Docket: 2005-394(GST)G

BETWEEN:

VILLE DE RICHMOND,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on March 6, 2007, at Sherbrooke, Quebec.
Before: The Honourable Justice Alain Tardif

Appearances:

Counsel for the Appellant: Isabelle Boisvert

Counsel for the Respondent: Michel Morel

AMENDED JUDGMENT

The appeal from the reassessment of Goods and Services Tax under Part IX of the *Excise Tax Act*, notice of which is dated April 21, 2004, bearing number 9130311, for the period from October 1, 2002, to December 31, 2002, is dismissed in part, because the fair market value of the building was determined by consent of the parties at $850,000. Consequently, there should be a reassessment on the basis that the building's value was set at $850,000, with costs to the Respondent, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 4th day of September 2007.

"Alain Tardif"

Tardif J.

Translation certified true
on this 28th day of February 2008.

François Brunet, Revisor

Citation: 2007TCC336
Date: 20070904
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BETWEEN:

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AMENDED REASONS FOR JUDGMENT

Tardif J.

[1] This is an appeal from an assessment of Goods and Services Tax (GST) under the *Excise Tax Act* ("the Act"). The assessment bears the number 9130311, is dated April 21, 2004, and pertains to the period from October 1, 2002, to December 31, 2002.

Issue

[2] Essentially, the issue in this case is whether a cancellation of an exchange of immovables, agreed upon by the parties on November 12, 2004, can be set up against the Respondent. If so, the Appellant owes no GST.

[3] The relevant sections of the *Excise Tax Act* are sections 123, 165, 169, 199, 209, 221, 228 and 259.

The facts

[4] In making and confirming the assessment under appeal, the Respondent relied on certain assumptions of fact listed at paragraph 11 of the Reply to the Notice of Appeal. Those assumptions are as follows:

> [TRANSLATION]
>
> (a) The facts admitted to above.
>
> (b) During the period from October 1, 2002, to December 31, 2002 ("the period"), the Appellant was a registrant for the purposes of the GST.
>
> (c) During the period, the Appellant, being a municipality, was a "public service body".
>
> (d) On November 18, 2002, the Appellant was the owner of a building located at 375 7th Avenue in Richmond.
>
> (e) On the same date, the Appellant was the lessee of a building owned by the Comité de Promotion Industrielle de la Ville de Richmond ("CPIR") and located at 790-800 Hayes Street in Richmond.
>
> (f) The Appellant used the building located at 790-800 Hayes Street for municipal purposes, and, in particular, for its roadways and fire departments.
>
> (g) By notarial contract dated November 19, 2002, Ville de Richmond ("the Town") and CPIR exchanged the aforementioned buildings.
>
> (h) Thus, under the deed of exchange dated November 19, 2002, the Appellant became the owner of the building located at 790-800 Hayes Street in Richmond, and the CPIR became the owner of the building located at 375 7th Avenue in Richmond.
>
> (i) According to the aforementioned notarial deed of exchange, the value of the building located at 375 7th Avenue in Richmond was $850,000.
>
> (j) In the GST return that it submitted for the quarter that ended on December 31, 2002, the Appellant failed to report and pay the GST in respect of this transaction.
>
> (k) By virtue of the exchange, GST was payable on the consideration, namely, the building located at 375 7th Avenue.

[5] The Appellant Ville de Richmond (sometimes referred to herein as "the Town") was assessed by notice of assessment issued under the Act on April 21, 2004, in respect of the period from October 1, 2002, to December 31, 2002.

[6] The assessment is based on the building exchange deed, dated November 19, 2002, between the Appellant and the Comité de Promotion Industrielle de la Ville de Richmond ("CPIR"), a non-profit organization.

[7] Prior to the exchange, the Appellant owned a building formerly used in connection with the operations of H. H. Brown Canada Ltd. The building, located at 375 7th Avenue in Richmond, became vacant. The Appellant and CPIR therefore agreed that CPIR would manage the building in order to meet the Town's economic needs.

[8] For reasons unrelated to the management of the building at 375 7th Avenue, the Appellant became the lessee of a building that belonged to CPIR; that building, located at 790-800 Hayes Street in Richmond, was used to house municipal services.

[9] In view of this cross-ownership of the buildings, CPIR proposed to the Appellant that the ownership of their respective buildings be exchanged. The Appellant accepted the proposal.

[10] Consequently, the parties entered into an exchange agreement that was signed before Denis Tanguay, notary. Under the terms of the deed of exchange, the Appellant became the owner of the building located at 790-800 Hayes Street, and CPIR became the owner of the building located at 375 7th Avenue in Richmond.

[11] The Appellant neither reported nor paid the GST under the Act because it believed, in completely good faith, that no GST was payable.

[12] Following an audit by the Minister of National Revenue ("the Minister") with respect to the period from October 1 to December 31, 2002, it was determined that the transaction was taxable. The Appellant and CPIR then signed a deed of cancellation dated November 12, 2004, on the ground that there had been a defect of consent. The purpose of the deed was to restore the parties to the condition that they were in prior to the exchange, and it was hoped that this would retroactively cancel the tax consequences of the exchange.

[13] The Appellant called Martin Lafleur and Guylain Beaudoin as witnesses in support of its case. Both gentlemen are lawyers, and hold senior management positions with each of the parties to the contract on which the assessment is based, dated November 19, 2002 (Document No. 4) [and] to the second contract, signed on November 12, 2004, entitled [TRANSLATION] "Exchange Cancellation – Document No. 5".

[14] Initially, Mr. Lafleur and Mr. Beaudoin invoked various theories in an attempt to explain and justify the facts and circumstances of the cancellation, emphasizing that the consent to the taxed transaction was vitiated by reason of incomplete information, if not a lack of knowledge. However, they ultimately admitted and acknowledged that the only explanation, or the only reason for the deed of cancellation, was the issuance of the assessment that they had not anticipated at the time that the contract of exchange was entered into.

[15] After considering the matter in terms of the percentage of occupancy for municipal purposes, the municipality determined that this avenue was not to its advantage, and the parties then agreed that the only alternative was a cancellation.

[16] Their next step was to mandate the same notary to draft the "deed of cancellation" of the contract signed on November 19, 2002.

[17] Paragraph 6 of the [TRANSLATION] "Exchange cancellation – Document No. 5" provides as follows:

> [TRANSLATION]
>
> 6- The parties believe that there was, *inter alia*, an error as to the nature of the contract, the object there of and various essential determinative elements of each party's consent, including, but not limited to, an error as to the intended use of each buildings, the value of each building and the absence of a cash adjustment, which absence was, under the circumstances, an error.

