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Date: 20210528

Dockets: T-1174-19
T-1175-19

Citation: 2021 FC 506

Ottawa, Ontario, May 28, 2021

PRESENT: Madam Justice Walker

Docket: T-1174-19

BETWEEN:

BRENT CARLSON FAMILY TRUST BY THE TRUSTEE BRENT CARLSON AND BIM HOLDINGS ULC

Applicant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

Docket: T-1175-19

AND BETWEEN:

TED CARLSON FAMILY TRUST BY THE TRUSTEE MELVIN CARLSON AND ROCKHEAD HOLDINGS ULC

Applicant

and

THE MINISTER OF NATIONAL REVENUE

Respondent

JUDGMENT AND REASONS

[1] The applicants, the Brent Carlson Family Trust and the Ted Carlson Family Trust, are family trusts settled by Laurie Carlson, the father of Brent and Melvin (Ted) Carlson. For ease of reference, I will refer to the applicants as the Trusts in this judgment.

[2] Laurie Carlson and the Trusts indirectly held all of the outstanding shares in the family's successful crushed stone and sand supply business, Mainland Sand and Gravel Ltd. (Mainland). In September 2014, Mr. Carlson and the Trusts agreed to sell all of the outstanding shares in Mainland to an arm's length third-party purchaser. The Trusts implemented a series of pre-closing transactions (the Pre-Closing Transactions) immediately prior to the third-party sale to enable their respective beneficiaries to use their capital gains exemptions (CGEs).

[3] Unfortunately, the Trusts' professional advisors failed to factor into their advice the fact that a number of the beneficiaries were still minors in 2014. On audit of the Trusts' 2014 taxation year, the Canada Revenue Agency (the CRA) concluded that subsection 120.4(5) of the *Income Tax Act*, RSC 1985, c 1 (5th Supp) (*ITA*), also known as the "kiddie tax", applied to two share exchange transactions completed in the course of the pre-sale reorganization. The subsection deemed the capital gains realized by the minor beneficiaries on completion of the exchange transactions to be taxable dividends, thereby preventing those beneficiaries from using their CGEs. The Trusts attempted to file amended T2057 rollover election forms with the CRA in reliance on subsection 85(7.1) of the *ITA* to address the error.

[4] This judgment addresses the Trusts' applications for judicial review of the decisions (the Decisions) by the Minister of National Revenue (the Minister) to deny their request to file the amended election forms (the Amended Elections). The Decisions are set forth in two letters signed by the Minister's authorized delegate dated June 20, 2019.

[5] On July 21, 2020, Prothonotary Furlanetto ordered that the Trusts' applications for judicial review (Court files T-1174-19 and T-1175-19) be heard together because they are based on common facts and issues and each seek the same relief. A copy of this judgment will be placed on the Court file for each application.

[6] Briefly, I have concluded that the Decisions must be set aside because the Minister has failed to reasonably explain her refusal of the Trusts' request to file the Amended Elections. As a result, the applications for judicial review in Court files T-1174-19 and T-1175-19 will be allowed.

I. **Background**

[7] The facts relevant to the applications are not in dispute. The Trusts are discretionary trusts settled on September 20, 2004 by Laurie Carlson. Brent and Ted Carlson are each the sole trustee of their namesake Trust. The beneficiaries of the Trusts are Carlson family members.

[8] The Trusts engaged Ernst & Young LLP (EY) to structure a pre-sale reorganization internal to the Mainland group to maximize the Carlson family's after-tax wealth on the sale of Mainland to a third-party purchaser. EY prepared a detailed memo (the Transaction Step Memo)

describing each Pre-Closing Transaction. One of the stated objectives of the reorganization was to permit Laurie, Brent and Ted Carlson and each of the Trusts' beneficiaries to use the lifetime CGE available pursuant to subsection 110.6(2.1) of the *ITA*.

[9] Immediately prior to the reorganization, Brent and the Brent Carlson Family Trust held all of the outstanding shares of BIM Holdings ULC (BIM) (Brent: 1,000 Class C shares; the Trust: 100 Class A shares and 1,000 Class B shares); Ted and the Ted Carlson Family Trust held all of the outstanding shares of Rock Head Holdings ULC (Rock Head) (Ted: 1,000 Class C shares; the Trust: 100 Class A shares and 1,000 Class B shares). In turn, Laurie Carlson, BIM and Rock Head, through one additional corporate entity, held all of the outstanding shares of Mainland.

[10] Steps 11 and 12 of the Transaction Step Memo provided for the exchange by the Trusts of all of the Class B common shares held in its respective subsidiary company for three classes of new shares of that subsidiary company, including fixed value Class F preferred shares. Each Trust and its subsidiary company agreed to effect the exchange of shares pursuant to subsection 85(1) of the *ITA* at an elected amount that would recognize a capital gain equal to the aggregate CGE available to that Trust's beneficiaries. The agreed elected amount would also be the fair market value and adjusted cost base (ACB) of the Class F preferred shares received by the Trusts. The exchange transactions were completed on September 3, 2014 and T2057 election forms (the Original Elections) were filed accordingly.

