Tax Law as Accessory?

Rescission, Rectification, and the Relation of Trust Law and Tax Law after *Re Pallen Trust*

***** DRAFT PAPER *****
***** SYMPOSIUM IN HONOUR OF TIM EDGAR *****
FEBRUARY 8 & 9, 2019

Abstract

This article sets out a few directions for further thought regarding the place of tax law as law, both as a form of public law and as an "accessory" to private law. It is often curiously remarked that the tax law exists as an accessory, as it were, to private law. Law students first encounter tax law as a sub-specie of public law, as the administration of tax is by way of the constitutionally conferred authority to deprive people of their property. More curiously, perhaps, is the fact that this accessory must apply and be applied to the legal fictions that ground the reality of private actors and their transactions. To attempt to comprehend the nexus between tax law, as accessory to private law, and Tax Law, as public law, is to confront some of the most enduring questions of jurisprudence and legal theory. In the relatively recent case of the B.C. Court of Appeal in *Re Pallen Trust*, 2015 BCCA 222, the court was called upon to think through the role of a provincial court in addressing questions of tax law, of what lawyers-as-tax-planners are called upon to do, and how agent's actions are governed by equitable principles, provincial law, tax law, and practices of legal avoidance. The obligation of the tax lawyer as planner is to understand that individuals stand before the law in different ways not only because the way law addresses the persons involved in taxable events differ in their respective situations, but also because the law itself differs with itself: "law" does not speak with one voice, and thus the challenge for lawyers, judges, and scholars is to grasp the "use" of the law in tax planning. The article considers the way both the Supreme and Appeal Courts of B.C. considered the question of the place of tax law in the contemplation of the issues before each court and the courts' respective views on the availability of rescission and / or rectification, and it aims to show how the question of tax law's existence as both an accessory of private law and an element of public law tells us something about the scope of the jurisdiction that tax law seems to compel, indeed most notably with respect to matters that are, at their heart, tax driven.

Bradley Bryan
Assistant Professor
Faculty of Law, University of Victoria

"In my opinion fiscal law is an accessory system, which applies only to the effects produced by contracts. Once the nature of the contracts is determined by the civil law, the *Income Tax Act* comes into effect, but only then, to place fiscal conse- quences on those contracts. Without a contract, without a law and an obligation, there can be no fiscal levy. Application of the *Income Tax Act* is subject to a civil determination, whether such a determination be according to civil or common law."

Décary J, in *The Queen v. Lagueux & Frères Inc*., 74 DTC 6569 (FCTD), at 6572

"A key determinant in this case is the common general understanding as to the operation of ss. 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*."

Masuhara J, in *Re Pallen Trust*, 2014 BCSC 305, at para. 57

"There seems something fundamentally unfair in the CRA's administration of proposed amendments to the *Income Tax Act* for the past ten years as if they were already law."

Evans JA, in *Edwards v. The Queen*, 2012 FCA 330, at para. 15

"By referring to the *status* of an idea (and here I use 'idea' quite loosely, including everyday notions as well as scientific concepts that articulate with others to form a system), I mean to highlight the effects not so much of particular ideas but of a framework's, or a literature's, conceptual architecture… When regarding governance from the 'assemblage' point of view (rather than through one of the many available world-scale theories), the point of analysis is not to classify, or to conceptually refine definitions, but to try to understand shifts, moves, contradictions, and, in general, dynamic processes, concretely."

Mariana Valverde, *Chronotopes of Law*, at ch.1

Orienting Remarks

This article sets out a few directions for further thought regarding the place of tax law, *as law*, and specifically offers a few directions for further thought regarding the place of tax law as law, both as a form of public law and in terms of being a sort of "accessory" to private law.

Questions about the way tax law must deal with the fictions of private law, of what tax law *is* when it goes to work, and of tax law's provenance seem to have been present in much of Tim

Edgar's work, animating his various thoughtful and resounding critiques of tax measures, provisions, or policies that succeeded or failed to properly account for the way that tax law purports to work.[1] As one only beginning to contemplate these questions, I could only hope to reach the levels at which Professor Edgar laboured, combining exceedingly detailed analysis of complicated aspects of tax and finance with a broad understanding of its policy purposes and direction. To that end, a contemplation of the idea that tax exists as an accessory to (of? for?) the private law through an analysis of arcane principles of equitable remedies seems appropriately Edgarian, this despite that my confused meanderings may not yet enjoy the incisiveness that the late scholar would have produced.

