Sent by email to GAAR-RGAE@fin.gc.ca

September 30, 2022

Finance Canada
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Ottawa, Ontario

RE: Canadian Chamber submission on GAAR consultations

This document constitutes the response of the Canadian Chamber of Commerce (the "Chamber") to the request of the Department of Finance ("Finance") in its August 2022 discussion paper entitled "Modernizing and Strengthening the General Anti-Avoidance Rule" (the "Paper") for feedback on specific questions raised in the Paper and other issues relating to the general anti-avoidance rule ("GAAR") in s. 245 of the *Income Tax Act* (Canada) ("ITA"). The Chamber welcomes the opportunity to articulate its views on GAAR generally and the specific issues raised in the Paper, and would be pleased to continue its dialogue with Finance on this issue at any time.

Executive Summary

The Chamber endorses the importance of GAAR in Canada's tax system. It believes that GAAR in its current form is generally achieving an appropriate balance between the competing objectives of protecting the Canadian income tax base from abusive tax planning, producing reasonably predictable results, and respecting the principle that taxpayers should be able to order their affairs to pay the least tax owing under the law within acceptable limits (of which GAAR itself is one).

The Paper's premise appears to be that some structural flaw within GAAR is preventing it from generating the results the government seeks, and that an undue level of tax avoidance is occurring as a result. The Chamber does not understand what evidence this apparent premise is based on, and encourages Finance to better articulate this. To the extent that Finance believes there are specific cases that the Crown should have won and didn't, it would facilitate the discussion to identify these and why Finance believes the result was wrong from a tax policy perspective, and the cause of such result (i.e., was there a deficiency in the rules, or did the Crown simply not make its case under the existing ones). A better understanding of the problem and the reasons for it would allow for a more targeted and effective solution.

The Chamber believes that the case for significant substantive amendments to GAAR of the type suggested in the Paper (e.g., introducing an economic substance test, shifting burden of the "misuse or abuse" element onto the taxpayer) is not apparent from the Paper's contents, and the Chamber strongly recommends against them as being unfair, unnecessary and unwarranted. In this regard, the Chamber is very strongly of the view that the government is far better placed to produce and bring forth evidence of (and to establish in court) the "object, spirit and purpose" ("OSP") of relevant ITA provisions and policies than are taxpayers, and that the burden of so doing must remain on the Crown.

The Chamber strongly supports the Paper's suggestion to take additional steps to articulate the OSP of provisions in the ITA for courts, taxpayers and tax authorities. It is essential that the government provide the courts, taxpayers and tax authorities with as much helpful evidence as possible of the OSP of relevant provisions (or the ITA as a whole), to enhance the ability of taxpayers to comply with the ITA, ensure the predictability and consistency of the tax system, and reduce the likelihood of time-consuming controversies. The Chamber supports measures to do so such as those described in the Paper, as it believes a clearer articulation of OSP by the government would address most of what appears to be Finance's concerns with the results of the GAAR jurisprudence. Specific, targeted amendments to address discrete issues (such as that announced earlier this year with respect to the definition of "tax benefit" capturing increased but unused tax attributes) are an appropriate way in which to addressed perceived deficiencies in the text of GAAR. The Chamber has a shared interest with Finance in an effective GAAR.

GAAR is meant to be a provision of last resort, applicable where the presence of abuse is clear rather than where reasonable people could differ. As such, the Chamber believes it is essential to the proper functioning of GAAR that it not amount to a "smell test", but rather that a rigorous and well-understood process for establishing the OSP of the provisions in question exist, since in most cases this is what will determine whether or not GAAR applies. The Chamber's intervention in *Deans Knight Income Corporation v. The King*, being heard by the Supreme Court of Canada on November 2, offers specific suggestions in this regard (its factum is attached as Appendix A).

As a final comment, Finance is in the process of enacting substantial changes to the reportable transaction rules (s. 237.3 of the ITA) as well as adding the notifiable transaction rules (s. 237.4 of the ITA) and reporting of uncertain tax treatments (s. 237.5 of the ITA). These reporting requirements should have the dual effect of inhibiting aggressive tax transactions as well as providing both the CRA and Finance with a significant amount of information on taxpayer activities that would in turn assist in targeting anti-avoidance legislation in the future. These initiatives should help significantly to address concerns identified in the Paper for modifying the GAAR rules and in turn position Finance to better target any such legislative changes in the future.