[11] The sale of Mainland closed the following day in accordance with Step 39 of the Transaction Step Memo. The third party acquired all of the issued and outstanding shares in BIM and Rock Head, including the Class F preferred shares held by the Trusts. As the gain in respect of the Class F preferred shares held by the Trusts had already been realized in Steps 11 and 12, the ACB of those shares was equal to the proceeds received and the Trusts did not realize additional capital gains on the ultimate sale of Mainland.

[12] EY failed to consider the possible application of subsection 120.4(5) of the *ITA* when it advised the Trusts to realize capital gains in Steps 11 and 12 of the pre-closing reorganization. The error came to light during the CRA's audit of the Trusts' 2014 taxation year. The auditor, Ms. T. Wu, concluded that the capital gains realized by the Trusts in the exchange transactions resulted from the disposition of shares in a private company to a person not dealing at arm's length with the minor beneficiaries. As a result, subsection 120.4(5) would apply to deem twice the amount of the taxable capital gains realized by the minor beneficiaries to be taxable dividends and the minor beneficiaries could not use their CGEs.

[13] Ms. Wu informed the Trusts of her position in letters dated January 23, 2018 and invited submissions from the Trusts prior to the issuance of reassessments for the 2014 year.

[14] EY responded on behalf of the Trusts on March 2, 2018 (the First Request). EY requested that the Minister exercise her discretion pursuant to subsection 85(7.1) of the *ITA* to permit an amendment of the Original Elections to indicate an agreed elected amount in each case equal to the nominal ACB of the Class B common shares of BIM and Rock Head for which the Class F

preferred shares were exchanged. If accepted, the Amended Elections would result in the Trusts realizing no gain in the non-arm's length exchange transactions undertaken at Steps 11 and 12. Instead, the Trusts would realize the same capital gains upon completion of the sale of the Class F preferred shares to the arm's length purchaser at Step 39. The subsection 120.4(5) anti-avoidance tax would not be triggered and the minor beneficiaries could use their CGEs in the same manner they had reported in their personal income tax returns for 2014.

[15] EY set out a detailed rationale in support of the exercise of the Minister's discretion, emphasizing that the Trusts were not engaging in retroactive tax planning. They were trying to correct an error in the original elected amounts. All of the agreements and transactions in the Transaction Step Memo were completed as contemplated; only the Original Elections would be affected. EY highlighted the consistent references in the Transaction Step Memo to the objective of permitting the Carlson family members to benefit from the use of their CGEs.

[16] On March 13, 2018, Mr. A. Dhaliwal of the CRA, acting as the Minister's delegate, issued letters to the Trusts denying their First Request (the First Refusals). He concluded that the Trusts' request involved retroactive tax planning and that it was not just and equitable in the circumstances to permit the Amended Elections. Ms. Wu was involved in the CRA's assessment of the First Request and in the preparation of the First Refusals. Mr. Dhaliwal was Ms. Wu's supervisor in the Audit Division of the CRA's Fraser Valley Tax Services Office (TSO).

[17] On April 26, 2018, EY submitted a second request and submissions to the Minister to permit the Amended Elections (the Second Request). EY asked that the request be considered by

a different TSO and treated as a fresh request for an impartial review. EY was concerned that the First Request was reviewed by Ms. Wu who had already concluded in her audit function that an amendment to the Original Elections would constitute retroactive tax planning.

II. **Decisions under review**

[18] The Decisions are dated June 20, 2019. They were signed by Mr. D. Wong, Assistant Director, Audit Division, Fraser Valley TSO, on behalf of the Minister. Mr. Wong denied the Trusts' Second Request to file the Amended Elections because he considered the "request to be retroactive tax planning".

[19] The Minister's delegate acknowledged that the application of subsection 120.4(5) of the *ITA* was an unintended consequence of the Pre-Closing Transactions but did not agree that it was an oversight against which the Minister's discretion should be exercised within the just and equitable ambit of subsection 85(7.1). Mr. Wong referred in the Decisions to the CRA's Appeal Manual (s. 6.3.2.4) and Income Tax Audit Manual. He cited the Audit Manual's description of retroactive tax planning as the result of an event that occurs after initial planning of a transaction(s) and upon receipt of new information.

[20] The Minister relied on recent jurisprudence regarding rectification, most notably the statement of the presiding judge in *Canada Life Insurance Company of Canada v Canada (Attorney General)*, 2018 ONCA 562 (*Canada Life*) that "any equitable jurisdiction that a court may have to relieve against a mistake cannot be invoked in order to retroactively alter a transaction to achieve a tax planning objective" (*Canada Life* at para 44). Mr. Wong stated that,

although the Trusts had implemented the Pre-Closing Transactions as contemplated, EY's failure to consider the age of certain beneficiaries did not permit the Trusts to avail themselves of subsection 85(7.1) to amend the original transactions.

III. **Issues**

[21] The Trusts raise two issues in their applications:

A. Are the Minister's Decisions to deny the Trusts' request to file the Amended Elections reasonable?

B. Was the Minister's decision-making process procedurally fair?

[22] More specifically, the Trusts argue that the Decisions are not reasonable because the Minister's delegate failed to follow the CRA's long-standing published administrative practice as to when an amendment should be permitted under subsection 85(7.1) and misinterpreted the scope of impermissible retroactive tax planning in the context of the subsection. The Trusts also argue that the Minister's delegate breached the duty of fairness owed to them by failing to ensure an impartial and thorough second review. Finally, the Trusts submit that the participation of Ms. Wu, the CRA auditor, in the Minister's consideration of their First and Second Requests compromised the impartiality of the Minister's second review and gives rise to a reasonable apprehension of bias.