[18] Despite the verbiage concerning the reason for the cancellation, there is no doubt that the fundamental purpose thereof was to avoid the payment of the assessment under appeal, because both contracting parties' persons in authority, namely Mr. Lafleur and Mr. Beaudoin, both of whom are lawyers, admitted to this, in a manner that leaves no room for equivocation or interpretation.

[19] Indeed, this is shown very clearly by two excerpts from the testimony that each of them gave.

Cross-examination of Martin Lafleur by Michel Morel at pages 26, 27, 29 and 32:

[TRANSLATION]

Q. Yes, but, Mr. Lafleur, you agree with me, do you not, that the reason that the transaction was cancelled was the GST and QST consequences?

A. I agree that there was definitely a consequence to the transaction.

Q. Yes, but the only reason — and I am coming back to this question — the only reason that the transaction was cancelled was the GST and QST consequences, correct?

A. Well, seeing that we are before you, that is certainly true.

. . .

Q. Yes, Mr. Lafleur, I put it to you that there was no error as to the intended purpose of the buildings, because the Town wanted ... the Town wanted to use, for municipal purposes, the building that it was already renting from CPIR. Do you agree with me?

A. Yes.

. . .

Q. No, I am talking about the time ... Could we please go back, Mr. Lafleur, to 2002, when you signed the deed of exchange? The parties were aware of the exact nature of the contract that they were signing, correct?

A. The exchange contract, yes.

Q. That's right. The only thing that caused you to reconsider that exchange was when you received the GST and QST assessments roughly in 2004, is that correct?

A. It's certain that when the municipality called me, and said that what we had agreed to was not transpiring. I said: Listen, if what we agreed to was not transpiring, that means that the basis of our consent at the time that we intended to do this ... we are going to return to our initial condition. That was our immediate reaction. In fact, when I think ... when the Department called me, I immediately referred to that solution. I said: Listen, if this is the consequence of what we did, we will put ourselves

right back where we were. Because, at the time of our transaction, that's not what we had in mind.

. . .

Cross-examination of Martin Lafleur by Michel Morel, at pages 41-43:

A. That one? I will look at it. Yes.

Q. So the grounds of objection are set out as follows: "We are objecting because will be seeking a cancellation." It says, "We will be seeking", so this was written on May 17, 2004, before the cancellation.

"We are objecting because we will be seeking the cancellation of the contract of transfer between CPIR and the Town, which will place the parties back in the situation that they were in before the transaction. This will automatically cancel the GST and QST assessment."

Period. You agree with me that the grounds of the notice of objection do not, in any way, reflect the provision contained in paragraph 6 of the 2004 contract, right?

A. Literally, it is not the same thing.

Q. Absolutely. Literally, it is not the same thing. Now, could you kindly look at the Notice of Appeal? I would refer you to paragraphs 10 and 11 of the Notice of Appeal. Paragraph 10 reads:

"The Appellant neither reported nor paid GST under the Act after this exchange, because it believed, in completely good faith, that no GST was payable because there was no cash supplement upon the exchange."

Paragraph 11 reads:

"The defect in the Appellant's consent, which results from the error as to GST liability at the time that the exchange was entered into, was discovered in the course of an audit that preceded the issuance of the aforementioned assessment."

Do you agree with me, Mr. Lafleur, that the only reason for the defect in consent alleged in the Notice of Appeal was the GST-related consequences?

A. So it would seem.

Q. So it would seem. Therefore, none of the factors set out in paragraph 6 of the 2004 contract are reflected in the notice of appeal either?

A. Well, the GST- and QST-related elements are reflected. And we're obviously before a court with respect to that aspect, yes.

. . .

Cross-examination of Guylain Beaudoin by Michel Morel, at pages 65 and 67-69:

Q. It was indeed also very satisfied in 2004, until the cancellation. It started to be less satisfied with the building when the Revenu Québec auditor arrived there, did it not?

A. Well, to tell you the truth, Your Honour, if I may, when the auditor showed up, it wasn't about the quality of the building, a hidden defect, or some defect in the building. Actually, it was about the consequence, about the fact that a huge expenditure vitiated our contract. This is what the dissatisfaction was really about.

. . .

Q. Precisely, Mr. Beaudoin, we have just learned ... we know that you are a lawyer and we have just learned that Mr. Lafleur is a lawyer as well. You were with Mr. Tanguay, a notary, before you signed that contract, so you were very informed parties who drafted clause 6.

A. I did not draft clause 6.

Q. When I say "you" ... listen, you represent the Town, which is one of the parties to the contract, right?

A. Indeed, and, as a party, when we met with the notary, we were very clear with him, because, as far as we were concerned, since there was an expenditure, certain *sine qua non* conditions of the contract were vitiated; he suggested this paragraph, which seemed quite broad in scope, but was not window-dressing.

Q. Earlier, in connection with clause 6, you used the expression "better safe than sorry", is that right?

A. Yes, that's right.

Q. You agree with me that, in your notice of objection, your only complaint about the assessment, that is to say, the assessment resulting from the cancellation, is about the cancellation of GST and QST. You have read your notice of objection, Mr. Beaudoin?

A. Absolutely. In our minds, Your Honour, this was the application of elementary legal principles regarding an essential clause of the contract.

Q. On May 17, 2004, when you signed this notice of objection, Mr. Beaudoin, the Town still owned the building on Hayes Street, right?

A. Yes.

Q. Is the Town still satisfied with the building?

A. There are no structural defects, though it is an oversized building.

Q. No problems with the intended use of the building, Mr. Beaudoin?

A. In terms of the intended use of the building, I believe the notary meant to say that it had to do with the 50% occupancy rule.

Q. You agree with me that this could mean plenty of things, but could also mean nothing?

A. Hence the importance of our testimony, counsel.

Q. You agree with me, Mr. Beaudoin, that, in the Notice of Appeal, the only ground for cancellation that is alleged in support of the Town's appeal pertains to the GST assessment that you received?

A. Indeed, and that is an extremely large expenditure.

. . .

[20] The parties' submissions can be succinctly summarized as follows.

The Appellant's submissions:

[21] The Appellant submits that there was a defect of consent stemming from a lack of awareness of the applicable provisions of the *Excise Tax Act* at the time that the exchange agreement was made.

[22] It submits that the fundamental reason for its consent was that the exchange would give rise to no financial obligations whatsoever.

[23] Indeed, it is saying that if it had known, at the time of the exchange, that GST was payable on the value of the consideration despite the absence of a cash adjustment, it would not have signed the deed of exchange.

[24] Lastly, the Appellant submits that the cancellation of the exchange, and of the effects thereof, may be set up against the Respondent.

The Respondent's submissions:

[25] The Respondent, for her part, submits that the November 12, 2004, cancellation of the deed under which the buildings were exchanged is valid as between the parties but cannot be set up against the Respondent.