I. Becoming Curious about the Idea of Tax Law as Accessory

It is often curiously remarked that the tax law exists as an accessory to private law, quoting the *obiter* of Décary J in *Lagueux & Frères Inc*.[2] Law students first encounter tax law as a sub-specie of public law, as the administration of tax is by way of the constitutionally conferred authority to deprive people of their property as a way to raise revenue. The idea that this

[1] To name only a couple, see, for example, Tim Edgar, *Income Tax Treatment of Financial Instruments: Theory and Practice* (Toronto: Canadian Tax Foundation, Tax Paper no. 105, 2000), especially the first chapter's discussion of debt and equity; Kirk A. Collins and Tim Edgar, "The Carter Report's Corporate Income Tax Proposals: Why They Were Rejected and an Assessment of the Current Canadian System as an Imperfect Alternative" in K. Brooks, ed. *The Quest for Tax Reform Continues: The Royal Commission on Taxation Fifty Years Later* (Toronto: Carswell, 2013), 115-54; and Tim Edgar, "Building a Better GAAR" (2008) 27:4 *Virginia Tax Review* 833.

[2] As noted by Décary J in *The Queen v. Lagueux & Frères Inc*., 74 DTC 6569; [1974] CTC 687 (FCTD), at 6572; 691. I am indebted to the following very insightful studies on the nature of taxation as an "accessory to private law", all of which cite this *obiter* statement. I only wish I was able to digest the insights of these more wholesomely into this paper: Matias Milet and Christopher Sheridan, "The *Income Tax Act* as 'Accessory': A Modern Re-Examination" in XX *100 Years of Income Tax*; Martha O'Brien, "Intention, Purpose, Objectives, Consequences: Rectification in Tax Law" in *100 Years of Income Tax*; Adam Parachin, "ITA as Accessory and the Charity Gift Tax Expenditure Program: Blurred Lines and Shifting Boundaries" in *100 Years of Income Tax*; Marie-Pierre Allard, "The Retroactive Effect of Conditional Obligations in Tax Law" (2001) 49:6 *Can Tax J* 1726; David Duff, "The Federal Income Tax Act and Private Law in Canada: Complementarity, Dissociation, and Canadian Bijuralism" (2003) 51:1 *Can Tax J* 1.

power to tax exists as a system that runs parallel to private transactions might strike some as strange, especially given the history of means used to raise revenue, ranging from the plunder of war, the exploitation of peoples and extraction of resources from colonies, not to mention the imposition of duties and "fees" at borders.[3] More curious, perhaps, is the fact that this accessory must apply and be applied to the *legal fictions* that ground the reality of private actors and their transactions.[4] Asking after the way that income tax *system* is an accessory to private law seems to beg the question of the specific role of income tax *as law*. To bring this notion of "the accessory" into focus, we will not be seeking to discredit the notion, nor to celebrate or acquit. Rather, the aim of this article is to try to understand why the notion is at times compelling, and at times clouds or misconstrues tax law, and thus specifically to see what can be illuminated by looking into the notion of "tax law as an accessory to private law". That is, the purpose of this article is not to say that the "fiscal levy" is or is not an accessory system, but rather what is illuminated by using the concept at all.

In a wide-ranging and helpful body of scholarly work on law, Mariana Valverde has shown that the way that the force of law is given effect is not only through physical violence, but through a variety of means that work on legal subjects to govern them through their very identity.[5] There

[3] In case it is not noticed, this study takes as its starting point the fact that the power to tax is a power reserved for sovereigns, and that in liberal legal societies (i.e. constitional democracies) that power has been circumscribed so as to be subject to principles of legality. I take this to be an underlying premise of Tim's helpful article on the GAAR: See Tim Edgar, "Building a Better GAAR" (2008) 27:4 *Virginia Tax Review* 833. See also: Allison Christians, "Towards a Political Theory of Taxation" as well as "Drawing the Boundaries of Tax Justice" in K. Brooks, ed. *The Quest for Tax Reform Continues: The Royal Commission on Taxation Fifty Years Later* (Toronto: Carswell, 2013), 115-54.

