Zhang may have to pay capital gains tax if the interest in LABest could be transferred to Beamtech. Bob asked Mr. Zhang if he wanted to explore the possibility of doing a s. 85 rollover but Mr. Zhang declined. He did not want to spend the money to explore that possibility. Mr. Zhang's concern was not the tax consequences of the transfer; his focus was on setting up the corporate structure to facilitate distribution of LABest's revenue in Canada in a tax-efficient manner. In other words, his specific intent was to establish the appropriate corporate structure for that purpose.
- [37] The events that took place following the August meeting serve to confirm this conclusion. In order to transfer his interest in LABest to Beamtech, Mr. Zhang had to get the approval of the Chinese government. That approval would establish the transfer price. Mr. Zhang made no enquiries of Bob as to how the transaction needed to be structured to obtain the approval of the Chinese government. He determined how that could be done in the PRC without concern about the tax treatment of the transaction by Canadian authorities. The idea to transfer his interest for cash was his, or derived from advice he received in the PRC, and he prepared or arranged for the preparation of the Agreement without concern for Canadian tax consequences.
- [38] I infer from these steps that the object of the transaction was consistent with the original object: to set up a structure which would permit the transfer of his interest in LABest to a British Columbia company and would facilitate receipt of the LABest revenue in Canada in a tax-efficient way. In other words, when the Agreement was entered into, Mr. Zhang was focused on two things. First, the clearly defined object was to create the corporate structure

whereby LABest would be a subsidiary of Beamtech. The second focus was on establishing the structure in a manner that was acceptable to the Chinese government. In order to do this, Mr. Zhang prepared the Agreement and completed the transaction. There is no evidence before the court that the Chinese authorities would have approved the transfer, had it been done by way of a share transaction for a different value than what was approved.

- [39] In these circumstances, it is not possible to say that the parties to the Agreement had a clearly defined common intention to limit the capital gains tax that might be payable on the transfer of Mr. Zhang's interest to Beamtech. To use the language of the Ontario Court of Appeal in *Juliar*, here, the true agreement between the parties was the acquisition of Mr. Zhang's interest in LABest by Beamtech in a manner that would allow for the distribution of LABest's income in British Columbia on a basis which attracted the minimum amount of income tax. It was not based on Beamtech acquiring the interest in LABest in a manner which would not attract immediate liability for capital gains tax. That was a secondary concern and one which Mr. Zhang asked Bob not to investigate. He did not seek assistance regarding the capital gains issue until long after the transaction concluded when the CRA took the position that he owed tax as a result of a capital gain.
- [40] To test the conclusion I have arrived at, it is appropriate to consider whether there would be an injustice, unfairness or unconscionableness in "leaving a mistake in a disposition uncorrected". The question is to be examined by looking, with an "intense focus" at the "mistake" "in the round" and examining "its degree of centrality to the transaction in question": *Kennedy & Ors v. Kennedy & Ors*. When that is done, it is evident that there is no unfairness or injustice in refusing to grant rectification in this case. There are a number of reasons for this:
- a) The "mistake", being the unfavourable tax consequence, is not something that Mr. Zhang ever saw fit to actively investigate. He was not prepared to pay to obtain advice on structuring the transaction. It may be that he did not think it worthwhile to do so because the Chinese authorities would make their decision on the transaction without any consideration of what a Canadian tax consultant might recommend.
  - b) To the extent that the Agreement contained a mistake, it was not an active mistake as in *Juliar*. Here, Bob gave no advice that was incorrect. Bob was provided with little information by Mr. Zhang because the latter did not want to incur expenses. While Mr. Zhang thought that the fair market value of his interest in LABest was equal to his investment in the company, this was an uninformed view. He did not attempt to value his interest or his current revenue stream. He failed to take any reasonable steps to value his interest in LABest. None of the cases suggest that a failure to make any proper inquiry can be the basis for rectification.

- c) When the "mistake" is considered in the context of all of the facts, it is evident that the transaction, which proceeded in accordance with the terms of the Agreement, actually accomplished the two things it was supposed to do: it created the structure which enabled the LABest revenue to be received tax-free in British Columbia; and the Chinese government approved the transaction.
- [41] The final reason for rejecting Mr. Zhang's position is that the rectification sought by the petitioners is aimed at a wholly distinct kind of tax avoidance which was not specifically contemplated at the time of formation of the Agreement. Mr. Zhang and Beamtech were focusing on the tax which might be payable on directing a stream of revenue from LABest to Beamtech in British Columbia. The Agreement successfully put in place the structure which allowed the parties to minimize tax on that revenue stream. The fact that the structure could have been set up in a different way to minimize tax on transfer of Mr. Zhang's interest to Beamtech is "a different kind of tax avoidance" which was not specifically contemplated when Mr. Zhang and Beamtech entered into the Agreement. Rectification should not be granted when the parties are seeking to rewrite history after the fact.
- [42] The petition is dismissed with costs at Scale B to the respondent.

"Butler J."

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