The Canadian Chamber of Commerce

1. Founded in 1925, the Chamber is a non-partisan, not-for-profit organization that represents nearly 200,000 businesses across Canada through its network of more than 400 affiliated chambers of commerce and boards of trade, as well as its own member companies and sectoral associations. The Chamber's members include businesses of every size, from all sectors of the economy and every region of the country, constituting a significant portion of Canada's tax base.

The Role of GAAR

2. The Chamber believes that GAAR plays an important and useful role in the Canadian tax system. The Chamber's members are themselves taxpayers collectively constituting a significant portion of the Canadian tax base, and when a small minority engage in abusive tax planning, the revenue shortfall thereby created falls on the remainder of the tax base. GAAR's role is to assist in preventing the abuse of the tax system as a "provision of last resort", while not impairing the legitimate tax planning undertaken by the vast majority who seek only to pay no more tax than the statute requires of them. As such, the Chamber has a shared interest with the government in an effective GAAR that produces "fairness" across the tax base.

3. That said, the prevention of abusive tax planning was never and is not the sole criterion for measuring GAAR's effectiveness. The Explanatory Notes accompanying GAAR's enactment described it as "a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs" (*Canada Trustco*, para. 15). At the time of GAAR's enactment, a senior Finance official described the government's objectives for GAAR as producing a rule that generates "a 'reasonably predictable result' so that taxpayers can comply with the rule, and the administration and the courts can easily apply it".[1] As such, GAAR represents a balancing of interests, one of which is respecting the basic principle "that tax planning — arranging one's affairs so as to attract the least amount of tax — is a legitimate and accepted part of Canadian tax law" (*Canada Trustco*, para. 31), and is protected ground under the Taxpayer Bill of Rights. The Chamber's understanding is that the government has not changed its view on the importance of balancing competing interests, which the Chamber believes is appropriate.

Defining the Problem

4. While the Paper includes no statistics on this point, the Crown has been successful on GAAR cases the majority of the time since the Supreme Court of Canada's first decision on this issue in 2005 (*Canada Trustco*). Of the five cases decided by the Supreme

[1] David Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988) 36:1 *Canadian Tax Journal* at p. 22.

Court for example, the Crown has won three. Of the other two, very few people in the tax community believe that the Crown should have prevailed in *Canada Trustco*, and a minority would think that it should have won *Alta Energy*.[2] As the Paper points out GAAR has been an important revenue-generator as a CRA assessing provision, and the most important and unquantifiable impact of GAAR is the deterrence of potentially abusive planning that never occurred due to the presence of GAAR.

5. Against that backdrop, the government's specific motivation for proposing significant (and in some cases far-reaching) changes to GAAR is not apparent from reading the Paper. Why exactly does the government believe that GAAR is not working as intended, and based on what evidence? GAAR is but one tool in the CRA's arsenal for preventing abusive tax avoidance, and the Paper seems to assume as a premise something not obvious to the reader.

6. There will always be specific cases on specific issues that the government feels strongly about and that it feels the need to react to. The recent amendment to the definition of "tax benefit" to include increased or preserved tax attributes even if not utilized is an example of this, and the Chamber takes no issue with it. However, the scope of many of the proposals included in the Paper is so far-reaching as to suggest that the government has much more fundamental concerns, without explaining what they are and how they manifest themselves. What are the government's expectations with GAAR that are not being met, and why? Is GAAR the right tool for meeting them? Which cases has it been unsuccessful in that it thinks illustrate a fundamental problem with the structure of GAAR (i.e., beyond that case) requiring major legislative surgery, and why was it unsuccessful in those cases (i.e., a structural flaw within GAAR or something else)? Presumably, the government is not defining success as prevailing in 100% of GAAR court cases. It would be helpful if the government would articulate more specifically what its expectations are of GAAR and why it feels they are not being met. A better explanation of the perceived problem enables a more focused dialogue on what the actual causes are and what potential solutions addressing those causes might be.