IV. **Standard of review**

[23] The merits of the Decisions are subject to review for reasonableness (*Canada (Minister of Citizenship and Immigration) v Vavilov*, 2019 SCC 65 at paras 23-25, 89 (*Vavilov*)). There is no basis for departing from the presumptive standard of review in this case. Moreover, a review

of the Decisions for reasonableness is consistent with the pre-*Vavilov* jurisprudence regarding subsection 85(7.1) requests (*Masson v Canada (Attorney General)*, 2019 FC 887 at para 18 (*Masson*)).

[24] The Supreme Court of Canada (SCC) describes a reasonable decision as one that is based on an internally coherent and rational chain of analysis and that is justified in relation to the facts and law that constrain the decision maker (*Vavilov* at para 85). The review has two aspects: the reasoning process of the decision maker must be intelligible and logical, and the outcome must be justified. In her submissions, the Minister relies on the SCC's statement that reasonableness review finds its starting point in judicial restraint to emphasize the wide discretion conferred on the Minister in subsection 85(7.1) and the importance of deference in the Court's review of the Decisions (*Vavilov* at paras 75, 85).

[25] The Trusts' allegations of procedural unfairness leading to the issuance of the Decisions are subject to review for correctness (*Mission Institution v Khela*, 2014 SCC 24 at para 79; *Canadian Pacific Railway Company v Canada (Attorney General)*, 2018 FCA 69 at paras 34-56 (*Canadian Pacific*)). The decision in *Vavilov* does not change this conclusion (*Vavilov* at para 23). A review for correctness of a decision maker's procedure is a legal question for the Court and requires me to ask in these applications whether the Minister's process was "fair having regard to all of the circumstances", including the factors set out by the SCC in *Baker v Canada (Minister of Citizenship and Immigration)*, [1999] 2 SCR 817 at paragraphs 22-27 (*Canadian Pacific* at paras 46, 54; *Denso Manufacturing Canada, Inc. v Canada (National Revenue)*, 2020 FC 360 at para 27).

V. **Analysis**

1. Are the Minister's Decisions to deny the Trusts' request to file the Amended Elections reasonable?

[26] The Trusts' primary argument is that the Decisions are unreasonable for two related reasons. First, they argue that the application by the Minister and her delegate of the principles of rectification to a request to amend an election pursuant to subsection 85(7.1) improperly narrowed the scope of the subsection and was fundamentally flawed. Second, the Trusts state that the Minister failed to reasonably interpret and apply the CRA's own guidelines regarding the circumstances in which the relief contemplated in subsection 85(7.1) will be granted.

[27] Subsection 85(7.1) permits the Minister to accept a late-filed or amended section 85 election if it is just and equitable in the taxpayer's circumstances to do so:

85 (7.1) Where, in the opinion of the Minister, the circumstances of a case are such that it would be just and equitable	**85 (7.1**) Lorsque le ministre est d'avis que les circonstances d'un cas sont telles qu'il serait juste et équitable :
(a) to permit an election under subsection 85(1) or 85(2) to be made after the day that is 3 years after the day on or before which the election was required by subsection 85(6) to be made, or	**a)** soit de permettre qu'un choix visé au paragraphe (1) ou (2) soit fait après la fin du délai de 3 ans qui suit la date à laquelle il devait être fait au plus tard en vertu du paragraphe (6);
(b) to permit an election made under subsection 85(1) or 85(2) to be amended,	**b)** soit de permettre qu'un choix fait en vertu du paragraphe (1) ou (2) soit modifié,
the election or amended election shall be deemed to have been made on the day on	le choix ou choix modifié est réputé avoir été fait au plus tard à la date à laquelle le

or before which the election was so required to be made if	choix devait être ainsi fait, si les conditions suivantes sont réunies :
(c) the election or amended election is made in prescribed form, and	**c)** le choix ou choix modifié est fait selon le formulaire prescrit;
(d) an estimate of the penalty in respect of the election or amended election is paid by the taxpayer or partnership, as the case may be, when the election or amended election is made,	**d)** le contribuable ou la société de personnes, selon le cas, paie le montant estimatif de la pénalité relative au choix ou choix modifié, au moment où celui-ci est fait.
and where this subsection applies to the amendment of an election, that election shall be deemed not to have been effective.	Lorsque le présent paragraphe s'applique à la modification d'un choix, celui-ci est réputé n'avoir jamais été en vigueur.

[28] As stated above, there is no dispute regarding the facts that gave rise to the First and Second Requests. EY failed to consider the involvement of minor beneficiaries in the Trusts and the potential application of subsection 120.4(5) of the *ITA* when devising the Pre-Closing Transactions. EY's mistake resulted in the minor beneficiaries being unable to use their CGEs following completion of Steps 11 and 12 of the Transaction Step Memo. Further, the parties agree that the Pre-Closing Transactions were carried out as contemplated in the agreements that implemented the pre-sale reorganization. The documents that required amendment were the Original Elections.