[26] The Respondent submits that the Appellant had to report the assessed GST to the Minister and remit it.

[27] Lastly, the Respondent submits that the cancellation of the deed of exchange is merely an attempt to avoid paying the GST that is due.

Analysis

1. *The relevancy of the civil law*

[28] Before analysing the validity and the effect of the cancellation of the deed of exchange, it is important to reiterate that the transactions between the parties are governed by Quebec civil law.

[29] The Appellant cites section 8.1 of the *Interpretation Act*, R.S.C. 1985, c. I-21, which reads:

> Both the common law and the civil law are equally authoritative and recognized sources of the law of property and civil rights in Canada and, unless otherwise provided by law, if in interpreting an enactment it is necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights, reference must be made to the rules, principles and concepts in force in the province at the time the enactment is being applied.
>
> [Emphasis added]

[30] Thus, in determining the effect and validity of the cancellation of the contract, the provisions of the *Civil Code of Québec*, S.Q. 1991, c. 64 (CCQ), not common law doctrines, are relevant.

[31] In particular, the common law doctrines of rectification do not obtain in Quebec, except to the extent that Quebec courts have addressed them.

[32] According to an explanatory article by tax law specialists:

> There is an obvious corollary to the general rule that tax is imposed according to the legal relationships or transactions established by the parties. That corollary is that a legal relationship or transaction will not be recognized for tax purposes if that relationship or transaction has not been validly established under the rules of the general law. Hogg, Magee and Li, *Principles of Canadian Income Tax Law*, 18.8 - Rectification.
>
> [Emphasis added]

[33] Tax law is an accessory system of law. In *Lageux & Frères Inc.*, [1974] F.C. 97, the Court wrote, at page 103:

> [F]iscal 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 consequences 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.

[34] In *Dale v. Canada*, [1997] F.C.J. No. 476 (QL) at paragraph 13, the Court stated:

> In determining whether a legal transaction will be recognized for tax purposes one must turn to the law as found in the jurisdiction in which the transaction is consummated. Often that determination will be made without the aid of guiding precedents which are on point and, hence, the effectiveness of a transaction may depend solely on the proper application of general common law or equitable principles. In some instances it will be necessary for the Tax Court to interpret the statutory law of the province. As for the Minister, he must accept the legal results which flow from the proper application of common law and equitable principles, as well as the interpretation of legislative provisions.
>
> [Emphasis added]

[35] Indeed, this principle was propounded in *Wilson v. The Queen*, [1983] 2 S.C.R. 594:

> That decision establishes the general rule that an order of a superior court cannot be attacked collaterally unless it is lawfully set aside.

[36] The last point to be made about this aspect of the matter is that the validity of the two contracts between the Appellant and CPIR must be determined based on the requirements of the *Civil Code of Québec*.

2. *The validity of the deeds of exchange and cancellation under Quebec civil law*

[37] The equitable doctrine of rectification is not recognized by the Quebec civil law. In the common law system, rectification is associated with the concept of mistake. There are three types of mistake in the common law system: common mistake, mutual mistake and unilateral mistake. All three can be rectified under certain circumstances.[1] What must be borne in mind is that [TRANSLATION] "[w]hen the mistake goes to consent, the rules of rectification cannot intervene."[2]

[38] This is especially relevant because the Appellant is indeed arguing that the deed of exchange is null based on the principle of vitiated consent.

[39] In Quebec, error is defined with reference to consent.[3] There are two types of error: material errors and errors of consent. The first type of error does not vitiate consent and can be corrected under certain circumstances, whereas the second type, an error of consent, causes the contract to be either absolutely or relatively null (articles 1416-1419 CCQ).[4]

[40] In the case at bar, the Appellant argues that it can have the deed of exchange set aside because the contract is null, as the Town made an error of consent, thereby making it unnecessary to address the question whether there was a material error, also known as an error in form.

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[1] Chikwa Zahinda, "La doctrine de rectification de contrats et son application en droit fiscal : étude comparée des principes de common law, droit civil et droit corporatif" in (2006) 27 Rev. planif. fiscale et successorale (APFF), at 24.
[2] *Ibid*., at 26.
[3] *Ibid*., at 45.
[4] *Ibid*., at 45 and 84-85.

[41] At page 116 of the transcript, the Appellant submits:

> [TRANSLATION]
>
> Civil law provides us with a method that can be used to correct a purely material error. However, errors that vitiate consent cause the contract to be invalid, and, where such an error has been made, one does not rectify the document or apply to have it corrected; rather, the document is cancelled.
>
> [Emphasis added]

[42] In other words, in order to be able to annul the deed of exchange, the Appellant must show that it made an error of consent. However, since it had CPIR's blessing, it chose not to do this, but, rather, to enter into a second contract under which the deed of exchange was cancelled so that it would not have to ask the courts to declare it null. The civil law doctrine calls this [TRANSLATION] "uncontested nullity" or [TRANSLATION] "conventional nullity."[5]

[43] The Appellant submits that, since it entered into the second contract before a notary, the Court has no choice but to acknowledge the transactions between the Appellant and CPIR.[6]

[44] The Appellant cites Zahinda for the proposition that [TRANSLATION] "it is not necessary to obtain a court order to correct a document that does not correctly reflect the parties' intentions."[7] However, it bears repeating that the corrections referred to in Mr. Zahinda's article are related to material errors, not errors of consent; thus, this argument does not apply to the case at bar.

[45] Based on the same article, the Respondent submits that it is only where the nullity of a transaction has been declared by a court that such nullity is binding on Revenu Québec. Judge Archambault of this Court stated as follows in *Ledoux v. The Queen*, [1997] TCJ No. 1097 (98 DTC 1034 (French) affirmed, 2000 DTC 6465 (Eng.), application for leave to appeal to the Supreme Court dismissed, 263 N.R. 395):

> **36** Before deciding whether this argument is valid, it is worth recalling the approach that must guide the Court in this undertaking. When taxpayers have engaged in transactions the primary purpose of which is to obtain tax benefits, the courts must be especially diligent in ensuring that those transactions correspond to the taxpayer's true intent and also that they are legally valid and complete transactions. The courts have developed several judicial tools to

[5] P. Malaurie, L. Aynès and P. Stoffel-Munck, *Les obligations*, 2d ed. (Paris: Defrénois, 2005), at 330.
[6] Transcript, March 6, 2007, at 118-120.
[7] *Supra* note 5, at 50 and 57.

help them in this undertaking, in particular the concept of the sham, the ineffective operation and the actual nature of a transaction. In *Stubart Investments Ltd. v. The Queen*, [1984] 1 S.C.R. 536, at 545, Estey J. proposed the following definition of a sham:

> . . . a transaction conducted with an element of deceit so as to create an illusion calculated to lead the tax collector away from the taxpayer or the true nature of the transaction; or, simple deception whereby the taxpayer creates a facade of reality quite different from the disguised reality.