7. Similarly, it is not evident from reviewing the Paper what elements of the government's thinking have changed since the time that GAAR was initially proposed and enacted. Quite a bit of time and effort went into the design of GAAR in the 1980s, and the version ultimately enacted is significantly different from that initially proposed (i.e., significant refinements were made, as the government's thinking evolved). Understanding whether today's concerns are motivated by a change in thinking relative to the 1988 version of GAAR enacted versus a view that GAAR's original policy tradeoffs remain sound but are not being realized in practice for some reason would generate a more fruitful discussion of the potential for changing GAAR. To this end, it would be further helpful to the discussion to understand why the government made the changes that it did in the design

[2] A sixth case (*Deans Knight*) is currently before the Court, on which the Chamber is intervening to provide suggestions to the Court on creating a more rigorous and well-understood process for determining the OSP of relevant provisions in a GAAR analysis.

of GAAR over the period between initial announcement and ultimate enactment (e.g., why was an economic substance test initially proposed and later rejected; why was the "purpose" test determined to be "primary purpose" as opposed to the alternatives, etc.).

8. The Chamber further observes that not all perceived problems with the application of GAAR involve a lack of success by the Crown. As is discussed below under **Misuse or Abuse**, the absence of sufficient rigor and process in determining the OSP of relevant provisions has resulted in the Crown seeking to stretch the scope of GAAR beyond its intended limits in an effort to catch perceived "close calls." This phenomenon is exemplified by the pending appeal in *Deans Knight Income Corporation v. The King* before the Supreme Court of Canada, in which the Chamber is intervening. Any review of the effectiveness of GAAR should encompass cases of apparent overreach by tax authorities.

Tax Benefit/Avoidance Transaction

9. The concepts of "tax benefit" and "avoidance transactions" as performing a "filtering" function within the GAAR system are such that they can effectively be considered together. Both constitute a low bar to the application of GAAR, and to the extent that amendment or refinement of either is under active consideration, it would be interesting to have more data as to how frequently cases reviewed by the GAAR Committee are rejected on the basis of either of these bases versus abuse or misuse. The sample size of 24 cases in Annex A of the Paper is quite small and may not reflect how often determinations of "tax benefit" and "avoidance transaction" actually constitute real impediments to applying GAAR as a practical matter.[3]

10. The primary question on both of these concepts is, "compared to what?" The courts have established for example that the mere fact an alternative transaction would have achieved an equivalent result with more tax payable is not sufficient to establish an avoidance transaction. In considering potential amendments that would lower the bar on what constitutes an avoidance transaction, it would be helpful to confirm that the government does not propose to depart from this principle.

11. More generally, the version of GAAR enacted in 1988 reflected substantial tax policy discussion and refinement, much of which determined the circumstances in which the "tax benefit"/"avoidance transaction" concepts should play a "filtering" role. It would be helpful to understand the process by which the current versions of these concepts were settled upon and why others (including lower standards for the "avoidance transaction" test) were rejected at the time. It is certainly possible to lower further what already appears to be a very low bar for proceeding with an abuse/misuse analysis (i.e.,

[3] For example, in cases such as *Spruce Credit* the Court did not bother to make a determination on "abuse or misuse" (which the Tax Court judge found not to exist), and in *Loblaw Financial* the Crown was successful before the Tax Court of Canada without the need to have recourse to GAAR, and chose not to pursue GAAR before higher courts.

lowering the “purpose” standard, expanding the “avoidance transaction” standard to include differing choices within a particular transaction), but before doing so it would be useful to understand the circumstances in which Finance felt an absence of benefit or purpose should prevent a misuse or abuse from triggering GAAR back in 1988. Again, at some point the bar is being set so low that it amounts to requiring taxpayers to choose to proceed in a manner that yields the most tax payable, which seems both unlikely to be the government’s objective and to largely eliminate any practical purpose for having such concepts within GAAR.

Misuse or Abuse

12. Most GAAR determinations are made on the “misuse or abuse” element of GAAR. This test requires the OSP of the relevant provisions to be established (i.e., is there something more in their rationale beyond what is apparent from a fair reading of their text), and the taxpayer’s conduct to be measured against that OSP.