[29] I turn first to the Trusts' submission that the Minister incorrectly applied recent jurisprudence defining the scope of the remedy of rectification in assessing their Second Request. The Minister disagrees, stating that the equitable principles that are the foundation of

rectification and rescission apply equally to the exercise of the discretion contemplated in subsection 85(7.1). The focal point of the parties' disagreement is the scope of the phrase "retroactive tax planning" as considered by Canadian courts.

[30] The Minister's delegate relied on jurisprudence that can be traced through three cases: *Canada (Attorney General) v Fairmont Hotels Inc.*, 2016 SCC 56 (*Fairmont*) and the companion appeal interpreting the Civil Code of Québec, *Jean Coutu Group (PJC) Inc. v Canada (Attorney General)*, 2016 SCC 55 (*Jean Coutu*); and *Canada Life* (cited in the Decisions). The Trusts submit that the later case of *Collins Family Trust v Canada (Attorney General)*, 2020 BCCA 196 (*Collins*) provides context for the prior decisions and their application to tax cases. The British Columbia Court of Appeal (BCCA) decision in *Collins* was released after the parties had filed their memoranda of fact and law in the applications but was provided to the Court in advance of the hearing.

[31] In *Fairmont*, Justice Brown addressed the scope of the equitable remedy of rectification calling it "a potent remedy" (para 13). Fairmont Hotels entered into a complex financing arrangement in 2002/2003 with a Canadian real estate investment trust (Legacy Hotels REIT) in which Fairmont owned a minority interest. The financing arrangement was designed to ensure foreign-exchange tax neutrality. When Fairmont was acquired in 2006, the goal of tax neutrality was frustrated but the various parties to the acquisition entered into a modified plan which deferred the foreign-exchange exposure but without a specific plan as to how tax neutrality would ultimately be preserved.

[32] In 2007, Legacy Hotels REIT asked Fairmont Hotels to terminate certain agreements in the original financing arrangement. Fairmont agreed and redeemed shares in its subsidiaries via resolutions of the subsidiaries' directors. The redemption resulted in an unanticipated tax liability discovered after the CRA's audit of the 2007 taxation year. Fairmont Hotels applied to the court to rectify the 2007 resolutions to convert Fairmont's share redemption into a loan. The chambers judge and Court of Appeal allowed Fairmont's application for rectification.

[33] On appeal to the SCC, Justice Brown overturned the lower courts' decisions and the decision in *Attorney General of Canada v Juliar*, 2000 CanLII 16883 (ONCA), 50 OR (3d) 728 (*Juliar*). Justice Brown's decision focuses on the principles underlying rectification and stressed that rectification is limited to correcting an error in the recording of a transaction in a legal instrument (*Fairmont* at paras 38-39):

> [38] To summarize, rectification is an equitable remedy designed to correct errors in the recording of terms in written legal instruments. […]
>
> [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.

[34] Justice Brown emphasized that there is no distinct threshold for granting rectification in the tax context. The tax consequences of a transaction flow from the parties' legal arrangements and documents and not from the intended or unintended tax consequences of those legal arrangements. Rectification is concerned with contracts and documents, not with intentions (*Fairmont* at para 29, citing a 1953 judgment of Lord Denning in *Frederick E. Rose (London) Ld. v William H. Pim Jnr. & Co.*, [1953] 2 QB 450 (CA) at p 461).

[35] In *Canada Life*, a case that dealt with a request for rescission and not rectification, the Ontario Court of Appeal (OCA) relied on *Fairmont* to state that the courts' equitable jurisdiction to relieve against mistakes could not be invoked for purposes of retroactive tax planning. Canada Life and certain of its affiliates carried out a series of transactions in 2007, the purpose of which was to realize a tax loss to offset unrealized foreign exchange gains accrued in the same taxation year. In 2012, the CRA disallowed the claimed loss and Canada Life successfully applied for rectification and an order setting aside the transactions and replacing them with other steps, retroactive to the original effective date.

[36] On appeal by the Attorney General, Canada Life abandoned its claim for rectification and requested relief through equitable rescission. The OCA held that rescission was not available in the circumstances of the case and stated that the relief sought in the guise of rescission was "the very type of correction of an error in the structuring and implementation of a transaction to achieve a particular taxation result that the [SCC] rejected in *Fairmont Hotels*" (*Canada Life* at para 7).

[37] The OCA addressed the elements of equitable rescission of a contract (*Canada Life* at para 89) and concluded that Canada Life's request to partially set aside the original transactions and replace them with a different series of transactions did not satisfy the requirements for equitable rescission. There was no common misapprehension as to the parties' respective rights, only as to the tax consequences of the transactions, and no equitable considerations warranting relief. More relevant to these applications are the Court's references to Justice Brown's treatment

of impermissible retroactive tax planning cited by the Minister in the Decisions (*Canada Life* at para 69):

> [69] […] Retroactive tax planning is not limited to attempts to secure a more favourable tax consequence than one had originally hoped to generate. It includes attempts to change one's affairs so that tax consequences that were intended, but which were prevented by a mistake, can be achieved. Brown J.'s reference to impermissible retroactive tax planning, which he noted occurred in *Juliar*, referred to both the "intended" and "unintended" effects of parties' transactions or arrangements. Indeed, *Juliar* involved a transaction that was undertaken to achieve a particular tax result, as did *Fairmont* – the court accepted that "tax neutrality was the parties' intention" (at para. 3).