[4] It should be uncontroversial to say that the *Income Tax Act* creates tax attributes. For an impressive study that illustrates the degree to which this occurs, see Kathryn Chan, "The Perils of Federalizing the Common Law: A Case Study of the ITA Gift Concept" (2017) 50 U.B.C. L. Rev. 579.

[5] See, for example, Mariana Valverde, *Law's Dream of a Common Knowledge* (Princeton: Princeton University Press, 1998), and, more recently, *Chronotopes of Law* (New York: Routledge, 2014).

is also plenty of helpful work by tax lawyers and scholars on the identity-conferring forces at work in tax law, and specifically at work in the *Income Tax Act*.[6] This work confounds the very idea of tax as an accessory insofar as the way tax goes to work on the legal subject is precisely not as an accessory, but as an effect of sovereign power. But rather than simply suggest that one of the socio-legal effects of the power to tax involves identity, let us be content, for now, to simply note that we have these persuasive accounts. This article follows these accounts by suggesting that (i) the idea of "tax law as an accessory to private law" is also "identity-conferring" insofar as it posits a realm of private transactions generative of "sources" of income, (ii) the condition of the possibility of tax avoidance rests upon an image of the sovereign power to tax as requiring justification, and (iii) the bureaucratic separation of fiscal powers into various levels and divisions of government compounds the difficulty of seeing the taxing power as a sovereign power and assists in portraying the possibility of "neutrality" as a policy goal. These suggestions may well be beyond the scope of this paper, but it is where the path that these musing take through rescission, *Re Pallen Trust*, and rectification.

Now, an essential aspect of successful tax practice is to keep on top of developments not only in tax law and policy, but also in areas of private law for which tax law is relevant. But as any tax aficionado also knows, this is easier said than done. Some amendments to the *Income Tax*

[6] This work is voluminous, and while these citations could not be representative of the impressive breadth, nevertheless see: Rebecca Johnson, *Taxing Choices* (Vancouver, BC: UBC Press, 1997); Claire Young, " 'Beyond Conjugality': Time for the Tax System to Take that Concept Seriously" in K. Brooks, ed. *The Quest for Tax Reform Continues: The Royal Commission on Taxation Fifty Years Later* (Toronto: Carswell, 2013); Lisa Philipps, "Registered Savings Plans and the Making of Middle Class Canada: Toward a Performative Theory of Tax Policy" (2016) 84:6 *Fordham Law Review* 2677; Lisa Philipps and Mary Condon, "Connecting Economy, Gender, and Citizenship", in *Law and Citizenship*, ed. Law Commission of Canada (Vancouver: UBC Press, 2006) 176-207; Michael Livingston, "Law, Culture, and Anthropology: On the Hopes and Limits of Comparative Tax," (2005) 18:1 *Canadian Journal of Law and Jurisprudence* 125.

Act[7] are years in coming, and indeed sit in annotated versions as proverbial warnings of what may come. Some other changes, however, materialize as new interpretations on older provisions, and can thus be the cause of the worry and dread accompanying "damage-control" drafting and pleading that can follow news of amendments, or even of a new approach to an old rule. If we can re-phrase Evans JA's comment in *Edwards v. The Queen*,[8] noted above, there seems something "fundamentally unfair" about new approaches to old rules that have the effect of creating uncertainty for tax planners, undoing carefully crafted "products" rolled out for clients and that inevitably require a revisiting of old agreements, deeds, directors' resolutions, shares issued, capital reorganizations carried out, even if previously "common in the industry" or thought to be sound.