37 Application of the second tool is relatively straightforward. The Court must minutely scrutinize whether the transaction used by the taxpayer, such as a contract, is a real transaction from the standpoint of formal as well as substantive conditions. Urie J. gave a good description of the application of this tool in *Atinco Paper Products Ltd. v. The Queen*, 78 D.T.C. 6387, at 6395:

> It is trite law to say that every taxpayer is entitled to so arrange his affairs as to minimize his tax liability. No one has ever suggested that this is contrary to public policy. It is equally true that this Court is not the watch-dog of the Minister of National Revenue. Nonetheless, it is the duty of the Court to carefully scrutinize everything that a taxpayer has done to ensure that everything which appears to have been done, in fact, has been done in accordance with applicable law. It is not sufficient to employ devices to achieve a desired result without ensuring that those devices are not simply cosmetically correct, that is correct in form, but, in fact, are in all respects legally correct, real transactions. If this Court, or any other Court, were to fail to carry out its elementary duty to examine with care all aspects of the transactions in issue, it would not only be derelict in carrying out its judicial duties, but in its duty to the public at large.
> [My emphasis.]

38 *Stubart* provides an illustration of this duty of the courts: in that case the taxpayer met the standard. In *Atinco*, however, the taxpayers were not so successful.

39 The third tool, the concept of the actual nature of the transactions, has prompted and continues to prompt problems of application. According to that theory, in assessing a transaction the courts must look at the commercial and economic reality of the transaction. In *Bronfman Trust v. The Queen*, [1987] 1 S.C.R. 32, at 53, Dickson C.J. said:

> Assessment of taxpayers' transactions with an eye to commercial and economic realities, rather than juristic classification of form, may help to avoid the inequity of tax liability being dependent upon the taxpayer's sophistication at manipulating a sequence of events to achieve a patina of compliance with the apparent prerequisites for a tax deduction.

40 There are those who think, and I agree with them, that this approach does not mean the courts may disregard the legal consequences of a transaction. In *Continental Bank of Canada et al. v. The Queen*, 94 D.T.C. 1858, at 1869, Judge Bowman clarified the meaning of this principle as follows:[5]

> So far as the broader question of substance versus form is concerned, we should at least be clear on what we are talking about when we use the elusive expression "substance over form". Cartwright, J. (as he then was) said in *Dominion Taxicab Assn. v. M.N.R.*, 54 D.T.C. 1020 at p.1021:
>
> > It is well settled that in considering whether a particular transaction brings a party within the terms of the Income Tax Acts [sic] its substance rather than its form is to be regarded.
>
> His Lordship did not elaborate but in light of other authorities I do not think that his words can be taken to mean that the legal effect of a transaction is irrelevant or that one is entitled to treat substance as synonymous with economic effect. The true meaning of the expression is, I believe, found in the judgment of Christie, A.C.J.T.C.C. in *Purdy v. M.N.R.*, 85 D.T.C. 254 at p. 256, where he said:
>
> > It must be borne in mind that in deciding questions pertaining to liability for income tax the manner in which parties to transactions choose to label them does not necessarily govern. What must be done is to determine what on the evidence is the substance or true character of the transaction and render judgment accordingly.
>
> [Emphasis added]

[46] Thus, the Appellant must show that its consent was defective. Specifically, it must prove that the error of consent was determinative and prevented it from entering into the contract of exchange and from consenting to it in a free and enlightened manner.[8]

[47] The facts, as established by the evidence, suggest three possible scenarios:

(1) there was an error that did not vitiate the Appellant's consent at the time that it entered into the contract of exchange;

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[8] *Supra* note 3. Article 1398 CCQ: Consent may be given only by a person who, at the time of manifesting such consent, either expressly or tacitly, is capable of binding himself. Article 1399 CCQ: Consent may be given only in a free and enlightened manner. It may be vitiated by error, fear or lesion.

(2) there was an error with respect to an essential and foundational element of consent, but since the error is inexcusable, it does not warrant the retroactive cancellation of the contract; or

(3) consent was vitiated in such a manner as to cause the contract of exchange to be null retroactively.

[48] Article 1400 CCQ explains the situations in which error vitiates consent:

> 1400. Error vitiates consent of the parties or of one of them where it relates to the nature of the contract, the object of the prestation or anything that was essential in determining that consent.
>
> An inexcusable error does not constitute a defect of consent.
>
> [Emphasis added]

[49] Baudouin and Jobin write:

> [TRANSLATION]
>
> Error is a "belief inconsistent with the truth," a "discrepancy between what one intends and how one has expressed one's intent," which compromises the integrity of one's consent to a juridical act. However, the circumstances in which error is allowed to result in the nullity of a contract are subject to certain limitations aimed at protecting the stability of contracts. Only certain types of errors, which have a determinative influence on consent, will be allowed to annul a contract.[9]

[50] Clause 6 of the contract to cancel the deed of exchange lists the reasons therefor:

> [TRANSLATION]
>
> The parties are of the opinion that there were, among other things, errors with respect to the nature of the contract, the object of the prestation, and various elements that were essential in determining each party's consent, including, among other things, an error with respect to the intended use of each building, the value of each building and the absence of a cash adjustment, which absence was erroneous under the circumstances.[10]

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[9] Jean-Louis Baudouin and Pierre-Gabriel Jobin, *Les obligations*, 6th ed. (Cowansville: Yvon Blais, 2005) at 277.

[10] Exhibit A-5: Cancellation of exchange, section 6.

[51] The Respondent vigorously contested the Appellant's submissions, notably with respect to the error concerning:

(1) the nature of the contract;[11]

(2) the object of the prestation;

(3) the intended use of each building; and[12]

(4) the value of each building.[13]

[52] The facts show that the only element giving rise to the error which was allegedly essential in determining consent was the absence of a cash adjustment.[14] Indeed, the excerpts from the testimony of Mr. Lafleur and Mr. Beaudoin, reproduced at paragraph 19 of this judgment, show this conclusion very convincingly.