[38] Finally, in *Collins*, Mr. Collins entered into a series of transactions to protect the assets of his corporate business from creditors without incurring income tax liability. The plan relied on the attribution rules in subsection 75(2) of the *ITA* and the inter-corporate dividend deduction in subsection 112(1). The transactions were premised on an understanding of the attribution rules that was subsequently narrowed by the Tax Court of Canada. As a result of the changed interpretation, the CRA audited Mr. Collins and his family trust and issued adverse reassessments for the particular taxation year. Mr. Collins and the trust applied to the court to rescind the transactions on the basis of mistake.

[39] The BCCA affirmed the order of the chambers judge granting rescission and stated that neither *Fairmont* nor *Jean Coutu* had undermined the principles expressed in a prior BC case based on a series of essentially identical transactions (*Collins* at para 45):

> [45] In my opinion, neither *Fairmont* nor *Jean Coutu* have undermined the principles expressed and applied in *Pallen Trust*. While both rectification (as sought in *Fairmont*) and rescission (as sought in *Pallen Trust*) are equitable remedies, each has its own legal test, and each applies in a non-tax as well as a tax context. If

> applicants meet the legal test for the remedy sought, they are entitled to that remedy. *Fairmont* did not establish otherwise.

[40] The BCCA took issue with one aspect of the lower court's reasoning. The chambers judge did not see why different equitable remedies should have dramatically different results and stated that *Fairmont* and *Jean Coutu* were intended to be of more general application and were intended to apply to all taxation cases.

[41] The BCCA held that the chambers judge interpreted the SCC decisions too broadly (*Collins* at para 53):

> [53] In my view, neither *Fairmont* nor *Jean Coutu* stand for the broad proposition that the granting of any equitable remedy in a tax context will result in "impermissible retroactive tax planning". Rather, they confirm that retroactive tax planning cannot be achieved by rectification (or amendment) of an instrument that correctly records an antecedent agreement, simply because the effect of that instrument produces an unexpected tax consequence. As Justice Brown stated in *Fairmont* at para. 24, *Juliar* allowed for "impermissible retroactive tax planning" because it erroneously departed from the principle that the inquiry is into what the taxpayer agreed to do. Similarly, Justice Wagner noted in *Jean Coutu* (at para. 42) that allowing the amendment of written documents where there is no discrepancy with the true agreement of the parties would amount to "retroactive tax planning".

[42] The Court stated that the corollary of its analysis is that the remedy of rectification is available if all of the prerequisites for granting rectification are met even if a tax advantage is obtained. The same is true for the remedy of rescission (*Collins* at paras 54-55).

[43] At issue in these applications is subsection 85(7.1) of the *ITA* and the remedy of amendment. The subsection permits an election made under subsection 85(1) or (2) to be

amended if, in the Minister's opinion, the circumstances of the case are such that it would be just and equitable to do so. The Trusts proposed the Amended Elections as amendments. They were and are not seeking rectification of an executed document or rescission of a transaction. The question before the Minister and her delegate was whether it was just and equitable to permit the amendments.

[44] The SCC emphasizes the importance of the statutory regime within which an administrative decision maker makes a decision (*Vavilov* at para 108). The starting point for the delegate's consideration of the Second Request was subsection 85(7.1). However, the Decisions contain no assessment of the scope of the subsection and the statutory remedy of amendment, where just and equitable, of previously filed section 85 elections. The Minister failed to set out a rational chain of analysis of the subsection. The Decisions do not explain the Minister's application of the principles of rectification to a statutory provision that contemplates amendments to a specific document and to the facts that underlie the Amended Elections (*Vavilov* at para 85). I find that this omission is a reviewable error for a number of reasons.

[45] The Decisions suggest that the Minister's delegate applied the requirements of rectification to the Trusts' request for amendment and that the remedies of rectification and amendment are equivalent. They are not. Read in its grammatical and ordinary sense, consistent with the nature and purpose of section 85, the reference in subsection 85(7.1) to the amendment of an election is broader than the rectification of a document to reverse what amounts in many cases to a clerical error (*Vavilov* at para 117, citing *Rizzo &Rizzo Shoes Ltd. (Re),* [1998] 1 SCR 27 at para 21). The subsection does not state that the Minister may permit rectification of an

election filed under subsection 85(1) or (2). If the Minister's position is that the inclusion of the words "just and equitable" in subsection 85(7.1) constrain the concept of amendment to that of rectification, the Trusts were entitled to an explanation of that position in the Decisions.

[46] The Decisions are supported by the Taxpayer Relief Recommendation Form (the Recommendation Form) dated June 20, 2019 and the CRA Memo to file dated June 11, 2019 (the Litt Memo), both prepared by Mr. N. Litt, a CRA auditor in the Fraser Valley TSO.

[47] The Recommendation Form cites the CRA's guidance for late or amended elections under section 85 in Information Circular IC76-19R3 (Transfer of Property to a Corporation Under Section 85) (the Circular) and relies on Mr. Litt's substantive analysis in the Litt Memo in support of the conclusion that the Trusts' Second Request should be denied because it engages in retroactive tax planning.

