

Editor: Vivien Morgan, LL.B.

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RECTIFICATION IN QUEBEC

The Quebec Court of Appeal (2011 QCCA 394) affirmed the authority of the Quebec Superior Court to rectify documents in a tax case when the request was legitimate and necessary and third-party rights were not adversely affected (*Services environnementaux AES inc.*, 2009 QCCS 790). The Agence du revenu du Québec (ARQ) has filed an application for leave to appeal to the SCC.

As part of a corporate reorganization, AES decided to sell 25 percent of its subsidiary's shares to a third party. AES was the registered owner of all of Subco's 1,217,029 class A shares (voting and participating). AES mistakenly thought that the shares' ACB was \$1,217,029; in fact, the ACB was \$96,001. AES entered into a section 86 reorganization (sections 541 and 543 of the Quebec Taxation Act) and in December 1998 exchanged all its Subco class A shares for a \$1,217,028 demand note and class B shares (voting and participating) with an aggregate PUC of \$1. Subco repaid the demand note in full by September 30, 1999. On September 15, 2000, the CRA issued a notice of assessment to AES that included a taxable capital gain of \$840,770 [$(\$1,217,029 - \$96,001) \times 75\%$] in its income for its taxation year ending September 30, 1999. AES objected to the assessment and with Subco jointly filed a motion in the Superior Court for rectification of documents relating to the reorganization to reflect the parties' true intent, and for a declaratory order to that effect. The parties requested (1) that any reference in the documentation to "\$1,217,029" be replaced by a reference to "\$95,000" and (2) that 1,122,029 class C shares with a value of

\$1,122,029 be issued so that the exchange by AES of its class A shares did not trigger a taxable capital gain.

The ARQ argued that the Superior Court did not have the authority to rectify the documents in the absence of a material error. Furthermore, articles 1400 and 1407 of the Civil Code of Québec allowed the Superior Court to annul the transactions only if it concluded that an error vitiated the parties' consent: the common-law doctrine of equitable rectification was not consistent with Quebec civil law. Alternatively, the ARQ said that the original documents reflected the parties' intent and thus could not be rectified. AES and Subco cited the residual power of superior courts under section 96 of the Constitution Act of 1867, and argued that section 96 did not specifically exclude from a superior court's inherent jurisdiction the authority to rectify contractual documents to reflect the parties' true intent.

The Court of Appeal dismissed the appeal, holding that the Superior Court has the authority to allow the modification of documents when, as in this instance, the request is legitimate and necessary and the modification sought does not adversely affect third-party rights. The court said that federal and Quebec taxation legislation specifically allowed certain tax-free share exchanges and that AES's and Subco's true intent was to benefit from those provisions; in those circumstances, the rights of the taxation authorities were not adversely affected by the documents' modification. (The decision did not address the documentation reflecting Subco's repayment of \$1,217,028 on a demand note that now had a \$95,000 face value.) The court also confirmed that Quebec civil law is a complete legal system, and thus it is not necessary to import common-law solutions to allow the correction of documents that contain errors: in certain situations, civil law allows contractual rectification to reflect the parties' verifiable intent.

Jean-François Dorais

Lapointe Rosenstein Marchand Melançon SENCRL,
Montreal