[53] The Appellant submits that one of the essential or determinative elements of consent was the fact that there were no outlays of any kind following the exchange of the buildings.[15]

[54] If such an error did vitiate its consent, it can, in theory, seek the cancellation of the deed of exchange based on article 1407 CCQ:

> 1407. A person whose consent is vitiated has the right to apply for annulment of the contract; in the case of error occasioned by fraud, of fear or of lesion, he may, in addition to annulment, also claim damages or, where he prefers that the contract be maintained, apply for a reduction of his obligation equivalent to the damages he would be justified in claiming.
>
> [Emphasis added]

[55] In order to have the first contract (that is to say, the deed of exchange) cancelled, the Appellant must show that the error, which must be a juridical fact,[16] is an error within the meaning of the CCQ; and that the nullity of the deed of exchange is effective against third persons, including the Minister.

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[11] *Supra* note 10; Transcript, at 31-32 and 39. The nature of the deed of exchange was an exchange of immovables.
[12] *Ibid*, at 28-30, 46-47, and 68.
[13] *Ibid*., at 30.
[14] *Ibid*., at 34 and 39. *Contra* page 31.
[15] *Ibid*., at 36 and 96.
[16] *Supra* note 14, at 291.

[56] As for the Respondent, she submits that, according to the case law and the doctrine to which the Appellant has referred, the error was not related to an essential element of consent, but was essentially economic in nature, and therefore may not lead to the nullity of the deed of exchange. The Respondent refers to *Anna Del Peschio-Carpanzanon v. 3660524 Canada Inc.*, [2005] J.Q. No. 1747 (QL):

> [TRANSLATION]
>
> 33. Although error is one of the grounds based on which contracts can be cancelled, only certain errors entitle a party to apply for the resolution of a contract. The principle that contracts should be stable remains a foremost and essential principle of Quebec civil law.
>
> 34. It is only if and when special and specific circumstances have been proven, and it has been shown that the error was related to the essential element that caused the parties to enter into the contract, that it can be cancelled or resolved.
>
> 35. It is also important to note that error will never be a ground for nullity where it is inexcusable or pertains to the economy of the contract, or even if it is a mere error of form.
>
> 36. In *Les obligations*, *supra*, Baudouin and Jobin specify as follows:
>
> > [TRANSLATION]
> > 211 - Economic error - Since there is a principle that a contract cannot be cancelled or revised on the basis of lesion (art. 1405 CCQ) and the Civil Code must be interpreted consistently, a certain limitation must be applied to error. An economic error, or an error with respect to the value of the object of a prestation, is generally not considered a ground of nullity. [See Note 5 below]. . . .
>
> ---
>
> Note 5: For example, see *Racicot v. Bertrand*, [1976] C.A. 441, rev'd [1979] 1 S.C.R. 441; J.-L. Baudouin, 1 Supreme Court L. Rev. 249; *Québec (Communauté urbaine de) v. Constructions Simard-Beaudry (1977) Inc.*, [1985] C.S. 983, aff'd J.E. 87-974 (C.A.); *Beaurivage et Méthot Inc. v. Corporation de l'Hôpital du St-Sacrement*, [1986] R.J.Q. 1729 (C.A.); *Cayer v. Martel*, J.E. 95-2071 (C.A.); *Réalisations Solidel Inc. v. Havre du village international Inc.*, J.E. 95-1229 (S.C.); Pineau, *Existence et limites de la discrétion judiciaire*, *supra* note 112, at 5-6; Pineau, Burman and Gaudet, *Obligations*, no. 74, at 119-120; Tancelin, *Obligations*, no. 178, at 87.
>
> ---
>
> 37. In 1995, the Court of Appeal issued the following reminder about economic error:

> [TRANSLATION]
>
> As we know from the doctrine and the case law, the second is that an error pertaining merely to value, that is to say, [on the basis of economic error (except, of course, in the event of lesion)], in principle, a cancellation may not be sought.
>
> Indeed, an error that is determinative as to consent is not an error related to the principal consideration for the obligation. . . .
>
> . . . In my opinion, one can indeed envisage situations in which the economic imperatives of the proposed contract are absolutely central to the decision to enter into a contract and therefore rise to the level of principal consideration and very condition of the obligation. However, such a determinative ground must still have been outwardly expressed. . . . [See Note 6 below].

Note 6: *Cayer v. Martel* (Que. C.A.) Montréal, 500-09-001620-905, November 7, 1995, Rothman, Baudouin and Deschamps JJ.A.

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38. The accountant, Mr. Rabinovitch, did indeed explain to the Court that the purpose for which 3660524 Canada Inc. was created was a tax rollover. The transfer of the shares of CGI or Global Creations Inc. into 3660524 Canada Inc. and the creation of the latter company were intended as a way to avoid paying tax on the company's high income.

39. It is true that this share rollover was not supposed to have any other tax consequences, and that losing this tax holiday was of no benefit to the shareholders.

40. Nonetheless, the evidence shows that the main objective of the creation of that company was a tax rollover.

41. The Court of Appeal also wrote the following on this subject in 1996:

> [TRANSLATION]
>
> In my opinion, one cannot empty the form of the existing contractual relationship of all its meaning in order to tailor one's arguments to tax-related constraints after the fact. The Appellant opted for an assignment of a contract of sale when it could just as well have chosen to proceed by way of a contract of loan. Consequently, the Appellant must bear the consequences tied to the form of contract that was chosen. Le Dain J.A., as

he then was, of the Federal Court of Appeal, wrote:

> The incidence of taxation depends on the manner in which a taxpayer arranges his affairs. Just as he may arrange them to attract as little taxation as possible, so he may unfortunately arrange them in such a manner as to attract more than is necessary. [See Note 7 below.]

Note 7: *Banque Nationale Inc. (Crédit-bail) v. Québec (Sous-ministre du Revenu)*, (C.A.) Montréal, 500-09-000351-932, September 15, 1997, Beauregard, Nuss and Forget JJ.A, at 6, paragraph 30.

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42. The case at bar is distinguishable from *B.E.A Holdings Inc. v. Trafsys Inc.* [See Note 8 below] cited by the Applicant, where B.E.A., an American company, purchased Trafsys Inc. of Canada. The federal Act provides that, in such a process, the majority of Trafsys's new board of directors must nonetheless be Canadian. B.E.A. therefore developed a strategy in which a Quebec company would be created and would be the transferee of all of B.E.A's holdings in Trafsys. After this, the two companies, Trafsys Inc. and Trafsys Communications Inc., could be amalgamated.

Note 8: *B.E.A. Holdings Inc. v. Trafsys Inc. et Trafsys Communications Inc./Les Communications Trafsys Inc.*, (C.A.) Montréal, 500-09-013408-034, February 12, 2004, Delisle, Chamberland and Morissette JJ.A; C.S. Montréal, 500-05-074753-029, April 16, 2003, *per* Dufresne J.

---

43. The Superior Court, before which had been brought an action to cancel that transaction on the basis of an error made in good faith, dismissed the claim.

