Federal Court of Appeal confirms a specific pleading of sham increases certainty

October 22, 2021

In the recent *Canada v. Pomeroy Acquireco Ltd., 2021 FCA 187* decision, the Federal Court of Appeal (FCA) dismissed the Tax Court of Canada's *decision* to deny the Crown leave to file an amended reply pursuant to section 54 of the *Tax Court of Canada Rules (General Procedure),* SOR/90-688a.

In allowing the appeal and the related amendments to the reply, the FCA held that the Tax Court made three errors of law in originally dismissing the Crown's motion for leave to file an amended reply.

The errors

First, the FCA held that the Tax Court applied the improper test for determining whether to allow an amendment. Contrary to the Tax Court's holding that an amendment must be 'vital' to the case in order to be allowed, the FCA reiterated that the controlling principle that courts must apply when considering whether to allow an amendment is that any such amendment should be allowed at any stage if it assists in determining the real issue, provided it would serve the interests of justice and that it would not result in a non-compensable injustice.

Second, the FCA considered the impact of a miscommunication made at trial. At trial, the Tax Court indicated it was satisfied that the facts contained in the existing reply were sufficient to support a sham argument. Relying on this, counsel for the Crown conceded at trial that it did not require the sham argument amendments contained in the proposed paragraphs. This concession was based on the premise that the Court was satisfied that the facts as alleged would be sufficient to support a sham argument if the Crown were to make the argument at trial. However, in the reasons for judgment, the Tax Court clarified that while the existing reply **did not** permit the Crown to raise the issue of sham at trial, it was sufficient for the Crown to challenge the nature of the underlying transactions at issue and argue that they were false or speciously mischaracterized. The FCA held that this misunderstanding resulted in an impediment of the Crown's right to be heard and have a 'reasonable opportunity to present its case.'

Finally, the FCA considered the Tax Court's finding that the amendments would result in prejudice to the Taxpayer that was not compensable with costs; here, that the Taxpayer

had recently passed away and was thus no longer available to instruct counsel regarding new arguments raised by the Crown or testify to any such arguments. The FCA held the Tax Court's conclusions were irreconcilable as the proposed amendments could not be both prejudicial to the respondent and purportedly embedded in the existing reply and before the trial judge for adjudication. The FCA held that allowing the Crown to specifically plead sham would ensure clarity and certainty at trial.

Further, the FCA held:

> There is well-established jurisprudence with respect to what constitutes a sham…and denying an amendment to plead sham while at the same time allowing a plea that the transaction was "falsely and speciously mischaracterized" injects uncertainty into the proceedings. This would leave both the parties and the trial judge adrift as to what legal principles govern the presentation and assessment of the evidence. This is not in the interests of justice.

Conclusions

Contrary to the recent decision in *Paletta*,[1] the FCA's decision in *Pomeroy* indicates that the sham doctrine must be specifically plead in order to be available to the Crown.

In our view, this decision is consistent with the general requirements on pleadings, the edict that taxpayers are entitled to know the case against them and have an opportunity to meet it, and the rules of natural justice. There is now conflicting FCA decisions on the requirement that the Crown specifically plead sham in order to benefit from it at trial. Such confusion in the law makes it difficult to predict how the Tax Court will deal with similar cases in the future. Until this issue is settled, it will be important for taxpayers and the Crown alike to give careful consideration when drafting and reviewing pleadings.

* To read more about Federal Court of Appeal's rule on sham being specifically plead, see our article on the decision in *Paletta*.

[1] *Paletta International Corporation v. Canada,* 2021 FCA 182.

By

Laurie Goldbach, Elizabeth Egberts

Expertise

Disputes, Tax

BLG | Canada's Law Firm

As the largest, truly full-service Canadian law firm, Borden Ladner Gervais LLP (BLG) delivers practical legal advice for domestic and international clients across more practices and industries than any Canadian firm. With over 800 lawyers, intellectual property agents and other professionals, BLG serves the legal needs of businesses and institutions across Canada and beyond – from M&A and capital markets, to disputes, financing, and trademark & patent registration.

blg.com

BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

The information contained herein is of a general nature and is not intended to constitute legal advice, a complete statement of the law, or an opinion on any subject. No one should act upon it or refrain from acting without a thorough examination of the law after the facts of a specific situation are considered. You are urged to consult your legal adviser in cases of specific questions or concerns. BLG does not warrant or guarantee the accuracy, currency or completeness of this publication. No part of this publication may be reproduced without prior written permission of Borden Ladner Gervais LLP. If this publication was sent to you by BLG and you do not wish to receive further publications from BLG, you may ask to remove your contact information from our mailing lists by emailing unsubscribe@blg.com or manage your subscription preferences at blg.com/MyPreferences. If you feel you have received this message in error please contact communications@blg.com. BLG's privacy policy for publications may be found at blg.com/en/privacy.

© 2026 Borden Ladner Gervais LLP. Borden Ladner Gervais LLP is an Ontario Limited Liability Partnership.