This "news of a new approach" is what seems to have befallen the tax advisors in *Re Pallen Trust*,[9] a case in which the court granted the trustees' petition to rescind dividends declared by a corporation on the grounds that the advisors made a mistake about the law from which it would be otherwise unjust to grant relief. In *Re Pallen Trust* we learn about the deep difference between law and equity, between trust law and trusts under the *ITA*, between pleading in tax court and in other superior courts in Canada, and thus between the proper scope of the jurisdiction of provincial superior courts with respect to matters that are, at their heart, tax driven. In looking closely at the doctrine of equitable rescission as set forth both in the trial decision and on appeal in *Re Pallen Trust*, we may grasp the way the court was called

[7] RSC 1985, c. 1 (5th Supp.) ("the *ITA*").
[8] 2012 FCA 330, at para. 15.
[9] 2014 BCSC 305, aff'd 2015 BCCA 222.

upon to think through the separation of taxation powers among judicial offices (i.e. the role of a provincial court in addressing questions of tax law), of what lawyers-as-tax-planners are called upon to do, of the place of the Canada Revenue Agency (the "CRA") in addressing provincial court, and how agent's actions are governed by equitable principles, provincial law, tax law, and practices of legal avoidance. To attempt to comprehend the nexus between tax law, as accessory to private law, and Tax Law, as public law, through the lenses of equity and its remedies would be to confront some of the most enduring questions of jurisprudence and legal theory. The obligation of the tax lawyer as planner is to understand that individuals stand before the law in different ways not only because the way law addresses the persons involved in taxable events differ in their respective situations, but also because the law itself differs with itself: "law" does not speak with one voice, and thus the challenge for lawyers, judges, and scholars is to grasp the "use" of the law in tax planning with trusts while not abusing it. The article considers the way both the Supreme and Appeal Courts of B.C. considered the question of the place of tax law in the contemplation of the issues before each court and the courts' respective views on the availability of rescission and / or rectification, and it aims to show how the question of tax law's existence as both an accessory of private law and an element of public law tells us something about the scope of the jurisdiction that tax law seems to compel, indeed most notably with respect to matters that are, at their heart, tax driven. By working through these questions, the article posits an answer to the question of whether, and how, tax law may be a victim of the legal fictions of private law, such that it comes to be seen as an accessory. Through this, we should be able to catch a glimpse of the variegated way that tax law is

manifest and expresses a complexity belied by the idea of tax law as an accessory to private law even while appreciating the productive role that such an idea has.

II. Rescission after Sommerer

How can the refusal to rescind a corporation's decision to distribute dividends pursuant to a risky or even aggressive tax planning scheme ever be seen as 'unjust, unconscionable, and unfair'? To answer this tells us about the professional obligations of the tax lawyer as planner that lie beyond or beside the usual ethics of not counseling "schemes." The obligation of the tax lawyer as planner is to understand that individuals stand before the law in different ways not only because they differ in their respective situations but because the law itself differs: "law" does not speak with one voice, and thus to "use" the law in tax planning with trusts is not to abuse the law. It may even be to respect it. In *Pallen Trust* we learn about the deep difference between law and equity, between trusts and trusts under the *ITA*, and thus between the proper scope of the jurisdiction of provincial superior courts with respect to matters that are, at their heart, tax driven.

The facts of the case as they relate to the Pallens are not in dispute. In 2007, the taxpayer's advisors devised a plan that would utilize the attribution rule in ss. 75(2) to have a dividend be deemed to have reverted to the settlor because of the gift of the shares by the settlor to the trust, in this case a holding company set up for the sole purpose of utilizing ss. 75(2) in this way, all carried out in 2008. In 2012, following the decision in *Sommerer*, the CRA audited and assessed the Trust on dividends it received (of approximately $1.75 million), claiming that the shares were transferred for fair market value and that therefore ss. 75(2) did *not* apply to

attribute the dividends to the settlor. The trustees then petitioned the court to have the dividends rescinded on the grounds of a mistake of law. The case affirms the equitable doctrine of rescission, and with respect to trusts stands for the proposition that rescission can be granted when a mistake (of fact *or* law) of causative gravity works an injustice against a party, usually a party that had sought to be benefitted and was inadvertently caused to be harmed.