13. The Paper makes the following statements (pages 15 and 17):

> It can be difficult to ascertain the object, spirit and purpose of a provision of the Act, or the existence and relevance of a general scheme in the Act read as a whole, in order to determine whether abusive tax avoidance has occurred. Moreover, the courts have looked to the Crown to make persuasive submissions on the object, spirit and purpose of provisions and where the existence of abusive tax avoidance is uncertain, the courts have given the benefit of the doubt to the taxpayer.
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> . . .
>
> As the determination of the object, spirit and purpose of a statutory provision gives rise to a pure question of law, the question arises as to whether the burden should be changed in the interest of improving the effectiveness of the GAAR and the fairness of the tax system.

14. The Paper also makes the following statement (page 20):

> Where a taxpayer enters into an avoidance transaction purposefully to use the provisions of the Act to obtain a tax benefit, it stands to reason that taxpayers and their advisors are well placed to form and express opinions with respect to the object, spirit and purpose of the relevant provisions upon which they are relying. Yet, in *Canada Trustco*, the Supreme Court of Canada noted at paragraph 65 that:
>
> > The Minister is in a better position than the taxpayer to make submissions on legislative intent with a view to interpreting the provisions harmoniously within the broader statutory scheme that is relevant to the transaction at issue.
>
> As the object, spirit and purpose of the relevant provisions is a question of law to be determined based on the words in the Act and other permissible extrinsic aids (all of which are publicly available), it is not clear that the Crown is in a better position (or has any special knowledge) to establish that abusive tax avoidance exists than taxpayers are to establish that the tax benefits sought are consistent (or are at least not inconsistent) with the object, spirit and purpose of the provisions relied upon.

15. The Chamber strenuously disagrees with the foregoing statements. To begin with, the assertion that determining OSP is "a pure question of law" is not a consensus view, and if correct is true only from a narrow technical standpoint. An OSP determination may constitute a legal conclusion, but even if so, it is very much one that is dependent on proof using various extrinsic aids. Ultimately the object in an OSP determination is to determine what Parliament's intention was (or *Copthorne* (at para. 69) describes it, "the 'legislative rationale that underlies specific or interrelated provisions of the Act' (V. Krishna, *The Fundamentals of Income Tax Law* (2009), at p. 818)." As the submissions of the various parties participating in the *Deans Knight* case amply demonstrate, extrinsic aids are an essential element of establishing legislative rationale, which render an OSP determination very much not "a pure question of law" in the broader sense but rather a matter of legal interpretation to be established based on the relevant evidence (i.e., extrinsic aids) of legislative rationale.

16. Similarly, given that "legislative rationale" essentially amounts to "what was the government thinking when enacting the relevant provisions," it does not seem plausible to suggest that there could be any doubt as to whether taxpayers or the government itself is better placed to determine and then prove what the government was thinking. While some sources of evidence of legislative rationale are publicly available as the Paper states, others are not and would be known only to those within government,[4] and others are public only in redacted form (e.g., advance tax rulings such as those in issue in the *Deans Knight* litigation). The reaction from within the tax community to the idea that the government is no better placed than taxpayers to establish OSP has generated responses such as the following:[5]

> Here's the stated rationale: The government doesn't understand the intention of the tax law any better than taxpayers and therefore the onus to interpret that intention and build an argument for a misuse or abuse should not fall on the government's shoulders. The paper argues that taxpayers have just as much insight into the intention of the law as the government. Wow. Just, wow.

17. It must further be observed that the government enjoys various other advantages over taxpayers in researching and establishing OSP. In addition to having what are effectively limitless financial resources (certainly relative to any particular taxpayer), the government has the ability to pick which GAAR cases to litigate (and in which order). The government also drafts the relevant legislation and can generate as much supplementary explanatory material as desired (i.e., extrinsic aids for a court), and can change the rules whenever at its discretion. Moreover, since the Crown is by definition a party to virtually every tax case, it has the unique ability to re-use the OSP work product generated in one case over any number of other cases being litigated on the same (or

[4] The Chamber is not aware of any formal legal prohibition on the government using heretofore non-public evidence of legislative intent in a case dealing with GAAR, nor can a taxpayer possibly be aware of any such document that might be supportive of its position.
[5] Tim Cestnick, "Looming legal changes that will affect Canadians' ability to pay less tax" *Globe & Mail*, August 18, 2022.

similar) issues, such that it can spread the cost over a number of cases in a way no taxpayer can. The government has various advantages of scale and scope in GAAR cases, and whatever difficulty the Crown may experience in establishing OSP cannot possibly justify shifting that burden onto taxpayers who are already facing a distinctly uphill battle and are clearly less-well positioned to establish OSP than is the government.