44. The Court of Appeal reversed this decision in a very succinct decision, writing:

> [1] It is clear from the evidence that the factor that was essential in determining the Appellant's agreement to participate in the sale of November 19, 2001, was that the sale would have no tax consequences.
>
> [2] The objective was simply to resolve a governance issue, and the Appellant merely sought to restructure in order to achieve it.
>
> [3] Based on the very specific circumstances of the case at bar, the

> Appellant's error was not inexcusable, and related to an essential element of the consent.

45. Upon a reading of this decision, it appears that economic error can be a basis for annulling a contract where the economic error pertains to the essential element of the transaction. The absence of tax consequences was the determinative reason for creating the Quebec company.

46. Now, in the case at bar, as we have already seen, the tax consequences associated with the creation of the new company was a rollover that deferred a tax liability.

47. The Ontario Court of Appeal had to address a question similar to the instant tax issue, and, although its decision is not fully apposite in the case at bar, it is worth noting. The Court wrote:

> The second reason why I would not exercise equitable discretion in the appellants' 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.
>
> The fundamental principle is stated by McKinlay J. in *Re Assaly and Minister of Revenue* (1986), 56 O.R. (2d) 30 at p. 40:
>
> > . . . the law is quite clear that when a taxpayer orders his affairs in a manner that attracts a tax in one amount, he cannot subsequently claim that he should be taxed as if he had ordered his affairs in a different manner, which would have attracted less tax.

[57] Mr. Lafleur, the director of CPIR, explained and described the reasons for the exchange in the following terms:

> [TRANSLATION]
>
> In my capacity as director of the Comité de Promotion Industrielle, I managed buildings, including a building that I rented to the municipality as a municipal garage, and the municipality also asked me to manage one of its own buildings for industrial purposes. . . .

> So, at a certain point each year, the people from the municipality get together [for what is known in French as a *lac-à-l'épaule*] to work out the broad outlines of their strategy. [17]
>
> . . .
>
> It's an exercise in which each sector will determine ... with respect to recreation, the economy or what you might call social and community issues ... will ask the municipality, propose things, ask it for some broad policy. From the economic standpoint, in the wake of the situation that I explained to you, I made the following proposal to the town council: Listen. You occupy a building that I built for commercial purposes ... and it's still for commercial purposes because the municipality was paying me rent, and I paid the GST and QST on that rent. . . . I told them this: This building over here belongs to you, and that one belongs for me, so why don't we do an exchange? Let me have your building for industrial purposes, and, well, you occupy it as a garage. We'll exchange it ... Look, we'll do a straight trade, and can give each other the buildings that way. Each building is of equal value, and each will fulfil the respective parties' missions. The town didn't want to manage buildings for industrial purposes anymore, but it had to do so because the building was built in 1956.[18]

[Emphasis added]

[58] It has been established clearly, on a balance of probabilities, that the Appellant's consent was not vitiated by one of the errors set out in article 1400 CCQ.

[59] Mr. Lafleur explained that the contract of exchange was entered into in order to [TRANSLATION] "make things easier for everyone." Thus, the contract of exchange was entered into for practical and rational reasons: the buildings concerned would be easier, and, above all, more sensible to manage. These appear to be economic circumstances that do not make the exchange of 2002 a nullity.

[60] However, in *B.E.A. Holdings Inc. v. Trafsys Inc.*,[19], the Court held that a contract can be cancelled based on an economic error where the error is the essential element of the transaction. Thus, in my decision, I must assess whether the error alleged by the Appellant was essential to its consent.

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[17] *Supra* note 10, transcript, at 12.
[18] Ibid, at 13-14.
[19] J.E. 2003-1102 (Que. S.C.), reversed on other grounds, [2004] J.Q. No. 646 (QL) (Que. C.A.).

Essential but inexcusable error

[61] The Appellant submits that the error was not an economic error but, rather, an essential error that vitiated its consent. The Appellant's two witnesses stressed repeatedly, and in several different ways, that if the parties had known that the transaction was taxable, it would never have taken place. In fact, this was very clear from the testimony that each of them gave.

[62] The explanations described in clause 6 of the contract of cancellation are not at all persuasive. And it was quite clear to me that the notary essentially put his imagination to work when he drafted the contents of that provision. The evidence does not give rise to any confusion or even to any problem of interpretation. The parties essentially agreed to cancel the transaction in order to avoid the assessment.

[63] However, the same evidence also raises the following question. Given the belief that the transaction was not subject to the provisions of the Act that pertain to the Goods and Services Tax, can the transaction be cancelled on the ground that there was a defect of consent resulting from the lack of knowledge of the tax consequences?

[64] I consider it important to note from the outset that it would be unusual for ignorance of the Act to be a valid ground for cancelling a contract, especially since all those involved, notably the notary who was responsible for drafting the contract, were, or should have been, knowledgeable.

[65] In addition, cancellation has the effect of putting the parties back in the situation in which they would have been before the juridical act that formed the basis of the assessment. On the other hand, it is just as obvious that such a cancellation does not affect the rights of third parties, including the Respondent.

[66] The Appellant's evidence consisted of the testimony of Mr. Lafleur and Mr. Beaudoin. Both of them have a legal education and, as very active participants, they explained how the matter developed.

[67] Mr. Lafleur testified as follows:

> [TRANSLATION]
>
> A. . . . Someone called me. I gave him explanations that reflect what I am telling you this morning. After that, there were notices of assessment and other notices, and now, we are before you.
>
> Q. And what was your reaction to those notices of assessment?
>
> A. When they issued them, I said: Listen, I said that it was clear that when we did this transaction, the *sine qua non* factor in the whole matter ... especially considering that the context was a municipality whose budget, let me tell you ... it was absolutely certain that, as far as we were concerned, the *sine qua non* basis of the exchange was that there was no impact, that is to say, there was no outlay by either side, because this was really what is called a transaction of convenience. *This was done to make it easier for all of us; in other words, instead of having something that you manage despite the fact that it is not really in your field, and, conversely, the other building, used for purposes that one would consider to be more related to community services, well it would belong to the party that was rendering those services.*[20]

[68] Mr. Lafleur also stated that one of the elements that were essential in determining both parties' consent was that there would be no financial impact, meaning no outlays at the time of the transaction. The following excerpt from the transcript reveals a great deal about the contracting parties' intentions.

> [TRANSLATION]
>
> It was done on the condition that it would be a trade, that there would be no impact, that it would cost the municipality nothing, and this was always the very basis of the essence of our transaction; it was a constant assumption that it would have no impact on our citizens. It was completely O.K. for all of us.[21]
>
> . . .
>
> [W]hen we carried out the transaction, the *sine qua non* factor in the whole matter ... especially considering that the context was a municipality whose budget, let me tell you ... it was absolutely certain that, as far as we were concerned, the *sine qua non* basis of the exchange was that there was no impact, that is to say, no outlay for either side, because this was really what one would call a transaction of convenience.[22]

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[20] *Supra* note 10, transcript, at 18-19.
[21] *Ibid.*, at 15-16.
[22] *Ibid.*, at 18.