The Crown argued that to allow rescission in a case "like this one" (and we will have occasion to wonder what such cases may be) is to give allow parties to use Provincial superior Courts to engage in retroactive tax planning. As was noted by McLachlin J (as she then was) in *Shell Canada Ltd. v Canada*, "a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done."[10] However, as Brown J astutely notes, this is most certainly not the same as saying that "parties who incur an unanticipated tax disadvantage would not have acted differently had they known of it in advance."[11] And the difference between these two notions of mistake resides in the intention that a party had when it carried out its transactions in the first place. Rescission, it will be seen, is available to those who intended to avoid tax liability and made a mistake. The scope for the granting of this equitable remedy is governed by the underlying rationale for applying equity to trusts used to avoid tax, and upon which one can distinguish tax avoidance that warrants equitable jurisdiction "artificial tax avoidance [that] is a social evil."[12] The questions that are thus importantly raised by *Pallen Trust* are: (i) are there 'clean hands' with tax avoidance, (ii) what is the scope of jurisdiction to

[10] [1999] 3 SCR 622, at para. 45.
[11] *Graymar Equipment (2008) Inc v Canada (Attorney General)*, 2014 ABQB 154, at para. 69.
[12] *WT Ramsay Ltd v Inland Revenue Comrs* [1982] AC 300 (HL).

provide equitable relief to mistaken tax driven transactions, (iii) which kinds of mistakes warrant relief, and (iv) what is the proper doctrine of rescission? While an answering of these four important questions is beyond the scope of this short paper, their relevance for the analysis lies in simply noticing that these critical questions are what circumscribe Mr. Justice Masuhara's reasons for judgment in *Pallen Trust*, and thus dictate a canvassing of how equitable principles are at work in the decision, how "mistakes" of fact and law are understood, and what this holds for the availability of rescission as a remedy for well-intentioned individuals who have made mistakes in the course of a complicated series of transactions the purpose of which is to minimize tax liability.

III. Tax Planning Beyond the Accessory

It is important to recognize that strictly speaking there is no “equity” in tax, which is to say that the principles of equity bequeathed to common law jurisdictions have a discernable range to which they apply and they do not apply in tax. The CRA owes a duty to the Minister of National Revenue and *not* to the individuals and persons liable for tax under the *ITA*, and any duties that the CRA owes are the ordinary ones owed by public officials.[13] In the petition to the court in *Re Pallen Trust*, equitable principles were in play because a petition for (equitable) rescission was brought, even though, or perhaps because, there would be no possible way to petition under the *ITA*. Thus one important differential aspects of trusts comes to light in this case: trusts are not individual entities *except* for the purposes of the *ITA*.[14] However, because they are often

[13] See: *Leroux v. The Canada Revenue Agency*, 2014 BCSC 720; see also *R. v. Samaroo* 2014 [pinpoint cite]

[14] Not as well that it is ss. 91(3) of *The Constitution Act, 1867*, 30 & 31 Vict, c 3, gives the federal government jurisdiction of taxation whereas ss. 92(13) provides for provincial jurisdiction over matters concerning property and civil rights.

used for tax planning purposes, those involved with them often think of them as entities instead of as a relationship among a settlor, trustees, and beneficiaries.

And while Masuhara J. was not alone in noting the procedural oddity of a trust applying to rescind a corporation's distribution, it is also important to note that the trust was not properly a party in any case. The trustee(s) are obligated to bring petitions in order to protect the interests of beneficiaries, and it may be the order to rescind a dividend sought by a petitioner "against" a corporation is appropriate insofar as it is the donee that wishes to have the voluntary disposition *qua* failed gift rescinded on the grounds that it is ineffectual. While truly a technicality, it highlights the importance of precision in naming the particular injustice visited upon the parties to a trust. The distribution of the dividend was intended to be a "gift" to the trust insofar as it aimed to transfer tax liability back to the donor by way of ss. 75(2) i.e. a deemed reversion of the dividend to be taxed in the hands of the corporation (other steps in the series of transactions notwithstanding).