18. Finally, from a practical perspective, in a GAAR case the government is by definition asserting the existence of a legislative rationale that is not apparent from a reading of the text of the statute. In such cases it is the government's position that there is something there that is not immediately evident, as defined and articulated by the government. It is only fair and logical that the government bear the burden of demonstrating the existence of such an unstated legislative rationale, and taxpayers cannot not reasonably be expected to bear an onus of disproving something that cannot be seen from the text, *viz.*, proving a negative. This is entirely consistent with GAAR's role as a provision of last resort applicable in cases of clear abuse. It was never intended (and should not be expected) to play a greater role than this, and if the essence of the government's concerns is to change this bedrock principle, it would be helpful for the government to articulate this clearly, as it fundamentally changes the discussion.

19. As discussed above, having a better understanding of the precise nature of the government's concerns with the results GAAR is currently producing would better inform the discussion about how it might be improved. However, the Chamber believes that the single most important thing the government could be doing to "improv[e] the effectiveness of the GAAR and the fairness of the tax system" is to do a better job of articulating and evidencing the OSP of the ITA's provisions. It is essential that the government provide the courts, taxpayers and tax authorities with as much helpful evidence as possible of the OSP of relevant provisions (or the ITA as a whole), to enhance the ability of taxpayers to comply with the ITA, ensure the predictability and consistency of the tax system, and reduce the likelihood of time-consuming controversies. The Chamber supports measures to do so such as those described in the Paper, as it believes a clearer articulation of OSP by the government would address most of what appears to be Finance's concerns with the results of the GAAR jurisprudence. Such articulation makes it easier for the vast majority of taxpayers who want to do so to remain compliant with the ITA, while making abusive tax avoidance harder for the small minority who do not. In so doing, the government will reduce the amount of time and expense spent (by itself and taxpayers) on resolving GAAR-based tax disputes, to the benefit of all.

20. With reference to the concern expressed in the Paper (page 16) with the Supreme Court's statement in *Alta Energy* to the effect that GAAR is intended to catch unforeseen tax strategies, the Chamber believes that the government may be reading too much into that one line, and doesn't think that in so saying the Court was indicating a refusal to apply GAAR to cases of foreseeable tax planning. As discussed in the Chamber's

factum in *Deans Knight* (attached as Appendix A), the foreseeability (or not) of a particular course of action taken by a taxpayer is simply one factor among many that informs someone undertaking an OSP analysis as to context. Logically, the text not explicitly addressing an issue (which occurs in every GAAR case) raises the question of whether or not this omission reflects a conscious choice by Parliament not to include something rather than a matter that Parliament would have included had its mind been turned to that matter. The foreseeability (or not) of that matter is simply one data point among many that forms part of the context in an OSP analysis, and the Chamber does not believe that a court would refuse to apply GAAR solely because the taxpayer's actions were foreseeable. Hopefully the Court's decision in *Deans Knight* will clarify this point.

21. The Chamber does not object to specific amendment instructing courts to consider the possibility of applying GAAR in a case where a taxpayer's actions constitute an abuse or misuse of the ITA as a whole (although as a practical matter this may be a difficult matter to establish).