. . .

A. Obviously, we would not even have considered the transaction ... it was clear that this was straight exchange.[23]

[69] Guylain Beaudoin, the Town Manager, explains:

[TRANSLATION]

A. …[I]t was clear in everyone's mind that this was tax-neutral and expenditure-free. So it was really an exchange of convenience in that sense. We closed the transaction in November 2002. The transaction deed, which Mr. Morel brought in earlier, refers to the absence of a cash adjustment. When we appeared before the notary, I certainly didn't sign at the same time as Mr. Martel, but we had received the documents; we had met with the notary beforehand to explain the context of the transaction to him. The explanation with respect to the GST and QST was that since there was no cash adjustment and there were truly no outlays, this was a tax-neutral transaction.[24]

[70] According to the Appellant's two witnesses, the consent was vitiated because there was an error with respect to an essential element of the contract. The veracity of this contention does not seem to be in dispute, although the evidence was that the error was rather economic in nature; it did not relate to an essential element of consent. It is clearly reasonable to believe that the contracting parties would not have entered into the transaction if they had known that there would be an assessment, since the Town did not have the financial wherewithal to handle an assessment.

[71] Having determined that the Appellant has met its onus of proving that there was genuinely an error, I must now determine whether it was an inexcusable error within the meaning of paragraph 1400(2) of the CCQ.

[72] Beaudoin and Jobin write that, in excluding the possibility of cancellation in the event of an inexcusable error, Quebec law draws its inspiration from French law. This rule against cancellations encompasses the notion that the order established by contracts should be stable[25] and the idea that each person must inform him or herself before entering into a contract or transaction. It is a well-established rule. And since the issue of the actors' personal or professional liability

[23] *Ibid.*, at 21.
[24] *Ibid.*, at 51-52.
[25] *Supra* note 14, at 277.

does not come within this Court's jurisdiction, I shall not devote any more time to it.

[73] The aforementioned authors are of the opinion that inexcusable error by one party to the contract must be proven by the other.[26] Here, not only did CPIR, the "other party" in this instance, not dispute the existence of an error of consent, it agreed that such an error was made because it has an interest in the success of the Town's appeal, having consented to the cancellation of the contract before the notary.

[74] The case at bar is unusual in that both parties admit to the existence of the error, and this unusual aspect poses the problem of determining who has the burden to prove that the error was inexcusable. In theory, it lies on the co-contractor who is opposed to the contract's cancellation.[27] However, in the case at bar, the Appellant's co-contractor consented to the cancellation of the deed of exchange.

[75] Assuming that the Appellant has shown that the error meets the requirement set out in article 1400(1) CCQ, it is up to the Respondent to show that the error was inexcusable.

[76] What does the evidence on this point show us? I believe that the following excerpt answers this important question.

> [TRANSLATION]
>
> Q. I refer you to the last paragraph of page 8...
>
> A. Yes...
>
> Q. ...where it says, among other things: [TRANSLATION] "Consequently, the liability to pay the Goods and Services Tax and Quebec Sales Tax is borne by each party that has received an immovable in the exchange."
>
> A. Yes, and, as I noted earlier, the distinctive element of the transaction that caused us to consent to it was that there was no such impact...
>
> Q. Naturally, before you signed that transaction, the legal document was seen by your legal advisors, right?
>
> A. We don't have legal advisors, but yes, I read it.

---

[26] *Ibid*., at 292.
[27] *Ibid*., at 292.

Q. You read it. In any event, there was a notary who prepared that deed, a notary by the name of Denis Tanguay, correct?

A. Yes.

Q. I imagine that the contract was reviewed by Mr. Tanguay and that the parties were present before the exchange was signed?

A. Yes, indeed.

Q. If I understand correctly, the only reason that you proceeded to annul that deed of exchange two years later was that the municipality of Richmond had to pay GST and QST.

A. That was the consequence, but the actual basis was the following thing that I was told when they brought it to me: Look, when we entered into the transaction with you — the CPIR, that is — you told us that there would be no actual outlay in relation to it, and that was the basis. The municipality told me that if they had known, they would never have consented to that, or to anything else. I said listen, that was why we took part in it.

Q. Yes, but, Mr. Lafleur, you agree with me, do you not, that the reason that the transaction was cancelled was the GST and QST consequences?

A. I agree that there was definitely a consequence to the transaction.

Q. Yes, but the only reason — and I am coming back to this question — the only reason that the transaction was cancelled was the GST and QST consequences, correct?

A. Well, seeing that we are before you, that is certainly true.[28]

. . .

Q. So, Mr. Tanguay had explained this at the time that ...

A. Mr. Tanguay. Yes.[29]

. . .

Q. Just a few questions to clarify. Mr. Morel noted that the deed of exchange contained a tax clause. At the time that you signed, or at any earlier time, did Mr. Tanguay give you advice about that, or tell you that there was no tax? What did Mr. Tanguay tell you at the time that the document was signed?

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[28] *Supra* note 10. Transcript, at 24-27.
[29] *Ibid.*, at 52.

A. As far as we were concerned, there was no reference to the impact on our organization because we have all our transactions executed before Mr. Tanguay, and there is no impact with respect to that. In every case, each party is responsible...

Q. But, was that raised at the time of the transaction or anything?

A. No, no.

Q. Were you both present at the time that the deed was signed? Because, if you look at the dates on the deed of exchange ... I am not sure if you are the one who has it. No, you have the deed of cancellation. As for the deed of exchange, if you look, just clarify for us how the signature was made. Were all the parties in attendance at the time of signing?

A. I can't answer that because I was not a signatory. The signatory was the president of the organization. . . .

A. I wasn't present. Michel Ménard, the president of the organization, was there to sign; I don't have the authority to sign contracts of sale, it's the president who has that authority. I was sent a draft beforehand, and I read it and returned it to my president, at which time I told him that it would not be a problem for him to sign it.[30]

. . .

Q. Mr. Lafleur, I presume that you know Mr. Beaudoin well?

A. Yes.[31]

. . .

Q. In fact, speaking of Mr. Beaudouin, we recently learned … we know that you are a lawyer, and we just learned that Mr. Lafleur (the director of CPIR) is a lawyer, and you were with the notary Mr. Tanguay in 2004 before signing that contract, so you were very well-informed parties and you drafted clause 6 (contract of cancellation).