The "who did what" aspect of the transactions is not to be thought of in terms of the agency of trustees (because trustees are not agents of a trust but act as the trust itself).[15] Thus it is not the arrangement on the whole that the petitioner was impugning as "ineffective" (these transactions are not the kind that can be "void"), but rather the specific transaction that was itself "voidable" because the intention expressed in the transaction is contrary to the result achieved: a transaction designed to relieve tax liability in fact produced it. There is in this

[15] Blair Dwyer, "Effective uses of Trusts in Estate Planning, Part 1: the Depth and Breadth of Trusts" PBLI, June 10, 2014.

sense a "mistake" – but of course there is no equitable remedy to be sought from the Tax Court of Canada. And so we find a strange situation confronts the Pallens and their tax advisors: they relied on the *ITA* to actively plan to limit their taxes, and when they prove mistake in their reliance have no equitable remedy available from the court that would hear any appeal of a forthcoming assessment. The turn to a provincial superior court is, of course, the only option.

The jurisdiction of the court to provide equitable relief in circumstances where transactions designed to avoid tax have failed is not new, but to obtain relief the transaction must have had avoidance of a specific tax as its specific purpose and not as an incident of its purpose – which, luckily for the Pallens, was the sole purpose of the elaborate tax plan.[16] One does well to note, however, that in Canada the superior courts of the provinces do not have the jurisdiction to hear federal income tax cases, nor to apply the income tax act in regards to cases they hear.[17] Provincial courts must be able to interpret the *ITA*, but they interpret it only so as to determine how it would apply to circumstances before them and only then so as to enlighten them as to tax consequences which may be an issue because of a set of questions properly before them. This is no small jurisdictional issue, and it gives us the key to the case. The provincial superior courts must be able to understand how a provision applies without applying, and must thus be able to take a kind of "judicial notice" of its application. In *Re Pallen Trust*, Masuhara J goes further by properly clarifying the scope of his jurisdiction with regard to the legal question of

[16] This was well put by Brown J in *Graymar Equipment*: "Just as a transaction which does not succeed in achieving its goal of avoiding tax is not the same thing as a transaction whose goal is other than tax avoidance but which unexpectedly results in a tax disadvantage, the intent of avoiding tax is not the same thing as the assumption that a tax liability would not be incurred."

[17] *783783 Alberta Ltd. v Canada (Attorney General)*, 2010 ABCA 226 at para 26, noting that the court has jurisdiction to "... interpret the provisions of the *Income Tax Act*, if that is necessary to decide an issue properly before the court."

tax liability as opposed to the factual question of tax practice.[18] Masuhara J does not allow his analysis to be interpreted as simply "notice" of income tax law but rather as findings about how ss. 75(2) has been understood in practice by tax professionals and members of the CRA. In what I think is an astute understanding of the role of law, Masuhara J looks not to the decision in *Sommerer v. the Queen*,[19] but to the way it was interpreted and used in practice. It would have been open to the Masuhara J to simply note that this is a changing practice of law and that such risks are the risks attendant to tax planning -- but that is not the way the equitable jurisdiction of a court is called upon. Indeed, the court is not asked about the efficient allocation of risk (i.e. the purview of contract) but of equitable relief and of the kind of mistake that invites it.[20]

For equitable relief to issue, the petitioner must come with "clean hands," and must seek relief from a mistake that does not, in being granted, circumvent the law, i.e. it must not simply be a mistake of law that the petitioners aim to fix. First, a scheme to avoid tax can be considered "clean hands" not only because it is "technically legal" but because it is common and authorized by the law itself. Courts have begun to articulate the limit of what will count as "clean hands" in tax avoidance, being clear that "artificial" or "aggressive tax schemes" (as opposed to "plans") will not be looked upon with favour. There is no hard and fast rule here, and petitioners will need to tread very cautiously in asking for relief.

---

[18] Cf. Valverde, *Dream of a Common Knowledge*, *supra*.
[19] 2011 TCC 212, aff'd 2012 FCA 207.
[20] I suspect that this is why the trust, and not the corporation, petitioned for relief – it was a "result" that was visited upon them, and with notice to the third party that distributed the dividend. Further, one wonders whether the fact that the petitioners sought only to rescind the distribution of dividends and not seek an unwinding of the entirety of the scheme was what rendered it as "palatable" tax avoidance.