[48] The Litt Memo acknowledges that one of the purposes of the pre-sale reorganization was for the Trusts' beneficiaries "to use their capital gains exemption on the gain from the sale of the shares of the Mainland group". The memo states that subsection 85(7.1) allows parties to file amended elections in extraordinary circumstances and considers the CRA's views in the Appeal Manual. Mr. Litt concludes that there is little guidance on what the CRA would consider just and equitable but that situations where tax arose because of reasonable error would satisfy the standard. Mr. Litt also references paragraph 16 of the Circular: a subsection 85(7.1) request may be based on the correction of unintended tax consequences when the parties intended a rollover without immediate tax consequences.

[49] Mr. Litt cites *Canada Life*, *Jean Coutu* and *Fairmont* and Justice Brown's statement that parties cannot be given *carte blanche* to exploit rectification for the purposes of engaging in retroactive tax planning (*Fairmont* at para 72). Mr. Litt states that, while the intention of the Transaction Step Memo was to effect a reorganization on a tax-deferred basis, the intention of Steps 11 and 12 was to realize a capital gain. He concludes that the Trusts' request to amend the Original Elections due to EY's oversight when designing the pre-sale reorganization involved impermissible retroactive tax planning and should be denied.

[50] The one reference in the Litt Memo to subsection 85(7.1) characterizes the situations in which relief will be available as extraordinary. Although Mr. Litt refers to the concepts of equity and fairness, he does not relate those concepts to the subsection itself or to his view that it applies in extraordinary circumstances. He draws no distinction between amendment, rectification and rescission, even though he relies on *Canada Life*, a case in which rescission was made available to rescind and replace a series of executed transactions. Most importantly, Mr. Litt does not explain why the Trusts' request to trigger capital gains at Step 39 of the Transaction Step Memo, the ultimate sale of Mainland to the third-party purchaser, is impermissible retroactive tax planning based on the general equitable principles in the jurisprudence. The analysis in the Decisions suffers from the same gap.

[51] I agree with the Minister's submission that her delegate did not err in stating that general equitable principles referenced in *Fairmont* and *Canada Life* can be used to inform her assessment of the words "just and equitable" as used in subsection 85(7.1). The error, or gap, in

the Decisions is that the Minister has not reasonably explained how the jurisprudence informed her consideration of the subsection and the Second Request.

[52] The discretion granted to the Minister in subsection 85(7.1) suggests an acceptable ambit for retroactive tax planning and the correction of unintended tax consequences. In other words, not every case in which a party seeks to amend a subsection 85(1) or (2) election involves impermissible retroactive tax planning. The Minister is required in each case to review all of the taxpayer's circumstances and explain why the requested amendment, which will inevitably have been prompted by an unintended tax consequence, is not just and equitable. Nowhere in the Decisions does the Minister's delegate reach such a conclusion. There is one reference to impermissible tax planning but that is part of the citation from *Canada Life*. The Minister's delegate explains his own rationale for denying the Second Request using the terms retroactive tax planning and unintended tax consequences.

[53] I also agree with the Trusts and the BCCA in *Collins* that the SCC's analysis of the principles of rectification in *Fairmont* do not constrain the Minister's assessment of whether an amended election proposed in reliance on subsection 85(7.1) is just and equitable (*Collins* at para 56). A request for equitable relief must be assessed against the particular remedy sought. The application by the Minister's delegate of *Fairmont* and *Canada Life* without analysing the words used in the subsection and why the requested amendments are not only retroactive tax planning but impermissible tax planning as referenced in *Fairmont*, is a significant error and is not saved by the analysis in the Litt Memo.

[54] The Minister's delegate states in the Decisions that the Second Request was similar to that in *Canada Life* where the OCA held that it could not substitute one series of transactions for another to avoid an unintended tax result (*Canada Life* at para 74). The Minister's delegate also states that EY's failure to consider the age of the Trusts' beneficiaries and the application of subsection 120.4(5) did not permit the Trusts "to amend the original transactions because they result[ed] in unintended tax consequences". I find that these statements in the Decisions do not reflect a reasonable analysis of the Second Request. There are significant factual differences between *Canada Life* and the requests to amend made by the Trusts. The Trusts implemented the transactions described in Steps 11 and 12 in accordance with the legal agreements executed by the parties. They did not seek to set aside or replace those transactions.

[55] The Minister argues that a taxpayer is not able to seek an amendment pursuant to subsection 85(7.1) based on the error of a professional advisor. However, there is no indication in the Decisions the Minister considered such an argument. The principle may apply to a request made under subsection 85(7.1) in some circumstances but it was not the reason given for the denial in this case.

[56] The two cases the Minister cited in support of her position, *Bugera v Canada (Minister of National Revenue)*, 2003 FCT 392 (*Bugera*) and *Masson* (previously cited), are cases involving requests to late file section 85 elections pursuant to paragraph 85(7.1)(a). In both cases, the applicants made submissions based on their advisors' errors but in neither case were those submissions determinative. For example, in *Masson*, the Court referred to jurisprudence stating that a third party's mistake is not a valid ground for an application for judicial review but

concluded that the Minister's refusal was reasonable because of the lack of any evidence establishing the parties' intention to proceed on a rollover basis. In contrast, in *Collins*, where the transactions that gave rise to unintended tax consequences were conceived by professional advisors, the BCCA granted the request for rescission on the facts before it.