A. I did not draft clause 6.[32]

[77] The evidence shows, on a balance of probabilities, that the error of consent alleged by the Appellant is inexcusable, notably because of the expertise of the persons involved: both Mr. Beaudoin and Mr. Lafleur were lawyers. In the light of

[30] *Ibid*., pages 43-45.
[31] *Ibid*., at 41.
[32] *Ibid*., at 67.

this evidence, which was highly persuasive, I find that the error of consent on which the Appellant is relying is inexcusable.

[78] The parties unquestionably had the skills necessary to at least have the reflex to raise questions and check what the provisions of the relevant statute had to say.

[79] Parties must always take the tax consequences of their transactions into account. The parties in the instant case had a duty to get informed before entering into a contract before the notary.

[80] The exchange was only cancelled in 2004, when the second contract (of cancellation) came into force. That cancellation was valid between the contracting parties and could be set up against third parties, but only in 2004, because it had no retroactive effect on third parties. Consequently, the assessment is valid.

[81] For the above reasons, I would dismiss the appeal because the Appellant has no right to seek to have the contract cancelled on the ground of inexcusable error.[33] Consequently, the effect of the contract of cancellation signed in 2004 is not retroactive. Even if I had not determined that the error was inexcusable, I would have to dismiss the appeal on another basis. Indeed, I would have had to take the following provisions into account.

Vitiated consent and valid nullity of the deed of exchange

[82] Article 1416 CCQ provides as follows:

> 1416. Any contract which does not meet the necessary conditions of its formation may be annulled.

[83] The effect of the nullity of the deed of exchange is set out in article 1422 CCQ

> 1422. A contract that is null is deemed never to have existed.
>
> In such a case, each party is bound to restore to the other the prestations he has received.

[33] For examples of cases in which the court did not grant a cancellation of a contract on the basis of an inexcusable error, see *Société québécoise d'assainissement des eaux v. B. Fréjeau & Fils Inc.*, J.E. 2000-809 (Que. C.A.); *Construction D.R.C. Rousseau Inc. v. Enchères de Chez nous Inc.*, [1997] R.D.I 261 (Que. S.C.). *Royal Bank of Canada v. 2969408 Canada Inc.*, S.C. Montréal, 500-17-010040-015, May 16, 2002, *per* Justice Carole Hallée; *Bonin v. Picard* [2004] R.R.A. 910 (Que. S.C.).

> 1440. A contract has effect only between the contracting parties; it does not affect third persons, except where provided by law.

[84] Since the deed of exchange is null, it is deemed never to have existed. The effects of cancellation are different from the effects of resolution, resiliation or revocation. The form is not, in fact, corrected.

[85] In order to better understand the concept of annulment, the Court will reproduce some of the Respondent's submissions about the distinctions that must be drawn between resolution, resiliation and revocation.

> [TRANSLATION]
>
> Resolution makes it possible to retroactively cancel a deed where a party has failed to perform the contract (e.g. resolution of a sale for non-payment of the price) whereas nullity can only be applied for in cases where there is a defect in the formation of the contract.
>
> Resiliation makes it possible to cancel a contract of successive performance prospectively (e.g. resiliation of a lease).
>
> Unlike cancellation, revocation enables a party to unilaterally terminate a juridical act (e.g. revocation of a mandate or will). Revocation does not necessarily entail a restoration of the parties to a prior situation, whereas cancellation does.

[86] Thus, we must determine precisely what the contract of cancellation was.

[87] Under article 1422 CCQ, an annulled contract is deemed never to have existed. Thus, each party must restore to the other what he has received. There is a retroactive effect in that the parties are put back in the same starting position that they would have been in if they had never entered into the contract.

[88] Rather than applying to a court for an annulment with retroactive effect, the parties agreed to cancel the deed of exchange before a notary. Consequently, the effects of this conventional cancellation apply only to the parties, as provided for in article 1440 CCQ.

[89] What is the situation of third parties, such as the Respondent?

[90] The Respondent submits that the retroactive effect referred to in article 1442 CCQ applies to the parties to the proceeding, and that attracts the application of the rule concerning restitution provided for in articles 1699 to 1707 CCQ.[34] She cites article 1707 CCQ, which states as follows, in support of her submissions:

> 1707. Acts of alienation by onerous title performed by a person who is bound to make restitution, if made in favour of a third person in good faith, may be set up against the person to whom restitution is owed. Acts of alienation by gratuitous title may not be set up, subject to the rules on prescription.
>
> Any other acts performed in favour of a third person in good faith may be set up against the person to whom restitution is owed.

[91] The Respondent correctly submits that the "amicable" or conventional cancellation cannot be set up against interested third persons.[35] She also cites *Placements Gentica Inc. v. Québec (Sous-ministre du Revenu)*, [1998] R.D.R.Q. 281 (C.A.) in support of her submission that the second contract, which cancelled the first, had no retroactive effect for the purposes of the *Retail Sales Tax Act*.

[92] In addition, the Respondent cites Karim:

> [TRANSLATION]
>
> In any event, the parties can agree to declare that their contract is null. . . . However, the parties cannot agree that their contract is null to the detriment of a third party who, by virtue of the signing of the contract, has the right to follow the property; the third party can validly object to any agreement that does not take the rights that he has acquired in good faith into account, and he can have the agreement declared ineffective against third parties.[36]

[93] In *B.E.A. Holding*, the parties admitted that they needed the court's authority to recognize retroactive nullity with respect to third parties.

> [TRANSLATION]
>
> 22. The parties admit that, being related companies, they could simply agree to annul the contracts, but the cancellation of these transactions would have no retroactive effect on third persons, including the tax authorities. The applicant therefore asks this Court to declare these contracts and other written deeds null, with retroactive effect.

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[34] Outline of Respondent's submissions, at 7.
[35] *Supra* note 9, at 330.
[36] V. Karim, *Les obligations*, vol. I, 2d ed. (Montréal: Wilson & Lafleur, 2002), at 288.

[94] For all these reasons, the appeal is dismissed in part, with costs to the Respondent; the assessment should be amended on the basis that the fair market value of the building was established by consent of the parties at $850,000.

Signed at Ottawa, Canada, this 4th day of September 2007.

"Alain Tardif"

Tardif J.

Translation certified true
on this 28th day of February 2008.

François Brunet, Revisor

CITATION:	2007TCC336
COURT FILE NO.:	2005-394(GST)G
STYLE OF CAUSE:	Ville de Richmond and Her Majesty the Queen
PLACE OF HEARING:	Sherbrooke, Quebec
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REASONS FOR JUDGMENT BY:	The Honourable Justice Alain Tardif
DATE OF AMENDED JUDGMENT:	September 4, 2007

APPEARANCES:

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