22. The Chamber believes that courts undertaking a GAAR analysis are already well attuned to the concept of fairness from the perspective of both individual taxpayers and to taxpayers as a whole, and that the Paper's reference to an excerpt from paragraph 1 of *Alta Energy* imputes to it a meaning that it does not have. GAAR cannot apply without a misuse or abuse of relevant ITA provisions, which is a standard that Parliament has established as the threshold at which fairness to other taxpayers takes precedence over the fairness in allowing any individual taxpayer to reduce their own taxes owing. Hence, the "abuse or misuse" concept is inherently a reference to "fairness" for taxpayers generally, exactly as the Supreme Court of Canada described its design in *Lipson* (para. 52):

> The GAAR is neither a penal provision nor a hammer to pound taxpayers into submission. It is designed, in the complex context of the *ITA*, to restrain abusive tax avoidance and to make sure that the fairness of the tax system is preserved. A desire to avoid uncertainty cannot justify ignoring a provision of the *ITA* that is clearly intended to apply to transactions that would otherwise be valid on their face.

Again, the Court's decision in *Deans Knight* may address this concern.

23. With reference to *Alta Energy* specifically, the Crown's failure to win that case arose not because the Court's majority gave insufficient weight to the concept of "fairness" to the tax system as a whole (i.e., other taxpayers), but rather because the majority concluded (correctly, in the Chamber's view) that the OSP of the tax treaty in question simply did not include a pre-condition not evidenced in the text of the treaty or in its context (or arguably its purpose). The government could have negotiated a treaty that included such a provision, or amended the *Income Tax Conventions Interpretation Act* to have included such a provision, or issued its own treaty guidance; or sought to terminate the treaty unless satisfactory changes were made. The Court quite properly declined to do what

the government chose not to do itself, not because it elevated "fairness" to the taxpayer at hand over "fairness" to the tax system as a whole, but rather because after reviewing the relevant context and extrinsic aids it was satisfied that the unstated pre-condition was simply not part of the bargain the treaty signatories had struck:

> [94] The *Treaty* makes it clear that Canada and Luxembourg agreed that the power to tax would be allocated to Luxembourg where the conditions of the carve-out were met. There is nothing in the *Treaty* suggesting that a single-purpose conduit corporation resident in Luxembourg cannot avail itself of the benefits of the *Treaty* or should be denied these benefits due to some other consideration such as its shareholders not being themselves residents of Luxembourg. In this case, the provisions operated as they were intended to operate; there was no abuse, and, therefore, the GAAR cannot be applied to deny the tax benefit claimed.

24. For these reasons, the Chamber does not believe that an absence of "fairness" to the tax system as a whole is evident in the GAAR jurisprudence to date: rather, such fairness will best be ensured by the government articulating to the best of its ability the OSP of the ITA's provisions (and if Finance deems appropriate the ITA as a whole).

Economic Substance

25. The Paper raises the issue of whether or not GAAR "sufficiently tales into consideration the economic substance of transactions." It observes that in *Canada Trustco* the Supreme Court "went on to say that economic substance is relevant only if, and to the extent that, the text of the law says that it is relevant", and notes a reference in the Explanatory Notes accompanying GAAR's enactment to the effect that GAAR (together with other provisions) should "require economic substance in addition to literal compliance with the words of the Act." It concludes that "this limited or *ad hoc* role for economic substance is unsatisfying from a policy perspective."

26. Once again, the Chamber is unclear as to exactly what the government perceives the problem to be, or how it is that an explicit "economic substance" test that the government proposes to introduce would address that problem:

    - does the government believe that *Canada Trustco* (a case decided almost 20 years ago) was wrongly decided, either on the law as it then was or from a policy perspective? If so, there is a very wide variance between what the government and the business community considers abusive.
    - what does the government mean by "economic substance"?
    - what other GAAR cases does the government believe it should have won and didn't that were lacking in "economic substance" and would have turned out differently had an economic substance test existed?

- what “pervasive impact on the tax system” is the Paper referring to?
- why exactly is the present role of economic substance “unsatisfying from a policy perspective?” “Unsatisfying” in what way, and how does that manifest itself (i.e., with what results)?

Without greater clarity as to the perceived problem, it is difficult to comment on the proposed solution.