[57] The Trusts also submit that the Decisions fail to explain the Minister's departure from the CRA's guidance in the Circular and Appeal Manual regarding reasonable error in light of the Trusts' intention to enable their beneficiaries to use their CGEs as part of the arm's length sale of Mainland. I agree with the Trusts that this second omission is a reviewable error.

[58] The Trusts rely primarily on paragraphs 16 and 18 of the Circular to demonstrate that the Minister has a history of accepting an amended election when it is clear that the parties wanted the rollover "without immediate tax consequences". The relevant portions of paragraphs 16 and 18 of the Circular state that:

> 16. We will generally accept an amended election under subsection 85(7.1) if its purpose is to revise an agreed amount, and without this revision, there would be unintended tax consequences for the taxpayers involved. We will permit revisions to correct an error, omission, or oversight made at the time of the original election. However, we will not permit revisions when, in the Department's view, the main purpose of the amended election is:
>
> > (a) retroactive tax planning, such as taking advantage of losses or tax credits not considered when the election was originally filed. In situations where the changes are partly retroactive tax planning and partly to correct errors, we will advise you that we will only accept an amended election for the latter;
> >
> > […]
>
> 18. Revenue Canada will generally accept an amended election when:

> […]
>
> (d) it corrects other situations which resulted in unintended tax consequences, e.g., the application of section 84.1, subsections 15(1), 84(1), and 85(2.1), or paragraph 85(1)(e.2), when it is clear the parties wanted the rollover without any immediate tax consequences.

[59] The Trusts argue that the Circular reflects the Minister's long-standing published administrative practice to allow amended elections to avoid unintended tax consequences. They refer to the virtually identical language found in paragraphs 16 and 17 of the prior circular, IC76-19R2, and contrast the current language to that of the first circular, IC76-19R, published on November 13, 1978 before the introduction of subsection 85(7.1). Paragraph 3 of the first circular limited the circumstances in which an amendment could be made to the correction of "clerical errors" and other limited situations, effectively using rectification language.

[60] The introduction of subsection 85(7.1) resulted in broader language in the revised circulars to include the avoidance of unintended tax consequences. The current Circular states that the Minister will generally accept an amended election to correct a situation that resulted in unintended tax consequences when it is clear that the parties intended a rollover transaction without immediate tax consequences. This general statement is qualified by the statement that the amendment will not be accepted if its main purpose is to carry out retroactive tax planning that the CRA views as impermissible. The Trusts wanted to correct unintended tax consequences by electing rollover treatment at Steps 11 and 12 and triggering a capital gain at Step 39 to allow all beneficiaries to use their CGEs. The Minister accepts that the Trusts intended rollover treatment to flow from the pre-sale reorganization. Mr. Litt acknowledges in his Memo that one of the situations noted in the Circular applies to the Trusts' Second Request.

[61] The Minister correctly submits that the Circular provides guidance only and is not binding (*Stemijon Investments Ltd. v Canada (Attorney General)*, 2011 FCA 299 at para 60). I find, however, that the Minister was required to explain her departure from the CRA's position in paragraph 16 of the Circular and did not do so. The Minister's delegate refers to language in the Appeal and Audit Manuals that supports his position. He does not address paragraph 16 of the Circular or its examples of impermissible retroactive tax planning. In terms of the Litt Memo, following his reference to the Circular, Mr. Litt summarizes the jurisprudence noted above. He does not explain why, when the Trusts' intention to permit the beneficiaries to use their CGEs in the course of the pre-sale reorganization was clear, he focussed on Steps 11 and 12 to conclude that the Second Request was a request to engage in impermissible retroactive tax planning.

[62] In summary, there is no explanation in the Decisions or the Litt Memo why EY's error in realizing gains prematurely in the reorganization resulted in the Minister's conclusion that it was not just and equitable to extend her discretion and permit the Amended Elections. This is not a case in which there was an intervening transaction which caused the Trusts to look retroactively at their tax planning and seek to recharacterize their prior actions (see, e.g., *Bugera*). The Second Request was made in the context of a third-party sale of Mainland in which the CGEs would normally be available with some pre-planning. The Trusts are not seeking a tax advantage they had not considered at the time. If the Minister considers these circumstances sufficient to meet the test of impermissible retroactive tax planning despite the guidance in the Circular, again, the Trusts are entitled to a clear explanation. The explanation need not be long but it must enable the Trusts to draw the line from the statute through the Circular and general principles of equitable relief to their own facts.

[63] I find that the Decisions lack the rational chain of analysis and transparency of reasoning that are the hallmarks of a reasonable administrative decision. The Minister's delegate has not demonstrated a logical analysis of the material facts relevant to the Second Request against the parameters of subsection 85(7.1). Instead, he imports equitable requirements specific to rectification and rescission without acknowledging any difference in the remedies sought. Both the Decisions and Litt Memo appear to overlook the fact that the Trusts proposed no amendment to the transactions in Steps 11 and 12 or to the documents executed in accordance with the Transaction Step Memo. They requested only the amendment of the Original Elections, as contemplated in subsection 85(7.1). The Minister's delegate erred when he stated, "[y]our request is similar to the request Canada Life put forward, in which [the] ONCA said, 'The court cannot substitute one series of transactions for another to avoid an unintended tax result'".