Second, the mistake cannot simply be one occasioned by lawyers who ought to have known better – for obvious reasons, but also because there would be no clear line between what forms of tax planning involve results that tax lawyers ought to be aware of. And thus while Masuhara J notes that the "mistake" was one of law, it would seem, on the basis of his findings and analysis, that the mistake is one of fact. These two notions together are the key elements for tax practitioners: that there can be tax avoidance with clean hands, and the "mistake of law" can be a question of fact. The former becomes clear in light of the latter, so let us take these in reverse order.

IV. Mistake and the "Proper" Doctrine of Rescission

How can a mistaken interpretation of the law be a "mistake of fact"? Because Masuhara J does not apply the *ITA*, he is obliged to grasp its application. But he is also obligated to make findings of fact with respect to the nature of the mistake. By noting that there was (a) a widespread understanding of the application of ss. 75(2) prior to *Sommerer*, and (b) that the CRA was unlikely to have applied ss. 75(2) in the manner expressed in *Sommerer* prior to that decision, Masuhara J's findings come up to the very edge of "mistake of fact" insofar as it was a fact that the parties all had a prior but mistake understanding of the law. It is clear that the "mistaken" understanding of the operation of ss. 75(2) is what caused the result that the dividends would be taxed in the hands of the trust. That is, the professional advisors' mistake was "allowable" in that the law as it stood was interpreted and applied in practice such that a mistake with regard to it is conscionably understandable (i.e. is an honest mistake).

The test that Masuhara J adopts comes from *Pitt v. Holt* [21] (and there is no reason to think that this test is the inappropriate one – it dispenses with the confusion between "effects" and "consequences" that ruled previously),[22] and it asks whether there was a mistake of sufficient causative gravity such that it would be unjust to deny relief (in the classic phraseology of equity).[23] Once we have seen that the kind of mistake that the Pallens' advisor made is one that is "allowable" (i.e. it is not the sort of mistake barred because the professional advisor ought to have known), and to have pursued tax avoidance in this fashion was not "artificial," "aggressive," or otherwise out of the ordinary. I think to find otherwise would be to suggest that a large part of what financial and tax planners do is somehow suspect in a way that has already been decided, when if anything one could say that at no other time has the proper place of tax planning been a question of importance to the broader political culture.

One can imagine that the CRA will argue that granting rescission to *Re Pallen Trust* is to give effect to retroactive tax planning through the courts. My sense is that such an argument has more of an uphill battle than one may think. First, the superior courts of each province have equitable jurisdiction, and to deny an equitable remedy because of a perception that parties are engaging in a practice that is not honest will require evidence to that effect. In the case, there was extensive evidence produced as to the understandings of the Pallens (who only seemed to generally understand what was going on), the tax advisors (prior to *Sommerer* this

[21] [2013] UKSC 26, in which the court set aside a voluntary disposition for mistake and reformulated the test by dispensing with the rule in *Re: Hastings-Bass*, [1975] Ch. 25 (CA).
[22] Kate S. Marples, "When You Can't Trust the Trust: The Scope for Reversing or Rectifying Trust Transactions" Pacific Business & Law Institute, Vancouver, BC, June 10, 2014, at pp. 5-6.
[23] Donovan W.M. Waters, QC, Mark R. Gillen, and Lionel D. Smith, *Waters' Law of Trusts in Canada,* 4th ed. (Toronto: Carswell, 2012), at pp. 1363ff.

was "standard practice"), and the CRA officials (who begrudgingly acknowledge that ss. 75(2) came up in a new way only after *Sommerer*). In light of these factual findings, one can conclude that any future petitions for rescission will be scrutinized in much the same way one finds in Masuhara J's careful differentiation between facts, applications of the *ITA*, and equitable principles. Specifically, in a successful petition for rescission, one will need to distinguish the kind of use of the courts for retroactive tax planning that would anathema to equity from the kind of honest mistake of those who pursue legal tax avoidance. The proper doctrine of rescission, then, is one grounded in an appreciation of the scope and limits of what can be found (i.e. argued and proven) as the kind of acceptable tax planning and use of the *ITA* as is accepted among tax planning professionals, and the degree to which changes in the law are attributable to judicial interpretation (more sudden) or legislative announcement (more opportunities to plan and take account of changes).