27. In general, the Chamber believes that the courts are already applying principles that are practically equivalent to “economic substance” (at least in its simplest and most easily-understood form) where appropriate to do so. For example, in *Copthorne* a unanimous Supreme Court concluded that transactions generating paid-up capital “in excess of amounts invested in the amalgamating corporations with tax-paid funds.” (para. 122) were abusive. It is hard to see appellate-level decisions such as these as anything other than the application of economic substance where the OSP of the relevant provisions or statutory scheme are clearly based on such. The Chamber therefore disagrees with the Paper’s assertion that “the courts have limited the role of economic substance to one of ascertaining the relevant factual context of transactions and have not considered it in determining how the provisions of the Act should be interpreted and applied in particular cases.” Where economic substance is relevant to the OSP of ITA provisions, the courts have proven themselves ready to consider that concept in a substantive way, whether or not using the actual words “economic substance.”

28. As the Paper notes, there are various forms of tax-motivated planning that are considered perfectly acceptable from a tax policy perspective but which ostensibly have little or no “economic substance” in the sense of leaving the participants in a materially different position (ignoring tax). Intra-group loss consolidation transactions are the obvious example, although others could conceivably qualify as well, depending on the meaning of “economic substance” (e.g., butterfly divisive reorganizations, post-mortem “pipeline” planning, etc.). By its very nature as a rule that applies across the entire statute, GAAR is a somewhat blunt instrument.[6] It is not clear how the government would be able to preserve the non-application of GAAR to acceptable tax planning that lacks significant economic substance, while embedding an economic substance requirement within GAAR beyond how the courts already consider and apply it in appropriate circumstances (which the government for some reason finds “unsatisfying”). Again, this issue highlights the difficulty the Chamber has in perceiving the exact problem the government feels an economic substance test would address. If the government is looking for something that would have reversed *Canada Trustco* for example, that is a very different discussion (and GAAR may not be the right place to

[6] For the same reasons (i.e., the exceptionally broad scope of GAAR combined with the varying circumstances in which it potentially applies), the Chamber does not believe that amending GAAR to incorporate greater reliance on accounting treatment or testing for pre-tax profit will achieve acceptable results: not all relevant transactions are profit-seeking, nor do accounting rules (which have various objectives) consistently reflect economic “reality.”

achieve something that would result in such a dramatic change). Not everything that has economic substance is acceptable, nor is everything that lacks it abusive.

29. The Paper notes that "the avoidance transaction test is, in a sense, a form of economic substance test." The Chamber agrees, in that transactions without meaningful economic substance seem almost certain to constitute avoidance transactions. As such, combined with the "where appropriate" use of economic substance concepts by the courts as part of the OSP analysis, the Chamber believes that economic substance is sufficiently represented in the application of GAAR. To the extent that specific instances where an absence of economic substance (or some element thereof) is producing material abusive tax avoidance, the Chamber believes that identifying those specifically and formulating a potential solution based on those circumstances is the proper way to deal with them.

Penalties

30. The Chamber notes the Paper's reference to GAAR's role as a deterrent to abusive tax planning, and to concerns that "there appears to be some judicial reticence to impose a penalty in the context of a rule that only the Minister can apply."

31. As the Paper notes, the ITA already contains various penalty provisions, and it is not obvious to the Chamber that a new one is necessary or appropriate for when GAAR applies, or why the "gross negligence" standard applicable to existing penalty provisions is not equally appropriate for GAAR cases. Indeed, the Paper cites only one case as evidence of the perceived "judicial reticence" to imposing penalties in a situation where GAAR applies.

32. Given that the Paper's focus is clearly directed towards making it easier to apply GAAR, the Chamber believes that it is premature to discuss changes to the existing rules as to when penalties should result for a taxpayer to whom GAAR has been successfully applied. As such, the Chamber reserves comment on GAAR-related penalties until we can see where the bar for applying GAAR has been set. In general however, the Chamber is strongly opposed to applying penalties in cases where legitimate interpretational uncertainty exists.

Conclusion

33. The Chamber thanks Finance for the opportunity to express its views on the Paper, and welcomes the possibility of continued dialogue on this topic. As noted above, the Chamber's membership constitutes a significant element of Canada's tax base, and its interests are therefore aligned with the government in a GAAR that prevents abusive tax avoidance (as Parliament defines it) and gives those taxpayers who wish to be compliant a reasonably clear (but not necessarily "certain") demarcation of the line between permissible and legitimate tax planning and abusive behavior that imposes an unfair burden on the rest of us.