2. Was the Minister's decision-making process procedurally fair?

[64] The Trusts challenge the fairness of the Minister's process in considering the Second Request in large part because of the involvement of Ms. Wu in the initial audit of the Trusts' 2014 taxation year and in the CRA's assessment of the First and Second Requests on behalf of the Minister. In her role as a CRA auditor, Ms. Wu concluded that the Trusts had failed to consider the application of subsection 120.4(5) of the *ITA* to the capital gains realized by their minor beneficiaries in Steps 11 and 12. She was also the CRA auditor who performed the substantive review of the First Request and recommended its refusal to her manager Mr. Dhaliwal. Finally, Ms. Wu prepared a background memo at the outset of the CRA's assessment of the Second Request that was delivered to the review team.

[65] I agree with the Trusts that Ms. Wu should not have been the CRA's lead analyst of the First Request. She was advised by a CRA trainer early in the process to recuse herself and failed to do so. Ms. Wu's role as auditor was substantially different from that required in the review of a request for relief pursuant to subsection 85(7.1). Her conclusion in the audit that subsection 120.4(5) applied to characterize the capital gains realized by the minor beneficiaries and her apparent desire to substantiate that conclusion as reflected in the Court record undermine the impartiality of the first review and First Refusal.

[66] At issue in these applications is the fairness of the Minister's process in considering the Second Request. My conclusion that the Decisions are not reasonable means that the fairness of the process is not determinative to the success of the applications but this issue is nonetheless relevant to the remedy requested by the Trusts.

[67] I find that Ms. Wu's involvement in the CRA's assessment of the Second Request on behalf of the Minister was minimal. The background memo she prepared was factual in nature and presented the events leading to the Second Request. It contained no recommendation and there is no evidence in the record that Mr. Litt or Mr. Wong relied on the memo. The Trusts' suggestion that there were unknown telephone calls involving Ms. Wu during the second review is speculative and not reflected in the record.

[68] I also find that Mr. Litt's assessment of the Second Request was comprehensive and even-handed. There is no evidence of a lack of impartiality. There is also no evidence that would support a reasonable apprehension of bias on the part of Mr. Wong or Mr. Litt or raise lingering

concerns from Ms. Wu's involvement in the first review sufficient to result in any unfairness in the Minister's process leading to the denial of the Second Request. The fact that Mr. Litt's recommendation was considered by the three members of the second review committee during one afternoon prior to Mr. Wong's summer vacation may be unsettling to the Trusts but is not in itself indicative of a lack of attention. The Information Form is brief and the Litt Memo is not unduly long or complicated.

VI. **Disposition and costs**

[69] I have found that the Decisions do not set out a logical and rational chain of reasoning or explanation sufficient to justify the Minister's denial of the Second Request. The Decisions will be set aside and remitted to the Minister for redetermination.

[70] The Trusts request that any redetermination of the Second Request be conducted by CRA personnel who are located in a different TSO because there are few audit managers in the Fraser Valley TSO who have delegated authority to make decisions under subsection 85(7.1) on behalf of the Minister.

[71] As I do not know the makeup of the Fraser Valley TSO, I will not order that the Minister's redetermination of the Second Request be conducted by a different TSO. However, I direct that the Minister ensure that the redetermination be conducted by CRA personnel who have not been involved in an audit role of any of the Trusts' or Carlson family's income tax returns or other tax matters or in the first and second reviews. If my direction means that a fully

impartial redetermination cannot be undertaken in the Fraser Valley TSO, the Minister should refer the matter elsewhere.

[72] During the hearing of these applications, the parties agreed to discuss the quantum of costs to be awarded. I have since received and reviewed correspondence from the parties and will adopt their proposal. Given my decision to allow the applications, the Trusts are entitled to costs from the Minister in the amount of $15,000.00, inclusive of disbursements and tax.

JUDGMENT IN T-1174-19 AND T-1175-19

THIS COURT'S JUDGMENT is that:

1. The applications for judicial review of the decisions of the Minister of National Revenue dated June 20, 2019 in Court files T-1174-19 and T-1175-19 are allowed.

2. A copy of this Judgment and Reasons will be placed on each of Court files T-1174-19 and T-1175-19.

3. The Respondent, the Minister of National Revenue, shall pay to the Applicants, the Brent Carlson Family Trust and the Ted Carlson Family Trust, collectively, costs of this application in the amount of $15,000.00, inclusive of disbursements and tax.

"Elizabeth Walker"
Judge

FEDERAL COURT

SOLICITORS OF RECORD

DOCKETS:	T-1174-19 AND T-1175-19
DOCKET:	T-1174-19
STYLE OF CAUSE:	BRENT CARLSON FAMILY TRUST BY THE TRUSTEE BRENT CARLSON AND BIM HOLDINGS ULC v THE MINISTER OF NATIONAL REVENUE
AND DOCKET:	T-1175-19
STYLE OF CAUSE:	TED CARLSON FAMILY TRUST BY THE TRUSTEE MELVIN CARLSON AND ROCKHEAD HOLDINGS ULC v THE MINISTER OF NATIONAL REVENUE
PLACE OF HEARING:	HELD BY VIDEOCONFERENCE
DATE OF HEARING:	OCTOBER 19, 2020
JUDGMENT AND REASONS:	WALKER J.
DATED:	MAY 28, 2021

APPEARANCES:

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Surksha Nayar	FOR THE RESPONDENT

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