Concluding Remarks

Rather than repeat what has been said, let me take a moment to clarify what has *not* been addressed or answered. While the foregoing has attempted to make sense of what is, on its face, a somewhat odd decision, there are related questions of tax law and trusts that are far from clear on the basis of *Re Pallen Trust*: under what circumstances can a provincial superior court justice "find" tax motivations when judicial notice of tax as central to transactions would be in rightly inappropriate;[24] what is the proper "standard" for tax professionals offering tax planning advice; and what kind of "knowledge" of the law in advance will count as important

[24] As noted by Brown J in *Graymar Equipment*, at para. 69.

when looking back on transactions that have gone awry (i.e. long standing amendments, or sudden changes by virtue of judicial interpretation)? As we see from *Re Pallen Trust*, we are only beginning to ask such questions.

Other concepts have come to illuminate how the state procures its wealth, from the concept of the "tax expenditure" developed in the 1970s by Stanley Surrey to perhaps the role of the notion of risk-based overrides developed by Tim Edgar in relation to derivate forward arrangements and synthetic disposition arrangements.[25] I hope that this analysis has taken some steps in that same direction with regard to the notion of the "accessory system" that tax law is purported to be. As Tim Edgar noted some time ago, the very fact that the full integration of corporate and shareholder income as suggested by the Carter Commission did not happen is curious enough when one considers that the ineffectiveness of the alternative must be known and understood. By analogy, I should not think it hyperbolic to suggest that tax-driven transactions and the possibility of their rescission suggest that the state's interest in promoting a policy ideal of neutrality that positions the state as the fairest party of them all.

By looking at the scope of the (proper) use of judicial discretion to apply principles of equity in certain tax cases before provincial superior courts (and thus to respect jurisdictional divides and not rule on the propriety of tax avoidance schemes), the tax system is regarded as an externally generated set of rules that affect the private affairs of families and businesses, such that tax practitioners come to have a duty to pay attention to the factual details of transactions, of trust

[25] Cf. Tim Edgar, "Risk-Based Overrides of Share Ownership as Specific Anti-Avoidance Rules" (Paper delivered at Allard Hall School of Law as part of the Tax Policy Colloquium in the Spring of 2015).

documents, and of the documented overall intentions of parties undertaking advanced forms of tax planning. "Tax planning" means understanding that transactions may have tax attributes, and that property ownership may give rise to taxable events by virtue of these attributes. Now, of course, these attributes are not features of the world, but of the fictions of law. Tax law relies on them, but it also creates them.

When a party acts in relation to something like the decision in *Sommerer*, we see something else besides: we see that the machinery of taxation in Canada both presupposes and requires the separation of the state's power to collect revenue into parts: (i) the legislative voice of law that sets forth the conditions under which the tax will be levied, along with provisions that ensure that the authorization of avoidance by taxpayers is circumscribed (i.e. by anti-avoidance rules like subsection 75(2)); (ii) the executive voice of law that sets forth the command to pay and the conditions of payment, and which entails an interpretation of the law as set forth by its counterpart; (iii) the judicial voice of law that clarifies the sense of legislative provision and the exercise of the power of the state to interpret and collect it; and (iv) the judicial voice of law interpreting the private law affairs of taxpayers that had arranged their affairs alongside these prior accounts. Note that because of the variegated voice of law, the taxpayer comes to understand its legal personhood in relation to the state as though the state acted upon it from the outside, but despite the fact that the taxpayer's position as this kind of legal subject is, above all, non-optional and not avoidable. This separation of the various aspects of the taxation power of the state into Diceyian and federalist aspects tells us that the condition of the possibility of a tax system that acts as an accessory to private transactions is the permissible

avoidance of tax. We might ask why the state has an interest in promoting this understanding of the tax system, or, rather, what it accomplishes.